Mayoral Combined Authority Board

25 July 2022

Budget & Business Plan Development 2023/24

Is the paper exempt from the press and public?	No
Reason why exempt:	Not applicable
Purpose of this report:	Discussion
Is this a Key Decision?	No
Has it been included on the Forward Plan?	Not a key decision

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Executive Summary
This report provides an outline on the process for developing the budget and supporting business plan for the new financial year. The report notes the challenging environment in which this process is taking place, the policy decisions that will drive the financial strategy, and the need for engagement with partners.

What does this mean for businesses, people and places in South Yorkshire?
The MCA's financial plan, as manifested through its budget, provides the resource to deliver upon South Yorkshire's aspirations. The developing business plans and accompanying budgets will determine how, where, and to what level the MCA invests in the region in the coming years and will set out how that investment is to be funded.

Recommendations
- Note the budget and business planning process being undertaken within the MCA;
- Note the significant uncertainties shaping the process; and
- Note the proposed approval timeline.

1. Background

1.1 In common with other public bodies and local partners, the MCA Group is required to set a balanced budget each financial year. This budget must be approved by Members ahead of the new year and be supported by a medium-term financial strategy that takes account of forecast future expenditure, funding flows, and the requirements for use of reserves.

1.2 The budget represents the financial plan and is in turn derived from the Corporate Plan and service level Business Plans. Collectively, these plans set out a defined body of activity for the year, and the ways and means through which the MCA will deliver upon it.

1.3 As the nation begins to transition to a post-pandemic era a number of generational policy and strategy choices lie ahead for the region. Decisions will be required around the future relationship between the MCA and bus service provision, whilst similar and equally challenging choices will be required around the operation and funding of the tram network.

1.4 Choices will also be required on how best to deploy Gainshare funding through the Renewal Fund's Investment Strategy, balancing the need for investment in economic growth with that required to meet skills, transport, housing, and infrastructure aspirations. Wrapped around all this will be the overarching need to ensure that investment is sustainable, inclusive, and supportive of net zero targets.

1.5 In common with other partners, however, the MCA's ability to plan is constrained by significant uncertainties. Principally, the MCA's activity will be heavily influenced by the evolving societal changes precipitated by the pandemic, the prospect of volatility in financial markets arising from high-inflation and low growth, and ultimately the resultant governmental response.

1.6 Significant organisational focus will also be consumed by the planning and delivery of the formal dissolution of the South Yorkshire Passenger Transport Executive (SYPTE) and the adoption of its roles, responsibilities, assets and liabilities into the MCA upon the passing of the necessary legislation.

1.7 As in the previous two budget and business planning cycles, the MCA will undertake a Group wide process that allows for activity and resource to be both rolled up at the Group level and disaggregated to the single entity level as necessary. This will support the ongoing practical integration activity and better enable management of resource between SYPTE and the MCA Executive ahead of the formal dissolution order being received.

1.8 This report outlines the business planning process that will be undertaken and notes the challenges ahead. At this stage of the planning cycle the report does not contain proposals for the transport levy or other member contributions but does set out the engagement path that will help to inform those proposals.

1.9 Formal agreement will be required for the South Yorkshire Transport Levy at the MCA's meeting of the 16th January. Should one be proposed, the MCA will also need to consider a Mayoral precept by early February. The Board will be asked to consider final budget proposals in March.

2. Key Issues

2.1 Building upon exercises undertaken in the previous two financial years, the MCA Group – consisting of the MCA Executive and SYPTE – have committed to undertaking an integrated business planning exercise for the forthcoming financial year.

