

Board

Date: 17 March 2016

Item: TfL Prudential Indicators 2016/17 to 2018/19

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 CIPFA Prudential Code (the Prudential Code), which are consistent with the proposed Treasury Management Strategy for 2016/17. These limits and indicators are based on figures in the 2016/17 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 2016/17 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.

2 Recommendation

- 2.1 **The Board is asked to approve:**
- (a) **The TfL Prudential Indicators as set out in Appendix 1 for 2016/17 and the following two years; and**
 - (b) **The Treasury Indicators as set out in Appendix 2 for 2016/17 and the following two years.**

3 Background

- 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 The Prudential Code was developed for local authorities in general, the vast majority of which do not have subsidiary companies. The scope of the Code therefore extends only to the Corporation's accounts and not those of the TfL Group (which consolidates the Corporation and its subsidiary undertakings), as the Corporation is the local authority.
- 3.5 Although not covered by the Code, equivalent indicators for the TfL Group have been included in Appendix 1 for information purposes only. Group indicators are provided on a voluntary basis to recognise the unique nature of the TfL Group compared to Local Authorities in general. Group indicators, although voluntary, can provide a better indication of overall performance as they are not affected by some intercompany transactions that can distort the outturn for the Corporation.
- 3.6 The proposed Budget included in this agenda has been used to calculate the proposed indicators for 2016/17 (see Appendix 1). For 2017/18 to 2018/19 the figures have been calculated based on income, expenditure, and working capital and other movements included in the 2014 TfL Business Plan, being the latest available approved TfL Business Plan figures for those years. The indicators for 2017/18 to 2018/19 do not take into account changes resulting from the 2015 Spending Review with the exception of changes impacting the direct borrowings limit. The other indicators for these years will therefore need to be revised once the next formal TfL Business Plan is approved.
- 3.7 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.

The "Estimated Incremental Impact of Capital Investment Decisions on Council Tax", although prescribed as an Indicator in the Prudential Code, is not relevant to TfL's circumstances and therefore is not included in the calculation of the Corporation's Prudential Indicators.

4 Treatment of PFI Liabilities in the Calculation of External Debt Limits for 2015/16

- 4.1.1 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.

- 4.1.2 It is not currently considered likely that the PFI liabilities in question will be refinanced in 2015/16. This will result in outturn long term liabilities for the Group being significantly over the voluntary indicator set, offset by lower direct borrowing (reflecting the fact that no refinancing is now expected to take place). For the voluntary 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 2016/17 and 2017/18

5.1 Changes to Borrowing Limits for Future Years

- 5.1.1 Revised Prudential Indicators for the years 2016/17 and 2017/18 were approved by the Board in March 2015. An increase in direct borrowings of £30.5m is now proposed for 2016/17 and 2017/18 to reflect an additional borrowing commitment agreed in the 2015 Spending Review with Government to fund capital works at Croxley Green.
- 5.1.2 Changes to the previously approved operational boundary for long term liabilities are also proposed in 2016/17 and 2017/18, reflecting a change in the expected settlement profile of long term Crossrail property claim provisions. The revised limits are set out in Appendix 1.
- 5.1.3 As noted in section 4.1.1, 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.
- 5.1.4 In the Group, the reduction to the authorised limit for long term liabilities for the possible refinancing of PFI liabilities has been amended for 2016/17 and 2017/18, reflecting the change in the outstanding liabilities under these contracts since the Prudential Indicators were last set.

5.1.5 Reconciliation of Changes in External Debt Limits for the Corporation for 2016/17 to 2018/19

	Paragraph reference	2016/17 £m	2017/18 £m	2018/19 £m
Corporation:				
Previous Operational Boundary for Gross External Debt		10,214.2	11,082.4	N/A
Increase in direct borrowings	5.1.1	30.5	30.5	N/A
Change in long term liabilities	5.1.3	(24.7)	(24.6)	N/A
Proposed Operational Boundary for Gross External Debt		10,220.0	11,088.3	11,570.7
Overdraft facility ¹		200.0	200.0	200.0
Refinancing of PFIs ²		392.5	392.5	392.5
Refinancing of short term borrowings ³		500.0	500.0	500.0
Proposed Authorised Limit		11,312.5	12,180.8	12,663.2

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.

