

## **Smoke and Mirrors on the Mersey**

**Liverpool City Region Combined Authority's flawed Bus Franchising Assessment**



*The **Mayor of Liverpool City Region** Combined Authority is about to consider the responses to his Consultation on a proposal to **bring the City Region's bus network fully under public control** based upon a **558 page Assessment** by the Authority and a **149 page Audit** by KPMG.*

There are **two commonly accepted and viable delivery models for urban bus services** around the World – **Public Sector Franchising** and **Public/Private Sector Partnerships**. They each have their Pros and Cons and UK legislation requires any Mayoral Authority switching to Public Sector Franchising to conduct a **robust Assessment of all the options with a clear plan for how its Franchising Proposal will work and deliver in the form of a Business Plan.**

*It is crystal clear from a detailed analysis that the **Assessment is simply not 'fit for purpose'**, containing **19 clear and fundamental errors**, and any decision based upon it **to proceed would be reckless rather than rational**. It is **simply not financially sustainable** without the ongoing injection of **substantial** and, more fundamentally, **unquantified** amounts of public subsidy. It will inevitably become an operation lurching from **funding crisis to funding crisis with service levels under constant threat of cuts and fares under constant threat of sharp increases.***

***If the Mayor truly believes that the franchising option is the best way forward for the Region's bus network (and he may very well be right), he first needs to level with the electorate on what the bill will be and what they will get for their money.***

***In that context, it is also debatable whether the Assessment complies fully with the statutory elements of the DfT Franchising Scheme Guidance, in particular, Paras 1.22, 1.24, 1.30, 1.35, 1.40, 1.59, 1.60 and 1.62.***

*It is significant to note that the Greater Manchester Combined Authority, which has yet to operate a single franchised bus, obtained an extra £18m in government support a few weeks ago and the Mayor came away from that complaining that it is still not enough for him to deliver what is needed.*

## **Background**

I remember, on a train journey about 10 years ago, reading through the **NEXUS plan to franchise the Tyne and Wear bus market** through what was then known as a '*Quality Contract*' under the Bus Services Act 2000.

It was a fascinating document, full of '*motherhood and apple pie*' proposals which sounded like a bus nirvana which would dramatically improve bus services under local authority direct control and save money at the same time.

I found myself agreeing with most of what it said but had that **nagging feeling that it was all too good to be true.**

Two years later, I spent two weeks in the aptly named '*Stadium of Light*' in Sunderland as it was forensically analysed in front of the QCS Review Board where **the whole analysis fell apart!**

It simply did not add up with NEXUS, themselves, admitting that, even based on their own optimistic assumptions, it had a **33% chance of financial failure** amongst a range of other weaknesses.

Not surprisingly, the QCS Review Board ruled that it was **not in the public interest for it to proceed** and it died there.

A couple of years later I was involved in **consultations on the Bus Services Bill** designed to reform governance arrangements for bus networks including giving Metro Mayors the power to franchise their urban bus networks. The objective was to devolve those decisions to elected local Mayors but it was **never the intention to simply give Mayoral Authorities a 'free pass' to Franchising especially in light of the NEXUS fiasco.**

Instead of a third party body signing off on a Franchising Proposal, it would be for the **Mayor to take a decision based on a formal Franchising Assessment which would also be subject to formal Independent Audit and then a Public Consultation.**

The sequence of the Statutory Assessment, Audit and Public Consultation should culminate in a **considered rational and reasonable decision by the Mayor** on what will be a **major, almost irrevocable, step with long term repercussions** and should not, therefore, be taken lightly given **the 'near miss' in Tyne and Wear in 2015.**

The formal **Assessment, therefore, needs to be comprehensive and robust, thoroughly audited and taken fully into account in any decision to franchise.**

#### ***Liverpool City Region Combined Authority***

Liverpool City Region Combined Authority (LCRCA), lead by Mayor Steve Rotheram, have just concluded the Public Consultation on the Mayor's proposal to franchise the City Region bus network based on a Statutory Assessment and Audit.

