Elizabeth Line Committee

TRANSPORT FOR LONDON
EVERY JOURNEY MATTERS

Date: 29 September 2022

Item: Crossrail Asset Restructuring

This paper will be considered in public

1 Summary

1.1 Now that the Elizabeth line has entered service a restructure and simplification of the intragroup lease arrangements for the Crossrail Central tunnel Operating Section (CCOS) land and related assets is proposed. This proposal impacts solely on the internal Transport for London (TfL) intragroup structuring and financing arrangements. There is no additional expenditure proposed, or impact on values reported at the consolidated TfL Group level.

1.2 As set out in the paper below, the arrangements proposed require Sponsor approval under the Crossrail Sponsors Agreement/Project Development Agreement, including approval from the Department for Transport (DfT). Discussions are ongoing with the DfT, who have raised several detailed questions around certain aspects of the transaction. We hope that these can be resolved quickly, so that approvals can then be sought.

1.3 Under our Standing Orders and terms of reference of Committees and Panels, the proposals require different approvals within the remit of this Committee and the Finance Committee. Similar papers have been provided to each Committee.

1.4 This Committee is asked to authorise officers to approve any amendments to the Crossrail Sponsors Agreement and/or Project Development Agreement and any other matter they consider necessary to implement the lease restructuring arrangements described in this paper.

1.5 Subject to this Committee’s approval, the meeting of the Finance Committee on 6 October 2022 will be asked to approve: Procurement Authority for an interest-bearing loan of up to £2.75bn by TfL Corporation to Rail for London (Infrastructure) Limited (RfL(I)); the disposal by Crossrail Limited (CRL) of the CCOS asset and related station infrastructure assets to fellow subsidiary undertakings of Transport Trading Limited (TTL); and to grant Land Authority for the assignment of the 150-year lease structure from TfL Corporation to RfL(I) and London Underground Limited (LUL).

2 Recommendation

2.1 The Committee is asked to note the paper and, subject to receipt of the necessary, related approvals from the Finance Committee and to consent from the Secretary of State for Transport, authorise any Chief Officer and any director of Crossrail Limited (for Transport for London and any of its subsidiaries) to finalise the terms, and authorise the execution, of any amendments to the Crossrail Sponsors Agreement and/or Project Development Agreement and any other matter they consider necessary to implement the lease restructuring arrangements described in this paper.

3 Background

3.1 CRL is a wholly-owned subsidiary of TTL, which is itself a wholly-owned subsidiary of TfL.

3.2 CRL was established to deliver the infrastructure for the Elizabeth line, a new railway for London and the South East, linking Heathrow and Reading in the west to Shenfield and Abbey Wood in the east. Crossrail is one of the largest railway infrastructure projects in Europe, sponsored by TfL and the DfT. The capital cost, including the cost of the CCOS assets on CRL's balance sheet, is in excess of £15bn and this capital expenditure has, to date, been financed by debt to a value of £2.75bn, with the remainder funded through equity.

3.3 Originally, there were put and call options in place over TTL's shares in CRL, which enabled TTL to put the shares in CRL on the DfT or for the DfT to call for the shares in CRL, exercisable by TfL and DfT respectively in certain defined circumstances. The exercise of either of these options would result in the transfer of ownership of CRL's issued shares from TTL to the DfT. The existence of these options also meant that, so long as the options were in place, CRL would need to retain ownership of the assets on its balance sheet after operations had commenced on the Elizabeth line, even though it was not envisaged that CRL would itself operate the completed line. These options fell away when further funding for the project was agreed with the Government and the GLA in early 2019 but were highly influential in shaping the internal operating structures originally envisaged for the line.

3.4 The Railways (Access, Management and Licensing of Railway Undertakings) Regulations 2016 (the Railway Regulations) stipulate that the infrastructure for regulated railways be managed by a separate entity from the operator. TfL has, therefore, established an operating structure in which RfL(I) is the infrastructure manager of the CCOS for the purposes of the Railway Regulations, with responsibility for maintenance, repair and renewal of the railway, signalling and the allocation of capacity for use of the CCOS. Rail for London Limited (RfL), another subsidiary of TTL, is responsible for service operation of the railway, opting to do this through a concession model. RfL has appointed MTR Corporation (Crossrail) Limited (MTR) to be the operator of the Crossrail services on its behalf under a concession agreement that runs until May 2025.

3.5 RfL(I) has granted track and station access to MTR. The access fees payable are currently limited to the directly incurred costs but will ultimately be determined in accordance with the charging framework once established by the Office of Rail and Road under the Railway Regulations.

3.6 To allow RfL(I) sufficient rights over the CCOS asset to be able to act as infrastructure manager, while accommodating the restrictions imposed by the existence of the put and call options, a leasing structure was designed to allow transfer of the necessary rights over the asset from CRL to RfL(I).

