

Sadiq Khan
Mayor of London
Kamal Chunchie Way
London
E16 1ZE



Department
for Transport

30 August 2022

Dear Sadiq,

Transport for London – Long-term Funding Settlement

1. It is important for Transport for London (hereinafter referred to as TfL) to operate and maintain essential and safe transport services in the capital; continue its full and vital contribution to the Government's (HMG) economic recovery from the pandemic both in the capital and in the wider economy; meet its statutory obligations in relation to a balanced budget, and support HMG's transport priorities.
2. Since the start of the pandemic, HMG has supported TfL by covering lost fare revenue; over four emergency settlements, HMG has provided over £5 billion of funding. Now, as the recovery continues, TfL must become financially sustainable, ensuring good value for money for the UK taxpayer. HMG defines financial sustainability as TfL's ability to cover, from sources available to it (including the consideration of potential new sources of income and committed Business Rates Retention but excluding HMG's extraordinary funding grant): operating expenditure; capital renewals; servicing and repaying debt; and capital enhancements. For major capital enhancements and major renewals (i.e. replacement of life expired rolling stock and signalling), TfL is not expected to solely finance these from operating incomes, as is consistent with other transport authorities. HMG also recognises that TfL, including Crossrail Limited, has existing near and long-term financial commitments, and will need to enter into new financial commitments, that extend beyond the funding period set out in this agreement. A combination of future measures from TfL, the Greater London Authority (GLA) and HMG will enable TfL to continue to meet these obligations and commitments. HMG recognises that further capital funding beyond this funding deal may be required by TfL should it not be able to generate such resources from its own means. Further capital funding support will be subject to TfL demonstrating real-terms like-for-like reductions in its cost base and TfL having met condition 11a in this Funding Settlement. HMG remains committed to supporting London and the transport network on which it depends via this funding settlement which recognises the reliance of London's transport network on fare revenue, and HMG's commitment to mitigating loss of fare revenue as a result of the pandemic.
3. This funding settlement will ensure the delivery of key capital renewals and investment in London worth £3.6bn until March 2024. This settlement will enable delivery of, amongst other things, completion of a number of major projects, new road schemes and increased bus priority.
4. The objective of this long-term Funding Settlement (hereinafter called the Funding Settlement) is to provide certainty for TfL as it transitions from short-term extraordinary funding provided by HMG to financial sustainability, while maintaining the existing quality of the transport network and reflecting post-pandemic demand.
5. The terms of this Funding Settlement shall remain in effect until 31 March 2024 or until TfL and DfT agree TfL has reached financial sustainability (as defined in paragraph 2), whichever is the sooner (hereinafter referred to as the Funding Period). If TfL wishes to exit from this agreement, they must do so in agreement with DfT, having provided DfT with at least 28 days' written notice. This Funding Settlement will end on the last day of the Reporting Period following agreement from both parties that the funding settlement is concluded.

6. During the Funding Period, HMG will retain passenger revenue risk, due to ongoing uncertainty of demand, while capital and operating cost risk will sit with TfL. HMG will provide financial support to fund the difference between TfL's costs and revenue up to the level of an agreed annual envelope on operational and capital expenditure. In exchange for this financial support, TfL will be expected to exercise restraint in their operating budget and manage their capital programme rigorously to ensure value for money for both farepayers and the national taxpayer. TfL will make every effort to maximise revenue. If any decisions that reduce revenue are made without HMG agreement, TfL will bear the cost.

7. Delivery of the matters set out in this Funding Settlement will consider and prioritise safety and other statutory and operational requirements of running London's transport network. HMG recognises that the delivery of such matters will need to take account of TfL's (and your) statutory responsibilities. Any decisions will be made in accordance with relevant legal powers and decision-making processes, considering any need for consultation.

8. This Funding Settlement sets out funding expectations for the full Funding Period. A letter will be sent to the Mayor of London at the start of each financial year confirming HMG's commitments for that financial year, as set out in this letter and as required in section 101 of the Greater London Authority Act 1999 (GLA Act).

Operational funding

9. This Funding Settlement sets an Operating Envelope for the Funding Period that includes TfL's core operating and other costs as well as non-passenger revenue. The Operating Envelope for the Funding Period is set out in **ANNEX A**. The Operating Envelope assumes inflation in line with TfL's March 2022 budget; to the extent that inflation varies materially from this assumption (+/- £10m), the Operating Envelope and the quantum will be updated to reflect this, subject to a maximum total adjustment of £15m for FY22/23 and the provision of sufficient information from TfL (as set out in **ANNEX C** paragraph 3). The additional inflationary impact for 23/24 will be subject to review by the DfT (and/or its advisers) to understand/challenge how the numbers have been derived.

