Mayoral Combined Authority Board

15 November 2021

Budget and Business Plan Development 2022/23 Update

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 update to the initial budget and business plan report that was presented to the Board on the 20th September. The report provides the latest information on passenger transport demand, assumed inflationary pressures, and the latest information that is available on likely funding.

Taking these forecasts and the engagement sessions held with the South Yorkshire Directors of Finance, the report provides proposals on the transport levy and local contributions.

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
1. Note the latest budget assumptions provided;
2. Note the proposal to freeze the transport levy at existing levels; and,

3. Note the proposal to freeze local contributions at existing levels.

Consideration by any other Board, Committee, Assurance or Advisory Panel
None

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1. Background

1.1 At its 20th September meeting the Board received a report that set out how the MCA would develop its business plan and accompanying budget for financial year 2022/23.

1.2 That report set out assumed pressures, potential opportunities, and the areas of uncertainty that were making planning difficult at that stage.

1.3 This report develops on those existing themes, providing the latest information on key budget variables such as forecast demand, available funding, and the assumed slippage of activity from the current year to the next. The report further considers the feedback received from engagement with the South Yorkshire Directors of Finance group.

1.4 The report notes the prevailing uncertainty on passenger transport demand, and the implications for both commercial sustainability and the MCA's role in supporting an appropriate level of service.

1.5 The report further notes forecast inflationary pressures and the impact that will have on the budget in the short-term, and the wider impact on medium-term sustainability.

1.6 Noting the inherent uncertainty that resides around the government's willingness and ability to support the revenue investment aspirations contained in the Bus Service Improvement Plan, the report acknowledges that a baseline plan will be required that could be flexed once greater certainty is available.

1.6 The report recognises the likely movement of significant amounts of funded capital activity from the current year to the next, and the implications for capacity as existing activity is met by that arising from new funding streams.

1.7 The report reemphasises sustainability concerns across the MCA's financial activity, noting reliance on time limited grant streams and finite reserves to support core activity. This issue is particularly prominent with the MCA's local transport activity and across its Business Growth theme.

1.8 Finally, the report considers initial outcomes from the Spending Review, which reported on the 27th October. The report notes that whilst the Spending Review provides some high-level messaging it may be some weeks before the details of Department level spending decisions are known.

1.9 In consideration of the latest information the report proposes that for planning purposes it assumed that both the transport levy and local subscriptions are held at their existing levels. This assumption would accord with those made by the four precepting authorities. The report also notes the proposal not to set a Mayoral precept for the year.

1.10 The report notes the proposal to offer one-to-one sessions with the Leaders in November/December when, hopefully, a clearer view of the Group's finances are available following the Spending Review.

1.11 The outcome of those discussions will then be fed into final preparations for the levy setting at the Board's meeting on the 24th January. Budget development will continue ahead of the final approval date on the 21st March.

2. Challenges and Assumptions

2.1 Developing business plans and budgets for the new financial year remains a challenge for the MCA and partners alike. Without a clear view on how the pandemic and governmental and societal response will evolve over the coming months, it is difficult to derive any certainty.

2.2 In this context this report provides an update on the key challenges identified and working assumptions for each part of the MCA Group, but noting that adopted plans will need to be responsive to the emerging challenges.

South Yorkshire Local Transport Authority Activity

2.3 As noted in the initial budget development report, financial pressures fall into two areas:

1. Those related to the ongoing impact of the pandemic; and,
2. Those issues related to the pre-pandemic decline in patronage, inflationary pressures, and the MCA's use of a finite body of revenue reserves to support the levy.

2.4 In the immediate term the key challenge in this area remains the commercial viability of the transport network. Viability is likely to be influenced by three principal factors in the new year:

1. The potential for further restrictions over the winter and/or spring;
2. Societal behaviour, particularly around the return to the office and pre-pandemic retail and leisure habits; and,
3. The commitment of government to further support, whether from recovery funding or through BSIP mechanisms

2.5 Since the last reporting date, and as restrictions have lifted, patronage has improved considerably. Bus patronage has grown by c. 50% to 75% of pre-Covid levels, whilst tram patronage has increased by c. 85% to 74% of pre-Covid levels.

2.6 These increases are welcome and edge services back towards commercial viability. However, the gap to pre-pandemic levels of c. 25% across modes continues to represent a real concern, and with the current government support packages due to expire in early April 2022 the risk that operators withdraw unprofitable services remains prominent.

