CREDIT OPINION
18 July 2024

Update

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**RATINGS**

**Transport for London**

| | |
|---|---|
| Domicile | United Kingdom |
| Long Term Rating | A2 |
| Type | Senior Unsecured - Dom Curr |
| Outlook | Stable |

*Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.*

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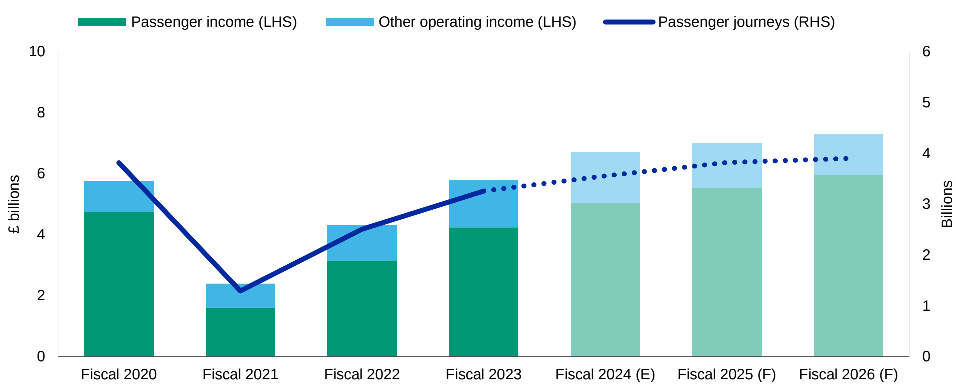
# Transport for London (United Kingdom)

## Update following upgrade to A2 stable

## Summary

The credit profile of Transport for London (TfL, A2 stable) reflects the significant improvement in its operating performance, driven by the recovery in passenger revenue, increased non-fare income and a focus on cost control, as well as its strong governance and strategic importance in London. It also incorporates the uncertainty of funding for its capital programme and rising debt levels. TfL benefits from our assessment that there is a strong likelihood the government of the United Kingdom (Aa3 stable) would act in a timely manner to prevent a default.

Exhibit 1
**TfL's turnover is expected to continue increasing over the next two years**
**Passenger income, other operating income and passenger journeys**




Fiscal year ends are 31 March. Fiscal 2024 is an estimate (E) based on TfL's draft financial statements, while fiscals 2025 and 2026 are forecasts (F) based on TfL's 2024 business plan and 2024/25 budget.
*Source: TfL and Moody's Ratings*

## Credit Strengths

» Strategic importance for the local and national economy

» Significant improvement in operating performance

» Robust management and governance with track record of cost containment

» Strong access to liquidity

## Credit Challenges

» Uncertainty of funding for the capital programme

» Debt to increase, but turnover growth will support stable debt metrics

## Rating Outlook

The stable outlook reflects the anticipated continued improvement in TfL's operating performance and the moderate scale of its capital programme, resulting in stable leverage over the next three years. Although uncertainty over a long-term funding agreement remains, TfL can fund the majority of its capital renewals, which are critical for maintaining service quality, using its own income.

## Factors that could lead to an upgrade

Upward pressure on the ratings could result from a multi-year funding agreement with the UK government to finance TfL's capital programme with a minimal borrowing requirement for TfL, coupled with a sustained improvement in operating performance.

## Factors that could lead to a downgrade

Downward pressure on the ratings could result from a weaker-than-anticipated operating performance or a substantial underfunding of TfL's capital programme that would result in higher debt levels than forecast or a deterioration in service quality.

## Key Indicators

Exhibit 2
**Transport for London**

| | Fiscal 2020 | Fiscal 2021 | Fiscal 2022 | Fiscal 2023 | Fiscal 2024 (E) |
|---|---|---|---|---|---|
| Own Source Revenues / Total Revenues (%) | 63.7 | 33.6 | 49.8 | 62.0 | 65.3 |
| Grants / Total Revenues (%) | 36.1 | 66.3 | 50.2 | 37.7 | 34.1 |
| Farebox Recovery Ratio (%) | 61.4 | 21.6 | 40.6 | 49.9 | 55.7 |
| Net Margin (Operating Surplus / Operating Revenues, %) | 18.6 | 12.0 | 19.8 | 21.6 | 20.4 |
| Interest / Operating Revenues (%) | 8.1 | 17.2 | 8.9 | 8.7 | 6.3 |
| Debt / Revenues (x) | 1.8 | 2.3 | 1.9 | 1.7 | 1.6 |

