Land and Property Committee

Date: **30 June 2022**

Item: **Financial Framework for TTL Properties Limited**

This paper will be considered in public

1 Summary

1.1 This paper updates the Committee on the approvals received to allow TTL Properties Limited (TTLP) to operate as a financially independent company within Transport for London (TfL). Matters relating to the financing of TTLP are reserved to the Finance Committee, but it is appropriate that relevant aspects are reported to this Committee.

2 Recommendation

2.1 The Committee is asked to note the paper.

3 Background

3.1 From 1 April 2022, TTLP began operating on the basis that no further funding would be provided by TfL and that TTLP would operate purely from its own financial resources. TTLP was separated from the TfL cash pooling arrangements and now runs independent banking arrangements.

3.2 As a non-recourse facility, TfL will have no obligation to support TTLP and the lenders will have no claim on TfL. TfL is aware that the implication of this is that in extremis it would need to be prepared to let TTLP fail, and this could mean the loss to the TfL Group of some or all of the assets vested in TTLP, with all the reputational and wider impacts this would have.

3.3 Assurance has demonstrated through affordability analysis that TTLP can operate without financial support from TfL. TTLP is a viable and sustainable business with mitigating options that will ensure it will not fail even under multiple stress scenarios.

3.4 To facilitate the non-recourse nature of the funding, a number of existing guarantees needed to be removed or not renewed.

3.5 TTLP also needed approval for a bespoke TTLP Treasury Management Strategy and Policy, setting out how TfL will continue to manage the funding, liquidity and cash arrangements for TTLP, as it does now, albeit with cash managed on a segregated basis and within revised authority limits and tighter liquidity requirements.

3.6 TTLP also needed approval for a dividend policy that stated 100 per cent of all operating profit will be returned to TfL as a dividend, with funds from any capital disposal and joint venture dividends recycled into the TTLP business.

4 Affordability Analysis and Stress Testing

4.1 The TTLP Business Plan was tested by TfL Corporate Finance for several specific and combined downside stress scenarios that include economic downturn, delayed market sales, extended inflation and interest rate rises, cost increases, delayed build, and lower income.

4.2 These scenarios were set against mitigating actions that could be reasonably deployed in any stressed scenario and the loan covenants that were negotiated into the term sheet (loan to value, net tangible worth and interest cover). The testing horizon was over five years.

4.3 The analysis concluded that in all stressed scenarios the loan covenants were either not breached or capable of being fully mitigated, and there was no call on TfL for further funding.

4.4 The work also identified recommendations for controls and processes that will be taken forward to support ongoing affordability and debt management.

5 CIPFA Prudential Code

5.1 Assurance was sought on the ability of TTLP to borrow, given recent changes to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code, which TfL is legally obliged to have due regard to.

5.2 The Prudential Code (updated in December 2021) now states that Local Authorities “must not borrow to invest primarily for financial return”. The Finance Committee had previously asked we confirm compliance to the code.

5.3 We believe that TTLP is not borrowing purely for financial return for reasons that include: a) it is investing in affordable housing delivery; b) its delivery is in line with the Mayor's Transport Strategy; and c) development of TfL’s estate is specifically permitted under legislation – the GLA Act 1999 states that “Transport for London may develop its land in such a manner as it thinks fit.”

5.4 This assessment has been tested with counsel who confirmed it is reliable.

6 Non-recourse Implications for Guarantees

6.1 The non-recourse nature of the proposed RCF has implications for the current TfL parent company guarantee structure and for the directors of TTLP, in that if the debt is truly non-recourse then all guaranteed support from TfL should be released.

6.2 Historically, as with other subsidiaries, TfL has provided a letter to TTLP’s directors providing comfort that the company will be funded to pay its debts as they fall due.

6.3 TTL has also provided a parent company guarantee to TTLP under section 479C of the Companies Act 2006, registered at Companies House, whose purpose is primarily to avoid the need for TTLP's accounts to be audited. These arrangements are replicated for TTLP's subsidiaries.

6.4 It was proposed that this parent support for TTLP and its subsidiaries is removed. In the case of TTLP's subsidiaries, that support is being replaced by a guarantee in substantially the same terms by TTLP.

6.5 In preparation, TTLP is already producing audited accounts for 2021/22.

6.6 Separately, there are guarantees from TTL to joint venture partners in respect of ongoing development projects. These guarantee the equity investment in the project. For several projects, the contractually committed equity investment has already been made so those guarantees will not be called upon. Of the remaining projects, some may be subject to contractual variations so opportunities may exist to substitute in TTLP as guarantor. On the rest, there are still contributions to be made so the guarantees still apply, and we are intending to leave these guarantees in place and allow them to fall away over time. For any new projects, TTLP will be offered as guarantor so there will be no further call on TfL.

