

Date: 28 June 2023

**Item: Enterprise Risk Update – Inability to React to External
Market Forces (TTLP-L0-6)**

This paper will be considered in public

1 Summary

- 1.1 This paper provides an overview of the TTL Properties (TTLP) Level 0 Enterprise Risk “Inability to react to external market forces” (TTLP-L0-6).
- 1.2 The risk is defined as “where market forces, in the form of increased inflation, higher interest rates, supply chain availability, weaker market confidence and demand, may affect the ability of TTLP’s business to deliver value for its customers and TfL.”
- 1.3 This could result in an increased cost of or reduced availability of financing, reductions in income from tenants or development schemes, missed housing targets, impacts on project viability, and a deterioration in the reputation of TTLP.
- 1.4 While several controls for this risk in place, further controls are under development. As such, the current management status of this risk is assessed as “requires improvement”.
- 1.5 Actions have been identified to improve control of this risk, with action owners and outline timescales assigned. These actions include the introduction of new TTLP policies and procedures and revisions to some existing ones; development of strategies; improvements to financial planning and appraisal processes; and further development of the approach to asset management.
- 1.6 Most of these actions have already commenced, with most due to be completed within the next 12 months. Progress against these actions will be reviewed when the management and control of this risk is reassessed in 12 months’ time.
- 1.7 A paper is included on Part 2 of the agenda which contains exempt supplemental information that is exempt from publication by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972 in that it contains information relating to the business affairs of Transport for London (TfL). 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 exempt supplementary information on Part 2 of the agenda.**

3 Context

- 3.1 This Enterprise Risk relates to the potential impacts on TTLP arising from external market forces. These can be in the form of increased inflation, higher interest rates, supply chain availability, market confidence and demand. These may affect the ability of TTLP's business to meet its objectives and deliver value for its customers and TfL. The impacts from this risk arising include an increased cost of and/or reduced availability of financing, reductions in income from tenants and development schemes, missed housing targets, impacts to project viability and a deterioration in the reputation of TTLP.
- 3.2 The key causes of this risk were agreed by the TTLP Executive Team and colleagues in TfL's Risk and Assurance Directorate. These are outlined as:
- (a) **increased inflation** – rising costs in the supply chain could limit the ability of TTLP to meet its financial objectives;
 - (b) **rising interest rates** – rising interest rates may increase the cost of finance and TTLP's ability to afford new finance;
 - (c) **market sector confidence** – reduced market sector confidence may decrease TTLP's ability to secure development partners or achieve planned disposals;
 - (d) **regulatory changes** – regulatory changes from central or local government could lower market sector confidence, increase investment costs and reduce project viability;
 - (e) **societal / economic impacts** – societal or economic factors may impact tenant retention, reducing project viability and revenue generation;
 - (f) **supply chain** – delivery partner exposure or lack of competition could limit supply chain availability or competitiveness; and
 - (g) **Internal capability / competence** – TTLP internal capabilities and competences may impact our ability to react to external market forces in a timely and effective manner.

4 Controls and Mitigation

- 4.1 The paragraphs below describe each control and action TTLP has identified to mitigate and control the risk expressed:
- (a) **Business planning and corporate strategy:** TTLP has an annual business planning process, integrated into TfL's wider business planning cycle, including long term capital planning and project prioritisation, reviewed against corporate discipline risk metrics;
 - (b) **Finance strategy, including risk management, stress testing and liquidity reporting:** TTLP has developed a robust approach to long-term stress and liquidity testing and risk management when approaching the market for borrowing. This is now performed in cycle with the annual business plan process – further work is now required to ensure these tests

will be embedded in business-as-usual process and reporting through the Shareholder Oversight Group, which has been set up to provide TfL with additional assurance over the ongoing performance of TTLP;

- (c) **Controls and actions related to customer and supply chain management:** TTLP has instigated a number of policies, processes and controls that enable careful vetting of tenants and suppliers. As part of this process, a tenant's ability to withstand financial pressure is appraised. There are also extant policies for the management of tenancies during times of market shock, where lessons learnt during the pandemic have informed an effective approach to customer support. Strong procurement processes ensure TTLP works with partners who can demonstrate financial stability, though more work needs to be done to ensure this is monitored continually throughout the length of a contract;
 - (d) **Operating model and governance:** TTLP's Investment Group has a formal approach to project approval and decision making, which ensures decisions are informed by a good understanding of any risks involved. There is, however, more to be done to ensure TTLP is appraising its projects with appropriate consideration of each market sector risk whilst ensuring appropriate returns at a portfolio level. In TTLP's development delivery model, the joint venture ensures risk sharing with commercial partners and also enables an extra layer of governance and risk oversight throughout the course of a project.
- 4.2 Seventeen controls in total have been identified to manage this risk, consisting of 14 preventative controls and three corrective controls. Of the 17 controls, 14 are key controls for managing this risk. A relatively high number of key controls have been identified. These reflect that TTLP is developing as an organisation and that there is ongoing work to optimally control this risk. Progress will be kept under review over the coming year.
- 4.3 Six of the controls have been assessed as currently effective in both design and operations:
- (a) **business planning and corporate discipline metrics** – TTLP produces annual business plans and corporate strategies detailing financial discipline metrics with forecast long-term financial performance against corporate risk metrics;
 - (b) **TTLP Investment Group oversight** – projects are assessed and approved at the TTLP Investment Group and monitored throughout the project at key decision making points. Lessons learnt are identified and recorded;
 - (c) **flexible approach to delivery structures** – maintaining flexible delivery structures allows TTLP to access and utilise market expertise in managing market shocks and achieving forecasted financial returns, and partnering in joint venture structures facilitates risk sharing, limiting exposure to TTLP from market shocks;
 - (d) **key performance indicator (KPI) reporting** – regular reporting on KPIs such as arrears and voids provides continual oversight of asset performance and early warning signals of any market shock impacts;

