2018 periodic review final determination

Supplementary document – other single till income

October 2018

Contents

About this document

The 2018 periodic review (PR18) is the process through which we determine what Network Rail[1] should deliver in respect of its role in operating, maintaining and renewing its network in control period 6 (CP6)[2] and how the funding available should best be used to support this. This feeds through into:

- the service that passengers and freight customers receive and, together with taxpayers, ultimately pay for; and
- the charges that Network Rail's customers, including passenger, freight and charter train operators, will pay for access to its track and stations during CP6.

In June 2018, we consulted on our PR18 draft determination[3], setting out our proposed decisions in all of the main areas of PR18. Following receipt of consultation responses, we have reviewed stakeholders' comments and these have helped to inform the final decisions set out in our final determination. We are grateful to all those who responded to the consultation.

Accordingly, the final determination sets out our overall decisions on PR18. Among the documents that we have published is an overview document, setting out:

- our decisions in all the main areas of PR18;
- a summary of how we will regulate Network Rail's delivery in CP6; and
- next steps in PR18.

In addition, there are high-level summaries of our main decisions for each of England & Wales and Scotland.

We have also published a document summarising stakeholders' comments on the PR18 draft determination and our response to these.

The full set of documents that form the final determination is set out in the box overleaf[4].

[1] All references to Network Rail in this document are to Network Rail Infrastructure Limited.

[2] CP6 will run from 1 April 2019 to 31 March 2024.

[3] The full suite of PR18 draft determination documents are available from this webpage. To access earlier consultation and conclusions documents that led up to the PR18 draft determination, please see the map of these documents here.

[4] Our policy on managing change will be published in November 2018. Some documents, such as the consultancy and reporter studies, will be published shortly after the final determination.

Our final determination documents (includes weblinks)

PR18 final determination overview document

England & Wales summary

Scotland summary (and settlement details)

Settlement documents

- FNPO route
- System Operator
- England & Wales
  - Anglia route
  - LNE & EM route
  - LNW route
  - South East route
  - Wales route
  - Wessex route
  - Western route

PR18 draft determination consultation – summary of comments and our response

Supplementary documents

- SBP assessment
  - Scorecards and requirements
  - Health & safety
  - Review of NR's proposed costs
  - Other single till income
  - Stakeholder engagement
- Policy
  - Financial framework
  - Review of network licence: conclusions from consultation
  - Overview of charges & incentives decisions
  - Infrastructure cost charges conclusions
  - Variable usage charge conclusions

Other documents

- Glossary
- Managing Change Policy
- Consultancy & reporter studies
- Grading of Network Rail's route and System Operator strategic plans for CP6

1. Other single till income

Introduction

1.1 In this supplementary document, we set out our final determination of other single till income (OSTI) for CP6. We have carried out separate assessments for England and Wales, and for Scotland. All values referred to in this document are in 2017-18 prices and some numbers in the tables may not cast due to rounding.

1.2 Under the decision confirmed in chapter 4 of our final determination for the PR18 financial framework, only the following items will be classified as OSTI in CP6:

- property rental;
- property sales;
- finance charge, facility charge income and the Crossrail supplemental access charge;
- qualifying expenditure recharges for managed stations;
- lease income for stations owned by Network Rail but operated by train operators;
- fixed contractual contributions from open access operators such as Heathrow Express;
- depots charges; and
- any other income not derived from regulated charges.

1.3 When we calculate Network Rail's net revenue requirements, we subtract our forecast of Network Rail's OSTI from Network Rail's gross revenue requirements to determine the net revenue requirements that are recovered through:

- franchised train operator track access charges;
- freight operator and charter access charges;
- open access operator charges;
- long-term charges for managed stations;
- long-term charges for stations repaired and renewed by Network Rail, but operated by train operators; and
- network grants from the governments.

