

Board



Date: 18 March 2020

Item: TfL Prudential Indicators 2020/21 to 2022/23

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 Code), which are consistent with the proposed Treasury Management Strategy for 2020/21 and the principles underpinning the proposed long-term TfL Capital Strategy. These limits and indicators are based on figures in the 2020/21 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 2020/21 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 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 7.
- 1.4 The proposed Prudential Indicators have been prepared on the basis of existing accounting standards. However, TfL will be required to apply the new lease accounting standard, IFRS 16 Leases, which supersedes IAS 17 Leases, in 2020/21. The impact of the application of this standard is expected to be the recognition of an additional £2.4bn of lease liabilities and related right-of-use assets on the Balance Sheet as at 31 March 2021. The expected impact of the implementation of IFRS 16 on our Prudential Indicators and Debt Limits is set out in Appendix 2 for noting. The figures in Appendix 2 are based on the budgeted IFRS 16 figures included in the Financial tables presented in the appendices of the 2020/21 TfL Budget. Our rating agencies have been updated with expected impact of IFRS 16 on our financial statements as our preparation work has progressed. Final indicators prepared on an IFRS 16 basis will be submitted for formal approval by the TfL Board during the 20/21 financial year.

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 for 2020/21 and the following two years;**
- (b) approve the Treasury Management Indicators as set out in Appendix 3 for 2020/21 and the following two years; and**
- (c) approve the Annual TfL Policy Statement on Minimum Revenue Provision set out in section 7 of the paper.**

3 Background on the Prudential Code

- 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 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 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 As required by the revised Code, TfL prepares Prudential Indicators at both the Corporation and TfL Group level.
- 3.7 The proposed Budget included in this agenda has been used to calculate the proposed indicators for 2020/21 (see Appendix 1). For 2021/22 to 2022/23 the figures have been calculated based on income, expenditure, and working capital and other movements included in the TfL Business Plan published in December 2019, 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 4.

4 Treatment of PFI Liabilities in the Calculation of External Debt Limits for 2020/21

- 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 2020/21 and 2021/22

5.1 Changes to Borrowing Limits for Future Years

Prudential Indicators for the years 2020/21 and 2021/22 were approved by the Board in March 2019.

- (a) As noted in section 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 2020/21 and 2021/22, reflecting the change in the outstanding liabilities under these contracts since the Prudential Indicators were last set.
- (c) The Operational Boundary for long-term liabilities (and the Total Authorised Limit for External Debt) in both the Corporation and Group have been amended to reflect, primarily, the revised settlement profile for long term capital provisions, the Corporation has increased by £7.6m in 2020/21 and

2021/22, whilst the Group has experienced a reduction of £7.1m in 2020/21 and £23.5m in 2021/22.

- (d) The phasing of the Crossrail funding package agreed with the Department for Transport in December 2018 has been updated. Under this package, TfL may make drawdowns under a £750m loan facility provided by the Department for Transport. The facility, however, can only be accessed when the project has further funding needs that cannot be met from other sources. TfL's debt limits have been amended to reflect the latest assumptions in respect of the drawdown and repayment profile of this facility.

Reconciliation of Changes in External Debt Limits for the Corporation for 2020/21 to 2021/22

	Paragraph reference	2020/21	2021/22	2022/23
		£m	£m	£m
Corporation:				
Previous Operational Boundary for Gross External Debt		12,915.7	13,424.6	n/a
Re-phasing of provisions and liabilities	5.1 (c)	7.6	7.6	n/a
Department for Transport loan facility ⁴	5.1(d)	450.0	375.0	n/a
Proposed Operational Boundary for Gross External Debt		13,373.3	13,807.2	14,227.1
Overdraft facility ¹		200.0	200.0	200.0
Refinancing of PFIs ²	5.1 (a)	165.0	146.0	140.0
Refinancing of short-term borrowings ³		500.0	500.0	500.0
Department for Transport loan facility ⁴	5.1(d)	-	75.0	150.0
Proposed Authorised Limit		14,238.3	14,728.2	15,217.1

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.

