Budget Monitoring Sub-Committee – Wednesday, 12 June 2019

Transcript of Item 8 – GLA Borrowing

Gareth Bacon AM (Chairman): OK. We are now on to item 8, the main item of business, which is on Greater London Authority (GLA) borrowing.

I would like to welcome our guests, in order: Sarah Bradley, the Group Financial Controller at Transport for London (TfL); Emanuela Cernoia-Russo, the Director of Corporate Finance and Strategy at TfL; Simon Kilonback - we have all met Simon - the Chief Finance Officer (CFO) at TfL; Luke Webster, the GLA Group Treasury and Chief Investment Officer and consistently the best-dressed man at the GLA --

Jennette Arnold OBE AM: I love the bowtie. I am going to take a picture of it.

Gareth Bacon AM (Chairman): -- which is a hands-down undisputed title; and finally, of course Martin Wheatcroft, who is a Fiscal Accountant at Pendan. Welcome to all of you and thank you very much for your time this morning.

The main item of business is to focus on GLA Group borrowing. A lot of that will be TfL and traditionally we start these things with some fairly open, setting-the-scene type of questions. The first one is to you all but probably I will go to you, Simon, for the first answer. Does borrowing remain an effective way of funding transport infrastructure?

Simon Kilonback (Chief Finance Officer, Transport for London): Yes, it does, Chairman. Transport infrastructure in particular tends to have very high upfront costs and very long useful and economic lives of the assets that are being invested in. Therefore, in order to allow that transport infrastructure to be delivered and for the farepayers and taxpayers who use that to get the benefit of it earlier, borrowing is an effective method of allowing those things to be delivered, provided there are sufficient revenues and funding to support those income streams.

The alternative would be to pay-as-you-go, which would mean, if we use the example of buying a house, spending 25 years trying to save up and things would come along probably during that time and you would never quite get there. In order to ensure that we can continue to invest in improving the infrastructure in the city, borrowing does remain an important part of that.

Gareth Bacon AM (Chairman): You gave a hint to the answer to the question I am about to ask you now in what you have just said. What would make a capital project ideal for borrowing and, equally, what would make a capital project unwise for borrowing?

Simon Kilonback (Chief Finance Officer, Transport for London): In my view, the types of investment that are suitable for borrowing are those sorts of assets that are able to help generate a revenue stream in return. For example, investing in and replacing the rolling stock and signalling for our railways as they need to be replaced allows you to run a business that drives the revenue that helps repay that borrowing going forward. In particular in infrastructure terms, at TfL we tend to focus our borrowing requirements on those assets that are capable of helping to deliver an income stream to support the repayment of the debt that was used to finance them.

Gareth Bacon AM (Chairman): An example of a project that would not be suitable then is one that does not produce an income stream?

Simon Kilonback (Chief Finance Officer, Transport for London): Yes. This is why, when we look at the discussions with the Government and with the GLA about how we fund and finance infrastructure in London, both borrowing and grant, councils, public sector net debt, the -- historically, when we have been discussing with central Government rather than with the GLA and the Treasury over grant funding and borrowing, we have talked to them about the total quantum of investment that is required and how that is then split between borrowing and grant. We have discussed the basis of the types of assets within that portfolio that generates return and services debts and also the availability of income and funding streams to service that debt.

Then, for the types of investment where typically TfL as the transport body would be unable to collect revenue -- many infrastructure assets generate social benefits but do not generate an income stream for the transport body. Those are the sorts of assets that we look to fund through the use of grant funding or other methods of taxation that more appropriately reflect the users and the benefits of those types of assets.

Gareth Bacon AM (Chairman): The former example where you get a revenue stream would be something like Crossrail, I suppose, but also the Silvertown Tunnel. The latter would be something like the Rotherhithe Bridge?

Simon Kilonback (Chief Finance Officer, Transport for London): Yes. Sorry, I was confusing myself there between Silvertown, where we are raising a toll and -- yes, assets like the [Rotherhithe] bridge or investments in road safety and walking and cycling infrastructure, where there is a clear benefit in terms of safety and in terms of air quality but do not derive an income stream that the transport body can appropriate through its fare box or through other mechanisms, would be an example where the use of grant funding would be the more appropriate way of funding it.

Gareth Bacon AM (Chairman): OK. Martin, I want to bring you in. We did some comparative analysis when putting this meeting together and we looked at various types of borrowing in different types of sectors. Transport infrastructure is funded from user charges to a much lesser degree than some of the others; for example, utilities, which is 100% funded by user charges. Transport is a very small portion of the whole lot. Why is that?

Martin Wheatcroft (Fiscal Accountant, Pendan): That is principally because we have a state-owned railway system. Network Rail is a Government entity and so most of the funding, through a policy choice, is coming through the national debt borrowing mechanism. In fact, a lot of the private funding that was raised when it was previously Railtrack has been refinanced through public debt. That is the principal reason.

Another reason is that most of the suburban and subway-type systems are state-owned or local government-controlled in this country. Again, that is funded. Most of the debt that is raised by TfL and so on is funded through the Public Works Loan Board (PWLB) or other public funding and so it is ultimately funded through the Debt Management Office (DMO) of the Treasury.

Simon Kilonback (Chief Finance Officer, Transport for London): Chairman, may I just make a factual response to that? One third of TfL's debt is raised through the PWLB. Two thirds of TfL's debt has been raised either in the bond markets or from the European Investment Bank (EIB) or other loan bodies around the world. You are right that that is all funded eventually by farepayers or taxpayers but the sources for TfL in particular - and also, I am sure Luke will say - have been largely funded in the public markets because it was determined that having a rating and lenders that are not the public sector brings a bit of discipline about the affordability of debt and the appropriateness of debt. That has been a function of what we have been doing over the last few years.

Martin Wheatcroft (Fiscal Accountant, Pendan): Yes, you are right.

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): To answer that, Chairman, for the GLA Group, borrowing and capital expenditure are hugely significant issues and pose some of the greatest risks that we face as a group. It is very important to distinguish between the concepts of funding and financing in a situation like this. The PWLB or the bonds that Simon has mentioned that both TfL and we have issued are financing mechanisms. Those are tools to generate cash today to incur the expenditure.

The funding is where the consequences really lie. How do we actually pay for that? How do we pay the interest on that? How do we pay it back over time? That is where there is a very complex picture within the Group. We have mentioned fare revenues as one source. In the GLA's case we do not have an operating business *per se*; it is TfL that will operate that asset. When we are engaging in borrowing, the income stream that we are relying on is often direct taxation of some form. In the case of Crossrail, it is the GLA's ability to levy the business rate supplement (BRS) that enables us to undertake that borrowing. In the case of the Northern line extension (NLE), which is our other major borrowing concentration at the moment, it is the Enterprise Zone and the access to business rates and various development tariffs that that gives us. It is very important to not muddle the two concepts.

Gareth Bacon AM (Chairman): Sure. Coming back to you, Simon, when TfL is assessing various capital projects, what is the internal process for deciding whether you will fund that project by borrowing or not?

Simon Kilonback (Chief Finance Officer, Transport for London): As I said, we are quite clear on the types of assets that are suitable to be funded by borrowing and the types of assets that need to be funded through other means. We know, for example, that we have a requirement as at today, when we have awarded the procurement of new rolling stock for the Docklands Light Railway (DLR) to replace the existing trains. That is likely to be something that will need to be financed because it has a high upfront cost that we incur over the next four to five years but a useful life of 30 to 40 years. We look at these sorts of assets in our business planning as the ones for which borrowing or finance leases or another financing mechanism will be the appropriate way to finance them; whereas large elements of our investment programme, as we have talked about, generate wider benefits that are captured through other taxation funding streams but not through fares revenue or not through the business rate mechanism that flows through the GLA to TfL.

