Transport for the North Board – Item 12

Subject: TfN Budget and Reserve Strategy 2020/21

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Meeting Date: Thursday 12 March 2020

1. Executive Summary:

1.1 Financial year 2020/21 represents the third budgetary period over which Transport for the North (TfN) has existed as a statutory sub-national transport body (STB).

1.2 This report notes a balanced budget proposal for the year of up to £88.05m consisting of:

TfN Expenditure	£m	%
Programmes:		
Revenue Programmes	£49.43	56%
Capital Programmes	£5.91	7%
Programme Contingency	£22.27	25%
	£77.62	**88%**
Rail Operations	**£2.98**	**3%**
Operational Areas (net)	**£7.46**	**8%**
Total	**£88.05**	

1.3 This expenditure will be fully funded from grants, contributions, contracted income, and brought forward reserves as follows:

TfN Funding	2020/21 £m	%
Core Grant	£10.00	11%
Integrated & Smart Ticketing Grant	£15.78	18%
Transport Development Fund - NPR	£59.00	67%
Rail Operations Grants, Contributions & Traded Income	£1.88	2%
Use of Reserves	£1.39	2%
Total Resource	**£88.05**	

1.4 As in previous years, some elements of TfN funding are dependent on Departmental approvals to release funds. Where such processes are delayed, the expenditure profiles will be managed accordingly.

1.5 This report sets out TfN's financial operating environment, and the budgets that will support delivery of the TfN business plan for 2020/21 and beyond. These budgets are underpinned by a reserve strategy, which serves as TfN's back-stop mitigation against financial risk.

1.6 As in the prior years, the budgets set out in this report have been informed by a business planning process. That process identified TfN's key strategic priorities and identified a common 'golden thread' from strategy to delivery that was maintained throughout the process. The 'golden thread' ensured that when detailed individual departmental plans were being designed and objectives set, there was a common and coordinated approach to delivery across the organisation. These common goals are what underpin the expenditure profile and budget for 2020/21.

1.7 Budget proposals have previously been shared with the Scrutiny Committee on 13 February, and Executive Board on 27 February and any comments from those meetings have been reflected in this report.

2. Recommendation:

It is recommended that:

2.1 TfN Board approves the revenue budget and capital programme as presented in this paper.

2.2 TfN approves the reserve strategy as presented in this paper, including the reallocation of £0.50m of Core grant savings to an earmarked 'Devolved Powers Reserve'.

2.3 TfN Board approves the Annual Treasury Management Strategy as presented in Appendix 12.2

3. **Issues:**

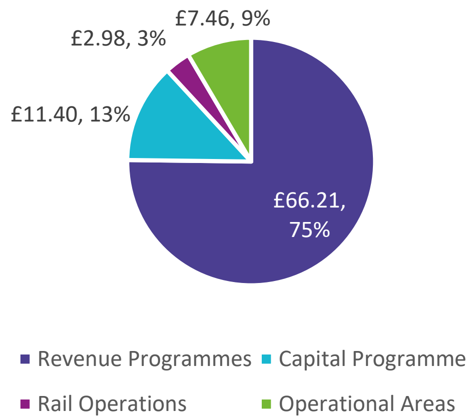
Background

3.1 TfN has conducted a business planning process designed to deliver upon the key priorities that have been agreed with Board since its inception as a statutory body.

3.2 This business plan includes the programmes of activity that deliver the key priorities, but also the role of the organisation: what it will do, and how it will do it. That business plan in turn drives the resourcing and financial plans for the organisation, resulting in the annual budget.

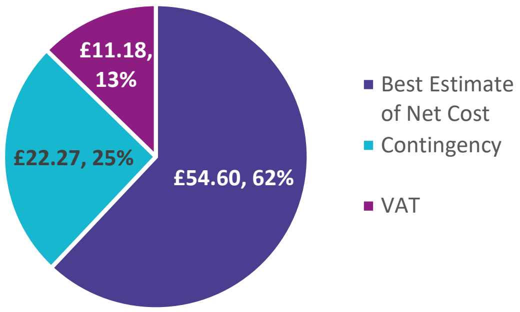
3.3 Following an iterative process, a draft budget is proposed that aligns resource to key priorities. The budget itself is differentiated between costs incurred in the delivery of programmes of activity, and the costs incurred in running the operations of TfN and meeting broader aspirations. The expenditure incurred in delivering Rail Operations functions is also presented separately, reflecting the different governance arrangements around that activity and its high profile.

3.4 The total budget for 2020/21 is proposed at £88.05m, consisting of:

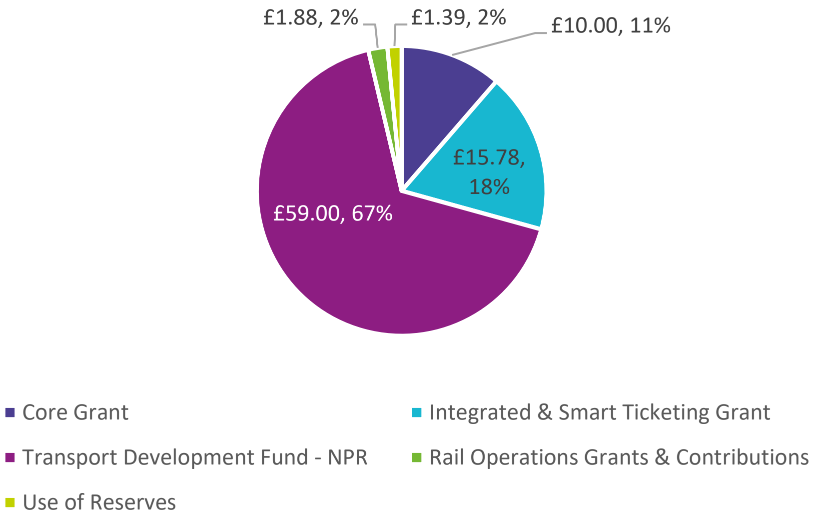


3.5 It should be noted that that the total budget envelope is elevated by both contingency values held to manage programme risk and meet emerging priorities, and by VAT costs that cannot be recovered (as is the case in TfN partner bodies).

