Finance Committee

Date: **13 October 2016**

Item: **Prudential Indicators – Outturn for the Year Ended 31 March 2016**

This paper will be considered in public

1 Summary

1.1 This paper reports on TfL's performance against the prudential indicators set for the financial year 2015/16 as required by the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code (the Code).

1.2 TfL (the Corporation) complied with both the direct borrowing and the long term liabilities components of the Authorised Limit for External Debt. The wider TfL Group of companies (the Group) is not obliged to comply with the Code but voluntarily provides equivalent indicators.

1.3 Although the Group exceeded the voluntary indicator for the long term liabilities component of the Authorised Limit, this was offset by lower direct borrowing and the overall Authorised Limit was not exceeded. There are no consequences for breaching this voluntary indicator and no remedial action is required as TfL's capital plans remain affordable, as demonstrated through the Business Plan. All other Corporation and Group indicators were within target.

2 Recommendation

2.1 **The Committee is asked to note the paper.**

3 Background

3.1 On 2 April 2015, the former Mayor approved the prudential indicators and debt limits for TfL for the 2015/16 Financial Year (Mayoral Decision 1461) as required and defined in the Code, to demonstrate it exercised prudence in assessing the affordability of the capital expenditure and debt necessary to support the budget outputs.

3.2 The 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.

3.3 Local authorities are required by regulation to have regard to the Code when carrying out their duties relating to capital finance and borrowing under Part 1 of the Local Government Act 2003.

3.4 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 the 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. The audited accounts of TfL alone (the Corporation) have been used to calculate the outturn against the Board approved indicators (see Appendix 1) as the scope of the Code only extends to the Corporation's accounts and not to those of the wider TfL Group.

3.5 The Code was developed for local authorities in general, the vast majority of which do not have significant subsidiary companies.

3.6 Although not covered by the Code, equivalent Group indicators 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 in comparison to local authorities in general. Group indicators, although voluntary, 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.

3.7 There are no penalties applied to a local authority for breaching individual indicators, with the exception of the Authorised Limit for External Debt. Borrowing in excess of the Authorised Limit is ultra vires and, therefore, unlawful.

3.8 Additional background information on the Code is included in Appendix 2.

4 Outturn

4.1 The key prudential indicator is the Authorised Limit for External Debt, which sets the total limit for direct and indirect (e.g. long term creditors, provisions) debt for the organisation. Both the Corporation and the Group were within the total Authorised Limits for External Debt for the year ended 31 March 2016.

4.2 As shown in Appendix 1, for 2015/16, the Corporation outturn at 31 March 2016 was below the limits set for both the direct borrowings and the long term liabilities components of the Authorised Limit.

4.3 For the Group, total external debt at £9,962.5m was within the Authorised Limit of £10,848.8m. However, within this overall position, and in line with previous years, the Group outturn for long term liabilities of £814.8m was significantly over the voluntary indicator of £472.3m. The borrowing element of the authorised limit is calculated and set to allow TfL to refinance certain Private Finance Initiative (PFI) transactions (namely Lewisham Docklands Light Railway extension and Northern line trains), as and when it is commercially advantageous to do so, without the need to revise the indicator. The long term liabilities element of the Authorised Limit is adjusted down by the same amount to ensure that there is no overall increase in the total Authorised Limit. The higher outturn long term liabilities are offset by lower direct borrowing, reflecting the fact that no such refinancing took place during the year. These debt reclassifications are not considered to be a matter for concern as the Code stipulates that, 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.

4.4 There are no consequences of breaching this voluntary indicator. As TfL's capital plans remain affordable, as demonstrated through the Business Plan approved by the Board, no remedial action is required.

4.5 All other Corporation and Group indicators were within target.

5 Conclusions

5.1 No remedial action is required to be taken in light of TfL's performance against the approved prudential indicators. Under the Code, movement may be made between the separately identified figures within the prudential indicators for borrowing and other long-term liabilities without penalty, provided that the total Authorised Limit for external debt is unchanged. The debt reclassifications experienced between the composite elements of the Authorised Limit at Group level are not, therefore, a matter for concern.