Jennette Arnold OBE AM: Yes. Going back to Simon, I wanted to just pick up something you said. You said you broke down the source and one third was from the Government and two thirds were from other sources. You made reference to the EIB. Would there be constraints or caveats over funding like that that would say it would always have to go to the infrastructure that has revenue rather than to the other type of funding that you have? You talked about the other, if you like, not soft work but the road usage and what-have-you. Just give me an idea, or are you just free? Do you just lump them together and it really does not matter where the source of the funding comes from?

Simon Kilonback (Chief Finance Officer, Transport for London): In the round, in our treasury management - and I am sure that Luke will say the same - having the flexibility to use the financing tools and linking them to projects but not directly hypothecating revenue and financing streams is important when you have scarce resources and you have to have some flexibility. However, in practice with, for example, the Export Development Canada loans that have supported specific projects such as the last set of rolling stock procured from Bombardier, and the EIB, which tends to lend on specific projects and has lent for --

Jennette Arnold OBE AM: Yes, I thought they did. I was just wanting you to confirm that.

Simon Kilonback (Chief Finance Officer, Transport for London): Yes. They lend for the Crossrail project. They lend to the London Overground project. They lend for parts of the DLR project. The loans are there to pay for those assets and we have to demonstrate that we deliver those assets as a result of the loans from those counterparties.

Jennette Arnold OBE AM: Do you give yourself the flexibility or is the flexibility given to you by statute?

Simon Kilonback (Chief Finance Officer, Transport for London): Sorry, which flexibility?

Jennette Arnold OBE AM: To use your pot as you want or because of political determination.

Simon Kilonback (Chief Finance Officer, Transport for London): There is a statutory element to it in that for all local government bodies, all loans must rank equally and without priority and, therefore, all lenders must have access to the same funding streams as each other. That is an important statutory requirement.

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): The borrowing powers are very wide. We can borrow from whatever source is most prudent and suitable at the time.

Coming back to your point about whether we mix it, we do have a statutory obligation as part of the guidance that flows from the Local Government Act 2003 to look at our debt position in the round relative to all of our income streams so that we can take a prudent view across the whole organisation. Yes, we manage things on a project-by-project basis - that is inevitable given the nature of the projects that we are looking at - but we do take that overview as well to make sure that the overall position remains prudent.

Jennette Arnold OBE AM: You are saying it is enabling?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): Yes. This is one of the areas of local government finance that is very well regulated and the statute is in fact very helpful here.

Jennette Arnold OBE AM: Thank you.

Len Duvall AM (Deputy Chair): In terms of your borrowing and planning and assumptions and all those issues, does the relationship around Government funding settlements make it harder to plan for and access future borrowing? Is there a cause-and-effect or a link in terms of levels of borrowing and issues like that? Can you just explain that to me in baby language?

Simon Kilonback (Chief Finance Officer, Transport for London): Certainly. TfL is relatively unique amongst public bodies in that we have historically had funding settlements that specify an amount of grant and an amount of borrowing and that we are not allowed to increase our borrowing above those amounts agreed with the Treasury without the Treasury's approval. They typically have been linked to the period of the Spending Review settlement - whether a two, three or five-year period, for example - and there has not been a lot of flexibility to move the debt for the optimal financial reasons around within that period.

If you compare that to Network Rail in the days before Network Rail was directly funded by the Department for Transport (DfT), Network Rail used to borrow for its whole regulatory settlement period and would have a total amount of debt that it was allowed to borrow in order to discharge its investment programmes but it was up to Network Rail to manage across that period of time flexibly and prudently how and when to borrow to secure best value or also to deliver the projects.

Until the 2017 Spending Review, we could not even move money between years, but in the 2017 Spending Review we secured some flexibility not to bring forward but to defer borrowing to when it was absolutely needed. The difficulty is five years ahead of time, for example, predicting in exactly which year we will need to raise the money. That has been what has led to the cash balances building up over time because we knew we needed the money to deliver the project but the delivery of the project would change as we tried to pursue the most efficient way of delivering the project. In the last couple of years, we have deferred about £300 million of borrowing from one year to the next and then raised it in the year in which the expenditure was incurred.

We do find ourselves constricted in two ways: one, by the Treasury limits and framework about what we can borrow and when - and historically that has been the thing that has constricted our borrowing - and, two, in more recent times with our well-known financial challenges the affordability of that debt has become the limiting factor about how much we can plan to borrow over the time and in the future.

Len Duvall AM (Deputy Chair): Is that the same for the rest of the GLA Group or is the relationship slightly different?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): No, it is different. As Simon says, TfL is the only part of the Group where the Government has attempted to impose a level of borrowing control. For the rest of us, it is the standard statutory position for local government where there is a duty to determine the amount you can borrow and then exercise that in a prudent fashion. The flexibility is useful for us but your initial point about the impact of settlements and so on means that any uncertainty is something that we have to factor into our assumptions about what we can sustain and afford. That is why the GLA's main risk exposures from borrowing are all tied to revenue streams that we have a very high degree of confidence in, namely the BRS, which has its own statutory underpin and is not something that we would expect to be tinkered with, and likewise the Enterprise Zone deal that we have entered into to secure revenues for the NLE. Uncertainty does make it difficult to forecast.

Len Duvall AM (Deputy Chair): In terms of the policy of the national Government, regardless of whoever is in power, there is always going to be tinkering in some ways but, Simon, your argument is that you want to be treated equally, the same as others?

Simon Kilonback (Chief Finance Officer, Transport for London): Yes.

Len Duvall AM (Deputy Chair): Should that be a bigger ask? I am not saying that it is just amongst you accountants having this debate in the Government or between civil servants and officials, but should that not be one of our bigger asks in the spending rounds in the future? Money is not going to increase and, even if it was, it is going to mainly be directed to certain priorities. Should that flexibility you are asking for be, in your mind, elevated to a much higher ask than when we go in to ask for Crossrail 2 or any other transport infrastructure and that, actually, no, we need to get the basic rules right before we go into how we fund it and that needs to be elevated much higher by the politicians in their discussions and asks of the Government?

Simon Kilonback (Chief Finance Officer, Transport for London): It certainly is part of the ask and the discussion this time around and it was last time around as well when we sought a number of wider flexibilities. For example, TfL has the ability to use hedging to manage currency risk and other types of risk, but we are not allowed to borrow in any currency other than sterling. There are times in which it would be cheaper for us to borrow in United States dollars, for example, and swap that back into sterling. We have made the case repeatedly that we have both the statutory ability and also the in-house technical expertise to be able to do that. Again, constraining the borrowing to sterling only, particularly in times when demand from investors for sterling-denominated debt might become more constrained for the United Kingdom (UK) as a whole, some of these flexibilities absolutely would be very helpful things to have.

Len Duvall AM (Deputy Chair): Of course these people that we are dealing with, we assume, do not get out of bed to make life tougher for you in terms of work and so there must be a counterargument for why they have put some of those constraints on you in terms of the ability to do it. Just tell me very quickly because we need to move on. What would be their arguments for why we should not allow you to have that flexibility? I can see the issue about working in other currencies, particularly if you are purchasing infrastructure and might want to purchase in another country abroad.

Simon Kilonback (Chief Finance Officer, Transport for London): The argument on currency would be that the UK Treasury through the Finance Ministry has spent a number of years making sure that almost all of its debt is denominated in the currency that it is responsible for. You can understand the argument for that, but the UK DMO does issue an element of currency debt for reserves purposes. If you think about TfL's debt in the round, it would be a rounding error, really. I know that £500 million to £1 billion a year is a lot of money and it is a lot of debt, but in terms of the quantum of debt raised by the DMO every year, it is not really going to feature as a material increment on that from a risk perspective.