3.6 Contingency will only be drawn on if required, and currently stands at £22.27m. The majority of this contingency is held within the NPR programme (£16.17m) as a flexible in-budget reserve which will be fed into the budget as certainty on requirements and costs emerge. Irrecoverable VAT accounts for £11.18m:



3.7 It is proposed that this expenditure is funded through a mixture of grant, contributions, and brought forward reserves:



3.8 In common with previous years, the majority of TfN expenditure is dependent on the receipt of funding from the DfT, either through the formal sign-off of business cases, or the release of development or other general resource funding. TfN will only commit itself to expenditure where appropriate commitments have in turn been received from the Department.

3.9 The draw of £1.39m from reserves represents the third planned annual draw on TfN's un-earmarked reserves. Those reserves were created from Core grant underspends in prior years when TfN was building its capacity and capability and are drawn upon in line with the reserve strategy adopted by TfN each year.

3.10 That strategy will see a planned draw on reserves to enable a managed transition down from current expenditure levels - which include material one-off development costs - to a lower and more sustainable steady-state cost-base. This approach will result in un-earmarked reserves of c. £4.50m at the end of the 2020/21 financial year and is set out in more detail in Section 13.

3.11 In the longer term, reserve levels will be targeted at no less than £2m in any given year to mitigate against financial shock. As in previous years, underspends that accrue during the year may mitigate the need to draw on reserves to the extent currently forecast.

4. Operating Environment

4.1 TfN's financial affairs are shaped by its operating environment. Parameters are set by the way in which the organisation is funded, and the practical consequences of certain limitations that are not common to local and combined authorities.

4.2 These limitations affect the organisation's approach and ability to access funds to manage risk. Unlike most partner authorities, TfN cannot access credit in the form of loans for capital investment and overdrafts to manage short-term cash flow fluctuations. In addition, it cannot levy or precept upon local tax bases to manage longer-term requirements as a council or local transport authority would.

4.3 These limitations mean that careful management is required in order to avoid insolvency risk: that is, ensuring TfN maintains sufficient cash and the resource to meet liabilities. The need for careful management is increased by TfN's inability to recover VAT, which means that it is exposed to higher costs without an associated increase in its resources.

4.4 These issues emphasise the importance of risk management when developing budgets, particularly the need for focused cost transparency, and alignment of costs to funding streams. In particular, it underscores the importance of managing resource to ensure TfN protects funding streams which afford TfN flexibility.

4.5 Due to the conditions placed upon the discrete grants which fund programme activity, discretionary resource is limited to TfN's annual Core grant (£10m) and the deployment of the reserve created from underspends against this grant in prior years. This grant, and the reserves that flow from it, must be used to mitigate the insolvency risk to which TfN could otherwise be exposed.

4.6 This approach is complemented by the manner in which TfN manages its discrete grant streams. 'Discrete' grant streams refer to funding which is restricted to certain activity. For high value and sensitive programmes, TfN allocates part of its grant envelopes as 'contingency'. Contingency is budgeted for separately, but not monitored against in the programme budgets. As calls are made by the programmes on contingency, resource is drawn down through budget variations and then reported and monitored against. This allows TfN to manage risk in its programmes through in-year grant envelope reserves, ensuring that resource is not overcommitted.

Budget Structure

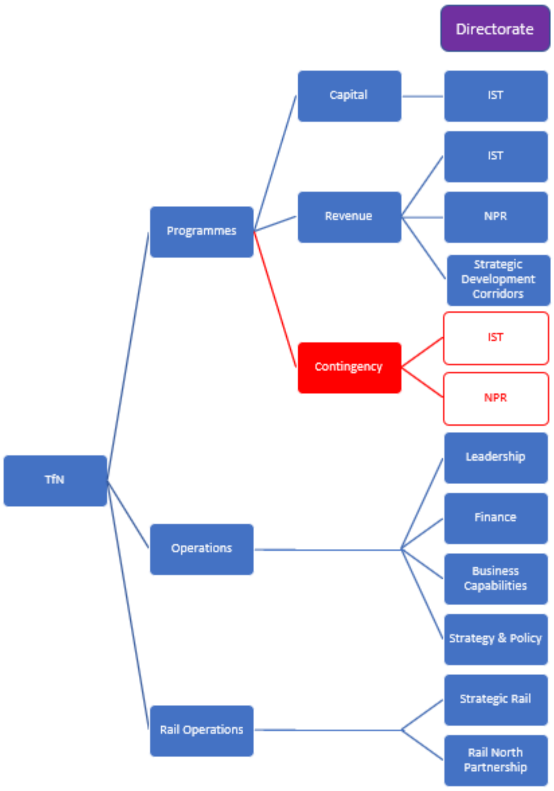
4.7 TfN’s budgets consist of its body of capital and revenue delivery programmes and its core operations. For budgetary purposes, a differentiation is drawn between operational and programme costs based upon the scale of the activity, and its funding source. Rail Operations activity is also separately identified to reflect the different governance and funding arrangements for that area, and its high profile.

4.8 Programme expenditure is in support of discrete areas of capital and revenue activity that often attract ring-fenced funding. The programmes are (or will be) generally materially larger than the underlying cost base of the wider organisation which supports them. Contingency held to manage programme activity risk and support emerging priorities is held discretely to avoid distorting budget forecasts.

4.9 Organisational operational expenditure consists of those costs incurred in the delivery of the ongoing business of TfN, the infrastructure required of any public body, and the supporting functions that enable TfN to deliver upon its programmes of activity and broader aspirations.

4.10 ‘Rail Operations’ activity reflects the work of the Rail North Partnership team who manage the northern rail franchises on behalf of the Secretary of State and whom are hosted by TfN, and TfN’s Strategic Rail team which advises the Rail North Committee on franchise matters.

4.11 Broadly, the budgetary structure of the organisation can be presented as follows:



4.12 Drawing a differentiation between operations and programmes in this manner assists TfN in the management of its financial affairs for three principal reasons.

4.13 Primarily, the distinction allows for better cost transparency. It is important for the organisation to see the true costs of running programmes of activity to allow it to both understand and manage those costs.

4.14 In addition, the scale of the programmes is sufficiently large that if reported without distinction to the operational costs it could affect the visibility of important issues within the operations element of the budget. That is, a relatively immaterial variance of 1% in the programme area (£0.77m) would be equivalent to a material variance of c.10% in the operational area.

