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FAO Eamonn Boylan (Chief Executive Officer)

26 September 2019

Dear Sirs

Observations on Transport for Greater Manchester's (TfGM) assessment of a proposed franchising scheme

This Observations Report (the "Report") is made in accordance with the terms of our call off contract with you dated 28 June 2019 (the "Engagement Letter") (under the Corporate Finance Services Framework Agreement (RM3719)). The purpose is to report to TfGM in connection with its requirement for Grant Thornton UK LLP to review its assessment of a proposed bus franchising scheme (the "Assessment" [1]) as prepared in accordance with the Transport Act 2000 (as amended by the Bus Services Act 2017 (together the Act)). The Report is prepared to document the observations from our review which we consider should be raised with TfGM but were not material enough to lead us to a modified conclusion. We have separately provided our conclusion per the Act (our "Independent Reasonable Assurance Report" dated 26 September 2019). This Report should be read in conjunction with our Independent Reasonable Assurance Report.

Background

In June 2017, the Greater Manchester Combined Authority (GMCA) decided to prepare an assessment of a proposed bus franchising scheme in accordance with the Act. TfGM were instructed to prepare the same (the work prepared by TfGM is referred to hereafter as "the Assessment") on GMCA's behalf, in accordance with the requirements of the Act and the Franchising Scheme Guidance (the "Guidance").[2]

In June 2019, TfGM's Assessment was completed and approved by the GMCA. The GMCA also decided to proceed to the next step in the Act by instructing TfGM to obtain, on its behalf, a report from an independent audit organisation. Following that instruction, Grant Thornton UK LLP (Grant Thornton, we or us) was instructed to prepare the Independent Reasonable Assurance Report. This Report should be read in conjunction with our Independent Reasonable Assurance Report.

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[1] The Assessment we have reviewed includes the five case business case and associated supporting papers, other supporting material that underpins the Assessment, the report to the Combined Authority ("CA report 26.9CFA.docx.docx") received on 26 September and the clarification responses provided to us by TfGM.
[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/694428/bus-services-act-2017-franchising-guidance.pdf

Introduction

Our responsibility under the Act is to provide a report and express an opinion in relation to the following areas required by the Act:

- whether the information relied on by TfGM in considering the matters referred to in section 123B(3)(d) of the Act (the affordability of the scheme) or section 123B(3)(e) of the Act (the value for money of the proposed scheme) is of sufficient quality
- whether the analysis of that information in the Assessment is of sufficient quality
- whether TfGM had due regard to the Guidance issued under section 123B of the Act in preparing the Assessment.

As per paragraph 1.87 of the Guidance, our role is not to report or pass judgement on the decisions taken by TfGM or the outcomes of the assessment – our role is purely to consider the process that has been followed, the accuracy and robustness of the information that has been used in the analysis, and that the mechanics of the process have been carried out correctly. Paragraph 1.85 requires us to take into account the quality and timeliness of any information received from bus operators and the following criteria:

- whether the information used comes from recognised sources
- whether the information used is comprehensive or selectively supports the arguments in favour of, or against, any particular option
- whether the information used is relevant and up to date
- whether the assumptions recorded as part of the Assessment are supported by recognised sources
- the mathematical and modelling accuracy of the analytical methods used to calculate the impacts of the options.

Our Independent Reasonable Assurance Report documents our conclusions on the Assessment. This notwithstanding, we believe that TfGM should share the observations set out in this Report, which we have discussed with TfGM, in its documentation to be provided to the Greater Manchester Combined Authority and as part of its consultation process.