From a control perspective, it has very much been the case - with London leading the way in terms of devolution over the last few years - that having the Treasury wanting to know where the money is going to be spent and what it is being spent on in its overriding desire to have certainty about the profile of debt and what it is being spent on. Again, as a CFO I could understand that, but at the same time, when we are being rightly charged with demonstrating that we can be more efficient, in some ways having a bit more flexibility would give us more ability to find opportunities to deliver things more efficiently.

Len Duvall AM (Deputy Chair): Your argument would be that it is about efficiency in planning and efficiency in flexibility and thought that you can deliver. Are there other checks and balances you can offer up to say, "Look, these are the wrong sorts of checks and balances. If you are worried about us in any way, there are other checks and balances that you might want to consider but not these ones because these are working against your interests as well as our interests in terms of delivery issues?" What would be those checks and balances that you would offer up in a different way so that I can keep my foot on the back of you and make sure you are delivering in the right way?

Simon Kilonback (Chief Finance Officer, Transport for London): Continuing to agree what transport infrastructure is. The elements that are in the national interest and therefore would be funded from debt, for example, which does contribute towards public sector net debt, is an important part of the discussion. We have a shared understanding with the DfT. We meet regularly and we know what they are and discuss and debate what they are.

Even if you took away the current constraints around the funding settlement, we would still have exactly the same constraints and framework as the rest of the local government sector and so we would still be required to set an authorised legal limit for our debt. We would still be required to demonstrate that that was prudent and affordable. In addition, we have for many years agreed with the Government that having a credit rating and having debt that is, in part, raised in the public markets as well as directly through the DMO does indeed impose that discipline and imposes it through a third party in the form of the credit rating agencies and the lenders.

We believe we have demonstrated all of those things, but there is an element here about being the most devolved part of the local government area that leads to a desire to have a few more checks and balances.

Jennette Arnold OBE AM: Chairman, just a quick question, if I might. You talked about devolution and we are talking about regulations that are around still, this old structure regarding the relationship between local government, the Government and the iron hand of the Treasury in between.

Do you get a sense that there are people now at the Treasury who have insight into the move towards greater devolution and are thinking that there needs to be now perhaps another look at allowing specific flexibilities as required by each region?

Simon Kilonback (Chief Finance Officer, Transport for London): I might perhaps defer to Luke, who probably has more direct discussions with the Ministry of Housing, Communities and Local Government (MHCLG) around devolution. We tend to focus on the transport infrastructure discussions.

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): Our statutory freedoms do come from MHCLG, as Simon acknowledges. The idea of self-regulation within a robust prudential framework is something that is well understood and supported by policymakers, but the tension balancing that is the fact that London's expenditures are so significant at a national level and there is a political sensitivity around London being seen to receive special treatment. That sometimes does lead to other parts of the Government - potentially the Treasury - taking very keen interest and often seeking to insert a level of conditionality into settlements and exercise some level of oversight and control through other means. There is a plurality of views, I would say, in central Government on this.

Jennette Arnold OBE AM: You do not know whether or not there would be any changes made if, say, a Government went gung-ho and gave new energy to the Northern Powerhouse or to wider devolution?

Simon Kilonback (Chief Finance Officer, Transport for London): The powers that Transport for the North, for example, are seeking mirror the powers that the GLA and TfL already have. Most of the discussion is about the regions being able to do the same things that London and TfL have been able to do for a number of years rather than significantly moving to a completely different place.

What seems to be emerging from a number of the reviews into how infrastructure should be paid for, the Williams Rail Review and some of the other reviews that are going on, is that having that greater ability at a more local level to make the decisions that balance where investment goes and how it is paid for is the right way forward, but clearly there are both constrained resources for the Government as a whole, which I understand, and also a political element at the moment as well, which we are all well aware of, in terms of seeking to, as Luke has said, demonstrate that other parts of the UK are also benefiting from investment. We have seen that with a number of London projects that have to move forward in 'lockstep' with the North. That has been the language that has been used. We should be getting investment at the same time as these sorts of constraints.

Jennette Arnold OBE AM: Thank you. That is very interesting.

Gareth Bacon AM (Chairman): The final scene-setting question is aimed at you, Simon and Luke. If you had not been able to borrow, what major projects would not have happened? Let us start with you, Simon.

Simon Kilonback (Chief Finance Officer, Transport for London): For both Luke and I Crossrail 1 would not have happened had London not been able to borrow. For TfL specifically, the upgrade and modernisation of the Circle, District, Hammersmith & City and Metropolitan lines, and the Victoria Line and the London Overground would not have been able to happen. The major rail improvements we have seen over the course of the last 18 years would not have been able to happen had we had to save up and pay for them as we went. Indeed, some of that investment, as you know, is catching up on years of underinvestment before the formation of the GLA.

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): The two projects that we substantively borrowed for are Crossrail and the NLE. As Simon says, neither of those would be remotely feasible on an idea of saving up first. Not only would that take a very long time, but the costs associated with delivering those projects increase by far more than inflation as a result of general structural complexity within London. Borrowing is the only possible solution for things of that nature, in my view.

Gareth Bacon AM (Chairman): Have we had any borrowing-funded projects over the lifetime of the GLA that have struggled to realise sufficient financial benefits to cover the funding costs?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): For the GLA itself, no. Crossrail was the first borrowing undertaken by the GLA. It was debt-free before that time.

Gareth Bacon AM (Chairman): TfL's debt, Simon, has been going up consistently since 2005/06, has it not? How do you ensure the outstanding debt relates to the assets that are still in use?

Simon Kilonback (Chief Finance Officer, Transport for London): The debt has gone up in a planned way. That is important to say to start off with. The debt has not been rising as a result of the operating position and choices made over the level of subsidy. The debt has been rising to fund the capital programme and has been deliberately targeted at those things that I have already mentioned - Crossrail, the first tranche of the Tube upgrades, London Overground, etc - and has been raised to do only those things.

In terms of going forward, our current business plan shows us continuing to borrow to complete those investments over the next two or three years but then not borrowing beyond that period of time unless and until either TfL can generate enough surpluses to support some further borrowing or there is more devolution of funding or there is another funding stream that could continue to support those sources of funding going forward.

Gareth Bacon AM (Chairman): We have reached peak borrowing? Can I put it that way?

Simon Kilonback (Chief Finance Officer, Transport for London): We are reaching peak borrowing based upon our current levels of income, yes.

Gareth Bacon AM (Chairman): And current level of debt?

Simon Kilonback (Chief Finance Officer, Transport for London): And current level of debt, yes.

Gareth Bacon AM (Chairman): The debt, as you say - and I accept your point - was planned to rise in the way that it has, but what about the debt profile? How are you planning for it to come down? As you say, unless the debt ceiling is increased, unless the limit is allowed to increase, there is no more room for manoeuvre unless you pay some of it off.

Simon Kilonback (Chief Finance Officer, Transport for London): We have, it is important to say, planned to reach a level of debt that pays for Crossrail 1 and pays for that first series of Tube and rail upgrades. Then there is an amortisation profile for that debt to pay it off to create further capacity in the future to borrow more for more projects.

I will perhaps ask Emanuela to go into more detail but I will give you the overview. We have borrowed £11 billion to date and the further £2.5 billion we will be borrowing over the next few years, we have planned that so that we have a range of maturities in every year going right out to 50 years such that our weighted average maturity of debt is about 19 years. The reason we do that is to reflect the economic life of the type of assets that we are financing: rolling stock 30 to 40 years, stations 50 years plus, tunnels for Crossrail 100 years plus, but other assets need to be replaced within, say, a ten-year cycle. We have looked to and we have worked in the past with the UK DMO to think about appropriate average lifespans for debt and we aim at having at least an average lifespan of 15 years, but that allows us to pay off debt at the same time as raising new debt to finish the current projects that we are doing.

