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Research Update:

Transport for London 'AA+/A-1+' Ratings Affirmed Despite Ongoing Grant Reductions; Outlook Stable

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Published Rating Factor Scores

Key Statistics

Key Sovereign Statistics

Related Criteria And Research

Ratings List

Research Update:

Transport for London 'AA+/A-1+' Ratings Affirmed Despite Ongoing Grant Reductions; Outlook Stable

Overview

- Transport for London (TfL) has performed in line with our expectations for the current year.
- Operating balances and balances after capital accounts are beginning to weaken, as government grant reduces and capital expenditure increases, but growth in fare revenues is proving robust.
- We are therefore affirming the 'AA+/A-1+' issuer credit ratings on TfL.
- The stable outlook reflects our expectation that TfL's credit strengths, particularly its flexibility, financial management, liquidity, and supportive institutional framework, will be sufficient to maintain its rating, despite the weakening of its financial profile.

Rating Action

On Nov. 15, 2013, Standard & Poor's Ratings Services affirmed its 'AA+' long-term and 'A-1+' short-term issuer credit ratings on Transport for London (TfL). The outlook is stable.

Rationale

The ratings on TfL reflect the predictable and supportive institutional framework within which it operates as a U.K. local authority, its very positive liquidity position, and the strength of London's economy, which underpins demand for TfL's services. Although TfL has a major capital program, it has considerable flexibility to defer much of its capital expenditure (capex), which we view as a positive rating factor. We also consider that the quality of its financial management has a very positive effect on the rating; TfL has a strong track record of staying within budget.

Constraining factors for the rating include the prospect of deficits after capital accounts as government funding reduces and as TfL continues its planned investments in infrastructure. Our previous outlook factored in the resulting gradual increase in debt and associated risks (see "Transport for London," published on June 12, 2013). However, the central government effectively underwrites much of the exposure to cost overruns on TfL's largest capital project--Crossrail--which limits TfL's contingent liabilities.

TfL is a functional body of the Greater London Authority (GLA) and is responsible for implementing the mayor's transport strategy in London. TfL has

many subsidiaries that together comprise the TfL Group. In our analysis, we focus on this consolidated group.

We continue to view the U.K. institutional framework, within which TfL operates as a local authority, as stable and predictable. Although grant levels are set to reduce over the coming years, as the U.K. continues to reduce the national deficit, we anticipate that this will be done in a way that allows local authorities to plan and reduce expenditures without threatening their mandatory responsibilities. In particular, much of TfL's future grant is highly predictable. In the spending review of June 2013, it was allocated a multiyear capital grant for 2015 to 2020. This reflects the ongoing central government support for investment in the London transport network, which is so vital to London's economy.

TfL currently receives an equivalent grant that is not earmarked for capital expenditure, but this will change with the new capital grant from 2015. Our forecasts for 2015 onward therefore assume that we will classify a significant portion of TfL's grant as capital revenues, rather than operating revenues. This change will affect a number of our key ratios for assessing budgetary performance, budgetary flexibility, and debt burden, but we do not anticipate that it will make a material difference to TfL's overall creditworthiness. Hence, we expect no direct consequences for the rating.

The strength of London's economy, and the consequent demand for public transport, is key to TfL's creditworthiness, supporting both the growth in its fare revenues (and resulting revenue flexibility), and the rationale for continued central government funding. We estimate that London's gross value added (GVA) per capita was £35,353 in 2012, and we forecast growth in GVA will continue to gather pace, rising to 2.8% in 2014, supported by rising employment levels. We expect London will grow faster than the U.K. average, reflecting the more-flexible and service-oriented nature of London's economy, in which financial services plays a key role. London is both pivotal to the U.K.'s economic growth and a major net contributor to the U.K.'s fiscal position.

