Board

Date: **27 March 2019**

Item: **TfL Prudential Indicators 2019/20 to 2021/22**

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 Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code (the Prudential Code), which are consistent with the proposed Treasury Management Strategy for 2019/20 and the principles underpinning the proposed long term TfL Capital Strategy. These limits and indicators are based on figures in the 2019/20 TfL Budget, which appears as an item 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 2019/20 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.

1.3 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 on Minimum Revenue Provision, as set out in section 7.

2 Recommendation

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

(a) the TfL Prudential Indicators as set out in Appendix 1 for 2019/20 and the following two years;

(b) the Prudential Indicators for Treasury Management as set out in Appendix 2 for 2019/20 and the following two years; and

(c) the TfL Policy on Minimum Revenue Provision set out in section 7 of the paper.

3 Background on the Prudential Code

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 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).

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 A revised Code was published in 2017, which stated that authorities that prepare Group accounts, in setting indicators, must include all items where a residual interest remains with the authority.

3.5 The Corporation which is made up of London Streets, Taxi and Private Hire and the corporate centre which, for legal and accounting purposes, constitutes TfL – a local authority. TfL Group is made up of the Corporation and its subsidiaries.

3.6 Although not historically covered by the Code, TfL has, in previous years, issued equivalent Group indicators on a voluntary basis. Group indicators can provide a better indication of overall performance for TfL as they are not affected by some intercompany transactions that can distort the outturn for the Corporation. In view of the 2017 revision, TfL will continue to issue the Group indicators, but on a required rather than a voluntary basis.

3.7 The proposed Budget included in this agenda has been used to calculate the proposed indicators for 2019/20 (see Appendix 1). For 2020/21 to 2021/22 the figures have been calculated based on income, expenditure, and working capital and other movements included in the TfL Business Plan published in December 2018, being the latest available approved TfL Business Plan figures for those years.

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

(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 3.

4 Treatment of PFI Liabilities in the Calculation of External Debt Limits for 2019/20

4.1 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.

4.2 The proposed Budget assumes that only the portion of PFI liabilities outstanding at the start of any particular year that is scheduled to be repaid within that year will be refinanced; and the Operational Boundary has been calculated to reflect this.

4.3 For the 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. These debt reclassifications are accordingly not considered to be a matter for concern as they have no net effect on the overall total limit for external debt.

5 Changes to Prudential Indicators for 2019/20 and 2020/21

5.1 Changes to Borrowing Limits for Future Years

Prudential Indicators for the years 2019/20 and 2020/21 were approved by the Board in March 2018.

(a) As noted in paragraph 4.1, 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. The calculation for this adjustment has been revised to reflect the fact that subsidiary PFI liability amounts outstanding (and hence the balances that could potentially be refinanced) have changed since the Prudential Indicators were last approved.

(b) In the Group, the reduction to the authorised limit for long term liabilities for the possible refinancing of PFI liabilities has been similarly amended for 2019/20 and 2020/21, reflecting the change in the outstanding liabilities under these contracts since the Prudential Indicators were last set.

(c) The Operational Boundary for Direct Borrowings in the Group and Corporation has been reduced by £92.6m in 2019/20 and by £49.6m in 2020/21 to reflect the fact that incremental borrowings planned for those years in the March 2018 budget, have now been replaced by the recognition of a finance lease creditor. The Corporation and Group Authorised Limits for Total External Debt remain unchanged in respect of this item.

(d) The Operational Boundary for Direct Borrowings in the Group and Corporation has been increased by £44m in 2019/20 and £22m in 2020/21 to reflect the fact that the proposed Budget assumes that scheduled repayments of PFI finance lease liabilities held within the subsidiaries are now expected to be refinanced by direct borrowings within the Corporation. Our previous Business Plans had not anticipated this refinancing. The Corporation and Group Authorised Limits for Total External Debt have also been adjusted to reflect the fact that these liabilities will be refinanced rather than repaid.

(e) The Group Operational Boundary (and the Group Authorised Limit) for Long-Term Liabilities for 2019/20 and 2020/21 have been increased by £136m in 2019/20 falling to £133m in 2020/21 to reflect the recognition of a new lease liability in one of TfL’s subsidiaries. The Corporation’s Operational Boundary and Authorised Limits remain unchanged in respect of this item.

(f) The Operational Boundary for long term liabilities (and the Total Authorised Limit for External Debt) in both the Corporation and Group have been increased by £27 m in 2019/20 and £26m in 2020/21 to reflect, primarily, a revised settlement profile for long term capital provisions set up in relation to the Crossrail project’s CPO property liabilities.

