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SPENDING REVIEW 2015: TRANSPORT FOR LONDON FUNDING AGREEMENT

1. This letter sets out a funding agreement for Transport for London (TfL) for the years 2016/17-2020/21.
2. We continue to have a shared commitment to ensure delivery of the programme of tube upgrades, improvements to London's road network and investment in Crossrail, all of which are essential not just to London, but to the national economy as a whole. The funding agreement set out in this letter supports essential investment in London's transport while encouraging TfL to deliver ambitious plans to further improve its efficiency, so that it can make an appropriate contribution towards necessary savings in public spending.

Basis of funding agreement and reviews

3. For the avoidance of doubt, any years quoted in this letter are financial years. This funding agreement ("SR2015") replaces any other outstanding funding agreements reached for 2016/17 onwards. It sets out my present intentions in relation to the Department for Transport's (DfT) funding of TfL for the years 2016/17-2020/21.
4. It also sets out the basis on which the Spending Review settlement has been drawn up. Except where otherwise expressly indicated, this letter sets out the totality of DfT grant and borrowing support for TfL for 2016/17-2020/21. Although it is my firm intention as Secretary of State to provide the support on the basis described, no commitment is given since I cannot fetter my ability, or that of a future Secretary of State, to determine final grant levels as I see fit in response to relevant considerations.
5. This settlement has been determined after discussion with you, as Mayor, and with TfL officials, and takes into account, amongst other things, what you have told me about TfL's existing and anticipated spending commitments and potential revenue during this period.

Context of the 2015 Spending Review

6. It is our shared intention that TfL will manage the financing of the activities across its business and estate within the levels of borrowing and grant funding set out below, and taking into account its other sources of income, including income from fares and non-domestic rates retained by the Greater London Authority (GLA) under the Business Rates Retention (BRR) scheme. These activities include:
- TfL's transport and corporate activities;
 - Pensions;
 - TfL's obligations toward third parties;
 - PFIs;
 - TfL's Crossrail contribution; and
 - The funding of the Independent Investment Programme Advisory Group.
7. To be assured that the financial support provided to TfL delivers value for money to the taxpayer and to provide independent assurance of TfL's Investment Programme, this settlement assumes your continued commitment to the Independent Investment Programme Advisory Group (IIPAG) in line with the Terms of Reference agreed in SR2010.

Funding Settlements

8. My firm intention is that, subject to the final grant determination process and taking into account the matters raised below, my Department will provide funding to TfL over the period to 2020/21 as set out in table 1 below.

Table 1: summary of funding intentions (all figures in £m cash)

	2016/17	2017/18	2018/19	2019/20	2020/21
Investment grant (CDEL)	944	960	976	993	1,010
General grant (RDEL)	447	228	0	0	0
LOROL grant	27	27	27	27	0

Other funding

Borrowing

9. TfL's borrowing to fund capital expenditure is to be contained within the profile in Table 2 below. Whereas in previous settlements the borrowing limit set in each year was available for use in that year only and could not be rolled over to future years, HM Treasury has confirmed that TfL will in the financial years 2016/17 onwards be able to defer borrowing from one year to the next until they need it, provided they inform the relevant HMT officials at least eight weeks ahead of the end of the financial year that they intend to delay borrowing from that year to the next.
10. TfL will also be allowed to borrow for short-term working capital in line with other local authorities as set out in the CIPFA Prudential Code. Otherwise borrowing is only to be

used for capital investment. It remains my expectation that TfL will not undertake borrowing in advance of need.

11. In conjunction with these new flexibilities, TfL should continue to engage with the OBR on a six monthly basis and seek to share short-term projections to help enable more accurate forecasts of borrowing and expenditure.

Table 2: TfL prudential borrowing limits

£m (cash)	2016/17	2017/18	2018/19	2019/20	2020/21
TfL borrowing	730.5 ¹	900	500	500	600

12. No further borrowing should be undertaken without specific agreement from HM Treasury. Guidance on interpretation of borrowing limits and PFI accounting treatment is set out at **Annex A**.

