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TfL Finances: The End of the Line?

Budget and Performance Committee
November 2018

Holding the Mayor to account and investigating issues that matter to Londoners

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The Budget and Performance Committee holds the Mayor to account for his financial decisions and performance across the Greater London Authority. It is responsible for scrutinising the Mayor's budget proposals for the next year, and carrying out investigations across the Mayor's various policy areas, such as transport, police, fire, housing, and regeneration.

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Gareth Bacon AM

Chairman of the Budget and Performance Committee

This has been a tough report to write. As you can imagine, our view of TfL's finances took a big swing when we learnt that the Elizabeth line would not open as scheduled. When we met with TfL in June we were still told that the line would open on time. A large part of the business plan we were discussing was the revenue that the Elizabeth line would generate.

If this has been difficult to write, imagine how difficult it must be for TfL to plan ahead. We now have fresh information about what the Crossrail delay will cost TfL – almost £200 million in 2019-20 in lost passenger fares and advertising revenue. But the capital costs are still unknown and current estimates are subject to change. We won't have a real figure until next Summer. What we do know is that TfL has already maxed out its corporate credit card just to keep the project going to March 2019.

"Freezing fares is a political choice and any Mayor is entitled to freeze fares. But Londoners need to know what they are committing to first, and that means how much it will cost"

Uncertainty about how much Crossrail might end up costing means TfL must do everything it can elsewhere. We still have concerns about TfL's passenger modelling, but do recognise that it is being more prudent than in the past. What really surprised us was to hear that TfL hasn't even thought about a second fares freeze yet. Freezing fares is a political choice and any Mayor is entitled to freeze fares. But Londoners need to know what they are committing to first, and that means how much it will cost.

On road pricing we are asking for a sense of direction from the Mayor. The Mayor claims that he's been clear, but the evidence says otherwise. We have a Transport Strategy that says TfL is "investigating" road pricing, but no evidence of any investigation. One month TfL tells us "we can make [road pricing] work,"[1] then the next month the Deputy Mayor for Transport tells us that ULEZ is the focus and road pricing won't be happening before 2020.[2] This is a big issue with major political and financial ramifications and the Mayor needs to set out his position sooner rather than later.

We try to recognise good work where we see it, and TfL is making huge inroads with its efficiency programme and has secured some good commercial deals recently. We agree that commercial income should be a major part of TfL's business and we think there needs to be a public debate about how far it can go. We want more details about where savings are being made too.

TfL clearly has some way to go to become a sustainable public body. The Crossrail saga is going to rumble into next year and beyond, and makes TfL's job that much harder. We will keep watching.

Executive Summary

This Committee chose to investigate TfL's finances this year on hearing that TfL's operating loss would be almost £1 billion. TfL is dealing with financial pressure on numerous fronts: a Crossrail project which is overspent and late, the end of government operating grant, a four-year fares freeze and sluggish passenger growth. And yet TfL says it has a plan to turn this around and return to surplus by 2021-22.

> **"TfL still says it will break even by 2021-22, even with the delay to Crossrail. This would be a huge achievement. Our job as the Budget and Performance Committee is to remain sceptical and TfL's is to prove us wrong."**

One of the key components of the plan was going to be the Elizabeth line opening in December 2018. We now know that this will not happen. This will cost almost £200 million in lost fares and advertising revenue next year, and that is before the capital costs. TfL is having to borrow as much as it can and is working on a funding package with DfT for the final cost. This will have effects on other infrastructure projects.

Demand for services has been sluggish and TfL needs to figure out fast if this is a trend or an anomaly. TfL's current plans for beyond 2020 are based on fares going back up again. Whether or not to freeze fares is a political choice, but one that needs to be made with the full information at hand. This Committee was surprised to hear that TfL has not even modelled a second fares freeze yet and we call for this to be done as soon as possible.

Turning to roads, TfL is operating at a loss and has to make up the cost from other transport modes. This isn't sustainable and this Committee needs to see a way forward. Currently we cannot. Vehicle Excise Duty is grossly unfair to London. On road pricing we are asking for some clarity. The Mayor's Transport Strategy says that road pricing will be investigated but we don't see this happening. London cannot keep avoiding this conversation.

Commercial income is something that TfL needs to think harder about. TfL has had some real success in the last few years, and now it needs to consider how much further it wants to commercialise. We think this merits a public debate.

Behind all this we have to recognise that TfL is quietly forging ahead with huge efficiency drives. It is doing remarkably well on this and, whilst this Committee would like more detail on where exactly savings are being made, the headline figures we see are encouraging.

Overall, we have concerns about TfL's optimism. TfL still says it will break even by 2021-22, even with the delay to Crossrail. This would be a huge achievement. Our job as the Budget and Performance Committee is to remain sceptical. TfL's job is to prove us wrong.

Recommendations

Recommendation 1

TfL should make its modelling for passenger demand open to the public on an annual basis.

Recommendation 2

Transport for London should publish modelling for a future fares freeze by the end of the 2018-19 financial year.

Mayoral candidates in 2020 should consider TfL's finances and the challenges posed by Mayoral commitments.

Recommendation 3

The Mayor should set out his position on ring-fencing any fares increase for certain projects.

Recommendation 4

- The Government should draw up plans to devolve Vehicle Excise Duty revenue to London.
- The Mayor and TfL need to keep pressing the Government on this issue and update the committee on any progress in six months.
- Failing any devolution, the Government should confirm that the National Roads Fund will be distributed throughout the country, reflecting the usage of roads and the need for upgrade work. We ask the Secretary of State for Transport to write to us by the end of February 2019 confirming his approach to Vehicle Excise Duty and the National Roads Fund in light of our recommendation.

Recommendation 5

By Summer 2019 TfL should commission and publish market research to learn about how transport users will react to new forms of advertising on its network, with any subsequent proposals put out for public consultation.

Recommendation 6

TfL should explain its plans for the Build to Rent sector in the same way that it explains its plans for advertising revenue.

Recommendation 7

In all future Operational and Financial Performance reports, TfL should set out what savings and efficiencies it has made in each business area, what further reductions are planned, and the impact on services.

1. Introduction

Key findings

- TfL expects to make an operating loss of almost £1 billion this year.
- TfL is having to deal with a number of pressures – notably the end of government operating grant and a four-year freeze on fares.
- TfL's business plan aims to turn a £1 billion loss into an operating surplus within four years.