5.2 Changes to Other Prudential Indicators for 2016/17 and 2017/18

5.2.1 The other prudential indicators for 2016/17 and 2017/18 for the Corporation and Group have also been amended to reflect TfL's proposed Budget. 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 the Chartered Institute of Public Finance and Accountancy (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 Following developments in the market place and the introduction of the Localism Act 2011, CIPFA published an updated TM Code in November 2011 with revised guidance in relation to the management of derivatives. The proposed treasury indicators, however, remain unchanged and are detailed in Appendix 2. They comprise:

- (a) upper limits on fixed interest and variable interest exposures;
- (b) upper and lower limits on the maturity structure of borrowing; and
- (c) upper limits to the total of principal sums invested longer than 364 days.

List of appendices to this report:

Appendix 1: TfL Prudential Indicators for 2015/16 to 2018/19

Appendix 2: Treasury Management Indicators

Appendix 3: Definitions for Prudential Indicators

List of Background Papers:

None

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**THE PRUDENTIAL INDICATORS FOR 2015/16 TO 2018/19
TRANSPORT for LONDON**

	Paragraph reference	Approved Indicators 2015 - 16 £millions	Proposed Revised Indicator Budget 2016 - 17 £millions	Proposed Revised Indicator Plan 2017 - 18 £millions	Proposed Indicator Plan 2018 - 19 £millions
<u>Operational Boundary for External Debt*</u>					
TfL Corporation	5.1.3,5.1.4				
Borrowing		9,251.9	9,982.4	10,870.3	11,370.4
PFI and long term liabilities		306	237.6	218.0	200.3
Total Operational Boundary for External Debt in TfL Corporation		9,557.9	10,220.0	11,088.3	11,570.7
TfL Group	5.1				
Borrowing		9,251.9	9,982.4	10,870.3	11,370.4
PFI and long term liabilities		864.7	732.5	614.9	538.2
Total Operational Boundary for External Debt TfL Group		10,116.6	10,714.9	11,485.2	11,908.6
<u>Authorised Limit for External Debt**</u>					
TfL Corporation	5.1				
Borrowing		10,376.5	11,074.9	11,962.8	12,462.9
PFI and long term liabilities		306.0	237.6	218.0	200.3
Total Authorised Limit in for External Debt in TfL Corporation		10,682.5	11,312.5	12,180.8	12,663.2
TfL Group	5.1				
Borrowing		10,376.5	11,074.9	11,962.8	12,462.9
PFI and long term liabilities		472.2	377.9	303.2	268.3
Total Authorised Limit for External Debt in TfL Group		10,848.7	11,452.8	12,266.0	12,731.2
<u>Estimates of Capital Expenditure (Annual)</u>					
TfL Corporation	5.2	4,516.3	3,279.9	3,263.5	2,727.8
TfL Group	5.2	5,315.2	3,946.5	3,716.2	3,266.4
<u>Estimates of Capital Financing Requirement (Cumulative)***</u>					
TfL Corporation	5.2	10,017.7	10,812.3	11,737.8	12,249.6
Total TfL Group	5.2	11,354.6	12,188.2	12,378.8	13,153.4

* 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 2015 - 16	Proposed Revised Indicator Budget 2016 - 17	Proposed Revised Indicator Plan 2017 - 18	Proposed Indicator Plan 2018 - 19
TfL Corporation	5.2	342.7%	19.8%	17.2%%	20.6%
TfL Group	5.2	13.3%	8.1%	7.1%	7.7%

Gross Debt and the Capital Financing Requirement*

Gross Debt at 31 March 2017

Capital Financing Requirement at 31 March 2019

TfL Group** £millions	Corporation £millions
11,452.9	11,312.5
13,153.4	12,249.6

* The Prudential Code stipulates that Gross Debt at 31 March 2017 should not generally exceed the Capital Financing Requirement at 31 March 2019.

**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.

Prudential Indicators for Treasury Management

Interest Rate Exposures

Borrowing upper limit – fixed
 Borrowing upper limit – variable
 Investments upper limit – fixed
 Investments upper limit – variable

Budget	Plan	Plan
31 Mar 17	31 Mar 18	31 Mar 19
100%	100%	100%
50%	50%	50%
50%	50%	50%
100%	100%	100%

If this indicator is broken it serves as a warning to management that the interest rate risk strategy is not being adhered to.

Maturity Structure of Borrowing

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

Budget	
31 Mar 17	
Upper	Lower
35%	0%
35%	0%
50%	0%
75%	0%
100%	20%

This indicator represents limits (for fixed rate debt) 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 364 days

Forward Financial Year 1
Forward Financial Year 2
Forward Financial Year 3
Forward Financial Year 4

Budget	Plan	Plan
31 Mar 17	31 Mar 18	31 Mar 19
£millions	£millions	£millions
1,500	1,500	1,500
1,000	1,000	1,000
750	750	750
500	500	500

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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 2018 is not exceeded by gross debt budgeted at the end of 2016. 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.