TfL Board

Date: **29 March 2023**

Item: **TfL Prudential Indicators 2023/24 to 2025/26**

This paper will be considered in public

As provided for under section 100B(4)(b) of the Local Government Act 1972, the Chair is of the opinion that this item should be considered as a late item. The reason for the urgency is that Members need to approve the Prudential Indicators before 1 April 2023 and not all information was available at the time the Board papers were published.

1 Summary

1.1 Investing in our transport infrastructure involves high upfront costs. Borrowing can play a role in the financing of capital projects, as it enables us to make vital improvements sooner by spreading the costs over time, including rolling stock and signalling replacements, new homes and growth, as well as air quality and decarbonisation.

1.2 This paper sets out the proposed TfL borrowing limits and other Prudential Indicators under the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code (the Code). These are consistent with the approved Treasury Management Strategy for 2023/24 and the principles underpinning the proposed long-term TfL Capital Strategy. These limits and indicators are based on figures in the 2023/24 TfL Budget submitted separately for approval by the Board and the 2023 TfL Business Plan approved by the Board on 7 December 2022.

1.3 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 2023/24 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 2.

1.4 TfL's Funding Settlement with the Government, dated 30 August 2022, extends until 31 March 2024 or until TfL and Government agree TfL has reached financial sustainability, whichever is the sooner. Therefore, the 2023 TfL Business Plan has been prepared using assumptions in respect of levels of future Government capital funding. The Government has recognised that TfL is not expected to finance major capital enhancements and major renewals from TfL's operating incomes, as is consistent with other transport authorities. However, no funding beyond 2024/25 has been confirmed by Government.

2 Recommendations

2.1 **The Board is asked to note the paper and:**

(a) approve the TfL Prudential Indicators as set out in Appendix 1;

(b) approve the Treasury Management Indicators as set out in Appendix 2 for 2023/24 and the following two years; and

(c) approve the Annual TfL Policy Statement on Minimum Revenue Provision set out in section 6 of the paper.

3 Background on the Prudential Code and Capital Financing Regulations

3.1 The Code plays a key role in capital finance in local authorities. It 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 by regulation to have regard to the Code when carrying out their duties under Part 1 of the Local Government Act 2003.

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 audited Statement of Accounts at each year end. Indicators relate to capital expenditure, external debt and treasury management.

3.4 As required by the Code, TfL prepares Prudential Indicators at both the Corporation and TfL Group level.

3.5 Under capital finance regulations, local authorities are also required each year to set aside some of their revenues as provision for debt. TfL has a statutory duty to make an annual statement as to its policy for the calculation of this provision. This paper, therefore, sets out and asks the Board to approve the TfL Policy Statement on Minimum Revenue Provision, as set out in section 6.

3.6 During the financial year TfL's property development subsidiary, TTL Properties Limited (TTLP), obtained a revolving credit facility (RCF). The facility is currently undrawn and is non-recourse to TfL. However, TTLP still falls within the scope of the borrowing limits set out in this paper and forms part of the overall TfL Group limits.

3.7 A revised Code was published in December 2021. This Code required certain changes by 2023/24, including changes to the requirements for the capital strategy investment reporting and a new prudential indicator for ratio of net income from commercial and service investments to net revenue stream. The Code also makes clear that an authority must not borrow to invest primarily for financial return.

3.8 The Capital Expenditure and External Debt Indicators relevant to TfL under the Code are the:

(a) Authorised Limit;

(b) Operational Boundary;

(c) Capital Financing Requirement;

(d) Capital Expenditure;

(e) Ratio of Financing costs to Net Revenue Stream; and

(f) Ratio of Net Income from Commercial Investments to Net Revenue Stream

Definitions for each indicator are set out in Appendix 3.

3.9 The debt limits – the Authorised Limit and Operational Boundary – proposed have been assessed against rigorous affordability criteria, informed in part by the metrics credit rating agencies used to assess TfL. The criteria include:

(a) net debt to operating surplus before financing;

(b) net debt to operating surplus before financing and renewals;

(c) debt service cover ratio; and
(d) interest cover ratio.

