TfN Scrutiny Commitee – Item 7

Subject:	TfN Budget and Reserve Strategy 2019/20
Author:	Gareth Sutton, Financial Controller
Sponsor:	Iain Craven, Finance Director
Meeting Date:	Thursday 24 January 2019

1. Executive Summary:

1.1 Financial year 2019/20 represents the second budgetary period over which TfN has existed as a statutory sub-national transport body (STB).

1.2 TfN is subject to essentially the same statutory framework as its partner local transport and combined authorities. Such legislation confers upon the organisation a set of requirements that shape how the organisation conducts its financial affairs. These requirements will be familiar to TfN members.

1.3 However, these requirements are further complemented by TfN's relationship with the Department for Transport - particularly around its funding - and how the organisation has been constituted. Taken together, these statutory obligations and the nature of the funding and partnership arrangements set the parameters in which TfN will set its financial strategies and manage its operations.

1.4 Internally, TfN's financial affairs are governed through the adoption of a number of constitutional documents which set out operational parameters. These documents include the Financial Regulations and the accompanying Scheme of Delegation.

1.5 This report sets out TfN's financial operating environment, and the budgets that will support delivery of the TfN business plan for 2019/20 and beyond. These budgets are underpinned by a reserve strategy, which serves as TfN's back-stop mitigation against financial risk.

1.5 As in the prior year, 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 2019/20. The Business plan for 2019/20 is presented as a separate item to this Committee.

2. Recommendation:

2.1 Note the proposals for a balanced 2019/20 budget, and a sustainable medium-term financial strategy.

2.2 Note the reserve strategy proposed at section 13.

2.3 Note the changes to the budget structure, particularly the isolation of contingency resource from base forecasts.

3. Issues:

Executive Summary

3.1 TfN has conducted a business planning process designed to deliver upon the key priorities agreed at the September 2017 Partnership Board in Hull and reiterated at TfN Board meetings over the course of financial year 2018/19.

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 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.

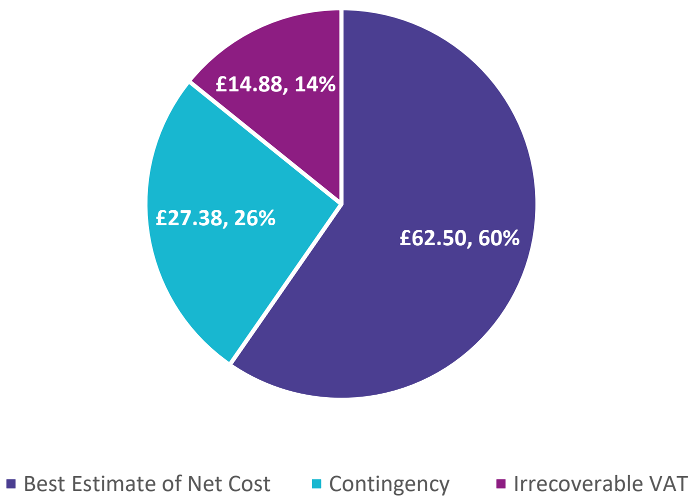
3.4 The total budget for 2019/20 is proposed at £104.76m, consisting of:

TfN Expenditure	£m	%
Programmes:		
Revenue Programmes	£35.49	34%
Capital Programmes	£33.00	31%
Programme Contingency	£27.38	26%
	£95.87	**91%**
Operational Areas (net)	£6.96	7%
Rail Operations	£1.92	2%

Total	£104.76	

3.5 It should be noted that that the total budget envelope is elevated by both contingency values held to manage programme risk, 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 at £27.38m represents c. 26% of the overall budget:



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

TfN Resource	£m	%
Integrated & Smart Ticketing Grant	£62.46	60%
Transport Development Fund Grant	£30.00	29%
Core Grant	£10.00	10%
Reserves	£1.11	1%
Rail North Grant & Contributions	£1.18	1%
	£104.76	

3.8 The draw of £1.11m from reserves represents the second planned annual draw on TfN's un-earmarked reserves. Those reserves were created from Core grant underspends in prior years and are drawn upon in line with the reserve strategy adopted by TfN in April 2018.

3.9 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 reserves of c. £3m at the end of the 2019/20 financial year and is set out in more detail in Section 13.

