

Date: 13 March 2017

Item: Treasury Management Strategy 2017/18

This paper will be considered in public

1 Summary

- 1.1 The purpose of this paper is to ask the Committee to recommend that the Board approves the proposed TfL Treasury Management Strategy (TMS) for 2017/18. The TMS 2017/18 comprises the Investment Strategy, the Borrowing Strategy, the Liquidity Strategy, the Risk Management Strategy and the Counterparty Exposure Limits.
- 1.2 A paper is included on Part 2 of the agenda, which contains exempt supplemental information and documentation. The information is exempt by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972 in that it contains information relating to the financial affairs of TfL. Any discussion of that exempt information must take place after the press and public have been excluded from the meeting.

2 Recommendations

- 2.1 **The Committee is asked to:**
 - (a) **note the paper and the supplementary information on Part 2 of the agenda;**
 - (b) **recommend that the Board approves the Treasury Management Strategy for 2017/18 (TMS), attached at Appendix 1, including the Investment Strategy, the Borrowing Strategy, the Liquidity Strategy, the Risk Management Strategy and the Counterparty Exposure Limits;**
 - (c) **recommend that the Board authorises the Committee to approve any changes to the TMS 2017/18 during the course of the year;**
 - (d) **note that the proposals to the Committee for derivative investments set out in Recommendation 2.1(e) have been approved by the Chief Finance Officer, as required under the Policy Relating to the Use of Derivative Investments 2017/18; and**

subject to the TfL Board approving the TMS 2017/18 and the Policy Relating to the Use of Derivative Investments 2017/18:

- (e) approve, pursuant to Section 49 of the Transport for London Act 2008 (as amended by the Transport for London Act 2016, together the Act) and in accordance with the TfL Group Policy Relating to the Use of Derivative Investments (the Derivatives Policy) for 2016/17 (or 2017/18 as maybe applicable at such time), Transport for London Finance Limited (as a qualifying TfL subsidiary for the purposes of the Act) entering into derivative investment(s) in relation to:
- (i) mitigating exchange rate risk related to specific currency exposures arising from the procurement of goods or services by any member of the TfL Group or receipts of European Union (EU) subsidies or other grants or revenues payable other than in sterling to any member of the TfL Group in the ordinary course of business as soon as practicable once the quantum of exchange rate risk to any member of the TfL Group is established;
 - (ii) mitigating exchange rate risk exposures arising from any TfL Group investments in foreign currencies as permitted by the proposed TMS 2016/17 (or 2017/18 as may be applicable at such time);
 - (iii) mitigating commodity rate and/or price risk related to specific commodity (including fuel and electricity) exposures arising from the procurement of goods or services by any member of the TfL Group in the ordinary course of business as soon as practicable once the quantum of commodity risk to any member of the TfL Group is established;
 - (iv) mitigating interest rate risk and if applicable currency risk related to any imminent TfL Group borrowing (including any leases), once the borrowing has become certain and authorised according to relevant TMS 2016/17 (or 2017/18 as may be applicable at such time) provisions;
 - (v) mitigating interest rate risk and currency risk if applicable related to existing and future TfL Group borrowing (including any leases) in accordance with the TMS and the Derivatives Policy 2016/17 (or 2017/18 as may be applicable at such time); and
 - (vi) mitigating risk related to any index reflecting any of the above matters referred to in paragraphs (i) to (v)

2.2 The following Officers and Subsidiaries shall have delegated authority:

- (a) TfL Officers: the Commissioner, Chief Finance Officer, General Counsel and Director of Group Treasury; and
- (b) Subsidiaries: Subsidiaries of TfL including Transport Trading Limited and any other subsidiary (whether existing presently or to

be formed) of Transport Trading Limited and any of the directors of the relevant company shall be authorised to act for and on behalf of that company.

3 Treasury Management Strategy 2017/18

- 3.1 The TMS 2017/18 includes TfL's proposed strategies for borrowing, investment and risk management for the financial year 2017/18. The TMS 2017/18 reflects TfL's expected liquidity position, borrowing requirements and risk exposure.

List of appendices to this report:

Appendix 1: Treasury Management Strategy 2017/18

A paper on Part 2 of the agenda contains exempt supplemental information.