10. If TfL's operating expenditure in any financial year exceeds the amount set out in the Operating Envelope and/or non-passenger revenue is lower than that set out in the Operating Envelope, this will be for TfL to manage and no additional funding will be provided by HMG. Equally, if TfL's operating expenditure is lower than set out in the Operating Envelope, HMG will not seek to recoup this amount. On fare revenue, the Operating Envelope assumes a rise in fares for 22/23 and 23/24, however it is for the Mayor to decide whether to increase fares and should he decide not to, no additional funding will be provided by HMG.

11. The Operating Envelope assumes the following as agreed in previous extraordinary funding settlements:

- a. On 15 December 2021, you confirmed how you plan to generate between £0.5-£1.0bn p/a of additional revenue from 2023. The Operating Envelope assumes TfL will progress its recommended options with a view to ensuring implementation by 2023, while noting that any council tax precept revenue will be ordinarily raised and used in the same financial year.
- b. Delivery against TfL's accelerated Modernisation Programme as set out in their report of 15 October 2021;
- c. That TfL's pay award for 2022/23 continues to follow public sector pay policy, and the assumptions set out in TfL's latest budget. TfL will provide an update on pay at the Oversight Group meeting (as set out in paragraph 58). The Operating Envelope may need to be updated each year, after public sector pay guidance is issued.
- d. The latest pay awards for London Underground were out of step with wider public sector pay policy. The Operating Envelope assumes TfL will find savings equivalent to this incremental amount from within the London Underground cost base and rebalance this settlement in future pay deals;

- e. If you and TfL wish Londoners to continue to benefit from travel concessions and/or other benefits above those typically available elsewhere in England (such as free travel for all Londoners aged under 18 and 60-65, excluding statutory entitlements including under the Education Act 1996) then you and TfL recognise that the costs of these additional benefits will not be met by HMG funding; and you and TfL commit to meeting the costs of these additional benefits during the Funding Period, without recourse to additional borrowing, savings, service changes, the new revenue streams resulting from paragraph 11a or deferrals.
- f. TfL maintain average quarterly Useable Cash Reserves of £1.2bn throughout the Funding Period (see paragraph 55).
- g. TfL maintain previously planned service levels in line with their Core package as set out in their September 2021 Service level review and continue to provide funding to boroughs in line with spend in 2021/22.

12. The Operating Envelope has been calculated taking into account the points above, but it will be for you and TfL to decide how to manage TfL's operating budget within the envelope agreed. However, we expect, as a minimum, that Local Implementation Plan (LIP) funding each year is aligned with funding provided in 2021/22.

Capital funding

13. HMG's willingness to support investment in major projects, renewals and enhancements must be combined with TfL showing prudence and identifying savings and efficiencies wherever possible. TfL will be responsible for managing risk across the capital programme.

14. **Business Rates Retention.** The 2021 Spending Review confirmed that TfL will continue to receive Business Rates Retention worth c.£1bn each year until 2024/25. We expect this to contribute towards TfL's capital programme. TfL must not exceed £500m of BRR that is used to support operational expenditure, without prior approval from HMT. This income is assumed in the calculation of the quantum.

15. We expect TfL to spend on an accruals basis in line with a minimum Capital Envelope of £1,719m in 2022/23 and £1,831m in 2023/24 on capital renewals and enhancements, including major projects and Elizabeth Line. This excludes spending on property and specific allocated grant funding for HS2.

16. If TfL spend less than the minimum Capital Envelope on an annual basis, then they will return a corresponding level of grant funding to HMG, up to a maximum of the total grant funding given as set out in **ANNEX C** paragraph 1.

17. **Major projects.** We expect TfL to continue to deliver the committed major projects in its capital programme. These are:

- a. Piccadilly Line Upgrade Phase 1 – Trains
- b. Four Lines Modernisation
- c. Rail System Enhancements for Northern and Jubilee lines
- d. Northern Line Extension
- e. Silvertown Tunnel
- f. Barking Riverside Extension
- g. DLR Rolling Stock Replacement Programme
- h. Elephant & Castle Station Stage 1
- i. Bank Congestion Relief (and necessary associated works)
- j. Works to support delivery of HS2
- k. The Elizabeth Line

18. **Sale & Buyback.** TfL's March 2022 budget assumes it will pursue a 'sale & buyback' option for new rolling stock on both the Piccadilly Line and DLR. We have assumed funding within the Capital Envelope and expect TfL to remove this option, as to reduce the overall cost to the public sector.