Deliverables

13. This settlement has been drawn up on the basis that these funding and borrowing limits will allow TfL to take forward its investment programme and deliver **the milestones listed at Annex B**. While the part 1 milestones are settled, we have agreed that the part 2 milestones reflect the progress you intend to make with your current delivery programme, noting that some reprioritisation will be needed to reflect the outcome of this settlement. We will therefore agree a revised list of milestones as part of the annual grant determination process for the 2016/17 grant, by which time TfL will also have prepared its annual budget to reflect the outcome of this settlement.

Elizabeth Line

14. The Elizabeth Line project is a key priority and we look forward to working together with you, as our co-Sponsor, to deliver the project successfully with full services on what will by then be called the Elizabeth Line commencing in December 2019. This letter does not affect or amend any of our respective funding commitments as set out in the latest version of the Crossrail Project Development Agreement.
15. On 31 May 2015 Stage 0 of the Elizabeth Line was successfully achieved as Greater Anglia franchise services between Liverpool Street and Shenfield transferred to a TfL concession. You will therefore now receive an additional source of income from the "Crossrail East" fare box, which will help to offset the reduction of your General Grant. I have taken this into account in making this settlement.
16. You will also receive additional income from the Elizabeth Line, farebox as further services transfer to the Elizabeth Line concessionaire ahead of full operations in 2019/20. I have taken this additional income into account in determining the overall

¹ Increased from £700m to allow £30.5m of additional borrowing for the Croxley rail link

settlement, and do not anticipate the need to adjust your annual grant to reflect it. In determining future Spending Review settlements, the income received by TfL for the Elizabeth Line will inform future discussions alongside all other inputs to that process put forward by both DfT and TfL.

Elizabeth Line extension to Reading

17. The existing agreement between the Elizabeth Line Sponsors which was intended to ensure that the Department is held financially neutral from the decision to extend the line from Maidenhead to Reading is outside the scope of this funding agreement. The details of this were set out in the letter of 22 December 2014 from Clare Moriarty (DfT) to Steve Allen (TfL). In any event, a new mechanism for payment will need to be agreed to account for any loss to the Department from 2019/20 onwards, as the “general” (RDEL) grant will be zero in those years.

Greater Anglia rail services

18. Since 31 May 2015, TfL has been responsible for providing rail services on the “West Anglia Inner” lines. In 2015/16, the Department adjusted TfL’s grant downwards by £6.3 million to reflect the additional income it expected to receive from these services. This was a “full and final” settlement, and I do not envisage any further need for grant adjustments to reflect the additional income you will continue to receive from operating these services.

19. As agreed between our officials earlier in 2015, I have increased your investment grant by £3m a year (a total of £15m over the SR period) to reflect the poor condition of some of the stations and other assets on the West Anglia route that TfL took over as part of the deal.

London Overground (LOROL)

20. Since April 2007, my Department has made a regular grant payment to TfL in support of the operation of the former “Silverlink Metro” network – as set out in the DfT/TfL grant memorandum, dated 13 February 2006. For the 2015/16 financial year, this was worth £31,162,886 and the four-weekly instalments to reflect this will continue to be made until March 2016.

21. As discussed between our officials, our intention is that this payment (“the LOROL grant”) should, from 2016/17 to 2019/20, be paid alongside the TfL General Grant. In relation to the LOROL grant, we have agreed a 15% reduction as part of the SR15 process. We judge this level of reduction to be reasonable and sustainable, and consistent with the support we will be providing to other devolved transport authorities in support of their local rail networks. The total value of the grant will therefore be £27,071,000 per annum from 2016/17 to 2019/20, and it will be paid alongside your GLA transport grant during those financial years on a fixed basis, as set out in table 1 above.

22. In the Department’s view, by the end of 2019/20 the former “Silverlink Metro” services will be sufficiently financially viable to no longer warrant any subsidy from Government. In the light of this the Department considers that it would be fair and

reasonable to discontinue the grant from that time. It is therefore the Department's intention that payments will cease entirely after the end of the financial year 2019/20.

Possible further devolution of rail in London

23. As our joint prospectus, published on 21 January, makes clear, we are both interested in the principle of your becoming responsible for more rail services in London as part of a partnership between us to further improve the services that passengers experience. This is a topic that we will continue to discuss, including the practical, financial and governance implications.