List of Background Papers:

None

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TRANSPORT FOR LONDON

TREASURY MANAGEMENT STRATEGY 2017/18

1 SUMMARY

1.1 This TfL Treasury Management Strategy (TMS) 2017/18 comprises the:

- (i) Investment Strategy;
- (ii) Borrowing Strategy;
- (iii) Liquidity Strategy;
- (iv) Risk Management Strategy; and,
- (v) Counterparty Exposure Limits.

2 BACKGROUND INFORMATION

- 2.1 The TMS has been prepared with regard to the Local Government Act 2003; the key recommendations of CIPFA's Code of Practice and Cross-Sectoral Guidance Notes for Treasury Management in the Public Services 2011 (the 'Code') and the revised investment guidance issued by the Department for Communities and Local Government (DCLG) which came into effect from 1 April 2010 (DCLG Guidance).
- 2.2 As recommended by the Code, this strategy will be updated at least annually and submitted for the approval of the TfL Board.

3 DELEGATION AND POLICIES

- 3.1 This strategy will be implemented, operated and administered in accordance with the Treasury Management Policies approved by the TfL Board.
- 3.2 The arrangements for the implementation, execution and administration of the TMS, including the arrangements for banking, cash management, investment of cash balances, borrowing, liquidity management and financial risk management are delegated to the Chief Finance Officer and the Director of Group Treasury, provided no decision contravenes the TMS, the Treasury Management Policies, the TfL Group Policy relating to the Derivative Investments or approved Counterparty Exposure Limits. This includes the selection of counterparties and the type and structure of any transaction. Subject as otherwise provided for in the TMS, the Treasury Management Policies, the TfL Group Policy relating to the Derivative Investments or approved Counterparty Exposure Limits the TfL Group Treasury Officers will enter into any appropriate documentation.

4 STRATEGIC OBJECTIVES

4.1 The objectives underpinning the TMS 2017/18 are:

- (i) to ensure that sufficient cash and liquidity facilities are available to enable TfL to discharge its financial obligations when they become due, in accordance with approved budgets;
- (ii) to undertake treasury management operations with primary regard for the security and liquidity of capital invested;
- (iii) to maximise the yield from investments consistent with the security and liquidity objectives identified above;
- (iv) to undertake treasury management activity having regard to Prudential Indicators (including treasury management indicators) and to remain at all times within the Authorised Limit for external indebtedness;
- (v) to manage its borrowing in a manner that is affordable and sustainable and combines flexibility, security of access to funds, diversity of funding sources and value for money;
- (vi) to support TfL's commitment to maintaining its credit rating relative to that of the UK Government as it recognises the value of its strong credit rating; and
- (vii) to use TfL subsidiaries' statutory power relating to risk management to achieve greater value for money through reducing costs or protecting revenues, reducing volatility / increasing certainty in the Business Plan and to manage treasury financial risks across the whole of TfL.

5 INVESTMENT STRATEGY

- 5.1 This Investment Strategy will be applied in accordance with the TMS strategic objectives listed in 4.1.
- 5.2 TfL maintains a low risk appetite consistent with the good stewardship of public funds, the overriding principle being the prioritisation of security before liquidity and liquidity before yield.
- 5.3 Where possible, TfL will seek to maximise direct investment in counterparties, rather than passive investments held through Money Market Funds (MMFs). This allows greater control over the quality of investments, may allow higher returns, and reduces fees. Some MMF investments will still be required for liquidity purposes.
- 5.4 TfL will have regard to expected cash flow requirements and aim to maintain a range of maturities within the investment portfolio.
- 5.5 All investments will have a maximum tenor of one year and at the time of investment will be rated a minimum of A-2, P-2 or F2 by Standard & Poor's, Moody's or Fitch Ratings credit rating agencies, with no more than 20% of the

portfolio invested in counterparties with a credit rating of less than any of A-1, P-1 or F1.

