



Gareth Bacon AM
Chairman of the Budget and Performance Committee
London Assembly
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Dear Gareth

Budget and Performance Committee – 28 June 2016

Thank you for your letter of 30 June following my attendance alongside Graeme Craig at your meeting last month. Our responses to the Committee's requests are set out below.

As I said at the meeting, I will be very happy to update the Committee with the cost of the TfL fares freeze as soon as 'actuals' are available. I will also update the Committee on the range of savings we expect to achieve over the course of our next business plan following its publication later this year.

Details of how TfL benchmarks itself against other organisations in relation to its borrowing costs

Our borrowing rates are quite low and compare favourably with others. We borrow from a range of sources including capital markets, the Public Works Loan Board (PWLB) and the European Investment Bank (EIB). From these main sources of borrowing, only capital markets, where we issue bonds and commercial paper, can offer benchmarking opportunities, as the pricing information is publicly available on the market. The terms of the EIB borrowing are confidential. The cost of borrowing from the PWLB is largely the same for all borrowers, mostly local authorities, irrespective of credit rating or risk profile, and therefore is not useful for benchmarking purposes.

Our strong credit rating, currently within one notch of the UK's sovereign rating, allows us to borrow from institutional investors, such as pension funds and insurance companies, by issuing bonds. Since 2012, we have issued bonds worth over £3bn, all at rates lower than those offered by the PWLB by up to 30 basis points (0.3 per cent). For these capital market transactions, we benchmark ourselves against the trading levels of outstanding TfL bonds and also other highly-rated bond issuers with a similar risk profile.

The scope for benchmarking is limited by the size and the liquidity of the sterling bond market, as we can (currently) only borrow in sterling and our borrowing costs can only be meaningfully compared with other sterling issuers. The factors that drive the differences in borrowing costs between us and closest comparable issuers include, but are not limited to, credit rating, the ability of other entities to issue in other currencies, availability of Government guarantee or other forms of security, the volume of existing borrowing, the size and length of the transaction and market conditions at the time of transaction.

I enclose an example of a benchmarking table which shows a number of comparable sterling bonds and their current trading levels against UK government gilts (Attachment 1). The column showing current spread to reference gilt represents the relative premium for risk that investors expect to receive on top of the government gilts of comparable maturity. These spreads, or premiums, could therefore be used to compare the relative costs of borrowing among companies at a point in time. For example, our 1.250 per cent bond due in 2017 is currently trading at a comparable level to that of the 1.375 per cent bond due in 2017 issued by the German transport and logistics company Deutsche Bahn. Our bond is trading at 53 basis points (0.53 per cent) above the level of the government gilt due in 2017 compared with Deutsche Bahns's at 49 basis points (or 0.49 per cent).

This benchmarking exercise is useful when establishing a fair relative price for a new bond at the time of the issue. It is less relevant when comparing the actual costs of borrowing, as these would largely be driven by the level of interest rates at the time of the transaction in addition to factors described above. Please let me know if the Committee would like a briefing from my team on our approach to borrowing and I will be happy to arrange this.

Details of which fares are covered by the fares freeze and which are not

The Mayor's TfL fares freeze covers:

- All London bus and tram fares, including bus and tram passes and pay as you go caps;
- Emirates Air Line fares;
- All Tube and DLR pay as you go and cash single fares;
- All single fares on London Overground and TfL Rail services where Tube fares apply; and
- All single fares on train operating company (TOC) run services in London where Tube fares apply (i.e. services that run parallel – or provide a clear substitute – to the Tube, such as the C2C service between Upminster and Fenchurch Street).

The freeze does not apply to fares which are set by the Department for Transport's franchised TOCs. Attachment 2 provides this information as a table and I would be happy to provide further details should this be required by the Committee.

Details of how the income from Travelcards and other fares not set by TfL is distributed between train operating companies and TfL

The income from Travelcards and other fares that are not set by the Mayor is shared between the TOCs and TfL based on long-standing contractual agreements. In general, revenue is shared based on the use ticket holders make of our services and TOC services that accept the tickets.

For many years, market research surveys have been the primary source used to determine Travelcard usage. However, work is underway to base revenue sharing on actual Oyster and contactless trips. This new methodology will be available next year, but it is unlikely to be used practically in revenue sharing calculations until current rail franchises are renewed.

Overall, just under 60 per cent share of the revenue from Travelcards is allocated to TfL services, with the remaining 40 per cent allocated to National Rail services.

The expected increased income from ending free travel for nominees of staff earning over £100,000 per year and the methodology for calculating that increased income

As the Mayor mentioned to the Assembly recently, while the financial savings to us would be relatively modest, it is right that we look at the benefits received by those earning a base salary of more than £100,000 per year. This is just one aspect of the wider root and branch review we are undertaking to reduce our costs to deliver a better and more efficient organisation.