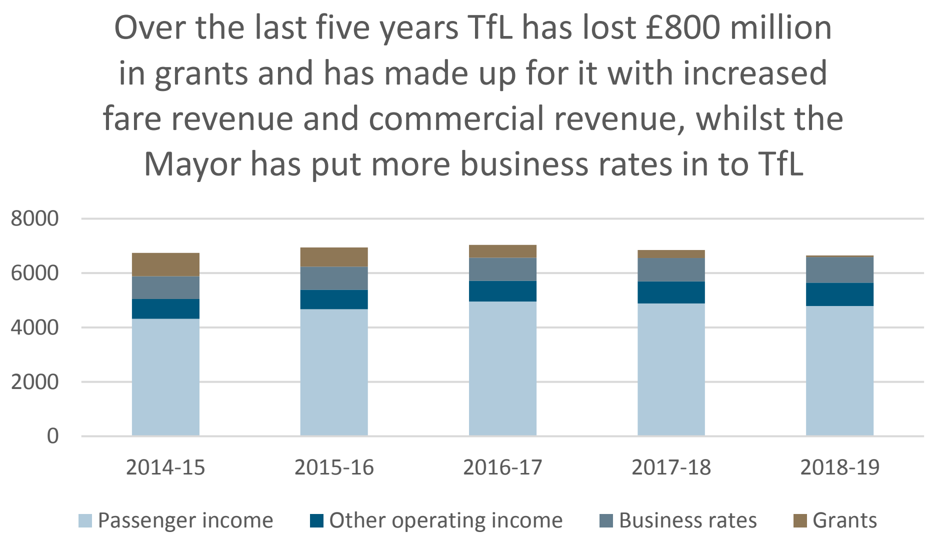
Background

1.1 TfL's budget is stretched. This year the organisation is planning for a deficit of nearly a billion pounds - £968 million. Whilst TfL has always known it would be in significant deficit this year, the position has worsened in comparison to previous business plans.

Where does the money comes from?

1.2 Most of TfL's income comes from fares. This year TfL will generate almost £5 billion in fares, or 72 per cent of its total income. 13 per cent of total income comes from other operating income – congestion charge, commercial revenue and others. Then there is some mayoral funding, in the form of business rates – worth £929 million in 2018-19. TfL now receives very little in grant funding – just £55 million.[3]

1.3 The loss of government operating grant within just a few years has been the single largest change to TfL's income streams and makes London one of the only cities in the world that does not receive government funding to support the operating costs of its transport network. Just four years ago, TfL received £876 million in grants.[4]



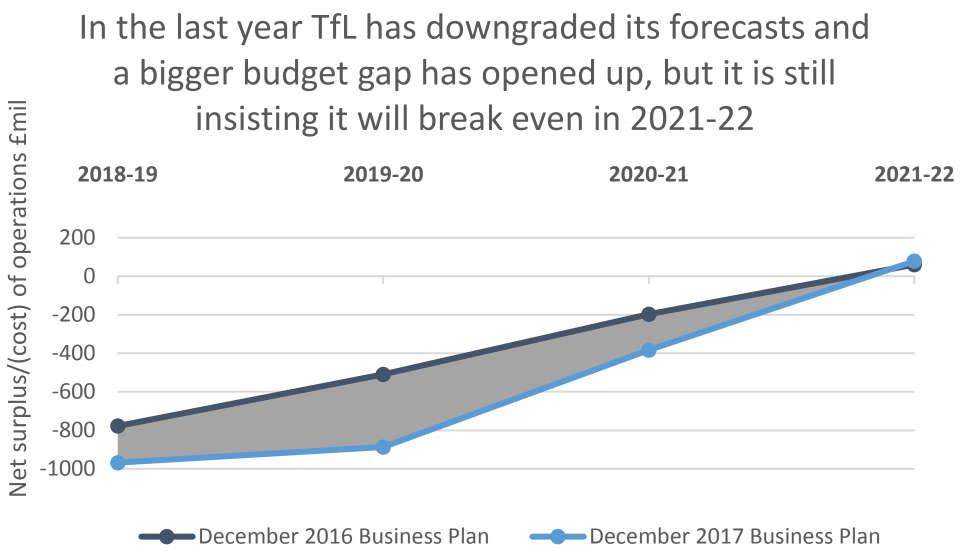
Where does the money go?

1.4 Unsurprisingly, most of the money goes on running the network. £6.6 billion – 87 per cent of total costs – goes into operating the network. TfL also pays around half a billion pounds for maintenance and the same in debt interest payments. Most of its transport modes are loss-making, and currently only the Underground returns a profit (the Elizabeth line is forecast to return a profit, but only once fully established).

Most transport modes run at a loss and are subsidised by the Tube and commercial income		
	Buses	Subsidised by £617 million
	Streets	Subsidised by £274 million
	Elizabeth Line	Subsidised by £133 million
	Other Services[5]	Subsidised by £111 million
	TfL Rail	Subsidised by £58 million
	Tube	Makes £172 million
	Commercial	Makes £203 million

What's the plan?

1.5 TfL has ambitious plans that it says will return the organisation to a net surplus by 2021-22. These plans hinge on substantially increasing income, both from fares and from commercial sources, as well as making cost savings that limit operating cost increases to inflationary increases only. The delay to opening the central section of the Elizabeth line will have major implications for all of these areas over the next few years.



2. Crossrail

Key findings

- The opening of the central section of the Elizabeth line has been delayed. This will have a range of financial implications for TfL, the scale and timing of which are currently uncertain.
- The up-front cost this year is small, but cumulatively it will add up.
- Not opening the Elizabeth line until 2019 will cost TfL between £180 and £190 million next year in lost fares and advertising revenue, according to TfL's own estimates.
- TfL has reached its borrowing limits for this financial year, making it more difficult to fund other capital projects.

2.1 The biggest shock to TfL's system is the revelation that part of the Elizabeth line is significantly behind schedule and will not open in 2018. The original timeline was for the Elizabeth line – known as Crossrail during construction – to launch in December 2018, with an extension to Shenfield six months later and to Reading six months after that. TfL now says that it needs more time to complete the infrastructure works and to conduct testing, and the central section will instead open in Autumn 2019.[6] Crossrail Ltd cannot yet give a more precise opening date. However, if TfL wants to coordinate with the National Rail timetable, it is likely that this means December 2019.

How much will this cost?

2.2 It is too early to say for certain what this delay means for TfL. We won't know the full impact until TfL publishes its next Business Plan in December, and even then, TfL cannot be sure until it has a fully revised timetable for delivering the project. But we can begin to piece together the likely consequences from what TfL has told the Assembly to date.

Revenue

2.3 TfL has said the impact of this delay will be £20 million for 2018-19. At first glance this seems quite low, and, whilst not ideal, within a budget envelope of over £6 billion it is manageable. TfL says that the figure is as low as £20 million because the Elizabeth line was only due to open in December 2018 and so would only run for just over a quarter of the financial year, and also because most of the passengers who would have taken the new line would not have been new revenue, but transfers from other TfL services.

2.4 TfL has now calculated lost passenger revenue caused by the delay for next year, 2019-20. TfL has told us that they estimate the loss in passenger revenue to be around £170 million. This is a net loss, which takes into account mitigating factors, such as passengers who were going to switch to the Elizabeth line now staying on existing transport modes.

2.5 Then there is advertising income to consider. Some of TfL's plans to grow advertising income are dependent on the Elizabeth line. This year TfL went to tender for six exclusive commercial partners for the Elizabeth line.[7] Each partner was due to invest a minimum of £6.5 million, or £39 million in total. The Deputy Mayor for Transport has quantified immediate lost income at £10 million and calls this "manageable within our overall commercial development budget."[8] We have now heard that TfL will lose between £10 and £20 million in commercial revenue in 2019-20. This may end up being manageable, but costs arising from the delay are starting to add up.

Capital

2.6 TfL has said that it is too early to say how much total additional capital expenditure will be required to get the Elizabeth line up and running. TfL says that this is an extremely fluid situation and that it might be some time before an accurate estimate can be made. TfL hopes to have "re-baselined" the project timetable by the end of November 2018. It will then have KPMG review the new project timetable. Any cost estimate at this point would be very fluid until the construction phase of the project is finished and TfL starts final testing. TfL expects that this will be in Spring 2019.