It is somewhat ironic that some of the **evidence used in the Assessment is drawn from the discredited NEXUS Proposal of 2013** so, indeed, not entirely surprising that the Assessment has a **significant series of flaws and weaknesses** which undermine its core recommendation to franchise especially in **the areas of affordability, financial sustainability and certainty.**

Franchising is being sold to the people of Liverpool as the best way to radically transform and improve the bus network to underpin the City Region's future economic development, mobility and environmental sustainability.

As with NEXUS, these are all worthy objectives.

Regrettably, the **Statutory Assessment misses the mark in several fundamentally critical areas.**

There are **three 'Big Ticket' items** in the Franchising Proposal.

- ***Conversion of the city bus fleet to zero emission***
- ***Lower fares***
- ***More services***

As with the NEXUS Proposal – what's not to like?

Principally, the cost and the high risk that it is simply not sustainable without a significant ongoing injection of **substantial unquantified amounts of public subsidy** and that it becomes an operation living from funding crisis to funding crisis.

So, let's unpick how the three Liverpool 'Big Ticket' items are funded in the Assessment.

### ***Zero Emission Fleet***

#### **Assessment error number 1**

LCRCA have assumed that they will **replace all 1,010 diesel buses** currently operating in the Liverpool City Region **with zero emission battery electric or hydrogen fuel cell buses** at between 70 or 80 per year over the 15 years up to 2039. The new fleet will be owned by LCRCA and provided to Franchise operators to deliver services.

However, in the Financial Assessment, they **only provide for a total capital spend of £252.5m** which is hardly enough to buy diesel fleet let alone fund battery electric and, even more expensive, hydrogen fleet plus the associated charging infrastructure.

**There is at least £300m capital spend missing!**

They have **simply assumed the UK Government will fund the difference!**

There is **no UK Government policy to fund the conversion of all 40,000 local service buses in England to zero emission which would cost around £13bn.** They may fund some – last offer was 4,000 buses or 10% of the fleet – but not them all.

Agreeing to provide funding over 15 years to Liverpool for that purpose would see a huge queue forming at the DfT from Leeds, Newcastle, Birmingham, Sheffield etc expecting the same deal.

Just to add to the concern, as at today, 1,200 buses are currently deployed on the Liverpool City Region network implying that another 190 buses will actually need to be replaced by zero emission vehicles over the next 15 years **amounting to an additional £95m of cost missing from the Franchising Assessment !**

#### **Assessment error number 2**

It is also assumed that LCRCA funding their share through **loans from the Public Works Loan Board will be cheaper than commercial operators purchasing them** as they will get lower interest rates as a public sector customer. The cost of interest on fleet purchase for major UK operators is such a tiny proportion of their total operating costs so **that saving simply won't move the dial.**

### **Assessment error number 3**

Whilst the **Assessment is, quite appropriately, over a 40 year horizon**, given it is a generational change, the **Financial Assessment is limited to the first 15 years** as to look further ahead, in LRCA's opinion, would be 'too uncertain'.

What is, however, certain is that all of the new zero emission buses would be life expired by then and **a second generation of fleet would require to be purchased costing another £645m** and, whatever happens with a 2024 request for Government funding, there is **no prospect of any of that second tranche being down to the UK Government**. It will be down to LRCA and **have to be funded by bus passengers in increased fares or service cuts or the people of Liverpool through higher taxes**.

### **Assessment error number 4**

Additionally, this **financial boost** is only reflected in the Franchising Proposal but **omitted from the comparative Enhanced Partnership Proposal** despite it being as available or unavailable as in the Franchising one thereby **distorting the comparative analysis of the options**.

### **Assessment error number 5**

Quite why LCRCA feel they need to franchise in order to deliver a **zero emission fleet** across the City Region is a bit of a mystery as 4 of the 5 major bus groups in the UK market are already committed to delivering fully zero emission fleets over the next 15 years.

**It will happen anyway without LCRCA intervention.**

Admittedly, the 4 Bus Groups firmly committed to those steps are Stagecoach, First, Go Ahead and National Express. Arriva, the fifth Group, are the largest operator in Liverpool and do not appear to have made a firm commitment yet but it is highly unlikely that they can be an outlier in this and survive.

Franchising simply to deliver a zero emission fleet is overkill and could more efficiently be achieved through a Partnership with a **bus industry** which is **already fully focused on that journey**.

