

## North East Joint Transport Committee

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**Date:** 23 October 2019

**Subject:** Nexus Budget Strategy – Medium Term Financial Planning 2020/21 – 2022/23

**Report of:** Director of Finance and Resources, Nexus

### Executive Summary

This report sets out details of the budget pressures and issues facing Nexus over the next three years and seeks the views of the Committee on such matters to inform its approach to its medium term financial plan, in particular the implications of Nexus preparing its budget for 2020/21.

### Recommendations

The North East Joint Transport Committee is recommended to note the contents of this report, consider the implications arising from the budget pressures and issues facing Nexus and provide initial comments in order to inform its approach to its medium term financial plan.

## 1. Background Information

- 1.1. When the Joint Transport Committee (JTC) agreed Nexus' budget in January 2019, the intention was to use reserves in 2019/20 and 2020/21 with the position thereafter likely to require either additional investment or a review of services given that significant efficiencies had been realised over the last ten years without impacting on service delivery.
- 1.2. The medium-term forecast set out at that time (against Nexus' share of the Tyne and Wear transport levy) is summarised below:

**Table 1: Medium Term Financial Forecast (January 2019)**

	2019/20	2020/21	2021/22
	£m	£m	£m
ENCTS	34.529	34.594	35.350
Discretionary Concessionary Travel	3.708	3.679	3.867
Metro	1.442	3.605	5.283
Ferry	1.004	1.062	1.128
Local Rail	0.190	0.199	0.215
Bus Services	11.737	12.116	12.615
Bus Infrastructure	2.528	2.576	2.632
Public Transport Information	1.228	1.234	1.321
<b>NET FUNDING REQUIREMENT</b>	<b>56.367</b>	<b>59.066</b>	<b>62.411</b>
<b>JTC GRANT (LEVY)<sup>1</sup></b>	<b>(55.667)</b>	<b>(59.000)</b>	<b>(59.000)</b>
<b>(SURPLUS)/DEFICIT</b>	<b>0.700</b>	<b>0.066</b>	<b>3.411</b>

- 1.3. The net funding requirement is after taking account of government grants, fare revenue and commercial income, most of which is secured in order to run the Tyne and Wear Metro. The net funding requirement represents the reliance Nexus places on the grant it receives from the JTC, which principally funds bus contracts, concessionary fares and public transport infrastructure.
- 1.4. In 2010, the JTC grant (levy) was £74.2m. In 2020/21 it will be £59.0m, a reduction of £15.2m or 20% over the last 10 years. By contrast, funding for the Metro has increased. In the past 5 years, Metro fare revenue has grown by £6.0m (or 15%) whilst Metro Rail Grant (MRG) from the Department for Transport (DfT) has

<sup>1</sup> The JTC Grant / Levy was reduced by £3.333m in 2019/20 in order to part fund the local contribution towards the new fleet of Metrcars. This retained funding, which will amount to £10.000m as at 31 March 2020 is held in an earmarked reserve by the NECA. The £3.333m is reinstated in future years.

increased by £1.6m (or 7%). Consequently, only £1.4m of Nexus' net funding requirement in 2019/20 relates to Metro, whilst Metro's gross budget in 2019/20 is in excess of £100.0m.

- 1.5. Over the past few years, Nexus has delivered a range of efficiency savings in order to protect frontline services. Most notably:
  - Headcount reduced by 20%;
  - The cost of operating Metro has reduced by circa £2m per annum after the concession with DB Regio ended in March 2017; and
  - A range of other savings have been achieved e.g. in tendered bus services and concessionary fares reimbursement.
- 1.6. In addition, since 2014, Nexus has generated surpluses of £11m, of which £7m has been invested in transport infrastructure, with the balance increasing usable reserves, which are available to support frontline services.