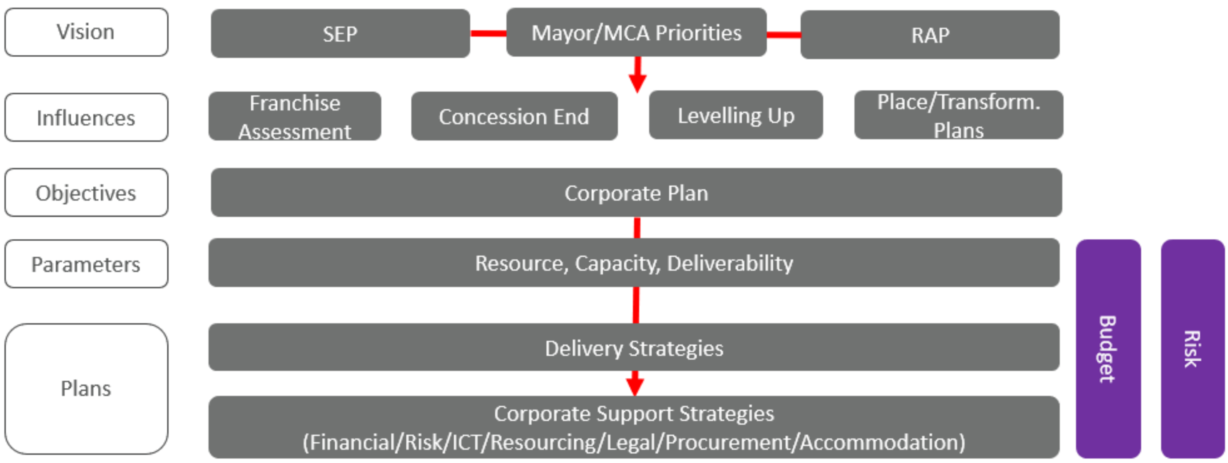
2.2 This exercise will drive corporate focus on the objectives for the year, help shape activity plans, and allow for resource to be deployed to agreed priorities. On the back of this exercise a budget and medium-term financial plan can be set. An integrated approach across the Group supports better alignment in planning and use of shared resource.

2.3 The business planning process is fed from the MCA's anchor vision statements and influenced by a number of national policy issues such as national budgets and Spending Reviews and the evolving approach to devolution now framed within the Levelling Up agenda. Local policy issues such as the development of the Renewal Fund Investment Strategy and its Place and Transformational Plans; the manifesto of the new Mayor; the work on the Bus Franchise Assessment; and the planning for the end of the current tram concession in March 2024 all serve to form how MCA decisions can react to and shape national and global issues locally.

2.4 The Corporate Plan, currently in development, will capture these issues and shape agreed objectives for the coming year. Parameters for delivery plans are then set by the financial resource available and organisational capacity. These issues determine deliverability – what can be achieved.

2.5 Within these parameters, delivery plans will then be developed by individual teams, in turn shaping the corporate support strategies. Collectively, these plans will then feed the budget requirements for the year.

2.6 The process can be exemplified as follows:



Local Transport Authority Activity

2.7 In the forthcoming financial year SYPTE and the MCA Group will face a number of interdependent, generational transport challenges:

a) Supporting the transition of the bus and tram network from the emergency subsidy model to a commercially viable one;
b) Undertaking a bus franchising assessment and determining next steps;
c) Preparing for the end of the current tram concession in 2024 and delivering the required operating and funding model for April 2024 onwards;
d) Developing a financial strategy to support all of the above issues and tackle the structural deficit in the revenue budget as the current reserve strategy begins to unwind.

2.8 Whilst patronage on buses and tram has improved it is still short of commercially sustainable levels, currently running at around 70-75% of the seasonal average across both modes. Reduced patronage results in reduced revenue for the commercial operators and increases the likelihood of services being withdrawn to the detriment of South Yorkshire's communities, businesses, and the recovery effort.

2.9 Patronage continues to be affected by a number of factors including passenger confidence; increased home-working; reduced social, retail, and leisure demand; and currently a lack of drivers and other personnel to service both bus and tram services.

2.10 To-date, lost-fare revenue has been mitigated by local and national interventions. SYPTE has continued to pay concessionary-fares at pre-Covid volume levels, whilst government has provided grant support directly to bus operators and tram support to the MCA. The MCA has further committed local resource to priming demand for services and supporting social mobility through the re-commitment of funding for a twelve-month 18–21-year-old concessionary discount and the one-off roll out of a 'Summer-Saver' 25% discount for journeys over an eight-week summer period in 2021.

2.11 All these measures have supported the continuing provision of services at close to pre-pandemic levels (albeit with some underperformance due to driver shortages and strike action) and helped to increase patronage from the depressed levels seen during the pandemic.

2.12 The continuation of the network at current levels is, however, subject to two persisting variables:
   a) Patronage levels, in particular their return to commercially viable levels; and,
   b) The continuation of Government support in one form or another.

2.13 At the time of writing government has committed to maintaining bus and tram funding to the end of October 2022. Accordingly, it is not expected that there will be further funding from Government to support the gap between current and required farebox income levels.

2.14 This issue is compounded by the fact that South Yorkshire received no funding from the Bus Service Improvement Plan funding round. Other MCA areas in receipt of this funding have already begun to deploy resource to patronage-primers to support recovery.

