

**Bus Franchising Consultation Document  
MSA response to the Independent Assurance Report**



Subject	Commentary	MSA Response
<p>Financial and Economic Assessment – Uncertainty in Forecasting</p>	<p>We are satisfied that the affordability and value for money analysis has been developed with appropriate care by suitably qualified experts and that the process was robust and in accordance with current guidance. However, it should be noted that variabilities always exist within this type of analysis and may impact on the financial forecasts and economic benefits of this Assessment.</p> <p>Throughout the Assessment, the Authority has reviewed available data and information sources, developing a set of baseline assumptions that have been used in the modelling of the franchising scheme, impacting both the economic and financial modelling. We acknowledge that economic modelling of this nature is inherently subjective and that reasonable practitioners may reach different conclusions when applying judgement to complex forecasting inputs. Our observations should therefore be read in that context.</p> <p>Whilst we understand the assumptions selected, due to a lack of contemporary industry data, we consider that there is an inherent risk that the outturn position would in practice be less favourable than the modelled scenario presented. In particular, while we acknowledge that there will be benefits derived from branding and marketing, the exact value of these are uncertain.</p> <p>We note that a sensitivity test has been run at a lower benefit level, more aligned to our professional view of a reasonable set of assumptions, and that under this sensitivity the economic case continues to demonstrate a value for money (VfM) outcome that remains sufficient to support the investment decision, albeit at a lower level. Should the lower sensitivity position materialise in practice, this would have an impact on the affordability position of the Assessment as discussed in our Observation in respect of the additional investment need, below. This financial risk is one of a wider set of financial risks inherent to bus franchising, which the Authority has considered in its Assessment. We would emphasise that forecasting and appraisal of this type is, by its nature, forward-looking and subject to a degree of uncertainty that cannot be fully eliminated.</p>	<p>The North East Mayoral Strategic Authority (MSA) notes the auditor’s confirmation that the underlying methodology is sound, is consistent with the latest applicable guidance, has been carried out by suitably experienced specialists and that the observation does not call into question the integrity of the approach.</p> <p>The MSA also notes the auditor’s acknowledgement that sensitivity testing with regard to branding and marketing impacts has been run at a lower benefit level and that under this sensitivity the economic case continues to demonstrate VfM. Were this scenario to materialise, franchising remains affordable.</p> <p>The MSA also notes the observation that there is a lack of contemporary industry data associated with branding and marketing interventions, and that inherent uncertainty exists in analysis of this nature.</p> <p>The MSA retains confidence in the assumptions that have been deployed in the FSA as the analysis undertaken is in line with Treasury Green Book requirements and this particular assumption is supported by qualitative analysis and experience from Tranche 1 of the Transport for Greater Manchester bus franchising scheme launched in 2023. This analysis suggested part of the bus demand growth was due to soft factors such as branding and marketing and of a magnitude in line with what has been assumed for the FSA.</p> <p>The auditor’s recommendation that the team continues to monitor actual outcomes against forecast benefits, revisits key assumptions at appropriate review points, and ensures affordability considerations are kept under regular review is accepted and such reviews fall within and will be undertaken in accordance with established processes as part of the MSA’s Single Assurance Framework.</p>

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	<p>The underlying methodology is sound, is consistent with the latest applicable guidance, and has been carried out by suitably experienced specialists. Our observations do not call into question the integrity of the approach adopted but rather reflect the inherent limitations of long-range forecasting and the sensitivity of the outputs to key assumptions. We recommend that the team continues to monitor actual outcomes against forecast benefits, revisits key assumptions at appropriate review points, and ensures affordability considerations are kept under regular review.</p>	