Gareth Bacon AM (Chairman): Is it possible to plot that? Do you have that available if I wanted to look at your debt profile over a ten-year period, a forecast?

Simon Kilonback (Chief Finance Officer, Transport for London): We can provide that to you, Chairman.

Gareth Bacon AM (Chairman): You can? Perhaps we can sweep that up in the letter. It is quite interesting to see how you are playing this going forward because you are now very constrained. When Crossrail was delayed, we know that famously the loan had to go to the GLA rather than to you because you could not take any more and then it had to grant fund you. That is right, is it not?

Simon Kilonback (Chief Finance Officer, Transport for London): Yes. Just to clarify, in the first instance to have the first slug of the cost overrun covered by a grant from the GLA, which the GLA is borrowing against the Mayoral Community Infrastructure Levy (MCIL) revenues, was very important in terms of both our affordability given the delays impacting our revenues and therefore the amount of debt that we can support and also to preserve some flexibility beyond the £750 million additional facility if it is required either for Crossrail or for other things.

Len Duvall AM (Deputy Chair): As I understood the question - maybe I have it wrong - and in terms of individual projects that we borrow against, there is a profile on performance and the nature of those projects. It does not really matter whether they are - it is hard to say in this case - poor performers or they are just the way the profile and the debt repayments come back. Does that revenue stream coming back to pay back the debt of borrowing really matter? You are collectively doing it as a TfL organisation and so the performance of one project versus another is neither here nor there. It just happens to be part of the borrowing and the debt repayments. Or do you do individual profiles of different schemes that you have borrowed for and their performance? Are we talking about the cable car [Emirates Air Line]?

Simon Kilonback (Chief Finance Officer, Transport for London): We have not borrowed for the cable car [Emirates Air Line].

Len Duvall AM (Deputy Chair): Was it the EIB? It was grant, was it not?

Emanuela Cernoia-Russo (Corporate Finance and Strategy Director, Transport for London): There was some grant funding from the European Union (EU) but not borrowing.

Len Duvall AM (Deputy Chair): In terms of some of the problems that you have had with revamping some of those Tube lines that you did and the stop-start nature of that, it must have had an impact on debt repayments. Is that the life of some of these projects? Crossrail was spectacular. I am not decrying it and the impact in terms of the debt, but is that not a life of borrowing against some of these transport projects and some of the problems that may arise as they come to fruition?

Simon Kilonback (Chief Finance Officer, Transport for London): We do look at it on a portfolio basis and so of course we understand for each of our capital projects and for each of our businesses, which have different characteristics. For example, the Underground is generating a direct operating surplus but we need it to continue to grow that operating surplus. Most of the borrowing has been raised for the Underground and so the Underground needs to effectively cover the interest costs of our borrowing and the repayment of that. It also needs to cover the renewal costs of replacing track and things like that as well, which we will come back to. The projects themselves all affect our financial position and so we look at them individually and in the aggregate, but, as Luke does for the GLA, we manage the debt on a portfolio basis in aggregate because there will be some projects that are performing very well and some projects, like Crossrail, that are requiring additional time and money to complete. We look at not just the individual impact of each of those things but the net impact as a whole as well.

Len Duvall AM (Deputy Chair): Thank you. Sorry, Chairman.

Gareth Bacon AM (Chairman): That is quite all right. Have you had any assets that have been funded by borrowing that have had to be replaced before the financing has been raised sufficiently to pay off the original borrowing in the first place?

Simon Kilonback (Chief Finance Officer, Transport for London): Not so far. We are still in the process of completing each of those projects I have discussed. They are in the course of finishing construction and delivery into service. You would expect that the income that they help to generate over the next 30 to 40 years helps repay that debt. Given that both TfL and the GLA when we were created in 2000 did not have any debts on our balance sheets at all, we do not have any legacy of older projects that may have underperformed in the way in which you describe.

Gareth Bacon AM (Chairman): This links with the question that Assembly Member Duvall has just asked, but presumably you are tracking each of your assets where you are funding by borrowing against the level of financial returns?

Simon Kilonback (Chief Finance Officer, Transport for London): No, we track each of our assets and projects, absolutely, but we also track in aggregate because there are other factors that affect our affordability.

Gareth Bacon AM (Chairman): I am just wondering. Are there any assets that you are funding by borrowing that are not raising sufficient finance at the moment or their run rate is not looking good? Everything is OK on that? OK.

Sarah, can you talk me through the minimum revenue provisioning (MRP) process, please?

Sarah Bradley (Group Financial Controller, Transport for London): Yes. We are required to make provision for the repayment of debt. Currently, the vast majority of TfL's borrowings are passed down to its subsidiaries. Very little is retained wholly within TfL. So that the borrowings are passed down to subsidiaries, the MRP is made through the depreciation charge on the assets that have been constructed. There is a charge of about £19 million per year on those assets, which are in the corporation and TfL itself and have been funded from borrowing.

Gareth Bacon AM (Chairman): Is that £19 million per year used to pay off the debt instantly or do you put it into reserves and save it for later?

Sarah Bradley (Group Financial Controller, Transport for London): It sits in reserves. It is part of the resources available to meet the repayments of the borrowings as and when they fall due.

Gareth Bacon AM (Chairman): How much is in reserves to cover that at the moment?

Sarah Bradley (Group Financial Controller, Transport for London): I cannot remember. It is three or four years' worth of MRP and so not an enormous amount.

Gareth Bacon AM (Chairman): £70 million or thereabouts?

Sarah Bradley (Group Financial Controller, Transport for London): Yes. We do not separately identify it in reserves.

Gareth Bacon AM (Chairman): Luke?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): Without delving too far into the arcana of local government accounting, MRP is a common source of confusion because it does, in effect, create a cash reserve but it is not appearing in reserves in the sense that if you look at the accounts and look at the reserve numbers you will see it. It is a cash phenomenon. As all local authorities have to, we need to set a balanced budget every year. The vast majority of our incoming resources come in as cash, as taxes, as fare income, as grants, cash resources matching the accounting number of income.

Because MRP is not a cash movement - like depreciation, it is a notional accounting charge - it counts towards the expenditure of our profit-and-loss account. If we have 100% of income coming in and let us say the MRP is 5% of the budget that year, we will have a budget that looks balanced but 5% of the total expenditure in cash will have just accumulated on the balance sheet. There is no transfer to reserves that you would see other than noting that the cash balance was higher. In due course that cash can be used to repay debt.

It is one of the features of local governance finance that can make accounts quite hard to understand.

Gareth Bacon AM (Chairman): There is not a movement into reserves, then?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): No, not in the sense of our normal reserve --

Gareth Bacon AM (Chairman): It is reflected on the balance sheet as cash but there is just an understanding that a certain level of that cash is set aside as the MRP?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): Yes. All things being equal, if there were no debtors and creditors and no other reasons for a mismatch of cash and reserves, as a result of MRP you would see a cash balance that was higher than the reserve balance until the point it was used to repay the debt.

Gareth Bacon AM (Chairman): We are going to move on to talk about the affordability of borrowing. Assembly Member Duvall?

Len Duvall AM (Deputy Chair): In terms of the question, really, this is to all of you. I do not know who wants to begin. What are the key warning signs to look at that would indicate that an organisation is borrowing too much? Luke, shall we go to you?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): We have clear forecasts of our expected revenues such as the BRS or the Enterprise Zone income from the NLE, which we are counting on to fund our repayment of debt and interest. If the costs approach the level of expected income, then that starts to give us some early warning signs. The worst case would be if that was exceeded and, therefore, there was a risk that we were having to use other sources of funding.

This is something that we look at very closely, as I am sure my colleagues in TfL do as well, typically on a five-year forward horizon. It is very central to the ratings process and so, I guess, for the taxpayer and others seeking assurance over how we are managing this, the rating is a key indicator. Making sure that we have the right ratio of income to financing costs and that we are able to manage that stably are the things that we look at.

