



Grant Thornton

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Dear Sirs

Assessment of the Transport for Greater Manchester's (TfGM) Covid-19 Impact on Bus Franchising Report

Call Off Contract dated 28 June 2019 for the provision of corporate finance Services by Grant Thornton UK LLP (as "Supplier") to Transport for Greater Manchester (as "Customer") pursuant to the Corporate Finance Services Framework Agreement (RM 3719) dated 6 June 2016 between the Minister for the Cabinet Office acting through Crown Commercial Service as the Authority and the Supplier.

This assessment reviewing TfGM's Covid-19 Impact on Bus Franchising Report (our "Report") is made in accordance with the terms of our call off contract dated 28 June 2019 (the "Engagement Letter") (under the Corporate Finance Services Framework Agreement (RM3719)). Its purpose is to provide the Greater Manchester Combined Authority (GMCA) with independent assurance on the approach taken by TfGM in preparing the Covid-19 Impact on Bus Franchising Report.

Background

In September 2019, Grant Thornton provided its opinion on TfGM's assessment of a proposed bus franchising scheme ("the Assessment") in accordance with section 123D of the Transport Act 2000 ("the Act"). From October 2019 to January 2020, GMCA consulted on its proposed bus franchising scheme ("the Proposed Franchising Scheme") and in June 2020, TfGM reported on the findings of the consultation.

As the potential implications of Covid-19 were not taken into account in either TfGM's Assessment or the consultation, GMCA noted the contents of that report and requested TfGM to prepare a further report to consider the potential impact and effects of Covid-19 on the bus market in Greater Manchester ("the Covid-19 Impact on Bus Franchising Report" hereafter referred to as "the Covid Impact Report" which is to be presented as an appendix to a report to the 27 November 2020 meeting of the GMCA ("the CA Report")).

This Report should be read in conjunction with our opinion of the Assessment dated 26 September 2019. For the avoidance of doubt, this Report has not been prepared in accordance with section 123D of the Act.

Responsibilities of TfGM

Per the variation to our Engagement Letter, TfGM's responsibilities in relation to this Report included but were not limited to:

- preparing the Covid Impact Report;
- providing us with any such information as was reasonably requested by us in connection with the preparation of this Report;
- responding to any queries that were raised by us and ensuring that there were appropriate resources available to respond to such queries.

Our responsibilities

Our responsibility is to report and provide assurance and comment on the overall appropriateness of the approach taken by TfGM in preparing the Covid Impact Report, and, in particular:

- whether the approach taken in the Covid Impact Report in considering the affordability and value for money of the Proposed Franchising Scheme in light of the potential impact of Covid-19 is appropriate;
- whether the information and analysis of that information as contained in the Covid Impact Report on the affordability and value for money of the Proposed Franchising Scheme is of sufficient quality for the purposes of the Covid Impact Report; and
- provide any specific recommendations on how the approach, information or analysis of that information might be improved.

We also report on those instances where, in preparing the Covid Impact Report, TfGM has departed from the guidance issued under section 123B of the Act on preparing the Assessment (as detailed by TfGM or identified by ourselves) and comment on whether any such departures are appropriate or not given the circumstances.

For the avoidance of doubt, our Report does not constitute a statutory audit under the Local Audit and Accountability Act 2014 nor is it either:

- an evaluation of the Covid Impact Report conducted in accordance with auditing standards issued by the Financial Reporting Council;
- an audit per the requirements of section 123D of the Act; or
- based on any other formal guidance.

Findings

General

We note that TfGM has set out its rationale for why a decision to proceed with the scheme is still appropriate now, in this period of uncertainty. In summary, TfGM explains that the franchising scheme is a central pillar of the Greater Manchester Transport Strategy 2040 and a failure to move forward now would have longer term consequences on the delivery of this overall strategy. Whilst we accept this is a reasonable argument to make, we highlight here, and specifically in the sections below, that the Covid-19 pandemic has created significant uncertainty and therefore has not allowed for as accurate forecasting as was previously the case. TfGM accepts this principle and accepts that in choosing to proceed now the risk has increased that the outturn position may be materially different from the central case previously set out in the Assessment.

Funding and Affordability – approach and analysis

Our original 'Observations Report' (dated 20 September 2019) noted that the Assessment did not include an annual assessment of the budget available to the GMCA to fund the Proposed Franchising Scheme. Instead, this information (up to the end of the transition period) was provided in a separate

report to GMCA. The Covid Impact Report confirms that each component of the original funding agreement that was approved by GMCA has been reviewed, and that these sources remain available.