2.7 We do know that the additional cost for the project, at current estimates, is £650 million. TfL told us that in July, Crossrail asked for £211 million extra to finish the project. Based on this, TfL and the DfT announced a joint funding package of £300 million, £150 million from TfL and £150 million from DfT.[9] Now the DfT has loaned the Mayor a further £350 million to keep the project going.[10]

2.8 The £650 million additional cost so far is only enough to keep the project going until the end of the financial year, to the end of March 2019. If we assume that TfL is looking at a December 2019 opening date (even though this is not yet confirmed), then that means at least a further eight months of capital expenditure. We cannot extrapolate future costs from previous spend, but TfL's expectation management seems to centre around the original budget for Crossrail back in 2007. TfL's argument against those saying that the project is overspent is that the final cost will end up near the 2007 estimate of £15.9 billion, before this was reduced to £14.8 billion in the 2010 Comprehensive Spending Review.

How can TfL and Government pay for it?

Revenue

2.9 On the revenue side, TfL is cautiously optimistic of being able to afford the delay. This is because of good financial management in 2018-19. At the time of writing, TfL has just published its Q2 2018-19 finance report, which shows it performing £113 million ahead of budget so far.[11] TfL told the committee that it was confident it would end up around £150 million ahead of budget in 2018-19. It attributed this underspend to better than expected performance on cost savings. We will of course have to keep monitoring TfL's quarterly reports to see if this does end up being the case.

Capital

2.10 On the capital side, additional cost means either borrowing more or cutting back on investment, or a mixture of the two. But TfL can't borrow any more without breaching its operational limit. The Mayor set TfL's operational borrowing limit at £11.3 billion for 2018-19,[12] and even before this delay there was only £93 million of wriggle room left. TfL is now going to use all of its authorised borrowing in 2018-19, the full £11.3 billion.. This is why the £350 million loan from DfT is being given to the GLA, who will then pass it on to TfL as grant. It would appear the Mayor is having to be creative to avoid legal borrowing limits.

2.11 The borrowing limits are set by government, who next year can give TfL a higher borrowing limit depending on where the costs end up. The Treasury has said it will work with TfL and might grant other financial flexibilities. But the limits are meant to serve as a warning that borrowing is unsustainable. TfL needs to take this into account in future decision making.

2.12 Borrowing comes with interest payments. TfL was already going to pay nearly half a billion in financing costs in 2018-19.[13] Hundreds of millions of additional borrowing will mean tens of millions more in interest payments, due straight away. The way that the Mayor has taken the loans on might mean that the GLA has to pay the interest, not TfL, but it is still public money. We are worried about the level of borrowing TfL is taking on. We understand that borrowing is needed to finance transport infrastructure, but by the end of this business plan interest payments alone will be 9 per cent of TfL's total spend,[14] and that is before any future infrastructure projects such as Crossrail 2. We will continue to challenge TfL on how sustainable such borrowing can be.

2.13 The other question this raises is what this means for other investment projects. We already know TfL has had to cancel plans to buy more trains for the Jubilee and Northern lines. Crossrail is going to take TfL's borrowing to the limits and there won't be much room for anything else. The Mayor asked the Treasury for funding to invest in the Piccadilly line in this year, which he did not receive. If the Treasury continues this stance, there is a high probability we will see projects being scaled back, delayed or cancelled over the next year.

The Elizabeth Line was already a tall order

2.14 Regardless of the delay, we have reservations about TfL's passenger growth predictions. TfL's planning assumes that new passengers will quickly fill the space created by passengers switching from other TfL services. To some extent this makes sense. Passenger demand has been so strong in recent years that, when TfL added capacity to the network, there would always be people to make use of that capacity. But passenger growth – as we will explore in the next chapter – has struggled of late. And that is before 100 million Underground passengers and 41 million bus passengers move to the Elizabeth line. A return to strong year-on-year growth may be possible but unproven and optimistic, as we will see in the next chapter.

2.15 We also question the timeline for when exactly Elizabeth line income will start to flow. The timeline shows a surplus in year 3 – whichever calendar year that ends up being - when the line is fully extended. This is what TfL told us in our committee session too: “it is only when we start through-running that the real income of the Elizabeth line starts to come in.”[15] But the original plan had through-running starting in May 2019 – and that same year the Elizabeth line was meant to settle at its base passenger demand of just over 250 million passengers. Imperial College told us that in its experience projects on this kind of scale tend to need a ramp-up of 4 to 5 years, not one. TfL’s timeline appears optimistic.

Our verdict

2.16 One’s view about what the delay means probably depends on what view you had about TfL’s finances before this even happened. It is, after all, a year’s delay, not a cancellation. The Mayor has said that TfL’s finances are not in a perilous state and that he is confident in TfL’s business plan.[16] From this perspective, the delay pushes recovery back, and does create its own problems, but these are not insurmountable. But the committee has expressed concern about TfL’s ability to deliver its business plan, even before this delay. TfL needs to consider whether it will continue with its current plan or revise its planned returned to surplus by 2021-22, which may require further cut backs.