<p>Investment need presented within the Assessment</p>	<p>The Financial Case notes that an additional investment need of £83.8m is required over the first 10 years of franchising and identifies possible funding sources to cover this, noting that the central assumption is that this can be met from the Integrated Settlement. There is more limited reference made to the larger 30-year additional investment need of £334.1m.</p> <p>For modelling purposes, the Integrated Settlement has been assumed to continue across the first 10 years of the franchising period, with a similar mechanism assumed to be available for the remaining 20 years. However, the current Integrated Settlement is due to end during the initial franchise term, having been set for an initial period covering 2026 to 2030, which will result in a need for alternative funding to be identified beyond this period (noting that a need to identify funding would apply in both the franchised and EP scenario). In the event that alternative funding is not identified, the FSA acknowledges that the Authority would need to explore potential solutions, which either be to increase funding, or to make adjustments to the bus service in terms of network, fares and levels of service to ensure long term affordability. However, it should also be noted that if a decision to change services were made, some savings would not be immediate and may be limited.</p>	<p>The MSA confirms that the investment needed for franchising over the appraisal period of 30 years has been assessed robustly and presented within the FSA (see section 7.2, Figure 9, and section 7.4, Table 17). It has been established that the funding sources available to the MSA are sufficient to cover the identified investment need.</p> <p>Whilst true that the current Integrated Settlement is timebound, this is applicable to all grant funding originating from central government and represents a longer term funding source than others. Comparable funding sources have however been in place in the long term. This funding uncertainty also exists and is managed under the current Enhanced Partnership arrangements to fund significant investment in the bus network (public funding accounts for around 51% of operator income). Furthermore, the English Devolution and Community Empowerment Act 2026 provides a framework which enables the long-term commitment from central government to provide devolved areas, such as the MSA, with long-term, consolidated and flexible funding. Alongside government policy associated with the Act, it creates an expectation that government will match devolved powers with devolved budgets. Therefore, whilst the Integrated Settlement is time-limited, it is reasonable to expect that a similar funding settlement will be agreed for future periods.</p> <p>The MSA confirms that additional narrative has been added in the “franchising and call for investment conclusion” of the financial case summary section of the Consultation Document, strengthening this area of the financial case, and including the risk of the Integrated Settlement (albeit highly unlikely) not being guaranteed.</p>

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<p>Identified financial modelling discrepancy</p>	<p>During our review of the financial models supporting the Assessment, we identified a formula error within the staff cost calculations. While the correct input assumptions were included within the financial model, a calculation error meant these were not included within the total of the investment need. The excluded costs amount to approximately £2.3m (unindexed) per annum, resulting in a cumulative additional investment need of approximately £29.8m (indexed) over the period to 2038/39 and £104.9m (indexed) over the 30-year appraisal period.</p> <p>We consider it appropriate to treat this as non-material for the purposes of this Assessment for the following reasons:</p> <ul style="list-style-type: none"> <li>• The existence of an additional investment need was already acknowledged within the Assessment; the omission increased its scale but did not alter its nature or the conclusions drawn regarding the affordability of the Assessment.</li> <li>• The Assessment already accepts that the additional investment required will need to be met from sources not yet fully identified, and this additional sum falls within the same category.</li> </ul> <p>The discrepancy has been subject to appropriate scrutiny by the management team, including the Statutory Section 73 Officer, who has confirmed that the ultimate affordability gap remains within the parameters of the potential funding sources identified in the Assessment.</p>	<p>The MSA confirms that whilst the costs associated with additional staff required for Franchising (less than 1% of the overall bus industry annual operating costs) have been included in the model inputs as well as presented in the FSA (page 281, Table 13), due to a financial modelling discrepancy, these have not carried through correctly into the calculation of the overall investment need presented in the FSA. The financial model has been updated, and the updated investment need is set out in the Consultation Document (financial case executive and full summary sections) which clearly highlights where the information differs from the information in the FSA.</p> <p>The Consultation Document sets out the updated total additional cost of franchising both over the 10 year period (£113.0 million) and the 30 year appraisal period (£437.8 million). The MSA notes the auditor’s opinion that this does not represent a material impact on the overall conclusions of the FSA regarding affordability and value for money, and franchising remains better placed to deliver the region’s strategic objectives.</p>