2.7 In the event of a cessation or reduction in government support to operators before patronage recovers to sustainable levels, the MCA is likely to see calls for increased local financial support via subsidy to services or subsidy to users.

2.8 Initial forecasting undertaken within SYPTE assumes that patronage will likely not recover beyond 80% of pre-pandemic levels on all modes. This recognises the pre-pandemic trends in patronage decline, the likely longer-term adoption of behavioural changes such as online retail and work-from-home patterns, and latent concern on the use of public transport amongst some user groups.

2.9 Patronage at those levels is likely to prompt operators to take commercial decisions to begin withdrawing unprofitable services. In this event, the MCA could consider buying back withdrawn services. This involves the MCA effectively subsidising the cost of individual services, with a risk share between the operator and the MCA. The MCA tenders for services with operators bidding based on the subsidy they assume is required to return a profitable service.

2.10 The uncertainty around demand (patronage) within the public transport market, coupled with price inflation and labour market pressures, is likely to mean that the risk appetite for the delivery of services amongst operators will be low. This will inevitably drive up the price of the subsidy the MCA has to pay to allow these services to be delivered.

2.11 On this basis forecasting suggests that the cost alone of maintaining the existing services currently bought back from operators (not including temporary DfE funded school routes) could increase in cost on a range of £3m-£4m. At the lower level this roughly equates to potential inflation pressures of c.£1m and patronage deficits that would need to be made good of c. £2m.

2.12 However, analysis shows that at 80% patronage there will be a further shortfall of pre-pandemic public transport system income levels of c. £20m.

2.13 The scale of this deficit is beyond the region’s ability to address without national support. The Spending Review offered little in comfort that government would maintain its existing support packages, and though BSIP activity may prime additional demand, it is likely that the MCA will need to consider prioritisation of routes to be considered for buy-back set against affordability envelopes.

2.14 Affordability will be shaped by the MCA’s wider cost-base, including the cost of supporting the national concessionary travel scheme. Initial forecasts suggest that reduced patronage in this cohort will generate pre-inflation savings in the region of £5m.

2.15 This saving, along with the earmarked ‘Protection of Priority Services’ reserve (£7m), is available to provide a bridge to a more commercially sustainable network and the outcome of the MCA’s BSIP proposals but is, alone, insufficient to protect the current level of service.

2.16 These macro pressures are also likely to be exacerbated by the inflationary environment. With the Spending Review suggesting that inflation will peak above 4% this year, there is now an expectation that pay and price inflation will increase above previous forecats. The cumulative impact of this is expected to be c. £0.50m on non-fare items alone. Budget challenge will attempt to mitigate this pressure, but there is a likelihood that an effect will be felt in the coming year and beyond.

The South Yorkshire transport budget is also exposed to pressures from potential loss of funding. Key sources of funding at most risk currently are:

- Rail Administration Grant and Bus Services Operator Grant (c.£2.5m combined p/a)
- Bus departure charges (c.£0.90m p/a)
- Rent from Interchange tenants (c.£0.40m p/a)

2.17 Immediate decisions on how to address the risk of priority services being withdrawn will also need to be considered in the context of the longer-term trajectory of the MCA's transport financial strategy.

2.18 The existing, pre-pandemic, financial plan for South Yorkshire transport activity was predicated on the release of revenue reserves linked to ongoing reductions in the Group's cost base as expensive legacy debt was retired. This strategy meant that in the medium-term the transport levy could be held at artificially low levels, with reserve requirements eventually being reduced until the budget broke even.

2.19 This strategy is now being undercut by inflation running above expectation and the likelihood of additional costs being incurred from 2024 onwards when the current tram concession ends.

2.20 Forecasting shows that if patronage returns to pre-pandemic levels the earmarked levy reduction reserve would be exhausted by 2026 with the budget running with a deficit reserve requirement of around £3.5m. This deficit would need to be made good with either cost reductions or levy increases of c. 7%.

2.21 The forecast decline in patronage does, however, mean that if patronage does not recover to pre-pandemic levels the savings made on the national concessionary scheme could be used to support the existing strategy, with falling concessions costs offsetting the need for reserve contributions.

2.22 Accordingly, in the longer-term the use of potential savings generated from concessionary fares becomes a policy issue with two basic options:

1. Reinvest into the network to support current under threat provision; or,
2. Hold back to offset pressures that may precipitate a future levy increase.