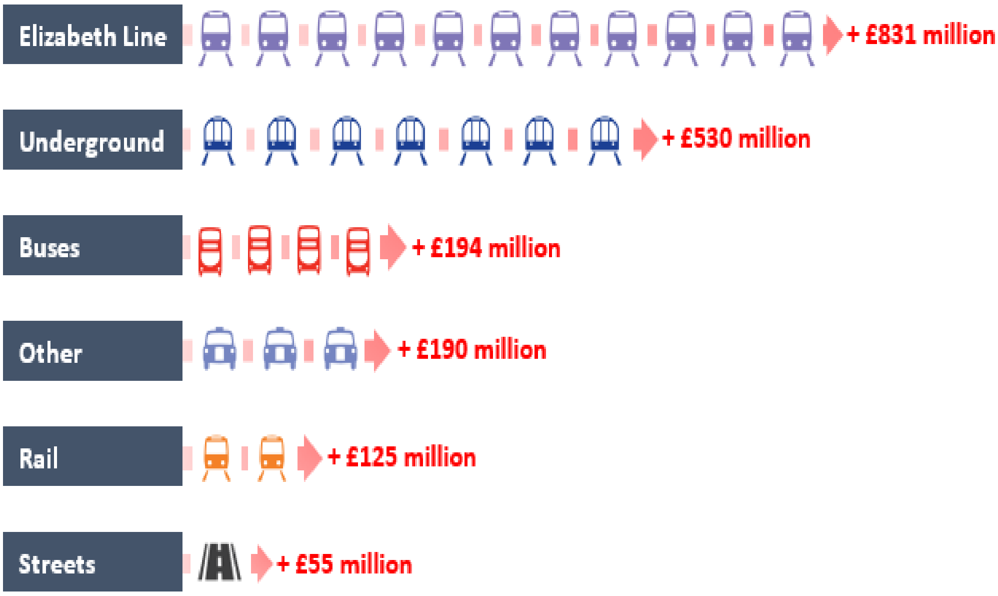
3. Increasing passenger income

Key findings

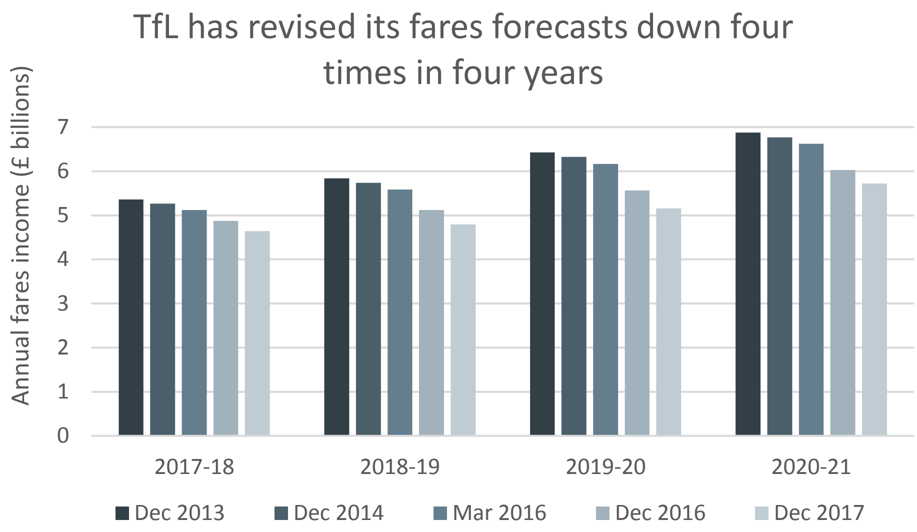
- TfL’s business plan hinges on increasing passenger income by almost £2 billion.
- But demand for some services is falling and TfL needs to figure out fast if this is a trend or an anomaly.
- TfL’s plan to break even by 2021-22 is based on fares going up again after the current fares freeze ends in 2020.
- Passengers are very responsive to the quality of services but providing consistently high-quality services costs money.

3.1 Passenger income is by far TfL's biggest source of income. In 2018-19, fare revenue will account for 72 per cent of TfL's total income. Of this income, the Underground makes up just over half, with buses contributing approximately a third. The rest is rail income, with three per cent from the newly opened Elizabeth Line.

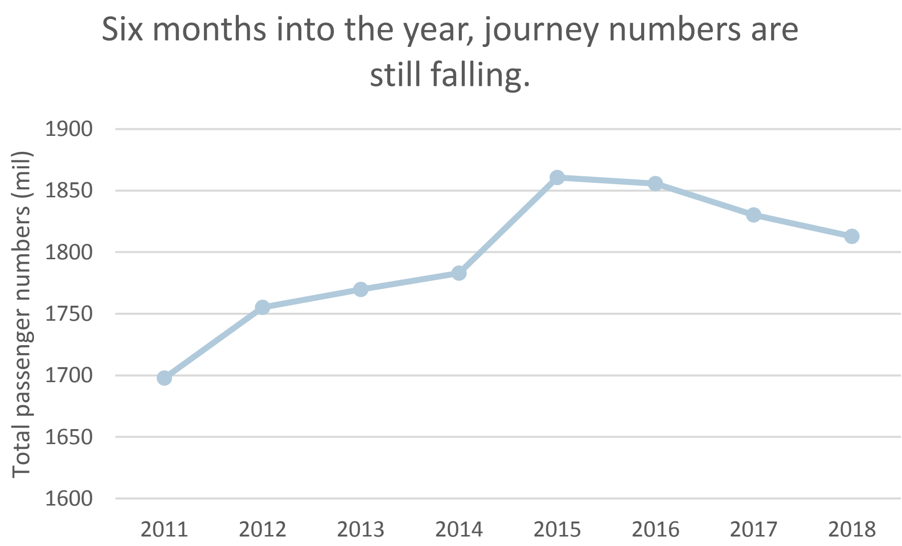
3.2 TfL has been planning for a significant increase in income. In the 2017 business plan, TfL's estimates showed income increasing by almost £2 billion over the next five years. Most of this new income was to come from the Elizabeth line and the Underground.[17]



3.3 As we have pointed out before, TfL has revised its fare forecasts down four times in the last four years. In 2013, TfL expected £6.9 billion from fares in 2020-21; by 2017 it had revised this down to £5.7 billion. A large part of this is a trend of passenger numbers not matching TfL's expectations. In 2015-16, there was a total of 4,063 million journeys in London across all modes of transport; this fell by 10 million the following year. In 2017-18, passenger journeys fell again by 42 million, to a total of 4,011 million.[18]



3.4 The early indications from this year's passenger numbers are not promising. Of course, we only have six months of journey data for 2018-19 so far and it may be unfair to make assumptions based on just a few months. But the trend for those six months, in comparison to periods 1-6 in previous years, seems to be downwards once more, even if only slightly.[19]



3.5 TfL is modelling for increases in passenger numbers for buses and the Overground, and holding passenger numbers flat on the Underground for two years. Holding passenger numbers flat is still modelling for growth, however, when the modelling has the Elizabeth line taking passengers away from other Tube lines – 100 million passengers by year 3.

3.6 Modelling for year on year increases in passenger numbers in the face of these trends is optimistic to say the least. We have raised these concerns before in both of our last two Pre-Budget Reports. TfL says that it is now using a more prudent forecast and it has revised its fare estimates downwards in light of the last few years. TfL's external auditor agrees and says that TfL's forecasts are in the "pessimistic range".[20]

3.7 Despite TfL efforts to increase transparency, it remains hard to interrogate TfL's modelling, and to properly scrutinise it. We think TfL has much to gain from making its demand modelling available for others to analyse, challenge and help improve. TfL has led the way in publishing transport data for reuse, and we urge it to take a similarly proactive approach to its demand modelling, which so much of its business planning depends upon.

Recommendation 1

TfL should make its modelling for passenger demand open to the public on an annual basis.

Are people travelling less?

3.8 The key question is if a highly unusual drop in passengers, now sustained for the last two years, is a temporary blip or a new trend. TfL has been modelling based on average per capita travel staying constant, even if there were movements between different travel modes. From 2000 to 2013-14, this was a fair assumption. Trips made per person per day stayed roughly constant during this time, although there was a large reduction in car trips (22 per cent), taken up by public transport modes. But this has changed. Since 2013-14 the average trip rate – how many trips each person makes on average per day – has fallen by an average of 4.1 per cent per year for the last three years.[21]

3.9 TfL says that "the fall in trip rate is mostly affecting discretionary journeys, for shopping or leisure."[22] Journeys to work, school or university have stayed relatively constant. TfL believes that a reducing trip rate for discretionary journeys is the main driver behind falling passenger numbers. It arrives at this conclusion because of timings – the decrease in trip rate for leisure purposes started in 2013-14, which is also when overall passenger numbers started to fall. This is a plausible link to make because leisure trips are the most common type of journey on the TfL network, much more so than commuting journeys.[23]

3.10 Consistent with the fall in trip rate affecting discretionary journeys, the reduction is mostly at inter-peak times. Inter-peak means between the AM and PM peak times, so 09:30 to 16:00 on weekdays, and all day on weekends. Most leisure and personal journeys are assumed to be in the daytime or on weekends. There have been slight falls in trip rates at other times, and so inter-peak journeys are not the sole culprit behind falling passenger numbers, but they are the most significant. To respond to the issue TfL has launched a new campaign called the "Wonderful World of Off-Peak", aiming to promote off-peak travel through its association with London culture.[24]

3.11 The largest drop in trip rate is for bus journeys. TfL's data shows that there has been growth in journey stages for the Underground, above pure population growth, although this has started to slow. The only fall in public transport journeys is by bus.[25] This is worrying, as buses carry the highest number of passengers in London, more than the Underground.[26] Falling bus passenger numbersare linked to increasing congestion, although the connection is less pronounced in outer London. The fall in bus passengers occurs from 2013-14 onwards, which is when average traffic speeds started their trend downwards, and when average vehicle delays started their trend upwards.[27]

Why are people travelling less?

