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**Chief Executive**



**Bill Reeve**  
**Transport Scotland**  
Buchanan House  
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3 December 2019

Dear Bill

## **Network Rail's funding for network grant related expenditure in year 1 of CP6**

Transport Scotland has asked ORR to provide its view on the deliverability of Network Rail's forecasts for 2019-20, year 1 of Control Period 6 (CP6). This is in the context of the limited flexibility that Network Rail has to move money across years.

This letter sets out ORR's views on Network Rail's forecasts for operating, maintenance and renewals (OMR) expenditure and income. The numbers included in this letter are on an accrued basis apart from network grant receipts/payments, which are on a cash basis. This letter is based on Network Rail's period 7 reporting<sup>1</sup>.

We have rigorously challenged Network Rail and undertaken additional engagement with its asset management team to better understand the renewals profile in year 1, deliverability of renewals volumes and the reasons for any slippages.

In summary, based on the information provided to us, we consider that Network Rail's forecast that it will draw down £25m (7%) less than agreed in the grant letter, is broadly reasonable. Within that, we also agree with Network Rail's forecast on likely renewals expenditure.

However, some aspects of Network Rail's analysis need improving and we are following this up with the company. Specifically:

- Network Rail's centre needs to better support Network Rail Scotland's forecasts, e.g. the information on central renewals is not robust enough to provide us with assurance;
- the accrual based analysis needs to align better with Transport Scotland's need for cash-based forecasts;

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<sup>1</sup> We are aware of some emerging changes in Network Rail's period 8 reporting such as the increase in the pipeline of renewals projects that can be 'turned on' from £4m to £14m, a change to the profile of renewals expenditure and the overlay, and a change in network grant receipts from £351m to £353m. However, this letter is based on period 7 reporting.

- there needs to be a wider analysis of the risks to its forecast and the likely range for network grant receipts;
- we are concerned about the forecast under-delivery of year 1 signalling renewals and we will be reviewing why this has happened and what Network Rail could do differently<sup>2</sup>; and
- we will examine the steps Network Rail can take to deliver its workbank of renewals more evenly across each year, which was a requirement of the Scottish High Level Output Statement (HLOS) for CP6<sup>3</sup>.

Also, the network grant receipts forecast for year 2 is currently £36m below the network grant funding letter assumption of £488m. This variance is disappointing and a major issue especially as the scale of the delivery challenge will increase in year 2. We have asked Network Rail to explain the reasons for this and escalated our concerns to Alex Hynes. We are also considering whether the issue of the forecast year 2 underspend and the risk to budget flexibility, needs to be placed on our regulatory escalator to ensure sustained focus.

We have impressed upon Network Rail the importance of having a robust and comprehensive forecast for year 2 and we understand that this will be provided in the next review at RF8 (period 8). Following RF8, we will conduct a review of Network Rail's plans and the leading indicators of delivery for year 2, including examining what renewals can be brought forward to mitigate the forecast underspend.

### **Our Monitoring of Network Rail's finances**

Given the importance of Network Rail's finances to your budget position, we have increased our monitoring of Network Rail. We have closely monitored its finances with Transport Scotland colleagues from the start of CP6.

To aid our review, Network Rail provided us with additional information and it produced a full re-forecast for period 6 (RF6) as we asked. This exercise was not undertaken in other regions.

Our monitoring has highlighted some issues with Network Rail's forecast. Shedding light on these issues will help to improve future forecasts.

This letter focuses on our views of the robustness of Network Rail's forecast for renewals as there is more material variability in that estimate than in the other income and expenditure categories.

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<sup>2</sup> We want to better understand why project risks were not taken into account earlier and what Network Rail will do differently going forward. We will share the findings with Network Rail and Transport Scotland.

<sup>3</sup> While Network Rail has explained the reasons for delivering larger volumes towards the end of each financial year (for example, avoiding track renewals during hot weather and reduced passenger usage over holiday periods), we want to understand whether improvements can be made.

For maintenance costs, Network Rail is forecasting an overspend for year 1 (£21m more than assumed in the network grant letter). This overspend is linked to the reallocation of funding for Network Rail's Asset Improvement Programme (from renewals to maintenance costs), which equates to £41m over the control period (£8m in year 1). It also includes an acceleration of Network Rail's vegetation management programme<sup>4</sup>. These changes reflect concerns over Network Rail's compliance with vegetation management standards and should improve safety and help reduce future Schedule 8 costs.