2.23 In the medium to long term the MCA will also need to consider how it reacts to the end of the current tram concession in 2024. For almost a decade the current concession has insulated the MCA from the financial risks associated with the tram, and whilst the tram has in previous years run a profit in the recent past it has incurred a deficit.

2.24 The MCA's adopted financial plan assumes that from 2024 the MCA will need to contribute to the costs of the network at £1m p/a. At this stage, this represents a prudent planning assumption, but the MCA will need to consider both whether this cost can be mitigated or indeed whether it is sufficient for the potential risk.

<u>Adopting a Baseline Plan</u>

2.25 As a planning assumption this report recommends a continuation of the short-term policy adopted for the current financial year.

2.26 This policy is predicated on the following core points:

- The transport levy is held at current levels to maintain existing spending power (albeit impact by inflation);
- Budget challenge seeks to offset operational inflationary pressures wherever possible;
- Should Government recovery funding continue at existing levels, the MCA continues to match with concessionary fares paid at pre-Covid levels;
- Should Government funding cease or be reduced, the MCA ends the current concessionary fare support with savings used to supplement reserves to protect priority services in the short-term; and,
- Earmarked reserves are available to cushion the impact of operator withdrawal, providing a bridge to a more sustainable network.

2.27 Adoption of this approach is, again, necessarily short-term but will afford the MCA a baseline budgeting position from which to better assess demand, Government funding intentions, and the MCA's own ability to support the network into the future.

<u>BSIP & Investment Opportunities</u>

2.28 The BSIP represents the MCA's aspirations for the South Yorkshire bus network and is appropriately ambitious. The costs of delivering those aspirations are inevitably significant, with over £470m of investment required.

2.29 Government have previously announced £3.2bn of support for bus investment, but the MCA now understands that the available BSIP funding is likely to be around £1.2bn of which only £600m is for revenue investment.

2.30 In this context, it is likely that the full quantum of BSIP investment will not be met and alternative resource for identified priorities will need to be considered.

2.31 The scale and longevity of commitment required will shape where alternative sources of resource could be found, but could include funding in full or in combination from:

1. Additional Levy Contributions
    a. Levy contributions currently contribute £3.96m to the discretionary child concessions and £5.82m to tendered bus services
    b. The MCA recognises the challenges faced by local authorities in balancing additional contributions with other pressures, and notes the potential requirements for additional levy requirements to meet existing activity
    c. A 1% levy increase generates c. £540k p/a
2. Mayoral Precepts
    a. The Mayor, with the support of the MCA, could choose to raise a precept to support the costs of investment
    b. This is the route that has been taken in Greater Manchester to fund a number of transport investments
    c. The Mayor and the MCA have previously chosen not to pursue precepts as a means of supporting time-limited transport investment
    d. A precept of £10 would generate c. £3.58m p/a
3. Gainshare funding

    a. The MCA is in receipt of a £12m annual gainshare revenue funding settlement as part of its devolution deal
    b. Subject to the MCA's adopted Assurance Framework, elements of BSIP activity could be considered for funding through this route
    c. Deployment of gainshare revenue would need to be considered in the context of competing priorities for revenue resource from across the breadth of the MCA's activity, in particular from those areas such as Business Growth that do not have an alternate dedicated funding stream
4. Reserves
    a. The MCA forecasts to have c. £42m in transport revenue reserves at the end of the financial year
    b. Of these, only £5m is held as unearmarked resource, with others pegged to specific issues – such as holding the levy down – or specific risks – such as the inflation linked PFI contract – as part of the MCA's refreshed Reserves Strategy adopted in the last budget round
    c. These reserves are expected to decrease by over half by the end of the decade as the levy reduction is exhausted and reserves held for the Bus Review implementation and tram concession project are drawn down
    d. Reserves can be used only once, and decommitting them from their existing purpose would require the MCA to consider how it would manage from other means the risks they mitigated

2.32 It is expected that BSIP funding will be announced in January. In the interim, and as part of the overall budget setting process for the year, the MCA will continue to consider how it may support new investment whilst managing the aforementioned financial risks.

MCA/LEP Activity

<u>Corporate Resource and Pressures</u>

2.33 The MCA's non-transport activity is funded by a shifting array of time-limited, conditional funding streams and a relatively small amount of resource generated from un-ringfenced grant, local contributions and commercial income (£5m).