Supported by London's economy, TfL's fare revenues have proved relatively buoyant. Combined with its grant, this has led to strong financial performance. Over the past three years, TfL has posted operating balances averaging in excess of 20% of operating revenues and surpluses after capital accounts averaging about 5% of total revenues. By contrast, because of the planned reduction in government grants and TfL's increased capital spending, over the next three years we expect TfL to post deficits after capital accounts averaging about 10% of total revenues. Consequently, we forecast in our base case that TfL's debt burden will rise to about 140% of operating revenues by 2015, up from 106% in 2012. TfL has planned these deficits after capital accounts for many years, and we do not consider that the implied weakening of TfL's financial profile represents any material change in its financial strategy.

Beyond 2016, we expect recurrent deficits after capital accounts of about

5%-10% are likely, given the fiscal pressures on the U.K., which are likely to constrain TfL's government funding, coupled with the increasing demands on London's transport infrastructure.

We understand that TfL is willing and able to defer or cancel many aspects of its capital program, if necessary, particularly where these relate to station upgrades or extending the network. More generally, TfL's financial management, which we view as very positive for the rating, has a strong track record of using its flexibility and control to stay within operating and capital budgets.

TfL's exposure to contingent liabilities is limited, given that the main risk--cost overruns on Crossrail--is effectively capped by the U.K. government.

Liquidity

We view TfL's liquidity position as very positive. It has a very positive debt service coverage of 3.5x, supported by strong and predictable cash flows. TfL also has ready access to external liquidity, which we view as exceptional in international terms, based on its ability to borrow from the U.K. government's Public Works Loan Board (PWLB). TfL also has an established track record of issuing on the capital markets.

On Nov. 4, 2013, TfL held unrestricted cash and short-term investments of about £2.7 billion. We expect this to reduce by 2016 to £0.4 billion to fund TfL's general capital program. In addition, TfL has additional cash and equivalents of about £2.2 billion, which is earmarked for spending on Crossrail up to 2018. We estimate that on average, and after allowing for some loss of value in a stress scenario, these cash and equivalents should cover debt service over the next 12 months by 3.5x. We calculate debt service to include repaying commercial paper. (TfL also has access to an undrawn committed facility of £200 million.)

Beyond the next 12 months, we see TfL's levels of free cash and equivalents continuing to diminish to fund its planned capital program. TfL has effectively been prefunding its capital program by raising debt in advance of the associated capex.

We view TfL as having exceptional access, in international terms, to external liquidity. This is primarily due to the U.K. government's PWLB, which can provide funding to TfL within 48 hours of an application, as long as TfL is operating according to the Prudential Code. In addition, TfL has an established track record of issuing commercial paper and medium-term notes on the capital markets.

Outlook

The stable outlook reflects our expectation that TfL's credit strengths, particularly its flexibility, financial management, and liquidity, will be sufficient to maintain its rating, even though its financial profile is set to weaken as grant reduces and capital spending rises.

We may consider raising the rating within the next two years if TfL's capital program were to be funded increasingly by the U.K. government. We consider this scenario unlikely but might raise the rating if, at the same time, TfL maintained its financial flexibility, particularly over fare revenues, and posted deficits after capital accounts of less than 5% of total revenues. This would be likely to result in TfL's debt burden and interest costs remaining at their current levels as a percentage of operating revenues.

Conversely, if TfL's flexibility to raise fares or defer capex were diminished, and if TfL looked set to post deficits after capital accounts beyond about 10% of total revenues on a recurrent basis, then we may consider a negative rating action. Such an action would likely be coupled with concerns about management's ability to stay within budget.

Published Rating Factor Scores

Table 1

Summary Of Published Rating Factor Scores*	
RATING FACTOR	SCORE
Institutional framework	Predictable and supportive
Financial management	Very Positive
Liquidity	Very Positive

*Standard & Poor's ratings on local and regional governments are based on, among other things, a scoring system that covers eight main rating factors, as further explained in our criteria (see below). We publish our scores for the three rating factors above.