24. Future rail devolution is an issue outside of this Spending Review and the scope of this letter. The terms of any future rail devolution must ensure that the Department is held financially harmless.

Changes to Network Rail funding

25. The productivity plan, published alongside the Chancellor's 2015 summer Budget, announced plans to change the way Government provides public money through the rail industry. Nicola Shaw is also due to complete her independent report on the future shape and financing of Network Rail shortly, and the Government will respond to her recommendations in due course. Should changes resulting from either of the above have any material impact on TfL's finances, my Department will engage with the relevant TfL officials to agree a way forward.

Croxley Rail Link

26. It is my expectation that, having regard to the funding under this settlement and all other sources of funding available to TfL, the Croxley Rail Link (Metropolitan Line Extension) project - including civil engineering works, systems and the procurement of additional rolling stock – is completed and brought into service, with a forecast date of December 2020. TfL's borrowing limits have been increased in 2016/17 to facilitate this, as set out in table 2 below.

London Underground modernisation

27. This settlement assumes that you will continue with the Tube Modernisation Programme in order to support TfL's wider efficiency programme, and will introduce the Night Tube in order to deliver benefits for London's night-time economy.

2016 rail fares package

28. The Government has made a commitment that rail fare increases nationally will be held at RPI inflation over this parliament. This settlement assumes that TfL's income from fares in London will rise broadly in line with your Business Plan assumptions, and the settlement will not be adjusted to take account of any future decisions made by the Mayor on fares.

Crossrail 2

29. I am supportive of further joint work to push forward with plans for Crossrail 2, as set out in our manifesto. As you will be aware, the Chancellor has asked the National Infrastructure Commission to provide advice on future large-scale investment in London's transport infrastructure by Budget 2016. This will include consideration of Crossrail 2.

30. This settlement does not include any funding for the development of Crossrail 2, but I will consider whether to make a contribution of funding for Crossrail 2 development once the Commission has reported. The decision, alongside all other relevant circumstances, will take account of the Commission's advice and the Government's assessment of the medium-term priorities for transport investment. Any funding would be separate to your overall grant and would come from the new £300 million Transport Development Fund I am establishing. Any money released from this fund will be conditional on your agreeing with my Department a joint programme of work; roles and responsibilities, a clear set of key deliverables; and approval gates. I expect TfL to continue to work with my officials to ensure that a robust and credible programme is prepared.

Other "asks" of TfL

Air Quality

31. Poor air quality in London is a significant public health challenge. The National Air Quality Plan, published on 17 December 2015², sets out how compliance with the Air Quality Directive will be achieved across the UK. . As stated in the Plan, the following measures are required in London to ensure compliance with the relevant air quality limit values by 2025 at the latest, and sooner if possible:

- the ultra-low emission zone (ULEZ) needs to be implemented in full;
- the entire bus fleet needs to meet the Euro VI standard;
- the entire black cab fleet needs to become zero-emission capable; and
- a London-wide Clean Air Zone needs to be introduced by 2025, requiring buses, coaches, heavy goods vehicles and vans to comply, as a minimum, with Euro VI/6 emissions standards.

32. The Government expects you to proceed with all of these measures using the resources that are being made available to you as part of this settlement. Should this not be possible, the Government will consider other options including allowing you to put in place a package of jointly agreed measures to ensure that compliance is achieved by 2025.

33. As announced at the 2014 Autumn Statement, £10m of capital funding will be provided to increase the uptake of ultra-low emission vehicles in London. This is in addition to the investment grant sums listed in table 1 above. In 2016-17 you will make

² "Improving air quality in the UK: tackling nitrogen dioxide in our towns and cities", UK overview document, December 2015. Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/486636/aq-plan-2015-overview-document.pdf

a formal agreement with the Office for Low Emission Vehicles on when, and for what purposes, this funding will be awarded between 2017-18 and 2019-20. I was pleased to announce recently the award of £13m to London as part of the *Go Ultra Low* city scheme. I would also welcome bids from London for the various other schemes which the Office for Low Emission Vehicles supports as part of its £600m Spending Review programme. These include the Low Emission Bus scheme and the Ultra Low Emission Taxi scheme— as well as future support for charging infrastructure.