## ***Lower Fares***

### **Assessment error number 6**

The Franchising Assessment assumes that upfront, there will be an **immediate reduction in fares across the network followed by a commitment for the full 40 years of the Franchising Assessment, to restrict fare increases to no more than RPI**.

That bold move has been **costed in the Assessment as zero!**

Making an assumption that a fares cut or freeze for one year would see the lost income matched by a rise in demand is brave, in itself, but **making that commitment over 40 years is simply reckless and unsustainable.**

Moving forward over those 40 years is seriously challenging as around **70% of bus operating costs are labour** in all of its forms and **labour costs tend to increase at around 1% more than RPI.** Given you will always need one driver for every bus, there are no easy labour productivity measures which can counteract that cost and, therefore, **costs will always increase by more than RPI.**

Consequently, you need to have in place measures which will ensure ongoing patronage growth of at least 1% and, at some stage, you will also need to provide for funding more capacity to carry that growth.

LCRCA have received £12.3m BSIP funding for a short term fare cap in 2022 so **it is clear that LCRCA understand that cutting fares costs money!**

Additionally, **in the EP Case, LCRCA assumes the same reduction in fares would lead to service cuts again confirming the naivety of the Franchise Proposal funding.**

### ***More Services***

#### **Assessment error number 7**

Much is made in the 'Case for Change' for the **bus network to be enhanced with better frequency, new routes and connections etc to improve mobility, connectivity and economic development** but having examined all 558 pages of the Assessment, **that statement is no more than rhetoric.**

There is **no plan for how the network will develop, what it will look like and, most fundamentally, what it will cost!**

There are **no projected annual mileage or fleet statistics.** There are some bizarre patronage projections for the first 15 years and even the best of them shows a 30% **reduction** in demand.

That Assessment appears to be a forecast of what will happen on the existing network and, frighteningly, the number doesn't vary much between the Reference Case, Enhanced Partnership and Franchising. Indeed, the **EP/Franchising numbers are so close as to be within the margin of error.**

If the **core purpose of the Franchising Proposal is to radically change the nature of the network and its pricing, that should be a major component**

**of the Assessment and, particularly, in the Economic and Financial Cases  
..... and it, simply, isn't!**

In that regard, alone, the **Assessment simply isn't fit for purpose and should be rejected.**

Additionally, a **bigger network will require more buses, more people, more resources and will have different demand patterns and fares levels.**

These changes are at **the core of the benefit being used to sell the Franchising Proposal and are also the critical element of its affordability so an Assessment of the Proposal without an Assessment of the cost of delivering its benefits is as useful as a cheese sandwich without the cheese!**

In practice, **expanding and developing bus services is challenging in terms of cash flow.**

Any new bus route or, even, increase of frequency on an existing one, has a significant cash flow implication. When you introduce either a frequency increase or a new service, the **cost of delivery kicks in at 100%+ on day one.** The plus relates to the necessary recruitment, training, marketing etc which will fade out reasonably quickly. However, **reaching the demand and revenue potential of the service will take up to somewhere between 3 and 6 years before it fully crystallises.**

This can be evidenced from a review of the '*Kick Start*' programme run by the DfT in the mid 2000's when local authorities and operators were invited to put forward proposals for new services or increased frequencies including an estimate of their development cost. In each of those schemes, the operator funded 50% of the initial gap between revenue and cost with the DfT funding the other 50%.

Any programme of **service expansion through franchising will incur material development costs over 3 to 6 years which will need to be funded and that funding is nowhere to be seen in the Assessment.**

It is also easy for Authorities to say that the **bus network is not optimised for economic growth etc but that case needs to be evidenced with concrete proposals which can then be fully costed and appraised and that should be contained within the Assessment for it to have credibility.**

I have dealt with Authorities and local politicians who have made this point many times but, whenever challenged to identify what is actually required, fail to identify anything concrete other than requesting the reinstatement of the odd previously withdrawn service.