There are other less material variances in the year 1 forecast:

- £15m adverse on Schedules 4 and 8, due to anticipated performance in the winter based on prior year performance;
- £6m favourable on operations, support, traction electricity, industry costs and business rates, mainly due to the allocation of risk funding from operating expenditure to Schedule 8<sup>5</sup>; and
- £5m favourable on other single till income (OSTI). Network Rail has incorrectly allocated £3m of variable track access charges to OSTI. This will be corrected in its period 9 reporting. [Redacted].

We have not considered enhancements as, under the pipeline approach, Transport Scotland is already informed of the issues with the forecast.

We set out below our view of the likely outturn for renewals in year 1 and the factors which support it. Further detail on our assessment and year 1 issues is appended to this letter.

### **ORR's view on year 1 OMR forecast**

Network Rail's recent period 7 forecast shows that it plans to draw down £351m of network grant payments from Transport Scotland in year 1. This is £25m (7%) less than it assumed in the network grant letter, largely because of a difference in the closing accrual assumptions (i.e. higher closing accruals).

For year 1 renewals expenditure, we think Network Rail's range of £307m to £316m (excluding central renewals) is reasonable. Our view is based on four main factors:

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<sup>4</sup> Network Rail decided to re-profile its vegetation management to continue the pace of work that existed at the end of CP5, which also ensures contractor support is maintained at the same level as there was at the end of CP5.

<sup>5</sup> The use of the financial risk provision is embedded in the income and expenditure categories shown in Table 1 of the annex to this letter, which compares the period 7 forecast expenditure to the assumptions in the network grant letter. Network Rail also reports periodically to Transport Scotland and ORR on its use of the risk provision and explains the reasons for any variance against forecasts.

- Network Rail's analysis of the accuracy of historic forecasts, which show that its forecasts for period 13 made in period 7, are on average 98% accurate. Applying this analysis to the forecast, gives a range of £307m to £316m (excluding central renewals), with a base forecast of £310m;
- we are now close to the last three periods (periods 9-11) that will affect the cash position at the end of the year, so Network Rail's forecast should be more robust from a cashflow perspective;
- the analysis of leading indicators, which show that 92% of planned renewal projects for this year have been authorised and Network Rail has arranged the access for the work (for example, access at Christmas for delivery of switches and crossings and plain line renewals); and
- Network Rail's £4m pipeline of renewal projects (which it can draw on in the event of planned renewals being deferred).

Network Rail has not provided a range for its other income and expenditure categories, so we cannot provide a range for network grant receipts. But overall we think Network Rail's forecast of £351m network grant receipts for year 1 is reasonable.

[Paragraph redacted].

In considering whether Network Rail's planned volumes for the remainder of year 1 are deliverable, one of the key risks is severe weather. While there is no way to predict the exact impact weather could have on Network Rail's forecasts, it is highly likely that Network Rail's Schedule 8 payments would increase significantly if the weather was worse than planned, which could offset the impact of weather impeding Network Rail's delivery of planned renewal volumes.

Network Rail is undertaking a full re-forecast for period 8 (RF8). This should provide Transport Scotland with a more reliable network grant receipts estimate for year 1. This is because only five rail reporting periods remain in the year, and Network Rail should be well-sighted on the first two periods. The last three periods have less impact on the year 1 cash position. However, the extent of the delivery of expenditure in year 1 will have a significant impact on the network grant receipts estimate for year 2, so this is an area we will monitor closely. We also recognise that the timing of this review does not align with the Scottish Government's timing for setting its annual budget.

### **Next steps**

On 28 October 2019, Network Rail agreed to provide an analysis that would show the effect on the five-year forecast, of the deferrals in years 1 and 2. It will also confirm what the forecast closing working capital position is at the end of CP6. In addition, to support Transport Scotland's ongoing consideration of budget re-profiling

for CP6, Network Rail will shortly provide a revised five-year forecast. We expect these issues to be discussed at our next meeting, on 6 December 2019.

Network Rail has also committed to supplying further information such as an analysis of the risks to its forecast and an analysis of the projects it has said can be 'switched off'. We expect this information to be added to the period 9 report.