3.10 These metrics are not formal Prudential Indicators under the Code, but given TfL's size and complexity, they provide useful insight into the affordability, sustainability and prudence of TfL's borrowing. Crucially, as set out in TfL's 2023 Business Plan, there is no incremental borrowing planned until after TfL has reached operating financial sustainability. Any incremental borrowing is also subject to a further assessment of affordability at the time of any borrowing.

4 Changes to Prudential Indicators for 2023/24 to 2024/25

4.1 The overall proposed Operational Boundary for gross debt for 2023/24 in the Corporation of £13,559.0m and the Group of £15,504.9m has decreased by £2.5m and £138.6m respectively when compared with the previously approved indicators as result of:

(a) long-term liabilities in both the Corporation and the Group have decreased £43.5m and £162.1m respectively. This is to reflect the revised settlement profile for long term capital provisions and movements in lease liabilities. The Group figure includes the termination of £97.3m lease liabilities related to the purchase of class 378 rolling stock;

(b) an allowance for short-term cash management fluctuations has been removed in both the Corporation and the Group. In accordance with the Code, a short-term breach of the operational boundary for this reason would not be considered significant;

(c) a rephasing of repayments for the Department for Transport (DfT) Crossrail loan facility of £35m in 2022/23 and £70m in 2024/25, compared to the previously approved indicators which had assumed these repayments would be deferred;

(d) planned new borrowing of £180m in 2023/24 impacting both the Corporation and the Group. This is primarily the £160m implementation costs of the London-wide expansion of the Ultra Low Emission Zone, which will be financed through Greater London Authority (GLA) financing;

(e) gross external debt for 2024/25 in both the Corporation and the Group is planned to increase by £440m due to additional net borrowing included in the 2023 TfL Business Plan to finance investment in rolling stock and signalling programmes; and

(f) a reduced draw down from the TTLP RCF facility in the Group of £16.5m in FY2022/23 and £52.9m in 2024/25, based on the latest TTLP development plans.

4.2 The overall proposed Authorised Limit for gross debt for 2023/24 in the Corporation of £14,809.0m has increased by £297.6m and the Group of £17,004.9m has decreased by £617.1m when compared to previously approved indicators. This is due to the Operational Boundary changes and the following changes in the way we account for headroom items:

(a) the allowance within the Authorised Limit to avail of favourable market conditions in relation to short-term refinancing activities has been maintained within both the Corporation and Group at £500m to continue to allow for flexibility when refinancing;

(b) a new allowance has been made in the Authorised Limit in both the Corporation and the Group to represent additional contingent facilities and options available to TfL to increase borrowings should the need arise. In previous years each facility was added to the Operational Boundary as separate allowances. The facilities and options are:

i. the GLA financing facility of £500m, which was established as a mitigation against a severe downside scenario should TfL be unable to deliver further efficiency savings and mitigate against further cost increases;

ii. an existing overdraft facility of £100m and a money market facility of £100m;

iii. the TTLP RCF of £200m (Group only); and

iv. new commercial or Public Works Loan Board borrowings.

With the exception of the TTLP RCF, these contingent facilities are to mitigate against financial shocks and are not to support planned investment;

(c) an allowance of £600m for refinancing of assets and assets under construction in the Group, which may have resulted in additional liabilities on the balance sheet, has been removed as these options are not currently being explored. The Funding Settlement with Government prohibited the sale and leaseback of new rolling stock on both the Piccadilly line and Docklands Light Railway; and

(d) an allowance for potential identification and classification of leases in the Corporation of £250m and the Group of £500m have remained unchanged.

4.3 Further amendments to reflect TfL’s Budget and Business Plan have been applied to the other Prudential Indicators from 2023/24 to 2024/25 for the Corporation and Group. Indicators have been set for the first time for 2025/26. The tables in Appendix 1 set out the revised indicators.