(g) To address funding shortfalls in relation to the delivery of the Crossrail project, TfL agreed, in July 2018, with Central Government to bring forward £20m of planned borrowings from 2020/21 to 2018/19. The Group and Corporation limits have been amended to reflect this change.

(h) A further Crossrail funding package was agreed with the Department for Transport in December 2018. Under this package, TfL may make drawdowns under a new £750m loan facility provided by the Department for Transport. The facility, however, can only be accessed once a £1.4bn grant from the GLA has been fully utilised and the project has further funding needs that cannot be met from other sources. TfL’s proposed budget assumes that £300m of this facility is drawn down in 2019/20. Thus, the Operating Boundary for External Debt in both the Corporation and the Group has been increased by £300m – with the Authorised Limit being increased by the full £750m.

Reconciliation of Changes in External Debt Limits for the Corporation for 2019/20 to 2020/21

	Paragraph reference	2019/20	2020/21	2021/22
		£m	**£m**	**£m**
Corporation:				
Previous Operational Boundary for Gross External Debt		**12,025.0**	**12,617.0**	n/a
Re-phasing of provisions and liabilities	(f)	26.8	26.3	n/a
Planned new borrowings restricted by recognition of new finance lease liability	(c)	(92.6)	(49.6)	n/a
Reborrowing of scheduled finance lease liability repayments	(d)	44.0	22.0	n/a
Rephasing of planned borrowing from 2020/21 to 2018/19	(g)	20.0	-	n/a
Department for Transport loan facility[4]	(h)	300.0	300.0	n/a
Proposed Operational Boundary for Gross External Debt		**12,323.2**	**12,915.7**	**13,424.6**
Overdraft facility [1]		200.0	200.0	200.0
Refinancing of PFIs [2]	(a)	227.0	205.0	186.0
Refinancing of short term borrowings [3]		500.0	500.0	500.0
Department for Transport loan facility[4]	(h)	450.0	450.0	450.0
Proposed Authorised Limit		**13,700.2**	**14,270.7**	**14,760.6**

Reconciliation of Changes in External Debt Limits for the Group for 2019/20 to 2020/21

	Paragraph reference	2019/20	2020/21	2021/22
		£m	**£m**	**£m**
Group				
Previous Operational Boundary for Gross External Debt		**12,286.0**	**12,856.2**	n/a
Re-phasing of provisions and liabilities		60.0	61.3	n/a
Planned new borrowings restricted by recognition of new finance lease liability	(c)	(92.6)	(49.6)	n/a
Reborrowing of scheduled finance lease liability repayments	(d)	44.0	22.0	n/a
New finance lease creditor recognised	(e)	136.0	132.5	n/a
Rephasing of planned borrowing from 2020/21 to 2018/19	(g)	20.0	-	n/a
Department for Transport loan facility[4]	(h)	300.0	300.0	n/a
Proposed Operational Boundary for Gross External Debt		**12,753.4**	**13,322.4**	**13,811.0**
Overdraft facility [1]		200.0	200.0	200.0
Refinancing of short term borrowings [3]		500.0	500.0	500.0
Department for Transport loan facility[4]	(h)	450.0	450.0	450.0
Proposed Authorised Limit		**13,903.4**	**14,472.4**	**14,961.0**

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.

4 facility made available as part of the funding package to deliver Crossrail agreed with the Department of Transport in December 2018, draw down is subject to conditions precedent

5.2 **Changes to Other Prudential Indicators for Future Years**

Further amendments to reflect TfL's proposed budget have been applied to the other prudential indicators for 2019/20 and 2020/21 for the Corporation and Group. The tables in Appendix 1 set out the revised indicators.

6 Prudential Treasury Indicators

6.1 A number of treasury indicators that historically formed part of the Prudential Code are now presented by CIPFA as treasury management indicators required by its 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 CIPFA acknowledged that the landscape for public services delivery has changed significantly following the sustained period of reduced public spending and the developing localism agenda. As a result it published an updated TM Code in December 2017. The updates reflect changes in regulatory environment, the increasing use of a wider range of investment opportunities, and include streamlined reporting requirements to promote engagements.

6.3 Following the changes to the TM Code, CIPFA has published revised guidance on treasury management for local authorities, which confirms changes to the treasury indicators. These changes are as follows:

(a) there is no longer a specific recommended indicator in respect of interest rate exposures;

(b) upper and lower limits on the maturity structure of borrowing should now include variable as well as fixed rate debt; and

(c) the period for upper limits to the total of principal sums invested has been revised to longer than one year (instead of 364 days previously).