3.7 At the same time, similar lease arrangements were put in place over new station facilities constructed by CRL which interface and connect the existing underground network to the CCOS (including escalators, lifts and platforms) (the Interface Areas). These arrangements were to allow LUL to operate and manage these facilities as part of its existing Underground station portfolio.

3.8 These intercompany lease arrangements are complex and are onerous from an administrative and accounting perspective. Under IFRS 16, the accounting for leases is fundamentally different for lessees and lessors. This accounting mismatch results in complex intercompany eliminations on consolidation. It also results in the same asset being recognised at different values (dependent on the lease terms) at the same time by different TfL Group entities. Furthermore, the fact that the asset ownership is recorded by a different company to that responsible for its operation and maintenance is sub-optimal from an operational management perspective and adds a layer of complexity that is no longer necessary given the fact that the put and call options have now fallen away.

4 Proposed Structure and Benefits

4.1 To reduce the administrative burden and create clarity over the operational accountabilities for specific assets, it is proposed (now that passenger service has started on the Elizabeth line and CRL has started to trade in its capacity as lessor of the infrastructure, thus triggering our ability to start claiming capital allowances related to the infrastructure), that the existing agreement for lease in favour of CRL will be transferred as to the CCOS land, to RfL(I) and as to the station interface land, to LUL in each case for an upfront premium of £1. At the same time, the infrastructure assets attaching to the land would be assigned by CRL to RfL(I) and LUL respectively, for upfront premiums equating to the book value (i.e. cost) value of those assets as recorded in CRL's accounts. Other operational assets relating to the line will be sold, by CRL, for book value, to the TTL subsidiary responsible for operating them.

4.2 These arrangements will have the accounting impact of transferring all operational assets constructed by CRL to those subsidiaries responsible for their operation, renewal and maintenance – thus aligning recognition of the assets held on the balance sheet of each company with the operational accountability for those assets. No ongoing right-of-use lease liabilities or assets would need to be recorded in the operational entities, which reduces the management of complex accounting entries over the life of the arrangement.

5 Financing

5.1 To maintain access to valuable capital allowances, RfL(I) and LUL will need to finance the acquisition of assets from CRL through a combination of equity and debt funding. This will require RfL(I) and LUL to issue new ordinary share capital respectively to their parent, TTL. At the same time, CRL will need to repay its existing interest-bearing intercompany debt of £2.75bn to TfL who can then re-lend these monies on to RfL(I) under the standard intercompany terms and conditions TfL uses for prudential borrowing

5.2 In order to fund TTL's investment in the new share capital of RfL(I)/LUL, CRL will need to undergo a share reduction exercise, returning the equity funding attached to the cancelled shares to its parent, TTL, for reinvestment.

5.3 The net impact of the above transactions will be to transfer the assets and liabilities of CRL to other fellow subsidiaries undertakings of TTL, reflecting a reduced role for CRL as the construction phase completes. The approvals for the increases and reduction in share capital required by these entities under the Companies Act 2006 will be addressed by officers of the relevant subsidiaries.

5.4 Going forward, the infrastructure access fees paid by MTR will be retained in full by RfL(I), rather than being passed on through lease charges to CRL as was previously envisaged. These monies will be used to finance the new loan (both interest and capital repayments) by RfL(I).

5.5 There will be no impact of the above intercompany transfers in the consolidated accounts of either the TTL or TfL Groups.

6 Tax Implications

6.1 It is crucial that the TTL Group's access to the capital allowances attached to the infrastructure is not lost in any transfer of the CCOS and station infrastructure assets out of CRL. These allowances were valued in 2018, at an estimated £2.5bn, a further capital allowance review is currently being undertaken to establish the final qualifying amount.

6.2 TfL has obtained independent legal advice in relation to the tax implications of the proposal structure, including seeking an opinion from Tax Counsel. Based on this advice we have concluded that the transaction is not considered to be high risk from a tax perspective and the capital allowances should pass to RfL(I) and LUL respectively.

6.3 As all transfers are within the TTL tax group, there should not be any other adverse tax consequences to the transaction.

7 Consents

7.1 Although the proposals set out in this paper are purely intra-group and have no impact at the consolidated TTL Group level, under the Crossrail Sponsors Agreement and Project Development Agreement, TfL is required to obtain the Secretary of State's consent before directing CRL to dispose of its interest in the CCOS. Thus, further changes to the Sponsors Agreement and Project Development Agreement may be required to reflect the nature of the intra-group arrangements and the possibility of any future disposals by RfL(I). As set out in the recommendations, any approval by this Committee is therefore made subject to the necessary consents and agreements of the Secretary of State being received.

List of appendices to this report:

None

List of background papers:
The Crossrail Act 2008
Crossrail Sponsors Agreement
Crossrail Project Development Agreement

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