The Covid impact report notes that there are additional financial pressures across GMCA and the Local Authorities of Greater Manchester as a result of Covid-19. We understand that the previously approved funding arrangements and additional mitigation options are to be considered in the CA Report.

The Covid Impact Report also indicates that the assumptions around the approved value of the precept are less prudent than in the Assessment, due to the future uncertainty around the Greater Manchester tax base. However, the analysis that has been undertaken indicates that the assumed value of the precept has been calculated on a reasonable basis in the context of the information available.

The CA Report includes the Covid Impact Report and the proposed funding strategy for the Proposed Franchising Scheme. We note that no updated annual profile of the budget available has been provided, but the impact on the annual profile previously agreed with GMCA has been described in the Report. The Assessment previously noted that further funding from Central Government would be desirable. The Covid Impact Report goes further and indicates this may be necessary particularly if material downside risks, for example the risks inherent within Scenario 3, were to materialise.

The Covid Impact Report recognises the present uncertainty that exists in the bus market and sets out that the central case in the Assessment is now subject to significant uncertainty. The Financial Case concludes that the material risk is to the farebox revenue assumptions made in the Assessment, and notes that, based on a range of scenarios, the unmitigated change to the Assessment assumptions for the transition period could be between a £31m (nominal) increase in revenue to a £292m (nominal) downside in revenue. Whilst the potential range across the four scenarios is significant, TfGM considers that scenarios 1 and 4 are more likely to reflect the potential bus patronage recovery from the Covid-19 pandemic which show a narrower range of downsides of between £82m (nominal) and £96m (nominal) reduction in revenue. Scenarios 2 and 3 are viewed to be less likely upside and downside scenarios respectively.

The Covid Impact Report provides a high-level assessment of a range of possible short, medium and long-term mitigating actions that could be taken to absorb future downside financial risks, and considers the risks and issues associated with each potential mitigation. Each mitigation also includes a high-level estimate of the additional resources that could be generated over the transition period if each mitigation were applied in isolation.

One of the key mitigations will be the extent to which network costs could be reduced if required. TfGM has provided us with analysis which sets out, by way of illustration, its estimate of what a 1% decrease in network size would deliver in terms of cost reduction from 2022-23 (excluding the impact on farebox). In certain scenarios, particularly if central government support is at lower levels than is currently being provided, or if some of the other mitigations are not realised in full, then reductions in network size of more than 1% may be required. It is likely that the relationship between network size and costs savings may not be linear. There remains a risk that for Scenario 3, without central government support, further local funding would be required to support the Proposed Franchising Scheme as the estimated impact of mitigations could be less than the potential funding gap. Nevertheless, we note that the potential value of the mitigations suggests that they would be sufficient to manage the farebox revenue downside in most scenarios, if implemented successfully.

We agree, that as noted in the Covid Impact Report, for all scenarios, including a 'Do Minimum' scenario, financial support to the bus industry will be required to enable recovery, though there is currently material uncertainty as to the form, value and duration of this from central government.

In summary, the approach taken to considering the affordability in the Proposed Franchising Scheme appears to be appropriate in the context of the limited amount of information available to TfGM on which to prepare detailed analysis. Based on the information provided to us in the Covid Impact Report and supporting documentation, the analysis appears to be of sufficient quality.

Value for Money – approach and analysis

The Covid Impact Report states that the outcome will be one of a wide range of possibilities that could be materially different from that of the original Assessment and we agree that a scenario-based approach is a sensible way to consider economic impacts in the current climate of uncertainty.

The “What If?” process allows a range of potential Value for Money (“VfM”) outcomes to be understood. These show that the uncertainty reflected in the range of scenarios adopted could be compounded by uncertainty in the realisation of important benefits that drive the economic case. This inherent uncertainty makes it more difficult for any conclusions to be robust because a wide range of possible outcomes all appear more likely now than they were at the time of the original Assessment.

The quality of information available (and hence quality of analysis that it is reasonable to do) is significantly lower than would be expected during times of relative stability. The limitations of the analysis are recognised in the documentation developed by TfGM, which is intended qualitatively to inform the robustness of Assessment findings on VfM. Although there might be some possibility to improve the evidence for relationships between bus market demand/revenue and costs (taking account of structural change), we would agree that the quality of analysis undertaken is generally reasonable, given the prevailing uncertainty.