We expect Network Rail to continue to evolve its reporting, building on the points raised by Transport Scotland and ORR. We are committed to continuing to work closely with Network Rail and Transport Scotland to improve Network Rail's reporting. We want to undertake a lessons learned exercise in early 2020. This will allow us to build on our engagement to date and embed any improvements ahead of the second year of CP6. We will shortly discuss this with both Network Rail and Transport Scotland.

We will also complete the further reviews we mentioned earlier.

Yours sincerely

John Larkinson  
Chief Executive

cc. Alex Hynes, RMD Scotland's Railway and Tom Greenan, Finance Director  
Scotland's Railway

## **Annex A – further detail of ORR’s assessment**

This annex sets out the other relevant issues that we have taken account of throughout our monitoring of Network Rail’s CP6 forecasts. It provides the basis for our view on Network Rail’s forecasts for year 1.

### **Basis of Network Rail’s forecasts**

Normally, our focus in the monitoring and reporting of Network Rail’s finances, is on income and expenditure variances on an accrued basis, as this was the basis of our 2018 periodic review (PR18). Also, Network Rail’s regulatory and company law accounts are largely presented on an accrued basis. However, we understand that Transport Scotland’s focus is on network grant receipts on a cash basis. For this reason we now look at Network Rail’s cash forecasts for Scotland and are encouraging Network Rail to focus its reporting to Transport Scotland on a cash basis. We draw out these issues below.

The accrual-based and cash-based numbers are connected and the main reason they can vary is due to differences in the opening and closing accrual and cash positions. The other issue with the movements in the accruals, is that Network Rail allocated £136m of cash to Scotland at the end of CP5. [Redacted].

### **Summary of the year 1 forecast**

Network Rail’s recent period 7 forecast is shown in Table 1 below. This shows that it plans to draw down £25m less in network grant in year 1. The £25m variance is due to a £30m difference in the closing accrual assumptions (i.e. higher closing accruals) partly offset by a £5m variance in the closing cash balance (i.e. a higher cash balance).

The most notable forecast underspend is on renewals (£29m), largely due to transfers to maintenance for the region (£8m) and for centrally allocated costs<sup>6</sup> (£5m), as well as slippage in signalling (£32m) and track drainage (£9m). This is partly offset by expenditure on accelerated renewal volumes.

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<sup>6</sup> Note that the renewals figure in Table 1 below includes £60m of central renewals.

**Table 1: Network Rail's 2019-20 period 7 re-forecast****2019-20 P7 re-forecast**

|                                  | <b>P7 Forecast</b> | <b>Grant letter</b> | <b>Variance</b> |
|----------------------------------|--------------------|---------------------|-----------------|
| Operations                       | 63                 |                     |                 |
| Support                          | 72                 |                     |                 |
| TEICR                            | 63                 |                     |                 |
| Operations, support and TEICR    | 198                | 204                 | 6               |
| Maintenance                      | 176                | 155                 | -21             |
| Renewals                         | 372                | 401                 | 29              |
| <b>Network Grant expenditure</b> | <b>746</b>         | <b>760</b>          | <b>14</b>       |
| Other single till income         | 42                 | 37                  | -5              |
| Variable charges                 | 58                 | 58                  | 0               |
| EC4T                             | 34                 | 39                  | 5               |
| Net Schedule 4 and 8             | -16                | -1                  | 15              |
| FTAC                             | 267                | 267                 | 0               |
| <b>Total income</b>              | <b>385</b>         | <b>400</b>          | <b>15</b>       |
| <b>Net expenditure</b>           | <b>361</b>         | <b>360</b>          | <b>-1</b>       |
| <b>Network Grant receipts</b>    | <b>351</b>         | <b>376</b>          | <b>25</b>       |

Note: The Traction electricity, Industry costs and Rates (TEICR) period 7 forecast includes £35m for electric current for traction (EC4T) that is largely offset in income, £16m for cumulo (business) rates and £12m of other joint industry costs.

**Renewals deliverability - back loading of renewals to the end of year 1**

Network Rail is planning to deliver a significant amount of renewals in the later periods of 2019-20 and there have been significant movements in Network Rail's full year 2019-20 forecast since its budget was finalised. While we accept it is appropriate for forecasts to be updated and amended throughout the year, a significant proportion of the movements in Network Rail's forecast could be due to circumstances that could have been foreseen or should have been considered and appropriately mitigated. This is a concern and we will review the reasons for it.

