Finance Committee

Date: **13 March 2024**

Item: **TfL Prudential Indicators 2024/25 to 2026/27**

This paper will be considered in public

As provided for under section 100B(4)(b) of the Local Government Act 1972, the Chair is of the opinion that this item should be considered as a matter of urgency. The reason for urgency is that the paper needed to reflect any impact on TfL of the Government's Budget 2024 that was announced on 6 March 2024 and not all information was available at the time the main agenda was published.

1 Summary

1.1 Investing in our transport infrastructure involves high upfront costs. Borrowing can play a role in the financing of capital projects, as it enables us to make vital improvements sooner by spreading the costs over time, including rolling stock and signalling replacements, new homes and growth, as well as air quality and decarbonisation.

1.2 Borrowing can complement direct Government capital funding. The Government has recognised that TfL is not expected to solely finance major capital enhancements and major renewals from its own operating incomes, as is consistent with other transport authorities. TfL has confirmed capital funding from Government until 31 March 2025. The 2024 TfL Business Plan reflected this and, in line with that settlement, made prudent assumptions in respect of levels of future Government capital funding.

1.3 This paper sets out the proposed TfL borrowing limits and other Prudential Indicators under the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code (the Code). These are consistent with the proposed Treasury Management Strategy for 2024/25, which is also being presented to this meeting, and the principles underpinning the proposed long-term TfL Capital Strategy. The proposed Prudential Indicators for 2024/25 and the following two years are attached to this paper as Appendix 1. In line with guidance from CIPFA, Treasury Management Indicators are shown separately in Appendix 2.

1.4 A paper is included on Part 2 of the agenda, which contains exempt supplemental information. 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 exempt supplementary information on Part 2 of the agenda and:**

(a) approve the TfL Prudential Indicators as set out in Appendix 1 for 2024/25 and the following two years;

(b) approve the Treasury Management Indicators as set out in Appendix 2 for 2024/25 and the following two years; and

(c) approve the annual TfL Policy Statement on Minimum Revenue Provision as set out in section 6 of the paper.

3 Background on the Prudential Code and Capital Financing Regulations

3.1 The Code plays a key role in capital finance in local authorities. It was developed as a professional code of practice to support local authorities in their decision-making processes for capital expenditure and its financing.

3.2 Local authorities are required by regulation to have regard to the Code when carrying out their duties under Part 1 of the Local Government Act 2003.

3.3 The framework of Prudential Indicators established by the Code aims to ensure that an authority's capital investment plans are affordable, prudent and sustainable. As part of the strategic planning process, authorities are required, on a rolling basis, to calculate a range of indicators for the forthcoming budget year and two subsequent years. Authorities are also required to monitor performance against indicators within the year as well as preparing indicators based on the audited Statement of Accounts at each year end. Indicators relate to capital expenditure, external debt and treasury management.

3.4 As required by the Code, TfL prepares Prudential Indicators at both the Corporation and TfL Group level.

3.5 Places for London Limited, TfL's wholly owned property subsidiary (Places) has a revolving credit facility (RCF). The facility is currently undrawn and is non-recourse to TfL. However, Places still falls within the scope of the borrowing limits set out in this paper and forms part of the overall TfL Group limits.

3.6 Under capital finance regulations, local authorities are also required each year to set aside some of their revenues as provision for debt. TfL has a statutory duty to make an annual statement as to its policy for the calculation of this provision. This paper, therefore, sets out and asks the Committee, under delegated approval from the Board, to approve the TfL Policy Statement on Minimum Revenue Provision, as set out in section 6.

3.7 The Capital Expenditure and External Debt Indicators relevant to TfL under the Code are the:

(a) Authorised Limit;

(b) Operational Boundary;

(c) Capital Financing Requirement;

(d) Capital Expenditure;

(e) Ratio of Financing costs to Net Revenue Stream; and

(f) Ratio of Net Income from Commercial and Service Investments to Net Revenue Stream.

Definitions for each indicator are set out in Appendix 3.

3.8 The debt limits – the Authorised Limit and Operational Boundary – proposed have been assessed against affordability metrics. These affordability metrics are informed in part by the quantitative assessments employed by credit rating agencies when assessing TfL. These have been derived on a first principles basis with debt service cover ratio as the overriding metric.

3.9 The other metrics, as defined in Appendix 3, include:

(a) debt service coverage ratio

(b) net debt to operating surplus before financing;

(c) net debt to operating surplus before financing and renewals; and

(d) interest cover ratio.

