Finance Committee

Date: **8 March 2023**

Item: **Treasury Activities, Policies and Strategy**

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 September 2022 to 17 February 2023 (the Reporting Period) including a summary of the changes to the Treasury Management Policies and Strategies.

1.2 This paper also sets out the proposed TfL Treasury Management Strategy (TMS) for 2023/24, the proposed TfL Treasury Management Policies (TMP) and the proposed TfL Group Policy Relating to the Use of Derivative Investments (Derivatives Policy), along with the proposed TTL Properties Limited (TTLP – TfL's property development company) Treasury Management Strategy (TTLP TMS) and the TTLP Treasury Management Policies (TTLP TMP).

1.3 Approval of these strategies and policies is within the authority of the Committee. The Committee is asked to exercise that authority in relation to each of the TfL and TTLP TMS, each of the TfL and TTLP TMP and the Derivatives Policy.

1.4 We have been largely insulated from the impact of rising interest rates, due to a high level of fixed rate debt, at 92.3 per cent. Our cash balance has been invested in short-term instruments, consistent with our TMS, and therefore we have seen upward movement in the interest receivable on these funds.

1.5 In December 2022, we purchased £715.5m of our outstanding Medium Term Note Programme bonds on the open market, for £669.2m.

1.6 In January 2023, Fitch upgraded our long-term credit rating from A+ to AA-. Our ratings with Moody's and Standard & Poor's remain unchanged

1.7 We have been looking at ways that we can develop our approach to environmental, social and governance (ESG) investing. In particular, we will continue to follow the Greater London Authority (GLA) Responsible Investment Policy as it further develops.

1.8 TfL has separated the commercial property arm of its business, TTLP, in line with government requirements in the February 2022 funding letter. TTLP remains a core part of the TfL estate, however, is able to act in an agile way to deliver a long term, sustainable property business aligned to the core objectives of TfL. Since this separation in April 2022, TTLP has developed and solidified its processes. As such its proposed TTLP TMS and TTLP TMP have been updated significantly to reflect these changes.

1.9 During the Reporting Period, we have complied at all times with the TfL TMS, the TfL TMP and the Derivatives Policy, each approved by the Committee (as delegated by the Board) on 9 March 2022, along with the GLA Responsible Investment Policy, the TTLP TMS and TTLP TMP which were both approved by Chair's Action, following consultation with the Committee (as delegated by the Board) on 22 June 2022.

1.10 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 Recommendations

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

(a) approve the TfL Treasury Management Strategy 2023/24, attached as Appendix 1 to this paper, including the Investment Strategy, the Borrowing Strategy, the Liquidity Strategy, the Risk Management Strategy and the Counterparty Exposure Limits;

(b) approve the proposed TfL Treasury Management Policies, attached as Appendix 2 to this paper;

(c) approve the proposed TfL Group Policy Relating to the Use of Derivative Investments, attached as Appendix 3 to this paper;

(d) note that the managing Chief Finance Officer will approve any non-material changes they consider necessary to the proposed TfL Pension Fund Policy, approved by the Committee in draft in March 2022, once the final regulations have been published, and will issue in final form and, f any material changes are necessary, further approval from the Committee will be sought;

(e) approve the TTL Properties Limited Treasury Management Strategy, attached as Appendix 4 to this paper, including the Borrowing Strategy; the Investment Strategy; the Liquidity Strategy and Banking and Cash Management provision;

(f) approve the Treasury Management Policies for TTL Properties Limited, attached as Appendix 5 to this paper; and

(g) subject to the approval of the TMS 2023/24 and approval of the TfL Group Policy Relating to the Use of Derivative Investments (Derivatives Policy) by the Committee (pursuant to paragraph 2.1(c) above), approve, pursuant to Section 49 of the Transport for London Act 2008 (as amended by the Transport for London Act 2016, together the Act), and in accordance with the Derivatives Policy for 2023/24, Transport for London Finance Limited (as a qualifying TfL subsidiary for the purposes of the Act) entering into derivative investment(s) in relation to:

i) mitigating exchange rate risk related to specific currency exposures arising from the procurement of goods or services by any member of the TfL Group or grants or revenues payable in currencies other than Sterling to any member of the TfL Group in the ordinary course of business as soon as practicable once the quantum of exchange rate risk to any member of the TfL Group is established;

ii) mitigating exchange rate risk arising from any TfL Group investments in foreign currencies in accordance with the TMS 2023/24;

iii) mitigating commodity rate and/or price risk related to specific commodity (including fuel and electricity) exposures arising from the procurement of goods or services by any member of the TfL Group in the ordinary course of business as soon as practicable once the quantum of commodity risk to any member of the TfL Group is established;

iv) mitigating interest rate risk and if applicable currency risk related to any existing, imminent and future TfL Group borrowing (including any leases), once the borrowing has become certain and authorised in accordance with the TMS 2023/24;

v) mitigating inflation risk related to specific exposures arising from the procurement of goods or services by any member of the TfL Group once the quantum of inflation risk to any member of the TfL Group is established; and

vi) mitigating risk related to any index reflecting any of the above matters referred to in paragraphs 2.1(b)(i) to (v) above.

3 Liquidity

3.1 The TfL TMP 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. 60 days' worth of forecast annual operating expenditure is approximately £1.2bn for 2022/23. The Long-term Funding Settlement agreed with Government in August 2022 requires that usable cash reserves are maintained at no more than £1.2bn, on average. Should usable cash reserves increase above £1.2bn, no top-up grant will be paid until they fall below this level again. We continue to balance these requirements by aiming to maintain our cash balances around £1.2bn on average, however there may be occasions when our cash balances fall slightly below the 60 days aim stated by our Liquidity Policy but would still be within the minimum requirements of the Policy.

3.2 This situation will be more pronounced as we move into 2023/24, where 60 days' worth of forecast operating expenditure will be £1.3bn. While the Liquidity Policy allows for fluctuations in cash reserves, we do expect cash to remain slightly below £1.3bn during 2023/24 to ensure we comply with the government funding agreement.

3.3 Despite the above, we are confident that we will retain sufficient liquidity to meet our financial obligations when they become due and continue to maintain a £100m overdraft facility and £100m money market facility to supplement our cash balances as and when required.

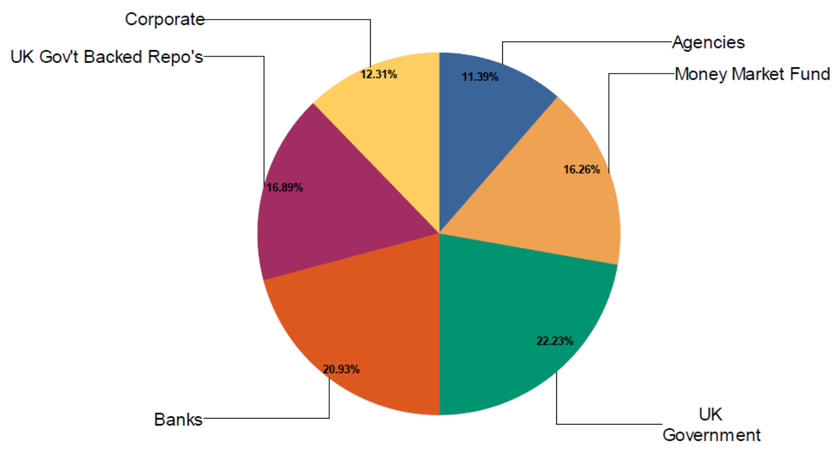
4 Investment Update

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, Bank of England base rates have continued to rise rapidly from 1.75 per cent on 17 September 2022, to 4 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 17 February 2023, 16.3 per cent of our investments were held in highly rated overnight money market funds (MMF) and 16.9 per cent in government collateralised repurchase agreements. Our investments remain short dated with 95 per cent maturing within two months. The weighted average maturity of investments over the Reporting Period decreased from 25 days to 23 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 of 17 February 2023, we held a diversified portfolio of investments in supra-nationals, government agencies and highly rated financial and corporate investments, as shown in Chart 1.