4.4 **Reconciliation of Changes in External Debt Limits for the Corporation for 2022/23 to 2024/25**

Corporation, £m	Reference	2022/23 Approved March 22	2023/24 Proposed	2024/25 Proposed	2025/26 Proposed
Previous Operational Boundary for Gross External Debt		**13,604.3**	**13,561.5**	**13,485.2**	**n/a**
Re-phasing of provisions and liabilities	4.1 (a)	-	(43.5)	(56.2)	n/a
Short-term cash management allowance removed	4.1 (b)	-	(104.0)	(104.8)	n/a
DfT Crossrail facility rephasing of repayments	4.1(c)	-	(35.0)	(70.0)	n/a
Net new borrowings	4.1 (d) (e)	-	20.0	460.0	n/a
ULEZ Implementation	4.1 (d)	-	160.0	160.0	n/a
Proposed Operational Boundary for Gross External Debt		**13,604.3**	**13,559.0**	**13,874.2**	**14,328.1**
Short-term refinancing of borrowings	4.2 (a)	500.0	500.0	500.0	500.0
Additional contingent borrowing	4.2 (b)	-	500.0	700.0	700.0
Overdraft and money market facilities*	4.2 (b)	200.0	-	-	-
Leases	4.2 (d)	250.0	250.0	250.0	250.0
Proposed Authorised Limit		**14,554.3**	**14,809.0**	**15,324.2**	**15,778.1**

* Facilities available to TfL that now form part of the additional contingency borrowing headroom item, as described in paragraph 4.2.

4.5 Reconciliation of Changes in External Debt Limits for the Group for 2022/23 to 2024/25

Group, £m	Reference	2022/23 Approved March 22	2023/24 Proposed	2024/25 Proposed	2025/26 Proposed
Previous Operational Boundary for Gross External Debt		**15,744.2**	**15,643.5**	**15,586.7**	**n/a**
Re-phasing of provisions and liabilities	4.1 (a)	-	(162.1)	(142.9)	n/a
Short-term cash management allowance removed	4.1 (b)	-	(105.0)	(104.4)	n/a
DfT Crossrail facility rephasing of repayments	4.1 (c)	-	(35.0)	(70.0)	n/a
Net new borrowings	4.1 (d) (e)	-	20.0	460.0	n/a
ULEZ Implementation	4.1 (e)	-	160.0	160.0	n/a
Changes to TTLP RCF drawdown	4.1 (f)	-	(16.5)	(69.4)	n/a
Proposed Operational Boundary for Gross External Debt		**15,744.2**	**15,504.9**	**15,820.0**	**16,206.9**
Short-term refinancing of borrowings	4.2 **Error! Reference source not found.**	500.0	500.0	500.0	500.0
Additional contingent borrowing	4.2 (b)	-	500.0	700.0	700.0
Overdraft and money market facilities *	4.2 (b)	200.0	-	-	-
TTLP RCF facility *	4.2 (b)	200.0	-	-	-
Asset refinancing provision	4.2 (c)	600.0	-	-	
Leases	4.2 (d)	500.0	500.0	500.0	500.0
Proposed Authorised Limit		**17,744.2**	**17,004.9**	**17,520.0**	**17,906.9**

* Facilities available to TfL that now form part of the additional contingency borrowing headroom item, as described in paragraph 4.2.

5 Treasury Management Indicators

5.1 In addition to the Prudential Indicators, there are a number of treasury indicators that outlined in CIPFA's Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (the TM Code), published in December 2017. Local authorities are required to have regard to these Treasury Management Indicators.

5.2 The TM Code recommends that local authorities should adopt the following Treasury Management Indicators:

(a) upper and lower limits on the maturity structure of borrowing, including variable as well as fixed rate debt;

(b) the period for upper limits to the total of principal sums invested longer than one year; and

(c) A debt liability benchmark indicator to support risk management of the capital financing requirement.

5.3 While there is not a specific recommended indicator in respect of interest rate exposures, the TM Code suggests that authorities should explain the strategy for managing their interest rate risk as part of the investment and/or capital strategies. We cover our targets for fixed and floating rate debt, as well as general approach to interest rate risk, in our Treasury Management Strategy.

