TRANSPORT FOR LONDON

TREASURY MANAGEMENT STRATEGY 2020/21

1 SUMMARY

1.1 This Treasury Management Strategy (TMS) 2020/21 comprises the:

(i) Investment Strategy;

(ii) Borrowing Strategy;

(iii) Liquidity Strategy;

(iv) Risk Management Strategy; and

(v) Counterparty Exposure Limits.

2 BACKGROUND

2.1 The TMS 2020/21 has been prepared having regard to the Local Government Act 2003 and the Local Authorities (Capital Finance and Accounting) Regulations 2003 (as amended), as well as the key recommendations of:

(i) the Code of Practice and Cross-Sectoral Guidance Notes for Treasury Management in the Public Services (the 'Treasury Management Code') issued by the Chartered Institute of Public Finance & Accountancy (CIPFA) and last updated in 2017;

(ii) the Prudential Code for Capital Finance in Local Authorities (the 'Prudential Code') issued by CIPFA and last updated in 2017; and

(iii) the Statutory Guidance on Local Government Investments (the 'Investments Guidance') issued by the Ministry of Housing, Communities and Local Government (MHCLG) and last updated in 2018, with respect to treasury investments.

2.2 As recommended by the Treasury Management Code, this strategy will be updated at least annually and submitted for the approval of the Board.

3 POLICIES AND DELEGATIONS

3.1 The TMS 2020/21 will be implemented, operated and administered in accordance with the Treasury Management Policies and the TfL Group Policy Relating to the Use of Derivative Investments approved by the Board.

3.2 The arrangements for the implementation, execution, operation and administration of the TMS 2020/21, including the arrangements for banking, cash management, investment of cash balances, borrowing, liquidity management and financial risk management are delegated to the managing Chief Finance Officer[1], Director of Corporate Finance and Group Treasurer, provided no decision contravenes the TMS 2020/21, the Treasury Management Policies, the TfL Group Policy Relating to the Use of Derivative Investments.

4 STRATEGIC OBJECTIVES

4.1 The objectives underpinning the TMS 2020/21 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 activities having regard to Prudential Indicators (including Treasury Management Indicators) and to remain at all times within the Authorised Limit for external borrowings;

(v) to manage its borrowing in a manner that is affordable, sustainable and prudent 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 manage financial market risks across TfL, with the primary objective of reducing volatility or increasing certainty in the Business Plan and achieving greater value for money through reducing costs or protecting revenues.

5 INVESTMENT STRATEGY

5.1 The Investment Strategy will be applied in accordance with the TMS 2020/21 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 active 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

---

[1] References to managing Chief Finance Officer in this document mean the Managing Director (Chief Finance Officer).

returns, and reduces fees. Some MMF investments will still be required for liquidity purposes.

5.4 The maturity profile of investments will reflect the expected cash flow requirements of TfL and accommodate for forecast variability.

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 per cent 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 invest 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 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 Corporate Finance or the Group Treasurer 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, meet unexpected liquidity requirements, improve its investment return or for ethical or reputational reasons.

5.10 TfL will seek to achieve year to date returns greater than the year to date average benchmark of seven day London Interbank Bid Rate (LIBID), which is widely regarded as the appropriate benchmark for short-term cash investments and is used by professional investors such as MMFs.

6 BORROWING STRATEGY

6.1 The Borrowing Strategy will be applied in accordance with the TMS 2020/21 strategic objectives listed in 4.1.

6.2 TfL's objective is to manage its borrowing in a manner that is affordable, sustainable and prudent and combines flexibility, security of access to funds, diversity of funding sources and value for money.

6.3 TfL's annual borrowing requirement, set out in Table 1 for 2020/21, is driven by the financing requirement of its capital investment programme and the refinancing of its maturing debt.