5.2 Prudential indicators for the current year 2016/17 were approved by the Board in March 2016. TfL continues to monitor prudential indicators for the current year on a quarterly basis. In the event that corrective action is required, or a statutory indicator requires a change, a paper will be brought to the Committee.

List of appendices to this report:

Appendix 1: Outturn Prudential Indicators
Appendix 2: Background Information - Prudential Indicators for Capital Finance

List of Background Papers:

None

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Prudential Indicators for Capital Expenditure and External Debt 2015/16

Authorised Limit for External Debt [1]	Actual £m	Approved Indicators £m
TfL Corporation		
Borrowing	9,147.7	10,376.5
Long term liabilities [2]	285.2	306.0
Total Authorised Limit for External Debt in TfL Corporation	**9,432.9**	**10,682.5**
TfL Group		
Borrowing	9,147.7	10,376.5
Long term liabilities [2]	814.8	472.3
Total Authorised Limit for External Debt in TfL Group	**9,962.5**	**10,848.8**

Capital Expenditure (Annual)	Actual £m	Approved Indicators £m
TfL Corporation	**3,675.0**	**4,615.3**
TfL Group	4,529.5	5,315.2

The Capital Financing Requirement (Cumulative) [3]	Actual £m	Approved Indicators £m
TfL Corporation	**9,608.8**	**10,017.7**
Total TfL Group	10,609.0	11,354.6

[1] The authorised limit for external debt is the sum of the authorised limit for borrowing and the authorised limit for other long term liabilities. This limit must not be breached.

[2] Includes all lease obligations.

[3] The Capital Financing Requirement is the cumulative amount of capital expenditure to be financed over and above the amount funded by grant, capital receipts or third party contributions.

Prudential Indicators for Prudence and Affordability 2015/16

The ratio of financing costs to net revenue stream	Actual	Approved Indicators
TfL Corporation	**21.2%**	**342.7%**
TfL Group	8.0%	13.3%
Comprising:		
On-balance sheet PFIs and leases	0.8%	1.0%
Direct borrowing/(Investment) and other financing*	7.2%	10.6%

Gross Debt and the Capital Financing Requirement*

	Actual	Approved Indicators
	£m	£m
Gross Debt including long term liabilities at 31 March 2016		
- Corporation**	**9,432.9**	**10,682.5**
- Group**	9,962.5	10,848.8
Capital Financing Requirement at 31 March 2018		
Approved Indicator - Corporation	N/A	**12,207.0**
Approved Indicator - Group	N/A	11,672.4

* The Prudential Code requires that Gross Debt at 31 March 2016 not exceed the Capital Financing Requirement at 31 March 2018.

**Gross Debt at 31 March 2016 includes all lease obligations and long term liabilities.

Background Information – Prudential Indicators for Capital Finance

Purpose

1. To provide additional background information on the local government framework for capital finance to inform the Finance Committee in their consideration of the outturn Prudential Indicators for the year ended 31 March 2016.

Background

2. The Local Government Act 2003 enables local authorities to determine their programmes for capital investment and associated borrowing requirements, provided they have regard to the Prudential Code for Capital Finance in Local Authorities developed by CIPFA (the Chartered Institute of Public Finance and Accountancy) and also take advice from the Chief Finance Officer.

3. The Prudential Code (the Code) is a professional Code that sets out a framework for self-regulation of capital spending; in effect allowing local authorities to invest in capital projects which best meet their service delivery objectives as long as they are affordable, prudent and sustainable, subject to Government reserve powers to restrict borrowing for national economic reasons.

4. The Executive Summary of the Code states that "The framework established by the Prudential Code should support local strategic planning, local asset management planning and proper option appraisal. The objectives of the Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. In exceptional cases, the Code should provide a framework which will demonstrate that there is a danger of not ensuring this, so that the local authority concerned can take timely remedial action."

5. This framework is designed to support decision making on planned capital expenditure, borrowing and treasury management activities, and to ensure that capital investment plans and borrowing are affordable, prudent and sustainable.

