Finance Committee

Date: **6 October 2021**

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 20 February 2021 to 16 September 2021 (the Reporting Period).

1.2 During the Reporting Period, we have complied at all times with the Treasury Management Strategy (TMS), the Treasury Management Policies and the TfL Group Policy relating to the use of Derivative Investments (Policies) (each approved by Finance Committee Chair's Action (as delegated by the Board) on 10 March 2021), 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 Liquidity

3.1 The Treasury Management Policies state that, for prudent financial management purposes, TfL will aim to maintain a minimum level of cash reserves of at least 60 days' worth of forecast annual operating expenditure, equating approximately to £1.2bn. During the Reporting Period TfL cash reserves, excluding specified subsidiaries, always remained above this level.

3.2 The latest funding agreement with government dated 1 June 2021 was based on a range of high-level assumptions, including phasing of the savings target. For a number of reasons, such as upfront phasing of emergency government base grant, earlier than expected delivery of savings and delays in capital expenditure due to funding uncertainty, the cash balances have been higher than expected, but will start reducing over the coming months. The funding agreement assumes that TfL's cash balances will reduce near to the minimum £1.2bn level by the end of the funding period, 11 December 2021 after restating for revenue true up adjustments in line with the funding agreement.

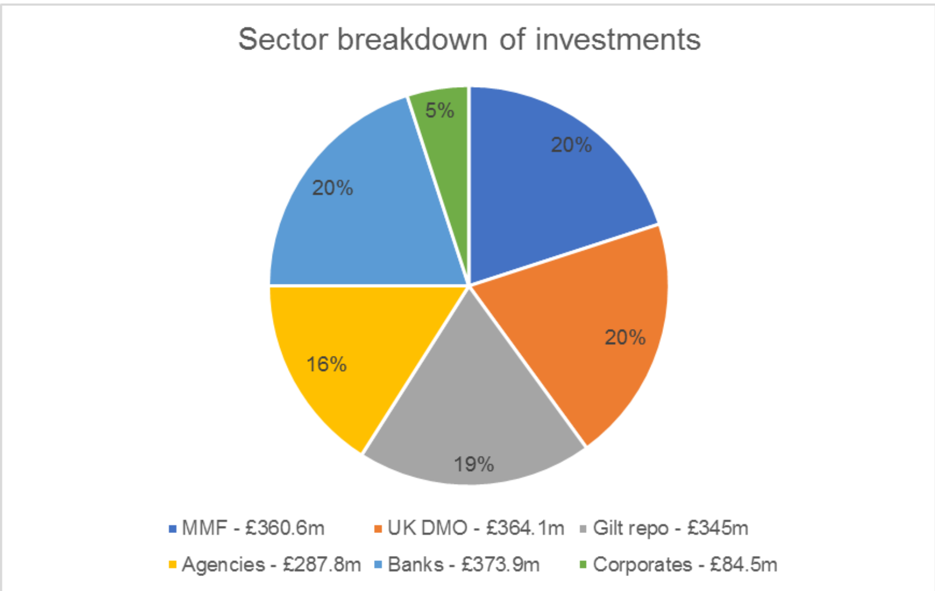
4 Investment Update

4.1 Financial markets operated without disruption over the Reporting Period and fears of counterparty credit risk subsided. We responded by gradually increasing the number of counterparties approved for investment. This has allowed us to further diversify cash investments by country, sector, liquidity and counterparty risk. The maximum duration of investments has remained at three months to reflect the relatively short-term nature of the funding agreement with government.

4.2 On 16 September 2021, cash under management was £1.8bn of which £706m (39 per cent) was held in highly rated, overnight money market funds (MMF) and government collateralised repurchase agreements (Gilt repo). Investments maturing within one and (at most) two months totalled £1,334bn (73 per cent) and £1,678bn (92 per cent) respectively. All investments mature within three months. The weighted average maturity (WAM) of investments over the Reporting Period reduced from 31 days to 22 due to a high relative return for overnight Gilt repo versus term investments.

4.3 While we have prioritised investments in short dated, highly rated instruments we continue to seek opportunities to diversify the portfolio and maximise yield. As at 16 September 2021, we held a diversified portfolio of investments in supra-national, government agencies and highly rated financial and corporate investments, as shown in Chart 1.

Chart 1 – Sector breakdown of cash position on 16 September 2021



4.4 The investment yield on cash investments on 16 September 2021 was 4.7bps, 13bps higher than the seven-day London Interbank Bid Rate (LIBID) benchmark. The yield is reflective of low interest rates, short duration of investments and investment in highly rated counterparties and liquid investments.