3.12 TfL maintains that the fall in passenger demand is a blip. In support of TfL's argument, our guests told us that the international trends for public transport are positive.[28] Demand for public transport continues to grow in developed economies similar to London.

3.13 TfL's argument rests on the reasons for the fall in trip rate being temporary. The business plan cites "economic factors affecting the whole of the UK" as well as uncertainty around Brexit.[29] Passenger journeys nationwide do follow the same pattern as TfL, increasing until 2016 when there is a small downturn.[30] Our guests also agreed that economic performance was the single largest factor which would return passenger demand to growth.

3.14 Of course, we cannot assume that economic depression of discretionary spending is temporary. As Imperial College put it: "if disposable incomes are squeezed in real terms and stay squeezed, that is a long-term trend."[31]

3.15 We do not know how much of the fall in passenger numbers is due to economic circumstances, and how much is due to cultural change. Two of the biggest factors we discussed were changing patterns of shopping and work.

3.16 When it comes to work, the trip rate for commuting has stayed fairly constant in recent years. But there are small signs that flexible working may be having an impact. The proportion of people observed making at least one trip each day for 7 days declined from 36 per cent to 31 per cent between 2002 and 2015.[32] More and more people are having one day a week that they do not travel on.

3.17 When it comes to shopping, the question is why people are making fewer discretionary journeys. If it is pure economic pressure, then a return to increasing real incomes will mean a return to trips into town centres for shopping and leisure. But if it is cultural, and Londoners choose to spend their discretionary income online, then TfL has a problem.

What can TfL do about it?

3.18 Ultimately, many of the factors outlined above are out of TfL's control. TfL is limited in changing cultural norms of working from home or online shopping. TfL can't change macro-economic performance. This makes it all the more important that TfL does make the most of what it can control.

The fares freeze

3.19 We are now two years into the Mayor's fares freeze. On taking office, the Mayor announced that he would freeze all fares within his control. The effect has been that around 70 per cent of pay-as-you-go journeys made on the network have not increased in price in the last two years. This is clearly beneficial for those passengers, but it has financial implications.

3.20 TfL argues that the fares freeze has helped sustain demand. It justifies this claim by comparing demand for London Overground to other rail networks, such as Govia Thameslink and Southeastern. London Overground passengers increased last year, whilst other rail network passengers decreased.

3.21 This is perhaps an unfair comparison. London Overground operates around London only, whilst Southern, for example, operates into and across London from stations as far afield as Southampton. Also, correlation does not equal causation. Fares may have been frozen and Overground passenger numbers may have increased but TfL has not proven that there is any link between the two. If this is the only proxy TfL can come up with for how effective the fares freeze has been, then we simply don't understand its impact yet.

3.22 From TfL's point of view, the fares freeze means revenue foregone. On introducing the fares freeze, TfL estimated that it would cost around £640 million over the four-year Mayoral term, and TfL confirmed to us that this estimate still holds true.[33] In the context of an organisation that raises over £4 billion in fares each year, this is relatively small. But setting fares is one factor that the Mayor has complete control over, in contrast to external factors such as the strength of the economy or changes to central government funding.

"If we want fares to fall further in real terms, difficult decisions would have to be made about the trade-offs between quality [and fare levels]."

Richard Anderson, Director of Railway and Transport Strategy Centre, Imperial College London

3.23 No matter what you think of the fare freeze's benefits, its effect on passenger demand or its impact on TfL services, it *was* a major factor in the last mayoral election. The current Mayor campaigned heavily on the issue and the question of a second fares freeze is inevitable for the 2020 mayoral election. We were surprised to hear from TfL that it had not yet modelled a second term fares freeze.

3.24 TfL's business plan does *not* factor in a second term fares freeze. TfL's plan – the plan that supposedly returns the organisation to a surplus – is built on fares rising again from 2020 onwards, at RPI.[34] A second fares freeze would mean less revenue, just when TfL is supposed to start breaking even. Considering inflation, the cost would likely exceed £640 million. That is a large cost to swallow and puts even more pressure on TfL's ability to make savings and generate more commercial income.

3.25 The committee has warned about the impact of the fares freeze for some time. In our report in 2016, we warned that it was unsustainable, and we have seen no evidence to make us change our minds.[35] We all recognise that lower fares are good for and popular with passengers. But, taking into account all the other pressures facing TfL, freezing fares for eight years in a row will make it incredibly difficult for TfL to provide London with the high-quality service it needs. It is putting short-term positives ahead of the long-term needs of London. Our guests agreed. A second fares freeze would be "a brave decision",[36] and TfL would have to make up the cost with further savings or other income sources. Mayoral candidates making political choices should do so within the context of proper assessment and financial information.

Recommendation 2

Transport for London should publish modelling for a future fares freeze by the end of the 2018-19 financial year.

Mayoral candidates in 2020 should consider TfL's finances and the challenges posed by Mayoral commitments.

3.26 Of course, we recognise that any talk of a price rise is not popular. The Mayor and Deputy Mayor's argument is that the fares freeze is keeping public transport affordable and accessible to those most hard pressed by life in London.

3.27 A deterioration in services isn't popular either. TfL runs a world-class network and it was able to get to this point because of huge levels of investment in the past two decades. This investment was made at a time of increasing fares. Those fares helped pay for the network we see today, and it was against those fares that TfL was able to borrow to invest in the infrastructure a world-class network requires.

3.28 TfL cannot afford to let the quality of its services slip. The evidence we heard from Imperial College was that passengers are more responsive to quality than they are to cost.

"The international experience is that there is a high elasticity of demand with respect to service quality and density. Yet the elasticity of demand with respect to fares is much lower. Internationally, on average, if you increase fares by 10% or reduce fares by 10%, you see, say, a 3% to 4% shift in demand, whereas for supply, if you increase capacity or density by 10%, you are seeing a 5% to 6% change in demand. It is much more responsive to quality than price. The question is: do we want to have the money available to continue to reinvest in the Tube, either through fares but also from central or London Government income, in order to maintain the supply, maintain the investment programme, increase frequencies and, therefore, increase demand?"

Richard Anderson, Director of Railway and Transport Strategy Centre, Imperial College London

3.29 Freezing fares may lead to, as one of our guests put it, a "downwards spiral."[37] Fares are frozen to make transport affordable and shore up passenger demand, but without an increase in fares yield TfL will find it ever harder to borrow money to invest and stay world-class. This is already happening: there is not enough cash to make the investments that would deliver the Mayor's transport vision.[38] If TfL can't keep investing in the service, quality goes down and, with it, passenger demand.