3.10 These metrics are not formal Prudential Indicators under the Code but, given TfL's size and complexity, they provide useful insight into the affordability, sustainability and prudence of TfL's borrowing. Any incremental borrowing is also subject to a further assessment of affordability at the time of borrowing.

4 Changes to Prudential Indicators for 2024/25

4.1 The overall proposed Operational Boundary for gross debt for 2024/25 in the Corporation of £15,222.0m and the Group of £17,106.1m represents an increase of £1,347.8m and £1,286.1m respectively when compared with the previously approved indicators for 2024/25 as result of:

(a) long-term liabilities in both the Corporation and the Group have decreased by £0.7m and £18.9m respectively. This is to reflect the revised settlement profile for long term capital provisions and movements in lease liabilities;

(b) the addition of the Silvertown Tunnel Private Finance Initiative (PFI) which comes on balance sheet as a liability for both the Corporation and the Group, when the tunnel is permitted to be brought into use. The tunnel is expected to be brought into use during 2025 and for prudent financial planning purposes this has been incorporated into the prudential indicators for 2024/25. Upon initial recognition, the liability is £1,373.1m and will be amortised over 25 years to 2050;

(c) a cumulative decrease in planned new borrowing by 2024/25 of £24.6m impacting both the Corporation and the Group. New borrowing is required to part finance TfL's investment in rolling stock and signalling programmes as a result of the Government's capital funding settlement for 2024/25 being below the level assumed in the 2023 TfL Business Plan. TfL's Budget assumes this additional borrowing to be approximately £47m and £470m for financial years 2023/24 and 2024/25 respectively; and

(d) amended draw down profile for the Places RCF facility in the Group being a cumulative reduction of £43.5m by 2024/25, based on the latest Places development plans.

4.2 The overall proposed Authorised Limit for gross debt for 2024/25 in the Corporation of £16,422.0m and the Group of £18,306.1m represents an increase of £1,097.8m and £786.1m respectively, when compared to previously approved indicators for 2024/25. The increase is due to changes within the Operational Boundary as listed in paragraph 4.1, partially offset by removal of the specific allowance for potential identification and classification of leases in the Corporation of £250m and the Group of £500m.

4.3 Removal of this item is considered prudent, as it reflects that the risk of existing contracts containing material embedded leases is now lower than it was in the years immediately following the implementation of accounting standard IFRS 16 Leases.

4.4 Guided by the Code, the Operational Boundary represents TfL's best estimate of most likely, i.e. prudent, but not worst case scenario, level of external debt. We do this by reflecting external debt levels that align to TfL's most recent, published, Budget and Business Plan.

4.5 Additionally, the Code requires that the Authorised Limit should provide headroom over and above the Operational Boundary that would sufficiently address liquidity requirements, arising from unforeseen or unusual circumstances i.e. not considered within the 'most likely' plans for levels of external debt.

4.6 The proposed Authorised Limit provides headroom of £1,200m, for the Group and the Corporation. This is a level deemed sufficient, taking account of the following items:

(a) allowance to avail of favourable market conditions in relation to short-term refinancing activities and allow for flexibility when refinancing; and

(b) contingency allowance for TfL to increase debt should the need arise and it is assessed as affordable at the time of borrowing.

Facilities and options available to support TfL, should headroom be required to absorb financial shocks and contingent events, include:

(i) the Greater London Authority financing facility of £350m;

(ii) an existing overdraft facility of £100m and a money market facility of £100m;

(iii) the Places RCF of £200m; and

(iv) new commercial or Public Works Loan Board borrowings.

4.7 The changes outlined to the Operational Boundary and Authorised Limit for financial year 2024/25 are also applicable to 2025/26 and outlined within the table at section 4.9. The planned borrowing in 2025/26 has reduced due to the rephasing of cash payments for the Piccadilly line rolling stock contract, as part of the mitigations for the shortfall in Government capital funding for 2024/25 as compared to the assumed level in the 2023 TfL Business Plan.

4.8 Additional Prudential Indicators listed within Appendix 1, for 2024/25 to 2025/26, have been updated to reflect the 2024 TfL Business Plan. Indicators are being set for the first time for 2026/27.