2.15 Whilst transport patronage levels have improved there is notable regional variability and little sign at this stage that the journeys lost to home-working and online retail will return in the near-term.

2.16 In the now likely event of a cessation in Government support to operators before patronage recovers to sustainable levels, SYPTE is likely to see calls for increased local financial support or risk the loss of services. At the time of writing it is expected that up to 30% of services will be withdrawn. The forecast cost to protect just those services that meet the existing tendered services criteria is estimated at c. £10m p/a, with the cost of buying back every withdrawn service much higher at around £40m p/a. Such support will be difficult to achieve without significant change to the limited discretionary elements of the SYPTE budget, or recourse to reserves in the short-term and levy increases in the longer-term.

2.17 Whilst the withdrawal of services may result in lower costs for the MCA's statutory concessionary fare budget (where costs are incurred based on journeys undertaken) this saving will eventually represent less income to operators. Savings made on the concessionary fare budget can be redeployed to the tendered services budget, but buying-back withdrawn services is ultimately a relatively cost-inefficient means of supporting services.

2.18 Accordingly, the ongoing commercial sustainability of the bus and tram networks will remain a key concern for the MCA over the forthcoming financial planning cycle. These macro issues are largely outside the MCA's direct control but will be strongly influenced by the local policy decisions that will be taken ahead of October and into Autumn around the future of bus services and the MCA's role in the delivery of those services.

2.19 In the new year SYPTE and MCA Group will also need to begin enacting plans for both the Mass Transit Renewal programme and the likely repatriation of operational tram responsibilities from March 2024 onwards.

2.20 Whilst the MCA has received an initial commitment from Government to £100m of renewals support via the new City Region Sustainable Transport Settlement (CRSTS) funding, a more pressing planning concern is the likely exposure to the financial risk and reward of operational services. Over the last decade this risk has been borne by Stagecoach under the long-term concession arrangement that ends in 2024.

2.21 Work has been ongoing for a number of months to explore operating models that best allow the MCA to maintain operations whilst limiting financial exposure, and soft market-testing will commence shortly. However, noting the existing commercial challenges in this market, for planning assumptions it will be prudent to assume that a commercial engagement similar to the existing concession will be difficult to achieve and that there will be a requirement for public subsidy.

2.22 Modelling to-date suggests that the ongoing shortfall in patronage, compounded by disruption from renewals activity, will mean that in the short to medium-term at least subsidy will be required in a range of between £4m - £7m p/a. At this stage this range represents the unmitigated position: work is underway to identify how that figure could be reduced through policy choices and potential operating efficiencies.

2.23 Other challenges and risks facing SYPTE in the new year include, but aren't limited to, considering:

- How to respond to likely operator behaviour around the cost of concessionary fares once the current SYPTE commitment to paying subsidy ends;
- How to react to likely ongoing disruption to commercial income streams; and,
- How to meet general inflationary pressures, which are now running significantly ahead of previous planning assumptions.

2.24 All these challenges will be framed within the context of the existing financial strategy that is based on a gradual release of a finite 'Levy Reduction Reserve'. This approach has sought to support partners' pressures by suppressing the need for levy contributions in the medium-term by releasing reserves as a bridge to a falling cost-base. Cost-base reductions are achieved through the retirement of legacy debt, generating revenue savings from interest payments.

2.25 Whilst this strategy has served local authority budgets well in prior years it is now becoming unsustainable as inflation and new cost pressures relating to tram subsidy outstrip the savings generated from retiring debt. Modelling now shows that by 2025 the Levy Reduction Reserve will have been exhausted with the budget in deficit by c. £6m. Accordingly, even to hold onto existing spending power either new resource or savings will need to be found.

2.26 In consideration of these points early engagement has already begun with the South Yorkshire Directors of Finance Group. Whilst a basket of potential savings and income generation options is being developed modelling has also been undertaken to determine how a phased increase in the levy could be adopted to avoid a cliff-edge in 2025.

2.27 Engagement will continue with officers and Members as both the MCA and local authority budget propositions are developed.

MCA/LEP Activity

2.28 The activity of the MCA/LEP is largely driven by access to ongoing funding streams for the delivery of capital and revenue programmes. Other, non-programme activity, such as policy development, business support, inward-investment, communications, and the delivery of statutory functions, is funded from an irregular and often unpredictable mix of funding streams.