3.30 If we were to see an end to the fares freeze, the public will want to see that the money they spend goes into improving the service they use. As Professor Tony Travers of the London School of Economics put it:

"At its simplest, the Mayor of London needs to maximise the fare yield however it is done. At the national level you see Ministers struggling to try to convince people that perhaps they should pay "a bit more tax" to pay for services. There is a question of whether ring-fenced fare revenues, ring-fenced taxes or whatever it is are the way forward to convince people, because of the sense that their money is being used for the purpose they thought it was to be used or that the fare increase is going to something they directly see. Although the Treasury has always been very unenthusiastic about so called hypothecation or ring-fencing, the truth is that the public is more convinced by it."

Recommendation 3

The Mayor should set out his position on ring-fencing any fares increase for certain projects.

Concessionary fares

3.31 Fares are subsidised or free for certain groups. This costs over £300 million per year in revenue foregone. We are not opposed to concessionary fares and see the social good in their existence for many Londoners. But it might be reasonable to question their *blanket* application. For example, we have heard that the majority of those between 60 and 65 who travel for free are workers using it to commute to work.[39] Some concessionary fares are not untouchable, no matter how politically sensitive it may be. Considering the current financial situation, it might be possible for TfL to review concessionary fares at some point in the future and see if their blanket application is in line with the Mayor's Transport Strategy.

Concession	Estimated cost to TfL in 2018-19
Zip Oyster photocards for under 16s	£90m
16+ Zip Oyster photocard	£75m
18+ Student and Apprentice Oyster photocards	£30m
Bus & Tram Discount photocard	£27m
Jobcentre Plus	£5m
Freedom Pass[40]	£21m
60+ Oyster photocard[41]	£69m
Other schemes	£1m

4. Funding London’s Streets

Key findings

- TfL is operating streets at a loss in London and has to make up the cost from other transport modes.
- TfL is “investigating” road pricing but no-one wants to say where exactly these discussions are. The Mayor can’t keep kicking this down the line.

4.1 TfL is responsible for the Transport for London Road Network, often known as 'red routes'. These roads are only 5 per cent of roads in London, but carry about 30 per cent of the traffic.[42] These are major arterial roads, such as Holloway Road or Finchley Road going north, or the A2 going south. Local councils are responsible for all other roads in London, with the exception of motorways managed by Highways England.

4.2 TfL loses money running roads in London. Over the next five years TfL will pay on average £540 million each year for these roads – money spent fixing potholes, updating signage and generally keeping London's traffic flowing.[43] But TfL does not receive any direct income from most of these streets. The income TfL receives from the congestion charge, and parking and motoring fines, is not enough to cover costs. TfL will only be able to recoup on average £368 million each year in this way.[44] This means TfL's streets function loses on average £172 million each year. TfL redirects surpluses from other transport modes to cover the losses. In the current context this is not a sustainable position.

"It is essential we find a long-term source for funding roads"
TfL Business Plan

Finding a funding solution

Vehicle Excise Duty

4.3 TfL currently receives no funding from government for London's road network. Central government collects Vehicle Excise Duty (VED) from motorists and then redistributes it around the country according to its Road Investment Strategy. The last Road Investment Strategy did not provide any money to TfL roads, and the only projects given funding that were within the Greater London Boundary were M25 junctions and outwards, i.e. not TfL roads.[45] TfL estimates that London's drivers pay £500 million each year in Vehicle Excise Duty (VED). All of this VED is being redistributed away from London.

4.4 The committee has raised the VED issue before. We wrote to the Treasury in January to ask that VED be devolved to London. The Treasury strongly rebuffed our request, saying that VED would soon go into a national funding pot called the National Roads Fund. But this is not a solution. If the National Roads Fund is anything like the current funding pot, then Londoners will not get any of the £500 million it pays in VED back. Furthermore, the DfT's funding criteria discriminates against London by counting *vehicles* on the road rather than *people* using the road. London has more buses and cyclists than other parts of the country. Both modes transport hundreds of thousands of Londoners around every single day, but use relatively few vehicles to do so. We also have issue with the DfT's argument that Londoners benefit from road investment outside of London. Yes, Londoners do use strategic roads when they drive outside of London. But they mostly use the roads where they actually live – in London. VED as it currently stands is a grossly unfair policy and the Mayor needs to keep lobbying government to ensure London gets a fair deal.

Recommendation 4

- The Government should draw up plans to devolve Vehicle Excise Duty revenue to London.
- The Mayor and TfL need to keep pressing the Government on this issue and update the committee on any progress in six months.
- Failing any devolution, the Government should confirm that the National Roads Fund will be distributed throughout the country, reflecting the usage of roads and the need for upgrade work. We ask the Secretary of State for Transport to write to us by the end of February 2019 confirming his approach to Vehicle Excise Duty and the National Roads Fund in light of our recommendation.

Road pricing

4.5 In the long run, it is clear that TfL's thoughts are turning towards some form of road pricing. Last year TfL commissioned an independent report on congestion in London which recommended a policy "introducing variable, distance-based road user charging at a London-wide level."[46] A majority of London Assembly members have agreed with this position from a congestion point of view.[47]

4.6 But we still don't know what the Mayor's position is. The Mayor has said that work is going on around road pricing and will start to surface soon.[48] The Mayor's Transport Strategy says that TfL is "investigating" road pricing. TfL told us in June that "from technology and data protection and all those perspectives, we can make this work,"[49] yet in July the new Deputy Mayor for Transport told us that the ULEZ is the focus for this mayoralty.[50]

> *"There has been work going on [road pricing technology] for some time now and this is continuing. It definitely is going on and we can start to surface it at some point"*
> *Mayor of London, Sadiq Khan*

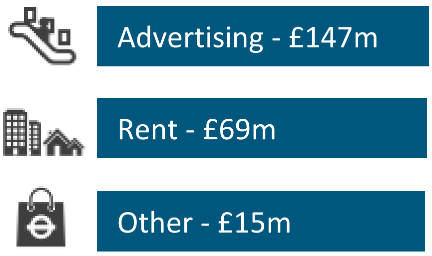
4.7 All mayoral candidates will need to make their case to the electorate and set out their views in manifestos. Of course, this topic is highly contentious, but that is exactly why any mayoral election has to address it. Road pricing, in any form, cannot be introduced without the mandate of Londoners.

5. Commercial income

Key findings

- TfL is planning on a big increase in advertising revenue but we don't think this is going to happen.
- TfL needs to consider how much further it wants to commercialise, as there are options out there to make a lot more money to reinvest in the transport network.
- TfL is starting to market its expertise internationally, but it is optimistic to think that this will be a reliable or substantial income source any time soon.
- The Build to Rent sector is a more realistic route towards a sustainable TfL.

5.1 TfL is looking to sustain itself with increased commercial income. This is a natural response to loss-making transport modes: extra commercial income reduces the pressure to raise fares or cut services. TfL currently generates two-thirds of its commercial revenue from advertising, together with some property rent.



2017-18 commercial income as per TfL Business Plan

5.2 Over the next five years TfL plans to increase commercial income by £119 million, a 51 per cent increase on current levels. This would take commercial income to £351 million. In the context of TfL's operating cost – which will be approaching £7 billion by 2022-23 - this is small change, around five per cent. But, in the current financial position, TfL needs to make most of revenue streams it has full control over.