This back loading of renewals, introduces delivery risks, particularly if the weather is worse than expected<sup>7</sup>. This has been a consistent concern with Network Rail's forecasts, especially, if it is relying on the later periods of the year to catch up with slippages that have occurred in earlier periods. That said, Network Rail does usually catch up with the majority of the slippage.

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<sup>7</sup> Network Rail has also said that if the weather is worse than anticipated, it has its pipeline of renewal projects that can be 'turned on', which should lower the impact on the end of year 1 position. However, if weather is severe this could limit Network Rail's ability to deliver either planned renewal volumes or renewals from its pipeline.

Network Rail has partly justified the higher renewal volumes later in the year as being due to reasons such as avoiding hot weather and the timing of access. While there is some validity to this comment, it does not explain why the slippages happen, as these factors should have been built into the budget. So, we will seek to better understand whether Network Rail could, going forward, deliver a more stable programme of work throughout the year, which will improve efficiency and help with supply chain stability. We recognise that this is important for Transport Scotland as it is a Scottish HLOS requirement and because of the implication for Scottish Government budgets if Network Rail significantly underspends.

In this year's previous forecasts, Network Rail has included a £12m overlay in its estimates for renewals expenditure in the last three periods of the year<sup>8</sup>. This is a reduction in the expenditure forecast, applied by the region in order to account for deliverability risks, and to counteract the effects of optimism bias in delivery teams' forecasts. However, as it was initially applied in the last three periods of the year, it did not affect cash expenditure in 2019-20. This is important as Transport Scotland's main concern is the cash position. For period 7, Network Rail moved this overlay in the expenditure to December and January, so it now does affect cash expenditure in 2019-20.

### **Significant deferrals in year 1**

For year 1, the most significant issue has been the under-delivery of planned signalling volumes, currently accounting for a forecast underspend of £32m in year 1. Network Rail has explained that the key drivers for this change include:

- Delays in external decisions including:
  - Cornton Level Crossing – change of strategy at Cornton from closure to renewal. The project now provides a full barrier crossing to replace the automatic half barrier (AHB), instead of its original plans to build a bridge. [Redacted]; and
  - Rosarie Level Crossing – Network Rail is now pursuing a strategy of closure [redacted].
- Enhancement projects slippage – this is driven predominantly by delays in authorisation of the Perth<sup>9</sup> and Carstairs projects. Network Rail had planned to deliver signalling renewals linked to these projects but in year 1 has had to revise its plans because:
  - the Perth project is now planned to be delivered in Control Period 7 (CP7); and

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<sup>8</sup> This is also called a deliverability overlay or risk overlay.

<sup>9</sup> This is a re-signalling and rationalisation enhancement.



- discussions between Network Rail and Transport Scotland are ongoing to agree the renewal design for Carstairs.
- Level of expenditure that was either unremitted<sup>10</sup> and/or unauthorised at the time of last year's RF11, relating to:
  - delay in schemes due to late remits/scope agreement including:
    - life extension works [redacted].; and
    - other schemes [redacted];
  - misalignment of the signalling business plan [redacted].

In period 4, Network Rail reported that it would reduce expenditure on drainage renewals (c.£7m) to offset an increase in unit rates for track<sup>11</sup>. However, Network Rail has identified drainage projects that can be easily 'turned on'. Therefore, Network Rail is confident that volumes can be recovered, as explained below. We agree that the volumes can be recovered, although we note that delivery may be affected by the level of access required.

We have highlighted our concerns with the year 1 deferrals (in particular the under-delivery of signalling volumes) with Network Rail and recently discussed it with Alex Hynes. As set out above, we will shortly undertake a review to look specifically at the decisions around the movement of the signalling volumes (and the timing of those decisions) to better understand why the issues for year 1 have occurred and how Network Rail can stop this from happening again. Network Rail is also in the process of undertaking its own lessons learned exercise.