6.4 We propose to remove the indicator in respect of interest rate exposures. Our targets for fixed and floating rate debt are explained in our Treasury Management Strategy.

6.5 The proposed indicators are detailed in Appendix 2.

7 TfL Policy on Minimum Revenue Provision

7.1 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 which it considers to be 'prudent' in relation to debt service obligations.

7.2 While statutory guidance suggests four potential methods for calculating Minimum Revenue Provision (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 Transport for London (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.

7.3 Given current levels of borrowing retained within the Corporation the MRP is anticipated to be approximately £25m per annum throughout the business plan period, and 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: TfL Prudential Indicators for 2019/20 to 2022/23
Appendix 2: Treasury Management Indicators
Appendix 3: Definitions for Prudential Indicators

List of Background Papers:

None

Contact:	Sarah Bradley, Group Financial Controller and Statutory Chief Finance Officer
Number:	020 3054 7748
Email:	SarahBradley@tfl.gov.uk

Appendix 1

THE PRUDENTIAL INDICATORS FOR 2018/19 TO 2021/22
TRANSPORT for LONDON

Operational Boundary for External Debt*	Paragraph reference	Approved Indicators 2018 - 19 £millions	Proposed Revised Indicator Budget 2019 - 20 £millions	Proposed Revised Indicator Plan 2020 - 21 £millions	Proposed Indicator Plan 2021 - 22 £millions
TfL Corporation					
Borrowing		11,339.9	12,113.0	12,715.0	13,234.0
PFI and long term liabilities	5.1	200.3	210.2	200.7	190.6
Total Operational Boundary for External Debt in TfL Corporation		**11,540.2**	**12,323.2**	**12,915.7**	**13,424.6**
TfL Group					
Borrowing		11,339.9	12,113.0	12,715.0	13,234.0
PFI and long term liabilities	5.1	200.3	640.4	607.4	577.0
Total Operational Boundary for External Debt TfL Group		**11,540.2**	**12,753.4**	**13,322.4**	**13,811.0**
Authorised Limit for External Debt**					
TfL Corporation					
Borrowing		12,382.1	13,490.0	14,050.0	14,550.0
PFI and long term liabilities	5.1	200.3	210.2	200.7	190.6
Total Authorised Limit in for External Debt in TfL Corporation		**12,582.4**	**13,700.2**	**14,250.7**	**14,740.6**
TfL Group					
Borrowing		12,382.1	13,494.0	14,050.0	14,550.0
PFI and long term liabilities	5.1	200.3	409.4	422.4	411.0
Total Authorised Limit for External Debt in TfL Group		**12,582.4**	**13,903.4**	**14,472.4**	**14,961.0**
Estimates of Capital Expenditure (Annual)					
TfL Corporation	5.2	**2,192.0**	**2,945.8**	**1,874.7**	**1,520.2**
TfL Group	5.2	**2,845.1**	**3,893.3**	**2,741.8**	**2,500.3**
Estimates of Capital Financing Requirement (Cumulative)***					
TfL Corporation	5.2	**11,812.5**	**13,259.9**	**13,897.6**	**14,460.8**
Total TfL Group	5.2	**13,111.4**	**15,339.1**	**16,493.1**	**17,607.0**

* 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	Approved Indicator 2018 - 19	Proposed Revised Indicator Budget 2019 - 20	Proposed Revised Indicator Plan 2020 - 21	Proposed Indicator Plan 2021 - 22
TfL Corporation	5.2	**12.4%**	**16.9%**	**23.5%**	**22.7%**
TfL Group	5.2	**8.7%**	**6.6%**	**6.7%**	**6.5%**

Gross Debt and the Capital Financing Requirement*	**TfL Group** £millions**	**Corporation £millions**
Gross Debt at 31 March 2020	13,903.4	**13,700.2**
Capital Financing Requirement at 31 March 2022	17,607.0	**14,460.8**

* The Prudential Code stipulates that Gross Debt at 31 March 2020 should not generally exceed the Capital Financing Requirement at 31 March 2022.

**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.

Appendix 2

Prudential Indicators for Treasury Management

Maturity Structure of Borrowing	**Budget 31 Mar 2020**	
	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 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 2020** £millions	**Plan** **31 Mar 2021** £millions	**Plan** **31 Mar 2022** £millions
Forward Financial Year 1	**0**	**0**	**0**
Forward Financial Year 2	**0**	**0**	**0**

Appendix 3

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 2022 is not exceeded by gross debt budgeted at the end of 2020. 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.