5.4 The proposed Treasury Management Indicators are detailed in Appendix 2.

6 TfL Policy Statement on Minimum Revenue Provision

6.1 Local authorities are required each year to set aside some of their revenues as provision for debt. TfL has a statutory duty to determine for the current financial year an amount of minimum revenue provision (MRP) which it considers to be 'prudent' in relation to debt service obligations.

6.2 While statutory guidance suggests four potential methods for calculating MRP, it also allows for other methods and approaches to be used. Since 2016/17, TfL has applied the principles inherent in the statutory guidance on MRP, to make an annual provision in the Corporation, that aims to build up a reserve on the Balance Sheet over the average useful economic life of the assets funded by borrowings in the Corporation, such that, at the end of that useful economic life, that reserve may be employed to either repay borrowings or to finance replacement capex for those assets that have reached the end of their lives. An MRP is effectively already made for borrowings passed down to the subsidiaries through TfL's existing processes for funding those entities.

6.3 There is an ongoing consultation being undertaken by the Department for Levelling Up, Housing & Communities that seeks views on proposed changes to the MRP statutory guidance to better enforce the duty of local authorities to make a prudent MRP. The matters being consulted on would not have an impact on TfL's current methodology.

6.4 Given current levels of debt (including finance leases) retained within the Corporation the MRP is anticipated to be approximately £58m for 2023/24 and increasing to £62m from 2024/25 resulting from additional borrowings forecast to be allocated in the Corporation. This will result in an annual transfer of this amount from usable reserves (i.e. the General Fund) to unusable reserves (namely the Capital Adjustment Account).

List of appendices to this report:

Appendix 1: For Approval: TfL Prudential Indicators for 2023/24 to 2025/26
Appendix 2: Treasury Management Indicators
Appendix 3: Definitions for Prudential Indicators

List of Background Papers:

None

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Appendix 1

FOR APPROVAL: PRUDENTIAL INDICATORS FOR 2021/22 TO 2024/25
TRANSPORT for LONDON

		Approved Indicator 2022 - 23 £millions	Proposed Indicator 2023 - 24 £millions	Proposed Indicator 2024 - 25 £millions	Proposed Indicator 2025 - 26 £millions
Operational Boundary for External Debt*					
TfL Corporation					
Borrowing		13,069.0	13,108.5	13,478.6	13,973.6
PFI and long term liabilities		535.3	450.5	395.6	354.4
Total Operational Boundary for External Debt in TfL Corporation		**13,604.3**	**13,559.0**	**13,874.2**	**14,328.1**
TfL Group					
Borrowing		13,069.0	13,113.5	13,525.5	14,020.5
PFI and long term liabilities		2,675.2	2,391.4	2,294.5	2,176.4
Total Operational Boundary for External Debt TfL Group		**15,744.2**	**15,504.9**	**15,820.0**	**16,196.9**
Authorised Limit for External Debt**					
TfL Corporation					
Borrowing		13,769.0	14,108.5	14,678.6	15,173.6
PFI and long term liabilities		785.3	700.5	645.6	604.4
Total Authorised Limit in for External Debt in TfL Corporation		**14,554.3**	**14,809.0**	**15,324.2**	**15,778.1**
TfL Group					
Borrowing		14,568.8	14,113.5	14,725.5	15,220.5
PFI and long term liabilities		3,175.4	2,891.4	2,794.5	2,676.4
Total Authorised Limit for External Debt in TfL Group		**17,744.2**	**17,004.9**	**17,520.0**	**17,896.9**
Estimates of Capital Expenditure (Annual)					
TfL Corporation		**1,571.6**	**2,060.6**	**2,293.2**	**2,399.6**
TfL Group		**2,445.1**	**2,909.8**	**3,172.1**	**3,285.2**
Estimates of Capital Financing Requirement (Cumulative)***					
TfL Corporation		**14,046.0**	**14,325.3**	**14,684.4**	**15,153.3**
Total TfL Group		**17,773.6**	**17,277.1**	**17,949.6**	**18,276.1**

* The Operational Boundary is a calculation based upon the cash flows in the TfL Budget. 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