Len Duvall AM (Deputy Chair): The determinant for the GLA Group borrowing too much is a change in the ratings?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): That would certainly be an indicator. Hopefully, we would head off any problems well before that occurred.

Simon Kilonback (Chief Finance Officer, Transport for London): It is just important to note there that clearly both the GLA and TfL are linked to the Government rating and so a change in both of our ratings has occurred because of a change in the central Government rating. A key indicator would be whether the relationship between TfL and the GLA's ratings, being one notch down from the UK Government's, changed. If that gap changed, that would be an indicator of the debt becoming more challenging in the rating agencies' view.

Martin Wheatcroft (Fiscal Accountant, Pendan): The important thing to understand about borrowing is that you get the benefit of building your assets or whatever you are borrowing for, but the *quid pro quo* is that you are committing that your first priority - and the first thing that Simon and Luke have to do in the morning when they get into the office - is to pay the interest and pay that debt. It is now the primary thing. That squeezes your flexibility because you now have a fix. That is why borrowing is quite often referred to as gearing or leveraging. It benefits you in one way that allows you to do more, but the *quid pro quo* is that you have now earmarked a portion of the cash coming in now to service that debt both in terms of interest and in debt.

It is really when the proportion that you are having to commit and the need to set aside cash to meet debt repayments becomes unaffordable. That is the key question that that you are looking at. Looking at what happened with Crossrail, that was clearly the case with TfL where you conclude you could not take on the extra debt at the TfL level because it just was not affordable. That was an indicator that you had overreached your ability.

Len Duvall AM (Deputy Chair): That is one of the reasons why the GLA was created in the way it was, to help, and it worked on that occasion.

Let us go to TfL in terms of your position. How concerned should we be as a Sub-Committee that TfL's current liabilities are twice its current assets and to what extent has this resulted in the level of debt servicing required by TfL borrowing?

Simon Kilonback (Chief Finance Officer, Transport for London): Let me try to unpack that a bit if I can and then I will let Sarah come in and perhaps correct me if I go wrong on the technical balance sheet side.

We have gross assets of about £55 billion and debt of £11 billion rising to £13 billion. In terms of current assets and current liabilities, I would not be too concerned about that. We use for efficiency purposes a form of short-term borrowing called commercial paper. It is a market-based paper and it puts some discipline on us, but it is also a very flexible form of borrowing that we cannot get from the PWLB. We can borrow for a day, a week, a month or anything up to a year at a very reasonable cost and in fact we have competition from investors to have that paper. We have about £800 million of that in issuance at the moment, but over the course of the last couple of years, given interest rates are historically very low, we have every year been converting some of that short-term debt into longer-term debt.

In some businesses that would be an indicator of an issue, but because we have statutory access to the PWLB we do not have a refinancing issue. That has been an important understanding that the rating agencies have arrived at in terms of why our commercial paper programme is a valid thing for us to do as a local authority because we can refinance it without risk.

What I would point you to in terms of your question about the affordability is that we have started to publish in our quarterly financial report some metrics. We show that our financing costs as a percentage of our total income are about 7% of our total income. That is reasonable. Again, in terms of our rating agency metrics and methodology, that is well within the range that would keep us within our current credit rating.

That is something that we wish to do. We have committed at TfL Board level to try to maintain that single-notch difference between us and the Government. The reason that is important is not so much for our borrowing because we do have access to the PWLB but, because we have a £7 billion supply chain, its own cost of debt to some extent depends upon our rating and, similarly for our pension fund, it relies upon the strength of our covenants to underpin the pension fund. That 7% cost of financing relative to our income we now report on.

The other thing that is really important in this quite volatile period is that we have been focusing on maintaining and rebuilding our cash balances so that we have cash coverage for those interest and financing costs and also if there were to be a prolonged period of business interruption. Again, we have moved from historically having a minimum cash requirement in our policy of £250 million. As TfL has grown over the last 18 years, £250 million is now only about two weeks' worth of cash and so, clearly, it would not be very prudent to be operating on that basis. We have a minimum policy of having a month's worth of cash, which we have agreed with the rating agencies is suitable given again our access to the PWLB and other financing mechanisms. However, in fact, given that we are now rated against our transport peers around the world, we are aiming to hold something like two to three months of operating cash, which gives that liquidity around both our borrowing and also our businesses in challenging and uncertain times.

Len Duvall AM (Deputy Chair): On that uncertainty, the credit ratings work on not just you as an organisation but the environment that you are working within. With issues of the international markets, the international climate, Brexit and all those issues, what do you believe to be the risk in managing these issues in terms of your rating being downgraded because of some of those issues?

Simon Kilonback (Chief Finance Officer, Transport for London): We are on negative outlook from a couple of the rating agencies. That is not because of our own financial performance. That is because they have a negative outlook on the UK Government because of Brexit and the performance of the UK economy. Clearly, the main impact for us would be an increase in the price of borrowing rather than the availability of borrowing. One of the benefits we do have in the UK is a very strong investor base through the insurers and the pension funds. Pretty much all of the debt Luke or I would need to raise could be raised in the UK through institutions and through their own requirements if we needed to. However, as I said, the effect of a rating downgrade, particularly as you start to go below the AA level, is that it would start to impact potentially on the costs that our suppliers can leverage from their own financial institutions, which would be passed back to us as increased costs. That is probably our major risk.

Len Duvall AM (Deputy Chair): Thank you.

Gareth Bacon AM (Chairman): What about viability of interest rates? You mentioned that they have been historically low for what seems like forever now. Everyone keeps predicting that that is going to change. How exposed is TfL if they do start to rise?

Simon Kilonback (Chief Finance Officer, Transport for London): Our Board-approved policy is that we have a minimum of 75% of our debt at fixed rates of interest. We currently have something more like 97% of debt at fixed rates of interest. Given that the interest bill is about £475 million per year, having certainty of the cost of financing is more important than having some ability to benefit if rates go up or down by a little bit.

On our current debt, which, as I said, has an average maturity of 19 years, we do not have any interest rate risk at all. We have also pursued facilities with the EIB and Export Development Canada that have allowed us to forward fix debt over the years and so we have been able to mitigate some of the interest rate risk on tranches of debt in the future through those facilities. We are coming towards the end of those current facilities but we are working on trying to secure some more at the moment. We also have an interest rate hedging ability and it is a live discussion with our Board as to whether we ought to be thinking about hedging some of our future issuance over the next few years, again to protect ourselves against interest rate movements.

Gareth Bacon AM (Chairman): On average, when you do borrow, what are the borrowing terms? You said it is 19 years normally but - I am trying to phrase this in a way that is intelligible - all of your borrowing will not be taken out at the same time and, similarly, it all will not mature at the same time and so it will be staggered over time. Ordinarily when you are borrowing, over what period of time are you borrowing for?

Simon Kilonback (Chief Finance Officer, Transport for London): As I said, if I try to answer that, we try to make sure that we have staggered the maturity of our debts over a very long period of time so that we do not have any specific huge spikes of debt that need to be refinanced in any one year relative to the size of our organisation. In doing so, Emanuela and her team are mindful of making sure that as -- short-term debt tends to be the very cheapest at the moment and at some point in history long-term debt has been cheaper. We look to be efficient in how we borrow but we also try to make sure the average maturity of the portfolio reflects the average economic life of the assets that we are financing. We keep the costs, the maturity profile, the liquidity, the refinancing risk and all of those things in mind when working through an annual strategy with our Board about when we borrow, how we borrow and for what period.

