

# *First parallel sessions*

## **B: Asset management and efficiency**

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# Structure

- ❑ Process
- ❑ Maintenance and renewals (chapter 5 of draft dets)
- ❑ Opex (chapter 6)
- ❑ Efficiency and input prices (chapters 7 and 8)
- ❑ Summary

# Our review and challenge of Network Rail's plans...

- ❑ **Detailed reviews** of its **asset policies**, its **safety management** proposals, its modelling tools, ...
- ❑ **Dozens of 'challenge' meetings** with Network Rail
- ❑ **Site visits** – to check the robustness of Network Rail's planning versus the actual state of the assets on the ground
- ❑ A series of **visits to overseas rail infrastructure managers** to understand other potential approaches to asset management, etc
- ❑ **Comprehensive work** to examine the **scope for efficiency improvement**
- ❑ Considered Network Rail's **capability to deliver** all of its work
- ❑ We have considered the **input from other interested parties** (e.g. EWS re North American practice, RIA re input prices)

# Renewals – pre-efficiency comparison

- ❑ **Track and signalling** – Network Rail’s proposals are broadly endorsed
  - Minor adjustments on some activities
  - Track renewal volumes are slightly below CP3 levels, signalling volumes are higher
- ❑ **Civils** – we have made significant reductions to Network Rail’s proposals
  - Network Rail has not justified the need for any increase above CP3 expenditure and we propose continuation of present levels of spend
- ❑ **Electrification, telecoms, plant & machinery** – Network Rail proposals largely endorsed
- ❑ **Operational property** – Network Rail improved its modelling and the cost of its proposals reduced significantly between its SBP and SBP update
  - We endorse the SBP update, which is substantially above CP3 levels
  - Most of the increase is for higher spend on major (managed) stations, franchised stations spend remains broadly in line with CP3 levels
- ❑ **Other** – Significant reduction, largely due to uncertainties around corporate accommodation and some IT schemes – these can be dealt with through the investment framework

# M&R – pre-efficiency comparison (GB)

£m (2006-07 prices)	NR SBP update	Draft dets	Difference
<b>Renewals</b>			
Track	3,991	3,820	(4%)
Civils	2,198	1,895	(14%)
Signalling	2,565	2,454	(4%)
Op. property	1,480	1,480	0%
Electrification	684	664	(3%)
Telecoms	887	870	(2%)
Plant & machinery	402	394	(2%)
Other (inc IT)	643	419	(35%)
Discretionary	85	68	(20%)
<b>Total renewals</b>	<b>12,935</b>	<b>12,064</b>	<b>(7%)</b>
<b>Maintenance</b>	<b>5,311</b>	<b>5,311</b>	<b>0%</b>

# Opex

- ❑ Network Rail's SBP forecast **£5.6bn** of total opex
  - **Controllable opex £3.8bn**, e.g. signallers, HR, insurance, etc
  - **Non-controllable opex £1.8bn**, e.g. traction electricity, BTP
- ❑ Our initial approach to PR08 put the **onus on Network Rail** to produce robust forecasts which we would review
- ❑ The SBP did include some improved analysis (compared to the ISBP) but it **did not provide a sufficiently detailed or justified basis for our review**
- ❑ In particular, **little detailed work on the scope for efficiency improvement**
- ❑ We therefore **commissioned our own studies** (*covered later*)

# Improvements in efficiency

- ❑ We have strong evidence that there is **significant potential for Network Rail to improve its efficiency by much more than the 13% it proposed**
- ❑ Network Rail faces an ‘efficiency gap’ of **35%** compared to the **upper quartile** of more efficient European infrastructure managers
- ❑ But we recognise all the challenges Network Rail faces. We have therefore assumed that it should **catch up the gap over 10 years/two control periods** (not just one)
- ❑ It is **not our responsibility to identify the specific initiatives** Network Rail will need to implement – but it will need to look to strengthen its capabilities, introduce new technologies and working methods, and strengthen partnerships with operators and suppliers

# Our CP4 efficiency assumptions

	2009-10	2010-11	2011-12	2012-13	2013-14	Total
<b>M&amp;R</b>	5%	5%	5%	5%	5%	22.6%
<i>Network Rail M&amp;R</i>	3.8%	3.5%	3.1%	2.8%	1.7%	14.0%
<b>Controllable opex</b>	3.5%	3.5%	3.5%	3.5%	3.5%	16.3%
<i>Network Rail controllable opex</i>	2.1%	2.2%	1.6%	1.1%	0.6%	7.4%

- ❑ We have reflected fully into our efficiency assumptions Network Rail's forecast increases in real **input prices** above RPI
- ❑ Overall input price adjustment average at **1.1% pa** (range: **-0.9% to 3.5% pa**) covering both labour and materials
  - Opex: average 1.6% pa
  - Maintenance: average 1.3% pa
  - Renewals: average 0.75% pa



# Opex efficiency

- ❑ Network Rail's **efficiency improvement in CP3 is impressive**
  - Average opex saving in CP4 is **7.2% pa** (net of input prices) – five times higher than the SBP proposals
  - Average in the last two year's of CP3 is **4.6% pa** (net of input prices)
- ❑ NR's opex can be **compared to other similar companies**
  - Oxera's central range for opex efficiency is **4.0% to 6.2% pa**
  - LECG study for Network Rail – average real unit operating expenditure improvement in comparable industries is **3.2% pa**
- ❑ We have assumed Network Rail can achieve savings of **3.5% pa** (net of input prices)
- ❑ We have conducted specific studies to support us, including:
  - **Operations** – significant additional scope to make savings (**11% pa**)
  - **Total employment costs** – NR is **15% to 20%** higher than the market / external benchmarks

# Summary

- Our assumptions on **efficient expenditure** are a key part of our **balanced package** – which we have established carefully, based on a **thorough assessment** and **strong evidence**
- The efficiency assumptions are **challenging and achievable**

## Summary of our CP4 efficient OM&R expenditure assumptions

£m (2006-07 prices)	SBP/SBP update	Draft dets	Difference
Controllable opex	3,776	3,392	(10%)
Non-con	1,796	1,776	(1%)
Maintenance	4,889	4,584	(6%)
Renewals	11,658	10,504	(10%)