<p>Establishment of Delivery Body arrangements</p>	<p>The implementation of Franchising depends significantly on the establishment of new Delivery Body arrangements. Importantly, the establishment of these arrangements falls outside the scope of the Assessment and is being progressed separately. This represents a material dependency: without a properly structured and adequately funded delivery approach, the strategic objectives and wider benefits of bus franchising cannot be realised.</p>	<p>The MSA agrees that establishing effective Delivery Body arrangements is critical to the implementation of a Bus Franchising Scheme and that a separate workstream, set out in the March 2026 North East MSA Cabinet report entitled ‘Bus Reform: approval to progress the Franchising Scheme Assessment’ in relation to this was approved and the workstream is underway.</p> <p>As described in the Cabinet Report, a Transport Delivery Body Transition Board has been established, chaired by the Chief Executive of the North East MSA and comprised of the officers responsible for the development of bus services across the region (from the North East MSA, Durham CC, Northumberland CC and Nexus) to oversee the work that is underway on the development of this Delivery arrangements, including funding, will be presented to Cabinet for approval. .</p>

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BSIP and Secured services funding	<p>In calculating annual BSIP and Secured Services income, the Authority has used confirmed 2024/25 values, rather than 2025/26 values, as the final values relating to that financial year had not been confirmed at the time the modelling was undertaken. It is noted that draft 2025/26 values were included (but not used) within the financial model. Instead, the 2024/25 values have been used, and have been assumed to increase annually at RPI.</p> <p>The difference between the agreed 2024/25 and draft 2025/26 values is significant. Extrapolated across the entire modelled term, this would significantly reduce the investment need required by the Authority to fund bus franchising. The use of the 2024/25 figures represents a prudent approach by the Authority and it is positive to acknowledge a degree of unmodelled upside that could potentially be used to counteract possible downsides identified in the franchising case.</p>	<p>The MSA notes the observations that the approach taken to BSIP and Secured Services Income funding is prudent and may have materially underestimated the amount of funding available for bus franchising, and is positive in providing a degree of unmodelled upside that could potentially be used to counteract possible downside scenarios identified in the franchising case.</p> <p>This will be kept under review if a decision is made to implement franchising.</p>
Operator Data in respect of small and medium operators	<p>The operator data received by the North East MSA is, in places, of inconsistent quality, particularly in respect of small and medium sized operators (SMOs). It is acknowledged that this is consistent with the challenges experienced by other authorities in gathering operator data for the purposes of assessing franchising. To address this issue, the North East MSA has considered data from both large operators and SMOs in aggregate, and, due to the issues in SMO data quality, has not been able to fully assess the differences in cost base of SMOs in comparison to a large operator. While this only represents approximately 11% of service mileage and 13% of Peak Vehicle Requirements, SMOs can represent disproportionate amounts of specific classes of services - for example school services.</p> <p>The Authority should ensure that, should it proceed to implement franchising, a detailed procurement plan is developed that gives specific consideration in respect of SMOs, with regards to contract sizes, pricing assumptions, and procurement qualification thresholds, to ensure the specific characteristics of SMOs are taken into account.</p>	<p>The impact on small and medium-sized operators (SMOs) has been robustly considered throughout the FSA, for example in section 5 of the commercial case. While operator data quality was variable in some areas, as is common with SMOs, this was recognised and addressed through the use of aggregated data across both large operators and SMOs, alongside other best practice methodologies to deal with gaps and variability in data. A comprehensive understanding of the SMO market (including data) has been built into the analysis through the experience of Nexus, Northumberland County Council and Durham County Council who currently contract SMOs to provide secured services and consequently have detailed knowledge of the regional SMO market.</p> <p>The MSA confirms that should a decision to implement franchising be made, a detailed procurement plan will be developed that gives specific consideration in respect of SMOs, as required by guidance and legislation.</p>