I do not doubt that **there are ways in which the Liverpool bus network can evolve to underpin economic growth but, to have material impact, they will be quite wide ranging and carry a significant investment cost which needs to be quantified.**

The following direct quotes from the Economic Case in the Assessment are highly relevant –

*'It should be noted that, in a context where the bus budget available is not too dissimilar to the current bus budget, the extent to which network enhancements could be afforded is limited under every Delivery Option under consideration'.*

*'The reliability benefits arising from the 'Vision for Bus' proposals have not been explicitly quantified .... but the scale of benefit will be small'.*

Moving on from errors related to delivery of the core objectives of the Franchising Proposal, there are a series of other flaws which cast doubt on its credibility.

### **Revenue Risk**

#### **Assessment error number 8**

In costing the Franchising Case, LCRCA have noted that 2% of current operator margin relates to the operators currently providing for revenue risk.

**Revenue risk does not go away simply because the network is franchised. It simply finds a new home with LCRCA and, as a prudent local authority, it would be expected that LCRCA would deal with financial risk by holding Reserves.** These need to be at an appropriate level for the risks they foresee and that level will increase materially with the risk posed by responsibility for revenue on the City Region bus network. **In good years, money will be added to those reserves and, in tough years, it will be drawn down so that 2% is not a saving.**

### **Sensitivity Testing**

#### **Assessment error number 9**

The KPMG Auditors identified that the level of sensitivity testing in the Assessment was inadequate as they were only run for individual risks in isolation.

**In the real world, risk does not form an orderly queue at the door or call for an appointment or even book online.**

Stuff just happens and things like BREXIT and COVID happened to the bus industry in 2020 – 2022 and the industry had to deal with the consequences of both at the same time.



Whilst, having highlighted the problem, the Auditors then stated it was not material but it is also certainly not best practice and the **Assessment on a major project of this sort should be tested for sensitivity to multiple risks** especially since, from the points made above, it is already being seen to be based on optimistic assumptions.

## ***Uncertainty***

### **Assessment error number 10**

**One of the key non-financial differences identified by LCRCA between the Franchising and EP proposals is in the area of uncertainty.**

**LCRCA concludes that delivery of the EP is uncertain** as it is dependent on continued agreement between the Authority and threatened by the CMA requirement for Partnership Agreements to be subject to review and renegotiation every three years.

However, **this argument should sit the other way round as uncertainty is actually greatest on the Franchising Proposal which is entirely dependent on sufficient funding being available.**

The **Franchising Proposal is dependent upon annual decisions of the 6 constituent members of the Combined Authority to fund the Transport Levy** and whether that levy will be sufficient to meet the needs of the Proposal.

There is an **assumption that all 6 constituent authorities will agree to meet the base level of Transport Levy required in Year One and agree to inflate it by 2% every year for the next 40 years.**

That implies **240 separate decisions** being taken to support the Levy at that level when **history shows that the Levy has been a contentious issue in the past.**

Not only is that an ongoing risk and uncertainty but there is the separate question that, even if those 240 individual decisions endorse an initial Levy at the required level and then increase it by 2% in each of the next 40 years, there is a **risk of inflation exceeding 2% during that period which would leave the Franchising Proposal underfunded.**

**Looking back over the last 40 years at UK inflation levels indicates that this is a serious risk.**

The Franchising Assessment is also based on UK Government core funding for buses through BSOG or other national grants remaining stable throughout the 40 year

assessment period. Any reduction in these payments could impact LCRCA's ability to deliver the network.

It is crystal clear, therefore, that the **Franchising Proposal does not have the attribute of greater 'Certainty of Delivery' as stated in the Assessment.**

Given there is **no definitive price** quoted in the Assessment **for all of the enhancements promised** to ensue from Franchising, it is **impossible to make any commitment on** the local authorities' ability to meet **a blank cheque.**

The following direct quotes from the Financial Case in the Assessment are very relevant –

*'With franchised services, LCRCA will need to be able to revise the bus network in order to manage the impact of reductions in service.'*

*'Franchising contracts would need to be flexible enough to provide reduced services if there were to be a cut in funding.'*

*'Consider introducing flexible contracts to enable LCRCA to adjust payments to operators if revenue drops.'*

*'In reality, if outturn or reforecast demand reduced below the expected level, then LCRCA could adapt its resourcing and fleet investment plans.'*

*'LCRCA will base the services it lets under franchise contracts on contemporary forward forecasts of affordability; the proposed contract will have a flexible change mechanism.'*

*'For all delivery options, LCRCA cannot spend more money than funding is available.'*

**It is clear from those quotes that outcomes promised from the Franchising Proposal are subject to uncertainty due to economic and financial reality in the same way as the EP.**

### ***Marketing Costs***

#### **Assessment error number 11**

According to the Financial Case, LCRCA currently spends around £800,000 per annum on marketing the bus network.