3.10 In the longer term, reserve levels will be targeted at no less than £2m in any given year to mitigate against financial shock.

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 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 The 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). This grant, and the reserves that flow from it, must be used to mitigate the insolvency risk to which TfN could otherwise be exposed.

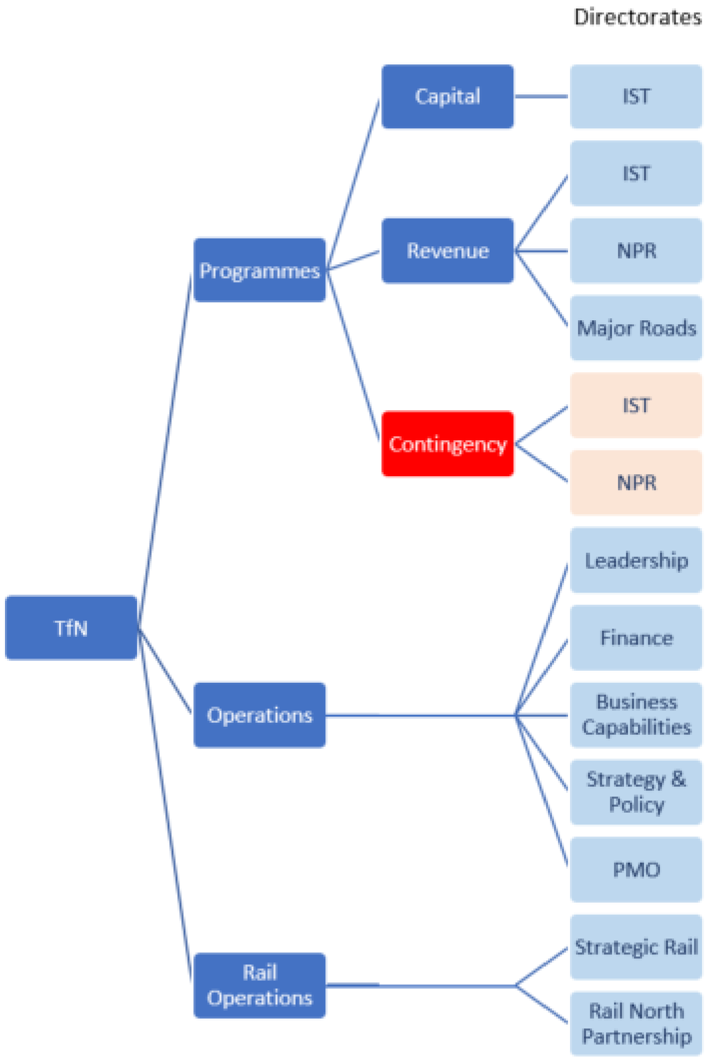
Budget Structure

4.6 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.

4.7 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 is held discretely to avoid distorting budget forecasts.

4.8 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.

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



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

4.11 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.

4.12 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 (£0.95m) would be equivalent to a material variance of 9% in the operational area.

4.13 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.

4.14 As indicated in the December Revision 2 Report that was provided to TfN Board, from 2019/20 TfN has opted to separately show contingency amounts held in the budget to mitigate risk around programme overspends and equally allow the programmes in-year resource to exploit opportunities as they arise. Isolating this resource will allow better oversight of performance against planned activity and associated forecasts as it will remove the distorting impact of underspend against contingency reserves – an issue that has been pertinent over financial year 2018/19.

4.15 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.

Budget 2019/20 Development

5.1 The 2019/20 budget is driven by the business plan and is to a large degree an iteration of its 2018/19 predecessor. The proposed plan is consistent with previous years' activity and the objectives agreed at the September 2017 Hull Partnership Board, including: development of the Strategic Transport Plan, including associated reports and the investment programme; Development of business cases for Northern Powerhouse Rail, the delivery of Strategic Corridor Studies; and Smart business case approval / delivery.

5.2 The 2019/20 budget was derived following a number of challenges, notably:

- How to use a finite, un-indexed funding stream (Core grant) to resource costs impacted by inflation;
- How to fund programme development costs not resourced from discrete funding (such as the Strategic Development Corridor studies);
- How to resource the enabling functions required of a statutory body; and, most pressingly,
- How to balance basic organisational requirements with the need to target resource at key development objectives.

