AGENDA ITEM 6

TRANSPORT FOR LONDON

FINANCE AND POLICY COMMITTEE

SUBJECT: PRUDENTIAL CODE – INDICATORS OF PRUDENCE AND AFFORDABILITY – OUTTURN FOR THE YEAR ENDED 31 MARCH 2009

DATE: 21 JANUARY 2010

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1 PURPOSE AND DECISION REQUIRED

1.1 When the Board approved the Updated Borrowing Strategy in September 2008, it also approved indicators to demonstrate that it had exercised prudence in assessing the affordability of the capital expenditure and debt necessary to support the budget outputs. These indicators are as required and defined in the CIPFA Prudential Code (‘the Code’).

1.2 The purpose of this paper is to:

(a) Report on TfL’s performance against approved indicators for the financial year 2008-09;

(b) Provide comment on one particular Corporation indicator and one related Group indicator where the approved values for the year were exceeded; and

(c) Outline changes TfL has made to its procedures to ensure that all indicators are reviewed regularly during each financial year.

1.3 It should be noted that Group indicators are not required under the Code but are provided on a voluntary basis to recognise the unique nature of the TfL Group compared to Local Authorities in general. In addition, although there are no penalties applied to a Local Authority for failing individual indicators, with the exception of the Authorised Borrowing Limit, TfL has implemented changes to its procedures to regularly review performance against the indicators.

2 BACKGROUND

2.1 The audited Corporation and Group accounts have been used to calculate the outturn against the Board approved indicators, as outlined in Appendix 1. The indicators for Corporation Capital Expenditure and Group Ratio of PPP payments to gross revenue stream were both exceeded, although as noted the Group indicators do not form part of the formal prudential borrowing regime.

3 CORPORATION-CAPITAL EXPENDITURE

3.1 Capital expenditure for the Corporation is defined under the Code as expenditure on fixed assets within the Corporation plus any grants or loans passed to subsidiaries for capital purposes. The approved 2008/09 indicator for this was £2,427m and the outturn was £2,537m, representing a variance of £110m.

3.2 The main reason for the variance is the accounting treatment of cash passed to London Underground in 2008/09, partly offset by lower capital expenditure across the Group and working capital movements in the subsidiaries.

3.3 In calculating the approved indicator, it was assumed that LU would require £612m of revenue grant to cover losses on its operations and a further £572m of either capital grant or loan to meet the total budgeted cash requirement of £1,185m. When the prudential indicators were calculated, the £572m would therefore have been counted towards the total budgeted capital expenditure of the Corporation.

3.4 Subsequently, and as a result of the acquisition of the Metronet Undertakings by the Group, LU recognised an exceptional profit of £1.7bn in the year ended 31 March 2009. As a result, LU's requirement for revenue grant was reduced to nil, and therefore its entire cash requirement was treated as capital grant or loan. This change to the accounting treatment of grant consequently inflated the Corporation's outturn Capital Expenditure.

3.5 Capital expenditure across the Group was under budget, predominantly due to the Crossrail project and below budget spend on London Rail projects. This is reflected in the Group Capital Expenditure Indicator being £457m under budget, as shown in the *Group* Capital Expenditure indicator in Appendix 1 attached. This is defined in the Code as all items capitalised in accordance with proper accounting practice and/or legislation and thus shows the Group's fixed asset additions and acquisitions as per the audited accounts.

4 GROUP-RATIO OF PPP PAYMENTS TO GROSS REVENUE STREAM

4.1 The target for the Group-ratio of PPP payments to gross revenue stream was set at 10.9 per cent, but the actual ratio was 11.3 per cent. This variance was caused by the fact that the budget assumed that there would be no payments to the former Metronet Companies in 2008/09. In reality the old companies continued for the first two periods of 2008/09 before their undertakings were transferred to the Nominee Companies on 27 May 2008. The actual ratio of 11.3 per cent therefore included two periods' worth of payments totalling £45m. Excluding these payments, the indicator would have been 10.6 per cent, below the approved indicator of 10.9 per cent.

4.2 To ensure that advance notice is given of any potential breach of prudential indicators, TfL has now instigated new procedures to monitor all prudential indicators on a quarterly basis. Comparisons between the approved and forecast indicators will be provided to the Chief Finance Officer and a paper will be presented to the Finance and Policy Committee should corrective action be required or in the event that circumstances are such that a statutory indicator requires a change.

5 RECOMMENDATIONS

5.1 The Finance and Policy Committee is asked to NOTE;

(a) TfL's performance against approved indicators for 2008-09 and;

(b) The procedures now in place to monitor performance against approved levels within the financial year.

6 CONTACT

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APPENDIX 1

Prudential Indicators for Prudence and Affordability
2008- 09

The ratio of financing costs to net revenue stream	Actual	Approved Indicators
TfL Corporation	**(2.3)%**	**4.4%**
TfL Group	9.2%	13.6%
Comprising:		
PPP finance leases	*4.5%*	*4.5%*
On-balance sheet PFIs	*1.1%*	*1.4%*
Direct borrowing/(Investment) and other financing*	*3.6%*	*7.7%*

The ratio of payments to gross revenue stream (this Group Indicator is not required by the Prudential Code)	Actual	Approved Indicators
Payments due under PPP	11.3%	10.9%
Payments due under On-balance sheet PFIs	0.6%	0.6%
Payments due under direct borrowing	1.8%	1.8%

Net Borrowing and the Capital Financing Requirement**	Actual £m	Approved Indicators £m
Net Borrowing /(Investment) including long term liabilities at 31 March 2009		
- Corporation***	**1,086**	**1,496**
- Group	3,214	3,660
Capital Financing Requirement at 31 March 2011		
Approved Indicator - Corporation	n/a	**4,034**
Approved Indicator - Group	n/a	10,080

* The line titled 'Direct Borrowing and other financing' includes net depreciation charged to TfL's Group Income and Expenditure Account.

** The Prudential Code requires that Net Borrowing at 31 March 2009 will not exceed the Capital Financing Requirement at 31 March 2011.

*** Includes all PPP lease obligations.

Prudential Indicators for Capital Expenditure and External Debt
2008- 09

<u>Capital Expenditure (Annual)</u>	Actual £m	Approved Indicators £m
TfL Corporation	**2,537**	**2,427**
TfL Group		
Acquired	2,208	2,834
PPP finance leases	484	348
On-balance sheet PFIs	216	183
TfL Group Total	2,908	3,365

<u>The Capital Financing Requirement (Cumulative)</u> [1]	Actual £m	Approved Indicators £m
TfL Corporation	**2,710**	**2,906**
Total TfL Group	6,110	6,160

<u>Authorised Limit</u> [2]	Actual £m	Approved Indicators £m
TfL Corporation		
Borrowing	3,018	3,067
Long term liabilities	29	30
Total Authorised Limit for External Debt in TfL Corporation	**3,047**	**3,097**
TfL Group		
Borrowing	3,200	3,250
PPP and long term liabilities [3]	2,016	2,230
Total Authorised Limit for External Debt in TfL Group	5,216	5,480

[1] The Capital Financing Requirement is the cumulative amount of capital expenditure financed by grant, asset sales or debt.

[2] The authorised limit is the maximum amount that TfL may borrow legally.

[3] Includes all PPP lease obligations.