Finance Committee

Date: **23 November 2022**

Item: **Enterprise Risk Update - Changes in Customer Demand (ER09)**

This paper will be considered in public

1 Summary

1.1 This paper sets out our current understanding and control measures on Enterprise Risk 09: Changes in customer demand. This is a very broad risk, with significant potential implication for our financial and transport strategy. Protection against revenue volatility is afforded until March 2024 as part of the August 2022 funding agreement with the Government, as a response to the continued elevation of the risk caused by the coronavirus pandemic. This does not mitigate the risk to TfL's financial sustainability from April 2024 onwards or the risk to policy aims which are impacted by mode shift, such as carbon reduction.

1.2 This paper discusses the risk and how it is controlled, concluding that the risk of change to customer demand has materialised as a result of the coronavirus pandemic, and TfL now needs a clear focus on how to improve against our post-pandemic baseline. This will also mitigate the risk of further falls in demand.

1.3 A paper is included on Part 2 of the agenda, which contains exempt supplemental information. The information is exempt by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972 in that it contains information relating to the financial affairs of TfL. Any discussion of that exempt information must take place after the press and public have been excluded from this meeting.

2 Recommendation

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

3 Background

3.1 The risk was initially identified as *SR9, Inability to meet changing demand* prior to the onset of the coronavirus pandemic. 'Changes in customer travel patterns' was identified as a possible cause to the risk, however the probability of the risk materialising was deemed low (less than 25 per cent), and the health and safety impact was assessed as very low.

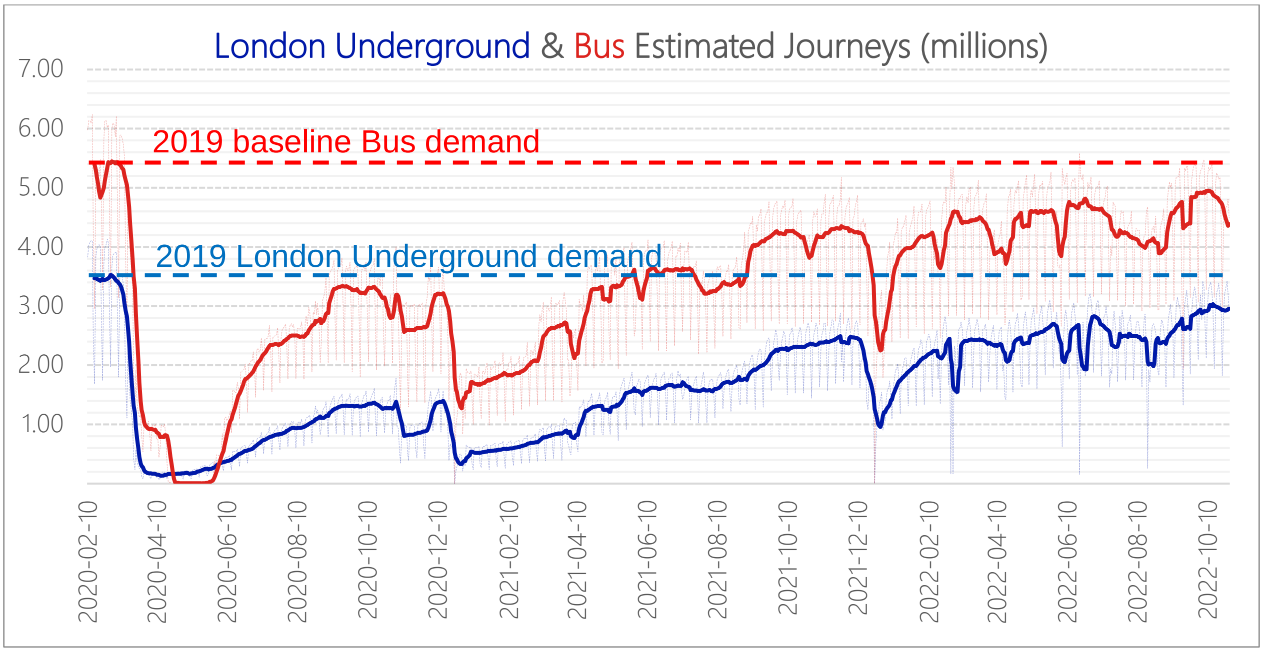
3.2 In 2020 the risk was reframed as ER09, Changes in customer demand during the coronavirus pandemic and reflected a very high (greater than 80 per cent) probability of the risk materialising with an increased impact to health and safety. The definition notes a risk of reduction in travel caused by the pandemic in the short-term, economic factors in the medium-term and behavioural changes in the longer-term, causing customer demand to be too low to meet income targets and deliver the Business Plan.