When taking account of the age and relevance of the evidence used to support the value of the branding benefits in the original Assessment (which remains the case) this includes plausible outcomes that represent poor value for money, as is highlighted in the Step 3A plus 3B ‘What If?’ test. TfGM has documented these outcomes in the conclusions to the Covid Impact Report and the draft CA Report.

The documentation developed by the team notes an opportunity for increased benefits of franchising in the context of a smaller bus network. These arguments seem sound in principle and, given the inevitable limitations on the quality of information available more generally, it seems reasonable for these to be identified to inform the conclusions drawn in the Covid Impact Report. Based on that limited quality of information, however, we would advise caution on anticipating more positive outcomes as a result of these observations, than were envisaged by the original Assessment.

Subject to the above caveats on how conclusions may reasonably be drawn, we do otherwise find that this process represents a fair and reasonable way to assess potential VfM outcomes.

Risk

TfGM has conducted a review of the Quantified Risk Assessment which supported the original Assessment. The review involved workshops with individual workstream leads to reassess the risks and understand the impact of Covid-19 under the 4 scenarios. This led to a change in the probabilities of some of the risks occurring. These updated probabilities were incorporated into a series of Monte-Carlo simulations for each of the 4 scenarios to provide updated values for risk contingency. The conclusion of this process is that Covid-19 will generally have a limited impact on the probability of risks materialising in Scenarios 1, 2 and 4, with the greatest proportional impact being in Scenario 3. The process and outcomes of this exercise are documented within the Covid Impact Report within the Financial Case (and aspects within the Management and Commercial Cases). TfGM has indicated that it will continue to monitor risks as the programme progresses.

Inherent limitations

The procedures we have performed do not constitute an examination made in accordance with International Standards on Auditing (UK). Our Report relates only to the Covid Impact Report and does not extend to any financial statements of TfGM nor the statutory financial statements of any of the bus operators on which the Assessment (and Covid Impact Report) is based.

We have not undertaken any review of the financial models which have been updated to produce the Covid Impact Report.

This Report has been prepared by Grant Thornton UK LLP for our client TfGM in line with the terms and conditions of our Engagement Letter dated 28 June 2019 and its variation dated 18 November 2020. For

the avoidance of doubt, the terms and conditions of that engagement, including but not limited to the parties' respective liability, shall apply.

Conclusion

In summary, our review concludes that:

- the approach taken in the Covid Impact Report in considering the affordability and value for money of the Proposed Franchising Scheme in light of the potential impact of Covid-19 is appropriate; and
- the information and analysis of that information as contained in the Covid Impact Report on the affordability and value for money of the Proposed Franchising Scheme is of sufficient quality for the purposes of the report recognising the uncertainty and difficulty in forecasting in the current environment and therefore the use of scenarios represents a sensible approach.

Specific Recommendations

Our review has been an iterative process and we have corresponded with TfGM over a number of versions of the Covid Impact Report and any suggestions and recommendations we have made have been reflected in the final version reviewed.

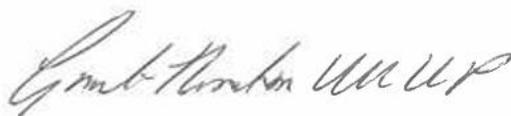
Departures from the guidance

Our scope of work required us to report on instances where, in preparing the Covid Impact Report, TfGM has departed from the guidance issued under section 123B of the Act on preparing the Assessment. We note that the guidance issued under section 123B did not consider the impact of a global pandemic and any updates that would be required to the Assessment as a result. As there is no guidance that TfGM could follow, we have not been able to report in this regard.

The purpose of our review was not to undertake an audit of any financial or other supporting models since the audit of the Assessment. Any areas where TfGM has made different assumptions to the Assessment have been commented on in the findings section above, but we note that any such changes do not necessarily represent departures from the guidance. Furthermore, we believe that the approach of using scenarios is sensible in light of the uncertainty created by the Covid-19 pandemic.

Use of our report

This Report is made solely to TfGM, as a body, in accordance with the terms of our Engagement Letter. Our work has been undertaken so that we could prepare a report on the Covid-19 Impact on Bus Franchising Report. We acknowledge that both TfGM and the GMCA (which is bound by terms signed by TfGM) may rely on the contents of the Report and that the Report may be used by both TfGM and GMCA in accordance with the provisions of the Act. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than to TfGM and GMCA, as a body, for our work, for this report, or for the conclusions we have formed.



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