4.9 **Reconciliation of Changes in External Debt Limits for the Corporation for 2023/24 to 2025/26**

Corporation, £m	Reference	2023/24	2024/25	2025/26	2026/27
Previously approved Operational Boundary for Gross External Debt		**13,559.0**	**13,874.2**	**14,328.1**	**n/a**
Re-phasing of provisions and liabilities	4.1(a), 4.7	-	(0.7)	(3.7)	n/a
Addition of PFI	4.1(b), 4.7	-	1,373.1	1,363.2	n/a
Net new borrowings	4.1(c), 4.7	-	(24.6)	(537.6)	n/a
Increase/(decrease)		-	1,347.8	821.9	n/a
Proposed Operational Boundary for Gross External Debt		**13,559.0**	**15,222.0**	**15,150.0**	**15,587.5**
Headroom	4.6	-	1,200.0	1,200.0	1,200.0
Short-term refinancing of borrowings	4.6	500.0	-	-	-
Additional contingent borrowing	4.6	500.0	-	-	-
Leases	4.2	250.0	-	-	-
Proposed Authorised Limit		**14,809.0**	**16,422.0**	**16,350.0**	**16,787.8**

4.10 **Reconciliation of Changes in External Debt Limits for the Group for 2023/24 to 2025/26**

Group, £m	Reference	2023/24	2024/25	2025/26	2026/27
Previously approved Operational Boundary for Gross External Debt		**15,504.9**	**15,820.0**	**16,196.9**	**n/a**
Re-phasing of provisions and liabilities	4.1(a), 4.3	-	(18.9)	(76.4)	n/a
Addition of PFI	4.1(b), 4.3	-	1,373.1	1,363.2	n/a

Net new borrowings	4.1(c), 4.3	-	(24.6)	(537.6)	n/a
Changes to Places RCF drawdown	4.1(d), 4.3	-	(43.5)	28.6	n/a
Increase/(decrease)		-	1,286.1	777.8	n/a
Proposed Operational Boundary for Gross External Debt		**15,504.9**	**17,106.1**	**16,974.7**	**17,571.4**
Headroom	4.6	-	1,200.0	1,200.0	1,200.0
Short-term refinancing of borrowings	4.6	500.0	-	-	-
Additional contingent borrowing	4.6	500.0	-	-	-
Leases	4.2	500.0	-	-	-
Proposed Authorised Limit		**17,004.9**	**18,306.1**	**18,174.7**	**18,771.4**

5 Treasury Management Indicators

5.1 In addition to the Prudential Indicators, there are a number of treasury indicators that are outlined in CIPFA's Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (the TM Code). Local authorities are required to have regard to these Treasury Management Indicators.

5.2 The TM Code recommends that local authorities should adopt the following Treasury Management Indicators:

(a) upper and lower limits on the maturity structure of borrowing, including variable as well as fixed rate debt;

(b) the period for upper limits to the total of principal sums invested longer than one year; and

(c) a debt liability benchmark indicator to support risk management of the capital financing requirement.

5.3 While there is not a specific recommended indicator in respect of interest rate exposures, the TM Code suggests that authorities should explain the strategy for managing their interest rate risk as part of the investment and/or capital strategies. We cover our targets for fixed and floating rate debt, as well as general approach to interest rate risk, in our Treasury Management Strategy.

5.4 The proposed Treasury Management Indicators are detailed in Appendix 2.

5.5 The liability benchmark is a comparison of gross external debt with the gross loans requirement. If gross external debt exceeds the gross loan requirement, this potentially indicates that excess cash is required to be invested. Being under the benchmark indicates a potential borrowing requirement.

6 TfL Policy Statement on Minimum Revenue Provision

6.1 Local authorities are required each year to set aside some of their revenues as provision for debt. TfL has a statutory duty to determine for the current financial year an amount of minimum revenue provision (MRP) which it considers to be 'prudent' in relation to debt service obligations, and having given regard to the Statutory Guidance on Minimum Revenue Provision. Several clarifications have been added to the statement below to further explain certain elements of the provision. There have been no changes to how MRP is calculated.

6.2 While statutory guidance suggests four potential methods for calculating MRP, it also allows for other methods and approaches to be used. Since 2016/17, TfL has used one of these approaches while also considering the principles inherent in the statutory guidance on MRP, to make an annual provision in the Corporation, that aims to build up a reserve on the Balance Sheet over the average useful economic life (UEL) of the assets funded by borrowings in the Corporation, such that, at the end of that UEL, that reserve may be employed to either repay borrowings or to finance replacement capex for those assets that have reached the end of their lives. The provision is also measured against the weighted average lifetime of TfL's debt.

6.3 An MRP is effectively already made for borrowings passed down to the subsidiaries for capital purposes through TfL's existing processes for funding those entities. Therefore, no additional MRP is provided for these borrowings passed down to subsidiaries.

6.4 Average UEL is used to measure the service potential of the assets that the borrowings have been used to fund. This is based on property, plant and equipment in the Corporation, excluding assets under construction.