Fiscal year ends are 31 March. Fiscal 2024 is an estimate (E) based on TfL's draft financial statements.
*Source: TfL and Moody's Ratings*

## Detailed credit considerations

On 15 July 2024, we upgraded TfL's baseline credit assessment (BCA) to a3 from baa2, the long-term ratings to A2 from A3 and the short-term ratings to Prime-1 from Prime-2 and changed the outlook to stable from positive. The rating action reflects a significant improvement in TfL's operating performance, which we anticipate will be sustained, and our expectation that TfL will maintain stable leverage metrics for the next three years, given the moderate size of its capital programme.

TfL's ratings combine: (1) a BCA of a3; and (2) a strong likelihood of extraordinary support coming from the UK government in the event that TfL faced acute liquidity stress.

### Baseline Credit Assessment

**Strategic importance for the local and national economy**

TfL's credit profile benefits from its scale and very strong market position. As the UK's largest urban transit system and amongst the largest globally, it serves nearly ten million people in London with minimal competition. It plays a crucial role in the city, which contributes approximately a quarter of the national gross domestic product. The city's economic growth and the public transportation system capacity are closely linked, making them significant policy concerns for citizens, businesses and governments.

Pre-pandemic, TfL's network of underground, bus and rail services provided around 4 billion passenger journeys annually. The pandemic led to a significant drop in passenger numbers, but there has been a robust recovery over the last two years, with annual ridership standing at 3.6 billion in fiscal 2024. TfL's very high utilization ratio (annual ridership relative to the service area population) of 365 in fiscal 2024 underscores the widespread use of public transportation.

TfL is a key functional body of the Greater London Authority (GLA). Its board is chaired by the Mayor of London, who also manages board appointments.

**Significant improvement in operating performance**

TfL's operating performance has significantly improved since the pandemic and we expect this positive trend to be sustained, with growing operating surpluses. The recovery is driven by a substantial growth in passenger revenue, which amounted to £5.0 billion in fiscal 2024, exceeding pre-pandemic levels of £4.5 billion in fiscal 2019. This has been supported by London Underground traffic reaching 85% of pre-pandemic levels in fiscal 2024, the launch of the Elizabeth line in May 2022 and an average fare hike of 5.9% in March 2023. We forecast a continued rise in passenger revenue over the next three years from increasing passenger demand.

TfL has also successfully boosted and diversified its revenue base with new non-fare income sources. Non-fare income, excluding GLA grants, more than doubled from fiscal 2019, reaching £1.7 billion in fiscal 2024. Primary income streams include proceeds from the congestion charging scheme and the Ultra Low Emission Zone (ULEZ), which collectively generated a net contribution of £406 million in fiscal 2024. Although we anticipate a decrease in ULEZ income due to a rise in ULEZ-compliant vehicles, we project that non-fare income will continue to exceed pre-pandemic levels. We also expect that the business rates and council tax paid to TfL from the GLA will continue to grow. The Mayor of London's decision to offset a one-year fare freeze from March 2024 with an increase in TfL's business rates retention funding demonstrates his support.

The improvements in operating performance have eliminated the need for central government financial support for TfL's operations. Going forward, we expect TfL to maintain its financial sustainability and continue to grow its operating surplus, which mitigates some of the uncertainties around government funding.

**Robust management and governance with track record of cost containment**

TfL's governance and management is strong, as demonstrated by a consistent ability to achieve cost efficiencies. TfL's major transformation programme since 2016 resulted in approximately £1.4 billion in recurring cost savings through various initiatives, including reducing layers in the organisation, consolidating functions and negotiating contracts. This allowed it to adapt to a lower grant environment and improve its financial sustainability.

We expect TfL to continue to realise cost savings. TfL plans additional recurring savings of £406 million by fiscal 2027, equivalent to 5% of its operating expenses (excluding depreciation and amortisation) for fiscal 2024, mainly through improved working practices and supply chain management. Despite potential downside risks, such as employee strikes, we expect TfL to realise most of the additional savings, given its proven track record.

TfL's strong governance is also reflected in its accurate budgeting, quality of data analysis and information transparency. Key documentation, including budgets, business plans and board meeting notes, is publicly available. Detailed information on significant policy changes impacting TfL, such as new road user charges, is also available from the GLA.

