Board

Date: **27 March 2013**

Item 9: **TfL Prudential Indicators 2013 to 2016**

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 2013/14. These limits and indicators are based on figures in the 2013/14 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 2013/14, 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.

1.3 On 13 March 2013, the Finance and Policy Committee considered the Prudential Indicators and the Treasury Indicators and supported the recommendations to the Board.

1.4 It should be noted that the indicators are based on the Budget as presented to the Finance and Policy Committee on 13 March 2013. The changes made in respect of Crossrail and set out elsewhere on the agenda were not received in time to be incorporated into the Mayoral approval process for Prudential Indicators. The impact on the indicators is not material, and the changes would not affect the recommendations of the Committee.

2 Recommendations

2.1 **The Board is asked to approve:**

(a) the TfL Prudential Indicators as set out in Appendix 1 for 2013/14 and the following two years; and

(b) the Treasury Indicators as set out in Appendix 2 for 2013/14 and the following two years.

3 Background

3.1 The Prudential Code plays a key role in capital finance in local authorities (which includes TfL). 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, local authorities are required, on a rolling basis, to calculate a range of indicators for the forthcoming budget year and two subsequent years. Local 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 Corporation's proposed Budget has been used to calculate the proposed indicators (see Appendix 1) as the scope of the Code only extends to the Corporation's accounts and not those of the Group.

3.5 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 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 Capital Expenditure and External Debt Indicators relevant to TfL are:

(a) Capital Expenditure;

(b) Capital Financing Requirement;

(c) Authorised Limit;

(d) Operational Boundary; and

(e) Ratio of Financing costs to Net Revenue Stream.

Definitions for each of these are included in Appendix 3.

3.7 As reported to the Finance and Policy Committee in October 2012, TfL requested that KPMG review the current methodology for calculating the indicators to ensure that it remains in line with the requirements of the Prudential Code. KPMG last undertook such a review prior to the Group's conversion to International Financial Reporting Standards and several minor updates to the Prudential Code. KPMG has confirmed that the methodology adopted continues to be consistent with the requirements of the Code.

3.8 The changes made to the Budget in respect of Crossrail represent relatively small deferrals of expenditure from 2012/13 and 2013/14 to later in the Crossrail project. These changes have no impact on the Operational Boundary nor on the Authorised Limit. There is also no impact on the ratio of financing costs to net revenue stream. There is a reduction of around 1 per cent in the estimates of capital expenditure and an increase of less than 0.5 per cent in the Capital Financing Requirement.

3.9 As the changes arise from a reduction in capital expenditure and the Budget was considered prudent before these changes were made, it is not necessary to revise the indicators at this stage. The position will be kept under review and revised indicators presented for approval at a later date if necessary.

4 Changes to Borrowing Limits for Future Years

4.1 Prudential Indicators for the years 2012/13 to 2014/15 were approved by the Board in March 2012. A minor change is proposed to the previously approved operational boundary for 2014/15 due to a small rise in long term Crossrail property claim provisions. The change increases the operational boundary and authorised limit for the Corporation by £6.6m (or 0.07 per cent), as shown below.

	2013/14 £m	**2014/15 £m**	**2015/16 £m**
Previous Operational Boundary	8,369.7	8,926.4	N/A
Change in long term liabilities		6.6	N/A
Proposed Operational Boundary	**8,369.7**	**8,933.0**	**9,405.8**
Overdraft facility [1]	200.0	200.0	200.0
Refinancing of PFIs [2]	453.0	453.0	453.0
Refinancing of short term borrowings [3]	500.0	500.0	500.0
Proposed Authorised Limit	**9,522.7**	**10,086.0**	**10,558.8**

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 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 SR2010 settlement letter) as and when commercial opportunities arise and value for money can be demonstrated.

3 In 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 Prudential Treasury Indicators

5.1 A number of treasury indicators that historically formed part of the Prudential Code are now more appropriately linked to the 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.

5.2 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 treasury indicators linked to the TM Code, however, remained 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.

5.3 In November 2012, CIPFA published an update to the Prudential Code, changing the indicator for prudence from the ratio of “Net Debt and the Capital Financing Requirement”, to “Gross Debt and the Capital Financing Requirement”. The revised indicator is considered by CIPFA to be a more appropriate indicator of whether debt has been drawn down solely for a capital purpose. As a consequence of this change the Treasury indicator for “Gross and Net Debt” has also been withdrawn. The indicators in Appendix 1 and 2 have been amended accordingly.

5.4 The Corporation’s Authorised Limit for Gross Debt for 2014 exceeds the cumulative Capital Financing Requirement (CFR) for 2016 by £208.6m (2.2 per cent), although the Operational Boundary is comfortably below the CFR. The requirement is that gross debt should not exceed the CFR, except in the short term. The reason that the Authorised Limit exceeds the CFR is due to the inclusion of £500m headroom in the Authorised Limit to allow for refinancing of short term borrowings. This is not therefore an indicator that debt has been drawn down for purposes other than capital expenditure.

5.5 In TfL, the strict funding regime for the Crossrail project is an additional factor in inflating the gross debt to CFR ratio, wherein debt is raised significantly in advance of the planned capital expenditure. The Sponsor Funding Account, representing monies held by the Corporation to fund Crossrail capital expenditure, shows a balance of £1,749m in 2014, increasing to £2,240m in 2016, before falling in the later years of the Plan. This timing difference results in the unusually high debt to CFR ratio, and is considered a temporary anomaly that does not give cause for concern.

6 Proposed Borrowing Limits for 2013/14

6.1 The composition of the borrowing limits is set out in the proposed Treasury Management Strategy, which is being considered in a separate paper to this meeting. It is expected that the Mayor will have consulted with TfL by the time of the 27 March 2013 Board meeting, which will allow the Board to adopt the in-year Authorised Limit for external debt as above, which includes direct borrowings of £9,177m in 2013/14.

