

TRANSPORT FOR LONDON

BOARD

SUBJECT: TfL PRUDENTIAL INDICATORS 2012 to 2015

DATE: 15 MARCH 2012

1 PURPOSE AND DECISION REQUIRED

- 1.1 This paper sets out the proposed TfL borrowing limits and other Prudential Indicators under the CIPFA Prudential Code (the Prudential Code), which are consistent with the proposed Treasury Management Strategy for 2011/12 and 2012/13. As such, the paper is an update to the March 2011 Board paper which revised indicators to take account of the acquisition of Tube Lines and related planned restructuring of its debt obligations.
- 1.2 Under the Prudential Code, TfL is required to adopt Prudential Indicators which support decision making on planned capital expenditure, borrowing and treasury management activities. The proposed Prudential Indicators for the current year, 2012/13, and the following two years are attached to this paper as Appendix 1. Following guidance from CIPFA, Treasury Management Indicators are now shown separately in Appendix 2.
- 1.3 The Board is asked to approve the Authorised Limit, Operational Boundary and other Prudential indicators for 2011/12 and the Prudential indicators for 2012/13 and the following two years, as set out in Appendix 1. It is also asked to approve the Treasury Management Indicators for 2012/13 and the following two years, as set out in Appendix 2.
- 1.4 At its meeting on 1 March 2012, the Finance and Policy Committee considered a similar paper and supported the recommendations.

2 BACKGROUND

- 2.1 Local Authorities are required by Regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003 (the Act).
- 2.2 The framework of Prudential Indicators established by the Code aims to ensure that an authority's capital investment plans are affordable, prudent and sustainable. As part of the strategic planning process, authorities are required, on a rolling basis, to calculate a range of indicators for the forthcoming budget year and two subsequent years. Authorities are also required to monitor performance against indicators within the year as well as preparing indicators based on the Statement of Accounts at each year end. Indicators relate to capital expenditure, external debt and treasury management.
- 2.3 The Capital Expenditure and External Debt Indicators relevant to TfL are:
 - (a) Capital Expenditure;

- (b) Capital Financing Requirement;
- (c) Authorised Limit;
- (d) Operational Boundary; and
- (e) Ratio of Financing costs to Net Revenue Stream.

Definitions for each of these are included in Appendix 3.

3 CHANGES TO BORROWING LIMITS FOR 2011/12

- 3.1 It is proposed to make certain changes to the borrowing limits for 2011/12 to reflect the impact of transactions that have taken place during the year. Under the Local Government Act 2003, there is an obligation to consult with the London Assembly (the Assembly) on proposals to make in year amendments to borrowing limits, after which the Mayor approves them.
- 3.2 In order to secure an increase in the borrowing limits, it was necessary to consult with the Assembly on the proposed changes in advance of these changes being considered by the Finance and Policy Committee. The last meeting of the Assembly Budget and Performance Committee before the end of the current financial year was 28 February 2012, earlier than usual because of the pre-election period and the Committee had until 7 March 2012 to comment. The Committee raised no objections to the proposals to amend the borrowing limits, and it is anticipated that a Mayoral Decision will be ready for approval and signature by mid March 2012.
- 3.3 The only amendment sought to the current year's borrowing limits is for the impact of the acquisition of City Airport Rail Enterprises (Holdings) Limited and Woolwich Arsenal Rail Enterprises (Holdings) Limited and their respective subsidiaries (the CARE and WARE groups), set out below.

4 ACQUISITION OF CARE AND WARE

- 4.1 On 23 November 2011, TfL acquired, through Transport Trading Limited, a 100 per cent interest in both CARE and WARE. The external borrowings held by CARE and WARE were subsequently refinanced by TfL to achieve lower rates of financing.
- 4.2 TfL is permitted to swap finance lease creditors in subsidiaries for direct borrowing in the Corporation, in accordance with its Spending Review 2010 funding agreement with the Secretary of State for Transport. The increase in direct borrowing as a result of the CARE and WARE acquisition is limited to the finance lease creditor outstanding in Docklands Light Railway Limited prior to the acquisition of these companies, of £326m.
- 4.3 The impact of the acquisition of CARE and WARE is reflected in both the operational boundary and authorised limit for 2011/12 and subsequent years.

