AGENDA ITEM 7

TRANSPORT FOR LONDON

BOARD

SUBJECT: TfL PRUDENTIAL INDICATORS 2011 to 2014

DATE: 30 MARCH 2011

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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 which are consistent with the proposed Treasury Management Strategy based on the proposed Business Plan position. As such, the indicators also take account of the acquisition of Tube Lines and allow for potential 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 2011/12 and the following two years are attached to this paper as Appendix 1. Following revised Guidance from CIPFA, Treasury Management Indicators are now shown separately in Appendix 2. The External Debt Operational Boundary and Authorised Limit indicators are separate from levels of borrowing agreed with the Department for Transport, which are outside the scope of this paper.

1.3 The Board is asked to approve revised Prudential Indicators for 2010/11, and TfL Prudential Indicators and Treasury Indicators for 2011/12 and the following two years as set out in Appendices 1 and 2.

1.4 The Finance and Policy Committee considered a similar paper at its meeting on 17 March 2011 and supported the recommendations.

2 BACKGROUND

2.1 The Prudential Code plays a key role in capital finance in local authorities. The Code has been developed as a professional code of practice to support Local Authorities in their decision making processes for capital expenditure and its financing.

2.2 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).

2.3 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.

2.4 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 IN ACCOUNTING RULES

3.1 Certain changes in the accounting rules applicable to TfL and other local authorities have an impact on the Prudential Indicators for 2010/11 and subsequent years.

3.2 The Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 (the Code), which is applicable to TfL's accounts for the year ending 31 March 2011, is based on International Financial Reporting Standards.

3.3 TfL is completing the transition to IFRS for the year ending 31 March 2011. This will result in certain leases, previously treated as off-balance sheet, coming on-balance sheet. The Prudential Indicators for 2010/11 and subsequent years shown in Appendix 1 include the impact of such leases coming on in 2011 under the Code. These only impact the Group's indicators, which are prepared for information only as the Act's requirements only extend to the Corporation itself. The Corporation's indicators have not been affected by these accounting based changes for 2010/11.

4 ACQUISITION OF TUBE LINES

4.1 On 27 June 2010 TfL acquired, through Transport Trading Ltd, a 100 per cent interest in Tube Lines Limited. Following acquisition, the opportunity was taken to pay down the PPP finance lease creditor in London Underground (LU). The impact of this transaction, at the Group level, was to replace borrowings in LU in the form of the lease creditor, with external loans in Tube Lines (Finance) plc. As such, there was no increase in the level of the Group's borrowings.

4.2 As part of the acquisition, TfL sought to raise an additional £135 million of Corporation borrowings to redeem the highest rate borrowings within Tube Lines (Finance) plc. This involved replacing borrowing in a subsidiary by borrowing in the Corporation, which required an increase in TfL's borrowing limit for 2010/11, which applies to the Corporation only. This was approved by the Board on 23 June 2010 and subsequently approved by the Mayor.

4.3 It is proposed that the Corporation's borrowing limit for 2010/11 in respect of the outstanding Tube Lines' debt be increased by £1,640 million, and that the borrowing limit for each subsequent year be increased by £1,775 million. These changes in effect keep TfL's total Tube Lines' related borrowing in line with previously agreed DfT Public Sector Net Debt calculations.

5 PICCADILLY LINE ROLLING STOCK AND OTHER CHANGES

5.1 The current borrowing limits were based on the assumption that TfL would undertake additional borrowing, commencing in 2010/11, for the new rolling stock for the Piccadilly line. The limits included borrowings of £105 million, £280 million and £532 million for 2010/11 and the following two years.

5.2 The latest Business Plan has re-phased this borrowing into later periods, resulting in a reduction of £105 million to this year's limit, £255 million to the 2011/12 limit and £462 million in 2012/13.

5.3 The borrowing limits also include indirect borrowing in the form of long term creditors and capital related provisions. These have not changed for the current year but have increased by £23 million and £69 million for 2011/12 and 2012/13 respectively, mainly due to later than expected settlement of claims for Crossrail property purchases undertaken within the Corporation.

5.4 The net effect to the Corporation's external borrowing for the impact of changes for Tube Lines, Piccadilly Line rolling stock and indirect borrowing is an increase of £1,535 million in 2010/11 followed by increases of £1,543 million and £1,382 million for the following two years.

6 PRUDENTIAL TREASURY INDICATORS

6.1 Following the financial market crisis, CIPFA published a revised Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (the TM Code), to address recommendations from reports published by the Audit Commission and the Local Government Select Committee on local authority treasury management practices.

6.2 A number of treasury indicators that previously formed part of the Prudential Code are now more appropriately linked to the revised TM Code and guidance. Local authorities are required to "have regard" to these treasury indicators.

6.3 The treasury indicators now linked to the TM Code are detailed in Appendix 2, being:

(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.

7 PROPOSED BORROWING LIMITS FOR 2011/12

7.1 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 30 March Board meeting which will allow the Board to adopt the in-year direct borrowing limit of £6,908.0 million in 2011/12. The Operational Boundary includes finance lease creditors and other long term creditors as well as external borrowing.

7.2 In addition, the Board will also be asked to approve the overdraft limit of £200 million, as part of the proposed TMS. This has been included in the Authorised Limits for both TfL Corporation and the Group.

8 RECOMMENDATION

8.1 The Board is asked to approve:

(a) the revised Authorised Limit, Operational Boundary and other Prudential Indicators for 2010/11 as set out in Appendix 1;

(b) the TfL Prudential Indicators as set out in Appendix 1 for 2011/12 and the following two years; and

(c) the Treasury Indicators as set out in Appendix 2 for 2011/12 and the following two years.