6.5 For right of use assets the MRP charge is equal to the depreciation charged against the associated assets. Depreciation has been used rather than the movement in lease liability as this is more reflective of the consumption of the service potential given movements in lease liability are impacted by payment profiles e.g. bullet rental arrangements.

6.6 For PFI assets the useful economic life of the asset is used to calculate the MRP charge. In most cases the UEL of the asset will exceed the duration of the PFI arrangement, which is permitted by the guidance as the UELs are determined by appropriately qualified individuals.

6.7 Changes to the MRP statutory guidance are currently being proposed by the Department for Levelling Up, Housing & Communities to better enforce the duty of local authorities to make a prudent MRP. The matters being consulted on do not have an impact on TfL's current methodology which continues to be prudent and in line with the requirements of the Code.

6.8 Given current levels of debt (including finance leases) retained within the Corporation, the MRP is anticipated to be approximately £54m for 2024/25 and increasing to approximately £64m from 2025/26 as a result of the Silvertown Tunnel PFI contract. This will result in an annual transfer of this amount from usable reserves (i.e. the General Fund) to unusable reserves (namely the Capital Adjustment Account).

List of appendices to this report:

Appendix 1: TfL Prudential Indicators for 2024/25 to 2026/27
Appendix 2: Treasury Management Indicators
Appendix 3: Definitions for Prudential Indicators, Treasury Management Indicators and Affordability metrics
A paper containing exempt supplementary information is included on Part 2 of the agenda.

List of Background Papers:

None

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Appendix 1

PRUDENTIAL INDICATORS 2024/25 to 2026/27

	Approved Indicator 2023 - 24 £millions	Proposed Indicator 2024 - 25 £millions	Proposed Indicator 2025 - 26 £millions	Proposed Indicator 2026 - 27 £millions
Operational Boundary for External Debt*				
TfL Corporation				
Borrowing	13,108.5	13,454.0	13,436.0	13,932.0
PFI and long term liabilities	450.5	1,768.0	1,714.0	1,655.5
Operational Boundary for External Debt, TfL Corporation	**13,559.0**	**15,222.0**	**15,150.0**	**15,587.5**
TfL Group				
Borrowing	13,113.5	13,457.4	13,511.5	14,214.2
PFI and long term liabilities	2,391.4	3,648.7	3,463.2	3,357.2
Operational Boundary for External Debt, TfL Group	**15,504.9**	**17,106.1**	**16,974.7**	**17,571.4**
Authorised Limit for External Debt**				
TfL Corporation				
Borrowing	14,108.5	14,654.0	14,636.0	15,132.0
PFI and long term liabilities	700.5	1,768.0	1,714.0	1,655.5
Authorised Limit in for External Debt, TfL Corporation	**14,809.0**	**16,422.0**	**16,350.0**	**16,787.5**
TfL Group				
Borrowing	14,113.5	14,657.4	14,711.5	15,414.2
PFI and long term liabilities	2,891.4	3,648.7	3,463.2	3,357.2
Authorised Limit for External Debt, TfL Group	**17,004.9**	**18,306.1**	**18,174.7**	**18,771.4**
Capital Expenditure (Annual)				
TfL Corporation	2,060.6	2,910.9	1,528.7	1,862.4
TfL Group	2,909.8	3,709.9	2,310.0	1,925.9
Capital Financing Requirement (Cumulative)***				
TfL Corporation	14,325.3	14,837.8	14,772.3	15,217.4
Total TfL Group	17,277.1	17,260.6	17,477.8	17,600.4

* The Operational Boundary is a calculation based upon the cash flows in the TfL Budget. If breached, it is a warning that financial plans may require review and amendment.

** The Authorised Limit is the maximum amount that TfL may borrow legally.

*** The Capital Financing Requirement is the amount of capital expenditure to be financed by means other than grant or asset sales proceeds.

Ratio of financing costs to net revenue stream	Approved Indicator 2023 - 24	Proposed Indicator 2024 - 25	Proposed Indicator 2025 - 26	Proposed Indicator 2026 - 27
TfL Corporation	15.7%	18.1%	27.0%	30.7%
TfL Group	16.9%	19.6%	15.9%	16.2%
Ratio of net income from investments to net revenue stream				
TfL Group	0.2%	0.3%	0.3%	0.4%

Gross Debt and the Capital Financing Requirement*	TfL Group £'m	TfL Corporation £'m
Operational Boundary (Gross Debt) at 31 March 2025	17,106.1	15,222.0
Adjusted Cumulative Capital Financing Requirement at 31 March 2027**	17,950.1	15,344.9

*The Code stipulates that Gross Debt at 31 March 2025 should not generally exceed the Capital Financing Requirement at 31 March 2027.