- 5.6 TfL will consider the risk of its overall portfolio as well as individual investments, seeking to diversify its investments as much as possible and have regard to the exposure to any one counterparty, country, industry, investment type, and credit. TfL will target allocating a portion of the portfolio across sovereign exposures, government agencies, financial institutions, and corporate instruments, subject to investments available at the time.
- 5.7 TfL will consider investing in instruments including: Sovereign Treasury Bills and bonds, UK Debt Management Office deposits, repurchase agreements, bank deposits, certificates of deposit, bonds, commercial paper, floating rate notes, MMFs or any other instrument allowing TfL to achieve the objectives set out in 4.1. Due to the short term nature of TfL's investments and the desire not to lose any principal, TfL will not invest in equity.
- 5.8 TfL may invest in non-sterling denominated investments where:
- (i) currency is bought in advance of a payment or payments in that currency, or where the currency is otherwise received and TfL can identify other future expenditures in that currency to offset against; or
 - (ii) instruments permitted under this TMS and denominated in currencies other than Sterling are swapped back to GBP as a matter of course.
- 5.9 TfL will generally hold investments to maturity, however where the Director of Group Treasury deems it appropriate, TfL may seek to break or resell fixed term investments early (including where doing so will result in TfL incurring penalties or crystallising a loss), in order to protect TfL against potential losses or to improve its investment return.

6 BORROWING STRATEGY

- 6.1 TfL's objective is to manage its borrowing in a manner that is affordable and sustainable and combines value for money, flexibility, security of access to funds and diversity of funding sources.
- 6.2 TfL's annual borrowing requirement, set out in Table 1, is driven by the financing requirement of its capital investment programme and the refinancing needs.

Table 1 – 2017/18 Borrowing requirement

Description	£m
2017/18 Incremental borrowing per latest funding settlement	900
Borrowing deferred from 2016/17 to 2017/18	50
Refinancing of £300m 1.250% Notes due Nov-2017	300
Refinancing of other debt maturing within 12 months	331
Borrowing Requirement for 2017/18	1,581
Financed by	
EIB Crossrail Rolling Stock and Depot Loan	500
EIB Urban Mobility for London Loan	300
EDC Rolling Stock and Depot Loan	150
Total Committed for 2017/18	950
Balance to raise for 2017/18	631

- 6.3 The annual increase in total outstanding borrowing will be within the limits set out in the prevailing funding settlement letter from central government. To the extent that permitted incremental borrowing is not required in 2017/18, it may be deferred to the following financial year, subject to notification to HM Treasury eight weeks prior to the end of 2017/18. The current strategy assumes that all debt maturing within the next 12 months is going to be refinanced.
- 6.4 The total value of outstanding borrowing and other long-term liabilities will be within the Authorised Limit set by the Mayor and adopted by the Board (as required by the Local Government Act 2003).
- 6.5 TfL seeks to achieve its borrowing objectives by maintaining access to capital markets through its Euro Commercial Paper (ECP) programme, Euro Medium Term Note (EMTN) programme and stand-alone capital market transactions, and complementing this with loans and other facilities from financial institutions where appropriate. TfL's borrowing plans are ultimately underpinned by access to the Public Works Loan Board (or any future body replacing it), a readily available source of liquidity. Other sources of finance will be used where they further TfL's stated objectives.
- 6.6 As debt service represents a relatively significant part of TfL's annual expenditure, a high level of certainty over the interest payment amounts is desirable to meet the balanced budget requirement. While fixed rates of borrowing are generally preferred, as they provide more certainty, TfL will assess the merits of having a certain amount of floating debt, where it is consistent with the borrowing and risk management objectives. The limits on fixed and variable interest rates exposures are set out on an annual basis as required by the Prudential Code, and are the subject of a separate Prudential Indicators document approved by the Mayor. For 2017/18, the strategy is to

have at least 75% of all outstanding borrowing at fixed interest rates and up to 25% of borrowing at variable rates.