Chart 1 – Sector breakdown of cash position on 17 February 2023



4.4 The weighted average investment yield on 17 February 2023 was 3.8 per cent, 12 basis points lower than the Sterling Overnight Index Average (SONIA) benchmark.

5 Risk Management

5.1 The level of floating rate borrowing, as a percentage of all borrowings outstanding, has decreased slightly over the Reporting Period, from 8.0 per cent to 7.7 per cent, primarily due to a small reduction in our Commercial Paper (CP) balance. This remains within the maximum target of 25 per cent set out in our TMS for 2022/23.

5.2 Although 7.7 per cent, or £985m, of total debt is exposed to floating interest rates, there is an element of natural hedge in the form of our short-term investments. This is because the income on our investments is also exposed to short-term interest rates. Therefore, a rise in interest rates on our floating rate debt is somewhat offset by a rise in interest receivable from our investment portfolio.

6 Borrowing Update

Borrowing during the Reporting Period

6.1 As of 17 February 2023, we had £12,721m in outstanding borrowing with an average tenor of 19.25 years and a weighted average interest rate of 3.4 per cent. We remained within the Authorised Limit for borrowing of £14,569m at all times during the Reporting Period.

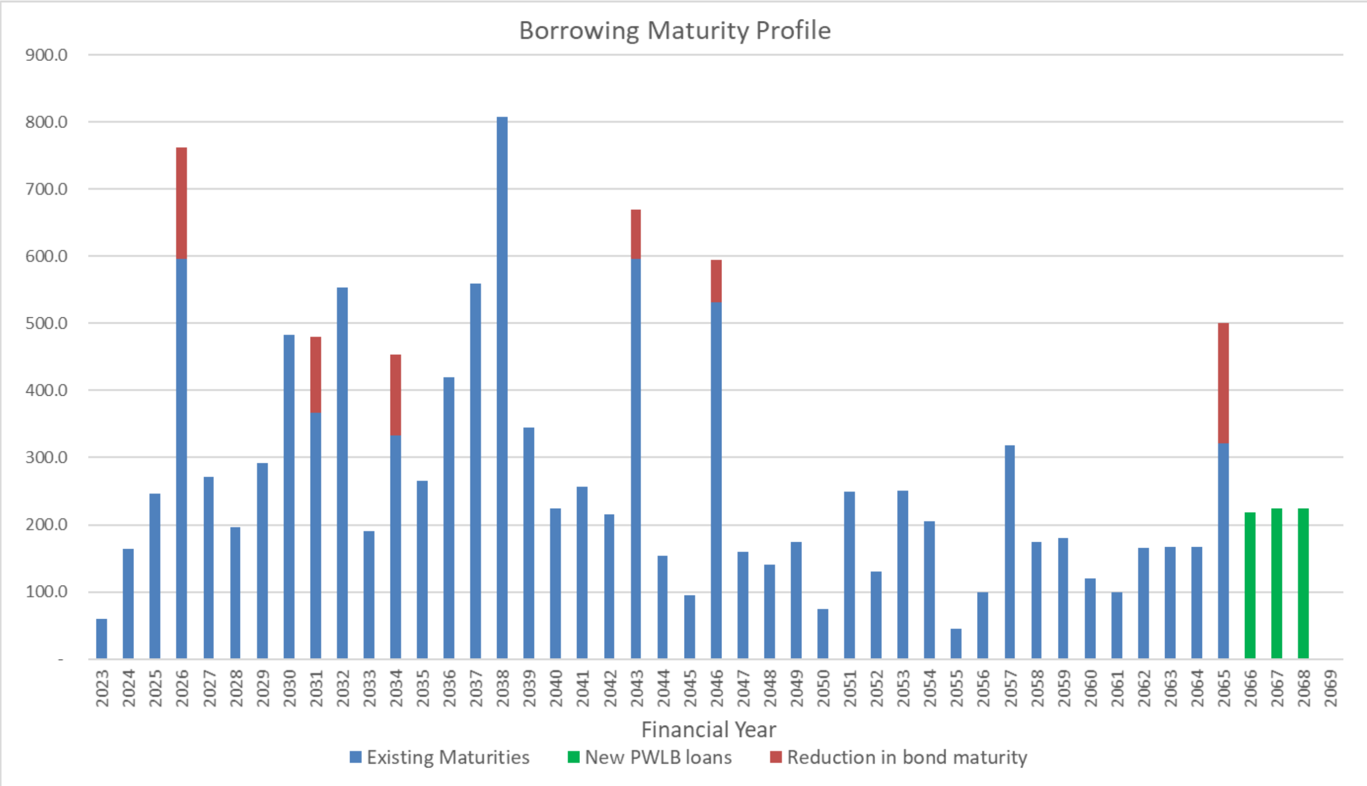
6.2 On 30 September 2022, we arranged a £53.8m variable rate loan with the Public Works Loan Board (PWLB) to refinance maturing loans with the PWLB and the European Investment Bank (EIB).