## **2. The 2019/20 forecast and its impact on future years**

- 2.1 In the run up to the end of the 2018/19 financial year and in the early part of 2019/20, a number of budget pressures have emerged. The 2019/20 deficit has increased from £0.7m to £4.1m, an increase of £3.4m. It should be noted that £1.1m of this variance relates to the development of Transforming Cities Fund (TCF) bids, such costs being non-recurring and possibly subject to capitalisation and potential recovery from any Transforming Cities Fund allocations once they are known.
- 2.2 The remainder is mainly explained by:
  - A reduction in Metro fare revenue of £1.2m (this equates to over 2% of the farebox) and broadly reflects the outturn position in 2018/19 also;
  - A reduction in Secured bus services fare revenue of £0.3m (this equates to circa 10% of the farebox);
  - The April 2019 pay award for Nexus (and NEMOL) employees were both 0.5% in excess of the budget provision, adding a £0.3m pressure; Contract inflation relating to high voltage power and cleaning, which are forecast to be £0.5m and £0.2m in excess of budget respectively;
  - Responses to catastrophic overhead line failures in May 2019 have added a £0.3m budget pressure;
  - Train crew overtime has added a £0.5m pressure; and
  - These cost pressures have been mitigated by:
    - The reclassification of capital grant as revenue grant (£0.5m);
    - A reduction in contract costs relating to the secured bus network (£0.3m); and
    - An increase in investment income (£0.2m).

2.3 Without intervention, most of these in-year pressures (and savings) will carry forward to next year, meaning that the full year effect will impact on the three-year forecast, 2020/21 to 2022/23. Broadly speaking, the medium term forecast, updated to take into account these cost pressures is set out in the table below (compared to that which was submitted to the JTC when the 2018/19 budget was set):

**Table 2 – Updated Medium Term Financial Forecast**

	2019/20	2020/21	2021/22	2022/23
	£m	£m	£m	£m
January 2019 Deficit (Table 1)	0.7	0.1	3.4	N/A
<b>August 2019 Deficit</b>	<b>4.1</b>	<b>1.6</b>	<b>4.7</b>	<b>7.3</b>
<b>Deterioration in Forecasts</b>	<b>+3.4</b>	<b>+1.5</b>	<b>+1.3</b>	<b>+7.3</b>

2.4 It should be noted that detailed work is ongoing in order to refine these estimates. However, it is evident that pay and contractual inflation, known commitments and additional pressures in order to ‘standstill’ continue to grow, whilst estimates of future revenues at best show only a marginal increase. In compiling these broad estimates for 2020/21 to 2022/23, there is an assumption that:

- Services are maintained at current levels, with previous commitments
- Pay and contract prices (including concessionary fares reimbursement) will broadly increase in line with inflation;
- MRG will increase in line with inflation (increasing from £25.1m to £25.6m, confirmed by DfT on 10 October 2019);
- Metro fares will increase in line with inflation;
- JTC grant will be £59.0m in 2020/21; and
- Nexus’ 2019 pension valuation will continue to show a surplus.

### **3. Impact of the new Metrocar fleet**

3.1 As Nexus prepares to award contracts for the manufacture and supply of its new train fleet and depot, together with the maintenance of its old Metrocars (MMA) and the new train fleet (TSA), it is apparent that there will be additional costs arising, which are not yet factored into the forecast set out in paragraph 2.3 above. These include:

- Fleet engineering costs are expected to increase, although in the time horizon associated with this medium term financial plan, an earmarked reserve created in anticipation of the transition from the old Metrocars to the new trains will help cover this additional cost; and

- Trades unions representing the train crew are seeking an increase in drivers' salaries because of the introduction of a more technologically advanced vehicle with resolution of this issue required prior to testing, commissioning and training, all of which are necessary for the new fleet to be successfully implemented.