19. **Enhancements.** We have assumed funding in the Capital Envelope to enable TfL to complete committed schemes and projects required to comply with safety and regulatory requirements. We also expect TfL to progress projects which contribute to reaching financial sustainability by reducing operating expenditure or increasing revenue. We expect TfL to continue to pursue opportunities to access third-party funding, including through developer contributions. If TfL provide appropriate evidence of need, HMG may instead agree that TfL can roll this funding over into the next financial year as specified in **Annex C**.

20. **Enhancements – Active Travel:** We expect TfL to continue to deliver throughout the Funding Period their active travel programme including funding for the London Boroughs under the Local Implementation Plan process. On average, £80m each year of the amounts in paragraph 15 will be ringfenced over the period of this settlement for active travel, defined as walking and cycling. Any cycle schemes implemented or supported under this funding shall be fully compliant with LTN 1/20 cycle infrastructure design guidance. We expect TfL to collaborate with ATE to ensure standards in Active Travel are consistent with the rest of England.

21. In accordance with its own Bus Action Plan, TfL will deliver at least 25 lane km of new bus lanes by 2024/5. It will, by July 2023, complete holistic and granular studies of at least five major bus corridors to ensure that road space is used more efficiently, including but not limited to parking and loading.

22. **Road User Charging.** You have decided to consult on proposals for the introduction of a London-wide Ultra Low Emission Zone for introduction in 2023, to improve air quality in London. TfL have estimated this will cost £250m in capital infrastructure costs. HMG grant funding in this settlement should not be used to cover the costs of your policy decisions to charge road users, and therefore if you choose to implement this scheme or other road user charging options, you must fund them through alternative sources available to you.

23. **Renewals.** HMG recognises TfL's progress during the past two years in building an evidence-based understanding of its assets. The minimum Capital Envelope has been calculated to include funding in 2022/23 for projects necessary for compliance with safety, legal and regulatory requirements, and for maintaining the reliability of London's transport network. HMG expects TfL to prioritise its spending accordingly. HMG expects TfL to spend at least £635m on capital renewals in 22/23 and £725m in 23/24. If TfL spend less than this minimum level of renewals spend in either 22/23 or 23/24, then, in the first instance, they will return a corresponding level of grant funding to HMG, up to a maximum of the total grant funding given as set out in **ANNEX C** paragraph 1. If TfL provide appropriate evidence of need, HMG may instead allow TfL to roll this funding over into the next financial year as specified in **ANNEX C** paragraph 1.

24. For 2023/24 for which specific data is not yet available, HMG again expects TfL to prioritise spending to ensure the reliability of London's transport network is maintained. TfL will provide DfT, before the end of the present financial year, with detailed information on its Renewals programme for 2023/24.

25. **Capital efficiencies.** We expect TfL to continue delivering its 2021 Capital Efficiency Plan (CEP) and pursue all opportunities to make efficiencies. To this end, TfL will continue to present DfT with its annual efficiencies report as set out in the CEP, including a summary of efficiency delivery against target; commentary on delivery; case studies; supporting metrics; and a forward look.

26. **Reporting.** TfL will provide period reports within 10 working days of the quarter end date which will report TfL's spending on enhancements, renewals and major projects. The form and content of the reports will be agreed between TfL and DfT. TfL will continue to provide management accounts at the end of each 4-week accounting period.

Hammersmith Bridge

27. TfL and the London Boroughs are responsible for local road maintenance, including bridge repairs. The London Borough of Hammersmith and Fulham is responsible for the safety and maintenance of Hammersmith Bridge. However, given the extraordinary circumstances of the pandemic, during the period of this agreement, we expect to finalise a memorandum of understanding between HMG, TfL and the London Borough of Hammersmith and Fulham to ensure all parties' commitment to the reopening of Hammersmith Bridge on a permanent basis – initially to pedestrians, cyclists and river traffic and, depending on cost, to motorists. Any funding from HMG will be conditional on the following:

- a. all parties must scrutinise and agree the cost of the project through the submission and scrutiny of Green Book-compliant business cases for each stage of the project;
- b. each party agrees to pay a share of the cost as agreed in the Full Business Case. Repair costs are to be led by the London Borough of Hammersmith and Fulham and TfL; HMG will not directly contribute more than one-third of the costs; and
- c. the independent board responsible for the case for continued safe operation, reporting to London Borough of Hammersmith and Fulham, will conduct regular assessments for controlled and limited opening of Hammersmith Bridge to pedestrians, cyclists and river traffic. London Borough of Hammersmith and Fulham should share the assessment with HMG and TfL.