2.34 At the time of writing there was significant uncertainty across most of these income streams:

- The £1m Mayoral Capacity Fund that currently resources the Mayoral Office costs and Mayoral non-programme priorities is not committed beyond March 2022;
- The £500k LEP capacity funding that resources much of the MCA's core costs is at risk and tied to the national review of LEPs being undertaken by Government;
- Enterprise Zone income (£2m) remains volatile; and,
- Commercial income streams related to property trading surpluses, income from loans to business, and income generated from cash held on deposit remain disrupted and depressed.

2.35 Concerns principally centre on the loss of the MCF and LEP funding. Losing £1.5m here would represent 30% of the un-ringfenced funding available to the MCA, with no alternate funding stream.

2.36 The loss of core income streams may be exacerbated by the loss of capital funding streams from 2022 onwards that have previously been recharged into. With the loss of the Local Growth Fund money and Getting Building Fund resource, some core services which received contributions from programme recharges will now need to flip to new funded programmes or be flexed down to meet a new budgetary envelope.

2.37 It is likely that in the event of funding being withdrawn without a successor income stream the MCA will be required to pare back certain discretionary areas of activity exacerbating existing capacity constraints.

2.38 Organisational pressures are likely to arise from pay and price inflation. At this stage there is uncertainty on whether the Government will reimburse MCA's for employer NI contributions, whilst indexed linked contracts, pay awards, and new commissions into market are all likely to be in excess of forecast. Initial forecasts suggest that pay inflation alone will add c.£200k.

<u>Business Growth and Recovery Resource and Pressures</u>

2.39 This area continues to be funded from a number of capital and revenue grant funding streams that are not sustained into the future. How to fund Business Growth activity into the medium-term is a significant planning issue.

2.40 Activity in 2022/23 will likely include slipped gainshare funded activity associated with the Renewal Action Plan. This activity is defined by the funding envelope initially provided (£6.91m) and cannot be sustained into the future without further funding being released.

2.41 Significant support to the local economy through the South Yorkshire Business Support Scheme will conclude in the current year, with all Additional Restrictions Grant funding to be used by March 2022. No successor scheme to this emergency and recovery funding has been announced.

2.42 Made Smarter grant funded activity is also now likely to slip into the new financial year (£0.89m). This activity is a pilot scheme with no commitment beyond the existing allocation.

2.43 The Business Growth area may also see activity slip into the new year relating to capital business investments supported from the residual LGF funding held by the MCA. At this time the pipeline of investable propositions significantly exceeds the residual LGF resource (£4.37m), and so decisions will be required as part of the Investment Strategy work on how that pipeline may be addressed.

2.44 Business support activity has to-date been supported by Growth Hub grant provided by Government (£0.41m). As in previous years, this grant is committed on a rolling annual basis. At the time of writing there was no certainty on whether this funding would be recommitted.

2.45 Activity across the thematic area is also supported by reserves. At outturn the MCA expects to have c. £2m in reserves earmarked to this area. This reserve was created from the initial £4m Growth Fund revenue allocation and has been drawn on and replenished since 2015. This reserve will sustain services for a number of years but will eventually be exhausted without – as yet - a successor funding stream being identified.

2.46 Finally, the Spending Review now suggests that the Shared Prosperity Fund – that may have provided funding for business activity – is still some way off, with funding unlikely to be received in the new year.

Housing and Infrastructure Resource and Pressures

2.47 Financial activity within this thematic area is dominated by capital investment funded from the Getting Building Fund, Brownfield Housing funding, and gainshare.

2.48 Whilst it is anticipated that the Getting Building Fund programme will hit requirements to defray all final year funding within the current financial year, the Budget Revision 2 report notes significant slippage of c. £17m Brownfield activity into the forthcoming year.

2.49 The MCA has engaged government on this slippage, noting the requirement to have defrayed £20m by March 2022. There is a latent risk that underperformance against the target may impact upon the MCA receiving the full balance of £20m of funding.

2.50 The Budget Revision 2 report also notes that the gainshare funded 'Place' and flooding investments are now also likely to largely fall into the new financial year. This investment totals £26.9m in aggregate.

2.51 Outside of the MCA's direct purview, resource also continues to be deployed through the JESSICA investment fund. This fund is now largely allocated, and whilst loans granted may be returned to the fund into the future there is no successor funding source available.