Martin Wheatcroft (Fiscal Accountant, Pendan): If you were to borrow everything at current rates, you would be able to get a really great deal and save a lot of money compared with what TfL is currently paying because it is paying rates on debt that was taken out, for instance, before the financial crisis at much higher rates than current rates. However, doing that exposes you to huge swings as interest rates can change overnight. It is much more sensible to embed it in and, therefore, you follow a path where you are gradually refinancing your debt every year a little bit. If it is over 19 or 20 years, then 5% of your debt is being refinanced every year and at the moment, because we have very low interest rates and in fact they have been going down recently, you can gradually bring the average rate of your debt down each year. Then, when it starts to swing up, you gradually move back up but you do that over a 20-year period and so you are in a much more stable position.

Your big exposure is new debt. If you are doing a new big project - if you start on Crossrail 2 or 3 or 4 - and you decide to finance that through new debt and if interest rates go up, that changes the whole economics of future projects, but you have a much more stable position through this approach of your current debt.

Gareth Bacon AM (Chairman): Sure. That 5% figure that you just suggested as an example of how much you would refinance per year --

Martin Wheatcroft (Fiscal Accountant, Pendan): That was on the basis of 20 years on average, yes.

Gareth Bacon AM (Chairman): Is that about right for TfL?

Emanuela Cernoia-Russo (Corporate Finance and Strategy Director, Transport for London): No.

Simon Kilonback (Chief Finance Officer, Transport for London): Yes. We will share the profile with you and you can see it. For efficiency purposes we have at times issued debt in larger tranches of £400 million or £500 million because we have a best price to do that for a particular programme. In other deals we have used smaller tranches of £50 million to £100 million. We have tried to manage the repayment profile in every year over a very long period of time and so it is not quite 5% but --

Gareth Bacon AM (Chairman): It would be plus or minus a few percent each year.

Simon Kilonback (Chief Finance Officer, Transport for London): When we share it with you, you will see it is quite evenly spread with the largest hump, if you like, in that 20- to 25-year period.

Gareth Bacon AM (Chairman): Your approach to debt management is minimum risk, it is fair to say?

Simon Kilonback (Chief Finance Officer, Transport for London): Yes.

Gareth Bacon AM (Chairman): The scenario I am about to give you now probably could not happen because of Bank of England independence, but probably the biggest swing in interest rates that I saw in my lifetime was of course the Exchange Rate Mechanism debacle on Black Wednesday [16 September 1992]. It started at 6% on the day, went up to 15% and then dropped back down to 12% by the end or something like that, which led to the huge recession that followed and all the repossessions and everything else.

How protected would TfL be against a scenario like that happening? Let us say for the sake of argument that we leave the EU with no deal and the economy is on a precipice and the answer is that we are to play around with interest rates. Would you be sheltered from that because it is all at fixed rates now and so little is having to be refinanced year on year?

Simon Kilonback (Chief Finance Officer, Transport for London): We would to a large extent because, as I said, 97% of the £11 billion is fixed and our intention is to continue fixing that debt. We do have the ability to hedge. Emanuela and her team speak to the banks and the economists on a regular basis. If there was a fear that future interest rates - and we look at forward interest rates - were to start to suggest there was a real risk of things spiking up or if the currencies and volatility indices suggested that would happen, then we would start to hedge our future debt programme. We of course always have a choice as well about not raising the debt. Some of the debt going forward would be for projects that we have not yet started. If all of a sudden interest rates were 15%, we might not do it.

Gareth Bacon AM (Chairman): We are going to talk about your current borrowing plans.
Assembly Member Arnold is leading on that.

Jennette Arnold OBE AM: Yes, thank you. I have a number of questions for you. I have in front of me as a reference this chart. The source is the Mayor of London's Capital Spending Plan 2019/20.

My starter question is to Simon, Emanuela and Luke. What are the key deliverables from the borrowing in the four-year Capital Spending Plan to 2022/23?

Simon Kilonback (Chief Finance Officer, Transport for London): For TfL, it is to finish the projects we have been talking about so far today. It is to finish Crossrail. It is to finish the upgrades of what we call the subsurface railway between the Circle, District, Hammersmith & City and Metropolitan lines. It will be for the new rolling stock that we have ordered over the last few years. It will be finishing the delivery of the Bank Station upgrade and the Victoria Station upgrade. Our programme now is to finish the current series of upgrades and then we will start to think about how we finance the next series of upgrades as we go into the Spending Review process with the Government.

Jennette Arnold OBE AM: Luke?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): For the GLA, the substantive items are Crossrail and the NLE and so there are some remaining grants to be made as a result of that borrowing. Our deliverable is to support our colleagues in TfL in bringing those projects to their conclusion within the currently forecast cost envelope.

Jennette Arnold OBE AM: Thank you.

Gareth Bacon AM (Chairman): Just on that one, if I may, correct me if I am wrong but the only reason the GLA is borrowing on the NLE and on Crossrail is because of this situation with Crossrail's borrowing cap, is it not?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): It is also an issue of where the tax-raising powers lie. The GLA is the entity that is able to levy the business rates charges directly and therefore it makes sense for the borrowing to be as close to that revenue stream as possible.

Gareth Bacon AM (Chairman): Would it be the GLA that was borrowing if TfL's cap had not been reached? Would TfL had borrowed it otherwise?

Simon Kilonback (Chief Finance Officer, Transport for London): Over many years, myself, Luke and others have thought about, as Luke says, who best should bear the borrowing almost regardless. Put aside for a minute whether or not you are towards your maximum limit, but what is your ability to influence and manage that borrowing? TfL can manage our own generated revenues - fares and commercial income and other things - but the tax streams flow to the GLA. Therefore, the tax base borrowing, whether it is business rates or MCIL or other things, now we have started to move forward with the ability to borrow against MCIL, which has been a feature of the new Crossrail funding facility, should sit with the GLA.

Gareth Bacon AM (Chairman): Aside from the NLE and Crossrail, does the GLA have any other borrowing?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): It does have some legacy borrowing dating from the abolition of the London Development Agency and that was debt that at the time was incurred to purchase the [Queen Elizabeth] Olympic Park. Some of that is still on the balance sheet and the resources that will repay that over time will ultimately flow from capital receipts resulting from the [Queen Elizabeth] Olympic Park redevelopment.

Gareth Bacon AM (Chairman): Sorry to interrupt you.

Jennette Arnold OBE AM: No, that really fits in. We are on the same page. We are of one mind. We have sat on this Sub-Committee too long together. A very interesting Sub-Committee it is as well.

I was just going to go on and ask if we should be suspicious that after 18 consecutive years of borrowing, TfL now is saying that it has no plans to borrow in 2023/24 or is it the fact that the GLA will do the borrowing on TfL's behalf?

Simon Kilonback (Chief Finance Officer, Transport for London): I am not quite sure what you mean about being suspicious.

Jennette Arnold OBE AM: We are always suspicious of TfL full stop.

Simon Kilonback (Chief Finance Officer, Transport for London): I know. I do not know why. We are part of the GLA family after all.

Jennette Arnold OBE AM: Do not start me off. You did give money to a bridge that was not built. I will not go there.

Gareth Bacon AM (Chairman): We are not going to steer into that one.

Simon Kilonback (Chief Finance Officer, Transport for London): No, we can rehearse that one in another forum. For both TfL and the GLA, what is clear and the case we will continue to make is that London has far less devolution than any other major city anywhere else in the world and therefore London's ability to be held to funding and financing large proportions of its infrastructure investment is clearly contingent upon having the devolved financial ability to support that. If you were to look at Paris or New York, they have 50% and 80% devolution of their fiscal framework and that gives them a greater ability to be self-reliant. We have a very centrally led public finance philosophy in this country and that therefore means that, for example, the GLA capital strategy is reflected in things like the National Infrastructure Commission's (NIC) 1.2% of gross domestic product recommendation for fiscal spending. We work with the NIC and we work with other cities and regions around the UK to make the case that all of us should have the ability to make more of our own decisions about what money we raise and how we spend it to deliver locally.