Summary of OSTI in Network Rail's SBP

1.4 Table 1.1 shows a summary of the forecast OSTI that Network Rail included in its strategic business plans (SBP).

Table 1.1: Network Rail's SBP forecast OSTI in Great Britain[5]

£m 2017-18 prices	2018-19	CP5 Total	2019-20	2020-21	2021-22	2022-23	2023-24	CP6 Total
Property rental	258	1,412	230	233	233	238	241	1,175
Property sales[6]	43	274	26	29	20	22	28	125
Finance charge Income[7]	76	168	-	-	-	-	-	-
Facility charges	59	285	56	55	54	54	54	272
Managed stations qualifying expenditure	68	319	68	68	68	68	68	339
Franchised station lease income	47	235	47	47	47	47	47	235
Open access fixed contractual obligations	19	97	18	18	18	18	18	89
Depots income	82	390	82	82	82	82	82	412
Other income	9	41	8	8	8	8	8	40
Total	**660**	**3,222**	**535**	**541**	**530**	**537**	**546**	**2,689[8]**

[5] With the exception of property sales, which is net of the costs of selling assets, all the numbers in this table are shown gross of the expenditure incurred to generate the income, e.g. the actual expenditure on managed stations qualifying expenditure.

[6] The property sales in this table exclude the strategic sales Network Rail is undertaking in CP5 as a result of the Hendy review.

[7] Network Rail receives charges for financing the construction of rail infrastructure on behalf of third parties. The amounts shown in the table are for Crossrail. Network Rail has assumed it will receive no funding from finance charges in its SBPs, as it no longer provides finance for third parties for these projects.

[8] Network Rail omitted the Crossrail supplemental access charge income (this replaces the Crossrail finance charge) it due to receive in CP6 and in CP5 (for periods 10 to 13 of 2018-19) from its England & Wales SBP. It has since forecast this income to be around £0.3bn over CP6.

Our assessment of Network Rail's OSTI forecasts

Introduction

1.5 Most of Network Rail's OSTI income comes from either property related items such as property rental or property sales, or some charges or contracts that are already in place. This income is sometimes unregulated, e.g. franchised station lease income. We commissioned the commercial property consultants Cushman & Wakefield (C&W) to assess Network Rail's property income forecasts.

Property income

Property rental income

1.6 Network Rail receives rental income from a range of properties, including its commercial estate and managed stations. Network Rail has agreed a sale of its commercial estate in England & Wales. It assumed in its SBP that it would receive £1,175m over CP6 in property rental income as shown in Table 1.2. This represents a material reduction compared to CP5, largely due to the sale of its commercial estate in England and Wales.

1.7 Network Rail also incurs renewals costs to assist in generating property rental income. These costs are covered in our review of Network Rail's proposed costs supplementary document to the PR18 determination.

Table 1.2: Network Rail's SBP - Property rental income in Great Britain

	CP5						CP6					
£m, 2017-18 prices	2014-15	2015-16	2016-17	2017-18	2018-19	Total CP5	2019-20	2020-21	2021-22	2022-23	2023-24	Total CP6
Property rental	263	286	300	306	258	1,412	230	233	233	238	241	1,175

Property sales income

1.8 Network Rail receives property sales income when it disposes of surplus property that is not needed by the railway. In its SBP for CP6, Network Rail has assumed it will generate £125m by disposing of surplus property. This is a considerable reduction from CP5 as shown in Table 1.3. This is partly because in 2015-16 there was a significant disposal of its interest in the shopping centre above Birmingham New Street station. Also, the sale of the commercial estate has reduced the opportunities for business as usual sales.

Table 1.3: Network Rail's SBP: Property sales income in Great Britain

	CP5						CP6					
£m, 2017-18 prices	2014 -15	2015 -16	2016 -17	2017 -18	2018 -19	Total CP5	2019 -20	2020 -21	2021 -22	2022 -23	2023 -24	Total CP6
Property sales	36	91	64	41	43	274	26	29	20	22	28	125

Note: The property sales in this table exclude the strategic sales Network Rail is undertaking in CP5 as a result of the Hendy review.

1.9 C&W thought that Network Rail's property income forecasts in its SBPs were broadly reasonable. However, they considered Network Rail should be able to generate more property income than it assumed in its SBP, in particular because C&W thought that Network Rail's forecasts of development and sales income were relatively conservative. C&W considered that Network Rail should be able to achieve additional property income in Great Britain (above its plan assumptions) of between £15m and £186m.

1.10 For our draft determination, we included C&W's base estimate of £67m additional property income. This was 5% higher than Network Rail's forecast of total property income (property rental and property sales).