7 Non-recourse implications for directors

7.1 In the absence of recourse to TfL and in addition to the affordability analysis described above, TTLP's directors must be satisfied on an ongoing basis that the company remains solvent.

7.2 TTLP's directors have been engaged and assurance will be provided to them through quarterly briefings and regular updates of documents including: business performance; cash flow and liquidity forecast and headroom; affordability, stress testing and mitigation updates; strategic risk register; and financial accounts.

7.3 Based on the affordability and stress testing scenarios, we are confident in the financial viability of TTLP. A plan to mature the business processes, controls and assurance is in place and has been agreed by senior TfL Finance teams.

8 Treasury Management Strategy and Policy

8.1 As a result of the change in funding arrangements and TTLP's financial independence, a new Treasury Management Strategy and Policy have been prepared for TTLP and approved by the Finance Committee.

8.2 They set out how TfL will continue to manage the funding, liquidity and cash arrangements for TTLP. Cash will be managed on a segregated basis within policy limits, required changes to authority limits and the need for tighter liquidity requirements.

8.3 The Liquidity Policy will require that there is sufficient undrawn borrowing commitment and cash in bank to meet financial commitments over the next 18 months and that a cash reserve of £10m is maintained.

9 Revolving Credit Facility

9.1 Discussions have progressed positively with selected lenders in relation to the £200m non-recourse RCF. A detailed term sheet was agreed, and the prospective lenders achieved credit approval. Alongside this, work has progressed to agree a draft of the full facility agreement.

9.2 We expect to have the facility in place by the end of this month.

10 Dividend Policy

10.1 The dividend policy forms an integral part of TTLP's overall corporate strategy by supporting TTLP's objectives of growing net operating profit that is returned to TfL whilst also building 20,000 new homes. To support these aims, the dividend is equal to profit after tax attributable to recurring income. Profit after tax attributable to non-recurring income, such as dividends from 'for sale' joint ventures and profits on disposal proceeds, will be recycled into the TTLP business plan to support further investment.

10.2 On 22 June 2022, the Finance Committee agreed the dividend policy and that it will be declared and paid out annually, post confirmation of the year-end position as a single 12-month trailing dividend payment.

11 Assurance

11.1 TTLP will put in place a formal three lines of defence assurance model. TTLP will have its own Integrated Assurance Plan and Enterprise Risk Framework, both modelled on TfL's current arrangements. This will include a TTLP Independent Investment Programme Advisory Group (IIPAG) sub-group, with a chair and two members to cover TTLP's functions. The new roles will operate to a plan set by the Audit and Assurance Committee and this Committee, with reports also distributed to this Committee.

11.2 Working arrangements are being put in place to articulate the interface between TfL and TTLP. This considers similar models currently in use, including for the London Transport Museum, and will set out the principles for engagement.

11.3 With the new governance arrangements in place, it is not considered necessary to continue with the Commercial Development Advisory Group (CDAG) and it is therefore proposed to close that Group. TfL and TTLP remain grateful for the significant contribution that CDAG members have made in helping TfL develop its property portfolio and setting up TTLP as a commercial property company.

12 HM Government and the Greater London Authority

12.1 TfL, HM Government and the Mayor are aligned on the objectives for TTLP. All want to see the 'double bottom line' focus on housing delivery and long-term income.

12.2 Government officials have supported the concept of TTLP from the time it was first set out to them in January 2021 as part of TfL's Financial Sustainability Plan. Government endorsement was confirmed in the TfL Settlement letter of 1 June 2021.

12.3 The Settlement Letter of 24 February 2022 included the following condition:

> You agree to ensure the commercial property company to be established by TfL will have the required operational and financial independence to deliver housing in a high demand area and to provide an increased revenue stream. There will be no recourse to TfL parent company. TfL will provide a commercial operating structure and business plan for the property company by May 2022.

12.4 TfL provided a commercial operating structure and business plan, and officials have again confirmed their support for the venture to deliver both housing and a growing income stream to be reinvested in transport.

12.5 It is not yet clear if Government wishes to appoint an observer to join this Committee.

12.6 The Greater London Authority (GLA) has been similarly supportive of the approach from the outset. TTLP was reviewed by Lord Kerslake in his report 'Review of GLA Group Housing Delivery.' Lord Kerslake noted that 'The TTLP delivery model has the potential to accelerate housing development.' Whilst recognising challenges, including the initial short-term nature of funding, Lord Kerslake concluded that City Hall should work alongside TTLP to support mutual housing delivery objectives.

List of appendices to this report:

None

List of Background Papers:

None

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