Money Market Fund reform

4.5 Following the severe market disruption brought on by the coronavirus pandemic, regulators across Europe and the United States are reviewing the rules under which MMFs operate. While MMFs successfully navigated the stresses resulting from the coronavirus pandemic, it is expected more stringent limits will come into force. Several consultations have taken place across multiple regulators and focused on: the susceptibility of large outflows in funds, liquidity of underlying money markets and continued adequacy of existing MMF rules. Regulators may choose to reform certain aspects of the framework including; decoupling liquidity thresholds with mandatory suspension and/or gates, review liquidity buffers and their use, review the status of certain fund types such as constant, variable and low volatility net asset value funds and assessing the role of fund sponsors. No date has been provided on when and/or if regulatory reforms will take place.

Investment yield benchmark

4.6 With the cessation of London Interbank Offered Rate (LIBOR) publication from 31 December 2021, MMFs are now using Sterling Overnight Index Average (SONIA) instead of the seven-day LIBID to benchmark returns. We also anticipate moving to SONIA to monitor performance of our investment portfolio from 31 December 2021.

5 Borrowing Update

Borrowing during the Reporting Period

5.1 As at the end of the Reporting Period, we had £13,069m outstanding borrowing with a weighted average maturity of 16.6 years and an average interest rate of 3.2 per cent. We remained within the Authorised Limit for borrowing of £14,494.8m at all times during the Reporting Period.

5.2 During the Reporting Period, we borrowed the final £74m under our £750m facility with the Department for Transport (DfT) for the purposes of the Crossrail project. We also refinanced some of our variable rate Public Works Loan Board (PWLB) loans to reduce the interest rate payable on some of our borrowing.

2021/22 borrowing requirement

5.3 Table 1 sets out our planned borrowing and refinancing requirement for 2021/22. In addition to the planned amounts, we might refinance our rolling commercial paper with alternative sources, should this be appropriate.

Table 1 – 2021/22 borrowing requirement as at 16 September 2021

Description	**Complete (£m)**	**Remaining (£m)**	**Total (£m)**
Refinancing of maturing borrowing, excluding rolling short-term commercial paper	45.0	315.2	360.2
Refinancing of PWLB variable rate loans	252.0	84.0	336.0
Borrowing requirement for 2021/22 (excluding borrowing under the £750m DfT loan facility for Crossrail)	**297.0**	**399.2**	**696.2**
Borrowing under the £750m DfT loan facility for Crossrail	74.0	-	74.0
Total borrowing requirement for 2021/22	**371.0**	**399.2**	**770.2**

DfT £750m loan facility for the purposes of the Crossrail project

5.4 On 28 April 2021, we drew down the final £74m under our £750m facility with the DfT for the purposes of the Crossrail project. This final drawdown fixes the future interest and principal payment dates under the facility.

Refinancing of PWLB variable rate loans

5.5 During 2020/21 we arranged four variable rate PWLB loans as part of the £600m borrowing agreed under the Extraordinary Funding and Financing Agreements with government. The variable rate loans totalled £336m, with the remaining raised as fixed rate PWLB loans. Since arranging the loans, the margin payable on new loans from the PWLB has reduced by one per cent. Variable rate PWLB loans (but not fixed rate PWLB loans) can be repaid early without penalty once they have been outstanding for at least 12 months. Therefore, to benefit from the lower margin we have been refinancing these variable rate loans with new PWLB loans as they become eligible for penalty-free repayment. The last of these loans will be refinanced before the end of September 2021.

Refinancing of maturing borrowing

5.6 We have £360.2m maturing borrowing in 2021/22, excluding maturing commercial paper. During the Reporting Period we have refinanced £45m of maturing debt with commercial paper. We expect to refinance the majority of the remaining 2021/22 maturities with a new PWLB loan towards the end of September 2021.

Changes to PWLB lending terms

5.7 In August 2021 the PWLB announced some changes to its lending terms, effective from 8 September 2021. The most significant change is an increase to the settlement period for new loans, which means proceeds from PWLB loans will take five days to arrive, rather than two days previously.

Debt financing of property subsidiary

5.8 As part of the Financial Sustainability Plan, submitted to government in January 2021, TfL's property subsidiary TTL Properties Limited (TTLP) is planning to increase the scope of its development activities in order to deliver more housing and a revenue stream for TfL. It is currently envisaged that the additional investment is financed by means of commercial debt, raised directly by TTLP without recourse to TfL. As TTLP will remain a fully owned subsidiary of TfL, any debt obligations will continue to be consolidated into the group balance sheet and will be subject to CIPFA prudential borrowing indicators and Authorised Borrowing Limit.

5.9 TfL's TMS and Policies are currently based on the assumption that all group debt is raised centrally by TfL and will be reviewed in order to enable TTLP to raise its own debt. Any potential amendments to TMS and Policies will be proposed to the Committee in future meetings.

UK Infrastructure Bank

5.10 The UK Infrastructure Bank (UKIB) is the new, government-owned policy bank, focused on increasing infrastructure investment across the UK. The bank has a mandate to lend to local and mayoral authorities for strategic and high value projects and invest in infrastructure projects alongside the private sector, crowding-in private sector capital. Launched in June 2021 in interim form, UKIB currently only offers a range of financing tools to the private sector. It was expected to start offering finance to local authorities, at rates cheaper than PWLB, from late summer 2021, however no further details have yet been announced. We continue to monitor any developments and our eligibility for cost efficient financing.