28. Approximate costs for the repair of Hammersmith Bridge have been included in the quantum and minimum Capital Envelope but will be confirmed through the Full Business Case. HMG's support for TfL's third of Hammersmith Bridge repairs will end at the point that TfL reaches financial sustainability, or upon the expiry of this Funding Settlement, whichever event occurs first.

Driverless Trains

29. TfL's record of modernisation and innovation should not leave it behind other European networks, which are achieving significant operational efficiencies through driverless trains. Accordingly, DfT and TfL will press forward with the joint programme on the implementation of driverless trains on the London Underground, recognising TfL's safety, regulatory and statutory responsibilities.

30. Taking the findings of the network review to the next stage, TfL will continue to work with DfT to develop the evidence required to make a strong case for investment in driverless trains on the London Underground. This will include but not be limited to the work set out below.

31. TfL will work with DfT to assess the case for introducing GoA4 on the London Underground network, taking into account opportunities and risks.

32. TfL will undertake further studies and wider research to support progressing driverless trains on the lines where the case(s) are strongest.

33. In addition, TfL should continue working with DfT to make progress developing and testing innovative technology, where it can save money in the delivery of driverless trains.

34. Based on the findings of the above, TfL will work with DfT to develop a business case for driverless trains as necessary.

35. TfL will ensure senior representation on the joint programme and will actively support this work through the provision of staff resources, expertise and access to both the London Underground network and any information sources. TfL's participation should seek to explore all options in a collaborative and open manner and work with the programme on an implementation plan. HMG will provide resource funding to TfL to enable it to support the programme's work.

Elizabeth Line

36. TfL have forecast a shortfall in funding to complete Crossrail. HMG continues to stand by its commitment to finance the full completion of the project but limited to items strictly essential to

operation of the Elizabeth Line (EL) and has previously committed financing towards this end goal. Therefore:

- a. As the primary beneficiary of Crossrail, London should bear any additional costs;
- b. TfL should seek to explore all options available with the Greater London Authority (GLA) and other sources to cover the shortfall in Crossrail funding;
- c. TfL should identify cost saving opportunities to eliminate the shortfall in funding by managing any outstanding cost pressures beyond the current available funding and focussing on capital items essential for operations of the EL.

37. We expect you to honour your commitment of £48.5m additional funding for the project and to consider raising this commitment if needed to complete the project. We expect TfL to prioritise items essential for the completion of the Line alongside the rest of its capital programme and manage any additional costs within the capital envelope. TfL will be at risk for any further overruns and no further HMG funding will be made available outside of this settlement.

General Terms

38. The Mayor's December 2020 Independent Review of TfL recognised that TfL's pension scheme is expensive, outdated and in need of modernisation. As part of this funding settlement, the Mayor commits to ensuring TfL's pension fund is financially sustainable and to protecting members' benefits built up to date.

39. Therefore, TfL will consider the findings of the Independent Review of the TfL Pension Fund and, by 13 September, provide a response to the Final Report alongside a workplan, setting out the steps that would be necessary for moving TfL's Pension Fund into a long-term, financially sustainable position. This workplan must include detail on what resources will be committed to achieving this objective. TfL and HMG officials will meet on 20 September to discuss TfL's workplan, progress to date and next steps. By the 30 September 2022, TfL will submit two categories of options for future service reform with no more than two sub-options under each, all of which will aim to reduce future service liabilities by circa £100m. TfL will set out their rationale as to why other potential options for reform have been ruled out. TfL will also provide:

- a. core design principles for each sub-option (including but not limited to: salary risk, retirement age, indexation and possible accrual rates);
- b. an assessment of how each sub-option meets key criteria related to: deliverability; affordability; (assessment of cost savings); sustainability (risk); fairness; and how it compares to other equivalent pension schemes;
- c. its view on what HMG support is needed to progress the shortlisted options alongside proposals for how past service liabilities will be managed under these proposals.

40. TfL and the Mayor will agree with HMG a final detailed proposal for any recommended changes to both future service benefits and past service liabilities, and an implementation plan by no later than 31 January 2023. Should the recommended approach require TfL to consult members, TfL will commence consultation by 1 May 2023. TfL will be expected to provide regular substantive progress updates during the Funding Period.

41. If TfL does not satisfy the terms of this Funding Settlement set out in paragraphs 38-40, I will consider varying the grant payments in this letter, after consultation in accordance with section 101 of the GLA Act. If, during that consultation period, TfL does satisfy those terms or HMG is sufficiently satisfied that TfL will use its best efforts to meet them as soon as possible, I will take that into consideration.

42. The passenger revenue scenario set out in **ANNEX B** will be updated annually to reflect the fares change on national rail.