3.3 Since 2020, the short-term risk identified has materialised, the predicted medium-term economic impact of the pandemic has materialised (exacerbated by geopolitical events) and customer behavioural changes persist but have not yet stabilised. Therefore, ER09 remains a top-level risk requiring pro-active intervention to mitigate against and to improve demand recovery.

4 Demand forecasting

4.1 Demand for travel in London covers all modes of transport, including public transport run by TfL and the Train Operating Companies, and private transport modes including cars, bikes, walking, private-hire vehicles and innovations such as e-scooters. Demand for each mode is linked and dependent on many factors – especially economic and demographic – and is constantly evolving.

Chart 1 – Demand recovery for Bus and London Underground since 2019



4.2 In 2020, demand across all modes fell to a fraction of previous levels in response to the coronavirus pandemic. Demand since has been recovering, with temporary reductions during periods of increased travel restriction.

4.3 At the time of writing, customer demand stands at approximately 80 per cent of pre-pandemic levels (with variation by mode). Demand recovery from the pandemic has slowed but is still on an upward trajectory. Numbers for 2022 have been affected by atypical events affecting travel patterns including extreme weather, the funeral of Her late Majesty, the Queen and national and local industrial action in the transport sector. Some new patterns however have emerged, including less peak commuting, more leisure and discretionary trips, more trips in outer London and relatively fewer trips on Fridays and Mondays.

4.4 TfL carries out two kinds of forecasting: demand and revenue forecasting (which looks at a five-year horizon) and longer-term multi-modal demand forecasting using TfL's suite of strategic transport models. In terms of the latter, TfL produces a Hybrid forecast which is drawn from emerging evidence on how London is changing including the latest population and employment projections, more working from home for office workers and a greater shift towards online shopping. TfL also produces a number of future scenarios dealing with uncertainty to help ensure that our long-term plans are robust and resilient. Scenarios have been used across TfL and applications including the Capital Planning work and the Service Level Reviews. Now that London is beginning to recover from the pandemic, our scenarios have been updated to build on previous work and reflect new long-term risks, challenges and opportunities. Forecasting was adapted in response to the pandemic to reflect increased uncertainty, with more frequent reporting and the development of several demand scenarios.

5 Risk causes and impacts

Risk causes

5.1 A number of risk factors have come to the fore in the last year which are affecting demand currently and may continue to do so over the medium to long-term.

(a) geopolitical instability:

(i) the increase in energy prices from the war in Ukraine negatively affects demand, as well as posing a threat to TfL's operations through the impact on energy security and the supply chain;

(b) domestic politics, economic pressures and the cost-of-living crisis:

(i) the Bank of England has warned that the U.K. is facing its longest recession since records began, forecast to continue into 2024. Double-digit inflation, instability in the pound, rising interest rates, stagnant wages (especially in lower-paid sectors) and rising housing costs are having a massive impact on TfL's customer base. The uncertainty around the length, extremity and impact of these economic pressures makes them a major risk to TfL's five-year revenue forecast in particular; and

(ii) forecasting and mitigating the impact is complicated by the complex effects of inequality. August 2022 analysis by the Greater London Authority reports that 19 per cent of Londoners are struggling financially, and seven per cent are going without essentials. This affects both customer behaviour and TfL's ability to influence it, and the pressure may increase with planned spending cuts and tax rises;

(c) return to the office and demographic and land use change:

(i) there is a risk that commuter numbers will not continue to increase, which is exacerbated by the damage to the perception of the reliability of public transport from industrial action. Furthermore, high cost of living and slow recovery in the London Central Activity Zone (estimated at 50-57 per cent of pre-pandemic levels as of August) may change the demographics and geography of people living in London. The Greater London Authority's recovery analysis notes that inner boroughs' populations are below where they were estimated to be, with three below 2011 population counts. These trends are accompanied by changes in land use, including repurposing of office estates with the continuation of remote working; and

(d) the climate emergency and demand seasonality:

(i) extreme weather events such as the summer heat in 2022 have impacted customer behaviour and the operation of the transport network. These will increase in magnitude and frequency as temperatures continue to rise. There has also been a seasonal winter rise in cases of coronavirus which may continue, although hospital admissions and mortality rates remain low this year compared to in previous waves.