4.15 Finally, the budget structure reflects how the areas of activity are funded. Programmes of activity are principally funded by discrete grant awarded by DfT. That grant is awarded for pre-approved activity and is drawn down on a need basis. Conversely, the varied business functions of TfN within the operations element of the budget structure must be funded from the finite £10m annual Core grant, over which TfN has discretion on its application.

4.16 TfN has also opted to separately identify the Rail Operations budgets from other activity to recognise the discrete governance and funding arrangements around that activity.

5. Budget 2020/21 Development

5.1 The 2020/21 draft budget is driven by the Business Plan and is to a large degree an iteration of its 2018/19 and 2019/20 predecessors.

5.2 As set out in the Business Plan Report to this meeting, the proposed activity for 2020/21 is consistent with prior years' activity and decisions made previously at TfN Board meetings.

5.3 The 2020/21 draft budget was derived following a number of year-on-year issues that aggregate to a wider sustainability challenge, notably:

a) How to use a finite, un-indexed funding stream (Core grant) to resource costs impacted by inflation (including an assumed 3% national pay settlement);
b) How to fund programme development costs not resourced from discrete funding (such as the Strategic Development Corridor studies); and, most pressingly,
c) How to balance basic organisational requirements with the need to target resource at emerging key development objectives such as sustainable development, carbon reduction, and the climate crisis.

5.4 In addition to the ever-present challenges set out above, the 2020/21 business planning and budgeting process has also had to take account of emerging challenges.

5.5 Ongoing high-profile issues around the performance of the north's rail franchises have led to proposals being developed for increased resource being made available to the Rail North Partnership and Strategic Rail teams.

5.6 This additional resource would provide for additional capacity and skills and would allow TfN to deliver on its proposals for discharging the recommendations of the Blake-Jones review of the Rail North Partnership. Delivering on these proposals is, however, largely reliant on new funding being made available – a matter unresolved at the time of writing.

5.7 A further challenge relates to the forecast near doubling in the budget envelope available to support the Northern Powerhouse Rail programme, following a doubling of the available resource in 2018/19, and conversely the wind down of Phases 1 and 2 of the Integrated and Smart Ticketing programme as those projects reach their conclusion.

5.8 The growth and complexity of programme led activity has a concomitant impact on the operational support teams that are required to provide the basic organisational infrastructure support to enable the delivery of these activities. Moving with the requirements of the programmes requires those teams to flex dynamically.

5.9 Taken together, these issues contribute to cost pressures across the organisation that are not always met by associated increases in grant resource. This is particularly the case for non-programme costs that are generally funded by the Core grant resource.

5.10 To mitigate this issue TfN has adopted processes for identifying where new costs are incremental to the growth of programme activity, enabling those costs to be recharged into discrete grant streams (where grant conditions allow). Recharging costs in this manner is consistent with existing accounting policies and allows TfN to properly resource programme activity and also see the true cost of delivery.

5.11 As part of the annual budget exercise TfN also isolates out 'one-off' non-repeating costs and activity that will fall out of the budget once completed. This allows TfN to better see its underlying structural cost-base, allowing for clearer medium-term planning.

5.12 Recharges of costs into discrete grants and the isolation of non-repeating expenditure allows TfN to propose both a balanced 2020/21 budget and moves TfN towards a sustainable medium-term financial strategy.

5.13 This report proposes that the budget is resourced through a mixture of in-year grant, local contributions, contracted income, and brought forward reserves (prior year underspend).

5.14 In-year grant reflects existing commitments made by the Department for Transport, commitments that we forecast may be made, and grant that will be made available to TfN contingent on projects passing through governmental gateways. Where contingent grant is not made available, or assumed grant is not forthcoming, activity will not ordinarily be undertaken with costs being deferred or removed.

5.15 Use of brought forward reserves recognises that TfN's cost-base retains a number of one-off or time limited costs that will not repeat into the future. Using reserves is sustainable in the short-term and allows the organisation to protect key elements of TfN's approach to quality evidenced-based decision-making and resource aspirational development activity.

5.16 Finally, this report proposes the additional reallocation of £0.20m of Core Grant resource from the General Reserve to the earmarked 'Devolved Powers Reserve'. This proposal will bring the total value of that reserve to £0.50m and recognises the increasing need for TfN to retain a suitable sum of available resource to support as of yet undefined but likely activity around further devolution.

6. Budget 2020/21 Summary

6.1 TfN proposes a gross budget for the year of £88.05m, inclusive of expenditure slipped from 2019/20 of c. £12.85. This represents a reduction of c. £17.04m (16%) on the gross budget adopted for financial year 2019/20. However, once the budget comparators are adjusted for contingency envelopes, TfN is proposing a smaller decrease of £11.93m (15%) on the prior year *net* budget:

Year-on-Year Comparison	2020/21 £m	2019/20 £m	Variance £m	Variance %
Programmes:				
IST	£15.78	£62.46	£46.68	75%
NPR	£59.95	£30.95	-£29.00	-94%
Strategic Development Corridors	£1.88	£2.57	£0.69	27%
	£77.61	**£95.98**	**£18.37**	**19%**
Rail Operations	**£2.98**	**£1.92**	**-£1.06**	**-55%**
Operational Areas	**£7.46**	**£7.19**	**-£0.27**	**-4%**
Gross Budget	**£88.05**	**£105.09**	**£17.04**	**16%**
Contingency Envelopes	£22.27	£27.38	£5.11	19%
Net Budget	**£65.78**	**£77.71**	**£11.93**	**15%**

6.2 Increases on the prior year budget principally relate to growth in the NPR programme and growth in activity in the Rail Operations area.

6.3 An almost doubling in the amount of Transport Development Fund (TDF) grant to £59m is forecast to be made available to TfN to accelerate the development of the NPR programme during the year.

6.4 For planning purposes, it has been assumed that £59m of TDF grant will be made available. At the time of writing a draft funding letter had been received from the Department, but final confirmation is awaited.

6.5 Work is ongoing between TfN and its key delivery partners (principally Network Rail) and the DfT as co-client to determine the scope of work for 2020/21 and the associated cost. At the time of writing, budget plans had been formulated to a value of c. £43.78m. These plans represent work in train and new work that will require Departmental approval before it progresses. The balance of the TDF allocation is, for now, held as contingency and reserve reflecting that some contingency is required to manage inherent risk in the contracting, whilst a material amount of resource is required to manage likely emerging priorities that are either contingent on future events or require further development before being committed to the budget.