- 6.7 All borrowing is expected to be drawn in Sterling, as currently permitted by HM Treasury. Should TfL receive HM Treasury approval to raise debt in foreign currencies, any foreign currency exposures arising from such borrowing will be subject to risk mitigation measures consistent with the principles of TfL's Risk Management Strategy.
- 6.8 Given the long life of the majority of the assets financed by TfL, TfL's objective is to have a weighted average tenor of TfL's debt of at least 15 years. TfL will aim to structure its borrowing in a way that avoids large concentrations of debt of the same maturity in order to minimise the refinancing risk. The limits for maturity structure of borrowing are set out on annual basis, as required by The Prudential Code, and are the subject of a separate Prudential Indicators document approved by the Mayor.
- 6.9 TfL will seek to arrange loan facilities that enable drawdown of debt in future years. Where TfL has the ability and option to do so, it will consider fixing the borrowing for drawdowns beyond the 2017/18 financial year, in order to mitigate interest rate risk related to future borrowing requirements. Any borrowing will be within the incremental borrowing limits and Authorised Limits, where applicable.
- 6.10 The source, tenor, currency (subject to 6.7) and the interest rate basis of individual debt transactions will be determined on a case by case basis taking into account value for money, TfL's risk appetite, market conditions, interest rates expectations, investors' preferences, the impact on TfL's debt maturity profile and target weighted average tenor.
- 6.11 TfL will consider opportunities to buyback, refinance, or otherwise restructure, existing liabilities (including leases) where doing so represents value for money, or will improve the structure of TfL's liabilities, or facilitate changes to TfL's corporate structure.

7 LIQUIDITY STRATEGY

- 7.1 TfL must maintain sufficient liquidity to be able to meet its contractual payment obligations, including debt service.
- 7.2 The TfL Group (excluding Crossrail) will hold a minimum acceptable level of cash and short-term investments as defined in the Treasury Management Policies.
- 7.3 Where appropriate, the cash and short-term investments will be supplemented by access to external liquidity sources, such as bank overdrafts, revolving credit facilities and other standby credit facilities. The adequacy of the external liquidity sources will be reviewed on an ongoing basis and TfL will arrange and maintain these facilities if required.
- 7.4 Bank overdrafts and standby credit facilities will not be used in the normal course of business, however TfL would consider borrowing temporarily within

the Authorised Limit to address short-term liquidity issues, where it represents prudent management of TfL's financial affairs.

- 7.5 Cash and short-term investment balances ring-fenced to the construction of the Elizabeth line will be managed to ensure sufficient liquidity to meet Crossrail Limited's forecast payment obligations.
- 7.6 In order to limit the liquidity risk created by rolling the commercial paper programme TfL will aim to manage its maturities so that no more than £200m of short-term borrowings fall due for repayment in any three day period.

8 RISK MANAGEMENT STRATEGY

- 8.1 TfL is materially exposed to a number of specific financial risks in the ordinary course of business, arising from the borrowing programme, the capital investment programme and certain ongoing contractual obligations.
- 8.2 Under Section 49 of the Transport for London Act 2008 (as amended by the Transport for London Act 2016), TfL was conferred powers to make arrangements for risk mitigation.
- 8.3 This Risk Management Strategy provides for measures to address highly probable exposures with a highly certain risk profile that fall within the categories outlined below:
 - (a) interest rate risk related to the TfL Group's existing or planned future borrowing requirements (including any lease);
 - (b) exchange rate risk related to specific currency exposures arising from the procurement of goods or services by the TfL Group; from receipts of European Union (EU) subsidies or other grants / revenues payable other than in Sterling; from any foreign currency borrowing (as permitted); and in the course of making foreign currency investments;
 - (c) commodity price/rate risk related to specific procurements or contracts containing a significant cost element for a commodity component and/or ongoing operational procurements such as power and fuel whether direct or indirect exposures; and
 - (d) inflation risk.
- 8.4 The high level principles established by this Risk Management Strategy are to:
 - (i) achieve greater value for money through reducing costs or protecting revenues;
 - (ii) reduce volatility / increase certainty relating to the impact of financial risks upon the business plan; and
 - (iii) holistically manage financial risks across the whole of TfL.

- 8.5 Where TfL arranges derivative investments through its subsidiary, Transport for London Finance Limited, it may put in place intra-group arrangements to confer the benefit of those derivative investments to the TfL entity bearing the underlying risk.
- 8.6 Under the TfL Group Policy relating to the use of Derivative Investments:
- (i) the Finance Committee has delegated authority from the TfL Board to approve entering into (a) any derivative investment; or (b) a programme of derivative investments;
 - (ii) the Chief Finance Officer is required to grant approval before any derivative investment programme of derivative investments are entered into and the Director of Group Treasury is authorised to approve any derivative investment of a notional value of not more than £100m within any such Chief Finance Officer approved programme; and
 - (iii) the Chief Finance Officer and/or Director of Group Treasury are authorised to give consent on behalf of TfL to approve entities that may be added to the Derivative Counterparty List.