Key Statistics

Table 2

	Transport for London: Economic Statistics					
	--Year ended Dec. 31--					
	2010	2011	2012	2013bc	2014bc	2015bc
Population	7,825,200	8,204,407	8,308,369	8,399,761	8,483,759	8,577,080
Population growth (%)	0.92	4.85	1.27	1.10	1.00	1.10
GDP per capita (local currency) (£)	35,422	34,490	35,353	36,367	37,843	39,528
Real GDP growth (%)	1.40	0.80	1.00	1.30	2.80	3.40
Unemployment rate (%)	9.10	9.60	8.50	8.50	8.00	7.50

Table 2

Transport for London: Economic Statistics (cont.)

The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. Sources typically include national statistical offices and Eurostat.

Title 3

Transport for London: Financial Statistics

(Mil. £)	--Year beginning April 1--					
	2010	2011	2012	2013bc	2014bc	2015bc*
Operating revenues	7,198	7,522	7,954	7,542	7,773	6,832
Operating expenditures	5,385	5,606	5,873	6,321	6,668	6,644
Operating balance	1,813	1,916	2,081	1,220	1,105	188
Operating balance (% of operating revenues)	25.19	25.48	26.16	16.18	14.22	2.75
Capital revenues	1,272	1,468	2,046	2,118	1,874	2,261
Capital expenditures (capex)	2,937	2,776	3,476	3,711	3,827	3,908
Balance after capital accounts	148	609	651	(372)	(848)	(1,459)
Balance after capital accounts (% of total revenues)	1.75	6.77	6.51	(3.86)	(8.79)	(16.05)
Debt repaid	220	1,547	1,255	1,211	823	837
Balance after debt repayment and onlending	(73)	(939)	(604)	(1,584)	(1,671)	(2,296)
Balance after debt repayment and onlending (% of total revenues)	(0.86)	(10.44)	(6.04)	(16.40)	(17.32)	(25.25)
Gross borrowings	1,084	3,780	1,533	991	1,335	1,325
Balance after borrowings	1,012	2,841	929	(593)	(336)	(971)
Operating revenue growth (%)	8.91	4.50	5.75	(5.18)	3.07	(12.11)
Operating expenditure growth (%)	(7.03)	4.09	4.77	7.64	5.48	(0.36)
Modifiable revenues (% of operating revenues)	49.22	51.05	51.88	58.00	59.65	71.94
Capital expenditures (% of total expenditures)	35.29	33.12	37.18	36.99	36.46	37.03
Direct debt (outstanding at year-end)	6,350	7,129	7,564	7,867	8,477	9,077
Direct debt (% of operating revenues)	88.22	94.78	95.10	104.31	109.05	132.87
Tax-supported debt (% of consolidated operating revenues)	112.08	112.29	106.29	115.21	118.64	142.52
Interest (% of operating revenues)	5.66	4.85	4.59	5.08	5.23	6.47
Debt service (% of operating revenues)	8.72	25.42	20.37	21.14	15.81	18.72

*In 2015, we assume that some of the grant that TfL receives is re-classified from operating revenues to capital revenues, as explained above. This largely explains the sharp move in the ratios showing operating balance, modifiable revenues, and tax-supported debt as a percentage of operating revenues. The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. Base case reflects Standard & Poor's expectations of the most likely scenario.

Key Sovereign Statistics

- Sovereign Risk Indicators, July 1, 2013
- Europe's Home Price Declines Continue, But Stabilization May Be Around The Corner, Oct. 31, 2013

Related Criteria And Research

- Principles Of Credit Ratings, Feb. 16, 2011
- Methodology For Rating International Local And Regional Governments, Sept. 20, 2010
- Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs, Oct. 15, 2009
- Public Finance System Overview: U.K. Local and Regional Governments, April 5, 2011
- International Local And Regional Governments Default And Transition Study: 2012 Saw Defaults Spike, March 28, 2013

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts. The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook.

Ratings List

Ratings Affirmed

Transport for London

Issuer Credit Rating	AA+/Stable/A-1+
Senior Unsecured	AA+
Commercial Paper	A-1+

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