Finance Committee

Date: **6 October 2022**

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 17 February 2022 to 16 September 2022 (the Reporting Period).

1.2 Over the last six months there have been a number of headwinds. During this period, we have negotiated multiple (and, until recently, short term) funding extensions or settlements with the government and have faced economic uncertainty in the form of increasing interest rates and inflation. During the Reporting Period the 20 year Gilt rate has risen from 1.6 per cent to 3.5 per cent whilst the Bank of England (BoE) base rate has more than tripled from 0.5 per cent to 1.75 per cent. As of the 16 September, the market predicts the BoE base rate to rise further to 4.6 per cent, by March 2023. According to the Office for National Statistics, inflation as measured by the Consumer Price Index (CPI), has risen from 6.2 per cent in February to 9.9 per cent in August, peaking at 10.1 per cent in July. Bloomberg predicts that CPI will continue to rise, peaking at 11.4 per cent in the last quarter of 2022.

1.3 Throughout the Reporting Period, we have kept in close contact with our lenders, who have remained supportive of our position, and take comfort from the level of ongoing and continuing support from the government.

1.4 Credit rating agencies S&P and Fitch have not changed their ratings during the Reporting Period, reflecting their expectation that TfL will continue to receive adequate government support until we achieve financial sustainability. Moody's have downgraded us during the Reporting Period, due to the short-term nature of the funding agreements from the government at the time of downgrade and their view on the potential impacts of weak economic growth and high inflation on passenger demand.

1.5 We have been largely insulated from the impact of rising interest rates, due to a high level of fixed rate debt, at 91.8 per cent. We have also taken the decision to fix the interest rate on around £600m of our train leases.

1.6 Our cash balance of approximately £1.2bn has been invested in short-term instruments, consistent with our Treasury Management Strategy, and therefore we have seen some upward movement in the interest receivable on these funds.

1.7 Our bond spreads in the secondary market have widened over the period from around 140 basis points to around 165 basis points, which is in line with general market movements. It remains significantly cheaper to refinance our maturing debt through the Public Works Loan Board (PWLB) than the bond markets. In August, we refinanced a £500m bond maturity through the PWLB.

1.8 We have focussed on looking at ways that we can develop our approach to environmental, social and governance (ESG) investing and have evaluated a number of third parties, with the aim of procuring ESG data on potential and existing investment counterparties.

1.9 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 9 March 2022, along with the GLA Responsible Investment Policy.

1.10 A verbal update will be provided at the meeting on the recent volatility in financial markets and the impact on TfL's Treasury position.

1.11 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, on average, equating approximately to £1.2bn. During the Reporting Period TfL cash reserves, excluding identified, separate subsidiaries, remained on average around this level.

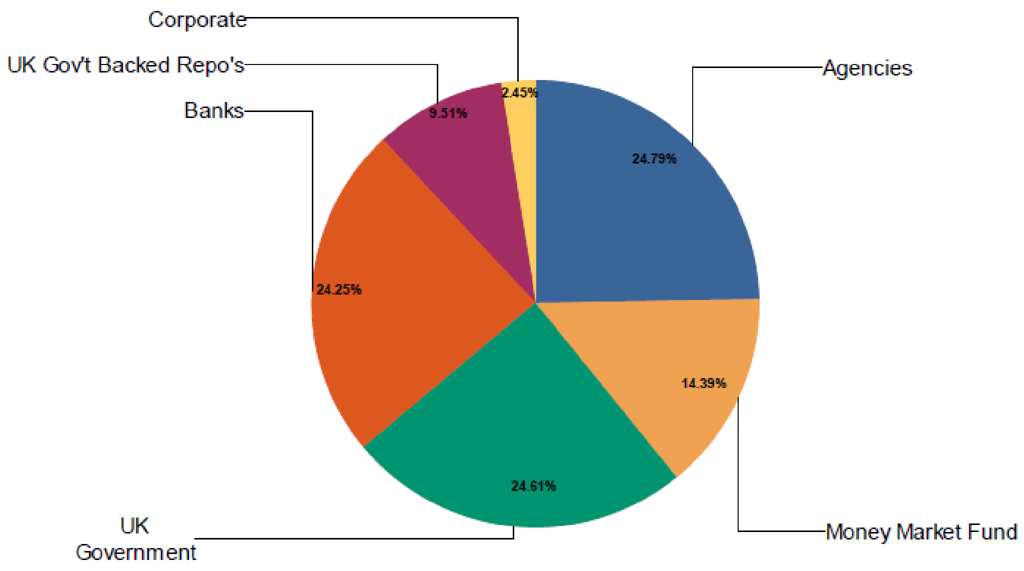
4 Investment Update

4.1 During the Reporting Period we have continued to diversify cash investments by country, sector, liquidity, and counterparty risk. The maximum duration of investments has remained at three months. During the Reporting Period, BoE base rates have rapidly risen from 0.5 per cent, on 17 February 2022, to 1.75 per cent by the end of the Reporting Period. The short-term nature of our investment strategy has meant that our investment yield has quickly reflected increases in interest rates.

4.2 On 16 September 2022, 14 per cent of our investments were held in highly rated overnight money market funds (MMF) and 9.5 per cent in government collateralised repurchase agreements (Gilt repo). Our investments remain short dated, with 89 per cent maturing within two months. The weighted average maturity of investments over the Reporting Period increased from 24 days to 25 days.