1.11 Network Rail said that our estimates of £67m additional property income for Great Britain in the draft determination was not achievable as:

- C&W had not taken account of falling footfall at stations;
- Network Rail think that there was a £12m error in our consultants analysis;
- speculative growth has been applied to a number of income lines in C&W's assessment; and
- the development market is cooling due to wider economic factors and Brexit which are also impacting on Network Rail's retailers.

1.12 Instead, it suggested that it could deliver £25m of additional property income.

1.13 C&W has confirmed that its report took account of these issues. However, it did agree that there was a misunderstanding with some data Network Rail provided, so it accepted Network Rail's view that its base forecast was £12m too high for this issue.

1.14 We also note that we have used C&W's base assumption. The high end of its range is considerably higher than this assumption. We also note that Network Rail's proceeds from its sale of the commercial estate was for more than it originally expected[9], suggesting that the market has a more positive view about the potential revenue from property.

1.15 Given these points, we have adjusted for the £12m error but not for Network Rail's other views. Therefore, our additional property income assumption is now £55m for Great Britain. Of which £52m is in England & Wales and £3m in Scotland. The Scotland number is unchanged, as the £12m error did not affect Scotland.

Supplemental access charges income

1.16 After Network Rail submitted its SBPs to us, it noted that it had omitted its forecast Crossrail supplemental access charge income (this replaces the Crossrail finance charge) that it is due to receive in CP6 and in CP5 (for periods 10 to 13 of 2018-19[10]) from both its SBP and the information that it provided to DfT to support the production of its SoFA.

1.17 At the time of our draft determination, Network Rail forecast this income to be between £250m and £300m over CP6. In calculating this forecast, Network Rail used its view of the range for its cost of debt (see the financial framework supplementary document).

1.18 Since our draft determination, the Crossrail project has been delayed, though not due to delays to Network Rail's supporting infrastructure ('on network works'). We understand that the CSAC is still payable to Network Rail from period 10 of 2018-19 (if it was not Network Rail would receive finance charge income instead).

1.19 The Crossrail track access option deed specifies that the cost of debt to be used in the calculation of supplementary access charges will be determined by ORR. We have now determined the pre-tax cost of debt for Network Rail for CP6 to be 1.45% real (RPI) [11].

1.20 Using our real (RPI) 1.45% pre-tax cost of debt we are forecasting that Network Rail will receive £274m (in 2017-18 prices) in CP6 from this charge.

1.21 In our PR18 draft determination financial framework supplementary document[12], we noted that DfT had provided a provisional view that income from CSAC should be

[9] Network Rail also has other operating income such as sales of scrap metal that is included in its forecasts as a credit (i.e. reduction) in operating costs. For Great Britain, this is forecast by Network Rail to be £1.2bn (in 2017-18 prices) in CP6. Network Rail provided some analysis of this forecast in late August 2018 and this showed a £0.4bn reduction compared to CP5. The large majority of the changes that Network Rail identified were reductions. We think that this is unrealistic.

[10] The Crossrail track access option deed includes provision for payments by Crossrail, through supplementary access charges (SACs), to allow Network Rail to recover the costs relating to works for Crossrail that took place on its network. The costs will be recovered over the life of the assets concerned, and the SACs include a finance cost component.

[11] See chapter 5 of the PR18 financial framework final determination document.

[12] This is available at: http://orr.gov.uk/__data/assets/pdf_file/0008/27791/pr18-draft-determination-financial-framework.pdf

available to Network Rail in CP6 to deliver HLOS outputs, but that it had not finalised its position.

1.22 DfT said that the CSAC income should be allocated to 'contingent renewals' (this is now called contingent asset management funding) on the basis that it may be recalled and re-allocated to other areas of transport expenditure. This would have meant including the CSAC income in the OSTI section of the England & Wales revenue requirement calculation and the contingent asset management funding section of the calculation. Overall, these two amounts would have netted off to zero.

1.23 Given the uncertainty over how much of this income Network Rail will be able to spend, we have decided not to include the CSAC income in the England & Wales revenue requirement calculation, as this would have overly complicated the risk funding process. In CP6, if the CSAC income that Network Rail will receive is not provided to the UK Government and it becomes available to Network Rail to spend, it should be treated as additional risk funding.

