

Board



Date: 30 August 2022

Item: Government funding settlement

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 to allow for the latest information available on TfL's financial position to be provided.

1 Summary

- 1.1 This is a pivotal moment in TfL's recovery from the pandemic. The devastating impact the pandemic had on TfL's finances meant that extraordinary Government revenue funding has been required to continue to operate our services. Over the course of the pandemic, the Government has provided over £5bn of funding to TfL. This has been provided in a series of short-term funding agreements, which have enabled TfL to continue to operate our services and support London through the pandemic. However, throughout the pandemic, TfL has had to continue to respond to the evolving crisis and it has been unable to plan for the future, has lacked certainty and has lacked stability.
- 1.2 TfL has been on a path back to financial sustainability by April 2023 and therefore on a declining trajectory of Government revenue funding. This means that 2022/23 is the last year that Government revenue support will be required.
- 1.3 TfL also requires longer-term capital funding to avoid the 'managed decline' trajectory upon which the current budget is based. Managed decline involves significant service reductions, deteriorating asset conditions and no new enhancement schemes. This would not only mean that we will fail to make progress on critical priorities such as safety, decarbonisation and air quality, but it would trap London's transport network in a vicious circle of deteriorating services and declining demand. Avoiding managed decline is critical to supporting the London economic recovery, and therefore the national economic recovery, following the pandemic. All major transport networks globally rely on a form of Government funding to support their pipeline of infrastructure investment.
- 1.4 Longer-term capital funding would also provide the certainty and stability required to make long-term decisions on infrastructure investments in an effective and efficient manner.
- 1.5 In response to TfL's request for short-term revenue support ending on 31 March 2023 – from which point TfL would be financially sustainable – and a multi-year capital settlement, on 22 July 2022 the Department for Transport (DfT) proposed a draft 20-month settlement with wide ranging and complex conditions.

- 1.6 As described at the meeting of the Board on 9 August 2022, we have been discussing the draft proposed funding settlement with Government since receiving the initial proposal on 22 July 2022. Those discussions have now concluded and this paper, together with the related paper on Part 2 of the agenda, describes the latest position and asks the Board to consider whether to accept the Government's funding proposal.
- 1.7 Since 24 June 2022, TfL has been operating under a series of extensions to the previous funding settlement, which have provided revenue top up, but no base funding. The last of these expired on 3 August 2022. Our cash reserves have decreased during this period, but we have continued to maintain our assumption of a balanced budget over the full year, on the basis that an acceptable settlement with Government will be achieved.
- 1.8 A paper is included on Part 2 of the agenda which contains exempt supplemental information that is exempt from publication by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972 in that it contains information relating to the business affairs of TfL. 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 Board is asked to consider this paper and the related paper on Part 2 of the agenda and decide whether, subject to receipt of a signed letter from the Secretary of State in the terms described in this paper and the related paper on Part 2 of the agenda, to accept a further funding agreement with the Department for Transport on those terms.**

3 Background

- 3.1 TfL's financial position has been considered at length at the meeting of the Finance Committee on 22 June 2022 and the meetings of the Board on 27 July 2022.
- 3.2 Late on 22 July 2022 we received a draft proposal for a funding settlement from the DfT. To provide time to properly consider and respond to this detailed proposal, TfL requested a two-week extension of its current funding settlement to 11 August. However, DfT were only willing to offer a five-and-a-half-day extension until midday on 3 August 2022. This has subsequently expired and since this point TfL has been operating using its cash reserves, without any revenue protection or other support from Government.
- 3.3 During this period, constructive discussions with Government on the proposed funding settlement have been ongoing. A second draft proposed funding settlement from the DfT was received on 4 August 2022, which informed the meeting of the Board on 9 August 2022.
- 3.4 After the meeting of the Board on 9 August 2022 had concluded, a third proposed funding settlement was received late that evening. Discussions continued on this revised proposal and a fourth proposed funding settlement was received from the DfT on 16 August 2022.

3.5 The Chairs of the Finance Committee and the Audit and Assurance Committee have also had interim briefings as the discussions with Government have been ongoing to provide additional context for this paper.

4 Context

Revenue funding

4.1 The pandemic has had a devastating and long-lasting impact on TfL’s income. Table 1 shows comparison of TfL’s actual passenger income compared to that assumed in the 2019 TfL Business Plan – the last business plan prior to the pandemic. This shows there is an ongoing structural reduction in passenger income of around £1.5bn pa. While we remain very grateful for the £5bn of extraordinary funding support the Government has provided in the past two years, this has not fully offset the revenue lost due to the pandemic.

Table 1 - Comparison of lost revenue and extraordinary Government funding

	£bn	2020/21	2021/22	2022/23	2023/24
Passenger revenue (2019 Business Plan)		5.1	5.4	5.8	6.5
Passenger revenue (Actual / budget)		1.5	3.0	4.3	5.0
Lost revenue		(3.5)	(2.3)	(1.6)	(1.5)
Government extraordinary funding (actual / budget)		2.5	1.7	1.2	0

4.2 During the pandemic, our approach of tight cost control and rebuilding our revenue has meant TfL has been on a declining trajectory of extraordinary Government support. The 2022/23 TfL Budget outlined the final step back to financial sustainability and set out a £1.2bn full year funding requirement in 2022/23 and no further extraordinary revenue support being required in 2023/24.

