

Board

Date: 26 March 2015

Item 7: TfL Prudential Indicators 2014/15 to 2017/18

This paper will be considered in public

1 Summary

- 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 (TMS) for 2015/16. These limits and indicators are based on figures in the 2015/16 TfL Budget. The TMS and TfL Budget are elsewhere on the agenda.
- 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 2015/16, and the following two years are attached to this paper as Appendix 1. In line with guidance from CIPFA, Treasury Management Indicators are shown separately in Appendix 3.
- 1.3 On 11 March 2015, the Finance and Policy Committee noted the Prudential Indicators and endorsed the recommendations in this paper. No specific issues were raised for the attention of the Board.

2 Recommendation

2.1 The Board is asked to approve:

- (a) **revised limits for long term liabilities and total external debt for 2014/15, reflecting changes to the expected settlement profile of the Crossrail property provision;**
- (b) **a revised voluntary Prudential Indicator for 2014/15, as set out in Appendix 1 of this paper, for the Group capital financing requirement. This revision reflects changes to the capital grant allocation to subsidiaries;**
- (c) **the TfL Prudential Indicators as set out in Appendix 2 of this paper for 2015/16 and the following two years; and**
- (d) **the Treasury Indicators as set out in Appendix 3 of this paper for 2015/16 and the following two years.**

3 Background

- 3.1 The Prudential Code plays a key role in capital finance in local authorities. The Code was developed as a professional code of practice to support Local Authorities in their decision making processes for capital expenditure and its financing.
- 3.2 Local Authorities are required to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003 (the Act).
- 3.3 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.
- 3.4 The Prudential Code was developed for local authorities in general, the vast majority of which do not have subsidiary companies. The Corporation's proposed Budget and Business Plan have been used to calculate the proposed indicators (see Appendices 1 and 2) as the scope of the Code only extends to the Corporation's accounts and not those of the TfL Group (which consolidates the Corporation and its subsidiary undertakings), as legally the Corporation is the Local Authority.
- 3.5 Although not covered by the Code, equivalent indicators for the Group have been included in Appendices 1 and 2 for information purposes only. Group indicators are provided on a voluntary basis to recognise the unique nature of the TfL Group compared to Local Authorities in general. Group indicators, although voluntary, can provide a better indication of overall performance as they are not affected by some intercompany transactions that can distort the outturn for the Corporation.
- 3.6 The Capital Expenditure and External Debt Indicators relevant to TfL are:
- (a) Authorised Limit;
 - (b) Operational Boundary;
 - (c) Capital Financing Requirement;
 - (d) Capital Expenditure; and
 - (e) Ratio of Financing costs to Net Revenue Stream.
- Definitions for each of these are included in Appendix 4.
- 3.7 The Estimated Incremental Impact of Capital Investment Decisions on Council Tax, although prescribed as an Indicator in the Prudential Code is not relevant to TfL's circumstances and therefore is not included in the calculation of the Corporation's Prudential Indicators.

4 Changes to Prudential Indicators for 2014/15

4.1 Changes to External Debt Limits for 2014/15

4.1.1 Proposed change to limit for long term liabilities

4.1.1.1 Prudential Indicators for 2014/15 were approved by the Board in March 2014. A change is proposed to the previously approved limit for total external debt for 2014/15 due to a change in the expected settlement profile of long term Crossrail property claim provisions. The change increases the operational boundary and authorised limit for the Corporation and for the Group by £106.2m (or 1.05 per cent), as shown in the table under paragraph 4.1.3. There is no change to the limits for direct borrowings. The outturn for the 2014/15 Actuals versus the approved Prudential Indicators will be presented to the Finance and Policy Committee on 15 October 2015.

4.1.1.2 Under the Act, there is an obligation to consult with the London Assembly (the Assembly) on proposals to make in-year amendments to the Corporation's borrowing limits, after which approval from the Mayor. The next meeting of the Assembly Budget and Performance Committee before the end of the current financial year is 19 March 2015.