9 COUNTERPARTY EXPOSURE LIMITS

- 9.1 The Chief Finance Officer and/or the Director of Group Treasury will approve individual counterparties and will set individual counterparty exposure limits following detailed analysis of each counterparty and its impact on the overall portfolio, including sector and country concentration risk. The maximum exposure limit per investment counterparty will be within the counterparty exposure limits in the table below. Counterparties within the same group will be subject to group limits.
- 9.2 To reduce investment risk and in line with the requirement to have primary regard to security, TfL aims to keep a diversified portfolio of investments by limiting exposures to individual counterparties. As the maximum tenor of investments is one year, short term ratings will be the primary rating used to determine these limits.

Moody's		S&P		Fitch		Concentration Limit per counterparty
ST	LT	ST	LT	ST	LT	
P-1	Aaa Aa1 Aa2 Aa3 A1	A-1+	AAA AA+ AA AA-	F1+	AAA AA+ AA AA- A+	10%
	A2 A3		A+ A		F1	A+ A A-
P2	A3 Baa1 Baa2	A-2	A- BBB+	F2	A- BBB+ BBB	5%
P-3	Baa2 Baa3	A-3	BBB BBB-	F3	BBB BBB-	0%
UK Sovereign						100%

- 9.3 As Moody's Rating Agency's short term rating does not have a P1+ category, when a counterparty is rated P1, its limit will be based on the average limit derived from any S&P and Fitch rating. In the event the counterparty only has a short term rating from Moody's and it is P1, the concentration limit will be 7.5%. Where it is rated P2, it will be based on the average of all the rating agencies supplying a rating. If any of the rating agencies rate the counterparty A3, P3, or F3, no investments will be permitted.
- 9.4 Where a counterparty does not have a short term rating, the equivalent long term rating as shown in the above table will be used to determine the counterparty exposure limit.
- 9.5 The exposure limit for TfL's clearing bank may be temporarily exceeded (for example, where cash is made available for investment after the daily deadline for deposits with other entities has passed).
- 9.6 Where an instrument benefits from a UK Government Guarantee, the limit will be that for the UK Sovereign rather than that of the entity.
- 9.7 TfL calculates its derivative counterparty exposures based on accepted market methodology. The current fair market value (FMV) of each derivative is added to the potential future exposure (PFE). The PFE is calculated based on the maximum counterparty exposure assuming a 95% confidence level of possible future movements in interest rates over the life of the instrument.
- 9.8 TfL expects to hold all derivative contracts to maturity. As such, exposures under derivative contracts are contingent exposures during the life of the contract. The contingent exposure is therefore the relevant risk factor rather

than the notional value of the contract. For 2017/18 the maximum potential notional value of financial exposures requiring hedging is estimated to be £3.6 billion, resulting in an estimated PFE of £2 billion, which is the current level of PFE available with TfL's existing derivative counterparties under this methodology.

- 9.9 Derivative counterparty exposures have a limit based on the long term credit rating, as these exposures will generally be for over one year. The limits are shown in the table below:

S&P	Moody's	Fitch	Derivative Limit per counterparty (£m)	CSA Threshold for New Derivative Counterparties* (£m)
AAA	Aaa	AAA	400	50
AA+	Aa1	AA+	400	40
AA	Aa2	AA	350	40
AA-	Aa3	AA-	250	40
A+	A1	A+	200	25
A	A2	A	175	25
A-	A3	A-	150	20
BBB+	Baa1	BBB+	0	0

* Will apply to new derivative counterparty ratings at the time the Credit Support Annex (CSA) is entered into.

- 9.10 Where a counterparty has a split rating, the limit for each rating is calculated as the average of the relevant limits for each rating available.
- 9.11 If any limit applicable to a counterparty changes while TfL has an outstanding investment or derivative with that counterparty, TfL may seek to bring its exposure down to within the revised limits but a breach of limits caused by such a change will not be considered a breach of these exposure limits. TfL may at the Director of Group Treasury's discretion decide to allow an investment or derivative to run its course for economic reasons.
- 9.12 TfL will apply the counterparty exposure limits as set out in this section for each counterparty unless circumstances outside its control prevent it from doing so. In this case the Chief Finance Officer and/or Director of Group Treasury will implement appropriate replacement limits for that counterparty.