- (e) **tenant processes and procedures** – TTLP tenant controls include credit monitoring, vetting, due diligence, and leases that reflect inflation exposure and affordability policy; and
- (f) **tenants' affordability policy** – TTLP policy is to reassess each tenant's ability to afford rents, including in times of economic disturbance.

4.4 Work is required to ensure the remaining eleven controls are effective in both design and operation:

- (a) **annualised stress testing of risks and their impacts on the TTLP business plan** – undertake annual stress testing of the TTLP business plan, including correlation risk assessment of impacts on different sectors to ascertain in any given downside event how each sector's income is potentially impacted;
- (b) **opportunity appraisal process** – a site triage process for identification and review of individual opportunities and assets, where multiple uses are being considered to ascertain and recommend the most appropriate use relative to impact of market forces on the various use opportunities;
- (c) **investment appraisals policy and procedure** – risk-informed, robust investment appraisal policies and procedures will be put in place to include expected value analysis, alignment to corporate objectives and impacts on the affordability of TTLP's business plan;
- (d) **formalised liquidity management practices and procedures** – further embed liquidity management practices, aligned to the TTLP Treasury Management Policy, setting out liquidity considerations when making long-term investment decisions;
- (e) **funding and financing strategy** – aligned to the business planning process, a financing plan to detail future funding and financings needs, including the consideration of options for raising additional finance;
- (f) **risk management policy and procedure** – a risk management policy and strategy is to be developed, including any additional training requirements;
- (g) **critical supplier and disposal partner monitoring** – a process of ongoing supplier monitoring is to be developed using available financial data and utilising monitoring agencies;
- (h) **market scanning** – utilising market data to scan and inform movements and risks in the wider macroeconomic environment, including inflation, interest rates, financing and wider real estate market performance;
- (i) **land agreements for non-JV projects** – when disposing of land or developing land outside of a joint venture partnership, TTLP ensures contracts (agreements) are in place to govern land value receipts – though these agreements are only partially effective because they are usually conditional on other factors, such as planning permission being obtained (other contractual options may be considered but it is likely this control will remain only partially effective);

- (j) **contingency budgets** – contingency budgets will be allocated to allow effective management of situations arising from economic or social disturbances; and
- (k) **shareholder oversight** – a new, regular oversight group will allow TfL, as shareholder, to be appraised of performance, risks faced and strategies to mitigate allowing a second line of assurance.

5 Action Plan

5.1 The following high priority actions have been identified to further mitigate the risk and ensure the identified key controls, as outlined in section 4 above, are effective in both design and operation. These will be completed in the next six months:

- (a) develop a process for the ongoing monitoring of supplier financial health rather than undertaking this only at the outset of projects as part of the procurement process;
- (b) develop a process for the ongoing monitoring of market and macroeconomic risks;
- (c) develop the risk management policy such that there is a specific process setting out how TTLP will monitor actions and controls;
- (d) enhance the existing appraisal processes, with sector-specific hurdle rates that reflect the relevant risks of each sector;
- (e) develop and embed liquidity monitoring and management practices to ensure that any long-term investment decisions consider TTLP's long-term liquidity position;
- (f) produce a residential strategy that describes the approach we take to residential development (both Build to Rent and Build for Sale) including the controls and actions we will take to mitigate the effects of a market downturn; and
- (g) with TfL, set up the Shareholder Oversight Group to provide TfL with additional assurance over the ongoing performance of TTLP.

5.2 Actions to be undertaken within the next 12 months are:

- (a) develop and maintain a liquid asset register;
- (b) develop the processes and policies by which TTLP will manage projects, for example its Programme Management Office organisation and project stage gates;
- (c) develop and implement a process and system to manage the supply chain and development partners' interfaces and risks;
- (d) develop the skills, capabilities and processes for asset disposal;

- (e) develop a long-term TTLP Financing Strategy;
- (f) conduct a review of the viability of TTLP's asset plans; and
- (g) put processes in place to enable TTLP to invest prudently in times of market downturn, taking advantage of lower prices and demand to increase asset value.

5.3 Actions which will take longer than 12 months to complete are:

- (a) develop processes and procedures that aid staff retention and corporate knowledge, and ensure the right skills and capability are in place to deliver all the actions and controls listed above; and
- (b) develop processes and systems to increase understanding of data that will foster a greater understanding of the market.

6 Conclusion

6.1 TTLP already has controls that help mitigate the impact of a market crash or shock event. Set out above are additional actions that TTLP has identified which will improve those controls, and the actions to deliver these are now embedded within TTLP's plans.

6.2 It is of course not possible to fully mitigate or control the market in the event of severe shocks, however, we are confident that with the controls and activities in place, we will be better able to manage the impact of such events.

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

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