AGENDA ITEM 7

TRANSPORT FOR LONDON

BOARD

SUBJECT: BORROWING LIMITS

DATE: 24 MARCH 2010

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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 and the proposed budget.

1.2 Under the Prudential Code, TfL is required to adopt Prudential Indicators which support planned capital expenditure, borrowing and treasury management activities. The proposed Prudential Indicators for 2010/11 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 Following changes to the accounting rules under which TfL operates, certain assets and liabilities from a number of previously 'off balance sheet' PFI schemes have been brought on the Group and Corporation Balance sheets. This has led to the requirement to restate the 2009/10 Prudential Indicators and these are also included in Appendix 1.

1.4 The content of this paper was discussed at the Finance and Policy Committee meeting held on 9 March 2010 and the Committee recommended the proposals to the Board.

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.

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:

- Capital Expenditure;
- Capital Financing Requirement;
- Operational Boundary;
- Authorised Limit; and
- Ratio of Financing costs to Net Revenue Stream.

Definitions for each of these are included in Appendix 3.

3 2009/10 LIMITS – 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 2009/10 and subsequent years.

3.2 The Code of Practice on Local Authority Accounting in the United Kingdom 2009: A Statement of Recommended Practice (the 2009 SORP), which is applicable to TfL's accounts for the year ending 31 March 2010, incorporates new requirements for accounting for PFI schemes and similar arrangements that are consistent with the adaptation of IFRIC 12 Service Concession Arrangements contained in the Government's 2009/10 IFRS-based Financial Reporting Manual (i-FReM) and Whole of Government Accounts' requirements. The impact of the new controls-based approach compared with the previous risks and rewards approach is that more PFI projects will be brought on the balance sheet for the public sector.

3.3 This means that the infrastructure will be recognised within fixed assets on the balance sheet and depreciated over its useful life. A corresponding financial liability representing the obligation to make payments under the PFI will be recognised and an interest expense will be charged on it.

3.4 This change of accounting policy will require restatement of prior year comparatives. The impact on the Group's balance sheet at 31 March 2010 is to recognise an additional finance lease creditor of approximately £520 million. This creditor balance includes forecast fixed asset additions for 2009/10 of £122m, mainly relating to the Power PFI contract with a smaller amount being attributable to Connect. Fixed asset additions under on-balance sheet PFIs in later years are significantly lower.

3.5 Where PFI contracts come "on-balance sheet" as a result of the IFRS-based approach, there is a requirement to adjust the Capital Financing Requirement, and local authorities will need to ensure their authorised limits and operational boundaries are set accordingly. The paper therefore includes within Appendix 1 revised indicators for 31 March 2010 for the Authorised Limit and Operational Boundary.

3.6 TfL will complete the transition to IFRS for the year ending 31 March 2011. This will result in certain leases, currently treated as off-balance sheet, potentially coming on-balance sheet. The Prudential Indicators for 2010/11 and subsequent years shown in Appendix 1 include the impact of the PFI balances coming on in 2010 under the 2009 SORP, but not that of leases coming on in 2011 following full adoption of IFRS. The Authorised Limit and Operational Boundary will be amended for leases in due course as soon as the impact is quantified and agreed with the external auditors.

3.7 It should be noted that, separately, confirmation has been received from the Department for Transport that any increase in TfL's balance sheet liabilities caused by a reclassification of TfL's existing PFI contracts as part of the transition to IFRS will not be required to be absorbed within TfL's existing borrowing limits.

4 PRUDENTIAL TREASURY INDICATORS

4.1 Following the recent turmoil in global financial markets, 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.

4.2 A number of treasury indicators which 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.

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

- upper limits on fixed interest and variable interest exposures;
- upper and lower limits on the maturity structure of borrowing; and
- upper limits to the total of principal sums invested longer than 364 days.

5 PROPOSED BORROWING LIMITS FOR 2010/11

5.1 It is expected that the Mayor will have consulted with TfL by the time of the Board meeting on 24 March which will allow the Board to adopt formally the in-year borrowing limit of £696 million in 2010/11. This is represented in the indicators by the movement in the Corporation's borrowing element of the Operational Boundary from £4,117 million up to £4,813 million as shown in Appendix 1. The Operational Boundary includes finance lease creditors and other long term creditors as well as external borrowing.

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

6 RECOMMENDATION

6.1 The Board is asked to APPROVE:

(a) the revised Authorised Limit, Operational Boundary and other Prudential Indicators for 2009/10 as set out in Appendix 1;

(b) the TfL Prudential Indicators as set out in Appendix 1 for 2010/11 and the following two years;

(c) the Treasury Indicators as set out in Appendix 2 for 2010/11 and the following two years; and

(d) the increase in the overdraft limit to £200 million.