Estimates of ratio of financing costs to net revenue stream	Approved Indicator 2022 - 23	Proposed Indicator 2023 - 24	Proposed Indicator 2024 - 25	Proposed Indicator 2025 - 26
TfL Corporation	**15.4%**	**15.7%**	**19.9%**	**22.9%**
TfL Group	**17.1%**	**16.9%**	**17.8%**	**18%**

Gross Debt and the Capital Financing Requirement*	TfL Group £'m	TfL Corporation £'m
Authorised Limit for total debt at 31 March 2024	17,004.9	14,809.0
Less headroom for short-term refinancing	(500.0)	(500.0)
Adjusted Gross Debt at 31 March 2024	**16,504.9**	**14,309.0**
Capital Financing Requirement at 31 March 2026	**18,276.1**	**15,153.3**

Ratio of net income from investments to net revenue stream

	Approved Indicator 2022-23	Proposed Indicator 2023-24	Proposed Indicator 2024-25	Proposed Indicator 2025-26
TfL Group	**n/a**	**0.02%**	**0.02%**	**0.13%**

* The Prudential Code stipulates that Gross Debt at 31 March 2024 should not generally exceed the Capital Financing Requirement at 31 March 2026 Headroom included in the calculation of the Authorised Limit for External Debt has been stripped out for the purposes of this comparison, as this represents a uplift of debt limits solely to allow flexibility in the timings of drawdown of debt such that TfL is able to obtain the most favourable rates on its borrowings. It does not represent debt that could be used to fund the capital activities of the Group.

Appendix 2

For Approval: Treasury Management Indicators

Maturity Structure of Borrowing	**Budget 31 Mar 2023**	
	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 of the percentage of borrowing maturing in the future periods above as a total of fixed and variable 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 365 days	**Budget 31 Mar 2023** £millions	**Budget 31 Mar 2024** £millions	**Budget 31 Mar 2025** £millions
Forward Financial Year 1	**0**	**0**	**0**
Forward Financial Year 2	**0**	**0**	**0**

Debt liability benchmark indicator	**Budget 31 Mar 2023 £millions**	**Budget 31 Mar 2024 £millions**	**Budget 31 Mar 2025 £millions**	**Budget 31 Mar 2026 £millions**
Loans CFR	13,902	14,031	14,348	14,781
Net loans requirement	11,660	11,688	12,079	12,695
Gross loans requirement (includes liquidity allowance)	12,860	12,988	13,479	14,095
Gross external debt	12,917	13,109	13,489	13,984
(Over)/under benchmark	**(58)**	**(120)**	**(9)**	**111**

Where gross external debt exceeds the gross loans requirement, this potentially indicates that excess cash is required to be invested. Being under the benchmark indicates a potential borrowing requirement.

Appendix 3

Definitions

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, short-term refinancing and other contingencies.

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 Prudential Code to ensure that the estimate for the CFR at the end of 2026 is not exceeded by gross debt budgeted at the end of 2024. 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.

6. Ratio of net income from commercial and service investments to net revenue streams

Indicator expresses net income from commercial and service investments, other than treasury management investments, as a percentage of TfL’s Revenue Grant and fare income plus or minus transfers to reserves.

Definitions for affordability criteria

1. Net debt to operating surplus before financing

This metric considers the level of our forecast net debt compared to our operating surplus before financing costs. Net debt is the level of borrowing and other financing liabilities less cash balances. The operating surplus is calculated by taking operating costs (including renewals) from operating income.

2. Net debt to operating surplus before financing and renewals

This metric considers the level of our forecast net debt compared to our operating surplus before financing costs and renewals. Net debt is the level of borrowing and other financing liabilities less cash balances. The operating surplus is calculated by taking operating costs (excluding renewals) from operating income.

3. Debt service cover ratio

The debt service cover ratio calculates how many times our operating surplus before financing costs and capital renewals covers our debt service obligations.

4. Interest cover ratio.

The interest cover ratio calculates how many times our operating surplus before financing costs and capital renewals covers the interest payments due on our borrowings.