Observations

Assessment at Outline Business Case Level

We note that within section 1.3 of the Assessment that TfGM has referred to the HM Treasury guidance on the development of business cases, known as the “Green Book”.[3] Section 1.3 highlights that the Guidance recommends that the Assessment should be carried out to a level of detail that is equivalent to that in an ‘Outline Business Case’ or (“OBC”). Separate to the Green Book, HM Treasury guidance on producing five-case business cases sets out the different stages and expectations at each stage.[4] In general, an OBC should be substantially, but not completely developed to enable a decision maker to decide on an option to be pursued and for work to commence to put that option into effect. The business case should be a live document that continues to develop into a ‘Full Business Case’ (“FBC”) that would contain definitive arrangements and final financial figures, usually following a procurement exercise. It is important to recognise that, the business case guidance expects that, at the OBC stage, the detailed proposals will not be fully complete. Our review of the Assessment has therefore considered the requirements of an OBC and the level of completion expected of the Assessment in that context. We also note that there are no explicit requirements for an FBC to be developed to meet the requirements of the Act and the Guidance.

[3] https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-governent
[4] Guide to developing the project business case: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/749086/Project_Business_Case_2018.pdf

The quantification of soft benefits

Over the course of our review we have discussed with TfGM a number of issues pertaining to the soft benefits relating to both the Partnership and Franchising options. The most significant of these issues affects the Franchising option alone. A substantial amount (£102m in Present Value Benefits) of the economic benefits of the Franchising option are derived from the quantified benefits resulting from the unified branding of bus services. Although we do not dispute that unified branding could generate economic benefits, the evidence was based upon data derived over 20 years ago (although we do acknowledge that the DfT republished this evidence without caveat in a 2009 AECOM report into soft measures in the bus market[5]). Furthermore, the source data does not appear to be directly relevant as this was based upon a study into branding benefits of a Hail and Ride service in London in 1996 (as documented in a TRL report from 2004).[6]

TfGM has stated that it believes that the valuation of a unified brand is reasonable and appropriate. TfGM has advised that it considers this valuation to be conservative. Before implementation of franchising (subject to Combined Authority and Mayoral decisions) then this valuation, along with other content in the Assessment, would be refined.

We understand that TfGM had previously attempted to develop more recent and directly relevant supporting material by commissioning research that would derive a local “brand” value. However, this research was discounted because TfGM felt the definition of brand was narrowly drawn and was not fit for purpose.[7] In addition, the research was focussed on current users rather than a wider population. TfGM has stated that its understanding of the value of unifying the bus system has evolved since the research was commissioned and completed in 2016 and that the research ignored the benefits that would arise in the following areas:

- Simplicity and ease of use
- Trust and confidence resulting from greater public accountability
- Place making value for Greater Manchester of a single bus brand

We do not dispute that unified branding could generate economic benefits. In order that TfGM can be more certain of the economic and financial benefits as it develops the detail of the franchising proposition, TfGM intends to commission a new study to further examine the above elements. We note that from our own experience of working on similar assignments in other sectors it is not uncommon to acknowledge the benefit that can be realised with a strong public sector brand. Examples include:

- the ScotRail rail franchise where Scottish Government believes its strong public sector brand benefits the franchise and creates economic and financial benefits;
- the DfT has accepted in rail franchising that a strong brand can generate increased financial (and therefore economic) value;
- there are several instances where public sector energy companies have a brand more closely associated with integrity and trust and that is a foundation that underpins public sector investment in these businesses.

Whilst the above are examples where a strong brand can generate benefits, we are not aware of any specific case where the value has been explicitly calculated. It should also be recognised that it might be appropriate to acknowledge that some passenger value might be attributable to the bus operator brands that the private sector companies have built up over many years in Manchester. Because this value is inherent to the Assessment’s reference case,[8] any value associated with the Franchising option’s unified brand needs to be quantified net of this value.

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[5] https://cambridge.blob.core.windows.net/public/ldf/coredocs/RD-T-050.pdf

[6] https://trl.co.uk/sites/default/files/TRL593%20-%20The%20Demand%20for%20Public%20Transport.pdf

[7] Brand was focused on a single livery to paint buses rather than the various facets of a unified brand, such as through a single customer contact centre, information, standards and performance and the network being presented as a whole.