7 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 2009-10**	**Plan 2010- 11**	**Plan 2011- 12**	**Plan 2012- 13**
TfL Corporation	**9.5%**	**7.9%**	**6.9%**	**8.3%**
TfL Group	**18.0%**	**23.5%**	**18.7%**	**20.0%**
Comprising:				
PPP finance leases	5.0%	5.4%	4.6%	5.1%
On-balance sheet PFIs	3.8%	3.8%	2.7%	2.8%
Direct borrowing and other financing*	9.2%	14.3%	11.4%	12.1%

Estimates of ratio of payments to gross revenue stream**	**Forecast 2009-10**	**Budget 2009- 10**	**Plan 2010- 11**	**Plan 2011- 12**
Payments due under PPP	9.0%	11.00%	11.1%	10.1%
Payments due under on-balance sheet PFIs	7.1%	3.2%	2.7%	2.5%
Payments due under direct borrowing	2.5%	2.4%	3.0%	3.2%

Net Borrowing and the Capital Financing Requirement***	**TfL Group****** £millions	**TfL Corporation** £millions
Net Borrowing including long term liabilities at 31 March 2011	4,165.9	4,041.7
Capital Financing Requirement at 31 March 2013	11,369.5	6,762.5

* 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 2011 will not exceed the Capital Financing Requirement at 31 March 2013.

****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 2009-10** £millions	**Budget 2010-11** £millions	**Plan 2011-12** £millions	**Plan 2012-13** £millions
TfL Corporation	**3,022.7**	**2,768.5**	**2,224.9**	**3,175.8**
TfL Group				
Directly Acquired	2,131.0	2,141.7	1,616.3	1,856.5
Crossrail capital expenditure	1,005.9	808.0	618.0	1,453.0
PPP finance leases	252.8	258.6	380.6	357.7
On-balance sheet PFIs	121.6	11.2	11.6	11.3
TfL Group Total	**3,511.3**	**3,219.5**	**2,626.5**	**3,678.5**

Estimates of Capital Financing Requirement (Cumulative)*	**Forecast 2009-10** £millions	**Budget 2010-11** £millions	**Plan 2011-12** £millions	**Plan 2012-13** £millions
TfL Corporation	**4,706.5**	**5,705.2**	**6,243.3**	**6,762.5**
Total TfL Group	**8,682.3**	**9,845.8**	**10,551.8**	**11,369.5**

Operational Boundary for External Debt**	**Forecast 2009-10** £millions	**Budget 2010-11** £millions	**Plan 2011-12** £millions	**Plan 2012-13** £millions
TfL Corporation				
Borrowing	4,117.0	4,813.0	5,388.0	6,040.0
Long term liabilities	656.8	538.4	391.9	322.1
Total Operational Boundary in TfL Corporation	**4,773.8**	**5,351.4**	**5,779.9**	**6,362.1**
TfL Group				
Borrowing	4,297.6	4,996.0	5,571.0	6,223.0
PPP and long term liabilities	3,175.3	3,150.0	3,060.7	3,041.8
Total Operational Boundary TfL Group	**7,472.9**	**8,146.0**	**8,631.7**	**9,264.8**

Authorised Limit for External Debt***	**Forecast 2009-10** £millions	**Budget 2010-11** £millions	**Plan 2011-12** £millions	**Plan 2012-13** £millions
TfL Corporation				
Borrowing	4,167.0	5,013.0	5,588.0	6,240.0
Long term liabilities	656.8	538.4	391.9	322.1
Total Authorised Limit in TfL Corporation	**4,823.8**	**5,551.4**	**5,979.9**	**6,562.1**
TfL Group				
Borrowing	4,347.6	5,196.0	5,771.0	6,423.0
PPP and long term liabilities	3,175.3	3,150.0	3,060.7	3,041.8
Total Authorised Limit in TfL Group	**7,522.9**	**8,346.0**	**8,831.7**	**9,464.8**

*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 11** £millions	**Plan 31 Mar 12** £millions	**Plan 31 Mar 13** £millions
Principal outstanding on borrowing	(5,013)	(5,588)	(6,240)
Principal outstanding on investments	971	1,612	2,049
Net (Borrowing)	**(4,042)**	**(3,976)**	**(4,191)**
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 11**	
	Upper	Lower
< 1year	20%	0%
1 year to < 2 years	10%	0%
2 years to <5 years	30%	0%
5 years to <10 years	50%	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 11** £millions	**Plan 31 Mar 12** £millions	**Plan 31 Mar 13** £millions
Total Invested more than 364 days**	**250**	**250**	**250**

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 is the amount of capital expenditure yet to be financed by 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 2013 is not exceeded by net borrowings budgeted at the end of 2011.

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.