5 CHANGES TO BORROWING LIMITS FOR FUTURE YEARS

- 5.1 As stated in paragraph 4.3 above, the impact of the CARE and WARE transactions on TfL's borrowing limits needs to be reflected in the operational boundary and authorised limit for future years. The Assembly consultation

process for these years is dealt with through the Mayor's Budget consultation, and separate consultation is not therefore required.

- 5.2 The changes for CARE and WARE affect both the operational boundary and the authorised limit. There are in addition a number of changes proposed that affect the authorised limit only. These are set out in sections 6 and 7 below.

6 REFINANCING OF PFI FINANCE LIABILITIES

- 6.1 As set out elsewhere on the agenda, TfL wishes to have the flexibility to acquire, refinance or restructure existing finance leases including PFI contracts as and when commercial opportunities arise and value for money can be demonstrated.
- 6.2 It is therefore proposed that the Authorised Limit for the Corporation should be amended to provide the flexibility to refinance certain of the Group's remaining PFI finance lease liabilities as permitted under annex C of TfL's SR2010 settlement letter. TfL has the ability under the 2010 funding settlement to swap finance leases (as measured for National Accounts purposes) with borrowing undertaken at the TfL level, subject to there being no overall increase in liabilities across the TfL Group.
- 6.3 It should be noted that incremental direct borrowing by TfL is only possible where the relevant PFI transaction is on balance sheet for National Accounts purposes. For those PFIs treated as off balance sheet for National Accounts purposes, any refinancing has to be undertaken from existing resources. This is the case even where the PFIs are on balance sheet in the Group's financial statements.

7 REFINANCING OF SHORT TERM BORROWINGS

- 7.1 During the last year, TfL has taken advantage of historically low short term interest rates, and borrowed short term through its Commercial Paper programme rather than borrowing long term through the Medium Term Note programme or the Public Works Loan Board.
- 7.2 As set out elsewhere on the agenda, TfL wishes to have the flexibility to refinance this short term borrowing by replacing with longer term borrowing when financially advantageous to do so. In order to secure the most favourable longer term interest rates, it is possible that new replacement borrowings might be entered into before the short term borrowings are scheduled for repayment, leading to a temporary "doubling up" of borrowings.
- 7.3 It is therefore proposed that the authorised limit should be increased to provide flexibility in refinancing of borrowings, to ensure that the most advantageous rates can be secured. There is no requirement to increase the operational boundary in the same way, as the Prudential Codes notes that "*It will probably not be significant if the operational boundary is breached temporarily on occasions due to variations in cash flow. However, a sustained or regular trend above the operational boundary would be significant and should lead to further investigation as appropriate*". A temporary breach of the operational boundary in these circumstances would not be significant and would not require further investigation or action.

8 NET IMPACT OF CHANGES

- 8.1 The net impact on the Corporation's Operational Boundary and Authorised Limit for the impact of the above changes from the March 2011 Board paper is shown below.

	2011/12 £m	2012/13 £m	2013/14 £m	2014/15 £m
Previous Operational Boundary	7,322.6	7,744.5	8,043.7	N/A
CARE and WARE	326.0	326.0	326.0	N/A
Proposed Operational Boundary	7,648.6	8,070.5	8,369.7	8,926.4
Overdraft facility	200.0	200.0	200.0	200.0
Refinancing of PFIs		453.0	453.0	453.0
Refinancing of short term borrowings		500.0	500.0	500.0
Proposed Authorised Limit	7,848.6	9,223.5	9,522.7	10,079.4

9 PRUDENTIAL TREASURY INDICATORS

- 9.1 A number of treasury indicators that historically formed part of the Prudential Code are now more appropriately linked to the Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (the TM Code). Local authorities are required to "have regard" to these treasury indicators.
- 9.2 Following recent developments in the market place and the introduction of the Localism Act 2011, CIPFA published an updated TM Code in November 2011 with revised guidance in relation to the management of derivatives. The treasury indicators linked to the TM Code, however, remained unchanged and are detailed in Appendix 2. They comprise:
- (a) upper limits on fixed interest and variable interest exposures;
 - (b) upper and lower limits on the maturity structure of borrowing; and
 - (c) upper limits to the total of principal sums invested longer than 364 days.