Advertising

5.3 Most of TfL's advertising runs through two major contracts. The biggest contract is TfL's partnership with Exterion, which handles advertising on the Underground, Overground, DLR, Trams, Victoria Coach Station and Elizabeth line (once open). The Exterion contract, which started in 2016 and runs for eight years, is structured as a partnership, meaning that the two share investment costs. The contract is expected to generate £1.1 billion in revenue over its lifetime.[51] Under the contract, TfL retains 55 per cent of all advertising revenue that Exterion secures.[52] Away from Exterion, bus advertising is contracted through JCDecaux and there are several small-scale contracts for other advertising opportunities.

5.4 We are not convinced that TfL will be able to increase its advertising income by 50 per cent over the next five years. Growth is slow in the advertising market at the moment. The Advertising Association told us that it was forecasting advertising revenues for the out-of-home market – where TfL sits – to grow by 1.5 per cent in 2018-19.[53] TfL's plans are based on building new advertising assets and introducing new passengers to the transport network. It is investing in digital assets such as large screens at some stations and is banking on the Elizabeth line to increase the number of passengers on the network. More passengers means more ad views and more revenue. This is of course in jeopardy for the next year.

More aggressive marketing?

5.5 Imperial College told us that, without a significant change in approach, TfL was already generating near-maximum advertising income. There are options that TfL has so far decided not to pursue. In this section we explore what a significant change in approach could look like.

"There might be a couple of per cent extra of operating costs to be gained out of the system [from advertising revenue], based upon international experience, but it is going to be limited"

Richard Anderson, Director of Railway and Transport Strategy Centre, Imperial College London

Branded stations

5.6 TfL has already explored branded stations in the past, but in a very limited way. Most recently and perhaps most prominently, Southgate Station became Gareth Southgate station for 48 hours after the 2018 World Cup.[54] In 2015, Canada Water station was branded "Buxton Water" for one day to tie in with the London Marathon, with a deal for £110,000.[55]

5.7 TfL has so far pushed back against any longer-term advertising deals. In particular, it has argued that the Tube map and station names are key to helping passengers navigate the network, and that any more long-term brand associations would threaten accessibility. On this basis, TfL has flatly refused to entertain the idea. In light of the problems TfL will face going forward, a braver choice might be needed.

Advertising around cycle lanes

5.8 Cycling is an important transport mode and will become even more so in future. Whilst bicycle journeys are still a small proportion of journeys around London – around four per cent[56] - cycling has been the fastest growing transport mode in the last ten years.

"If the audience is moving on to Cycle Superhighways, what are the commercial opportunities around that from an advertising perspective?

Matt Bourne, Director of Communications, Advertising Association

5.9 A cyclist does not pay TfL anything to cycle. The Mayor has pledged to spend on average £169 million each year on new cycling schemes to 2022-23.[57] At present there is no advertising revenue derived from TfL's cycling infrastructure, as there is for other modes.[58] Safety cannot be compromised, and nothing should be done that in any way impedes cycling as a primary mode of transport. But there may be opportunities not yet explored.

Station and trains specifically built for maximum advertising

5.10 In some Asian metro systems the transport authority has designed the platforms and the trains specifically to maximise space to advertise and for retail outlets. Station areas and train carriages have digital screens that can carry far more adverts than traditional posters. These metros are able to achieve a much higher commercial yield, and we heard that Tokyo for example is able to cover around 20 per cent of its operating costs through commercial income.[59]

Tokyo Metro Station

5.11 TfL is already pursuing this to some extent. More modern stations on the network are now designed with advertising space in mind, such as Canary Wharf with its two huge LED screens in the main ticket hall. This is much harder for older stations.

Canary Wharf

5.12 We accept that this is a difficult thing to suggest. No-one wants to be bombarded with advertising. There cannot be any compromise on clear signage on the network. But there is an opportunity here. One only needs to compare the two pictures above. London's flagship advertising platform is two screens, albeit very large ones, whilst every wall and pillar of Tokyo metro is advertising space. That opportunity could mean better quality services, or services more affordable to the average Londoner.

Do Londoners want to do this?

5.13 Advertising helps fund services around the world. More advertising could be the price we pay for better services. TfL needs to at least have a public debate about this.

5.14 We commissioned fresh research from YouGov to look at Londoners' attitudes towards advertising on the transport network. We surveyed 1,003 adults, all of whom live in London. We asked each person whether they would oppose or support particular kinds of advertising that TfL is not yet exploring, as a way of avoiding fare increases or service reductions. We published our full findings separately this October.[60]

5.15 Some of the advertising methods we put to the test were indeed rejected by Londoners. There was clear opposition to pop-up ads when using Wi-Fi on the Tube or to any form of auditory adverts. Comparatively few Londoners wanted to relax restrictions on advertising junk food on the transport network.

5.16 Three of the advertising methods we asked Londoners about received more support than opposition, as a way of avoiding fare increases or service reductions:

1. More electronic advertising screens.
2. Sponsored stations or Tube lines.
3. Advertising around cycle lanes.

5.17 Support for more electronic advertising screens was not a surprise. Electronic screens already exist on the transport network, mostly on the Underground. Passengers are used to this advertising method, and it is less intrusive than some of the other options surveyed. This advertising method received the most support of all.

5.18 We found support for sponsored stations or Tube lines. This includes more permanent sponsorship. The last time this was put to TfL, it insisted that commuters valued station heritage and were against names being sold off "to anyone waving a cheque book and offering a bad pun".[61] Our evidence does not support TfL's confidence that this is how Londoners feel.

5.19 Support for advertising around cycle lanes was a surprise. The Mayor has pledged to spend on average £169 million each year on new cycling schemes to 2022-23. At present there is no advertising revenue derived from TfL's cycling infrastructure, as there is for other modes. We are not advocating any particular method of advertisement, but this finding should prompt TfL to have the conversation. Safety cannot be compromised, and nothing should be done that in any way impedes cycling's growth as a primary mode of transport.

Recommendation 5

By Summer 2019 TfL should commission and publish market research to learn about how transport users will react to new forms of advertising on its network, with any subsequent proposals put out for public consultation.

Selling the TfL brand internationally

5.20 TfL has spoken a few times recently about its efforts to trade on its international brand and expertise. This is feted as a way for TfL to raise income without raising fares, reducing services or doing anything drastically different. TfL seems much more willing to pursue this option than to increase the level of advertising on its transport network.

5.21 TfL expertise is incredibly marketable and can raise significant income. TfL has had some successes of late, such as licensing its contactless ticketing technology to other cities around the world.[62] TfL has been rumoured to be thinking of bidding as part of a consortium to run the Buenos Aires metro, although no bid has been made yet.[63] The head of TfL's consulting arm says that she is aiming to contribute "tens of millions" towards TfL running costs.[64]

5.22 This is not easy business. The Hong Kong Mass Transit Railway (MTR) is the world leader at generating international transport income. MTR raises revenue of over £1.5 billion per year from operating transport systems around the world, such as the Stockholm or Melbourne metros.[65] From this, MTR retains profit of around £75 million per year. If the world leader for international business is only able to generate profit of £75 million, and that is with well-established business in multiple countries, TfL is right to be cautious and only aim for tens of millions. Marketing the TfL brand abroad is not an easy win that avoids hard decisions back home.

Build to Rent

5.23 One more option TfL has is Build to Rent. TfL owns and is building some of the most desirable locations in London. It can build homes and shops within or above these developments, and rent these out, either to repay the capital investment or to generate revenue to fund services.