Table 1 – 2020/21 borrowing requirement

Description	**£m**
2020/21 incremental borrowing per latest funding settlement	580
Refinancing of debt maturing within 12 months, including rolling short-term commercial paper	235
Borrowing up to the headroom created by amortisation of finance leases	22
Borrowing requirement for 2020/21	**837**
EDC Rolling Stock and Depot loan facility – fixed for drawdown in June 2020	100
Remaining requirement for 2020/21	**737**
Crossrail borrowing under the £750m DfT loan facility	up to 750

6.4 The annual increase in total outstanding borrowing will be within the incremental borrowing limits set out in the March 2017 funding letter from Central Government. To the extent that permitted incremental borrowing is not required in 2020/21, it may be deferred to the following financial year, subject to notification to HM Treasury eight weeks prior to the end of 2020/21.

6.5 TfL will borrow under the £750m loan facility provided by the Department for Transport for Crossrail purposes. This facility has been made available to TfL as part of the additional Crossrail financing package agreed in December 2018. It can only be accessed once the £1.4bn grant provided by the GLA has been fully utilised by Crossrail Limited (CRL). The borrowing will be undertaken on a periodic basis and the exact amounts will be matched to CRL's cash requirements in 2020/21 up to the total of £750m.

6.6 The notional amount of outstanding debt is expected to be £12,321m at the end of 2020/21, excluding any amounts drawn under the £750m DfT Crossrail facility described above.

6.7 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).

6.8 TfL seeks to achieve its borrowing objectives by maintaining access to capital markets through its Euro Commercial Paper programme, Euro Medium Term Note 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.

6.9 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. TfL aims to have at least 75 per cent of all outstanding borrowing at fixed interest rates and up to 25 per cent of borrowing at variable rates.

6.10 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 the Risk Management Strategy.

6.11 Given the long life of the majority of the assets financed by TfL, TfL's objective is to have a weighted average tenor of 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 suggested by the Treasury Management Code, and are the subject of a separate Prudential Indicators document approved by the Board.

6.12 TfL will consider opportunities to arrange loan facilities that enable drawdowns of debt in future years. Where TfL has the ability and option to do so, and where it is consistent with future borrowing limits agreed with the Government, it will consider fixing the borrowing for drawdowns beyond the 2020/21 financial year, in order to mitigate interest rate risk related to future borrowing requirements.

6.13 The source, tenor, currency (subject to 6.10) and 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 rate expectations, investors' preferences, the impact on TfL's debt maturity profile and target weighted average tenor.

6.14 TfL will consider opportunities to buy back, 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 The Liquidity Strategy will be applied in accordance with the TMS 2020/21 strategic objectives listed in 4.1.

7.2 The TfL Group (excluding Crossrail Ltd, London Transport Insurance (Guernsey) Limited and London Transport Museum Limited) will hold a minimum 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 as 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 needs, where it represents prudent management of TfL's financial affairs.

7.5 Cash and short-term investments balances ring-fenced for the construction of Crossrail 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 The Risk Management Strategy will be applied in accordance with the TMS 2020/21 strategic objectives listed in 4.1.

8.2 TfL maintains a low risk appetite consistent with the good stewardship of public funds. It aims to mitigate financial risks to the extent possible, aiming to provide security of TfL's funds and certainty of costs and revenues.

8.3 The objectives of the Risk Management Strategy are to:

(i) reduce volatility or increase certainty relating to the impact of financial risks upon the Business Plan;

(ii) achieve greater value for money through reducing costs or protecting revenues; and

(iii) holistically manage financial risks across the whole of TfL.

8.4 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. These risks include:

(a) interest rate risk related to TfL and its subsidiaries' existing or planned future borrowing requirements (including leases);

(b) exchange rate risk related to specific currency exposures arising from the procurement of goods or services by TfL or its subsidiaries; from receipts of grants or revenues payable to TfL or its subsidiaries in currencies other than Sterling; from any foreign currency borrowing (if permitted); and in the course of making foreign currency investments;

(c) commodity price and/or rate risk related to specific procurements or contracts across TfL and its subsidiaries 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 across TfL and its subsidiaries.