Franchising objectives	The Strategic Case sets out a range of objectives and associated outcomes and measures intended to support the comparison of	Six strategic objectives are established in the strategic case. These were developed with close reference to the MSA's policy framework – in particular the

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	<p>franchising with the Enhanced Partnership, alongside a capability-based argument that franchising is better placed to achieve these objectives.</p> <p>However, the definition of objectives and measures in some instances could be developed further to add additional clarity around SMART (Specific, Measurable, Achievable, Realistic, Time bound) characteristics (a requirement of the Guidance), and the use of at least one self-referential measure defined relative to the reference case being assessed.</p> <p>While this does not impact upon our conclusion with regards to the Assessment, incorporating these findings would provide for a strengthened Strategic Case that more clearly articulates why franchising performs better than the EP against these objectives. The Authority should ensure that, should it proceed to implement franchising, a detailed procurement plan is developed that ensures it aligns with the delivery of SMART objectives.</p>	<p>region’s Local Transport Plan and its ambition to create a green, integrated transport network that works for all. 13 intended outcomes complement the objectives, each of which is presented alongside a measure.</p> <p>As these objectives include measures which are Specific, Measurable, Achievable, Realistic and, Timebound, the MSA considers that the objectives set are sufficiently ‘SMART’ for their intended use in the FSA which is to enable an objective and informed comparison. It should be noted however that these objectives can only be finalised if the decision is taken to introduce a franchising scheme as the baseline for these objectives would be set from the implementation date.</p>
<p>Agglomeration benefits</p>	<p>The approach to calculation of agglomeration benefits is not strictly in line with DfT Transport analysis guidance (TAG) and uses a bespoke method that should only be seen as an approximation. Specifically, this bespoke method uses the estimated change in generalised cost for bus users in place of the change in generalised cost for all transport users, which could over-estimate benefits.</p> <p>Although the implication of this is not likely to be material to overall conclusions of the Assessment, in our view the business case would be strengthened by noting explicitly this divergence from DfT TAG.</p>	<p>The MSA notes that the auditor’s observation that the implication of this methodology is not likely to be material to the overall conclusions of the FSA. A bespoke method was applied as an alternative to complex modelling; this was judged to be appropriate and proportionate for impacts which are likely to be marginal and not materially impact the VfM.</p> <p>Furthermore, it is noted that agglomeration benefits only impact the ‘adjusted’ benefit-cost ratio (BCR); it does not impact the core BCR which only includes the monetised transport benefits.</p> <p>If the calculation of agglomeration benefits was adjusted to be aligned with TAG, this would only have a marginal impact on the ‘adjusted’ BCR and the franchising scenario would still represent ‘medium’ value for money (VfM),</p>
<p>Depot acquisition</p>	<p>The Commercial Case identifies depot acquisition as a critical dependency for the successful implementation of franchising and recognises the associated delivery risks. However, it does not clearly demonstrate how the Authority has assured itself that proposed contingency approaches, including the potential use of compulsory</p>	<p>The MSA notes the auditor’s observation and confirms that should a decision to proceed to franchising be made, a detailed acquisition plan in respect of depots will be developed, which would be implemented by the MSA and will include further detail on the deliverability of proposed contingency approaches (including any related legal processes) and will build on lessons learnt from other authorities that have implemented or are in the process of implementing bus franchising.</p>

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	<p>purchase powers, are legally robust and practically deliverable within the proposed transition timescales.</p> <p>The acquisition of depots is a critical enabler of franchising, without which, such a transition is unlikely to be feasible. It is acknowledged that this is consistent with the position of other authorities seeking to introduce franchising. Should the decision to proceed to franchising be made, a detailed procurement plan in respect of depots should give appropriate consideration to analysis of feasibility, precedent, timescale or risk in relation to depot acquisition contingencies.</p>	