5.3 These challenges were present in the prior year and have been exacerbated by predictable challenges such as cost inflation, but also issues that weren't expected during the prior business planning process.

5.4 These issues include the scope and scale of resources required to manage statutory Rail North obligations, and the iterative burden on modelling and appraisal teams to support the development of aspirational activity such as the Strategic Development Corridors.

5.5 The growth and complexity of programme led activity has also had 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.

5.6 Taken together, these issues contribute to cost growth across the organisation that is 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.

5.7 To mitigate this issue work has been undertaken to identify where new costs are incremental to the growth of programme activity, enabling those costs to be recharged into discrete grant streams. Recharging costs in this manner is consistent with existing accounting policies and allows TfN to both properly resource programme activity and also see the true cost of delivery.

5.8 An exercise has also been completed to isolate '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.

5.9 Recharges of costs into discrete grants and the isolation of non-repeating expenditure allows TfN to propose both a balanced 2019/20 budget and a sustainable medium-term financial strategy.

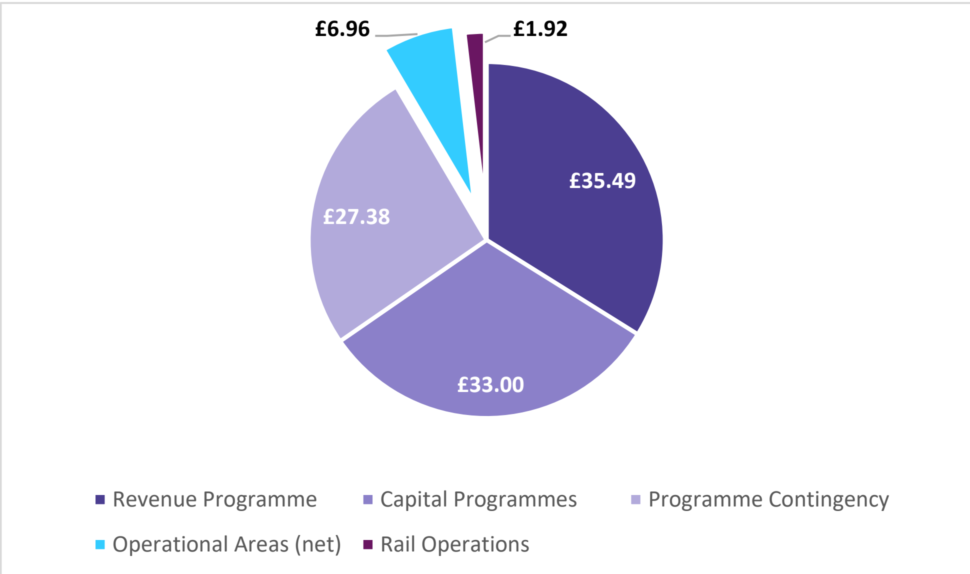
5.10 This report proposes that the budget is resourced through a mixture of in-year grant and brought forward reserves (prior year underspend).

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

5.12 Using reserves in this manner recognises that TfN's cost-base has a material number of one-off or time limited costs that will not repeat into the future. This 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.

Budget 2019/20 Summary

6.1 TfN proposes a budget totalling £104.76m that can be split between the programme, operational, and Rail Operations areas as follows:

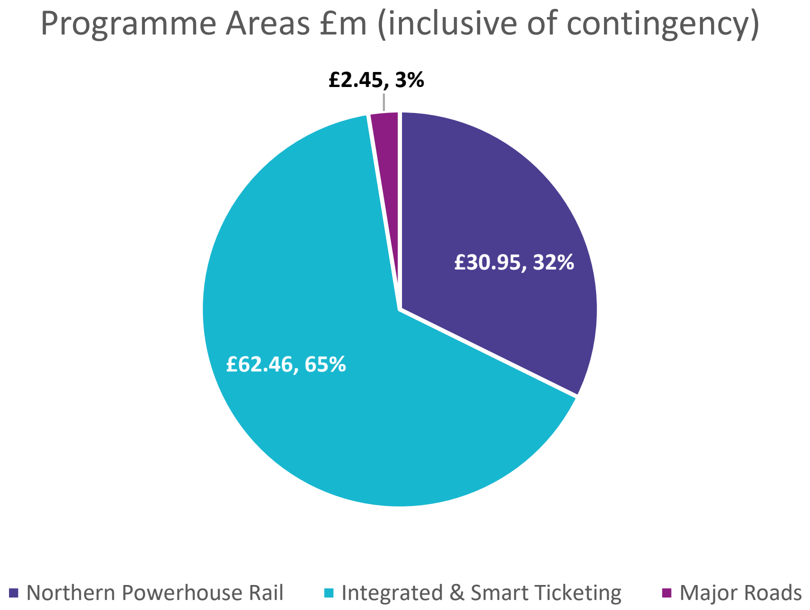


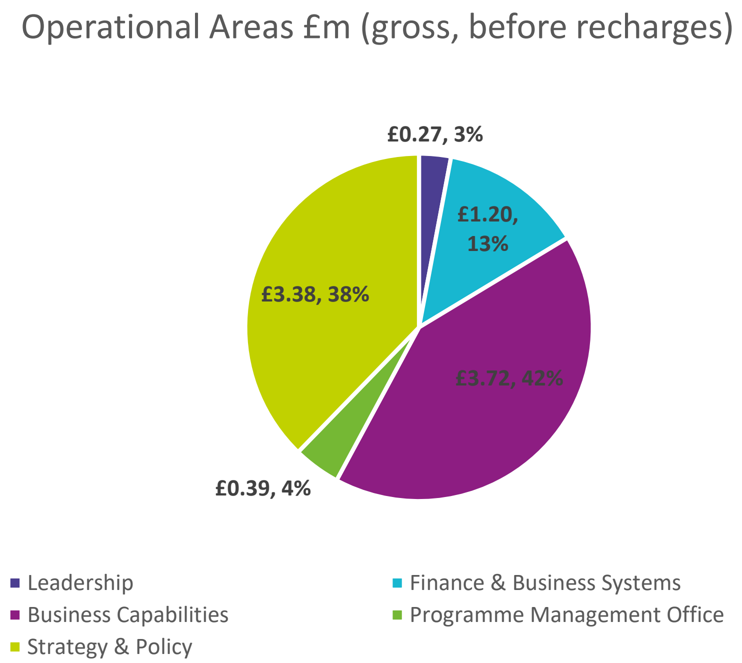
6.2 This graphic highlights that TfN is largely a programme led organisation pursuing its aspirations around Northern Powerhouse Rail; Integrated and Smart Ticketing; and Major Roads through the Strategic Development Corridors. These programmes typically attract significant amounts of contingency to allow the management of in-year risk.

6.3 The graphic also highlights the discrete business-as-usual activity around discharging the statutory obligations the organisation has towards the Rail North area.

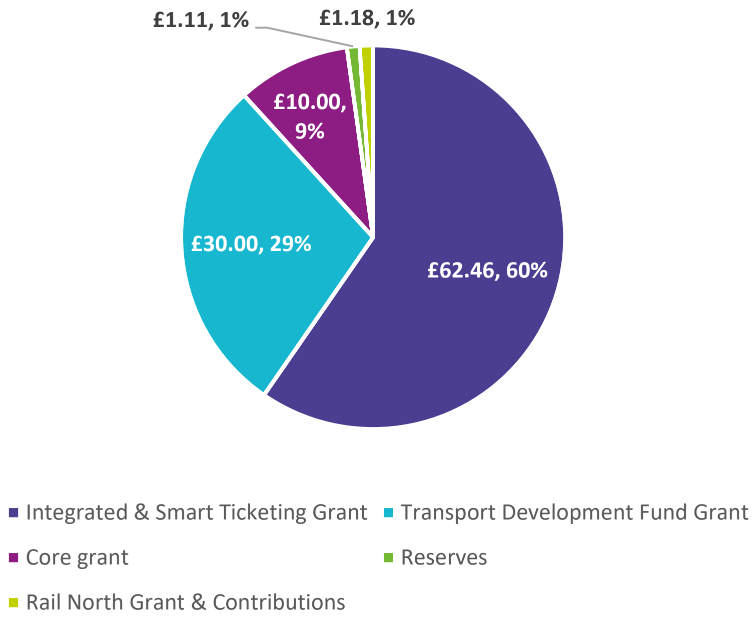
6.4 Both the programmes and Rail Operations workstreams are enabled by the operational areas which provide the business infrastructure necessary for those areas to function.