### **Re-profiling work, overlay and pipeline**

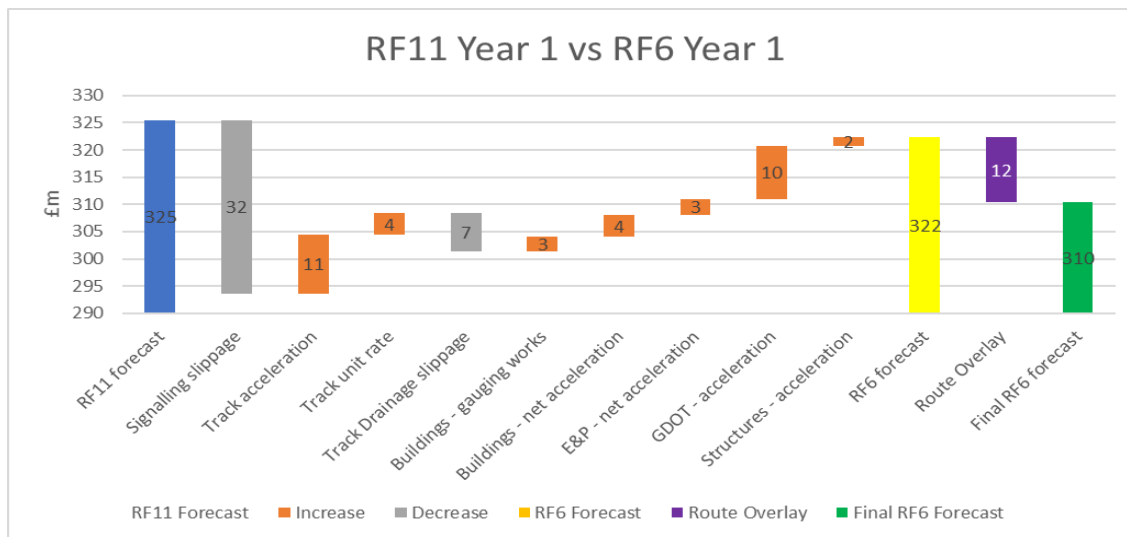
Network Rail is trying to recover from the slippage of signalling costs and volumes by re-profiling its renewals workbank for year 1 and accelerating work in other areas to make up the shortfall (see Figure 1 below). In practice, this means that £32m of the money originally forecast to be spent on signalling projects, is now forecast to be spent on other renewal projects. This involves accelerating work from future years in areas including track, buildings, structures, electrification and plant and geo-technical, additional drainage renewals, and off track.

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<sup>10</sup> Unremitted means projects which have not been passed on to the delivery teams (these subsequently go through the authorisation process).

<sup>11</sup> Network Rail has explained that actual unit rates are higher due to site-specific factors and/or changes to the detailed scope of works.

**Figure 1: Summary of movements in the 2019-20 renewals forecast from RF11 to period 7 (excluding central renewals)**



The inclusion of the £12m overlay should allow Network Rail to incentivise its managers to spend money efficiently and at the right time, rather than undertake renewals in an ad-hoc and unplanned way. In addition, there are further renewal pipeline works being considered, particularly within geo-technical, drainage and off track renewals to mitigate the risk of non-delivery of the work Network Rail has planned. This gives a degree of confidence that, while forecast renewals volumes increase in the remaining periods of 2019-20, Network Rail has a plan of what it will deliver and a pipeline of renewal projects that can be drawn on if plans change. There is currently £4m of projects in Network Rail’s pipeline. Network Rail has already evidenced its use of the pipeline by drawing on pipeline projects to recover from the deferral of £32m of signalling work but this means there is only £4m left in the pipeline at period 7.

To provide assurance that there is the volume of work ready and able to be ‘switched on’, we asked Network Rail to report on this on a regular basis going forward. We have also asked for and not yet been supplied with, a list of the projects Network Rail has said can be ‘switched off’ should significant cash pressures arise. Network Rail has committed to supply this information in the period 9 report.

While we consider that the use of the regional overlay and the pipeline of renewals projects lowers the risk of underspend towards the end of the year, we would prefer that Network Rail instead uses a more comprehensive approach to risk assessment, management and mitigation. This should ensure Network Rail delivers in the most efficient manner and avoids large underspends or overspends. Network Rail has committed to supplying further information in the period 9 report, such as an analysis of the risks to its forecast (which it has said underpin its forecasts) and the likely range for network grant receipts.

In addition to the regional overlay and the pipeline of projects, Network Rail has recently confirmed that it is undertaking a number of other activities to try to recover year 1 expenditure, including:

- workshops with the supply chain to identify schemes with potential for acceleration; and
- supplementing the asset team resource from the supply chain to progress significant remits.

Network Rail has also said that formal consolidation of the Signalling Delivery team into the Regional Capital Delivery team in November 2019, will further improve control and confidence.