One hundred and fifty six nominee Oyster cards are linked to staff earning a base salary of more than £100,000 per year. We estimate that these nominees would pay fares of around £30,000 per year – or around £200 each – if their passes were withdrawn. This estimate is based on average results and assumes less travel if free journeys were withdrawn. Where staff commute from outside of London, their nominees tend to make minimal use of their passes. Where staff live in inner London, usage tends to be higher than average.

Revenue estimates for the Ultra Low Emission Zone

The Mayor launched his Clean Air Consultation earlier this month, including proposals to bring forward and expand the Ultra Low Emission Zone (ULEZ). As the final design, scope and parameters of the scheme are still being considered and are subject to consultation, we are not yet in a position to provide revenue estimates for the ULEZ. I will provide a further written update to the Committee as soon as these estimates are available.

An estimate of the advertising income in 2015/16 for advertisements that would now not be permitted under the ban on advertisements depicting an unhealthy body image

From an overall advertising income of £169m in 2015/16, we estimate that around £75,000 would have been impacted by the new policy. However, we do not expect future revenues to be affected. This is because we will work with advertisers and agencies to ensure they meet our requirements.

Advertising on our network is unique in that it is a closed environment where customers cannot simply turn a page or change the channel. Our new advertising policy ensures that advertisements meet the expectations of our customers, including on issues of body image.

If you would like any further information please let me know. I also look forward to providing the Committee with an update on the progress of the root and branch review of the organisation, the improvements we are making to our financial reporting and to answer any other questions you may have at the session we have scheduled on Monday 17 October 2016.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian Nunn', with a long horizontal flourish extending to the right.

Ian Nunn
Chief Finance Officer

cc: Dale Langford, Principal Budget and Performance Committee Manager

Attachment 1: Transport for London and comparable sterling bonds and current trading levels against UK government gilts

Company	Credit Rating	Bond (coupon, final repayment year)	Date Issued	Size	Current spread to reference gilt (trading level), basis points
Transport for London	Aa2 / AA	1.250% due 2017	Nov-12	£300m	53
Deutsche Bahn	Aa1 / AA-	1.375% due 2017	Oct-12	£300m	49
Transport for London	Aa2 / AA	2.250% due 2022	Jul-12	£500m	75
Deutsche Bahn	Aa1 / AA-	2.750% due 2022	Jun-12	£400m	63
Network Rail	Aa1 / AA	4.750% due 2024	Jan-05	£750m	27
Transport for London	Aa2 / AA	1.250% due 2025	Apr-15	£400m	74
Deutsche Bahn	Aa1 / AA-	3.125% due 2026	Jul-13	£425m	59
London & Quadrant	A1 / AA-	2.625% due 2026	Apr-16	£300m	91
Network Rail	Aa1 / AA	4.375% due 2030	Dec-05	£875m	42
Transport for London	Aa2 / AA	4.000% due 2033	Sep-13	£300m	71
London & Quadrant	A1 / AA-	4.625% due 2033	Mar-12	£250m	118
Community Finance (GLA)	NR / AA	5.017% due 2034	Jul-11	£600m	78
Transport for London	Aa2 / AA	3.875% due 2042	Jul-12	£500m	72
Transport for London	Aa2 / AA	3.625% due 2045	May-13	£400m	72
Cardiff University	Aa2	3.000% due 2050	Feb-16	£300m	71
University of Leeds	Aa2	3.125% due 2050	Feb-16	£250m	68
University of Cambridge	Aaa	3.750% due 2052	Oct-12	£350m	46
University of Manchester	Aa1	4.250% due 2053	Jul-13	£300m	64
Transport for London	Aa2 / AA	4.000% due 2064	Mar-14	£500m	72

Source: Bloomberg, 19 July 2016

Attachment 2: Fares included and not included in the Mayor's fares freeze**Table 1 - Bus and Tram fares included in the Mayor's freeze**

Fare	Types
PAYG single fare	Adult Half price concession for jobseekers and Income Support/ESA/JSA recipients
One Day Cap	Adult Half price concessions as above
Monday to Sunday Bus cap	Adult (contactless only)
Bus Pass season – weekly, monthly and annual	Adult Students and apprentices (1/3 off) Half price concessions as above

Table 2 – Tube and DLR fares included in the Mayor's freeze

These fares are also frozen on TOC services where Tube fares are accepted, on London Overground and on TfL Rail

Fare	Types
PAYG single fares	Adult Child fares for 11-15 year olds Half price concession for 16/17 year olds, jobseekers Off-peak concession for railcard holders
Cash single fares	Adult Child

Table 3 – Fares not included in the Mayor's freeze

Fare	Types
TOC cash fares, PAYG single fares and rail season tickets	All
Travelcard season – weekly, monthly and annual	Adult Students and apprentices (1/3 off) Half price concession for under 16s and 16-17 year olds
Day Travelcard	Adult, child and Railcard concession
Multi-modal PAYG Daily Caps	Adult Child cap for 11-15 year olds Half price cap for 16/17 year olds, jobseekers Off-peak concession for railcard holders
Monday to Sunday Travelcard cap	Adult (contactless only)