6.3 In December 2022, we repurchased £715.5m of our Medium Term Note Programme bonds as part of a tender offer. The bonds were trading below their face value, and we were able to purchase £715.5m worth of our debt for £669.2m. The repurchase was financed by three fixed rate long-term loans from the PWLB, as shown in Table 1. Financing costs have been reduced by around £25m, spread over several years, as a result of this transaction. Chart 1 shows the maturity profile of our long-term debt, and how it has changed following the bond repurchase.

Table 1: Details of the PWLB loans used to finance our bond repurchase

Tenor (years)	Interest Rate (%)	Loan amount (£m)
43	4.07	219,186,000
44	4.06	225,000,000
45	4.04	225,000,000

Chart 1: Long-term debt maturity profile including changes from bond buyback



6.4 We have £60.3m of maturing borrowing (excluding commercial paper) to refinance during the remainder of 2022/23. We will continue to monitor all of our refinancing options; however, it is likely we will utilise the PWLB to refinance these maturing loans.

6.5 In addition, there may be new PWLB borrowing in March 2023 in relation to the purchase of the London Overground Class 378 rolling stock. This borrowing was not included in the 2022/23 TMS and any increase in borrowing as a result of this transaction would be offset by a reduction in outstanding lease liabilities. However, this additional borrowing will be within the Authorised Limit for borrowing. Further detail on the purchase of the Class 378 rolling stock is included in a separate item elsewhere on the agenda for this meeting.

6.6 During the Reporting Period we have updated our CP Programme. Our previous Issue and Paying Agent (IPA) had announced that it would no longer be performing IPA services for any of its clients. We therefore appointed Bank of New York Mellon as our new IPA under our CP programme, following negotiation with potential IPAs. At the same time, we updated the programme to bring our documentation in line with some changes in market standards.

7 Credit ratings

7.1 Our credit ratings, as of 17 February 2023, are shown in the table below.

Table 2: TfL's credit ratings as of 17 February 2023

	Standard & Poor's	**Moody's**	**Fitch**
Long-term rating	A+	Baa1	AA-
Outlook	Stable	Stable	Negative
Short-term rating	A-1	P-2	F1+

7.2 We continued to engage with all three credit rating agencies on a regular basis during the Reporting Period, including discussing our latest Business Plan with the agencies.

7.3 On the 25 October 2022, Moody's affirmed our long-term credit rating as Baa1 and our short-term credit rating as P-2. The outlook was maintained at stable. On 21 December 2022, Moody's published a credit opinion detailing their views on several factors, including the new multi-year funding agreement with government, TfL's "relatively inflexible cost and revenue base", as well as TfL's "strategic importance as the main public transport provider in London and its strong management and governance".

7.4 On 26 January 2023, Fitch upgraded our long-term credit rating from A+ to AA-. This reflects our improving financial profile and Fitch's assessment of the link between TfL and the Government. Fitch have assigned a negative outlook, which reflects the negative outlook they have assigned to the Government's credit rating. No changes have been made to our short-term rating from Fitch.

7.5 There has been no rating action from Standard & Poor's during the Reporting Period.

8 Banking

8.1 We continue to work with our banking provider and the Business Support Function (BSF) to automate the daily 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. The BSF are now sending low value same day payments to the bank. Full automation of this process is expected to be implemented in March 2023.