9 CONTACT

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APPENDIX 1

THE PRUDENTIAL INDICATORS
TRANSPORT for LONDON

Prudential Indicators for Prudence and Affordability

Estimates of ratio of financing costs to net revenue stream	**Forecast 2010- 11**	**Budget 2011- 12**	**Plan 2012- 13**	**Plan 2013- 14**
TfL Corporation	10.8%	11.7%	14.1%	15.5%
TfL Group	**16.4%**	**14.7%**	**17.3%**	**18.9%**
Comprising:				
PPP finance leases	2.3%	0.0%	0.0%	0.0%
On-balance sheet PFIs	2.4%	2.1%	2.3%	2.5%
Direct borrowing and other financing*	11.7%	12.6%	15.0%	16.4%

Estimates of ratio of payments to gross revenue stream**	**Forecast 2010- 11**	**Budget 2011- 12**	**Plan 2012- 13**	**Plan 2013- 14**
Payments due under on-balance sheet PFIs	3.3%	3.2%	2.8%	2.7%
Payments due under direct borrowing	3.0%	3.4%	3.3%	3.3%

Net Borrowing and the Capital Financing Requirement***	**TfL Group****** £millions	**TfL Corporation** £millions
Net Borrowing at 31 March 2012	5,387.8	5,207.9
Capital Financing Requirement at 31 March 2014	12,623.3	6,940.8

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

** This ratio is not an Indicator within the Code, but is recognised as useful for TfL.

*** The Prudential Code requires that Net Borrowing at 31 March 2012 will not exceed the Capital Financing Requirement at 31 March 2014.

****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 2010- 11 £millions	Budget 2011- 12 £millions	Plan 2012- 13 £millions	Plan 2013- 14 £millions
TfL Corporation	**4,529.0**	**2,723.6**	**2,627.2**	**3,154.8**
TfL Group				
Directly Acquired	1,797.8	1,674.3	1,510.1	1,487.4
Crossrail capital expenditure	559.0	997.8	1,154.8	1,752.5
PPP finance leases	259.1	0.0	0.0	0.0
TfL Group Total	**2,615.9**	**2,672.1**	**2,664.9**	**3,239.9**

Estimates of Capital Financing Requirement (Cumulative)*	Forecast 2010- 11 £millions	Budget 2011- 12 £millions	Plan 2012- 13 £millions	Plan 2013- 14 £millions
TfL Corporation	6,735.2	6,805.5	6,923.4	6,940.8
Total TfL Group	9,387.9	10,096.9	11,096.8	12,623.3

Operational Boundary for External Debt**	Forecast 2010- 11 £millions	Budget 2011- 12 £millions	Plan 2012- 13 £millions	Plan 2013- 14 £millions
TfL Corporation				
Borrowing	6,483.0	6,908.0	7,353.0	7,698.0
PFI and long term liabilities	538.4	414.6	391.5	345.7
Total Operational Boundary in TfL Corporation	**7,021.4**	**7,322.6**	**7,744.5**	**8,043.7**
TfL Group				
Borrowing	6,665.8	7,087.9	7,529.6	7,874.6
PFI and long term liabilities	1,297.4	1,038.7	963.7	857.2
Total Operational Boundary TfL Group	**7,963.2**	**8,126.6**	**8,493.3**	**8,731.8**

Authorised Limit for External Debt***	Forecast 2010- 11 £millions	Budget 2011- 12 £millions	Plan 2012- 13 £millions	Plan 2013- 14 £millions
TfL Corporation				
Borrowing	6,683.0	7,108.0	7,553.0	7,898.0
PFI and long term liabilities	538.4	414.6	391.5	345.7
Total Authorised Limit in TfL Corporation	**7,221.4**	**7,522.6**	**7,944.5**	**8,243.7**
TfL Group				
Borrowing	6,865.8	7,287.9	7,729.6	8,074.6
PFI and long term liabilities	1,297.4	1,038.7	963.7	857.2
Total Authorised Limit in TfL Group	**8,163.2**	**8,326.6**	**8,693.3**	**8,931.8**

*The Capital Financing Requirement is the amount of capital expenditure yet to be financed by 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	**Budget 31 Mar 12** £millions	**Plan 31 Mar 13** £millions	**Plan 31 Mar 14** £millions
Principal outstanding on borrowing	(7,108.0)	(7,553.0)	(7,898.0)
Principal outstanding on investments	1,900.1	2,966.2	3,342.0
Net (Borrowing)	**(5,207.9)**	**(4,586.8)**	**(4,556.0)**
Borrowing upper limit – fixed	100%	100%	100%
Borrowing upper limit – variable	50%	50%	50%
Investments upper limit – fixed	50%	50%	50%
Investments upper limit – variable	100%	100%	100%

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	**Budget 31 Mar 12**	
	Upper	Lower
< 1year	35%	0%
1 year to < 2 years	35%	0%
2 years to <5 years	50%	0%
5 years to <10 years	75%	0%
10 years and above	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	**Budget 31 Mar 12** £millions	**Plan 31 Mar 13** £millions	**Plan 31 Mar 14** £millions
Forward Financial Year 1	**1,500**	**1,500**	**1,500**
Forward Financial Year 2	**1,000**	**1,000**	**1,000**
Forward Financial Year 3	**750**	**750**	**750**
Forward Financial Year 4	**500**	**500**	**500**

APPENDIX 3

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 2014 is not exceeded by net borrowings budgeted at the end of 2012.

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.