6. The framework set out in the Code requires that a range of limits and financial indicators (together the Prudential Indicators) are set for the forthcoming budget year and two subsequent years by the same body that takes decisions for the budget (in TfL's case the Board).

7. The Chief Finance Officer is responsible for ensuring all matters required to be taken into account are reported to the Board for consideration and for establishing procedures to monitor performance against the indicators

8. The Code also sets out how the Chief Finance Officer must make arrangements for monitoring the Prudential Indicators.

9. The Prudential Indicators comprise:

(a) Authorised Limit;
(b) Operational Boundary;
(c) Ratio of Financing costs to Net Revenue Stream
(d) Capital Financing Requirement;
(e) Capital Expenditure; and
(f) Indicators for Treasury Management:
    i. Interest Rate Exposures
    ii. Maturity Structure of Borrowing
    iii. Maximum Outstanding Principal Sum Invested > 364 Days

10. 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. Prudential Indicators are therefore only required under the Code for the Corporation and not for TfL Group.

11. Although not covered by the Code, equivalent indicators for the TfL Group 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.

Prudential Indicators

Affordability

12. The Code requires TfL to be aware of the impact of financing capital expenditure on its overall revenue expenditure position.

13. The costs of financing capital expenditure are:

(a) Interest payable to external lenders less interest earned on investments; and
(b) Amounts set aside for repayments of amounts borrowed (including repayments of amounts relating to PFI schemes and other finance lease liabilities).

14. The Prudential Code requires local authorities to make reasonable estimates of the total of capital expenditure that it plans to incur in the forthcoming financial year and at least the following two financial years.

Prudence and Sustainability

15. One of the features of the Prudential Code arrangements is the need to calculate the Capital Financing Requirement. This figure covers capital expenditure which has not yet been permanently financed through the revenue account.

16. The Code states that “In order to ensure that over the medium term net debt will only be for a capital purpose, the local authority should ensure that net debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.” This is a key indicator of prudence.

17. The Mayor, in consultation with TfL and the London Assembly, sets two borrowing limits for next year and the following two years with respect to external borrowing:

    (a) Operational Boundary – operational boundaries have to be set for both borrowing and long term liabilities. This measure encompasses all borrowing and is used in-year as a tool for monitoring the Council’s prudent borrowing requirements. The operational boundary is calculated by taking account of existing borrowing and long term liabilities, planned new borrowing, net change in long term liabilities and any amounts set aside for repayment of debt.

    (b) Authorised Limit – the ‘Authorised Limit’ on borrowing (consisting of direct borrowing and other long-term liabilities) acts as the statutory limit on borrowing for the purposes of the Local Government Act (with any borrowing beyond this level being ultra vires)

18. The Prudential Code also requires that in the medium to long-term any borrowing is used for capital purposes only (rather than to fund operating deficits)

19. The Prudential Code indicator in respect of treasury management is the adoption of the CIPFA Treasury Management Code of Practice. The County Council has formally adopted the code and approves an annual Treasury Management Policy and Strategy. This includes setting the treasury indicators:

    (a) upper limits for fixed and variable interest rate exposures
    (b) upper limit for investments over 364 days
    (c) upper and lower limits for the maturity structure of borrowing.

Setting of Prudential Indicators

20. Each year, as part of the Budget approval process, the Finance Committee are asked to consider proposed Prudential Indicators for the forthcoming Budget year and following two years.

21. These indicators, if approved by the Finance Committee, are then presented to the Board for consideration and approval.

22. Separately, the Mayor is required to set borrowing limits for the same time period. The consultation on these happens as part of the consultation on the Mayor’s Budget in January/February, and once this process has concluded there is then a Mayoral Decision formally setting the borrowing limits. This takes place at the end of March after the TfL Board has also approved the Budget.

Monitoring of Prudential Indicators

23. During the year performance against the indicators is monitored. If it appears that TfL is at risk of breaching an indicator the monitoring procedures allow remediating activity to take place.

Reporting of performance against Prudential Indicators

24. After the end of the financial year and after the Group's Statements of Accounts has been published the outturn indicators are calculated and reported to the Finance Committee.