8.2 As part of our collaboration with the GLA for Payroll Services we have opened two new bank accounts for the GLA and Old Oak and Park Royal Development Corporation (OPDC) and linked all associated liquidity services to the accounts and banking platform in order facilitate employee payments. The first employee payments where successfully paid on 28 November 2022.

9 TfL Treasury Management Policies and Strategy

9.1 The Committee is asked to approve the proposed TfL TMP, and Derivatives Policy. These policies support our commitment to financial prudence through risk management. The Committee is also asked to approve the proposed TfL TMS for 2023/24.

TfL Treasury Management Strategy

9.2 The TfL TMS 2023/24 includes TfL's proposed strategies for investment, borrowing, liquidity and risk management for the financial year 2023/24, as well as proposed counterparty exposure limits. It sets out TfL's borrowing requirement for 2023/24 and can be found in Appendix 1, with changes shown tracked against the version approved by the Committee in March 2022.

9.3 As part of the ongoing collaboration with the GLA, we will invest in the London Treasury Liquidity Fund LP and have added a £10m initial investment counterparty limit. This fund does not have its own credit rating and therefore the fund was not covered within existing counterparty investment limits.

9.4 All references to 'investments' in the TMS 2023/24 refer to investments held for treasury management purposes only and do not cover non-treasury related investments.

9.5 In relation to the Risk Management Strategy, the proposals to the Committee for derivative investments set out in Recommendation 2.1(g) have been approved by the statutory and managing Chief Finance Officers, as required under the Derivatives Policy.

9.6 We have removed reference to the use of third party ESG data as part of the process for updating and maintaining the Approved Investment Counterparty List. This is because we will instead adhere to the proposed GLA Responsible Investment Policy to inform investment decisions, as discussed in 9.13.

2023/24 Borrowing requirement and sources

9.7 TfL's borrowing requirement for 2023/24 is expected to be up to £288.9m, excluding rolling commercial paper, as set out in the TMS. This amount consists of £128.9m maturing borrowing that TfL intends to refinance and up to £160m of incremental borrowing. We retain several options for refinancing during the year, including public and private capital markets transactions, issuance under our commercial paper programme, and the PWLB.

Derivative Exposure Limits Update

9.8 Following a review of our counterparty limits, we are proposing to increase our derivative counterparty limits by 50 per cent to ensure they remain appropriate given recent material market volatility. This change is shown in Table 3 below.

9.9 In March 2022, the Committee approved a reduction in derivative counterparty limits to align with our counterparty investment limits, however this year our limit utilisation has increased despite a stable level of hedging activity. Our derivative counterparty exposures are calculated by adding the current mark to market of each derivative to the potential future exposure (PFE). The increase in limit utilisation has been driven by increases in our mark to market positions, as well as recent market volatility increasing the PFE. The proposed increase to limits will ensure that there is adequate capacity to hedge upcoming risks and deliver value for TfL, whilst allowing continued diversification away from counterparty specific risks.

9.10 Our one-way credit support annexes remain in place, giving us the ability to call collateral from counterparties if the aggregate mark to market exposure exceeds the agreed threshold.

Table 3: Revised derivative counterparty exposure limits

Moody's		Standard & Poor's		Fitch		2022/23 derivative counterparty limit (£m)	Proposed 2023/24 derivative counterparty limit (£m)
ST	**LT**	**ST**	**LT**	**ST**	**LT**		
P-1	Aaa	A-1+	AAA	F1+	AAA	120	180
	Aa1		AA+		AA+	115	172.5
	Aa2		AA		AA	110	165
	Aa3		AA-		AA-	105	157.5
	A1				A+	100	150
		A-1	A+	F1	A+	90	135
	A2		A		A	80	120
	A3				A-	70	105
P-2	A3	A-2	A-	F2	A-	60	90
	Baa1		BBB+		BBB+	0	0
	Baa2				BBB	0	0

TfL Treasury Management Policies

9.11 The background section of the TfL TMP document has been updated to clarify that the Policies only cover treasury related investments and provide further detail on some of the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) guidance. This information was in previous TMP annual approvals included in a public paper, but since it is relevant to the Policies and does not change on a regular basis, we consider it more appropriate to provide this context in the Policies themselves.