4.1.2 Treatment of PFI liabilities in the calculation of the external debt limits

4.1.2.1 In setting the direct borrowings element of the authorised limit an allowance was made for the Corporation to refinance certain PFI transactions held as long term liabilities in subsidiary entities as and when it becomes commercially advantageous to do so. The long term liabilities element of the authorised limit for the Group was adjusted down by the same amount to ensure that there was no overall increase in the total authorised limit for the Group.

4.1.2.2 It is not currently considered likely that the PFI liabilities in question will be refinanced in 2014/15. This will result in outturn long term liabilities for the Group being significantly over the voluntary indicator set, (even after adjusting for the increase in the Crossrail property provision noted in paragraph 4.1.1.1). However, as the higher expected long term liabilities are offset by lower direct borrowing (reflecting the fact that no refinancing is now expected to take place) these debt reclassifications are not considered to be a matter for concern as they have no net effect on the overall total limit for external debt.

4.1.2.3 For the voluntary Group indicator, so long as total debt remains within the overall authorised limit, movement may be made between direct borrowings and other long-term liabilities without penalty. 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. Given there is no impact on the overall total expected debt from such refinancing, a change to the Group's limit for total external debt is not proposed.

4.1.3 Reconciliation of Changes in External Debt Limits for the Corporation for 2014/15

	Paragraph reference	2014/15 £m
Corporation: Previous Operational Boundary for Gross External Debt		8,964.9
Change in long term liabilities	4.1	106.2
Proposed Operational Boundary for Gross External Debt		9,071.1
Overdraft facility ¹		200.0
Refinancing of PFIs ²	4.1.2.1	424.6
Refinancing of short term borrowings ³		500.0
Proposed Authorised Limit		10,195.7

Notes

- 1 an overdraft facility is in place to mitigate short term adverse cash flow variances and this is included in the authorised limit.
- 2 In setting the Prudential indicators in March 2012 the Board approved an increase in the authorised limit to allow for the refinancing of certain PFI contracts (as permitted in annex C of TfL's SR2013 settlement letter) as and when commercial opportunities arise and value for money can be demonstrated.
- 3 In setting the Prudential indicators in March 2012 the Board also approved an increase in the authorised limit to provide flexibility in refinancing of borrowings, to ensure that the most advantageous rates can be secured.

4.2 Changes to Estimate for the Group Capital refinancing Requirement for 2014/15

- 4.2.1 As set out in Appendix 1 it is also proposed that the Group's voluntary capital financing requirement for 2014/15 be increased by £603.8m to £10,621.7m, from the previous indicator of £10,017.8m. This reflects the cumulative impact on both the 2013/14 outturn and the 2014/15 forecast of a reduction in the allocation of capital grant to fund capex in 2014/15 in London Underground and Crossrail. As the Group produces a balanced Business Plan, this does not affect the affordability of the underlying capex, but is a reflection of short-term fluctuations in funding from working capital.

5 Changes to Prudential Indicators for 2015/16 and 2016/17

5.1 Changes to Borrowing Limits for Future Years

5.1.1 Prudential Indicators for the years 2015/16 and 2016/17 were approved by the Board in March 2014. As is proposed for the 2014/15 limits, changes are proposed to the previously approved operational boundary for long term liabilities in 2015/16 and 2016/17, reflecting a change in the expected settlement profile of long term Crossrail property claim provisions as outlined in paragraph 4.1. The revised limits are as set out in Appendix 2.

5.1.2 As noted in paragraph 4.1.2, the calculation of the Corporation's authorised limit for direct borrowings includes an amount of headroom to allow for the refinancing in the Corporation of certain PFI contracts currently held by subsidiary companies. In the Group the authorised limit for long term liabilities is reduced correspondingly to avoid double counting these liabilities.

5.1.3 In the Group, the reduction to the authorised limit for long term liabilities for the possible refinancing of PFI liabilities has been amended for 2015/16 and 2016/17, reflecting the change in the outstanding liabilities under these contracts since the Prudential Indicators were last set.