6.5 These areas can be further broken down into activity areas:





6.6 This activity will be funded from the following resource (in £m):



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 2019/20 it is forecast that there will be three thematic elements of the programme budget:

- Integrated & Smart Ticketing (IST);
- Northern Powerhouse Rail (NPR); and,
- Major Roads (principally 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 the IST programme's activity constitutes capital expenditure, reflecting the relative maturity of that programme 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 costs are as follows:

2019/20	Expenditure Type	Forecast £m	Contingency £m	Total Budget £m
IST	Revenue	£3.28	£0.00	£3.28
	Capital	£33.00	£26.18	£59.18
		£36.28	**£26.18**	**£62.46**
NPR	Revenue	£29.75	£1.20	£30.95
Major Roads	Revenue	£2.45	£0.00	£2.45
		£68.48	**£27.38**	**£95.87**

7.6 Within these costs are significant amounts of contingency (£27.38m). Contingency is required to mitigate against the risk of activity costing more than forecast and indeed 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. The levels of contingency held are developed and agreed in collaboration with the Department for Transport through the business case approval process.

7.7 After contingency, the costs of the programmes are principally around professional services and development activity. This is a key differentiation to the operations budget where the majority of costs are incurred on staff and business infrastructure.

7.8 Professional services are principally drawn from major contracts for work – such as that with Network Rail for the NPR programme – whilst capital costs represent the payments made to partners and contractors for the development of the IST infrastructure. It is notable that there is £9.94m of irrecoverable VAT within these numbers, whilst recharges reflect the reallocation of costs from other TfN teams providing the necessary business infrastructure:

Cost Category	£m	%
Professional Services	£28.04	29%
Contingency	£27.38	29%
Capital	£21.88	23%
Irrecoverable VAT	£9.94	10%
People	£4.69	5%
Recharges	£2.63	3%
Consumables	£0.74	1%
Travel	£0.09	0%

Stakeholder Engagement	£0.00	0%
	£95.87	

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

Funding	£m	%
IST Grant	£62.46	65%
Transport Development Fund (NPR) Grant	£30.00	31%
Core Contributions	£2.30	2%
Reserves	£1.11	1%
	£95.87	

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 of the Strategic Development Corridors within the Major Roads area.

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.

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 are significant (£26.18m) and reflect the complexity of delivering an innovative ICT project in such a challenging operating environment.

8.5 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	Project (Contingency Inclusive)	£m	%
Phase 1	ITSO on Rail	£10.40	17%
Phase 2	Customer Information/Innovation/Collaboration	£4.26	7%
Phase 3	Accounts Based Back Office	£47.18	76%
Programme Costs	Programme Costs (including recharges)	£2.63	1%
		£62.46	

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

IST Programme (Contingency Inclusive)	Revenue	Capital	Total
Phase 1	£2.69	£7.71	£10.40
Phase 2	£0.12	£4.13	£4.26
Phase 3	£0.37	£46.81	£47.18
Programme Costs (including recharges	£0.11	£0.53	£0.57
	£3.28	£59.18	£62.46

8.7 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	Revenue	Capital	Total
Phase 1	£2.69	£2.99	£5.68
Phase 2	£0.12	£2.15	£2.28
Phase 3	£0.37	£25.32	£25.69
Programme Costs	£0.10	£2.53	£2.63
	£3.28	£33.00	£36.28

8.8 It is against these numbers 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.

8.9 IST costs are particularly sensitive to the pace of the tranches through DfT's business case approval process. Should the activity not progress as forecast, it is likely that the cost profile and the cost mix will change as delivery plans are adjusted.

8.10 The progress of Phase 3 of the programme through the FBC approval process will largely determine the levels of expenditure on that project. At this stage it is expected that FBC approval will be sought in the autumn of 2019. Should that approval decision be deferred to a later date, it is likely that material amounts of expenditure could slip into the next financial year.

Northern Powerhouse Rail (NPR)

9.1 The principal element of the the NPR programme budget is the Network Rail contract for the provision of rail studies. These studies are supplemented by economic analysis and modelling to determine the benefits of proposed interventions, which will inform the design of the NPR SOBC submission to DfT, and the work that follows.

9.2 The budget also includes provision for the TfN officers employed within the NPR team. These officers direct the programme, manage the large contracts, and internally commission the economic analysis and modelling work. Finally, the budget also includes the organisational overhead costs that are incremental to the programme's activity; such as, office accommodation, ICT kit and licenses, and back-office support.