6.6 The proposed Business Plan also forecasts growth in the high-profile Rail Operations area. This reflects, in part, additional contract funded resource being recruited to the Rail North Partnership (RNP) team to support Trans-Pennine Route Upgrade (TRU) activity and also proposals for the recruitment of new grant funded resource to both RNP and Strategic Rail team to deliver on the recommendations of the Blake-Jones review. At the time of writing discussions with the Department regarding this grant were still ongoing.

6.7 Reductions on the budget are principally due to movement in the IST programme.

6.8 Phases 1 and 2 of the programme will move towards their conclusion in the new year, with aggregate expenditure across these two projects £7.15m lower.

6.9 Phase 3 of the programme sees expenditure forecast reduced by £45.31m (96%) as the delivery element of the project will no longer proceed as previously planned.

6.10 Significant uncertainty remains around the Phase 3 project at the time of writing. Following the shortfall in support for the project from bus-operators that crystallised in the spring of 2019 the project was paused pending an options review. The TfN Board approved the proposals to proceed with a revised project in January 2020, but the shape, scope and cost of this remain undeveloped. Budget provision is included to support initial development of proposals, with further funding required from the Department to proceed to delivery stages.

6.11 Operational area expenditure is impacted by two movements. Gross expenditure has fallen by c. £0.73m despite the absorption of pay inflation pressures, largely due to one-off development costs falling away. This is offset, however, by lower recharges (£1m) into programme areas as the IST programme’s scale diminishes, leading to a net increase of £0.27m.

6.12 TfN’s activity will be funded from a mix of grant, local contributions, contracted income, and brought forward reserves:

Funding	2020/21 £m	%
Core Grant	£10.00	11%
IST Grant	£15.78	18%
NPR - TDF Grant	£59.00	67%
Rail Operations Resource	£1.88	2%
Total In-Year Grant	**£86.66**	**98%**
Use of Reserves	£1.39	2%
Total Resource	**£88.05**	

6.13 Variances on funding largely reflect the variances on expenditure, with discrete grant awards tracking forecast expenditure. A lower draw on reserves reflects the removal of a number of lines of non-repeating development activity.

7. Programme Budgets

7.1 The programme budget includes the discrete areas of activity where projects are either underway (as with the 'ITSO on Rail' and 'Disruption Messaging and Journey Time Information' elements of the IST programme) or working towards business case submission and/or approval.

7.2 In 2020/21 it is forecast that there will be three thematic elements of the programme budget:

a) Integrated & Smart Ticketing (IST);
b) Northern Powerhouse Rail (NPR); and
c) The Strategic Corridor Studies ('SDCs').

7.3 Activity can be further broken into revenue and capital programmes. It is TfN's policy to capitalise expenditure on programmes that are past outline business case and for which there is a reasonable assumption that the programme of activity will go on to deliver assets (either intangible or tangible) which will provide economic benefit over a period greater than one year. At this stage, only Phases 1 and 2 of the IST programme's activity constitutes capital expenditure, reflecting the relative maturity of those projects compared to the other programmes.

7.4 Programme costs are presented at the forecast level, and then the forecast plus contingency level. The forecast level reflects the current view on the level of effort and associated cost required to deliver the activity. The contingency reflects the adjustments that are made in line with governmental guidelines on managing risk in innovative projects. The differentiation between the two is drawn simply because adding contingency into general budgets when there are no current plans to draw upon it risks distorting financial reporting, leading to a misalignment between financial planning and business planning.

7.5 Forecast gross programme expenditure for 2020/21 totals £77.62m, which equates to 88% of TfN's overall draft proposed budget:

2020/21	Expenditure Type	Forecast £m	Contingency £m	Total Budget £m
IST	Revenue	£3.77	£0.61	£4.38
	Capital	£5.91	£5.49	£11.40
		£9.68	**£6.10**	**£15.78**
NPR	Revenue	£43.78	£16.17	£59.95
Major Roads	Revenue	£1.88	£0.00	£1.88
		£55.35	**£22.27**	**£77.62**

7.6 Within these costs is contingency, currently held for Phases 1 and 2 of the IST programme (£6.10m) and within the NPR programme (£16.17m). Contingency is required to mitigate against the risk of activity costing more than forecast and to allow the programmes to react to opportunities that arise. This is particularly pertinent for innovative projects such as those within the IST programme, where activity is often the first of its kind or based on complicated technical solutions, or expansive projects such as NPR where there are likely to be requirements to flex development work to react to events and opportunities and resource is required to manage contractual risk.

7.7 The levels of contingency held are developed and agreed in collaboration with the Department for Transport through business case approval processes or, in the case of NPR, through the co-client budget arrangements. Within the NPR budget, a material amount of available in-year grant is held uncommitted to reflect that the opportunity may arise to accelerate certain priority workstreams. Uncommitted resource is earmarked to this activity to ensure that should approvals for the activity be forthcoming the resource is available to deploy without displacing in-train activity.

7.8 Year-on-year the programme areas have seen significant internal changes, but at an aggregated level the total level of net expenditure (not inclusive of contingency envelopes) decreased by 21% as reductions in IST and SDC expenditure offsets the increase in NPR activity:

TfN Programmes	2020/21 £m	2019/20 £m	Variance £m	Variance %
IST	£9.68	£36.28	£26.60	73%
NPR	£43.78	£30.95	-£12.83	-41%
Strategic Development Corridors	£1.88	£2.57	£0.69	27%
Net Expenditure	**£55.35**	**£69.81**	**£14.46**	**21%**

7.9 It is proposed that these programmes be funded from a number of sources:

TfN Programmes	2020/21 £m	2019/20 £m	Variance £m	Variance %
IST Grant	£9.76	£36.28	£26.52	73%
NPR - TDF Grant	£43.11	£30.00	-£13.11	-44%
Core Grant/Reserves	£2.48	£3.53	£1.05	30%
Net Expenditure	**£55.35**	**£69.81**	**£14.46**	**21%**

7.10 The proposed use of reserves reflects an opportunity to match this one-off source of revenue against one-off costs, notably the development work in relation to the Strategic Development Corridors.

