Finance Committee

Date: **4 July 2018**

Item: **Treasury Activities**

This paper will be considered in public

1 Summary

1.1 This paper provides a brief update on our key treasury activities for the period from 1 April 2018 to 13 June 2018 (the Reporting Period).

1.2 During the Reporting Period, we have complied at all times with the Treasury Management Strategy and the Treasury Management Policies approved by the Board on 20 March 2018, including the GLA Responsible Investment Policy.

1.3 A paper is included on Part 2 of the agenda, which contains exempt supplemental information and documentation. The information is exempt by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972 in that it contains information relating to the financial affairs of TfL or of a sensitive nature to our listed counterparties. Any discussion of that exempt information must take place after the press and public have been excluded from this meeting.

2 Recommendation

2.1 **The Committee is asked to note the paper and the supplementary information on Part 2 of the agenda.**

3 Treasury Highlights

3.1 Since 1 April 2018 we have undertaken a number of treasury activities of note, which include:

(a) the continued active investment management of the cash portfolio (£1.7bn including Crossrail, as at 13 June 2018) resulted in a year-to-date weighted average return of 0.55 per cent versus the average benchmark of seven-day London Interbank Bid Rate (LIBID) of 0.36 per cent;

(b) a total of £250m has been fixed and drawn under our European Investment Bank (EIB) and Export Development Canada (EDC) facilities, with a further £100m drawdown expected to take place in September 2018; and

(c) we have implemented hedging programmes in order to mitigate foreign exchange risk on a number of procurements.

4 Borrowing Update

Authorised Limit, Target and Current Borrowing

4.1 The Authorised (legal) Limit for borrowing for 2018/19 is £12,353m. Target borrowing by 31 March 2019 is £11,247m. As at 13 June we had £10,681m outstanding borrowing.

4.2 The difference between the Authorised Limit and target borrowing gives us the option to temporarily exceed, within the financial year, our incremental borrowing limit where necessary or desirable. For example, for working capital purposes, or to refinance existing debt due to mature before the outstanding amount is repaid. We have remained within the Authorised Limit for borrowing at all times during the Reporting Period.

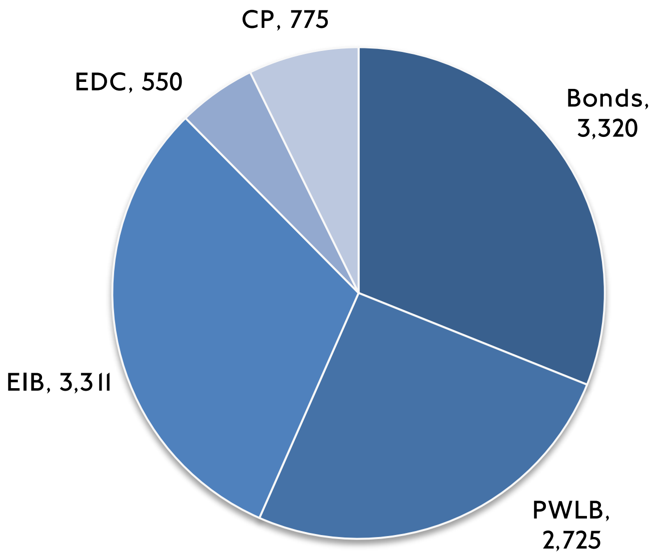
4.3 Table 1 sets out our borrowing requirement for 2018/19 as per the TfL Budget for 2018/19. The TfL Budget assumes we will increase our borrowing by £800m during the year, which includes £300m deferred from 2017/18. This is within the incremental borrowing limits agreed with HM Treasury, as set out in the March 2017 funding letter.