2.29 The ability to forecast which of these funding streams will continue, and/or to what quantum, in the new year represents one of the most prominent planning obstacles for the MCA in the current planning cycle.

2.30 This uncertainty is exacerbated by the decisions taken extremely late in the planning cycle for the current financial year to unexpectedly reduce LEP capacity and Growth Hub grants after budgets had been set. This shortfall has reduced MCA core income by c. £0.50m. Receipt of this information at such a late date reflects how exposed the Mayoral Combined Authorities are to the whims of Government funding decisions.

2.31 In the near-term the loss of this income will be met from Income Resilience Reserves, but in the forthcoming cycle the MCA will need to both meet the shortfall and consider the possibility that both grants are withdrawn entirely.

2.32 Whilst it is possible that the MCA/LEP will lose a number of funding streams which underpin investment and organisational resourcing, it is also likely that the MCA/LEP will have significant ongoing challenges in delivering at pace a number of capital investment programmes, continuing to deliver new revenue programmes, all whilst operationalising the new Gainshare funded Investment Strategy.

2.33 Key financial challenges for the MCA/LEP in the new year include:

- Operationalising the new Gainshare funded Investment Strategy
- Delivering the franchise assessment within the funding envelope (£3m) and supporting next steps
- Adjusting the organisation to the potential loss of time-limited funding streams which cumulatively provide c.£2m in support to organisational costs including:
    - LEP capacity funding which has resourced core costs since 2014;
    - Growth Hub grant; and,
    - The Mayoral Capacity Fund grant which supports Mayoral Office costs.
- Delivering, at pace, an extensive capital programme including:
    - Existing commitments from:
        - Slipped gainshare activity;
        - Slipped and in-year Transforming Cities Fund activity;
        - Slipped and in-year Brownfield Housing Fund activity; and,
        - Slipped and in-year Active Travel Fund activity.
    - New allocations from:
        - Gainshare;
        - Shared Prosperity capital activity; and,
        - City Region Sustainable Transport.
- Delivering a growing body of revenue programmes, including:
    - The Adult Education Budget (AEB);
    - The Skills Bank programme;
    - The Multiply programme;
    - Shared Prosperity revenue activity;
    - Made Smarter; and,
    - Renewal Action Plan programmes funded from committed gainshare.
- Effectively forecasting income flows from commercial income streams sensitive to the economic recovery and macro economic factors such as inflation.
- Managing the formal dissolution of SYPTE and its integration with the MCA.

2.34 The inflationary environment will impact on all of this activity. Inflation is driving costs up across the wide scope of MCA operations, making it harder to sustain public transport activity, harder to keep revenue and capital programme schemes within their funding envelope and harder to generate surpluses from commercial activity.

2.35 These pressures limit the amount of resource available to the MCA, encourage us to be more defensive in resource allocation, and impact upon the pace of delivery as schemes are subject to re-design to bring them back in budget. Inflationary pressures are also continuing to make recruitment and retention more difficult as competitor organisations adjust their pay and reward policies.

2.36 Flexing organisational design to manage funding fluctuations and cost pressures such as those outlined above will be a fundamental challenge and re-emphasises the MCA's sensitivity to the vagaries of Government funding and the volatility of commercial income streams.

2.37 Whilst the future of LEP funding remains uncertain it is prudent to assume that the core capacity funding received each year since 2014 (£0.50m) will not be received in the new year. Though the loss of that funding may not seem material in the context of the MCA's overall funding package it does represent c. 10% of the MCA's overall un-restricted revenue funding.

2.38 It is also prudent to assume that the unexpected national cuts to Growth Hub funding will continue, with the loss of £0.15m needing to be made good.

2.39 The loss of that funding coupled with ongoing uncertainty around Mayoral Capacity Funding (£1m) and volatility around the quantum of retained business-rates, rental income, and investment returns is a fundamental impediment to long-term planning and capacity building.

2.40 The MCA is also likely to remain reliant on recharging into the programmes of activity it delivers to ensure that it receives a stable and consistent level of funding to discharge its obligations in delivering that activity. This reliance requires that - where funding conditionality allows – the MCA recovers the incremental costs of delivering activity and affords itself a contribution towards overheads that it would not otherwise incur if it were not running programmes at the scale it does.

2.41 Whilst much of the MCA/LEP's financial position reflects its reliance on government funding decisions the receipt of devolution powers and funding offers South Yorkshire the opportunity to build up its own financial resilience.