Facility charges

1.24 Network Rail receives facility charges income when it finances the construction of rail infrastructure assets for third parties. These repay the capital and associated finance costs over the life of the asset. Network Rail's forecast of facility charge income is shown in Table 1.4.

1.25 Network Rail has assumed that facility charges will reduce slightly in CP6 compared to CP5. This is because charges associated with some schemes are expected to end in CP6. Network Rail has assumed that there will be no further investment framework schemes in CP6, reflecting the wider changes in its funding structure, following its reclassification as an arm's length public sector body. Instead, it anticipates that schemes might be promoted by parties who have access to their own funding, such as local enterprise partnerships.

1.26 We have discussed these forecasts with Network Rail as part of our review. We did not identify any material issues.

1.27 We have now determined the pre-tax WACC for Network Rail for CP6 to be 4.15% real (CPI). This value would be used as the cost of capital in the calculation of any new facility charges arising in CP6.

Table 1.4: Network Rail's SBP: Facility charges in Great Britain

	CP5						CP6					
£m, 2017-18 prices	2014-15	2015-16	2016-17	2017-18	2018-19	Total CP5	2019-20	2020-21	2021-22	2022-23	2023-24	Total CP6
Facility charges	55	54	59	58	59	285	56	55	54	54	54	272

Managed stations qualifying expenditure

1.28 Managed station qualifying expenditure (QX) gives rise to charges by Network Rail to train operators to recover the day to day running costs of providing services and amenities (such as cleaning or refuse collection) at the stations it manages. With the exception of the qualifying expenditure management fee (which covers central support costs and has a profit element), charge levels are not set by ORR and are instead decided via bilateral negotiation between Network Rail and the train operators using the station.

1.29 Network Rail assumed in its SBPs that it will receive £339m of managed station QX income over CP6 as shown in Table 1.5. We have discussed these forecasts with Network Rail as part of our review. We did not identify any material issues.

Table 1.5: Network Rail's SBP: Managed stations Qualifying Expenditure in Great Britain

	CP5						CP6					
£m, 2017-18 prices	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**Total CP5**	**2019-20**	**2020-21**	**2021-22**	**2022-23**	**2023-24**	**Total CP6**
Managed stations qualifying expenditure	58	61	66	66	68	319	68	68	68	68	68	339

1.30 Network Rail has provided an updated forecast of managed stations QX income as part of its response to our draft determination. These forecasts showed increased QX income in CP6 from £339m to £361m (in 2017-18 prices)[13].

1.31 We have included these forecasts in our calculation of revenue requirements. They include the two additional managed stations at Guilford and Clapham Junction.

1.32 Network Rail has now concluded its July 2017 consultation on the managed station qualifying expenditure management fee[14] and proposed an increase in the profit element from 5 percent to 6 percent. As set out in our supplementary document, an 'Overview of charges and incentives decisions', we think that 6 percent is a reasonable profit element as it is consistent with industry benchmarks. Our final determination includes the revised profit element.

[13] This excluded the revised profit element that we have now decided on in the Supplementary document – Overview of charges and incentives decisions.

[14] This is available at: https://cdn.networkrail.co.uk/wp-content/uploads/2018/05/Network-Rails-conclusions-on-Variable-Station-charges-in-CP6-May-2018.pdf

Franchised stations lease income

1.33 Franchised stations lease income covers property rents associated with franchised stations such as retail and car park income. This income, which ORR does not regulate, represents a share of income received in 1994-95, and is index-linked to RPI inflation.

1.34 In its SBP, Network Rail is forecasting to recover £235m of franchised stations lease income in CP6 as shown in Table 1.6 below. We have discussed these forecasts with Network Rail as part of our review. We did not identify any material issues.

Table 1.6: Network Rail's SBP: Franchised stations lease income in Great Britain

	CP5						CP6					
£m, 2017-18 prices	2014-15	2015-16	2016-17	2017-18	2018-19	Total CP5	2019-20	2020-21	2021-22	2022-23	2023-24	Total CP6
Franchised stations lease income	47	47	47	47	47	235	47	47	47	47	47	235

Open access fixed contractual contributions

1.35 Open access fixed contractual contributions are paid by certain open access operators for access to Network Rail's infrastructure, e.g. Heathrow express and Nexus. These charges do not constitute track access charges and are set outside the regulatory framework.