**Strong access to liquidity**

TfL has a robust access to liquidity, supported by a diverse investor base and the ability to borrow from the Public Works Loan Board (PWLB), a statutory entity within the UK Debt Management Office. As the local government sector's lender of last resort, PWLB reduces the risk of liquidity shocks. TfL's liquidity sources include a £5 billion Euro Medium Term Note programme, a £2 billion Euro Commercial Paper programme, undrawn £350 million GLA financing facility and £100 million UKIB facility, as well as a £200 million overdraft and money market facility.

TfL maintains a policy of minimum cash levels equivalent to 60 days of operating expenses. Its cash balances stood at £1.5 billion as of March 2024 and we expect these to remain around this level over the next three years.

**Uncertainty of funding for the capital programme**

TfL requires significant capital expenditure to maintain and improve its services. Over the next three years, TfL has allocated £5.7 billion towards its capital programme, divided between capital enhancements (£3.2 billion) and capital renewals (£2.5 billion). Major projects include signalling, modernisation and upgrades to rolling stock and stations, intended to boost service and capacity in the existing network. Investments are also planned to improve walking and cycling infrastructure.

TfL relies on government funding for large-scale capital projects and the ongoing uncertainty over a long-term capital funding framework continues to impact its credit strength. The stability and predictability of funding subsidies and policy support from the UK government weakened since the start of the pandemic. This is evidenced by the difficulties in securing funding support, which during the pandemic has been provided through numerous short-term funding agreements, often agreed upon or after the expiry of the previous agreement. Nonetheless, we note that the financial support from the government was sufficient to prevent TfL from incurring material additional debt.

While the government has expressed its willingness to support TfL's capital programme through a multi-year funding agreement, none has been finalised to date. The current funding agreement from December 2023, amounting to £250 million, only covers capital expenditures until March 2025 and constitutes only half the amount assumed in TfL's previous business plan. Lower government funding than anticipated could lead to higher debt or cuts to its capital programme, potentially resulting in a gradual deterioration in service quality.

**Debt to increase, but turnover growth will support stable debt metrics**

TfL's debt is high and expected to gradually increase to finance the capital programme. TfL's debt (including leases) amounted to £15.3 billion in fiscal 2024 and is projected to rise to £17.4 billion by fiscal 2027. This is driven by the anticipated opening of the Silvertown tunnel, which will bring the operating lease onto TfL's balance sheet, and £1.2 billion of debt issuance. Despite this, we expect stable leverage at around 1.7x due to revenue growth. The pace of debt growth, however, remains dependent on capital funding received from the government.

Under the Prudential Code, TfL can borrow for capital purposes up to a mayor-approved limit, subject to reserve powers retained by the government. We expect TfL to remain significantly below this limit, currently set at £18.8 billion for the TfL Group by fiscal 2027. Additional debt is expected to be issued by TfL's commercial property company, Places for London Limited. Although this subsidiary is included in TfL Group's borrowing limit, it is financially independent from TfL and the debt will be non-recourse.

TfL's three-year average interest to operating revenue was 8.0% in fiscal 2024, lower than 11.6% in fiscal 2023 but exceeding pre-pandemic levels of 5.5% in fiscal 2019. We forecast an improvement to an average of 7.2% over the next three years, supported by turnover growth. TfL's interest rate risk is limited, with around 90% of its debt at fixed rates as of July 2024.

TfL's net pension surplus increased to £2.3 billion in fiscal 2024, a significant improvement from the net deficit of £3.2 billion in fiscal 2022, driven by higher discount rates. As part of the 2022 funding agreement with the Department for Transport, TfL was required to present viable options to reduce future pension liabilities by approximately £100 million annually, which was met with strong opposition from unions and threats of widespread strikes in the summer of 2023. TfL has put forward options and identified significant complexities that need resolution before a final detailed proposal can be agreed with the government. Nonetheless, TfL has stated that, should any reform be proposed, no change could be effected before 30 September 2026 at the earliest, to allow sufficient time for consultation and implementation.

## Extraordinary Support Considerations

The strong level of extraordinary support factored into the ratings reflects the importance that the transport system and infrastructure improvement in London have for the UK, as demonstrated by the exceptional funding support TfL received during the pandemic to compensate for the large reduction in passenger income.

## ESG considerations

### Transport for London's ESG credit impact score is CIS-3

Exhibit 3
**ESG credit impact score**

CIS-3


ESG considerations have a limited impact on the current rating, with potential for greater negative impact over time.