7.11 The table usefully highlights that the programme areas are almost entirely funded from discrete grant. This reflects that TfN has relatively little flexible resource, relying upon earmarked resource to fund major programmes of activity.

8. Integrated & Smart Ticketing (IST)

8.1 The IST budget is comprised of both revenue and capital activity. Revenue activity consists of non-capitalisable activity such as marketing, non-apportionable staffing costs, and revenue grants that are provided to third parties to support their operations. Capital activity consists of grant awards to third parties for their asset purchases and development, and asset purchases and development where TfN will retain control (at least in the short term) of those underlying assets.

8.2 The budget further includes the direct delivery of activity (such as the procurement through train operating companies of hardware for ITSO on Rail), the design and development work (as with the customer information and accounts based back office activity), and the incremental costs to the TfN organisation of delivering the overall programme. The latter point includes the costs of staffing, and incremental business infrastructure costs such as accommodation and ICT provision.

8.3 All these costs are charged into discrete IST grant awarded by DfT. This grant comprises revenue and capital allocations reflecting the different types of expenditure.

8.4 IST forecasts are shown at the 'upper' level. This level includes best estimates on scheme costs, but also contingency and optimism bias costs. These latter costs (£6.10m) reflect the complexity of delivering an innovative ICT project in such a challenging operating environment but are much reduced on the prior year given Phase 1 and 2's relative maturity and the removal of the previously planned delivery element of Phase 3.

8.5 Per the Business Plan, the operational intention is to split Phase 3 of the IST programme into two elements – a new Phase 3 that will involve the delivery of contactless on rail and Phase 4 which will be focused on locally delivered projects. However, at the time of writing this is not well developed and is therefore currently treated as a single element for budgetary purposes.

8.6 At the macro level, the IST programme's cost can be shown by the individual phases of activity. The table below shows the forecast cost of activity per phase inclusive of contingency:

IST Programme (Contingency Inclusive)	2020/21 £m	%

Phase 1	£9.01	57%
Phase 2	£3.31	21%
Phase 3 / 4	£1.87	12%
IST Programme Support	£1.60	10%
	£15.78	

8.7 These costs can then be split between revenue and capital expenditure designations:

IST Programme (No Contingency)	Revenue £m	Capital £m	Total £m
Phase 1	£2.41	£6.60	£9.01
Phase 2	£0.38	£2.93	£3.31
Phase 3 / 4	£1.87	£0.00	£1.87
IST Programme Support	£1.60	£0.00	£1.60
	£6.25	**£9.53**	**£15.78**

8.8 Finally, the costs can be further adjusted to remove the contingency resource that is inflating these values. As there are no current plans to use the contingency beyond treating it as an in-year ready reserve, it makes sense to view the budget without these values:

IST Programme (No Contingency)	Revenue £m	Capital £m	Total £m
Phase 1	£1.80	£1.76	£3.56
Phase 2	£0.38	£2.28	£2.66
Phase 3 / 4	£1.87	£0.00	£1.87
IST Programme Support	£1.60	£0.00	£1.60
	£5.64	**£4.04**	**£9.69**

8.9 It is against these forecasts that the IST budget will be monitored during the year, with draws upon the contingency being made as required through a formalised budget virement process.

8.10 Significant uncertainty remains around the shape of the revised Phase 3 project. In January 2020, TfN Board approved a proposal to reshape the project to a rail only scheme, with available resource also being deployed to local schemes that could help deliver the wider regional policy objectives.

8.11 However, TfN's ability to redeploy existing and future resource in this manner is largely dependent on approval from the Department for Transport as the project funder. The Department has indicated that the proposals for the two new projects will need to pass through its business case gateway approval stages. Whilst the Department has indicated that an element of existing resource can be used to progress the schemes to initial gateway approval stages in the spring, further progression will be dependent on the successful navigation of those processes and ongoing alignment to the Department's wider policy objectives. In particular, it is likely that any Departmental decision would be contingent on the outcomes of the Williams Review into the rail franchising system.

8.12 TfN officers are working closely with Departmental colleagues to address these issues, and any changes to existing assumptions will be reflected through the quarterly budget review process.

9. Northern Powerhouse Rail (NPR)

9.1 The resource made available to NPR from the DfT has seen significant step-change increases in recent years: rising from £15m in 2018/19 to £30m in 2019/20 to a forecast £59m in 2020/21.

9.2 TfN receives this resource as Transport Development Fund (TDF) grant, with the use of the resource being managed through a co-client mechanism. Under this mechanism there is an effective budget holder function performed by the Department, with line item level expenditure being approved via funding letters. TfN cannot access TDF grant without prior approval of all expenditure requests from the Departmental budget holder.

9.3 For budgeting purposes it has been assumed that £59m will be made available to TfN, which will be supplemented with Core grant contributions of £0.95m. TfN's NPR aspirations are further supported by TDF resource that the Department will directly disburse to HS2 in 2020/21 for related activity; TfN does not control or receive that resource, so it is not included in this budget.

9.4 Work is currently underway between the co-clients to determine the scale and scope of work packages for the new financial year to support the delivery of the NPR Strategic Outline Case by January 2021. These work packages will include: TAME led modelling and economic appraisal studies; business case development; programme management activity; necessary business infrastructure and support; and the major rail studies that will be undertaken by Network Rail and their subcontractors.

9.5 For budget planning purposes the NPR budget is split between items that will be committed to the budget and a sum of resource that will be held in contingency as an effective uncommitted reserve. Within that reserve, resource will, in some cases, be earmarked to known issues and aspirations.

9.6 Retaining a significant amount of resource as uncommitted contingency at this stage is prudent, noting the inherent risk in some of the major contracting and the opportunities that may emerge for acceleration of activity.

9.7 In particular, it is considered prudent to hold in reserve resource whilst the co-clients and Network Rail determine how pre-Sequence 5 activity is taken forward, whilst the March 11 budget and the recent post-Oakervee Review announcements around high speed rail in the north may present political imperatives that require deployment of material amounts of resource.

9.8 Earmarking contingency to anticipated issues in this manner helps to ensure that the co-clients do not overcommit resource at the expense of emerging issues that are deemed likely to arise, but around which there is insufficient certainty at this stage to include in the committed budget.