Reconciliation of Changes in External Debt Limits for the Group for 2020/21 to 2021/22

	Paragraph reference	2020/21	2021/22	2022/23
		£m	£m	£m
Group				
Previous Operational Boundary for Gross External Debt		13,322.4	13,811.0	n/a
Re-phasing of provisions and liabilities	5.1(c)	(7.1)	(23.5)	n/a
Re-phasing of Department for Transport loan facility ⁴	5.1(d)	450.0	375.0	n/a
Proposed Operational Boundary for Gross External Debt		13,765.3	14,162.5	14,550.1
Overdraft facility ¹		200.0	200.0	200.0
Refinancing of PFIs ²	5.1 (b)	(20.1)	(18.9)	(7.7)
Refinancing of short term borrowings ³		500.0	500.0	500.0
Department for Transport loan facility ⁴	5.1(d)	-	75.0	150.0
Proposed Authorised Limit		14,445.2	14,918.6	15,392.4

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 2020/21 and 2021/22 for the Corporation and Group. The tables in Appendix 1 set out the revised indicators.

5.3 **Expected impact of the implementation of IFRS 16 Leases**

Appendix 2 sets out the Prudential Indicators in Appendix 1, as amended for the expected impact of the implementation of the new accounting standard, IFRS 16 Leases, which supersedes IAS 17 Leases. Under the new accounting rules, the Operational Boundary for long term liabilities is expected to increase, reflecting the recognition of an additional budgeted lease liability of £0.4bn for the Corporation in 2020/21 and £2.4bn for the Group compared with prior years.

Certain contracts TfL enters into in the ordinary course of business may result in the recognition of lease liabilities where prior to IFRS 16 these contracts were not so classified. Classification is highly technical and dependent on the specifics of each contract which may not be known in advance of that contract being entered into. An increase in the Authorised Limit is therefore also expected to be necessary, to provide headroom against the risk that items included in the Budget and Business Plan may have been incorrectly classified.

These Indicators, as prepared under the revised basis of accounting, will be finalised and presented to the TfL Board for approval in 2020/21.

6 **Treasury Management Indicators**

- 6.1 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.
- 6.2 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; and
 - (b) the period for upper limits to the total of principal sums invested longer than one year.
- 6.3 While there is no longer 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.
- 6.4 The proposed Treasury Management Indicators are detailed in Appendix 3.

7 **TfL Policy Statement 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 debt (including finance leases) retained within the Corporation the MRP is anticipated to be approximately £26m per annum throughout the business plan period (£57m after the application of IFRS 16) 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: For Approval: TfL Prudential Indicators for 2020/21 to 2022/23
Appendix 2: For Noting: Draft TfL Prudential Indicators for 2020/21 to 2022/23 as prepared under IFRS 16 Leases
Appendix 3: Treasury Management Indicators
Appendix 4: Definitions for Prudential Indicators

List of Background Papers:

None

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Appendix 1

FOR APPROVAL: PRUDENTIAL INDICATORS FOR 2019/20 TO 2022/23 TRANSPORT for LONDON

	Paragraph reference	Approved Indicators 2019 - 20 £millions	Proposed Revised Indicator Budget 2020 - 21 £millions	Proposed Revised Indicator Plan 2021 - 22 £millions	Proposed Indicator Plan 2022 - 23 £millions
<u>Operational Boundary for External Debt*</u>					
TfL Corporation					
Borrowing		12,113.0	13,164.3	13,608.3	14,039.3
PFI and long term liabilities		210.2	209.0	198.9	187.8
Total Operational Boundary for External Debt in TfL Corporation	5.1	12,323.2	13,373.3	13,807.2	14,227.1
TfL Group					
Borrowing		12,113.0	13,164.3	13,608.3	14,039.3
PFI and long term liabilities		640.4	601.0	554.2	510.8
Total Operational Boundary for External Debt TfL Group	5.1	12,753.4	13,765.3	14,162.5	14,550.1
<u>Authorised Limit for External Debt**</u>					
TfL Corporation					
Borrowing		13,490.0	14,029.3	14,529.3	15,029.3
PFI and long term liabilities		210.2	209.0	198.9	187.8
Total Authorised Limit in for External Debt in TfL Corporation	5.1	13,700.2	14,238.3	14,728.2	15,217.1
TfL Group					
Borrowing		13,494.0	14,029.3	14,529.3	15,029.3
PFI and long term liabilities		409.4	415.9	389.3	363.1
Total Authorised Limit for External Debt in TfL Group	5.1	13,903.4	14,445.2	14,918.6	15,392.4
<u>Estimates of Capital Expenditure (Annual)</u>					
TfL Corporation	5.2	2,945.8	2,512.7	2,073.5	1,369.0
TfL Group	5.2	3,893.3	2,778.7	2,250.4	2,261.2
<u>Estimates of Capital Financing Requirement (Cumulative)***</u>					
TfL Corporation	5.2	13,259.9	14,135.3	14,604.9	15,125.0
Total TfL Group	5.2	15,339.1	15,980.9	16,299.5	17,400.2