9.3 The NPR budget is materially higher than in previous years reflecting the funding allocated in the 2018 budget that will pay for an increase in the pace of activity as the programme progresses towards outline business case submission, and then on to full business case development.

9.4 This increase in activity is underpinned by increased government support through Transport Development Fund grant. This grant allows TfN to commission works – principally through Network Rail – in support of NPR development through a co-client arrangement. For financial year 2019/20 £30m has been made available, which will be supplemented with Core grant contributions.

9.5 In 2019/20, the NPR budget will consist of expenditure on the following headings:

NPR	£m	%
NPR Team	£1.95	6%
Stakeholder Engagement	£0.23	1%
Modelling & Economic Appraisal	£4.77	15%
Rail Studies	£24.00	78%
	£30.96	

9.6 A relatively low level of contingency (£1.20m) has been earmarked within this budget, to be deployed against emerging priorities. This recognises that there are likely to be additional pieces of activity that arise as the programme progresses through OBC stage that cannot yet be defined.

9.7 The NPR cost mix reflects the significant use of third parties for professional support. This includes the work of consultants to support studies and the supporting analysis, but also the engagements with Network Rail in its role as system operator for northern rail infrastructure:

Cost Category	£m	%
Professional Services	£22.19	72%
Irrecoverable VAT	£4.73	15%
People	£1.84	6%
Contingency	£1.20	4%
Consumables	£0.42	1%
Recharges	£0.37	1%
Communications	£0.19	1%
Travel	£0.02	0%
	£30.96	

9.8 As in the prior year, the NPR programme will be resourced from a combination of TDF grant and Core grant resource. 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	£m	%
Transport Development Fund	£30.00	97%
Core Grant	£0.96	3%
	£30.96	

9.9 As with the IST programme, funding drawdowns for the NPR programme are contingent upon the successful passage of the programme through government gateway approval processes.

9.10 It is anticipated that the NPR programme could receive its SOBC approval in March 2019, allowing for the release of the 2019/20 TDF allocation in the new financial year. Should that approval be delayed, it is possible that expenditure could slip. However, unless that delay is material, it is likely that slipped costs could be caught up as the year progresses. In addition, discussions with the Department for Transport are ongoing with regard to the NPR TDF expenditure plan for 2019/20.

This budget draft is based on the current assumed approach as shared with the Department.

Major Roads

10.1 The Major Rods programme budget principally resources a number of Strategic Development Corridor (SDC). Work on all 7 studies has been ongoing throughout 2018/19 with a view to informing the first published version of the long-term Investment Programme. A number of delays have been encountered during the year, in particular in relation to the scope and complexity of the economic modelling that is required, but it is expected that the initial stages of the studies will be complete by the end of the financial year 2018/19.

10.2 In 2019/20 the Transport Analysis, Modelling, and Economics team will pick upon the work undertaken by external consultants and further refine the evidence base to support a business case submission into the Department for Transport.

10.3 The Major Roads programme budget stands at £2.45m for financial year 2018/19:

Major Roads	£m	%
Major Roads Programme Team	£0.56	23%
Strategic Development Corridors	£1.71	70%
Major Route Network	£0.19	8%
	£2.45	

10.4 The Major Roads 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 Major Roads 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:

Major Roads	£m	%
Core Grant	£1.34	55%
Use of Reserves	£1.11	45%
	£2.45	

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 In financial year 2018/19, significant stress came on the operational budgets provided to the Rail Operations teams as additional resource and skills were called upon to support TfN's response to the summer rail timetabling issues.

11.4 Mid-year budget virements were authorised by the Finance Director (c. £0.31m) displacing other Core grant funded activity, whilst the Department of Transport afforded TfN additional discrete grant (£0.11m).

11.5 The 2019/20 budget proposals have been developed within this context, with more resource being invested in officer capacity. For the forthcoming financial year, the budget proposals are:

Rail Operations	£m	%
Strategic Rail	£1.06	55%
Rail North Partnership	£0.86	45%
	£1.92	

11.6 This activity is resourced from a mixture of Core grant contributions and local and Department for Transport grant:

Rail Operations	£m	%
Grant and Contributions	£1.18	61%
Core Grant	£0.74	39%
	£1.92	

11.7 Additional posts budgeted for in the Rail North Partnership team are contingent on an extension to the existing Rail North Partnership grant, awarded from the Department for Transport. At the time of writing, Departmental governance arrangements precluded confirmation of this award. It is expected that clarification around the award will be made available in the latter half of Quarter 4.