Both major operators, who currently take revenue risk, will also be making material spend on marketing to maximise their revenue.

When revenue risk transfers to LCRCA the marketing budget remains at £800,000 for the first 10 years and only then increases to £900,000 for the last five. **Given**

the reliance LCRCA place on patronage growth to fund cheaper fares and network expansion, that is simply not credible.

### **Depot Assumptions**

#### **Assessment error number 12**

The LCRCA assumptions in respect of depot provision for 8 large franchises will be expensive, but possible, to deliver but, if it is **intended to use any of the current operator depots, there will be significant logistical issues associated with taking them out of service 24 months before they are required to allow for refurbishment. How will the current network be delivered over those periods?**

LCRCA are assuming a net saving from their depot plans but it is **more likely to be a significant net cost as the financial provisions made seem very optimistic.**

### **Management Costs**

#### **Assessment error number 13**

**The funding proposed for employing 210 FTE to manage the 1,000 + franchised bus operating business seems very low with an average total cost of employment of £21k per employee including oncosts!**

The Auditor remarked that there is.

*'limited or no supporting evidence in the calculation of the relevant salaries'*

The Auditors also state –

*'Staff costs are included at 2022/23 prices in the Franchising Model and are subject to no fixed indexation (not linked to CPI) with a 4% growth rate assumed in 2023-24 and 2% per annum thereafter. This assumption has been made by LCRCA to reflect that the levy is not expected to grow with general inflation over the next few years.'*

**Para 3.3 of Financial Case.**

**Labour markets are what they are and cannot simply be changed because the Authority does not want to spend the money** – that will just result in staff shortage or poor performance impacting on the delivery of the Franchise operation.

It is unclear if that same assumption applies to staff employed by the Operators but, if it does, it will lead either to poor operational delivery or higher operational costs.

Additionally, LCRCA assume that operators will no longer need network planning, scheduling or on street supervision resources under Franchising. To plan and deliver reliably Operators will retain personnel in these and other roles and, therefore,

LCRCA are being **overly optimistic in their assessment of operating company management, administration and supervisory costs** as there will be a **degree of duplication necessary between LCRCA and Operators** which is not provided for in the Franchising Proposal costs.

### ***Capital Cost of Smart Ticketing under Franchising***

#### **Assessment error number 14**

It appears that **no specific provision has been made for the Smart Ticketing infrastructure required under the Franchising proposal** and that will be a significant cost which will be much simpler and cheaper in the case of an EP.

### ***Fares Simplification***

#### **Assessment error number 15**

The assumption that **fares simplification will be revenue neutral** relies on the **research on the issue done for the discredited NEXUS proposal in 2013 and was challenged at the Public Inquiry by the QCS Board in 2015** as an **unrealistic assumption not supported by hard evidence**.

### ***Audit Weakness***

#### **Assessment error number 16**

Preparation of an **Assessment as wide ranging as this over a 40 year appraisal period is subject to potential model and spreadsheet error** and, therefore, the Audit should address this issue within its scope.

However, the Audit states –

*'For the avoidance of doubt, KPMG's work has not involved a review of all the unique formulae within the models and is not expected to comment on the accuracy of the models or identify all errors within the models.'*

**Spreadsheet and model error was one of the issues uncovered in the unravelling of the NEXUS proposal in 2015.**

### ***Compliance with the Statutory elements of DfT Franchising Guidance***

#### **Assessment error number 17**

The **DfT Franchising Guidance states clearly at Para 1.30 that a Franchising Assessment should draw on information about the current and predicted future performance of local bus services including data on patronage, journey speeds and reliability.**

The Assessment is completely silent on journey speeds and reliability although movements in both could have a material impact on financial performance of the network.