43. HMG will continue to engage on and monitor the financing of Northern Line Train Services contract. If a Supervening Event occurs in accordance with clause 25A.1.1 of the Amended and Restated Usage Contract, HMG will work with TfL and take reasonable steps to assist TfL in

meeting the contractual obligations set out in clause 25A of that contract and other associated provisions, or finding alternative forms of support acceptable to the relevant counterparties.

44. DfT and TfL will agree an Information Sharing Protocol and an Engagement Protocol which shall apply to both organisations and their external advisers.

45. TfL shall consult with HMG, including agreement of appropriate demand scenarios, as part of its annual budget setting process. Specifically, TfL will, if requested, actively engage with DfT and its advisers in preparing its budgets throughout the Funding Period and fully cooperate with DfT's advisers to enable them to fully review and report to DfT on TfL's final budgets. TfL shall make available to HMG and its external advisers on request relevant financial modelling and plans for the duration of the Funding Period.

46. TfL shall undertake to deliver the requirements of this funding agreement on an open book basis, including full transparency and data provision on reasonable request to HMG.

47. TfL will continue to provide monthly management accounts and cashflow forecast within 10 working days of the Reporting Period end. These will be reviewed by DfT. In accordance with the Engagement Protocol, this may be done with support from DfT's external advisers. Information relating to actual cumulative passenger revenue cash receipts and a calculation (flash report) of the Top Up Grant shall be produced by TfL at the end of each Reporting Period and shall be provided to DfT within 10 business days following the end of each Reporting Period. The flash report will include a weekly closing balance of its Usable Cash Reserves throughout the Reporting Period. This flash report will also report the difference between TfL's cash balances and TfL's Usable Cash Reserves, identifying each third-party grant.

48. TfL will inform DfT of any policy decision outside of its budgets published during the Funding Period where it intends to publicly announce a change which could increase its operating costs or reduce its revenue. TfL will inform DfT at least five business days before such decision is publicly announced. This must clearly set out the impact on costs and revenues for the duration of the period TfL is expected to be in receipt of HMG funding. Whilst DfT respects that operating decisions are a matter for TfL, HMG expects to be informed of proposals such as the permanent reintroduction/ceasing of services and any public consultation that impacts costs or revenues whilst HMG is providing support under the Funding Settlement.

49. Any such policy decisions that result in material service changes, operating cost increases or revenue reductions will not be met by HMG funding and will not amend the Capital or Operating Envelopes as set out in paragraph 15 and **ANNEX A** unless specific consent has been provided by HMG. HMG funding will not be used for policy decisions on which HMG has not been consulted prior to their announcement.

50. To complete the prioritisation of any agreed updating of the safeguarding regime for Crossrail 2, DfT and TfL will enter into an appropriate agreement as soon as reasonably possible whereby they agree to share equally the costs of any statutory blight claims arising from the updated safeguarding regulations for the scheme.

Funding mechanics – see ANNEX C

Overall quantum

51. Based on the Operating Envelope (as set out in **ANNEX A**) and the Capital Envelope (as outlined above in paragraph 15), the overall funding amount will be £598m for the period 30 August 2022 to 31 March 2023 and £565m for 2023/24 (including £589m for TfL not to pursue sale and buy back as set out in para x).

52. These payments will be made in accordance with the payment schedule at **ANNEX E**.

Top Up and True Up process

53. The funding amounts in the Funding Settlement are based on a scenario that passenger demand for each four-week period (Reporting Period) over the Funding Period is at the levels described in **ANNEX B** (the Funding Period Scenario) and take into account the financial effects of delivery of other conditions set out in this letter.

54. Dates for Top Up Grant and True Up payments are set out in **ANNEX D**, together with the mechanism by which any Top Up Grant or True Up payments are agreed.

Cash

55. TfL is to continue to maintain cash balances (that is, cash and liquid investments held by the TfL Group (excluding ring fenced subsidiaries; Crossrail Limited, London Transport Insurance (Guernsey) Limited, TTL Properties Limited and London Transport Museum Limited)) of no more than on average £1.2bn for each quarter, throughout and at the end of the Funding Period, subject to normal commercial payment practices, earmarked third party grants and grant payments (excluding top-up grants) received under this agreement (Usable Cash Reserves). Should TfL exceed an average of £1.2bn at the end of each quarter:

- a. TfL will report to DfT and, if requested, its advisers within eight working days of the end of the quarter on why its Usable Cash Reserves have reached that level and how it plans to return them to an average of £1.2bn within the next quarter; and
- b. No top-up grant will be paid until TfL's Usable Cash Reserves fall below £1.2bn, taken as an average over the quarter. However, HMG may, subject to consultation with TfL and to support the managed return of TfL's Usable Cash Reserves to average £1.2bn:
 - i. adjust the amount of funding provided to TfL under this agreement through varying, including deferring part or all of any future payments under this funding agreement; and/or
 - ii. claw-back any funding already provided to TfL under this agreement in accordance with the formula at paragraph 7 of **ANNEX D**.