Benefits from improved bus priority and bus stops	<p>The financial forecasts in the Financial Case incorporate a significant uplift in overall bus demand resulting from bus priority measures (2%) and bus stop improvements (2%). Based on additional evidence presented through our process of clarification questions, we are aware that, although not material to the assessment, the justification given within the FSA for the assumption did not accurately reflect why the amounts had been modelled.</p>	<p>The MSA notes the auditor's observation that this is not material to the FSA. As acknowledged by the auditor, further evidence was presented through the clarification question process. A broad assumption of the impact of these measures (2% for each programme) was applied in the FSA rather than model the impact on individual services/corridors. This assumption was sense-checked against outturn evidence of similar schemes and the MSA therefore consider the assumption to be appropriate.</p>
Typographical errors within the Financial Case	<p>The Financial Case contains typographical errors that, while not impacting on the outcome of the Financial Case (as the financial modelling itself utilised the appropriate figures), would benefit from being amended to aid clarity and readability of the case. In particular, we would note that:</p> <ul style="list-style-type: none"> <li>• Section 2.2.3 of the Financial Case states that "£11.2 million is used to operate and subsidise services that are not seen as commercially viable by the commercial operators". This figure should have been stated as £13.5m</li> <li>• Section 4.4.13 of the Financial Case states that "ENCTS patronage is forecast to reduce by 22%". This figure should have been stated as 43%</li> </ul>	<p>The MSA confirms these are typographical errors in the narrative of the FSA and that the correct figures have been used in modelling. It is confirmed by the MSA as acknowledged by the auditor that these typographical errors do not have an impact on the outputs and conclusion of the Financial Case.</p>
Residual value mechanism for fleet	<p>Section 6.3.17 of the Financial Case states that ongoing fleet investment in the franchising case is assumed to be the same as in the current EP. The Authority has confirmed that they consider the introduction of a Residual Value mechanism with regards to the transfer of fleet from one</p>	<p>This observation is noted and the MSA will work through the exact nature of any Residual Value mechanism if a decision to implement the proposed franchising scheme is made, in order to address this risk.</p>

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	<p>operator to another will have no impact on the modelled costs of the Authority. While the exact nature of any Residual Value mechanism is yet to be defined, it should be noted that it is considered likely any such mechanism would result in the Authority assuming liability for the fair value of vehicles, which, if the network were to be reduced in scale during franchised operations, the North East MSA would be expected to meet, which could impact on the available funding of the Authority for other purposes.</p>	<p>The FSA models no reduction in the scale of the network over the first 10 years of franchising. Should decision makers decide to reduce the network thereafter, a long planning period for such change, as well as the likely small and gradual scale of any reduction, would make management of the fleet / residual value impacts manageable.</p> <p>We note that some other CAs have chosen to (or intend to) adopt a residual value mechanism.</p>
<p>Financial &amp; Economic cases – impact of forecasting simplifications</p>	<p>Within the approach to forecasting operating costs and passenger demand/revenue there are two issues, relating to the quality of the analysis, which add to our conclusion that the franchising case may be positioned towards the upper end of the range of realistically possible outcomes for both affordability and the economic case. These are as follows:</p> <ul style="list-style-type: none"> <li>• It has been confirmed that no marginal impact of worsening road congestion on bus driver hours or fleet size has been taken into account in calculating operating costs. Although we understand that these impacts can be managed to a degree, we would expect this to be in tension with the improvements to performance and reliability that are also assumed. Although the Authority’s experienced advisor has confirmed its view that this omission is a reasonable simplification, in our view this simplification remains unjustified – and appears unnecessary given that the relevant factors are generated within other parts of the modelling approach.</li> <li>• We note that no assessment has been made to support the assumption that no demand/revenue will be lost to routine occurrence of crowding. We would anticipate this to be localised and that the impacts on the case might be managed in practice. We concluded that, without any assessment of its potential significance however, this represents an unknown level of risk to the case.</li> </ul>	<p>The MSA considers that not including the marginal impact of congestion is a reasonable simplification as, in reality, mitigation measures would be put in place on the road network. This includes committed bus priority infrastructure measures. As this impact would apply in both scenarios it also has an immaterial impact on the FSA, and it has been demonstrated that a ‘worst case scenario’ of this would represent an adjustment of the BCR by 0.08.</p> <p>In terms of crowding, the MSA also considers that bespoke crowding analysis would not be proportional for this FSA as it is only valid at individual journey level, for which data is not available. At the strategic level, DfT bus statistics show average bus occupancy was circa 13 passengers for 2024/25 in English metropolitan areas which is far lower than capacity of a single decker bus (40-50 passengers) and a double decker (70-90 passengers).</p>