More generally, it is questionable whether the Assessment also complies with Paras 1.22, 1.24, 1.35, 1.40, 1.58, 1.59, 1.60 and 1.62.

### ***Passenger Journeys under Franchising and Enhanced Partnership***

#### **Assessment error number 18**

The Auditor notes that, whilst the **Franchising Assessment shows passenger journeys under Franchising at 0.2% higher than under an Enhanced Partnership, there is no rational explanation provided.**

Given how close the results are for Franchising and Enhanced Partnership, this is a critical point in the comparative merits of the proposals

### ***Pensions***

#### **Assessment error number 19**

**Pensions are an area of potential cost risk unique to the Franchising Case but no financial provision for that risk has been made.**

### ***Passenger Satisfaction***

With a **91% passenger satisfaction score** in the independent annual Transport Focus survey following the creation of the Bus Alliance, **customer satisfaction is hardly a pressing reason for Franchising as potential upside is limited.**

### ***Summary***

In summary terms, the cost of **more services, revenue risk, financial sensitivity, uncertainty, smart ticketing, fares simplification, journey speed and reliability risk, demand trends and pension costs** are **unquantified and unfunded.**

The cost of **zero emission fleet, marketing, depot provision and management** are **seriously underestimated.**

**Of all 14** of those issues, **none** of them **are fully funded**, only **4** of them are **partially funded** and **one** of them is **completely unexplained.**

### ***Where should LCRCA go from here?***

This Analysis is **not driven by any ideological objection to Franchising** which is a **perfectly workable method for delivering bus services** used in a variety of forms in many cities around the World. Franchising does have certain **inherent characteristics of being financially expensive, weak on innovation and exposing consumers to the negative effects of monopoly pricing power** but a **valid approach nonetheless** if those weaknesses are accepted. No system is perfect so there is **always a need to choose the best approach or mix of approaches for a particular market.**

**This particular Franchising Proposal** just happens to be **very badly put together and completely fails to make the Business Case as required by the Bus Services Act 2017 either through accident or design.**

It is clear from the above analysis that **the Assessment is deeply flawed and any decision to franchise on the limited evidence put forward to date would be reckless and irresponsible.**

The appropriate response would be **to take a step back and accept that the Assessment needs to be reconducted** and address the following issues –

1. The **19 errors** outlined above.
2. Ensure that **any fresh Assessment fully documents and assesses the changes proposed to the network and fares promised to the people of Liverpool – a bigger network and lower fares. In the current proposal, these are simply left unquantified and an open-ended long-term risk to the viability of the entire regional bus network!**
3. Take **account of** the role perceived for bus in **the UK commitments to decarbonisation** and the **major modal shift required from car to mass transit, including bus in Liverpool.** That will require **major investment in bus service supply which will need to precede, rather than follow, the modal shift.**
4. Investigate an **alternative much more radical type of Public/Private Sector Partnership Model than the anodyne rolling 3 year agreements favoured by the CMA.** Private Sector **investments in developing urban bus networks have payback horizons of at least 6 to 10 years and will not be forthcoming against arrangements with only a 3 year life.** Capital spend on buses relates to a 15 year life and development expenditure on new routes and material frequency enhancements have a 3 – 6 year period before any positive payback emerges.

**The people of Liverpool, and the taxpayers of the UK from whom LCRCAs are seeking funding, deserve a properly researched choice of delivery models to be produced and presented for their consideration.**

#### **About the Author**

**Robert Montgomery** has held senior management positions in the UK and Irish bus industry since 1983, **directly operating urban bus networks in Sheffield, Manchester, Glasgow and Dublin** and heavily involved with many more during 20 years on the UK Bus Executives of, firstly First Bus for 4 years and, subsequently, Stagecoach for 15 years culminating in the role of Managing Director of Stagecoach Group's UK and European Bus and Coach Division in 2017. He has also been **involved in government consultations on the 1985 Transport Act, the Buses (Scotland) 2000 Act and the 2017 Bus Services Act and in the Review of the failed NEXUS Proposal to franchise bus operation in Newcastle and Sunderland in 2015.**