Jennette Arnold OBE AM: I totally agree with you. We see report after report pushing for those who are in power to think through fiscal devolution because other cities clearly show that it can work but we are held within this centralised bubble.

Gareth Bacon AM (Chairman): Luke wanted to add to what Simon just said.

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): If I may, also a piece of context that is very important to bear in mind is that we have in a sense punched above our weight over the last decade or so because, as Simon mentioned a while ago, both the GLA and TfL at the start of this journey were debt-free. What we have managed to do with the major projects that we have discussed recently is to effectively take almost all of the financial flexibility we have and convert that into the ability to invest now. To put that another way, we have maxed out our borrowing. That is a one-trick event. We cannot raise money on the scale that we have repeatedly without a much more fundamental devolution of revenues. When you look at these projects and when you look at some of the studies that have been done that look at the incremental tax benefit of these, a very small proportion of that is retained within London. The greatest benefits flow through corporation tax and income tax and are of course abstracted to the centre.

Jennette Arnold OBE AM: Shall I understand that to mean that a driver behind the current borrowing plans is about achieving an operating surplus post 2022/23?

Simon Kilonback (Chief Finance Officer, Transport for London): For TfL, yes. To turn that around slightly, the driver about moving from a deficit to a surplus is to create the capacity to continue to invest in the future and also to reflect the fact that if you continuously run deficits at some point you run out of cash.

Jennette Arnold OBE AM: Yes. That is understandable. It is a big figure to me but, Luke, the information I have here suggests that if the GLA Group and TfL within that were to continue with the annual financing cost and more borrowing, then by 2022/23 we would be in the region of over £1 billion in financing costs, which sounds big to me. Is that big?

Simon Kilonback (Chief Finance Officer, Transport for London): Not in the context of this. It is a huge amount of money, clearly --

Jennette Arnold OBE AM: It is frightening.

Simon Kilonback (Chief Finance Officer, Transport for London): -- but I will let Luke talk about the GLA because the circumstances are different for the GLA than for TfL. We have said the reason why we are not planning on continuing to borrow in the 2020s, unless and until we either secure more devolution or find another funding stream or create significantly greater services, is that we believe that that level of borrowing is affordable and we can afford to repay it, but in order to take on more borrowing we would have to have additional sources of income or funding to support that.

Jennette Arnold OBE AM: Thanks. I just have a question now and I suppose it is about your opinion. This question is about the Mayor of London's Capital Spending Plan 2019-20. It includes £18.6 billion of investment, of which only £4.7 billion is funded by borrowing. This is to all of you. I would welcome your thoughts as to how reasonable it is that the burden of current investment falls on current taxpayers when they may not benefit from the investment. Who wants to start with that?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): I can start off. That reflects the fact that a lot of the investment we are undertaking is potentially grant funded and so, from a whole-of-Government perspective, it may well be funded by borrowing. In fact, it probably is, but we are acting as agents of central Government in a number of ways. The most significant example is housing, of course. The Government through whatever means is raising that money and transferring it to us in order to deliver these outcomes.

The other thing that can again slightly muddle that picture is capital receipts. It may be the case. The Fire Brigade and the Police would be good examples of organisations using receipts heavily to finance capital expenditure. These are existing assets that are being sold, generating some money, and then that is being redeployed for new capex. That is not an immediate tax burden falling on taxpayers today. It is an accumulation of a longer-term approach.

Jennette Arnold OBE AM: All right. Anyone else?

Simon Kilonback (Chief Finance Officer, Transport for London): It also reflects that in TfL's capital strategy submission. One of our clear assumptions was that, because we do not have any certainty of how we will be funded beyond March 2021, we are not going to assume that we will do any more borrowing beyond that, which we have set out in our additional business plan. For public sector net debt, the Government ought to be agnostic about whether the funding is in grant form or borrowing form because they both equally contribute to public sector net debt. The most efficient thing actually for the UK as a whole would be for the DMO to borrow the money because it can borrow at the lowest cost. However, we recognise that borrowing where we can against fares revenues or other revenues demonstrates that we are taking some responsibility for the repayment of that debt.

It does look a bit odd because we have not flowed through, for example, in the 2025 onward element of the capital strategy an assumption about borrowing more money because we do not know how our funding will be split. What we have said is that there is an absolute requirement for funding. The split between grant and borrowing will need to be determined later. It is more likely that there will be further borrowing at a future point if there were a movement on devolution. Indeed, in the past, TfL has been able to borrow more against the total higher level of our grant income because we are able to borrow against the grant. There is a leveraged effect of having a grant and then borrowing against it.

Jennette Arnold OBE AM: In terms of your revenue, is there a cap on revenue, say, from the fares pot? Is there a figure that you cannot go beyond? The price of the ticket has to have some cap to it, does it not? That would cap that funding source for you.

Simon Kilonback (Chief Finance Officer, Transport for London): The main cap on the fares revenues is actually the capacity of the system to carry more people. A very large part of the investment that we are seeking to make over the next 20 years is to increase the capacity of the system. If we can increase the capacity of the system and attract more people to use it, then the increased ridership will have a bigger effect in terms of driving more income than the pricing policy. The pricing policy is quite complex because there is a large interplay with what people are willing to pay and whether they choose to travel. We have seen that over the last few years when for the first time ever, two years ago, we started to see a reduction in demand for the Tube because there was a point at which people were making choices not to travel for discretionary trips as part of their overall discretionary spending.

Jennette Arnold OBE AM: That is interesting. My last question is about this Silvertown Tunnel. This has been constructed using private sector borrowing. How confident are you that this will deliver value for money given that the Government abolished this type of arrangement in the 2018 Budget for new projects, claiming that they do not represent value for money?

Simon Kilonback (Chief Finance Officer, Transport for London): We have a long history with private finance initiatives (PFIs) and public-private partnerships (PPPs). PFIs and PPPs are not inherently bad. It is whether or not you apply them to the right types of projects. If you have been using them to pay for things because you cannot really afford them and you do not want them on your balance sheet, then that is one thing.

For TfL, the DLR is a great example of a piece of infrastructure that was delivered through a PFI and has been a significant success. One of the reasons why it was so successful is it was a new discrete piece of infrastructure that did not have an interplay with the existing network. You could let the private sector deliver it, run it, repay the debt and then hand it back to the public sector at the end of that period of time.

PFIs and PPPs have been less successful when the inherent rigidity of embedding the finance over 30 or 40 years has had a direct operational impact upon the transport services. Therefore, when one of the PPPs collapsed into administration and the other one was brought back in-house, one of the very large reasons for doing that was because things change, particularly operationally, and those sorts of contracts being embedded in a PFI or PPP structure are very difficult then for the public sector to manage.

On the Silvertown Tunnel, the reason why we chose to do this particular project at a time at which the Government announced that it was no longer going to be using PFI as a mechanism was that they specifically allowed devolved administrations to continue to do so if they satisfied themselves of the value for money. I was phoned on the day of the announcement by the Treasury to say that that means this type of project. TfL has a lot of experience over the years in building railways and commissioning railways. We have not built any road tunnels at any time probably in the last 50 or 100 years, whereas other people around the world build them regularly. The private sector is better placed to deliver Silvertown [Tunnel]. The fact that the design consent order requires a toll to be levied to manage the congestion in the area and to be a demand management tool in the area creates a revenue stream. We are not asking the private sector to take the revenue risk. TfL is retaining that. We are asking them to take the risk on building and delivering the project. There is no need for any scope change and so it is a relatively simple project. We are just in the process of awarding the contract. We have had a great competition and a lot of global interest and people who are vastly experienced in building road tunnels have been successful in winning this. The overall cost of finance embedded in this PFI reflects that and we think, given the requirements to do this and the constraints on TfL's balance sheet, this is one of the few occasions on which this type of financing mechanism makes sense.