Disclosure Procedures Policy

5.11 In accordance with the Disclosure Procedures Policy, the Finance Committee is to be provided with an update on the operations of the Disclosure Group from time to time. Since the adoption of the policy in November 2019, TfL has continued to comply with the policy, including monitoring the existence of inside information, maintaining insider lists as and when required and issuing stock exchange announcements.

6 Credit ratings

6.1 Our credit ratings as at 16 September 2021 are shown in the table below.

Table 2: TfL's credit ratings as at 16 September 2021

	Standard & Poor's (S&P)	Moody's	Fitch
Long-term rating	A+	A3	A+
Outlook	Stable	Negative	Stable
Short-term rating	A-1	P-2	F1+

Changes to our credit ratings during the Reporting Period

6.2 On 20 May 2021, S&P affirmed our credit ratings and revised the outlook on our long-term rating to stable from negative. This reflected its view that the government would continue to provide adequate support to TfL until ridership rebounds to sustainable levels.

6.3 On 15 June 2021, Moody's downgraded our long-term credit rating from A1 to A3 and maintained the negative outlook on the rating. It also downgraded our short-term rating from P-1 to P-2. The downgrades reflected Moody's view on several factors, including the impact of the coronavirus pandemic, its assessment of the financial support provided by the government and the absence of a longer-term funding arrangement.

6.4 The downgrade has increased the interest rates that would be payable on new long-term commercial debt (for example, a public bond issuance) and has made these forms of borrowing less attractive. For clarity, the rating change does not affect our ability to access the PWLB, nor the interest rates available to us from the PWLB.

6.5 We have worked to reassure our financial stakeholders following the downgrade and are not aware of any material negative action by our debt holders as a result of the downgrade.

6.6 There have been no changes to our rating from Fitch during the Reporting Period.

LIBOR Transition Programme update

6.7 We continue to engage in detailed negotiations with lessors on our finance leases to transition to SONIA and make the relevant contract amendments in advance of the cessation of LIBOR from 31 December 2021. As SONIA is an overnight rate, the interest payment is therefore not known until the end of the interest period, whereas the LIBOR rate is known at the beginning of an interest period. This creates challenges in processing payments, and a significant part of negotiations has been focused on producing an appropriate solution to address this, including amending the invoicing process.

6.8 Where we have interest rate swaps against these leases, we are in discussions with the relevant counterparty to change these swaps to use the SONIA methodology which will follow the leases, rather than relying on the International

Swaps and Derivatives Association IBOR Fallbacks Protocol, maximising hedge effectiveness.

6.9 We are also reviewing the use of LIBOR in our systems and processes and transitioning accordingly, including upgrading our treasury management system, and changing our investment yield benchmark, as noted in this paper.

7 Banking

7.1 We have successfully migrated 1,670 sub accounts from our legacy Client Money Manager banking platform to a new virtual banking platform. The migration took place in July 2021, ahead of the scheduled date of 30 September. We continue to work with our banking partner to provide support to the users ensuring they maximise the platform’s enhanced functionality.

7.2 We are working with our banking provider and business partners on the addition of Image Survivable Features on TfL’s cheque stationery. The introduction of Image Survivable Features is to reduce the risk of fraud across the banking industry. The features consist of an encrypted code number printed on the front of the cheque which is then validated during the clearing process against the actual image of the cheque. Our banking provider will introduce the new cheque clearing software from 1 January 2022 and we are working to have the new cheque stationery in place by 30 November 2021.

7.3 We are also working with our banking provider and the Business Support Function (BSF) to automate the daily manual CHAPS payment process. The new process generates a file from SAP which after authorisation is automatically sent to the bank via an API connection for same day processing. The new process brings cost efficiencies as the files are cheaper to process so reducing bank charges and by removing the current manual payment process this will allow the BSF to focus on other activities. The target date for implementation is December 2021.

8 Other

CIPFA Consultation on the Prudential Code and Treasury Management Code

8.1 During the Reporting Period, the Chartered Institute of Public Finance and Accountancy (CIPFA) have published their response to consultations on the CIPFA Prudential Code and the CIPFA Treasury Management Code. Following the consultation responses, we expect CIPFA to make some changes to the Prudential Code to strengthen provisions around borrowing for yield. We are required to have regard to both of these Codes and will review any changes once they are published.

Treasury Management System upgrade

8.2 The Quantum Treasury Management System is being upgraded to receive continued support from the software vendor and to obtain new functionality required for the replacement of LIBOR (for the calculation of interest flows and the valuation of the relevant treasury instruments). The upgrade commences in autumn 2021 and is due to complete by the end of the financial year.

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

Contact Officer: Joanna Hawkes, Director of Corporate Finance
Email: JoannaHawkes@tfl.gov.uk