Table 1: Borrowing requirement for 2018/19

	£m
Incremental borrowing as per TfL Budget for 2018/19	800
Refinancing of debt maturing during the year, including rolling short-term commercial paper	472
Total borrowing requirement	**1,272**
Financed by:	
EDC ATC Signalling loan (drawn in April 2018)	(150)
EIB Urban Mobility for London loan (drawn in April 2018)	(100)
EIB Urban Mobility for London loan (to be drawn in September 2018)	(100)
Total raised or committed	**(350)**
Minimum amount to be kept as unhedged rolling commercial paper	**(225)**
Maximum remaining balance to be raised in 2018/19 as long-term debt	**697**

4.4 The £10,681m of debt outstanding comprises £775m of short-term commercial paper (CP), of which £350m is unhedged. Keeping an element of unhedged CP gives us the flexibility to vary the amount of CP outstanding during the year to align with our requirements and adjust depending on the cost of carry.

Chart 1: Outstanding borrowing as at 13 June 2018 (£m)



4.5 The weighted average interest rate on our debt was 3.60 per cent, with a weighted average life of 19 years.

Local Infrastructure Rate

4.6 In the 2017 Autumn Budget, the government announced that it would make available £1bn of lending at the Local Infrastructure Rate of gilts + 60bps to English local authorities to support the delivery of infrastructure. There will be two rounds of bidding, with the first round closing on 31 July 2018. The maximum amount available per applicant is £100m, and construction must commence prior to 1 April 2022 for projects to qualify. We are exploring which projects may be eligible and plan to submit an application for up to £100m of lending at the first bidding round.

TfL's Credit Ratings

4.7 Table 2 shows our current credit ratings. Standard & Poor's downgraded our credit rating from AA to AA- on 13 March 2018, and revised the outlook from negative to stable. The downgrade from Standard & Poor's aligns our three credit ratings at the lower level of a high investment grade rating.

4.8 There have been no changes to our credit ratings by Moody's or Fitch during the reporting period. Moody's affirmed our rating at Aa3 with stable outlook on 8 March 2018 and Fitch affirmed our rating at AA- with negative outlook on 3 May 2018.

Table 2: Current credit ratings

	Standard & Poor’s	Moody's	Fitch
Long-term rating	AA-	Aa3	AA-
Outlook	Stable	Stable	Negative
Short-term rating	A-1+	P-1	F1+

4.9 The rating agencies have indicated the main factors that could lead to a further downgrade of our rating include a downgrade of the UK Sovereign, a dilution of the UK government’s support, a significant weakening in our growth prospects, cost overruns on large capital projects, or a failure to realise savings from the cost reduction programme. Conversely, the rating could be upgraded if the rating of the UK Sovereign is upgraded, our internal cash generation capacity improves significantly, our revenues increase materially, or the level of debt and interest payments is substantially reduced.

5 Risk Management Update

Foreign Exchange Risk

5.1 We have continued to support commercial teams on procurements which contain foreign currency exposure. Over the Reporting Period, we have hedged foreign currency exposure on a number of projects, including the procurement of a new passenger information system for the Central line and signalling enhancements for the Northern line. A number of other procurements are being monitored for potential hedging. Additional information is provided in the paper on Part 2 of the agenda.

Interest Rate Risk

5.2 A total of £50m of interest rate swaps, used to fix the borrowing rate for the commercial paper programme, have matured since the beginning of the financial year. As at 13 June 2018, floating rate debt comprised 3.3 per cent of total borrowing outstanding, which is in line with the Board approved Prudential Treasury Indicator for the upper limit on variable rate borrowing of 25 per cent.

5.3 It was widely expected that the Bank of England would increase the base rate from 0.50 per cent to 0.75 per cent in May 2018. However, due to weaker than expected inflation and other economic data the base rate was kept unchanged. It is now expected that any rate hike will be gradual, with potentially no more than three rate hikes over the next three years. Financial markets are currently pricing in a 50 per cent chance of a 0.25 per cent hike later in 2018. The interest rate hedging considerations are covered in Part 2 of this paper.

6 Liquidity Update

6.1 Over the Reporting Period, the liquidity position has been robust and we have maintained sufficient liquidity to meet our contractual payment obligations. Daily closing cash and year to date average cash balance have consistently remained above the target level (30 days' forecast operating costs or £547m for 2018/19).