Wifi/4g on tube

34. You have agreed that TfL will continue to discuss with the Home Office options for delivering the necessary infrastructure to allow wifi/4g to be rolled out across the tube network by a date to be mutually agreed, subject to reviewing the value for money of this for the public sector as a whole.

Buses for Free Schools

35. You have agreed that TfL will continue to support new free schools, as well as variants of free schools such as studio schools and university technology colleges, by continuing to make appropriate provision for operating buses to serve them without seeking to reclaim the costs from the schools in question.

Other financial flexibilities

36. We agree in principle that TfL should be allowed to hedge risks that it is indirectly exposed to, for example the price of diesel for its bus contracts. The approach to each commodity hedge should be agreed in advance with the Treasury.
37. HMT will also continue to work closely with TfL and the Department to explore granting TfL some other financial flexibilities. My officials will discuss the detail of this with TfL.
38. Separate discussions are continuing between our officials on the question of whether TfL might also be able to temporarily draw upon some of the Crossrail cash balances held in the Crossrail Sponsor Funding Account (SFA).

Business Rate Retention

39. Since April 2013, TfL has received a proportion of funding through the Business Rate Retention (BRR) scheme, in which the GLA passes TfL an agreed share of locally retained business rates, including an amount to reflect changes to the payment of BSOG introduced in 2013. My expectation is that this funding stream will continue to be made available by the GLA to TfL and that it will increase each year in line with the Retail Price Index.
40. The Chancellor has announced that from 2020, 100% of Business Rates will be devolved to local authorities, and the Government will be consulting on the details of this in due course. One of the options to be consulted on is the potential for the Mayor of London to receive additional income from retained Business Rates to replace TfL's

capital investment grant. The Department will work with TfL and the GLA on the details of this proposal.

Bus Service Operators Grant

41. For the avoidance of doubt, this settlement includes an amount for the Bus Service Operators Grant (BSOG), as described in the SR13 settlement letter.

Supporting TfL efficiencies and commercial development

42. The Government is committed to supporting you in the delivery of TfL's efficiencies programme and commercial development income, particularly where legislative changes may be needed.

Future Reviews

43. As Secretary of State, I reserve the right to review this SR2015 settlement if there is significant deviation from the commitments referred to above or if TfL does not meet its existing funding commitments set out in the Crossrail Project Development Agreement. The settlement may also be subject to review in the context of a further government Spending Review or other wider pressures on the Department's finances or those of the Government as a whole.

44. In any future review, the Secretary of State will take all relevant circumstances into account including:

- a) Delivery of the transport infrastructure milestones listed in Annex B;
- b) Adherence to the agreed borrowing limits listed below in this letter;
- c) The extent to which TfL has managed its business and estate, including the use that TfL and the Mayor have made of their capacity to raise further income and reduce expenditure; and the extent to which any exceptional pressures on TfL's budget could have been, or can be, prevented or alleviated by them;
- d) DfT's public expenditure position and other pressures on the Department's budget and the finances of the Government generally;
- e) Whether TfL has met its existing funding commitments and obligations in relation to the Crossrail project;
- f) Amounts available for the GLA to transfer to TfL under the BRR scheme; and
- g) The proposed further devolution of business rates in London.

45. I acknowledge that in order to achieve some of the milestones efficiently, TfL will need to enter into contractual commitments that extend beyond 2020/21. Where TfL have obtained approval from the Department and HM Treasury for significant commitments that extend beyond 2020/21, the Government will take account of these when considering levels of grant and borrowing headroom in future Spending Reviews.

Oversight of TfL

46. TfL is now receiving more and more of its income from a wider and more diverse range of sources, including the farebox, Business Rates, and its commercial development programme, and this trend is set to continue. It will be important to ensure that the current audit and scrutiny arrangements remain fit for purpose given these changes, and I have written to you separately with some thoughts on this.

A handwritten signature in black ink, appearing to read 'Patrick', with a stylized flourish above the 'P'.