Impact

5.2 There is an obvious, primary effect from customer numbers across modes on three of TfL's other top ten enterprise risks, which are discussed in detail in their own reports:

(a) ER01: Inability to deliver safety objectives and obligations;

(b) ER03: Environment including climate adaptation; and

(c) ER07: Financial resilience.

5.3 High priority strategic aims are also directly impacted. Notably, the Mayor's Transport Strategy aims for 80 per cent of trips in London to be undertaken by active, efficient, and sustainable modes by 2041. TfL therefore has a strategic objective to encourage customer demand to change over time towards greater use of public transport, walking and cycling.

5.4 Further to the direct impacts, the financial implications have a secondary effect on TfL's ability to maintain and invest in its services and network to support demand growth, which means that low customer demand has the potential to have a compounding effect. Many capital investment projects are advantageous in a range of demand scenarios, but may not be affordable.

6 Risk response (preventative and corrective)

Preventative actions and monitoring

6.1 TfL monitors changes to demand and demand drivers through the revenue forecasting and scenario planning work discussed previously, as well as through horizon scanning and market intelligence work.

6.2 A number of measures are in place and under consideration to aid demand recovery: recovery campaigns are underway to reassure customers that they can travel with confidence as London adjusts post-pandemic, with additional incentivisation including partnership deals, fare incentives and charging; and customer experience is being improved through upgrades and extensions like the Elizabeth line opening, service and reliability increases, and quality improvements such as those set out in the Bus Action Plan. Fare evasion is also being tackled to recover revenue.

6.3 The criticality of maximising demand recovery now and building and maintaining growth in a range of possible future operating environments means that work to understand and influence customer behaviour is of great strategic importance. A customer strategy is in development to address this need, which aims to provide a clear proposition and action plan for demand growth on top of the existing interventions. Prioritising demand recovery in this way is also a mitigation against further impact from demand risk.

Corrective actions

6.4 Corrective action focusses on mitigating the impact of fares revenue reduction from low demand.

6.5 One major protection is the insurance against revenue volatility afforded by the allowances in the August 2022 funding agreement, which is in effect until March 2024. While this is a comprehensive mitigation against short-term uncertainty, it is crucial that revenue is recovered and stabilised by the time the protection ends if TfL is to achieve independent financial stability.

6.6 Another key corrective approach is to look at options to diversify income so that TfL is less dependent on fares revenue. Income sources which are not driven by the same factors that drive customer demand are of particular importance. TfL is currently pursuing opportunities including business rates, grants, community infrastructure levies, developer contributions and property investment through its new independent property company.

6.7 Where income cannot be increased, spend reduction is the mitigation. Planning processes such as business planning, long- and medium-term capital planning and the service level review integrate scenario planning work to proactively adjust plans to what is affordable. Adaptations do include flexibility in service provision (where there are marginal costs that could be recovered), though it is noted that this compromises the preventative mitigation of driving demand through improvements to service. Spend reduction continues monitored through ongoing financial governance and tight financial controls.

7 Overall assessment of risk

7.1 This is a broad risk at the heart of our business so scores extremely highly. The financial impact it can create is exceptionally high, as has been experienced over the course of the coronavirus pandemic. It also has a fundamental influence over our relationship with customers and stakeholders and the long-term prosperity outlook for London.

7.2 This risk will always be large, and this is reflected in the target scores. Although lower than last year, all four risk impact categories are still considered to be outside tolerance. The risk has materialised and remains a top priority to monitor and mitigate. Actions to drive customer demand will be key to TfL achieving its strategic aims.

List of appendices to this report:
A paper containing exempt supplementary information is included on Part 2 of the agenda.

List of background papers:
None

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