56. No payments under this agreement will take TfL's Usable Cash Reserves above £1.3bn at the end of the Funding Period. HMG is willing to reconsider this position at the second quarterly Oversight Group meeting. HMG will consider the case for TfL to build its Usable Cash Reserves, subject to TfL making sufficient progress towards becoming financially sustainable and fulfilling the terms of this agreement.

Governance

57. A Financial Sustainability Group will meet in autumn 2022 to support and assess TfL's progress towards financial sustainability. To inform these meetings, TfL will provide DfT 15 working days prior to the meeting, a detailed report on their progress towards reaching financial sustainability, including progress on demand and passenger revenue, deal terms and risks.

58. An Oversight Group will take place every quarter to provide oversight and assurance of the following elements:

- a. Capital (Renewals and Enhancements, including Major Projects) and Operating Expenditure: TfL will provide a dashboard update on spend against budget for these areas. The dashboard should also include light-touch reporting on improvements and targets related to capital efficiencies, as anticipated in the 2021 Capital Efficiency Plan.
- b. Financial Reporting: a review of TfL's cash balance, Usable Cash Reserves, operating income, passenger revenue, operating costs and pay.
- c. Ongoing Workstreams: TfL will provide a progress report of ongoing workstreams.

59. As part of the Oversight Group, HMG will be able to monitor the progress of the Funding Settlement and act as an escalation point for issues. This meeting will be chaired by a Director at DfT with representation from DfT, HMT, No.10 and TfL. The Strategic and Technical Special Representative will be invited to attend the Oversight Group Meetings. If requested by the chair of the Oversight Group, TfL must provide information that is reasonably necessary to monitor TfL's delivery against the funding settlement and to require TfL to answer questions through oral or written responses and by providing supporting documentation.

60. DfT working level leads will meet with their TfL counterparts ahead of each Oversight Group to review progress on each workstream before updating the Oversight Group dashboard. To

monitor the extent to which TfL decision making is within the spirit of this funding agreement, a Strategic Special Representative and a Technical Special Representative will be appointed by the Secretary of State. The Strategic Special Representative will attend all TfL Board meetings. The HMG appointed Technical Special Representative will attend all TfL Board, Programmes and Investment Committee and Finance Committee meetings, being able to raise questions, request additional information as reasonably required and report back to the Secretary of State on these matters. All relevant papers will be shared by TfL with the Special Representatives as well as a nominated contact in DfT in advance of each meeting. The Strategic and Technical Special Representatives will be invited to attend the Oversight Group Meetings.

61. HMG may consider discontinuing the role of Special Representatives at the end of the current financial year if TfL are on track to achieving financial sustainability in line with HMG's expectation.

62. If a measure that has been agreed in this Funding Settlement has not been met and, following consideration by the Oversight Group of proposals for resolution from TfL, such proposal has either not been agreed or implemented and no alternative action plan agreed, then a "Dispute" will have arisen and shall be addressed as follows:

- a. If a Dispute arises, DfT shall give to TfL written notice of the dispute, setting out its nature and full particulars (Dispute Notice), together with relevant supporting documents. On service of the Dispute Notice, the TfL Commissioner and DfT's Permanent Secretary shall attempt in good faith to resolve the Dispute.

63. If the TfL Commissioner and DfT's Permanent Secretary are for any reason unable to resolve the Dispute within 7 days of the notice being given in accordance with the process at paragraph 62a then DfT will consider TfL's performance and HMG may, acting proportionately and subject to consultation in accordance with section 101 of the GLA Act, adjust the amount of funding provided to TfL under this settlement through varying and/or deferring part or all of any future payments under this Funding Settlement.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Grant Shapps', written in a cursive style.

Rt Hon Grant Shapps MP

SECRETARY OF STATE FOR TRANSPORT

ANNEX A

Operating Envelope

	2022/23	2023/24
Other Operating Income	£1,667m	£1,712m
Operating BRR*	£868m	£785m
Other revenue income*	£121m	£185m
Operating costs	(£7,296m)	(£7,352m)
Finance costs	(£426m)	(£420m)
Net Operating Envelope	(£5,066m)	(£5,090m)

* TfL also received BRR for capital purposes of c.£1bn/annum and other capital income totalling £132m, £126m and £23m respectively. This is not included in the Operating Envelope as it is used to fund capital renewals and enhancements, but this incorporated into the quantum.