- 3.2 Over the longer term, these costs will be offset by expected increases in Metro fare revenue and reductions in high voltage power consumption, however this will only be realised once the new fleet is operational.
- 3.3 Although it is too early to accurately assess the increase in costs associated with the introduction of the new fleet, the following table estimates the potential impact:

***Table 3 – Forecasts Updated to reflect New Fleet Estimated Impacts***

	2019/20	2020/21	2021/22	2022/23
	£m	£m	£m	£m
January 2019 Deficit	0.7	0.1	3.4	N/A
October 2019 Deficit	4.1	1.6	4.7	7.3
<b>Potential Deficit (incl new fleet)</b>	<b>4.4</b>	<b>2.4</b>	<b>6.0</b>	<b>8.8</b>
<b>Deterioration in Forecasts</b>	<b>+3.7</b>	<b>+2.3</b>	<b>+2.6</b>	<b>+8.8</b>

- 3.4 The cumulative deficit across the medium term is therefore estimated at circa £21.6m, with a budget shortfall of £4.4m in 2019/20 increasing to £8.8m by 2022/23.

#### **4. Impact of 2019 Spending Round**

- 4.1 The 2019 Spending Round outlined Government spending plans for 2020/21
- 4.2 The technical consultation relating to the Local Government Finance Settlement for 2020/21 was issued in October 2019. Final details of the settlement for individual local authorities will not be known until later this calendar year. Tyne and Wear local authorities are in the process of considering the potential outcome of the spending round and the implications for their funding for 2020/21. As part of considering available funding, consideration will need to be given to the levy for 2020/21 taking account of the information contained in this report.
- 4.3 As an example, a 2.0% increase on a base of £59.0m equates to £1.2m. Assuming this was applied in 2020/21, with a freeze thereafter, the impact on Nexus' medium-term forecast is set out below:

**Table 4 – Impact of a 2% increase in grant (levy) in 2020/21**

	2019/20	2020/21	2021/22	2022/23
	£m	£m	£m	£m
January 2019 Deficit	0.7	0.1	3.4	N/A
October 2019 Deficit	4.1	1.6	4.7	7.3
Potential Deficit (incl new fleet)	4.4	2.4	6.0	8.8
<b>Impact of 2% increase in JTC grant (20/21 only)</b>	<b>4.4</b>	<b>1.2</b>	<b>4.8</b>	<b>7.6</b>
<b>Deterioration in Forecasts</b>	<b>+3.7</b>	<b>+1.1</b>	<b>+1.4</b>	<b>+7.6</b>

A 1% levy change is approximately £0.6m

- 4.4 An increase of 2.0% would potentially allow Nexus to pursue some growth initiatives or fund planning studies into future service improvements.

## 5. Reserves Strategy

- 5.1 One legitimate means of dealing with the forecast deficit is to deploy reserves. This however can only ever be a short-term measure whilst more sustainable solutions are identified.. Nexus' reserves as at 31 March 2019 amounted to £50.3m<sup>2</sup>, of which:
- £10.0m is assessed as being necessary to cushion the impact of unexpected events or emergencies arising;
  - £7.0m is earmarked for capital investment, mainly away from the Metro;
  - £3.0m is earmarked to cover the expected increase in the (fleet) MMA;
  - £14.0m is earmarked for the new fleet; and
  - £16.0m is available to underpin the revenue budget.
- 5.2 Options for how reserves might be used were discussed with members of TWSC at its policy seminar held on 15 August 2019. These included:
- Using reserves to deal with the in-year deficit only with potentially sizeable service reductions necessary from 2020/21 onwards if the level of grant (levy) to Nexus did not increase accordingly;
  - Deploying the full £16.0m reserve until it is fully exhausted, with sizeable service reductions required from 2022/23 onwards if the level of grant (levy) to Nexus did not increase accordingly; and
  - Taking a more prudent approach, whereby the budget deficit is only partly addressed through use of reserves, with more modest service reductions phased in over the medium term.
- 5.3 Feedback from TWSC members was that the more prudent approach should be adopted. Based on this feedback, and factoring in the latest forecasts of budget

<sup>2</sup> This excludes reserves held by NECA of £6.7m in respect of the new fleet (increasing to £10.0m by 31 March 2020) and £9.2m in respect of the Metro Asset Renewal Programme

pressures, a proposed strategy to deploy reserves is illustrated in the table below<sup>3</sup>:

**Table 5 – Utilising Reserves over the Medium-Term (Levy Freeze assumed)**

	2019/20	2020/21	2021/22	2022/23
	£m	£m	£m	£m
Potential Deficit (incl new fleet)	4.4	2.4	6.0	5.8
Potential use of Reserves	-4.4	-2.4	-3.0	-2.8
<b>Potential Deficit (after use of reserves)</b>	-	-	<b>3.0</b>	<b>3.0</b>
<b>Remaining Usable Reserves</b>	<b>11.6</b>	<b>9.2</b>	<b>6.2</b>	<b>3.4</b>

- 5.4 In the above forecast, there is an assumption that £3m of savings are delivered in 2021/22 and 2022/23, leaving savings of £2.8m to be achieved in 2023/24. At this point remaining reserves would be £3.4m.

## 6. Potential Impact on Services

- 6.1 The impact on services would need to be considered if, after use of reserves, and assuming there is no increase in the grant (levy), there was still a deficit to eradicate. This is highlighted in the table above.
- 6.2 In September 2016, Nexus reported to the TWSC the outcome of its public consultation, 'Have Your Say', which ranked Nexus' services in order of importance<sup>4</sup>.
- 6.3 The ranking (with 1 denoting the most popular service and one that the public most wished to see protected) is replicated below:

Priority	
1	Bus services, Group travel and Ferry Services
2	Public Transport Information
3	Local Voluntary Concessions
4	Bus Waiting Facilities
5	Major Projects

## 7. Proposals

- 7.1 This report sets out details of the budget pressures and issues facing Nexus over the next three years and seeks the views of the Committee on such matters to inform its approach to its medium term financial plan, in particular, the implications of Nexus preparing its budget for 2020/21 on the basis that its grant from the Committee will be kept at 2019/20 levels.

<sup>3</sup> This shows the deployment of reserves in the 2020/21 JTC grant (levy) freeze scenario only. If the JTC grant (levy) was increased by 2% in 2020/21, remaining usable reserves in 2022/23 would increase to £6.8m.

<sup>4</sup> The consultation only focused on 'discretionary' levy funded services and therefore did not focus on the statutory elements of the English National Concessionary Travel Scheme or the Tyne and Wear Metro (because of the way in which Metro is funded i.e. primarily from fare revenues and government grant).

## **8. Reasons for the Proposals**

- 8.1 To consider the implications arising from the budget pressures and issues facing Nexus and provide strategic guidance to Nexus in order to inform its approach to its medium term financial plan.

## **9. Alternative Options Available**

- 9.1 The development of Nexus' medium-term financial plan depends largely upon the level of its future grant from the Committee, the deployment of its reserves and how any necessary service reductions will be agreed and implemented in the future should that be necessary.

## **10. Next Steps and Timetable for Implementation**

- 10.1 The budget timetable setting out next steps and timetable for implementation is attached at Appendix 2.

## **11. Potential Impact on Objectives**

- 11.1 Nexus' future spending plans and resources will have a direct impact on the ability to achieve the objectives within the Tyne and Wear Local Transport Plan and associated policies and strategies.

## **12. Financial and Other Resources Implications**

- 12.1 Financial implications are considered throughout this report. The report exemplifies the significant cost pressures which are affecting the Nexus budget for 2019/20 and in future years, and the impact of a range of scenarios on the forecast deficit: a cash freeze in the grant from the Tyne and Wear Levy, a 2% increase in 2020/21 and the deployment of reserves to cushion the impact of budget pressures over the medium term as a short term measure to set a balanced budget.

- 12.2 Budget planning assumptions, particularly the approach to achieving savings can have a direct impact on staffing levels within the services provided by Nexus.

## **13. Legal Implications**

- 13.1 There are no legal implications arising directly from the recommendations in this report.