2.42 Following the Board's decisions in March 2022 the MCA has begun the process of developing a Transformational Investment Plan which will complement the four local authority led Place Plans. These plans will largely determine how the final 26 years of committed Gainshare funding could be deployed. Feasibility funding has been made available from these plans to support their development.

2.43 Ahead of the agreement of these plans Gainshare capital is made available to support delivery ready schemes, whilst an element of revenue (£1m) is available to support borrowing should it be required.

2.44 Gainshare funding is also made available to support destination management organisation (DMO) costs, along with provisions made for wider programme management, and an annual provision to build up costs for the funding of the four-yearly Mayoral election. Whilst these costs are funded in 2022/23 and 2023/24 decisions will need to be made on how they are sustained into the future.

2.45 Ultimately, Gainshare funding made available through the Renewal Fund represents the only source of significant funding available to the MCA that is not ringfenced by Government imposed funding conditions. The flexibility this affords will need to be considered in the round with other Government funding streams to determine how best it can be deployed alongside and in alignment with conditional funding.

2.46 Heading into the new financial year the MCA has significant amounts of transport, housing, and skills money through existing funding streams, but relatively little for business growth and infrastructure. Whilst the Shared Prosperity Fund does provide some funding for potential business support activity there is very little capital for the sort of gap funding initiatives that have attracted major investors into the region.

2.47 Finally, it is hoped that some of the cost and income pressures identified will be offset by better returns generated from cash held on deposit. Rising interest-rates are the Bank of England's primary tool to manage the inflationary pressures in the economy and serve to increase yields on investment products. This is of benefit to the MCA which is holding large cash balances from grants received in advance of need.

2.48 Whilst cash balances linked to delivery programmes are inherently hard to forecast, the MCA does expect to retain a sizeable amount of cash on deposit as capital slippage from 2021/22 takes time to unwind and new funding streams commence. These balances are likely to attract higher yields than in prior years offering the MCA the opportunity to offset some cost and income pressures against this income stream.

Engagement

2.49 Following the practice used in prior years it is proposed that MCA Group officers conduct a series of one-to-one sessions with partners outside of the formal MCA cycle.

2.50 Initial financial planning sessions have been undertaken with each of the South Yorkshire Directors of Finance in June, focussing on the Local Transport Authority position and potential implications for the levy. These sessions have allowed the MCA to better understand partner pressures and present initial proposals on how savings, efficiencies, and additional income could be generated.

2.51 More detailed budget assumptions will be prepared for the MCA Board in the September and November cycles. This will be informed by the decisions to be taken on how to respond to the likely withdrawal of bus services in October and the developing plans for the tram operating model.

2.52 Subject to the November Board, levy and precept proposals will be developed with partners ahead of the January Board cycle.

2.53 Work with the Directors of Finance Group will continue over this period with an aspiration to develop proposals that can be fed into local authority planning processes.

Budget Approval Timeline

2.54 Under law, the South Yorkshire transport levy must be approved by the middle of February, and a balanced budget be agreed by the end of March.

2.55 The MCA will also need to consider a Mayoral budget and proposals for a Mayoral precept. The MCA must consider initial budget proposals by the 1st February and has until the 8th February to propose changes. Any precept must be agreed by the 1st March.

2.56 It is proposed to use the MCA's meeting on January 16th to formally consider levy and precept proposals. Should there be agreement at this stage, it is proposed that the full revenue budget and capital programme be approved at the MCA's meeting on March 6th. Should there be dissension from the proposals for the non-transport levy budget in January, an additional MCA meeting may be required in February.

3. Options Considered and Recommended Proposal

3.1 **Option 1**
This is a discussion paper for noting only, hence there are no alternative options for Members to consider.

4. Consultation on Proposal

4.1 Officer and members will be engaged in line with the proposals in the main body of this report.

5. Timetable and Accountability for Implementing this Decision

5.1 The Director of Finance and Investment will lead on the budget and business planning preparation and engagement.

6. Financial and Procurement Implications and Advice

6.1 This is a finance report the details of which are covered in the main body.

7. Legal Implications and Advice

7.1 None.

8. Human Resources Implications and Advice

8.1 None.

9. Equality and Diversity Implications and Advice

9.1 None.

10. Climate Change Implications and Advice

10.1 None.

11. Information and Communication Technology Implications and Advice

11.1 None.

12. Communications and Marketing Implications and Advice

12.1 None.

List of Appendices Included
None

Background Papers
None