Longer-term capital funding

4.3 Due to a lack of certainty on longer-term capital funding from Government, the 2022/23 TfL Budget is based on a ‘managed decline’ scenario. This involves significant service reductions, deteriorating asset condition and no new enhancement schemes.

4.4 Table 2 shows the impact this managed decline scenario on our planned capital expenditure for 2022/23 and 2023/24, would have, compared to the 2019 TfL Business Plan.

Table 2 - Capital expenditure

	22/23 -23/24 £bn <u>two year total</u>
Current Managed Decline Budget)	3.4
2019 Business Plan (like-for-like basis)	4.2
Decrease in capital funding (on like-for-like basis)	<u>0.8</u>
NB: 2019 Business Plan (as published)	3.8

- 4.5 Therefore, on a like-for-like basis, the planned capital expenditure in 2022/23 and 2023/24 is c.£800m lower than was planned pre-pandemic, a reduction of almost 20 per cent.
- 4.6 As a large proportion of the TfL capital programme was contractually committed prior to the pandemic, for example on major contracts for rolling stock procurement, this reduction in the managed decline budget has not been equally applied across the capital programme.
- 4.7 The managed decline scenario has had a disproportionate impact on smaller schemes, which have shorter lead times in contractual terms, and were therefore more flexible. The most significant impacts of the managed decline budget were on:
- (a) Healthy Streets programmes, which in the 2019 Business Plan had on average £230m pa funding, compared to circa £30m pa in the managed decline budget. The majority of the funding in the managed decline budget is to complete the improvements at Old Street. Therefore, the funding for London Boroughs ceased entirely on 24 June 2022. There was only £10m pa for safety improvements that are statutorily required, meaning that no substantive improvements will be made to the safety of our road and public transport networks.
 - (b) Environmental schemes, such as investment in charging infrastructure or improvements to energy efficiency, which has been removed entirely in the managed decline budget.
 - (c) Step-free access schemes – with no further projects included in the managed decline budget after the completion of the current tranche of initiatives, many of which were third-party funded. We have stopped the remaining TfL funded schemes.
- 4.8 This means the managed decline scenario fails to make any progress towards key strategic outcomes on safety, decarbonisation, air quality and accessibility. Even a modest increase in capital funding above the managed decline level can unlock significant benefits for London and – through our supply chain impact – across the UK.
- 4.9 To create this like-for-like comparison of the 2019 Business Plan and current managed decline budget, a number of adjustments are required, as detailed in

Table 3. A superficial comparison of the headline figures would not provide a meaningful evaluation.

Table 3 - Like-for-like adjustments to 2019 Business Plan

<u>22/23 -23/24 two year total</u>	<u>£bn</u>
	3.8 2019 Business Plan (as published)
0.25	Inflation has been significantly higher than expected in the 2019 Business Plan
0.23	Grant funded projects were excluded from the 2019 Business Plan and are now included in gross expenditure and funding lines
0.26	Increase in the costs of completing Crossrail since 2019 (the majority of which have been met by London)
(0.37)	Property investment was included in the 2019 Business Plan but is now shown separately
	<u>4.2 2019 Business Plan (like-for-like basis)</u>

- 4.10 Even after these quantified adjustments, this is likely to understate the negative impact of the managed decline budget. During the pandemic, in 2020/21 and 2021/22, TfL significantly reduced planned expenditure on capital renewals – with the actual level of delivery being £280m below the 2019 Business Plan. This has created a backlog of asset renewals and an ongoing deterioration in the state of good repair. Therefore, to achieve a similar level of outcomes as the 2019 Business Plan an increased level of asset renewals is required to address this backlog.

5 Next steps

- 5.1 We described to the Finance Committee at its meeting on 22 June 2022 and the Board meetings on 27 July 2022 and 9 August 2022, the position that would apply if we no longer have certainty of Government support or other funding to be able to meet our obligation to operate to a balanced budget. That position remains a constant backdrop to our funding discussions with Government.
- 5.2 At those meetings, we described the process for and implications of section 114 of the Local Government Finance Act 1988 (s114). If the Chief Finance Officer were to consider it necessary to prepare a report under s114, careful consideration would need to be given to what services TfL is able to continue to run within available funds, taking into account our general financial obligations and our core statutory duty to provide safe and efficient public passenger transport services as well as those services specified in statute and the significant contractual and statutory consequences which would be presented to Members to consider.
- 5.3 If the decision of the Board is to accept the further funding agreement referred to in this paper, it is not considered necessary to issue a s114 report at this time.

List of appendices to this report:

None

Background papers:

Finance Committee paper 22 June 2022 Update on Funding

TfL Board paper – 27 July 2022 – Finance Report

TfL Board paper – 9 August 2022 – Update on Funding

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

Contact Officer: Patrick Doig, Group Finance Director and statutory Chief Finance Officer

Email: Patrick.doig@tfl.gov.uk