RT. HON. PATRICK McLOUGHLIN MP

ANNEX A: GUIDANCE ON INTERPRETATION OF BORROWING LIMITS AND PFI ACCOUNTING TREATMENT

The borrowing limits set out in this letter relate to net additions to borrowing, or other on-balance sheet liabilities, across the TfL Group. Within these overall limits, TfL should manage its liabilities as it sees fit; this may include swapping finance leases (as measured for National Accounts purposes) with borrowing undertaken at the TfL level, subject to there being no overall increase in liabilities across the TfL Group.

Following the adoption of IFRS from 2009/10, HM Treasury has prepared guidance for central Government Departments regarding the budgetary treatment of PFIs. In determining whether PFI transactions undertaken by TfL or its subsidiaries score within the borrowing limits, TfL should take account of the impact of those transactions on the National Accounts rather than the accounting treatment under IFRS. To determine whether a particular transaction should be treated as on or off balance-sheet for National Accounts purposes, TfL should follow the guidance on HM Treasury website: "Consolidated Budgeting Guidance" which is updated each year. TfL should consult with the Department if there is any uncertainty Accounts purposes, TfL should follow the guidance on HM Treasury website: "Consolidated Budgeting Guidance" which is updated each year. TfL should consult with the Department if there is any uncertainty over the interpretation of this guidance. Contracts signed before 2009 will continue to be treated as they were under UK GAAP (as a proxy for the National Accounts framework of the time) for budgeting purposes unless there is a material change to the relevant PFI contract, at which point the PFI contract should be reassessed against the latest framework (currently ESA10) and following the guidance on HM Treasury website "Consolidated Budgeting Guidance".

The Department is aware that changes to the treatment of leases under IFRS are under consideration. No decisions have yet been taken on how such changes, if they were to come about, would affect budgets and borrowing limits in the public sector.

ANNEX B: INDICATIVE INFRASTRUCTURE AND SCHEME DELIVERY MILESTONES

ITEM	MILESTONE	DATE
Part one: agreed milestones		
1.	Roll out of new air conditioned trains on the District line complete.	2016
2.	16% of track on Bakerloo, Central, Victoria and Sub Surface lines replaced since 2010, to replace life-expired assets and support service reliability and capacity improvement works.	2016
3.	Completion of Phase 1 of Structures and Tunnels Investment Programme which involves major renewal and replacement works on the Capital's most important bridges and tunnels including Highbury corner, Ardleigh Green Bridge, Power Road, Upper Holloway and Fore Street Tunnel.	2017
4.	Tottenham Court new passenger facilities open, including new entrances to the station and new ticket hall.	2017
5.	Victoria Station Upgrade – Northern ticket hall complete, including step-free access to all platforms via lifts.	2017
6.	Bond Street station upgrade complete, including a new station entrance and step-free access to all platforms.	2017
7.	Split Cycle Offset Optimisation Technique (SCOOT) operates at traffic signals to make sure the signal timings adapt to live traffic conditions, keeping delays to a minimum. A further 1,500 sites will be completed for a total of 4,500, covering approximately 75 per cent of all traffic signals.	2018
Part two: longer term milestones to be progressed through period to 2021, to be reviewed as part of 2016/17 annual grant determination process		
8.	Progress TfL's Road Modernisation Plan to ensure road assets are fit for the future, including major highways enhancements and phase 2 of the Structures and Tunnels Investment Programme to improve reliability of the road network and reduce congestion.	
9.	Progress investment to deliver improvements in London's air quality, through new infrastructure to enable and incentivise cleaner vehicles.	
10.	Progress the delivery of additional capacity on the existing Rail & Underground network through line upgrades and additional capacity programmes (e.g. Sub Surface Four Lines Modernisation).	
11.	Progress the delivery of key Rail and Underground station congestion and interchange schemes to improve passenger flow (including accessibility benefits) and facilitate additional capacity delivered through the line upgrade programme (e.g. Victoria).	
12.	Progress a number of key line extensions to add new capacity to the Rail & Underground network (e.g. Crossrail, Northern Line Extension, Metropolitan Line Extension, Barking Riverside)	
13.	Deliver a programme of Rail & Underground core asset renewals which focuses on the provision of safe and reliable services for customers.	