* 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 2019 - 20	Proposed Revised Indicator Budget 2020 - 21	Proposed Revised Indicator Plan 2021 - 22	Proposed Indicator Plan 2022 - 23
TfL Corporation	5.2	16.9%	23.2%	24.9%	22.2%
TfL Group	5.2	6.6%	7.0%	7.3%	6.5%

Gross Debt and the Capital Financing Requirement*	TfL Group* £millions	Corporation £millions
Gross Debt at 31 March 2021	14,445.2	14,238.3
Capital Financing Requirement at 31 March 2023	17,400.2	15,125.0

* The Prudential Code stipulates that Gross Debt at 31 March 2021 should not generally exceed the Capital Financing Requirement at 31 March 2023.

Appendix 2

FOR NOTING: THE DRAFT PRUDENTIAL INDICATORS FOR 2019/20 TO 2022/23 AS PREPARED UNDER IFRS 16 LEASES TRANSPORT for LONDON

	Paragraph reference	Approved Indicators + 2019 - 20 £millions	Proposed Revised Indicator Budget 2020 - 21 £millions	Proposed Revised Indicator Plan 2021 - 22 £millions	Proposed Indicator Plan 2022 - 23 £millions
<u>Operational Boundary for External Debt*</u>					
TfL Corporation					
Borrowing		12,113.0	13,144.3	13,683.4	14,189.4
PFI and long term liabilities		210.2	628.2	598.9	587.8
Total Operational Boundary for External Debt in TfL Corporation		12,323.2	13,772.5	14,282.3	14,777.2
TfL Group					
Borrowing		12,113.0	13,144.3	13,683.4	14,189.4
PFI and long term liabilities		640.4	3,020.2	2,954.2	2,810.8
Total Operational Boundary for External Debt TfL Group		12,753.4	16,164.5	16,637.6	17,000.2
<u>Authorised Limit for External Debt**</u>					
TfL Corporation					
Borrowing		13,490.0	14,049.4	14,548.3	15,037.1
PFI and long term liabilities		210.2	878.2	848.9	837.8
Total Authorised Limit in for External Debt in TfL Corporation		13,700.2	14,927.6	15,397.2	15,874.9
TfL Group					
Borrowing		13,494.0	14,049.4	14,548.3	15,037.1
PFI and long term liabilities		409.4	3,335.1	3,289.2	3,163.1
Total Authorised Limit for External Debt in TfL Group		13,903.4	17,384.5	17,837.5	18,200.2
<u>Estimates of Capital Expenditure (Annual)</u>					
TfL Corporation		2,945.8	2,762.7	2,323.5	1,619.0
TfL Group		3,893.3	3,278.7	2,750.4	2,761.2
<u>Estimates of Capital Financing Requirement (Cumulative)***</u>					
TfL Corporation		13,259.9	14,801.4	15,251.2	15,771.3
Total TfL Group		15,339.1	18,866.1	19,071.1	20,171.8

+ Approved Indicators for 2019/20 continue to be prepared under IAS 17 Leases. Indicators for 2020/21 and later years have been prepared under IFRS 16 Leases, which becomes mandatory for Public Sector bodies from 1 April 2020.

* 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 2019 - 20	Proposed Revised Indicator Budget 2020 - 21	Proposed Revised Indicator Plan 2021 - 22	Proposed Indicator Plan 2022 - 23
	5.3				
TfL Corporation		16.9%	25.7%	27.1%	23.8%
TfL Group		6.6%	8.2%	8.3%	7.3%

Gross Debt and the Capital Financing Requirement*

Gross Debt at 31 March 2021

Capital Financing Requirement at 31 March 2023

TfL Group* £millions	Corporation £millions
17,384.5	14,927.6
20,171.8	15,771.3

* The Prudential Code stipulates that Gross Debt at 31 March 2021 should not generally exceed the Capital Financing Requirement at 31 March 2023.

For Approval: Treasury Management Indicators

Maturity Structure of Borrowing

Budget	
31 Mar 2021	
Upper	Lower
35%	0%
35%	0%
50%	0%
75%	0%
100%	20%

< 1 year
 1 year to < 2 years
 2 years to <5 years
 5 years to <10 years
 10 years and above

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	Plan	Plan
	31 Mar 2021 £millions	31 Mar 2022 £millions	31 Mar 2023 £millions
Forward Financial Year 1	0	0	0
Forward Financial Year 2	0	0	0

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 2023 is not exceeded by gross debt budgeted at the end of 2021. 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.