The quantum set out in paragraph 51 also reflects expected cash movements assuming TfL maintain a Usable Cash Reserves balance of £1.2bn throughout the funding period.

ANNEX B

Passenger revenue scenario

Quarter	Passenger Revenue
Q1 2022/23 (Periods 1-3)	£1,024m
Q2 2022/23 (Periods 4-6)	£974m*
Q3 2022/23 (Periods 7-9)	£1,041m
Q4 2022/23 (Periods 10-13)	£1,423m
Q1 2023/24 (Periods 1-3)	£1,173m
Q2 2023/24 (Periods 4-6)	£1,183m
Q3 2023/24 (Periods 7-9)	£1,194m
Q4 2023/24 (Periods 10-13)	£1,608m

* for top up purposes, pro rata scenario is £226m between 30/8/22 to 17/9/22

Updates to the passenger revenue scenario

1. As noted in paragraph 42 above, the passenger revenue scenario will be updated annually in line with the fare increase on national rail. The above passenger revenue scenario assumes an annual fare increase of 4% in March each year. To the extent that the national rail annual fares increase differs from this, the scenario above will be updated to reflect this.
2. If the Mayor chooses to increase fares by a different amount, this will be factored into any top up funding provided as set out in paragraph 10.

ANNEX C

Funding mechanics

The Quantum is the net funding requirement taking into account total revenue sources (including the passenger revenue scenario from Annex B), total costs (including the Operating Envelope as set out in Annex A and the Capital Envelope detailed in paragraph 15) as well as cash movements (including prior FY2022/23 period funding and top-ups).

Capital minimum and claw back

1. As noted in paragraph 15, the funding quantum is based on a minimum amount of capital spend for each financial year. TfL can choose to spend more than this amount on capital, however no additional funding will be provided by HMG unless agreed in writing in advance. To the extent that capital spend in any given financial year is below the minimum capital spend this money will be repaid to HMG within 40 working days of the end of the financial year, unless agreed with HMG in advance that this money can be retained and utilized in future years. For the avoidance of doubt, if it is agreed that any funding is allowed to rollover to a new financial year, this amount will not be counted towards that year's minimum capital spend.

Pay

2. As noted in paragraph 11c, we expect TfL to continue to follow public sector pay guidance. Excluding the 2022/23 pay award, TfL's latest budget includes net costs of £18m for assumed pay increases in 2023/24. We recognise that detailed public sector pay guidance is yet to be issued for the second year of the Settlement Period and therefore the operating envelope may need to be reviewed and amended to reflect the cost of that guidance based on the staffing levels assumed in TfL's budget. This will be reflected in the operating envelope at the end of the quarter following publication of the public sector pay guidance and the annual amount will be incorporated in the remaining payments due that financial year.

Inflation

3. The Operating Envelope as set out in **ANNEX A** includes £286m related to the impact of inflation in 2022/23 (of which £106m relates to the London Underground pay award). For the inflation impact not related to the LU pay award (£180m), to the extent that the impact of inflation is +/- £10m from this amount, the operating envelope above may be amended up to a maximum total adjustment of £15m for FY22/23. This can be reviewed at the end of each reporting quarter with information to be provided by TfL no later than 10 working days after the end of the quarter. If inflation forecasts have reduced, DfT can request the following evidence to be provided by TfL within 10 working days of the end of the quarter and any such information must be provided by TfL within 20 working days of such a request. TfL will need to provide evidence against the Level 4 cost line, clearly setting out the previous assumption (as confirmed during the baseline review of TfL's budget), the event that had led to a change in assumptions and the impact this had on the inflation assumption incorporated in the Operating Envelope. Any evidence provided will be subject to review by the DfT (and/or its advisers) to understand/challenge how the numbers have been derived and must reflect the latest OBR forecasts available at the time of the update. Any update required to the operating envelope will be pro rata'd over the remaining payments for the financial year, it will not amend any previous payments.

4. In 2023/24 the Operating Envelope above assumes an inflation impact totaling £132m As noted in **ANNEX C** paragraph 3 above, to the extent that inflation is +/-£10m/annum from the number assumed for the impact of inflation in 2023/24, the impact on inflation in that year may be updated in the Operating Envelope. This update will be considered in the January prior to the start of the financial year. Any update must reflect the latest OBR forecasts available at the time of the update and TfL will be expected to provide evidence in support of such an update against the Level 4 cost line (as confirmed during the baseline review of TfL's budget).