9.9 The NPR budget is accordingly presented in terms of committed budget around thematic workstreams and the uncommitted contingency that is held to opportunity and manage risk:

NPR	2020/21 £m
Committed Budget:	
Programme Development	£13.40
Network Rail Studies	£26.40
Programme Support	£3.03
Core Team	£0.95
	£43.78
Uncommitted Contingency:	
Earmarked Resource	
Ground Investigations	£6.00
Constructability Assessment	£1.20
Programme Development (Risk)	£1.20
Network Rail Studies (Risk)	£3.16
	£11.56
Unearmarked Resource	**£4.62**
	£59.95

9.10 Should requirements for the deployment of contingency emerge, the budget will be flexed at the normal re-forecast Revision points. However, should the co-clients be able to deliver the Business Plan outputs under the assumed £59m TDF envelope, resource will be redeployed at the Department's discretion. This reflects both TfN's commitment to delivering on its aspirations in the most cost-effective manner and the budget control the Department hold over the application of the resource.

9.11 As in the previous years, the TDF grant is supplement with Core grant resource of £0.95m. Core grant is retained to part fund the programme team, whilst TDF will in the first instance be deployed to meet the costs of the major studies and external costs commissioned through the co-client arrangements:

NPR Programme	£m	%
Transport Development Fund	£59.00	98%
Core Grant	£0.95	2%
	£59.95	

9.12 At the time of writing the DfT had not confirmed the TfN TDF allocation beyond a draft funding letter at £59m. Whilst the Department has confirmed that £75m of TDF allocation will be made available for the wider NPR programme, the division of resource between TfN, HS2, and the Department's own requirements requires confirmation.

9.13 The pace at which the co-clients can determine the work-packages for the coming year and clarify the grant allocations will determine how quickly activity can be taken to procurement and into delivery. TfN officers are actively engaging with Department officials and key suppliers to seek to ensure that activity can be moved into delivery as soon as possible in the new year.

10. Strategic Development Corridors

10.1 This work compromises seven 'qualitative' studies that informed the first published version of the long-term Investment Programme, and a 'quantitative' element that encompasses the modelling elements required to develop TfN's Assurance Framework and evidence-based sequencing aspirations.

10.2 The 2019/20 budget provided sufficient resource to allow for the completion of the qualitative elements of the SDC studies and then for the delivery of the quantitative TAME led modelling elements. However, throughout the year the quantitative element has slipped behind schedule and it is now forecast that the work will move in its entirety into the new financial year. The value of this slippage stands at £0.82m and is supplemented by an additional £0.31m in the new financial year to reflect forecast additional effort required.

10.3 Inclusive of this slipped activity, the Strategic Development Corridor programme budget stands at £1.88m for financial year 2020/21. At this value the budget has decreased by £0.70m on 2019/20:

Strategic Development Corridors	2020/21 £m	2019/20 £m	Variance %	Variance %
Major Roads Programme Team	£0.58	£0.56	-£0.02	-4%
SDC Qualitative Studies	£0.03	£1.01	£0.98	97%

SDC Quantitative Studies	£1.13	£0.82	-£0.31	-38%
Major Route Network	£0.14	£0.19	£0.05	26%
	£1.88	**£2.58**	**£0.70**	

10.4 This activity does not attract discrete development funding at this time, and so serves as a good example of TfN's need to maintain the ability to draw upon its Core grant funding to resource material development costs.

10.5 For 2019/20, it is proposed that the activity is resourced from a mix of in-year Core grant and brought forward reserve that has arisen from prior year underspends on Core grant funded activity. The table highlights that reserves are resourcing the major development activity around the SDCs:

Strategic Development Corridors	2020/21 £m	2019/20 £m	Variance %	Variance %
Core Grant	£0.72	£1.47	£0.75	51%
Use of Reserves	£1.16	£1.11	-£0.05	-5%
	£1.88	**£2.58**	**£0.70**	

11. Rail Operations:

11.1 Rail Operations activity consists of the work undertaken by the Strategic Rail team and the Rail North Partnership team in collaboration with the Department for Transport.

11.2 This work is centred on discharging TfN's statutory obligations towards the oversight and advice provided to the Secretary of State for Transport on the northern rail franchises.

11.3 The Rail Operations budget has seen year-on-year increases as additional resource has been recruited to support these functions. Business Planning proposals for 2020/21 have identified further requirements for recruitment to support a number of workstreams including Trans-Pennine Route Upgrade (TRU) work through the Rail North Partnership team and delivery of the Blake-Jones recommendations across both teams.

11.4 Forecasts place total expenditure at £2.98m, representing an increase of £1.06m, or 55% on the prior year:

Rail Operations	2020/21 £m	2019/20 £m	Variance £m	Variance %
Strategic Rail Team	£1.39	£1.06	-£0.33	55%
Rail North Partnership Team	£1.59	£0.86	-£0.73	45%
	£2.98	**£1.92**	**-£1.06**	**-55%**

11.5 Rail Operations activity is funded from a combination of DfT grant award, local contributions from TfN partners, contracted income, and TfN Core Grant contributions. For planning purposes TfN has assumed that Blake-Jones activity will be funded from new DfT grant:

Rail Operations	2020/21 £m	2019/20 £m	Variance £m	Variance %
DfT Grant	£0.98	£0.58	-£0.40	-69%
Local Contributions	£0.64	£0.60	-£0.04	-7%
Core Grant	£1.00	£0.74	-£0.26	-35%
Contracted Income	£0.36	£0.00	-£0.36	-
	£2.98	**£1.92**	**-£1.06**	**-55%**

11.6 At the time of writing the DfT has not formally responded to TfN's request for grant support to deliver on the recommendation of the Blake-Jones review. Should resource not be forthcoming, officers will consider options to address the position on both a short and longer-term sustainable basis.

11.7 Contracted income relates to the billable time of TfN officers recruited to deliver work on behalf of North Yorkshire County Council for the Esk Valley line reopening, and those officers who will be funded via a contract-for-services with Network Rail for TRU activity.