<p>Balance sheet assessment</p>	<p>It is a requirement of the statutory guidance in respect of the Financial Case that Authorities should undertake an assessment of how the</p>	<p>While a detailed assessment of the balance sheet implications of both options was not presented explicitly in the FSA, the MSA is satisfied that the balance</p>

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	<p>options considered would impact on the balance sheet of the franchising Authority.</p> <p>We note that an assessment of the balance sheet implications of franchising has not been included within the Financial Case. However, we have been provided with a briefing note, reviewed and confirmed as reflective of the understood balance sheet position by the Statutory Section 73 Officer at the North East MSA, that demonstrates the impact on the Authority balance sheet has been considered.</p>	<p>sheet implications of both options have been considered by the MSA and are fully understood.</p>
<p>Impact of franchising on SMOs in the Economic Case</p>	<p>The Economic Case section of the Franchising Guidance sets out that: “Particular consideration should be given to small and medium sized operators, and the potential impacts of the options on that group and that an authority should include in this section an assessment of local operators that they consider to be small and medium sized.”</p> <p>We note that the impact on SMOs has been considered within the FSA which reduces our concern in principle. However, it has not been addressed directly within the Economic Case section as specifically required by the relevant guidance.</p>	<p>The MSA considers that this guidance requirement is robustly met in other areas of the FSA which consider the impact on small and medium sized operators. While it may add clarity to include a cross reference to the Commercial Case (for example section 5.7) in the Economic Case, the MSA does not consider this an issue.</p>
<p>Operator data used to develop assumptions for the Assessment</p>	<p>As part of developing the Assessment’s assumptions, the Authority collected operator data from a range of sources, including large operators and a number of small and medium operators (SMOs). This data informed the patronage and revenue assumptions used within the Assessment.</p> <p>Operator-reported cost data was subsequently adjusted through triangulation against publicly available financial statements, resulting in a downward revision to operator costs to align model outputs with an assumed 4% operating margins.</p> <p>While triangulation against recognised external sources is a reasonable validation approach in circumstances where operator data is of variable quality, the Assessment does not make it clear to the reader that operator-reported cost data has been adjusted in this way. This creates uncertainty around a key input: If operator costs are higher than the adjusted figures suggest, the modelled financial outcomes could be less</p>	<p>The operating cost data received from operators was used as an input to the Operating Cost Model, however, this data was of variable quality in some areas.</p> <p>The MSA therefore triangulated operating cost data received from operators with evidence from publicly available financial statements and local knowledge from Subject Matter Experts (SME)s in the MSA. This resulted in a modelling adjustment being applied in order to reach a modelled position for the base year, which reflects operating margins observed and evidenced in audited financial statements, rather than an <i>assumed</i> operating margin.</p> <p>Due to the variable quality of the unadjusted operating cost data, it was not considered a credible starting position for modelling the reference case or franchising case without the modelling adjustment.</p> <p>The MSA notes the auditors’ observation that triangulation against recognised external sources is a reasonable validation approach in circumstances where operator data is of variable quality.</p>

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	favourable than the modelled scenario presented. The Assessment would be strengthened by explicitly acknowledging these adjustments, explaining the basis on which a 4% operating margin was considered a reasonable proxy for the true operator costs, and setting out the sensitivity of the financial outputs to this assumption.	The adjustment and approach are fully documented in the technical modelling suite of documentation.