MOODY'S
RATINGS

Rating Action: Moody's Ratings upgrades Transport for London's ratings to A2 from A3; outlook stable

15 Jul 2024

London, July 15, 2024 -- Moody's Ratings (Moody's) has today upgraded Transport for London's (TfL) long-term senior unsecured debt ratings to A2 from A3 and its long-term senior unsecured MTN programme rating to (P)A2 from (P)A3. The outlook has been changed to stable from positive. We have also upgraded TfL's short-term issuer rating and short-term commercial paper rating to Prime-1 (P-1) from Prime-2 (P-2). The Baseline Credit Assessment (BCA) was upgraded to a3 from baa2.

RATINGS RATIONALE

The upgrade of the BCA and long-term debt ratings reflects the significant improvement in TfL's operating performance, which we expect to be sustained, with growing operating surpluses over the medium term. This is driven by the recovery in passenger revenue post-pandemic, new revenue sources and TfL's robust governance practices, particularly its focus on cost control, which have eliminated the need for any financial support from the central government to fund operations. The upgrade also reflects our expectation that TfL will maintain stable leverage metrics for the next three years due to the moderate scale of its capital programme.

The primary driver of the improvement in TfL's operating performance is the recovery in passenger income, which reached £5.0 billion in fiscal 2024, surpassing pre-pandemic levels of £4.5 billion in fiscal 2019. This increase is supported by the recovery of traffic on the London Underground, at 85% of pre-pandemic levels, the opening of the Elizabeth line in May 2022 and an average fare increase of 5.9% in March 2023. We forecast that passenger income will continue to grow, bolstered by steady increases in passenger demand.

The improvement in TfL's operating performance is also supported by non-fare income sources, which have diversified TfL's revenue. Non-fare income, excluding grants from the Greater London Authority (GLA), has more than doubled from fiscal 2019, reaching £1.7 billion in fiscal 2024. Primary income sources include revenue from the congestion charging scheme and the Ultra Low Emission Zone (ULEZ), which together generated a net contribution of £406 million in fiscal 2024. Although we anticipate a decline in ULEZ income due to an increase in ULEZ-compliant vehicles, non-fare income is still projected to stay above 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 business rates retention funding for TfL underscores his support.

TfL has consistently achieved significant cost savings due to its stringent focus on cost control, demonstrating its solid management and governance practices. TfL has realised recurring savings of £1.4 billion since 2016 and plans additional recurring savings of £406 million by fiscal 2027, equivalent to 5% of its operating expenses (excluding depreciation and amortisation) for fiscal 2024. We expect TfL to realise most of the additional savings, given its proven track record, which will support growing operating surpluses. Nevertheless, downside risks remain, notably the potential for strike action by its employees.

Following the completion of the Elizabeth line, we expect TfL's capital programme to remain at a moderate level, averaging £1.9 billion annually over the next three years. This is a significant decrease from the £3.3 billion per year during fiscal 2017 to fiscal 2020. We anticipate that debt will only see a moderate increase to approximately £17.4 billion by fiscal 2027, up from £15.3 billion at the end of fiscal 2024. The increase will be driven by the expected opening of the Silvertown tunnel in fiscal 2025, which will bring the operating lease onto TfL's balance sheet, and around £1.2 billion of debt issuance to fund the capital programme. However, we forecast leverage to remain stable, with debt to revenues of around 1.7x, due to revenue growth over the period.

Despite this, TfL relies on government funding for large capital expenditure projects and a long-term capital funding framework remains uncertain. The existing funding agreement only covers capital expenditures until March 2025. Lower government funding than anticipated in TfL's current business plan could lead to higher debt levels or cuts to its capital programme.

The A2 ratings incorporate a BCA of a3 and a one-notch uplift based on Moody's assessment of a strong likelihood of support from the UK government. The strong support assessment 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.

The short-term ratings were upgraded to P-1 from P-2. TfL benefits from strong access to liquidity, underpinned by a diverse investor base and the ability to borrow from the Public Works Loan Board (PWLB), a statutory body operating within the UK Debt Management Office. PWLB is also the local government sector's lender of last resort, reducing the risk of liquidity shocks. Moreover, TfL adheres to a policy of maintaining minimum cash levels equivalent to an average of 60 days of operating expenses.

RATIONALE FOR THE STABLE 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.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) CONSIDERATIONS

TfL's credit impact score (CIS) of 3 indicates that ESG considerations have a limited impact on its current ratings, with potential for greater negative impact over time.

TfL has a material exposure to environmental risks (E-3), as it is required to fully upgrade its bus fleet and transition to fully renewable energy for rail services in order to achieve the Mayor of London's ambition for a carbon-neutral city by 2030. TfL also has a material exposure to social risks (S-3), arising from its susceptibility to ridership trends, the politically-sensitive nature of fare rises and the unionised nature of its workforce. However, TfL has limited governance risks (G-2), reflecting its strong management practices. This is evidenced by its clear strategy, comprehensive budgets and business plans, a high degree of transparency and a consistent track record of achieving cost savings.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

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.

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.

PRINCIPAL METHODOLOGY

The methodologies used in these ratings were Government-Related Issuers methodology published in January 2024 and available at https://ratings.moodys.com/rmc-documents/406502 , and Mass Transit Enterprises Methodology published in December 2017 and available at https://ratings.moodys.com/rmc-documents/64385 . Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions .

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At least one ESG consideration was material to the credit rating action(s) announced and described above.

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