9.12 We consider that paragraph 4.4 of the TfL TMP authorises the managing Chief Finance Officer to approve the pre-payment, refinancing, re-purchase or redeeming of existing debt instruments, including loans, debt securities and leases. The document has been updated to make this clearer.

9.13 In October, we updated the Committee on potential plans to use a third party Environmental, Social and Governance (ESG) data provider to inform investment decisions. Since then, we have been collaborating with the GLA on the development of their GLA Responsible Investment Policy and will instead follow this policy to inform investment decisions once the final version has been approved in due course. The revised GLA Responsible Investment Policy covers

ESG investment considerations as well as an approach in respect of sanctioned countries and fossil fuel companies. We have updated the TfL TMP to confirm that intend to comply with the GLA Responsible Investment Policy.

9.14 The proposed TfL TMP document is included as Appendix 2, with changes shown tracked against the version approved by the Committee in March 2022.

TfL Group Policy Relating to the Use of Derivative Investments

9.15 The Derivatives Policy must be reviewed annually. This is because prior to section 49 (power to plan for risk mitigation) of the Transport for London Act 2008 being enacted, TfL agreed with the House of Commons Committee that were considering the original TfL promoted Bill, that an annual policy on the use and governance of derivative investments entered into under section 49 would be put in place and approved annually.

9.16 The Derivatives Policy has been reviewed and there are no changes to the proposed policy which can be found in Appendix 3;

Draft TfL Pension Fund Policy

9.17 The Pension Schemes Act 2021 introduces new Pensions Regulator (Regulator) powers and civil and criminal offences regarding the operation of defined benefit occupational pension schemes, such as the TfL Pension Fund (the Scheme). In March 2022, the Committee approved a proposed TfL Pension Fund Policy in draft form and authorised the managing Chief Finance Officer to approve any changes they considered necessary once related final regulations had been published. The draft policy relates to proposed new notifiable events that had been anticipated to come into effect on 6 April 2022; however, the relevant regulations relating to such notifiable events have since been delayed for an unknown amount of time. This is because the responses to a related consultation are still being analysed by the Department for Work and Pensions.

9.18 No changes have been made to the proposed policy since it was presented to the Committee in March 2022, and it remains in draft form pending the final regulations. In line with the authorisation given by the Committee in March 2022, the managing Chief Finance Officer will approve any non-material changes they consider necessary to the draft TfL Pension Fund Policy once the final regulations have been published in due course, and then issue a final form. If any material changes are necessary once the regulations are published, further approval from the Committee will be sought.

10 TTL Properties Treasury Management Policies and Strategy

TTL Properties Limited Treasury Management Strategy

10.1 In June 2022, a final form of the TTLP TMS was approved by the Chair of the Committee, following consultation with the Committee. The TTLP TMS comprises of TTLP's Borrowing Strategy; Investment Strategy; Liquidity Strategy and Banking and Cash Management. The TTLP TMS has now been updated to reflect how TTLP has evolved further since it was separated in April 2022. In particular we can now provide fully developed strategies around cash forecasting, the investing of cash balances and associated limits as well as an indication of how much we expect to borrow. As the strategy has been updated substantially, it has been provided without any tracked changes in Appendix 4.

TTL Properties Limited Treasury Management Policies

10.2 In June 2022, a final form of the TTLP TMP was approved by the Chair of the Committee, following consultation with the Committee. The proposed TTLP TMP have now been updated to reflect how TTLP has evolved further since it became financially independent in April 2022. In particular, the Borrowing Policy has been updated to ensure that the financial covenants of TTLP's external Revolving Credit Facility are met, and the Liquidity Policy has been updated. As the TTLP TMP has been updated substantially, it has been provided without any tracked changes in Appendix 5.

List of appendices to this report:

Appendix 1: TfL Treasury Management Strategy

Appendix 2: TfL Treasury Management Policies

Appendix 3: TfL Group Policy Relating to the Use of Derivative Investments

Appendix 4: TTL Properties Limited Treasury Management Strategy

Appendix 5: TTL Properties Limited Treasury Management Policies

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

List of background papers:
None

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