Inevitably throughout the control period things will change. When this happens we expect to see Network Rail re-profiling its planned renewals. However, given the changes to how Network Rail is financed, in particular the budget flexibility controls that now apply, Network Rail needs to adapt quickly. To do this it needs to provide robust challenge to its plans, fully understand the risks to delivery, consider the implications of those risks materialising and the mitigations for those risks. We will explore this further as part of our future work.

### **Leading indicators for year 1**

Throughout CP6, we will use leading indicators to help determine the likelihood of Network Rail delivering its renewal volumes. The leading indicators that we monitor include indicators for workbanks being authorised and securing access to the railway for planned disruptive engineering.

For year 1, the workbank authorisation<sup>12</sup> position is set out in Table 2 below and the position with the other indicators is shown below the table.

This shows that, generally, Network Rail is in a reasonable position at this point in 2019-20, as 92% of the projects have financial authorisation and the possessions that have the most effect on renewals delivery have been fully booked.

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<sup>12</sup> Authorisation: The amount of work authorised by the region's investment panels (as reported within Oracle) compared to the aggregate renewals budget for the year.

**Table 2: Leading indicators for 2019-20 at period 7 (excluding central renewals)**

|                   | Earthworks | Drainage | Buildings | Structures | Signalling | Track | E&P  | Workplace Mgt | Overlay | Total |
|-------------------|------------|----------|-----------|------------|------------|-------|------|---------------|---------|-------|
| Authorised        | 28         | 7        | 19        | 62         | 35         | 125   | 10   | 0             |         | 287   |
| Un-authorized     | 1          | 0        | 7         | 3          | 3          | 2     | 2    | 0             |         | 17    |
| Un-remitted       | 7          | (1)      | 3         | (2)        | 6          | 3     | 1    | 1             | (12)    | 6     |
| FY20 per RF6 (£m) | 36         | 6        | 29        | 63         | 45         | 129   | 12   | 1             | (12)    | 310   |
| Authorised        | 79%        | 112%     | 67%       | 99%        | 79%        | 96%   | 78%  | 0%            | 0%      | 92%   |
| Un-authorized     | 2%         | 0%       | 24%       | 4%         | 7%         | 2%    | 13%  | 0%            | 0%      | 6%    |
| Un-remitted       | 20%        | -12%     | 9%        | -3%        | 14%        | 2%    | 10%  | 100%          | 100%    | 2%    |
|                   | 100%       | 100%     | 100%      | 100%       | 100%       | 100%  | 100% | 100%          | 100%    | 100%  |

Workbank stability<sup>13</sup>: 80%

Disruptive access booked<sup>14</sup>: 135%

### Overview of the renewals forecast

Inevitably a forecast for renewals expenditure will be uncertain, so it is useful to consider what the range could be. We have been discussing this at length with Network Rail since the spring. Our main concern was whether there was some optimism bias in Network Rail's forecasts.

Over this time, the range for 2019-20 renewals expenditure has reduced. Network Rail's latest view, based on its analysis of previous years' outturns compared to forecasts, is that the range for renewals expenditure in the region is between £307m and £316m (excluding central renewals). This is consistent with our and Network Rail's historic analysis.

Overall, Network Rail is confident that it can deliver its year 1 renewals forecast of £310m. We think Network Rail's range of £307m to £316m is reasonable. Our view is based on four main factors:

- Network Rail's analysis of the accuracy of historic forecasts that shows that Network Rail's forecasts for period 13 made in period 7, are on average 98% accurate. Applying this analysis to the forecast, gives a range of £307m to £316m, with a base forecast of £310m;
- we are now close to the last 3 periods (periods 9-11) that will affect the cash position at the end of the year, so Network Rail's forecast should be more robust;
- the analysis of leading indicators, which shows that 92% of planned renewal projects for this year have been authorised and it has arranged the access for

<sup>13</sup> Workbank stability: The change to the total cost of work forecast for the year, as reported each period, expressed as a percentage of the total value for the year.

<sup>14</sup> Disruptive access. The proportion of total access hours estimated to be required in year 1 that are booked within Network Rail's Possession Planning System.

the work (for example, access at Christmas for delivery of switches and crossings and plain line renewals); and

- Network Rail's £4m pipeline of renewal projects (which it can draw on in the event of planned renewals being deferred).