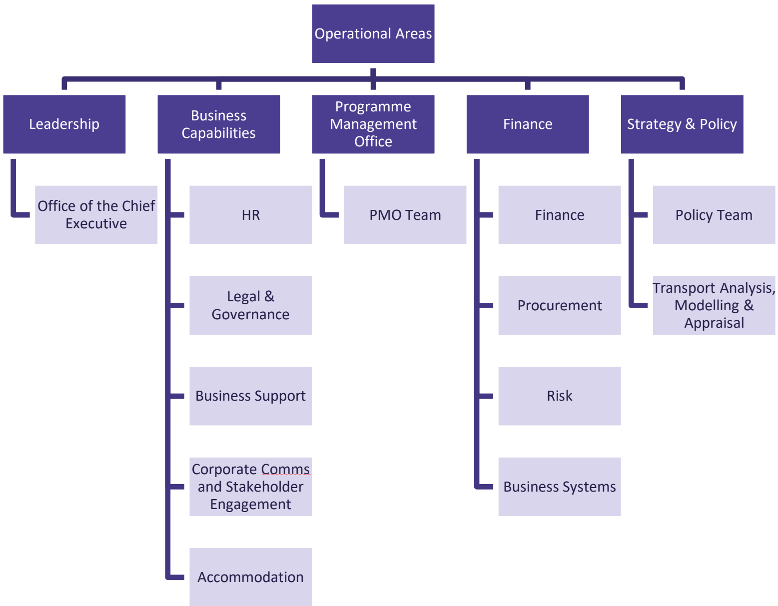
12. Operational Areas

12.1 The operational budget covers the functions of the back, middle, and front office of the organisation along with the business infrastructure.

12.2 TfN is subject to the same regulatory environment as local and combined authorities and must discharge its responsibilities as an autonomous body. It must also act in accordance with the TfN/DfT Memorandum of Understanding.

12.3 Accordingly, the activity carried out within these areas represents the required enabling-functions familiar to all public-sector organisations, but also the teams that develop and deliver upon many of TfN's aspirations. This includes the Policy team that defines TfN's strategic vision; the Corporate Communications and Stakeholder Engagement team that supports the North's ability to speak with one voice; and the Transport Analysis, Modelling and Economics (TAME) team that underpins TfN's commitment to evidenced-based decision-making.

12.4 The operational area budget structure can be shown as follows:



12.5 Total gross expenditure proposed for the operational areas is £8.46m, of which £1.00m will be recharged into the programme areas. This represents a reduction in gross expenditure of £0.73m (7%), but an increase in net expenditure after programme recharges of £0.27m.

Operational Areas	2020/21 £m	2019/20 £m	Variance £m	Variance %
Leadership	£0.32	£0.27	£0.05	18%
Finance & Business Systems	£1.35	£1.23	£0.12	3%
Business Capabilities	£3.78	£3.72	£0.06	-1%
Programme Management Office	£0.32	£0.39	-£0.07	-10%
Strategy & Policy	£2.70	£3.58	-£0.88	-18%
Total Expenditure	**£8.46**	**£9.19**	**-£0.73**	**-7%**
Recharges to Programmes	-£1.00	-£2.00	£1.00	**-50%**
Net Expenditure	**£7.46**	**£7.19**	**£0.27**	**5%**

12.6 Decreases in gross expenditure represents a net movement as the inflationary effect of forecast national pay awards and local pay scale progression dampens expenditure reductions arising from the removal of development costs, particularly in the Strategy & Policy team:

Strategy and Policy Directorate	2020/21 £m	2019/20 £m	Variance £m	Variance %
Policy Team	£0.92	£1.06	£0.15	14%
Modelling Team	£1.04	£1.27	£0.23	18%
Innovation Activity	£0.00	£0.09	£0.09	100%
Economic Appraisal Team	£0.75	£1.16	£0.42	36%
	£2.70	**£3.58**	**£0.88**	**25%**

12.7 It is likely that some of the costs that have fallen out of the budget between 2019/20 and 2020/21 will repeat in future years given the need to refresh items such as the Strategic Transport Plan and the Investment Programme.

12.8 As the programmes continue to develop and grow in both complexity and basic metrics such as headcount and funding, the operational areas will need to adjust their levels of service to ensure they can continue to offer the required level of support. As TfN's Core grant levels are fixed, this will likely mean higher recharges into the programme areas. Such recharges simply reflect the cost of business and delivering a programme in an appropriately controlled manner.

12.9 The reduction in recharges in 2020/21 over the prior year reflects the reduction in the scale and value of the IST Programme. A proposal will shortly be put to the Department TDF grant budget holder to recharge certain operational area costs into the NPR programme's funding.

13. Medium-Term Financial Strategy & Reserve Strategy

13.1 Under statute, all local government bodies – including TfN – are required to operate to a locally defined reserves strategy that ensures that the organisation always holds a prudent level of reserves.

13.2 Such reserves enable the organisation to operate with a degree of flexibility and guard against in-year financial shock.

13.3 A prudent reserve strategy is particularly important to TfN as it has few other levers to mitigate financial risk. As discussed, unlike other northern partners, TfN cannot access credit for short-term cash flow management and long-term investment, nor can it levy or precept upon a local tax-base to underwrite its operations.

13.4 TfN's approach to managing financial risk therefore has to rest on two pillars:

a) A prudent risk culture that ensures TfN limits its exposure to financial risk arising from contracting and business operations; and
b) A prudent reserve strategy that ensures TfN always holds a level of cash at bank to guard against residual financial shock.

Practically, this means that TfN must work in collaboration with DfT and partners when entering into multi-year and high-risk transactions to ensure that the right balance of risk share is achieved between partners.

13.5 It also means that TfN's reserve strategy must be managed in conjunction with the use of the annual Core grant allocations. As Core grant is the only discretionary resource TfN holds that can fund any and all expenditure, it follows that financial risk must primarily be managed through this resource.

13.6 Following discussions with the DfT, it has been agreed that TfN will target a core cash balance of *no less than* £2m to be held as a reserve in any given year.

13.7 This value was considered sufficient to allow for modest draws to be made in-year to meet un-budgeted opportunities that may arise, whilst also ensuring cash remained at bank to meet both unexpected costs and cash flow fluctuations.

13.8 From year to year this reserve may be drawn upon in-year, or contributions made from surpluses, with adjustments being made in following years to replenish it.