5.1.4 Reconciliation of Changes in External Debt Limits for the Corporation for 2015/16 to 2017/18

	Paragraph reference	2015/16 £m	2016/17 £m	2017/18 £m
Corporation: Previous Operational Boundary for Gross External Debt		9,497.0	10,199.3	N/A
Change in long term liabilities	4.1.1.1	60.9	14.9	N/A
Proposed Operational Boundary for Gross External Debt		9,557.9	10,214.2	11,082.4
Overdraft facility ¹		200.0	200.0	200.0
Refinancing of PFIs ²		424.6	424.6	424.6
Refinancing of short term borrowings ³		500.0	500.0	500.0
Proposed Authorised Limit		10,682.5	11,338.8	12,207.0

Notes

- 1 an overdraft facility is in place to mitigate short term adverse cash flow variances and this is included in the authorised limit.
- 2 In setting the Prudential indicators in March 2012 the Board approved an increase in the authorised limit to allow for the refinancing of certain PFI contracts (as permitted in annex C of TfL's SR2013 settlement letter) as and when commercial opportunities arise and value for money can be demonstrated.
- 3 In setting the Prudential indicators in March 2012 the Board also approved an increase in the authorised limit to provide flexibility in refinancing of borrowings, to ensure that the most advantageous rates can be secured.

5.2 Changes to Other Prudential Indicators for 2015/16 and 2016/17

- 5.2.1 The other prudential indicators for 2015/16 and 2016/17 for the Corporation and Group have also been amended to reflect TfL's latest Business Plan, published in December 2014. The tables in Appendix 2 set out the revised indicators.
- 5.2.2 In addition to changes resulting from the revised Business Plan, a change to the methodology for calculating the Ratio of Financing Costs to Net Revenue stream is also proposed. Guidance included in the Prudential Code stipulates that the Net Revenue total should comprise "taxation and non-specific grant income". Calculating the indicator as recommended by the Prudential Code, (as has been done in previous years) is of limited relevance to TfL's particular circumstances as it excludes fare revenues and other income received from the calculation of net revenue and therefore does not give a true indicator as to the affordability of borrowings. The calculation of the indicator therefore has been amended to include fares and other income to give a greater degree of relevance to TfL's particular circumstances.

6 Prudential Treasury Indicators

- 6.1 A number of treasury indicators that historically formed part of the Prudential Code are now presented as treasury management indicators as required by CIPFA's 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.
- 6.2 Following 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 proposed treasury indicators, however, remain unchanged and are detailed in Appendix 3. 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.

Composition of the Proposed Borrowing Limits for 2015/16

- 6.3 The composition of the borrowing limits is set out in the proposed 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 26 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 £10,376.5m in 2015/16 as set out in Appendix 2.

List of appendices to this report:

- Appendix 1: TfL Prudential Indicators for 2014/15
- Appendix 2: TfL Prudential Indicators for 2015/16 to 2017/18
- Appendix 3: Treasury Management Indicators
- Appendix 4: Definitions for Prudential Indicators

List of Background Papers:

Paper submitted to the Finance and Policy Committee 11 March 2015

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**THE PRUDENTIAL INDICATORS FOR 2014/15
TRANSPORT for LONDON**

	Paragraph reference	Original Indicator 2014 - 15 £millions	Movement £millions	Proposed Revised Indicator 2014 - 15 £millions
<u>Operational Boundary for External Debt*</u>				
TfL Corporation				
Borrowing		8,651.9	-	8,651.9
PFI and long term liabilities		313.0	106.2	419.2
Total Operational Boundary for External Debt in TfL Corporation	4.1	8,964.9	106.2	9,071.1
TfL Group				
Borrowing		8,651.9	-	8,651.9
PFI and long term liabilities	4.1	1,037.6	106.2	1,143.8
Total Operational Boundary for External Debt TfL Group		9,689.5	106.2	9,795.7
<u>Authorised Limit for External Debt**</u>				
TfL Corporation				
Borrowing		9,776.5	-	9,776.5
PFI and long term liabilities	4.1	313.0	106.2	419.2
Total Authorised Limit in for External Debt in TfL Corporation		10,089.5	106.2	10,195.7
TfL Group				
Borrowing		9,776.5	-	9,776.5
PFI and long term liabilities	4.1	643.1	106.2	749.3
Total Authorised Limit for External Debt in TfL Group		10,419.6	106.2	10,525.8
<u>Estimates of Capital Expenditure (Annual)</u>				
TfL Corporation		4,853.6	-	4,853.6
TfL Group		4,566.7	-	4,566.7
<u>Estimates of Capital Financing Requirement (Cumulative)***</u>				
TfL Corporation		9,399.1	-	9,399.1
Total TfL Group	4.2	10,017.8	603.8	10,621.7

* 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.