11.8 The outcomes of the Blake-Jones review may impact upon the future role of the Rail Operations teams and how functions are discharged. On the conclusion of that review, the budgets will be reviewed in line with the proposals and funding requirements.

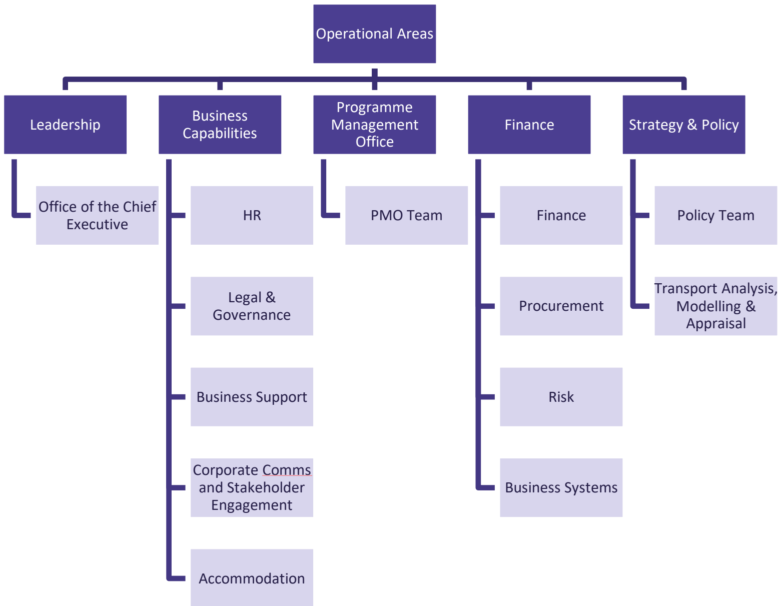
Operational Areas

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 much 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 £9.57m, of which £2.61m will be recharged into the programme areas:

Operational Directorates	£m	%
Leadership	£0.27	3%
Finance & Business Systems	£1.20	13%
Business Capabilities	£4.23	44%
Programme Management Office	£0.39	4%
Strategy & Policy	£3.48	36%
Gross Expenditure	**£9.57**	
- Recharges to Programmes	-2.61	
Net Expenditure	**£6.96**	

12.6 It is notable that the cost mix within the operational area is materially different to that of the programme area, with a heavier weighting towards resourcing (£4.48m) and consumables and supplies and services (£2.06m). This reflects that the operational budgets provide much of the business infrastructure for the programmes (such as general ICT provision) but also general business costs such as accommodation, audit fees, insurance, and the back-office systems any business requires.

Cost Categories	£m	%
People	£4.48	47%
Professional Services	£2.13	22%
Irrecoverable VAT	£0.81	8%
Consumables	£0.60	6%
Accommodation	£0.59	6%
ICT	£0.46	5%
Communications	£0.38	4%
Travel	£0.10	1%
Insurance	£0.03	0%
Gross Expenditure	**£9.57**	
Recharges	-£2.61	
Net Expenditure	**£6.96**	

12.7 The recharge line in the above table reflects the costs incurred in TfN's operational teams that are apportionable to the programme areas. Such recharges are made in line with TfN's accounting policies and when grant conditions allow for transactions.

12.8 Whilst operational area activity includes a material amount of unavoidable statutory and regulatory requirements and also the basic level of service expected for any organisation, it is also sensitive to the growth of the programme areas.

12.9 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.

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 prudent risk culture that ensures TfN limits its exposure to financial risk arising from contracting and business operations; and
- 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. 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 reducing the Core grant cost-base.

13.11 TfN proposes to draw £1.1m from Core grant reserves in financial year 2019/20, based on a brought forward Core grant reserve balance of £4.14m.