5. At all times we expect TfL to take all reasonable steps to mitigate the impact of inflation on their cost base.

6. For the avoidance of doubt, the quantum as set out in paragraph 51 can be updated for the following items (or as agreed between the parties):

Update	What is updated?	When/How often?	Payments updated	Evidence required
Passenger revenue	Passenger revenue scenario as set out in paragraph 42 to align with the annual national rail fares change	Annually, once the national rail fares are announced	Future years' payments will be updated. To the extent payments in year require updating, this will be confirmed within 20 days of the end of the quarter and this will be incorporated in any remaining payments due that year or, if no payments are due, this will be paid /repaid as a one off adjustment.	Output from fares change confirmed with TfL
Underspend on minimum capital	n/a	Annually	Any underspend must be repaid within 40 working days of the end of the financial year	TfL will need to provide evidence of any underspends they wish to rollover and this will need to be agreed with HMG
Public sector pay guidance	Operating Envelope as set out in Annex A	Annually following publication of public sector pay guidance	The annual amount will be incorporated in the remaining payments due that financial year.	TfL will need to provide evidence of how the public sector pay guidance differs to that set out in their March 2022 Budget
Inflation	Operating Envelope as set out in Annex A	2022/23 – at the end of any quarter 2023/24 annually by January before the start of the year	2022/23 – updates will be pro-rata'd over the remaining payments due that year 2023/24 – Future years payments will be updated	TfL will need to provide evidence against the Level 4 cost line, clearly setting out the previous assumption (as confirmed

				during the baseline review of TfL's budget), the event that had led to a change in assumptions and the impact this had on the inflation assumption incorporated in the Operating Envelope.
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ANNEX D

Top Up process

Dates for payments

1. At the end the first Reporting Quarter of the Funding Period, HMG and TfL will assess whether actual cumulative passenger revenue cash receipts for the Funding Period are in line with the expected cumulative Funding Period Scenario. If the actual cumulative passenger revenue cash receipts are below this level (excluding a de minimis amount of £10m) then the amount of funding under this Funding Agreement will increase to compensate for the shortfall between the actual cumulative passenger revenue cash receipts and the Funding Period Scenario (a Top Up Grant).
2. This Top Up Grant shall be calculated from 30 August 2022 on a cumulative basis every quarter and then paid in accordance with the timescales set out in paragraph 3 of this ANNEX and for every quarter thereafter for the remainder of the Funding Period, until the final Reporting Quarter.
3. Information relating to actual cumulative passenger revenue cash receipts and a calculation of the Top Up Grant shall be produced by TfL at the end of each Reporting Quarter and shall be provided to DfT within 10 business days following the end of each Reporting Quarter. Payment of any Top Up Grant will be made on the twentieth working day of each quarter.
4. In accordance with paragraphs 1 to 3 of this ANNEX, and subject to paragraphs 53 and 54, the following formula will be used to calculate any Top Up Grant payable.
 - The maximum of zero and (Cumulative of Funding Period Scenario Passenger Revenue Cash Receipts – Cumulative Actual Passenger Revenue Cash Receipts – Previous Top Up Grants – (maximum of zero and (Reporting Quarter Average Usable Cash Reserves - £1.2bn)) = Top Up Grant for the Quarter (noting that no Top Up Grant will be payable if less than the De Minimis sum of £10m).

True Up process

5. For the final Reporting Quarter, there will be a process (the True Up Process) to determine any balancing payment of Top Up Grant (True Up Grant) or balancing repayment (True Up Repayment) during the Funding Period.
6. The formula for this final Reporting Quarter shall be:
 - Total Funding Period Scenario Passenger Revenue Cash Receipts – Total Actual Passenger Revenue Cash Receipts – Previous Top Up Grant Payments = True Up Grant (if positive) or True Up Repayment (if negative).
7. After all payments (including any deferred or varied payments) and any True Up repayment by TfL under this agreement have been made, to the extent residual Useable Cash Reserves is greater than £1.3bn, the excess amount over £1.3bn will be repaid by TfL to DfT.
8. The balancing payment by DfT of True Up Grant or by TfL of True Up Repayment will only compensate TfL for any loss caused by passenger revenue income and not losses caused by TfL not managing costs or non-passenger income within the Operating Envelope.
9. The calculation and evidence of True Up Grant or True Up Repayment shall be provided to DfT within 10 working days following the Funding Period. Payment of the final True Up Grant or True Up Repayment will then be made within 20 working days of receipt of that information.

ANNEX E

Payment Schedule

Date	Payment (£m)
2/9/22	140
29/9/22	185
27/10/22	80
24/11/22	15
22/12/22	65
16/3/23	113
Total	598

The payment schedule for FY2023/24 will be agreed between the parties ahead of the start of the financial year.