4.3 While we have continued to prioritise investments in short dated, highly rated instruments, we continue to seek opportunities to diversify the portfolio and maximise yield. As at 16 September 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 2022



4.4 The weighted average investment yield on 16 September 2022 was 1.82 per cent, 13bps higher than the Sterling Overnight Index Average (SONIA) benchmark.

5 Borrowing Update

Borrowing during the Reporting Period

5.1 As at the end of the Reporting Period, we had £12,808m in outstanding borrowings with a weighted average tenor of 18.0 years and an average interest rate of 3.3 per cent. We remained within the Authorised Limit for borrowing of £14,569m at all times during the Reporting Period.

5.2 In March, we arranged a £132m variable rate loan from the PWLB, in part to refinance some Commercial Paper (CP) and to ensure we remained consistent with our liquidity policy. During the Reporting Period, we also refinanced a £45m maturing PWLB loan, and used CP to refinance a £35m loan repayment to the Department for Transport (DfT) under the DfT loan facility for the Crossrail project.

5.3 In August one of our public bonds matured. This bond had a principal value of £500m and was refinanced with three fixed rate loans from the PWLB. The PWLB was the cheapest option for long-term borrowing. Splitting the £500m across three loans, with varying maturities, allowed us to better manage our debt maturity profile compared to one loan of £500m. Long-term tenors allowed us to benefit from lower interest rates for longer maturities when compared to slightly shorter maturities; the interest rates payable on 39-41 year maturities were lower than, for example, 20-35 year maturities. The three loans are set out in the table 1.

Table 1: Summary of the three loans issued by the PWLB

Tenor (years)	Interest Rate (%)	Loan amount (£)
39	3.29	166,000,000
40	3.28	167,000,000
41	3.28	167,000,000

Remaining 2022/23 borrowing requirement

5.4 We have £114.1m of maturing long-term debt remaining to refinance in 2022/23. This consists of maturing loans from the European Investment Bank and the PWLB. Whilst we will continue to monitor all our refinancing options, it is likely we will utilise our access to PWLB to refinance this debt.

6 Environmental, Social and Governance (ESG) criteria for investment purposes

6.1 We have investigated several ESG data providers with the objective of improving both risk management and sustainability practices for our investment decisions. As part of our research, we approached key suppliers of ESG data to understand their services and assess coverage of our existing investment counterparties.

6.2 We will use the ESG metrics provided to form a key factor in the approval process of our investment counterparties. All approved counterparties will be reviewed regularly, with their associated ESG metrics continuing to be a key factor. Our ESG processes will be incorporated into our TMS, which is next due to be updated for the Committee in March 2023.

7 Banking

7.1 We continue to work with our banking provider and the Business Support Function (BSF) to automate the daily manual CHAPS payment process. The new process brings cost efficiencies as the files are cheaper to process and automating the current payment process will allow the BSF to focus on other activities. User Acceptance Testing is currently being undertaken and the target date for implementation is October 2022.

7.2 The Cash and Banking team has been working with the BSF and the service provider, Bottomline, to future proof the way TfL makes supplier and payroll BACS payments by moving to a new cloud based solution (Bottomline PTX). The project successfully went live in June 2022.

Treasury Management System accounting upgrade

7.3 Further to the successful upgrade of our Treasury Management System, Quantum, we are now improving the system for accounting processes. This will enable the automatic generation of daily, periodic and financial year end accounting entries coupled with a direct interface to TfL's Enterprise Resource Planning system, SAP. The project is expected to complete, with benefits realised, and 'go live' in financial year 2023/24.

8 Credit ratings

8.1 Our credit ratings as at 16 September 2022 are shown in the table below.

Table 2: TfL's credit ratings as at 16 September 2022

	S&P	Moody's	Fitch
Long-term rating	A+	Baa1	A+
Outlook	Stable	Stable	Stable
Short-term rating	A-1	P-2	F1+

8.2 On 9 May 2022, Moody's downgraded our long-term credit rating from A3 to Baa1 and assigned a stable outlook. This reflected Moody's view on several factors, including concerns that operating performance will be weaker than expected due to weaker economic growth and higher inflation, as well as the then ongoing uncertainty around our long-term funding, at the time.

8.3 On 26 May 2022, S&P affirmed our credit ratings at the existing level of A+/A-1. This reflected its view that the government would continue to provide adequate support to TfL until performance returns to sustainable levels

8.4 In early September 2022, we held a management meeting with Fitch. On 13 September, Fitch announced they had reviewed TfL's rating and taken no action. We expect them to perform further analysis once the final version of our 2021/22 statutory accounts are published.

9 TTLP

9.1 On 29 June 2022, TfL's wholly owned subsidiary, TTL Properties Limited (TTLP), entered into a three-year £200m Revolving Credit Facility. The facility is supported by NatWest, BayernLB, and HSBC and is non-recourse to TfL. TTLP will be able to draw funds as required over the next three years to help fund its capital programme.

9.2 TTLP has put in place an 18 month cash flow forecast, as required under the TTLP Treasury Management Policy, which indicates that TTLP will have sufficient liquidity over this period.

9.3 We have also put in place a separate pooling arrangement and £10m overdraft facility for TTLP. We negotiated the terms and conditions in the relevant banking service and facility agreements with our banking provider.

List of appendices to this report:

A paper containing exempt supplementary 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