Finance Committee

TRANSPORT FOR LONDON
EVERY JOURNEY MATTERS

Date: **13 March 2024**

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 implications for our financial sustainability and the delivery of our transport strategy. Passenger demand has now stabilised and is around 90 per cent of pre-pandemic levels. However, our protection against revenue volatility will end by 31 March 2024 when the August 2022 funding agreement with the Government ends, which will increase the level of exposure TfL has to change in customer demand and increase the potential impact of this risk to TfL’s financial sustainability. Due to the fact that passenger demand has increased by six per cent this financial year, we have reduced the overall risk score from Very High to High following the risk assessment.

1.2 This paper outlines the risk and how it is controlled, concluding that the level of risk that customer demand is too low to meet income targets and deliver against our strategic priorities, has reduced since the coronavirus pandemic, based on the strong demand growth over the current financial year and the current demand stability. TfL now needs to continue to improve passenger demand to achieve our six per cent passenger growth target that we have set in the proposed 2024/25 Budget. This will mitigate the risk of further reduction 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 although customer demand has stabilised recently, the ongoing geopolitical and economic turmoil limits our ability to properly forecast demand growth to determine how long it will take for demand to recover fully. Based on the balance of factors influencing customer demand, we have reduced the probability of ER09 risk materialising from Very High to Medium, with the recognition that it requires pro-active intervention to mitigate the risk and to continue 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. However, this risk focuses on passenger demand for TfL’s public transport services.

4.2 In 2020, demand across all modes fell to a fraction of previous levels in response to the coronavirus pandemic. In the past year, our ridership levels have continued to bounce back, returning to around 90 per cent of pre-pandemic levels, with many weekends surpassing 2019 demand. In our 2024 Business Plan, we are forecasting annual demand levels to return to pre-pandemic levels of 4bn by 2026/27.

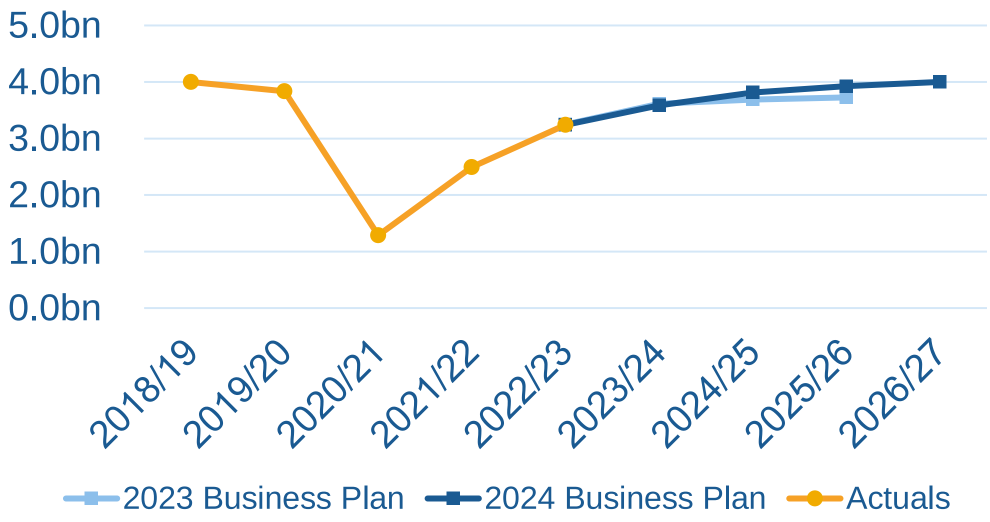

Chart 1: Passenger demand forecasts (billions per annum)

4.3 TfL carries out two kinds of forecasting: demand and revenue forecasting (which looks at a shorter-term horizon); and longer-term multi-modal demand scenario planning and forecasting using TfL's suite of strategic transport models.

4.4 The coronavirus pandemic presented us with a huge forecasting challenge and, although this situation has become more stable, the associated movement towards the new normal for travel behaviour continues to cause some uncertainty. Our demand forecasts have always been underpinned by independent data and statistics and informed by our analysis of the effect of real events and our own expertise, but the continued uncertainty means we must continuously adapt our approach to forecasting.

4.5 TfL produces a number of future demand scenarios dealing with uncertainty to help ensure that our long-term plans are robust and resilient. These scenarios are underpinned by a range of external forecasts relating to the economy and population but now also include projections for less reliable factors, such as the commuting frequency of office workers and when we are likely to reach the new normal for travel behaviour.