[8] The reference case is TfGM’s forecast of the bus market assuming no partnership or franchising interventions

In seeking to clarify the basis of the calculation of the economic benefits associated with branding TfGM has highlighted that whilst it accepts that there is uncertainty in the calculation of the branding benefits it has mitigated this risk by being more prudent in other areas. Specifically, it has not included any economic benefits associated with the simplification of fares or broader changes to bus services. It could be expected that the simplification of fares could deliver additional benefits that have not been included within the analysis and therefore an element of prudence has been included within its figures.

In concluding on this issue, we note that if all of the branding benefits are removed from the Assessment, the Net Present Value of the Franchising option still exceeds that of the Partnership options, albeit it is reduced to a level which brings the options closer together. In that context, the relative performance of the options becomes more sensitive to other areas of the soft benefits. Nevertheless, because the impact would not change the ranking of the options, the impact of uncertainty over the branding benefits was not viewed as being a qualification to our opinion. However, it is sufficient for us to raise as an observation in this Report.

Sensitivity Analysis

We are aware that TfGM has run a number of standalone sensitivities which show the first order impacts of individual downside scenarios, ie before any potential mitigation has taken place. It is normal to also set out the impact of the mitigations, however we note that these are only incorporated to a limited extent in the Assessment.

We note, however, that the report to the Combined Authority explicitly sets out the options available to it to address these downside scenarios and has included analysis on the operational and financial levers available to it in order to respond to downside sensitivities. It is clear that these options provide significant flexibility to manage downsides over the life of the scheme. Of utmost importance is that these options have been included in the report to the Combined Authority so that it is fully aware of some of the measures that may be needed under certain downside scenarios.

For example, the ability to adjust network size in response to any shocks and the expected long-term decline in demand is one of the responses that could be adopted under the Franchising option. It is noted that many of the economic case sensitivity tests do not reflect the network size adjustment in either the reference or option cases. There are a number of areas where we feel additional sensitivities could have been modelled:

- Should the network change processes be less effective under the Franchising option than how this is modelled in the Assessment, this could lead to additional financial cost, or the risk of crowding disbenefits for passengers.
- An assessment of a longer appraisal period than 30 years has been run but the Assessment did not incorporate a sensitivity which was for a shorter period than 30 years

It is often desirable, although not essential, to incorporate combined downside sensitivities and the Green Book recommends “switching-value” or breakeven analysis to be calculated. We note that these have not been undertaken. This is in part due to the fact that the sensitivities applied would likely impact on all options to a similar degree and therefore it would be difficult to run credible scenarios that would only apply to one case over another. We have therefore only included this as an observation and not a qualification of our opinion.

Funding and Affordability

In relation to the affordability of the proposals, the Guidance (paragraph 1.62) suggests that an annual assessment of the budget available to GMCA is provided. TfGM has stated that it believes it has addressed the requirement in this area, however, our interpretation of the Guidance is that an annual breakdown of funding sources should be provided in either graphical or tabular format for each “relevant year” rather than just relying on the statements made in the Assessment. TfGM has included additional financial analysis within the report to the Combined Authority which meets our understanding of the requirements set out above. We have reviewed this paper and are satisfied that it demonstrates that senior leaders have been requested to sign up to the profile and financial commitments required in the Franchising base case for the transition period to 31 March 2025. Beyond 2025, there is only an outline description of possible mechanisms for the forecast financial requirements to be met at that time. We note that the long-term annual commitment of funds would be unusual in Public Sector budgeting, and therefore it is not unreasonable to assume that the mechanisms in place to manage financial variability will continue beyond the transition period.

Timeliness of the information

We note that the bus operator information used as the basis of the analysis is sourced from a 2016/17 base year. Whilst more recent information is now available, we are satisfied that TfGM has acted reasonably in using 2016/17 data given the constraints it faced in collating the information.

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 Assessment, which includes providing an opinion on the matters required under the Act. 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.

Grant Thornton UK LLP

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Chartered Accountants

London

26 September 2019