2.52 Revenue funding for this thematic area is in short supply, largely centred on core funding for teams and the Brownfield revenue accelerator funding. This latter funding is now deployed in full, with expenditure expected be incurred into the next financial year.

2.53 The Spending Review offered little in the way of funding commitments for infrastructure investment beyond that allocated to transport through the CRSTS programme. Announcement of a further £300m for Brownfield housing was confirmed, though it is unclear how this will be allocated.

2.54 Decisions on how to fund non-transport infrastructure investment into the future will be a central issue for the developing Investment Strategy.

Skills, Education & Employment Resources and Pressures

2.55 Financial activity in this area is centred on the Adult Education Budget, supplemented by gainshare funding for the apprenticeship and KickStart South Yorkshire proposals. This activity is supplemented in-year with the interim Skills Bank programme and the Working Win health led trial.

2.56 The Adult Education Budget represents sustainable funding that will continue indefinitely as part of the region's devolution deal. However, sustainability concerns are an issue for the other principal spheres of activity: gainshare funded activity is defined by the previously agreed envelope (£7.2m); the Skills Bank programme is funded from reserves (£7m); and the Working Win programme is funded from a discrete grant from Government.

2.57 The majority of gainshare funded activity is now likely to slip into the new financial year, whilst the Skills Bank successor programme will also be funded from reserve in the new year. At this stage there is no commitment from government to a continuation of the Working Win programme.

2.58 At the time of writing there was little clarity on how the £3.8bn of additional funding announced through the Spending Review for skills and learning would be distributed.

<u>Strategic Transport Resources and Pressures</u>

2.59 The non-LTA transport functions of the MCA will likely see a significant capital programme in the new financial year.

2.60 Slippage from the existing Transforming Cities and Active Travel programmes will be met by the first year of the City Region Sustainable Transport Settlement programme, which may stand at over £100m in 2022/23. Of this value, the majority of the CRSTS funding will relate to the final year of the TCF programme and the highways maintenance grants previously received.

2.61 Grant funded activity is supplemented with gainshare bus investment from the £3.17m funding made available for shelter upgrades and the electrification of parts of the community transport fleet.

2.62 The region has not been successful, however, in its bid for Levelling Up Funding to enhance that gainshare investment. This leaves the MCA with a shortfall of c. £50m for previously described priority investment in bus infrastructure. In partial mitigation of this, the MCA has received £12m of capital funding related to its previous Growth Deal. This funding is ringfenced to transport activity.

2.63 Whilst the MCA will be eligible to bid into further rounds of LUF, and capital funding may be made available through BSIP, questions on how or whether to supplement the existing transport funding will need to be considered as part of the Investment Strategy activity.

2.64 Revenue funding for strategic transport activity is limited to the grant capability funding made available for Active Travel and the revenue funding made available by the Department for Transport to develop BSIP proposals and CRSTS schemes (£5.2m).

2.65 This latter funding is intended to cover the first CRSTS period (5 years) and so could be used for feasibility work on the existing programme, or to begin to develop a pipeline of investable propositions that can be matched to the next round of CRSTS funding.

2.66 **Conclusion and Next Steps**

This report presents the latest information available at the time of writing. In order to mitigate the uncertainty surrounding key sources of funding, business planning and budgeting will proceed on the basis of the planning assumptions set out in this report.

We will continue to consult and engage with South Yorkshire Directors of Finance, as well as Leaders and Chief Executives, in the coming months. As further information becomes available, we will update key stakeholders accordingly.

3. Options Considered and Recommended Proposal

3.1 **Option 1**
This is a discussion report.

3.4 **Option 1 Risks and Mitigations**:
N/A

3.5 **Option 2**
This is a discussion report.

3.8 **Option 2 Risks and Mitigations**
N/A

3.9 **Option 3**
This is a discussion report.

3.12 **Option 3 Risks and Mitigations**
N/A

3.13 **Recommended Option**
This is a discussion report.

4. Consultation on Proposal

4.1 N/A

5. Timetable and Accountability for Implementing this Decision

5.1 Decisions on the levy must be made by the MCA Board's meeting on the 25th January.

5.2 Decisions on the final revenue and capital budgets must be made at the Board's meeting on the 22nd March.

6. Financial and Procurement Implications and Advice

6.1 This is a financial report, the details of which are presented 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