6.2 The Operational Boundary calculations exclude the transfer of the Group's existing PFI finance liabilities into the Corporation's direct borrowings, as the refinancing is not reflected in TfL's current Business Plan. Therefore, levels of direct borrowings under the Operational Boundary are substantially below the Authorised Limits for direct borrowings. The Operational Boundary for gross External Debt does, however, include finance lease creditors and other long term creditors as well as external borrowing.

7 Views of the Finance and Policy Committee

7.1 On 13 March 2013, the Finance and Policy Committee considered the Prudential Indicators and Treasury Indicators and supported the recommendations to the Board.

7.2 Members were informed that the Prudential Indicators for Prudence and Affordability – Estimates of ratio of financing costs to net revenue stream was designed to be a useful indicator of affordability for the majority of local authorities. However, because of the unique nature of TfL and the way that it is funded, the indicator is not particularly useful for TfL. Accordingly, the significant change in the indicator for TfL in 2014/15 was not of concern as it reflected both a reduction in overall levels of government grant but also that a larger proportion of the grant had been allocated for capital rather than revenue costs in the Business Plan. Notwithstanding the indicator, TfL remains confident that its Business Plan is affordable.

List of appendices to this report:

Appendix 1: TfL Prudential Indicators
Appendix 2: Treasury Management Indicators
Appendix 3: Definitions for Prudential Indicators

List of Background Papers:

None

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Appendix 1

THE PRUDENTIAL INDICATORS
TRANSPORT for LONDON

Prudential Indicators for Capital Expenditure and External Debt

Operational Boundary for External Debt*	Budget 2013 - 14 £millions	Plan 2014 - 15 £millions	Plan 2015 - 16 £millions
TfL Corporation			
Borrowing	8,024.0	8,674.0	9,173.1
PFI and long term liabilities	345.7	259.0	232.7
Total Operational Boundary for External Debt in TfL Corporation	**8,369.7**	**8,933.0**	**9,405.8**
TfL Group			
Borrowing	8,024.0	8,674.0	9,173.1
PFI and long term liabilities	1,122.8	957.4	794.2
Total Operational Boundary for External Debt TfL Group	**9,146.8**	**9,631.4**	**9,967.3**

Authorised Limit for External Debt**	Budget 2013 - 14 £millions	Plan 2014 - 15 £millions	Plan 2015 - 16 £millions
TfL Corporation			
Borrowing	9,177.0	9,827.0	10,326.1
PFI and long term liabilities	345.7	259.0	232.7
Total Authorised Limit in for External Debt in TfL Corporation	**9,522.7**	**10,086.0**	**10,558.8**
TfL Group			
Borrowing	9,177.0	9,827.0	10,326.1
PFI and long term liabilities	696.2	562.9	439.6
Total Authorised Limit for External Debt in TfL Group	**9,873.2**	**10,389.9**	**10,765.7**

Estimates of Capital Expenditure (Annual)	Budget 2013 - 14 £millions	Plan 2014 - 15 £millions	Plan 2015 - 16 £millions
TfL Corporation	**3,375.9**	**2,986.2**	**3,088.5**
TfL Group	**3,797.2**	**3,753.5**	**3,559.8**

Estimates of Capital Financing Requirement (Cumulative)***	Budget 2013 - 14 £millions	Plan 2014 - 15 £millions	Plan 2015 - 16 £millions
TfL Corporation	8,279.2	8,656.7	9,314.1
Total TfL Group	9,688.1	10,508.5	11,325.1

* 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

Estimates of ratio of financing costs to net revenue stream	**Budget 2013 - 14**	**Plan 2014 - 15**	**Plan 2015 - 16**
TfL Corporation	**20.0%**	**32.2%**	**35.1%**
TfL Group	**37.1%**	**55.9%**	**59.2%**

Gross Debt and the Capital Financing Requirement**	**TfL Group***** £millions	**TfL Corporation** £millions
Gross Debt at 31 March 2014	9,873.2	9,522.7
Capital Financing Requirement at 31 March 2016	11,325.1	9,314.1

* The line titled ‘Direct Borrowing and other financing’ includes net depreciation charged to TfL’s group revenue account.

** The Prudential Code stipulates that Gross Debt at 31 March 2014 should not generally exceed the Capital Financing Requirement at 31 March 2016. For the Corporation the levels of Authorised Gross Debt in 2014 do exceed the Capital Financing Requirement for 2016. Reasons for this are set out in paragraphs 5.4 and 5.5.

***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.

Appendix 2

Prudential Indicators for Treasury Management

Interest Rate Exposures	**Budget 31 Mar 14**	**Plan 31 Mar 15**	**Plan 31 Mar 16**
Borrowing upper limit – fixed	100%	100%	100%
Borrowing upper limit – variable	50%	50%	50%
Investments upper limit – fixed	50%	50%	50%
Investments upper limit – variable	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	**Budget 31 Mar 14**	
	Upper	Lower
< 1year	35%	0%
1 year to < 2 years	35%	0%
2 years to <5 years	50%	0%
5 years to <10 years	75%	0%
10 years and above	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	**Budget 31 Mar 14** £millions	**Plan 31 Mar 15** £millions	**Plan 31 Mar 16** £millions
Forward Financial Year 1	**1,500**	**1,500**	**1,500**
Forward Financial Year 2	**1,000**	**1,000**	**1,000**
Forward Financial Year 3	**750**	**750**	**750**
Forward Financial Year 4	**500**	**500**	**500**

Appendix 3

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 2016 is not exceeded by gross debt budgeted at the end of 2014. 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 plus or minus transfers to reserves.