However, there is a greater risk with the delivery of the £60m of central renewals as less analysis has been done by Network Rail's centre on the variability of this estimate, than Network Rail Scotland has done on its regional estimate, and the centre has not gone through a RF6 process<sup>15</sup>. But the central renewals estimate should be more robust after the RF8 process. We have raised the role of Network Rail's centre in supporting Network Rail Scotland's forecasts for Transport Scotland, with Network Rail's central planning team, and stressed that it needs to do more.

### **Schedule 8**

Network Rail is, as at period 7, forecasting a net £10m expenditure on Schedule 8 for the full financial year. We think this is a reasonable forecast.

In considering whether Network Rail's planned renewals volumes for the remainder of year 1 are deliverable, one of the key risks is severe weather. While there is no way to predict the exact impact weather could have on Network Rail's forecasts, it is highly likely that Network Rail's Schedule 8 payments would increase significantly if the weather turns out to be worse than planned.

The outturn position for Schedule 8 payments has in recent years been below Network Rail's forecast as at period 7. The exception to this was 2017-18, when severe weather meant the outturn costs were £16m higher than forecast (£21m vs. £5m). But also in 2017-18, the renewals outturn was £14m lower than the period 7 forecast, primarily due to delivery slippage. So, 2017-18 is an example of how the additional costs associated with Schedule 8 payments, can be offset by the problems bad weather causes to the delivery of renewal volumes.

### **Five-year cash forecast**

We have asked Network Rail on a number of occasions to produce a detailed CP6 cash forecast. This is important as it would provide Transport Scotland with a better view of Network Rail's cash requirements across CP6, including the impact of changing accrual estimates. To date we only have high-level numbers for the full control period. A more detailed forecast will give Transport Scotland forewarning of any budget flexibility issues. This is a significant barrier to our being able to provide assurance to Transport Scotland.

On 28 October 2019, Network Rail agreed to provide an analysis that would show the effect on the five-year forecast, of the deferrals in years 1 and 2. It will also confirm what the forecast closing working capital position is at the end of CP6. In

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<sup>15</sup> We also note, as an example of the potential variability in central renewals expenditure that the forecast for the allocation to Scotland in year 2, has recently changed by £25m.

addition, to support Transport Scotland's ongoing consideration of budget re-profiling for CP6, Network Rail will shortly provide a revised five-year forecast. We expect these issues to be discussed at our next meeting, on 6 December 2019.

## **Year 2 OMR funding**

Network Rail recently presented its year 2 forecast for OMR as at period 6 of year 1. The network grant receipts forecast is currently £36m below the network grant funding letter assumption of £488m. This is largely due to the ongoing re-phasing of signalling works (with signalling accounting for a deferral of £45m) and re-profiling of year 1 renewals. There is also a forecast reduction of £25m in central renewals, mainly due to re-phasing of expenditure across CP6<sup>16</sup>. These variances are disappointing and a major issue. We have asked Network Rail to explain the reasons for them and escalated our concerns to Alex Hynes.

The current expenditure profile in year 2 mirrors 2019-20 in that renewal volumes are back ended to later periods. Network Rail has said that its current profile of expenditure in year 2 is currently simply copied from year 1, and has yet to be reviewed. In light of the issues set out above with year 1, we have impressed upon Network Rail the importance of having a robust and comprehensive forecast for year 2 and we understand that this will be provided in the next review at RF8 (period 8).

Following RF8, we will conduct a review of Network Rail's plans and the leading indicators of delivery in the context of the forecast underspend in year 2, including examining what renewals can be brought forward to mitigate the forecast underspend.

Network Rail Scotland has used leading indicators to help demonstrate its view of the deliverability of the year 2 forecast. For example, it is positive for year 2 deliverability prospects, that as at year 1 period 6, all planned disruptive possessions for year 2 (until December 2020) have been negotiated and uploaded into the possessions planning system.

## **RF8 review**

Network Rail is undertaking a full re-forecast for period 8 (RF8). This should provide Transport Scotland with a more reliable network grant receipts estimate for year 1. This is because only five rail reporting periods remain in the year, and Network Rail should be well-sighted on the first two periods. The last three periods have less impact on the year 1 cash position. However, the extent of the delivery of expenditure in year 1 will have a significant impact on the network grant receipts estimate for year 2, so this is an area we will monitor closely. We also recognise that the timing of this review does not align with the Scottish Government's timing for setting its annual budget.

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<sup>16</sup> This is based on Network Rail Scotland's view of central renewals following discussions with Network Rail centre. The rest of Network Rail has not gone through a RF6 forecast process.