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. These include:

(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 warned of a 50 per cent chance of a recession by the middle of 2024/25, beginning around spring. It forecast four quarters of zero growth in Gross Domestic Product, should interest rates follow the current path predicted by financial markets. Furthermore, if interest rates continue to be high for longer, a recession in the summer is likely. Further government austerity measures, especially real terms cuts to working age benefits, will have a disproportionate impact on Londoners living in low income households; 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 change in customer travel patterns:

  (i) while coronavirus and related restrictions on activity may no longer be materially affecting travel demand directly, demand remains stable at around 90 per cent of pre-pandemic levels. There is however uncertainty around whether commuter numbers will increase and how long it will take for demand to recover fully. This uncertainty is exacerbated by the ongoing periods of industrial action and the impact it has on the perception of the reliability of public transport;

(d) asset performance:

  (i) investment in our assets has been constrained to between £400m and £600m over the last five years against an estimated steady state requirement of around £1bn per year. This has led to a level of decline in condition and performance, but our renewals investment is now on an upward trajectory as our 2024 Business Plan builds our investment to a level of around £925m over the duration of the plan. Based on our asset modelling, experience of other transport networks and experience of TfL's predecessor organisations, a decline in condition and performance is likely to lead to a reduction in customer satisfaction and demand;

(e) major national or London-wide events:

  (i) major events such as a future pandemic or a terrorist event will have significant impacts on customer demand; and

(f) the climate emergency and demand seasonality:

  (i) impact of extreme weather events on TfL's services and demand. The number and intensity of severe weather events is increasing, with prolonged periods of hot weather, flash flooding and winter storms and all of these could lead to service disruptions or delays.

Impact

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

(a) ER04: Significant security incident including cyber security;

(b) ER03: Environment including climate adaptation;

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

(d) 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 The key controls through which we mitigate the risk are business planning and budgeting and scenario planning and revenue forecasting, complemented by horizon scanning and market intelligence work, through which TfL monitors changes to demand and demand drivers.

6.2 A number of measures are in place and under consideration to aid demand recovery. Incentivisation schemes include partnership deals, fare incentives and charging such as the 2024 fares freeze and the recently announced proposal for off-peak Fridays trial. Customer experience is being improved through upgrades and extensions like the Elizabeth line and service improvements like the Superloop express bus routes improving connectivity in outer London, the boosting of DLR services to increase the frequency of services across the network 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 strategic importance. We have developed our Customer Strategy in December 2023. It brings together key activities from across the business in a coherent way and it will form the basis for our 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 focuses on reducing the impacts of fares revenue reduction resulting from low demand.

6.5 The protection against revenue volatility which was afforded by the revenue top-up mechanism in the August 2022 funding agreement with Government comes to an end in March 2024 but the increased exposure to demand risk is partly mitigated by the fact that demand has increased since 2022/23 and we are on track to achieve operational financial sustainability in 2023/24.

6.6 Another key corrective approach is to implement measures to diversify our 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 to diversify and increase its income including business rates, grants, community infrastructure levies, developer contributions and development of a green project pipeline through which we can unlock third party funding, commercial media partnerships and property investment through our property company, Places for London.

6.7 Where income cannot be increased, spend reduction and cost reduction are mitigations. Planning processes such as business planning, long- and medium-term capital planning and service level reviews 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 this compromises the preventative mitigation of driving demand through improvements to service. Spend reduction is continually monitored through ongoing financial governance and tight financial controls.

6.8 In the 2023 Business Plan, we committed to £600m of recurring operating savings by 2025/26, adding to the £1.1bn of savings already delivered between 2016/17 and 2021/22. Our new 2024 Business Plan, approved in December 2023, stretches that target to £650m (over the same time period) to continue offsetting the impact of inflation, such that on a like-for-like basis, after adjusting for new services, restructuring and other one-off costs, our operating costs in 2026/27 will be, in real terms, lower than the current financial year of 2023/24.

7 Overall assessment of risk

7.1 This risk will always be large due to its potential financial impact but due to the strong demand growth over the current financial year and the current demand stability, we have lowered the overall risk score to High from Very High. The customer and stakeholder confidence impacts have both reduced from High to Medium, the Safety, Health and Environment impact remains Low, while the cost impact remains Very High. The risk remains a top priority to monitor and mitigate and the controls we have in place should enable us to do achieve both.

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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