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

Prudential Indicators for Prudence and Affordability				
	Paragraph reference	Original Indicator 2014 – 15	Movement	Proposed Revised Indicator 2014 - 15
<u>Estimates of ratio of financing costs to net revenue stream</u>				
TfL Corporation		58.9%	-%	58.9%
TfL Group		135.7%	-%	135.7%

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.

**THE PRUDENTIAL INDICATORS FOR 2015/16 TO 2017/18
TRANSPORT for LONDON**

	Paragraph reference	Proposed Revised Indicator Budget 2015 - 16 £millions	Proposed Revised Indicator Plan 2016 - 17 £millions	Proposed Indicator Plan 2017 - 18 £millions
<u>Operational Boundary for External Debt*</u>				
TfL Corporation	5.1.2, 5.1.3			
Borrowing		9,251.9	9,951.9	10,839.8
PFI and long term liabilities		306.0	262.3	242.6
Total Operational Boundary for External Debt in TfL Corporation		9,557.9	10,214.2	11,082.4
TfL Group	5.1			
Borrowing		9,251.9	9,951.9	10,839.8
PFI and long term liabilities		864.7	733.6	645.0
Total Operational Boundary for External Debt TfL Group		10,116.6	10,685.5	11,484.8
<u>Authorised Limit for External Debt**</u>				
TfL Corporation	5.1			
Borrowing		10,376.5	10,076.5	11,964.4
PFI and long term liabilities		306.0	262.3	242.6
Total Authorised Limit in for External Debt in TfL Corporation		10,682.5	11,338.8	12,207.0
TfL Group	5.1			
Borrowing		10,376.5	11,076.5	11,964.4
PFI and long term liabilities		472.2	378.9	333.3
Total Authorised Limit for External Debt in TfL Group		10,848.7	11,455.5	12,297.7
<u>Estimates of Capital Expenditure (Annual)</u>				
TfL Corporation	5.2	4,516.3	2,592.5	3,263.5
TfL Group	5.2	5,315.2	2,532.8	3,716.2
<u>Estimates of Capital Financing Requirement (Cumulative)***</u>				
TfL Corporation	5.2	10,017.7	10,708.6	11,634.1
Total TfL Group	5.2	11,354.6	11,672.4	12,761.1

* 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.

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

Prudential Indicators for Prudence and Affordability

<u>Estimates of ratio of financing costs to net revenue stream</u>	Paragraph reference	Proposed Revised Indicator Budget 2015 - 16	Proposed Revised Indicator Plan 2016 - 17	Proposed Indicator Plan 2017 - 18
TfL Corporation	5.2	342.7%	22.7%	26.4%
TfL Group	5.2	13.3%	8.8%	7.7%
Gross Debt and the Capital Financing Requirement*			TfL Group**	Corporation
			£millions	£millions
Gross Debt at 31 March 2016			10,848.7	10,682.5
Capital Financing Requirement at 31 March 2018			12,761.1	11,634.1

* The Prudential Code stipulates that Gross Debt at 31 March 2016 should not generally exceed the Capital Financing Requirement at 31 March 2018.

**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 Treasury Management

Interest Rate Exposures

	Budget 31 Mar 16	Plan 31 Mar 17	Plan 31 Mar 18
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 16	
	Upper	Lower
< 1 year	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 16	Plan 31 Mar 17	Plan 31 Mar 18
	£millions	£millions	£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

Definitions for Prudential Indicators used by TfL

1. 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.
2. 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.
3. 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.
4. 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 2018 is not exceeded by gross debt budgeted at the end of 2016. This requirement seeks to ensure that over the medium term, debt will only be for a capital purpose.
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 and fares income plus or minus transfers to reserves.