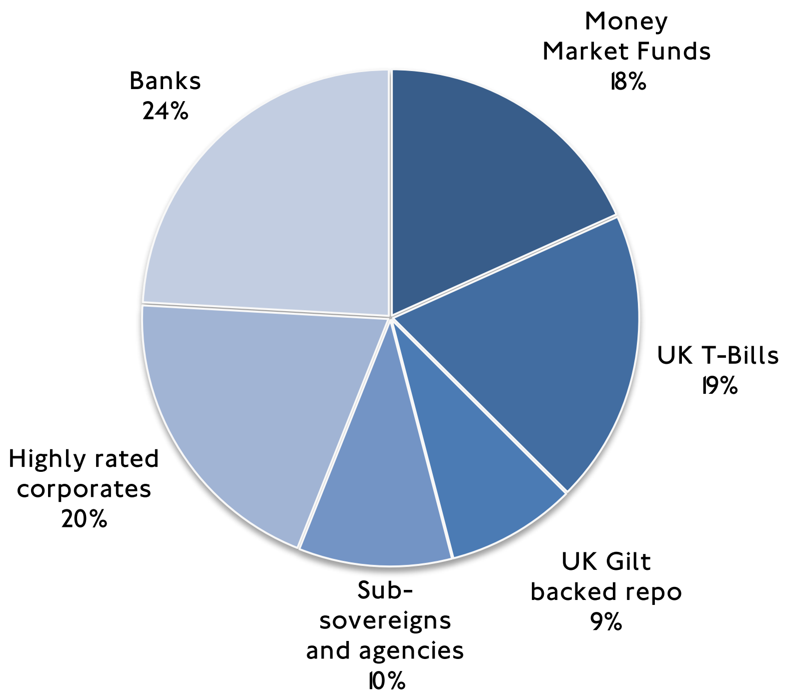
7 Investment Update

7.1 We have complied with Board approved counterparty exposure limits and the GLA Responsible Investment Policy at all times during the Reporting Period. As part of our standard investment procedures, we have also implemented internal forward looking and dynamic investment limits within the Board approved counterparty exposure limits. These limits allow us to further increase the security of cash under management.

7.2 As at 13 June 2018, we held £1.7bn of cash under management, which includes £522m of cash ring-fenced to fund the construction of the Crossrail project.

7.3 The allocation of our cash investments is summarised in Chart 2 below.

Chart 2: Cash investment allocation as at 13 June 2018



7.4 Our year-to-date average yield at 13 June 2018 was 0.55 per cent, 19 basis points above the seven-day LIBID benchmark, which is widely regarded as the market benchmark for short-term cash investments for professional investors, including Money Market Funds (MMFs). The weighted average maturity of cash investments is 43 days.

Credit

7.5 We continue to complete regular in-depth credit reviews of our investment and derivative counterparties. Additionally we monitor our investment counterparties through daily monitoring of core credit indicators and news flows.

8 Other Activities

Banking

8.1 We launched our banking and cash management services tender in January 2018, with a market sounding questionnaire published on the TfL's e-Tendering portal on 16 January 2018. Follow up questions have been discussed with the banks who responded to the market sounding questionnaire. Suggested solutions have been discussed with the stakeholders within the organisation and work continues on the documentation required for the standard selection questionnaire. This will be followed by an Invitation to Tender in August 2018. The tender will ensure competitive pricing and that the latest technology and innovation available are considered. A target award date has been set for December 2018.

LIBOR Benchmark Replacement

8.2 We have participated in the non-financial corporate working group on Sterling Risk-Free Reference Rates. The working group is one of four sub-working groups established by the Bank of England to determine a suitable replacement of London Interbank Offer Rate (LIBOR) as the industry benchmark for setting interest rates. The replacement, which will take place not later than 2021 when LIBOR will cease being published, will result in changes to contracts, derivatives, loans and any other agreement that use LIBOR as a reference rate. This will be a significant administrative task for all parties as it may have accounting, tax and commercial implications. We are assessing the impact of the proposed changes.

List of appendices to this report:

A paper containing exempt supplemental information is included on Part 2 of the agenda.

List of background papers:

None.

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