10 PROPOSED BORROWING LIMITS FOR 2012/13

- 10.1 The composition of the borrowing limits is set out in the proposed Treasury Management Strategy (TMS), which is being considered in a separate paper to this meeting. It is expected that the Mayor will have consulted with TfL by the time of the 15 March Board meeting which will allow the Board to adopt the in-year Authorised Limit for external debt as above, which includes direct borrowings of £8,832m in 2012/13.

10.2 The Operational Boundary calculations exclude the transfer of the Group's existing PFI finance liabilities into the Corporation's direct borrowings, as the refinancing is not reflected in TfL's current business plans. Levels of direct borrowings are therefore substantially below the Authorised Limits. The Operational Boundary does, however, include finance lease creditors and other long term creditors as well as external borrowing.

11 RECOMMENDATION

11.1 The Board is asked to approve:

- (a) the revised Authorised Limit, Operational Boundary and other Prudential Indicators for 2011/12 as set out in Appendix 1;
- (b) the TfL Prudential Indicators as set out in Appendix 1 for 2012/13 and the following two years; and
- (c) the Treasury Indicators as set out in Appendix 2 for 2012/13 and the following two years.

12 CONTACT

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**THE PRUDENTIAL INDICATORS
TRANSPORT for LONDON**

Prudential Indicators for Prudence and Affordability					
<u>Estimates of ratio of financing costs to net revenue stream</u>		Forecast 2011- 12	Budget 2012- 13	Plan 2013- 14	Plan 2014- 15
TfL Corporation		15.5%	16.8%	19.3%	21.7%
TfL Group		31.7%	28.3%	33.2%	38.4%
Comprising:					
On-balance sheet PFIs		5.3%	3.5%	3.5%	3.6%
Direct borrowing and other financing*		26.4%	24.8%	29.7%	34.8%
Net Borrowing and the Capital Financing Requirement**		TfL Group***		TfL Corporation	
		£millions		£millions	
Net Borrowing at 31 March 2013		5,854.9		5,823.0	
Capital Financing Requirement at 31 March 2015		9,642.4		8,608.6	

* The line titled 'Direct Borrowing and other financing' includes net depreciation charged to TfL's group revenue account.

** The Prudential Code requires that Net Borrowing at 31 March 2013 will not exceed the Capital Financing Requirement at 31 March 2015.

***The Prudential Code requires information in respect of TfL Corporation and also requires the effect of subsidiaries to be taken into account. Accordingly, Group figures are also stated.

Prudential Indicators for Capital Expenditure and External Debt

Estimates of Capital Expenditure (Annual)

	Forecast 2011- 12 £millions	Budget 2012- 13 £millions	Plan 2013- 14 £millions	Plan 2014- 15 £millions
TfL Corporation	3,162.5	3,234.7	3,142.8	3,093.5
TfL Group				
Directly Acquired	1,810.6	1,989.8	1,871.1	1,705.2
Crossrail capital expenditure	920.8	1,414.7	1,590.4	1,916.1
TfL Group Total	2,731.4	3,404.5	3,461.5	3,621.3

Estimates of Capital Financing Requirement (Cumulative)*

	Forecast 2011- 12 £millions	Budget 2012- 13 £millions	Plan 2013- 14 £millions	Plan 2014- 15 £millions
TfL Corporation	7,246.7	7,607.0	8,249.9	8,608.6
Total TfL Group	8,274.3	8,475.7	9,072.2	9,642.4

Operational Boundary for External Debt**

	Forecast 2011 - 12 £millions	Budget 2012 - 13 £millions	Plan 2013 - 14 £millions	Plan 2014 - 15 £millions
TfL Corporation				
Borrowing	7,234.0	7,679.0	8,024.0	8,674.0
PFI and long term liabilities	414.6	391.5	345.7	252.4
Total Operational Boundary in TfL Corporation	7,648.6	8,070.5	8,369.7	8,926.4
TfL Group				
Borrowing	7,234.0	7,679.0	8,024.0	8,674.0
PFI and long term liabilities	1,318.9	1,232.1	1,122.8	957.4
Total Operational Boundary TfL Group	8,552.9	8,911.1	9,146.8	9,631.4