*Source: Moody's Ratings*

TfL's **CIS-3** reflects our view that ESG considerations have a limited impact on its current ratings, with potential for greater negative impact over time. TfL has high expenditure requirements related to carbon transition and pollution, as well as exposure to social risks stemming from ridership trends, fare increases and a unionised workforce. However, governance risks are limited due to TfL's robust management practices.

Exhibit 4
**ESG issuer profile scores**

ENVIRONMENTAL
E-3

SOCIAL
S-3

GOVERNANCE
G-2

*Source: Moody's Ratings*

### Environmental

TfL has a material exposure to environmental risks (**E-3**), relating to its central role in achieving the Mayor of London's target for a carbon-neutral city by 2030. To meet these environmental objectives, TfL would be required to fully upgrade its bus fleet to zero-emission vehicles and transition to renewable energy for all rail services.

### Social

TfL has a material exposure to social risks (**S-3**), with the transition to hybrid work models resulting in an ongoing decrease in ridership compared to pre-pandemic levels, despite its monopoly in London. Fare hikes, being politically sensitive, are uncertain. Moreover, the unionised nature of TfL's workforce could pose challenges to changes in staff wages, working conditions and pension schemes, potentially escalating the frequency of strike actions. This could affect TfL's ability to realise projected cost savings.

### Governance

TfL has a limited exposure to governance risks (**G-2**). TfL has strong management practices, demonstrated by a clear strategy, comprehensive budgets and business plans, a high degree of transparency and a consistent ability to achieve cost savings. Although TfL relies on government funding for large capital projects, the current funding agreement with the government, agreed in December 2023, does not enforce strict conditions on TfL, suggesting a decrease in government control and oversight.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

## Rating methodology and scorecard factors

The assigned BCA of a3 is in line with the scorecard-indicated BCA.

TfL's ratings reflect our assessment of the company's business profile and financial performance in line with our Mass Transit Enterprises Methodology, published in December 2017, and our Government-Related Issuers Methodology, published in January 2024.

Exhibit 5

**Fiscal 2023 scorecard**

| Global Mass Transit Enterprises Methodology | Measure | Score |
|---|---|---|
| **Factor 1: Size (15%)** | | |
| a) Issuer Size - Annual Ridership (Million) | 3259 | Aaa |
| b) Market Size - Service Area Population (Million) | 10 | Aaa |
| **Factor 2: Market Position (35%)** | | |
| a) Operating Environment | Baa | Baa |
| b) Service Area Characteristics | Aaa | Aaa |
| c) Market Share - Utilization (%) | 338 | Aaa |
| **Factor 3: Financial Flexibility (20%)** | | |
| a) Level of Self-Support - Farebox Recovery Ratio (%) | 49.9% | Aa |
| b) Budget Flexibility (3-Yr Avg Fixed Costs as % of Operating Expenditures) | 30.7% | Ba |
| **Factor 4: Debt & Financial Metrics (30%)** | | |
| a) Leverage - Debt / Revenues | 1.7x | Baa |
| b) Budget Balance - 3-Yr Avg Interest as a % of Operating Revenues | 11.6% | Baa |
| c) Budget Balance - 3-Yr Avg Net Margin (Operating surplus / revenues) | 17.8% | Aaa |
| d) Liquidity - Days Cash on Hand | 60 | A |
| **Adjustments / Notching Factors** | | |
| **Factor 2: Market Position** | | |
| 1) Challenges adopting adequate fare increases | -0.5 | |
| **Factor 3: Budget Flexibility** | | |
| 3) Collective bargaining or high labor costs that decrease financial or operational flexibility | -1 | |
| 5) Other analyst adjustment to Budget Flexibility | -0.5 | |
| **Rating** | | |
| a) Indicated Rating from Grid after Notching Adjustments | a3 | |
| b) BCA assigned | a3 | |
| c) Long Term Rating | A2 | |

Fiscal year ends 31 March 2023.
*Source: TfL and Moody's Ratings*

## Ratings

Exhibit 6

| Category | Moody's Rating |
|---|---|
| **TRANSPORT FOR LONDON** | |
| Outlook | Stable |
| Baseline Credit Assessment | a3 |
| Senior Unsecured -Dom Curr | A2 |
| Commercial Paper -Dom Curr | P-1 |

*Source: Moody's Ratings*

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