Jennette Arnold OBE AM: Thank you.

Gareth Bacon AM (Chairman): Martin wanted to come in.

Jennette Arnold OBE AM: Yes, Martin?

Martin Wheatcroft (Fiscal Accountant, Pendan): Yes, very quickly just to say that PPPs have not been abolished by the Treasury. What they have done is they have announced the end of Private Finance 2 (PF2), which was the successor to PFI, which has basically not been successful. There were very few PF2 contracts awarded and so they have gone back to rethink.

Jennette Arnold OBE AM: Is that because people are struggling with bad PFIs?

Martin Wheatcroft (Fiscal Accountant, Pendan): As Simon said, PFIs are not inherently bad --

Jennette Arnold OBE AM: You have to have the appropriate project.

Martin Wheatcroft (Fiscal Accountant, Pendan): In fact, some of the initial ones were not necessarily very good models to follow, but over the period of PFI contracts a lot of them have been quite successful and a lot of things have been built that would not otherwise have been built. It is a very much a mix of things. There have been things that have gone wrong and have been unsuccessful, but there have been things that have gone right.

The point is that the attempts to try to achieve a model that both delivers what you might call protection for the taxpayer and for the consumer and also is sufficiently attractive to the private sector to finance is a challenging one. PF2 has proved not to be in that road. There have been some examples where things have been possible within the framework, but they basically have their thinking caps on about how to replace it. It is not that we will not see these things going forward in the future. We will see them in the future, probably, but there will be a new name and a new technical approach. Hopefully, we can retain the lessons from PFIs and what went wrong and what went right into the new model.

Jennette Arnold OBE AM: Thank you. I wish the Silvertown Tunnel project well. Back to you, Chairman.

Gareth Bacon AM (Chairman): We are into the final section, which is the scope of additional borrowing. I suppose the opening question would be: what are the ideal conditions required to support further borrowing? That again would be either you, Simon, or you, Luke.

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): Maybe our answer is simpler and so I will start with us. It is really the identification of new revenue streams to support any incremental proposed borrowing. As I mentioned earlier, based on the resources that we have available to us now, it is very challenging for us to contemplate further increases in existing debt without a detriment to our rating. The GLA potentially could borrow for other things in the future but it would need to be very comfortable that there is a discrete revenue stream coming with that that would support the repayment of debt in the long run.

Gareth Bacon AM (Chairman): Something like Crossrail 2, for example?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): Subject to suitable revenue streams, that could be something we would consider.

Simon Kilonback (Chief Finance Officer, Transport for London): Chairman, if I may, just to support Luke in this, the issue is identifying incremental funding. If we can identify and secure incremental funding, then we can use borrowing as a financing mechanism to deliver things earlier.

Gareth Bacon AM (Chairman): How likely do you think that is going to be in the coming few years?

Simon Kilonback (Chief Finance Officer, Transport for London): The Crossrail 2 team is submitting another strategic outline business case (SOBC) this summer which does identify a number of streams of additional income that could be used to finance London's share of that project. That will be submitted over the summer to both the DfT and TfL investment programme assurance processes. We will see where we get to. We have demonstrated clearly in SOBCs that have not been approved as yet that the economic case is shared and accepted for Crossrail 2. The challenge has been increased over time about how much London should pay and when and the current SOBC will reflect those challenges and we will see where we get to.

Gareth Bacon AM (Chairman): Yes. That is a subject for a whole other meeting. I am just going to tease out a date. When are you expecting to know more about that? We have had this before --

Simon Kilonback (Chief Finance Officer, Transport for London): I know, yes. We are in the process of submitting a revised SOBC this summer [2019]. We are dependent upon the Government approving it and giving us an answer when it is ready to do so. Our shared intent with the DfT is to approve the SOBC and then to discuss with the Treasury in the Spending Review the funding of that project.

Gareth Bacon AM (Chairman): It is the mythical Spending Review that might happen at some point, maybe in the future, perhaps?

Simon Kilonback (Chief Finance Officer, Transport for London): Exactly.

Gareth Bacon AM (Chairman): All right. Luke, we [the London Assembly Budget and Performance Committee] met with the Old Oak and Park Royal Development Corporation yesterday to talk about its plans. It is planning on increasing land values by implementing capital infrastructure. Is there a case to make for borrowing to fund that capital infrastructure?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): The GLA would be comfortable taking some risk to support that endeavour. Whether that involved directly borrowing new money or whether it involved using some of the GLA's cash on the balance sheet to support it, which is a form of debt financing but with not quite the same introduction of risk to the GLA, it would be something that we would consider. However, we would have to be very comfortable with the business case and there would have to be an incremental benefit observable to support the repayment of any such commitment.

Gareth Bacon AM (Chairman): One of the problems they have is that they have been awarded a £250 million Housing Infrastructure Fund grant. They do not have the money. There has to be a way of satisfying various conditions but they said yesterday that they are going to be talking to the GLA about underwriting that. Where have the conversations got to on that?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): Certainly not to the point where I am able to confirm anything, but my team will be looking at the risks involved with any borrowing or borrowing-like solution.

Gareth Bacon AM (Chairman): One final question is to you again, Simon. One of the Mayor's pledges was to deliver 10,000 affordable housing units on the TfL estate and the delivery of that has been, to say the least, slow so far. Has TfL considered borrowing to deliver that rather than relying on private development?

Simon Kilonback (Chief Finance Officer, Transport for London): This is one of the frustrations that Assembly Member Duvall referred to earlier. We do not have the flexibility to do that currently. Within our agreed borrowing limits from the Government, there is no provision for us to borrow to deliver housing and it is one of the things that we will explore, but now we have a very clear strategy about what we are going to do. We have identified that we have sufficient asset that you would expect to be able to borrow against the value of those assets in order to do so. It is one of the things that we will be exploring with the Government. I know discussions have been taking place with Homes England and others who also see that, with greater flexibility to finance housing given the estates that TfL has, we could be more ambitious about the delivery, but that does require the Government to allow us to borrow or to provide us the ability to use financing mechanisms to do that.

Gareth Bacon AM (Chairman): Tempting fate, that is another conversation that may happen as and when the Government is not focused solely on Brexit?

Simon Kilonback (Chief Finance Officer, Transport for London): Yes.

Gareth Bacon AM (Chairman): The final question is coming back to Crossrail. If Crossrail were to be delayed again - and nobody in this room hopes that it is but let us say it is - how sustainable would it be for the GLA to take on the borrowing to fund any shortfall?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): Based on our current view of the world, that would be very challenging. One of the things that we are very pleased with in terms of the settlement we arrived at with the Government for the incremental additional borrowing for Crossrail was the fact that we were able to secure a regulatory change that allows us to use the MCIL to support borrowing. It may be the case that if our current forecasts are exceeded as a result of that revenue stream being stronger than we currently expect, there may be some headroom there, but again the ability to borrow further from where we are today without detriment to our rating or financial stability very much depends on additional income being identified.

Gareth Bacon AM (Chairman): The short answer to that then is, "Not really", is it not? It would not really be very sustainable at all?

Luke Webster (Group Treasury and Chief Investment Officer, Greater London Authority): Not without more money being identified. We have been very prudent with our MCIL forecasts and so I would say there is quite a high likelihood of some upside there, but additional borrowing from where we are today is not something that I would recommend today.

Gareth Bacon AM (Chairman): That is very clear. All right. In the absence of further questions, we have now reached the end.

Can I thank all of our guests for attending and for your answers, which were very informative? In particular, you, Luke, have stayed beyond the time. I was told that you needed to leave 45 minutes ago and so thank you for sticking around.