## **14. Key Risks**

- 13.1 The key risks outlined in this report relate to sustainability of current service delivery going forward given the significant financial challenges facing Nexus. The final budget proposals will include an assessment of risk facing the Nexus budget, which will be used to inform the level of reserves that are determined to be prudent. This report highlights a range of financial pressures and issues facing Nexus over the next three years and seeks the views of the Committee on such matters to inform its approach to its medium term financial plan, in particular the

implications of Nexus preparing its budget for 2020/21 on the basis that its grant from the Committee will be kept at 2019/20 level. The report is for information and discussion as part of the budget process and has no specific risk management implications at this stage.

**15. Equality and Diversity**

15.1 There are no specific equalities and diversity implications arising from this report

**16. Crime and Disorder**

16.1 There are no specific crime and disorder implications arising from this report.

**17. Consultation/Engagement**

17.1 The budget timetable setting out consultation/engagement is attached at Appendix 1.

**18. Other Impact of the Proposals**

18.1 There are no other specific impacts arising from this report. The budget assumptions over the level of grant (levy) provided to Nexus by the Tyne and Wear authorities has a direct impact on the budget setting processes of those authorities.

**19. Appendices**

19.1 Appendix 1 - Budget/Consultation Timetable

**20. Background Papers**

20.1 Tyne and Wear Sub-Committee Policy Seminar held on 15 August 2019.

**21. Contact Officers**

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**22. Sign off**

- The Proper Officer for Transport: ✓
- Head of Paid Service: ✓
- Monitoring Officer: ✓
- Chief Finance Officer ✓:

**23. Glossary**

DfT – Department for Transport

MRG – Metro Rail Grant

MTFF – Medium Term Financial Forecast

TWSC – Tyne and Wear Sub Committee

## **Appendix 1 – Budget Timetable 2020/21 – Joint Transport Committee**

<b>Date</b>	<b>Meeting/Event</b>	<b>Action</b>
14 August 2019	Tyne and Wear Sub-Committee (Briefing)	Consider 3 year forward forecasts of budget pressures and issues in relation to Nexus
17 September 2019	North East Joint Transport Committee (Briefing)	Consider 3 year forward forecasts of budget pressures and issues in relation to Nexus
23 October 2019	North East Joint Transport Committee	Initial budget proposals and 3 year forecasts in relation to JTC/Transport budgets. Consultation requirements to be considered / agreed
7 November 2019	Joint Transport Committee Overview and Scrutiny Committee	Examine initial budget and consultation proposals and make any recommendations to the JTC
19 November 2019	North East Joint Transport Committee	Consider updated draft Transport budget proposals and any feedback from JTC Overview & Scrutiny Committee
21 November 2019	Tyne and Wear Sub-Committee	Consider report on the draft budget proposals with specific reference to Tyne and Wear Transport activity
26 November 2019	NTCA Cabinet Meeting	Consider draft Transport budget proposals developed by JTC and implications regarding Transport Levy for constituent authorities as part of the budget consultation process
TBC – Meeting to be arranged w/c 9 December 2019	NECA Leadership Board	Consider the decisions and any recommendations made by the JTC and JTC Overview and Scrutiny Committee
12 December 2019	Joint Transport Committee Audit Committee	Consider budget proposals as part of consultation process
19 December 2019	JTC Overview and Scrutiny Committee	Consider (updated) budget proposals as part of consultation process (if necessary)
21 January 2020	North East Joint Transport Committee	Approve Transport Revenue Budget and Transport Levies
28 January 2020	NTCA Cabinet	Formally agree to issue the Transport Levy to

<b>Date</b>	<b>Meeting/Event</b>	<b>Action</b>
	Meeting	constituent NTCA authorities
4 February 2020	NECA Leadership Board	Leadership Board formally issue levy agreed by Joint Transport Committee in January. Formal agreement of non-Transport budgets and contributions.
15 February 2020	Levy letters issued to constituent authorities	Date by which Transport levies must be issued in line with Transport Levying Bodies Regulations