13.12 This reserve balance has accumulated from prior year savings, and planned underspends in 2018/19 following the reporting of forecast slipped activity. Drawing down on £1.1m of resource in 2019/20 will allow for a balanced budget, and further smaller 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 £0.30m of Core grant resource in 2019/20 to support potential work on devolved powers activity. 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:

	2019/20 £m	2020/21 £m	2021/22 £m
Core Grant Requirements	**£11.11**	**£10.26**	**£10.41**
Resource			
Annual Core Grant	-£10.00	-£10.00	-£10.00
Deficit	**£1.11**	**£0.26**	**£0.41**
Reserves:			

Core Grant Reserve			
Balance b/f	**£4.14***	**£2.73**	**£2.46**
Contributions to Reserve	£0.00	£0.00	£0.00
Draw on Reserve	-£1.11	-£0.26	-£0.41
Earmarking of Reserve	-£0.30	£0.00	£0.00
Balance c/f	**£2.73**	**£2.46**	**£2.05**
Earmarked Devolved Powers Reserve			
Balance b/f	**£0.00**	**£0.30**	**£0.30**
Contributions to Reserve	£0.30	£0.00	£0.00
Draw on Reserve	£0.00	£0.00	£0.00
Balance c/f	**£0.30**	**£0.30**	**£0.30**
***forecast**			

13.15 Whilst the above table highlights an ongoing need for reserves, it should be noted that TfN forecasts the removal of material system development costs from the budget in 2021/22 as the amortisation profiles of initial costs end. This will reduce the requirement for Core grant resource on an on-going basis.

13.16 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.

4. Options Considered:

4.1 This budget is informed by the TfN 2019/20 Business Plan. Amendments to the budget would require adjustments to the Business Plan.

5. Considerations:

5.1 This budget contains proposals on how to fund the 2019/20 Business Plan whilst maintaining financial stability.

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

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

6. Preferred Option:

6.1 Adoption of this budget and reserve strategy.

7. Appendices:

7.1 Appendix 1 – Budget Summary

Transport for the North
Revenue Budget & Capital Programme: 2019/20 Dashboard

A programme led organisation supported by operational areas:

TfN Expenditure	£m	%
Programmes:		
Revenue Programmes	£35.49	34%
Capital Programmes	£33.00	31%
Programme Contingency	£27.38	26%
	£95.87	**91%**
Operational Areas	£6.96	7%
Rail North	£1.92	2%
Total	**£104.76**	

Budgets include significant amounts of contingency that will only be drawn on if required:

TfN Expenditure	Best Estimate of Net Cost £m	Contingency £m	Total £m
Programmes:			
Revenue Programmes	£35.49	£1.20	**£36.69**
Capital Programmes	£33.00	£26.18	**£59.18**
	£68.49	**£27.38**	**£95.87**
Operational Areas (net)	£6.96	£0.00	**£6.96**
Rail North	£1.92	£0.00	**£1.92**
Total	**£77.38**	**£27.38**	**£104.76**

Gradual draw on reserves as TfN transitions to more sustainable cost base:

	2018/19*	2019/20	2020/21	2021/22
General Core Grant Reserve	£4.14	£2.73	£2.46	£2.05
Earmarked Devolved Powers Reserve	£0.00	£0.30	£0.30	£0.30

** forecast at outturn*

No revenue raising powers: all funding comes from grants and contributions:

TfN Resource (inclusive of contingency)	£m	%
Integrated & Smart Ticketing Grant	£62.46	60%
Transport Development Fund Grant	£30.00	29%
Core grant	£10.00	10%
Reserves	£1.11	1%
Rail North Grant & Contributions	£1.18	1%
	£104.76	

Budget will be monitored on the lower estimate, with draws on contingency through budget virements:

Programme Areas		
Northern Powerhouse Rail	£29.75	38%
Integrated & Smart Ticketing	£36.28	47%
Major Roads	£2.45	3%
Programme Gross Sub-Total	**£68.49**	
Rail Operations		
Strategic Rail	£1.06	1%
Rail North Partnership	£0.86	1%
Rail North Sub-Total	**£1.92**	
Operational Directorates		
Leadership	£0.27	0%
Finance & Business Systems	£1.20	2%
Business Capabilities	£4.23	5%
Programme Management Office	£0.39	1%
Strategy & Policy	£3.48	5%
Operational Gross Sub-Total	**£9.57**	
- Recharges to Programmes	-2.61	
Operational Net Sub-Total	**£6.96**	
Total TfN Expenditure	**£77.38**	

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.	Sasha Wayne	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