5.24 Done right, Build to Rent can generate huge amounts of income. Imperial College used Hong Kong as its prime example. We heard that Hong Kong was able to self-fund, and it raises four times as much in rent that it does from advertising.[66] TfL may not be able to do exactly the same - Hong Kong is a much denser city than London, and London's stations are mostly old and do not have spare space for retail. But there is significant potential.

> *"Property, that is a completely different game…there is one metro in our group that is totally self-funded from outside revenue. That is the metro in Hong Kong, where it is able to develop over stations and, therefore, that rent or sale of assets is then used to fund and finance the original construction of the metro"*
>
> *Richard Anderson, Director of Railway and Transport Strategy Centre, Imperial College London*

5.25 TfL is already starting to realise this potential. TfL brought nearly 5,000 homes to market in the past two years and expects to deliver another 3,000 this year. For example, TfL's Commercial Development Director has spoken about a scheme at Morden, where the local council and TfL have pooled their land interests and will build more than 2,000 homes.[67] Most recently TfL gave the go-ahead for a seven-storey development above the Elizabeth line platforms at Farringdon.[68]

5.26 TfL is constantly making difficult decisions on property. The target is to raise over £500 million from property transactions to support transport investments over the next five years. This means selling property and forgoing future revenue. It also means tension between maximising revenue and providing affordable housing or retail units. As long as TfL's capital needs outstrip its resources – something that TfL's board has said will be the case after 2022[69] - there will be a tension between needing money now instead of pursuing long-term rents.

Recommendation 6

TfL should explain its plans for the Build to Rent sector in the same way that it explains its plans for advertising revenue.

6. Cutting costs

Key findings

- TfL is embarking on a huge savings programme but it is still too hard to see where savings are being made and what impact on performance it has.

6.1 TfL is in the middle of a huge savings programme to cut costs. By 2022-23 the organisation plans to remove £1.2 billion in operating costs. A lot of these savings are predicated on better contract management. TfL says it will save[70]:

- £375 million by retendering and renegotiating bus contracts, including cuts to bus services
- £200 million by exiting a private partnership maintenance contract
- £100 million by relocating its head office to a new hub in Stratford

6.2 TfL's drive for efficiency in the last few years has been mostly successful. Imperial College told us TfL had made real progress. In Imperial's international benchmarking system, TfL had previously been at the higher end for back-office costs as a proportion of total operating costs. After work in recent years TfL is now on par with comparable metros around the world. We welcome TfL's success in this area.

6.3 As well as making efficiencies, TfL will make cuts to certain budgets. Given these are reductions in service, many of these are controversial.

- TfL has plans to 'streamline' bus services across London. Overall, TfL is planning to remove seven per cent of bus services by 2022-23. It says that this is part of a redistribution programme, moving capacity from central London, where there is often excess capacity - to outer London. A seven per cent reduction means that some people will inevitably see fewer buses in their area.
- TfL is also suspending its programme of proactive road maintenance. According to the Business Plan, "in the short to medium term we will have to significantly reduce our programme of proactive capital renewals on the road network, although we will ensure safety of the network is maintained." Some of those we spoke to were concerned that this would exacerbate congestion, something that would make it even harder to increase bus passengers and therefore income.
- TfL is reducing its funding to boroughs for local transport improvements – Local Implementation Plans (LIPs). TfL originally planned to reduce LIPs funding by £30 million, but intervention from the Mayor brought the cut down to £18.4 million. Boroughs use this money to fund things such as road maintenance, local cycling schemes or improving transport around town centres.

6.4 There is also an investment impact that will be felt in the medium to long-term. TfL is cancelling planned improvements, or at least deferring some. TfL says it is "temporarily pausing our plans to buy more trains for the Jubilee and Northern lines".[71] Not increasing capacity jeopardises increasing passenger numbers. It is not all large-scale projects too. TfL has even had to stop planting trees on streets to try and save money and will rely on third-party donations to fund any new trees.[72]

6.5 These cuts and their impacts are talking points in themselves, but they show what TfL’s financial position means to the ordinary Londoner. A £1 billion deficit sounds huge, but it is an abstract concept, too big a number to make sense to an individual person. Too many of TfL’s savings are combined in large savings but it’s very hard to break down. It is time that TfL provides details about where those savings have been made and what the impact to services has been.

6.6 TfL can say that it is making efficiencies, but it is still too difficult to see exactly where. Two years ago, we asked TfL to lay out its savings openly in all operational and financial performance reports. It still does not do this. Without the ability to see where TfL is trying to save money, we have little to no idea how TfL services will look in future. We will be able to see the final output - a lower operating cost – but not where the savings have been made. TfL has made progress in improving its financial and performance reporting in recent years – we hope it now addresses this gap.

Recommendation 7

In all future Operational and Financial Performance reports, TfL should set out what savings and efficiencies it has made in each business area, what further reductions are planned, and the impact on services.

Our conclusion

In simple terms, TfL's strategy to reach a surplus position within the next five years was founded on five factors. We have serious doubts about at least three of these factors.

Factor	**Our Assessment**
1. Generate new revenue from the Elizabeth Line	The Elizabeth line won't open in 2018-19 and TfL won't receive any revenue. This will cost £20 million in 2018-19 and nearly £200 million in 2019-20.
2. Return other transport modes to growth levels	Passenger levels in the last few years do not support such optimism. There is no sign of the economic growth that TfL hopes will bring discretionary journeys back up to where they were 4 years ago.
3. Generate additional commercial income	We are sceptical about commercial income increasing at the rate that TfL are hoping for.
4. Hope for a solution to roads funding	There are no signs of any changes to how Vehicle Excise Duty is allocated across the country, and London will continue to lose out. Road pricing is a tough political decision and the Mayor is kicking it down the line.
5. Make savings and efficiencies across the board	TfL has been mostly successful here, though it does need to be clear what services are impacted.

What is important now is what it will mean for TfL, and what it will mean for passengers. Financial setbacks have consequences for services. In 2018-19 we saw TfL cut back on all non-essential road maintenance. We saw plans to remove seven per cent of bus services by 2022-23. We saw TfL cancelling plans to invest in new trains for the Jubilee and Northern lines.

We need to know exactly what the ordinary passenger can expect in the coming years.

Our approach

The Budget and Performance Committee agreed the following terms of reference for this investigation:

- To set out TfL's financial position and performance
- To examine TfL's plans to increase revenue to address its deficit
- To examine TfL's plans to cut costs to address its deficit, and the consequences of cut
- To explore how the TfL of the future might be financed

We took evidence from expert guests in two public sessions on 12 June and 12 July 2018. Guests were from TfL, Imperial College Railway and Transport Centre, LSE, the Advertising Association and London Reconnections. We also held a session on passenger demand with UCL.

A poll of 1,003 Londoners was commissioned from YouGov, providing evidence on attitudes towards advertising on the transport network.

We also held a targeted call for evidence. We had submissions from the below organisations as well as from members of the public:

- Licensed Taxi Drivers' Association
- BargainPHV
- Campaign for Better Transport
- London Forum of Amenity and Civic Services
- Railfuture London and South East
- London TravelWatch
- London Cycling Campaign
- Heart of London Business Alliance
- Centre for London
- Transport Salaried Staff Association (TSSA)
- Federation of Small Businesses
- London Road Safety Council

We would like to thank all those who contributed to this report.

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