**The Code states the Cumulative Capital Financing Requirement should be based on the actual from the preceding year plus estimates of any additional capital financing requirement for the current and next two years. If in any of these years, there is a reduction in the capital financing requirement, this reduction is ignored in estimating the cumulative increase in the capital financing requirement used for comparison with gross external debt.

Appendix 2

TREASURY MANAGEMENT INDICATORS 2024/25 to 2026/27

Maturity Structure of Borrowing	**Budget 31 Mar 2024**	
	Upper	Lower
< 1year	20%	0%
1 year to < 2 years	10%	0%
2 years to <5 years	25%	0%
5 years to <10 years	40%	0%
10 years and above	80%	50%

Max Outstanding Principal invested >365 days The numbers in this table reflect the Core Contribution element of TfL's intended investment in London Treasury Limited Fund LP which does not have a fixed maturity date	**31 Mar 2025 £m**	**31 Mar 2026 £m**	**31 Mar 2027 £m**
Forward Financial Year 1	18.0	18.0	18.0
Forward Financial Year 2	18.0	18.0	18.0

Debt liability benchmark indicator	**31 Mar 2025 £m**	**31 Mar 2026 £m**	**31 Mar 2027 £m**
Loans CFR	13,747	13,738	14,376
Net loans requirement	12,117	12,108	12,746
Liability benchmark	13,490	13,485	14,109
Gross external debt	13,457	13,512	14,214
(Over)/under benchmark	**64**	**33**	**(26)**

Appendix 3

Definitions for Prudential Indicators, Treasury Management Indicators and Affordability metrics

Prudential Indicators

1. External Debt - Operational Boundary

The Operational Boundary is a sum of external borrowings and long term capital liabilities, including finance lease creditors and provisions, as shown in the Budget and Business Plan. If breached, it is a warning that financial plans may require review and amendment.

2. External Debt - Authorised Limit

The authorised limit is the maximum amount that TfL may borrow legally.

It comprises the Operational Boundary plus an element of headroom to allow for unexpected cashflow fluctuations, short-term refinancing and other contingencies.

3. Capital Expenditure

For the Group this is the total of fixed asset additions for the given period.

For the Corporation this is the Corporation's own fixed asset additions plus any loans or capital grants passed to the subsidiaries for the given period.

4. Capital Financing Requirement

The Capital Financing Requirement (CFR) is the amount of capital expenditure to be financed by means other than grant or asset sales proceeds. It is calculated from the balance sheet of the Group and Corporation by deducting deferred grant, and capital reserve balances from the total fixed asset balance.

There is a requirement in the Prudential Code to ensure that the estimate for the CFR at the end of 2026 is not exceeded by gross debt budgeted at the end of 2024. This requirement seeks to ensure that over the medium term, debt will only be for a capital purpose.

5. Ratio of financing costs to net revenue streams

Indicator expresses the interest costs, net of interest income as a percentage of TfL's Revenue Grant and fares income plus or minus transfers to reserves.

6. Ratio of net income from commercial and service investments to net revenue streams

Indicator expresses net income from commercial and service investments, other than treasury management investments, as a percentage of TfL's Revenue Grant and fare income plus or minus transfers to reserves.

Definition of Treasury Management Indicators

1. Debt Liability Benchmark Indicator

(a) Gross external debt is the authority’s loan debt at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.

(b) Net loans requirement: the authority’s gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.

(c) Liability benchmark (or gross loans requirement) equals net loans requirement plus short-term liquidity allowance.

(d) Loans CFR excludes any part of the CFR related to other long-term liabilities rather than borrowing.

Definitions for affordability metrics

1. Net debt to operating surplus before financing

This metric considers the level of our forecast net debt compared to our operating surplus before financing costs. Net debt is the level of borrowing and other financing liabilities less cash balances. The operating surplus is calculated by deducting operating costs (including renewals) from operating income.

2. Net debt to operating surplus before financing and renewals

This metric considers the level of our forecast net debt compared to our operating surplus before financing costs and renewals. Net debt is the level of borrowing and other financing liabilities less cash balances. The operating surplus is calculated by taking operating costs (excluding renewals) from operating income.

3. Debt service cover ratio

The debt service cover ratio calculates how many times our operating surplus before financing costs and capital renewals covers our debt service obligations.

4. Interest cover ratio

The interest cover ratio calculates how many times our operating surplus before financing costs and capital renewals covers the interest payments due on our borrowings.