1.36 In its SBP, Network Rail is forecasting to recover £89m of open access fixed contractual contributions over CP6 as shown in Table 1.7 below. We have discussed these forecasts with Network Rail as part of our review. We did not identify any material issues.

Table 1.7: Network Rail's SBP: Open access fixed contractual contributions in Great Britain

	CP5						CP6					
£m, 2017-18 prices	2014-15	2015-16	2016-17	2017-18	2018-19	Total CP5	2019-20	2020-21	2021-22	2022-23	2023-24	Total CP6
Open access fixed contractual contributions	20	20	19	19	19	97	18	18	18	18	18	89

Depots income

1.37 Network Rail receives income for access to its light maintenance depots. These charges are set via commercial agreements that are not linked to control periods. ORR reviewed the contractual framework for these charges in 2014.

1.38 Network Rail has forecast it will recover £412m of depots income in CP6 as shown in Table 1.8. This is based on an assumption of no growth in the depots portfolio in CP6, or any material price rises.

1.39 We have discussed these forecasts with Network Rail as part of our review. We did not identify any material issues.

Table 1.8: Network Rail's SBP: Depots income in Great Britain

	CP5						CP6					
£m, 2017-18 prices	2014-15	2015-16	2016-17	2017-18	2018-19	Total CP5	2019-20	2020-21	2021-22	2022-23	2023-24	Total CP6
Depots income	68	69	81[15]	89	82	390	82	82	82	82	82	412

Other income

1.40 Network Rail recovers other income not derived from regulated charges from a range of sources. In CP6, Network Rail has forecast that it will receive £40m of income from the provision of insurance to passenger train operators and the recovery of operating costs relating to third-party connections maintained by Network Rail[16], as shown in Table 1.9 below.

1.41 We have discussed these forecasts with Network Rail as part of our review. We did not identify any material issues.

Table 1.9: Network Rail's SBP: Other income in Great Britain

	CP5						CP6					
£m, 2017-18 prices	2014-15	2015-16	2016-17	2017-18	2018-19	Total CP5	2019-20	2020-21	2021-22	2022-23	2023-24	Total CP6
Other income	7	8	8	9	9	21	8	8	8	8	8	40

[15] 2016-17 included some favourable one-off income for the resolution of some contractual issues. After these issues were resolved, around £10m was added to the yearly on-going depots income.

[16] These are for physical connections from facilities such as terminals, ports, sidings and depots to the main network.

Scotland

1.42 Similar to the position across Great Britain, most of Network Rail's OSTI income either comes from property related items such as:

- property rental or property sales; or
- income related to charges or contracts that are already in place - in some cases this is unregulated income.

1.43 Network Rail's OSTI assumptions in CP6 (in total £176m in 2017-18 prices) are similar to the levels in CP5.

1.44 Most of the comments made about other single till income in the Great Britain section also apply to Scotland. The two main differences are:

- supplemental access charges income, which does not apply to Scotland as Crossrail income only relates to England & Wales; and
- property income, due to the proposed sale of the commercial estate in England & Wales, and the different development/sales environment in Scotland.

1.45 In Scotland, Network Rail is not planning to sell its commercial estate in 2018-19, so, it does not have a decline in property rental income in CP6.

1.46 C&W considered that Network Rail's property income forecasts for Scotland were based on assumptions that were broadly reasonable, but Network Rail should be able to generate more income than it assumed in its SBP. C&W's range for additional income in Scotland (in 2017-18 prices) was a lower limit of £0.9m and an upper limit of £9.0m compared to Network Rail's base case.

1.47 For the purposes of our draft determination, we used C&W's base estimate, which was £3.1m (3%) higher than Network Rail's SBP.

1.48 Network Rail's response said this forecast was too optimistic because of declining station footfall and the potential effect of Brexit. However, C&W had taken account of these issues in its forecast. Therefore, we have not revised our assumption.

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