Authorised Limit for External Debt***

	Forecast 2011 - 12 £millions	Budget 2012 - 13 £millions	Plan 2013 - 14 £millions	Plan 2014 - 15 £millions
TfL Corporation				
Borrowing	7,434.0	8,832.0	9,177.0	9,827.0
PFI and long term liabilities	414.6	391.5	345.7	252.4
Total Authorised Limit in TfL Corporation	7,848.6	9,223.5	9,522.7	10,079.4
TfL Group				
Borrowing	7,434.0	8,832.0	9,177.0	9,827.0
PFI and long term liabilities	1,318.9	779.1	696.2	562.9
Total Authorised Limit in TfL Group	8,752.9	9,611.1	9,873.2	10,389.9

* The Capital Financing Requirement is the amount of capital expenditure to be financed by means other than grant or asset sales proceeds.

** The Operational Boundary is a calculation based upon the cash flows in the Budget and Plan. If breached, it is a warning that financial plans may require review and amendment.

*** The Authorised Limit is the maximum amount that TfL may borrow legally.

Prudential Indicators for Treasury Management

Interest Rate Exposures

Principal outstanding on borrowing
Principal outstanding on investments

Budget	Plan	Plan
31 Mar 13	31 Mar 14	31 Mar 15
£millions	£millions	£millions
(8,832.0)	(9,177.0)	(9,827.0)
2,977.1	3,315.9	3,032.9
(5,854.9)	(5,861.1)	(6,794.1)
Borrowing upper limit – fixed	100%	100%
Borrowing upper limit – variable	50%	50%
Investments upper limit – fixed	50%	50%
Investments upper limit – variable	100%	100%

Net (Borrowing)

Borrowing upper limit – fixed
Borrowing upper limit – variable
Investments upper limit – fixed
Investments upper limit – variable

If this indicator is broken it serves as a warning to management that the interest rate risk strategy is not being adhered to.

Maturity Structure of Borrowing

< 1 year
1 year to < 2 years
2 years to <5 years
5 years to <10 years
10 years and above

Budget	
31 Mar 13	
Upper	Lower
35%	0%
35%	0%
50%	0%
75%	0%
100%	20%

This indicator represents limits (for fixed rate debt) of the percentage of borrowing maturing in the future periods above as a total of fixed rate borrowing outstanding.

Actual amounts will depend on the projects financed and which ones have been converted into long-term obligations

Maximum Outstanding Principal sum Invested for more than 364 days

Forward Financial Year 1
Forward Financial Year 2
Forward Financial Year 3
Forward Financial Year 4

Budget	Plan	Plan
31 Mar 13	31 Mar 14	31 Mar 15
£millions	£millions	£millions
1,500	1,500	1,500
1,000	1,000	1,000
750	750	750
500	500	500

Definitions for Prudential Indicators used by TfL

1. Capital Expenditure
 - For the Group this is the total of fixed asset additions for the given period.
 - For the Corporation this is the Corporation's own fixed asset additions plus any loans or capital grants passed to the subsidiaries for the given period.
2. Capital Financing Requirement
 - The Capital Financing Requirement (CFR) is the amount of capital expenditure to be financed by means other than grant or asset sales proceeds. It is calculated from the balance sheet of the Group and Corporation by deducting deferred grant, and capital reserve balances from the total fixed asset balance.
 - There is a requirement in the Code to ensure that the estimate for the CFR at the end of 2015 is not exceeded by net borrowings budgeted at the end of 2013.
3. External Debt - Operational Boundary
 - The Operational Boundary is a sum of external borrowings and long term capital liabilities, including finance lease creditors and provisions, as shown in the Budget and Plan. If breached, it is a warning that financial plans may require review and amendment.
4. External Debt - Authorised Limit
 - The authorised limit is the maximum amount that TfL may borrow legally.
 - It is comprised of the Operational Boundary plus an element of headroom to allow for unexpected cashflow fluctuations.
5. Ratio of financing costs to net revenue streams
 - Indicator expresses the interest costs, net of interest income as a percentage of TfL's Revenue Grant plus or minus transfers to reserves.