13.9 TfN's medium-term financial strategy is predicated on two central assumptions:

1. Material programme activity will be resourced from discrete grant resource
    a. Activity levels will be tailored to the funding available and any grant restrictions thereon
    b. Within each major grant allocation, an element will be held as 'contingency' to mitigate inherent risk
    c. Accordingly, material programme activity will not require resource contributions from TfN's Core resource
2. Core grant funded activity will be reduced to sustainable levels once non-repeating activity has been tapered out of the budget
    a. This includes aspirational development activity such as the residual work on the Strategic Development Corridors
    b. This also includes formative organisational development activity, principally around the creation of TfN's Analytical Framework

13.10 The principal variables to manage through the medium-term financial strategy are therefore around the Core grant activity, and in particular how to align the reserve strategy with business plans to allow key priorities to be resourced whilst managing inflationary pressures.

13.11 TfN proposes to draw £1.39m from Core grant reserves in financial year 2020/21, based on a brought forward Core grant general (non-earmarked) reserve balance of £5.97m.

13.12 This reserve balance has accumulated from prior year savings and identified underspend in the current year following the reporting of forecast slipped activity and savings. Drawing down on £1.39m of resource in 2020/21 will allow for a balanced budget, and further draws into the future to allow for a managed reduction in the cost-base whilst absorbing forecast inflation.

13.13 It is also proposed to earmark an additional £0.20m of Core grant underspend to the Devolved Powers Reserve. This is likely to be a significant piece of work but is not sufficiently developed at this stage to be included in the budget proposals. Earmarking resource within the budget would allow TfN to draw down on resource as and when it is required. Should a decision be made that the resource is not required, the earmarked reserve could be released to support other priorities.

13.14 The following table highlights forecast core grant requirements, resource, and the associated requirements for reserve support:

Reserves	2019/20 £m	2020/21 £m	2021/22 £m	2022/23 £m
Core Grant Reserve				
Balance b/f	£5.28	£5.97	£4.58	£3.88
Draw	£0.00	-£1.39	-£0.70	-£1.02
Contribution	£0.69	£0.00	£0.00	£0.00
Balance c/d	**£5.97**	**£4.58**	**£3.88**	**£2.86**
Earmarked Devolved Powers				
Balance b/f	£0.30	£0.50	£0.50	£0.50
Draw	£0.00	£0.00	£0.00	£0.00
Contribution	£0.20	£0.00	£0.00	£0.00
Balance c/d	**£0.50**	**£0.50**	**£0.50**	**£0.50**
Total Available Reserves				
Balance b/f	£5.58	£6.47	£5.08	£4.38
Draw	£0.00	-£1.39	-£0.70	-£1.02
Contribution	£0.89	£0.00	£0.00	£0.00
Balance c/d	**£6.47**	**£5.08**	**£4.38**	**£3.36**

13.15 Future year draws on the reserve are affected by assumed pay and price inflation and also a prudent assumption that additional one-off development activity will be required, or cyclical resource intensive activity (such as renewal of the Strategic Transport Plan) will occur.

13.16 On this current trajectory TfN will encounter sustainability issues in the medium-term as the ability of the brought forward reserve to accommodate inflation is placed under pressure.

13.17 To mitigate this TfN will require either resource in excess of current allocations or be required to reduce its discretionary expenditure, namely the use of professional services to support its development activity. Whilst the latter option is possible, it would impact upon TfN's development capacity.

13.18 TfN also notes the impending government spending review, which will allow TfN to bid for a funding package that is more aligned to its resource requirements informed by its relative maturity as an operating organisation.

14. Options Considered:

14.1 This budget is informed by the TfN 2020/21 Business Plan. Amendments to the budget would require adjustments to the Business Plan.

15. Considerations:

15.1 This draft budget report contains proposals on how to fund the 2020/21 Business Plan whilst maintaining financial stability.

15.2 The draft proposals include draws upon TfN's Core grant reserves, and the earmarking of reserves for specific activity.

15.3 This report asserts that the draft budget proposals are a prudent means of resourcing Business Plan priorities.

16. Preferred Option:

16.1 Adoption of this budget and reserve strategy.

17. Appendices:

17.1 12.1 - Forecast financial position at outturn.
12.2 – Annual Treasury Management Strategy.
12.3 – Annual Treasury Management Strategy Statement.

List of Background Documents

Required Considerations

Please confirm using the yes/no options whether or not the following considerations are of relevance to this report.

Equalities:

Age	~~Yes~~	**No**
Disability	~~Yes~~	**No**

Gender Reassignment	~~Yes~~	**No**
Pregnancy and Maternity	~~Yes~~	**No**
Race	~~Yes~~	**No**
Religion or Belief	~~Yes~~	**No**
Sex	~~Yes~~	**No**
Sexual Orientation	~~Yes~~	**No**

Consideration	**Comment**	**Responsible Officer**	**Director**
Equalities	A full Impact assessment has not been carried out because it is not considered necessary for this report	Gareth Sutton	Iain Craven

Environment and Sustainability

~~Yes~~	No

Consideration	**Comment**	**Responsible Officer**	**Director**
Sustainability / Environment	A full impact assessment has not been carried out because it is not considered necessary for this report. Financial sustainability considerations are highlighted throughout the report.	Gareth Sutton	Iain Craven

Legal

~~Yes~~	No

Consideration	**Comment**	**Responsible Officer**	**Director**
Legal	TfN Legal Team has confirmed there are no legal implications.	Rosemary Lyon	Dawn Madin

Finance

Yes	~~No~~

Consideration	Comment	Responsible Officer	Director
Finance	The financial implications have been considered and are included in the report.	Gareth Sutton	Iain Craven

Resource

~~Yes~~	No

Consideration	Comment	Responsible Officer	Director
Resource	TfN HR Team has confirmed there are no resource implications.	Stephen Hipwell	Dawn Madin

Risk

Yes	~~No~~

Consideration	Comment	Responsible Officer	Director
Risk	A risk assessment has been carried out and the key risks are included in the report.	Gareth Sutton	Iain Craven

Consultation

~~Yes~~	No

Consideration	Comment	Responsible Officer	Director
Consultation	A consultation has not been carried out because it is not considered necessary for this report.	Gareth Sutton	Iain Craven