8.5 Financial risks will be identified, managed and controlled through a number of instruments, methods and techniques, including passing the risk to the counterparty where appropriate. Where the identified risks fall into the categories described in paragraph 8.4 and have highly probable exposures with a highly certain risk profile, TfL may use financial instruments to manage exposure to these risks.

8.6 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.

9 COUNTERPARTY EXPOSURE LIMITS

9.1 The managing Chief Finance Officer or the Director of Corporate Finance or the Group Treasurer 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.

9.2 The maximum exposure limit per investment counterparty will be within the counterparty exposure limits set out in Table 2. Counterparties within the same group will be classified as one counterparty for the purposes of the concentration limit. Where banks are required to have separate entities for retail (ring-fenced) and investment (non-ring-fenced) activities, TfL will apply separate counterparty exposure limits to the applicable entities. This may result in ring-fenced banks having different counterparty limits to non-ring-fenced banks

9.3 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 credit ratings will be the primary ratings used to determine these limits, as defined in Table 2.

9.4 As Moody’s short-term credit rating does not have a P-1+ category, when a counterparty is rated P-1, its concentration limit will be based on the average limit derived from any Standard & Poor’s and Fitch ratings. In the event the counterparty only has a short-term rating from Moody’s and it is P-1, its limit will be 7.5 per cent. Where it is rated P-2, its limit will be based on the average of all the rating agencies supplying a rating. If any of the rating agencies rates the counterparty A-3, P-3, or F3, no investments will be permitted.

Table 2 – Investment counterparty exposure limits

Moody’s		**Standard & Poor’s**		**Fitch**		**Concentration limit per counterparty (as a percentage of total portfolio)**
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-1	A+ A	F1	A+ A A-	7.5%
P-2	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%

9.5 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.

9.6 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).

9.7 Where an instrument benefits from a UK Government Guarantee, the limit will be that for the UK Sovereign rather than that of the entity.

9.8 For investments benefitting from collateral arrangements, the counterparty exposure will not be counted as the full face value of the investment, but will be calculated based on the potential shortfall caused by any expected movement in the value of the collateral.

9.9 TfL calculates its derivative counterparty exposures based on accepted market methodology. The current mark to market of each derivative is added to the potential future exposure (PFE). The PFE is calculated based on the maximum counterparty exposure assuming a 95 per cent confidence level of possible adverse future movements in interest rates or foreign exchange rates over the life of the instrument.

9.10 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.

9.11 Derivative counterparty exposures have a limit based on long-term credit ratings, as these exposures will generally be for over one year. The limits are shown in Table 3.

Table 3 – Derivative counterparty exposure limits

Moody's	Standard & Poor's	Fitch	Derivative limit per counterparty (£m)	CSA threshold for new derivative counterparties* (£m)
Aaa	AAA	AAA	400	50
Aa1	AA+	AA+	400	40
Aa2	AA	AA	350	40
Aa3	AA-	AA-	250	40
A1	A+	A+	200	25
A2	A	A	175	25
A3	A-	A-	150	20
Baa1	BBB+	BBB+	0	0

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

9.12 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.

9.13 The proposed derivative counterparty exposure limits provide sufficient headroom for all proposed risk management activities in 2020/21. Derivative exposures are allocated over numerous approved counterparties to minimise concentration risk.

9.14 TfL will apply the investment and derivative limits as set out in this section for each counterparty unless circumstances outside its control prevent it from doing so. In this case the managing Chief Finance Officer or the Director of Corporate Finance or the Group Treasurer will implement appropriate replacement limits for that counterparty.

9.15 If any investment or derivative limit applicable to a counterparty changes while TfL has an outstanding investment or derivative with that counterparty it will not be considered a breach of these limits. TfL may seek to bring its exposure down to within the revised limits, or at the Director of Corporate Finance’s or the Group Treasurer’s discretion, may decide to allow an investment or derivative to run its course for economic reasons.