Explanatory note and draft price lists for CP5 franchised and managed station Long Term Charges

April 2013

1. Introduction

The franchised and managed station Long Term Charges (LTC) allow Network Rail to recover the efficient maintenance, renewal and repair (MRR) costs associated with the stations that it owns. They are regulated charges and are determined by ORR at each periodic review.

Following consideration of the responses we received to our September 2012 LTC consultation[1], in January 2013 we concluded on the structure of the franchised and managed station LTCs for CP5[2]. Our key policy conclusions were:

- to not move to portfolio-based charging by operator for franchised station LTCs (which we had previously proposed in our September 2012 consultation document); and
- to move the recovery of the MRR of Station Information and Security Systems (SISS) at franchised and managed stations from the Fixed Track Access Charge (FTAC) to the LTC[3].

Since January 2013, we have developed our LTC charges model for CP5, which calculates an annual charge for each station on the network. The franchised and managed station draft LTCs are set out in **Annex 1**[4] **and Annex 2** of this document respectively.

2. Purpose of this note

This purpose of this note is to supplement the draft franchised and managed station LTC price lists, attached at **Annex 1**, and forms part of our proposals to ORR. It explains some refinements to the franchised station LTC calculation methodology which was originally set out in our September 2012 LTC consultation document. It also highlights two errors in our January 2013 Stations and Depots Income Strategic Business Plan (SBP) submission[5] which have had a minor impact on the forecast level of franchised and managed station LTC income for CP5.

The purpose of publishing draft price lists at this stage of the 2013 Periodic Review (PR13) is to give operators an early indication of the level of their access charges, and also to provide them with an opportunity to input into the emergent price lists.

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[1] http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064783639
[2] http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064784761
[3] The maintenance of SISS equipment at managed stations is currently recovered by the managed stations' Qualifying Expenditure charge. In January 2013, we also concluded that in CP5, we would recover SISS maintenance at managed stations through the managed station LTC.
[4] For ease of reference, we have separated the operational property and SISS components of the LTC for each franchised station (on separate worksheets). The combined values will form the total draft LTC for each franchised station.
[5]http://www.networkrail.co.uk/browse%20documents/strategicbusinessplan/cp5/supporting%20documents/financing%20and%20funding/stations%20and%20depots%20income.pdf

Particularly in the case of franchised station LTCs, we are aware that there are a number of instances where there are station-specific contractual arrangements in place that may impact the way in which the associated MRR expenditure is recovered. We have endeavoured to reflect these contractual arrangements in the draft franchised stations LTC price list. Where an operator believes this not to be the case, however, **we would welcome further engagement such that it is reflected in the next update to the draft price list, which we anticipate providing following ORR's Draft Determinations in June 2013.**

It is important to note that, ultimately, all decisions with regards to track and station access charges for CP5 will be made as part of ORR's Final Determinations in October 2013.

If you would like to discuss any aspect of this note or the draft franchised and managed station LTC price lists attached at **Annex 1 and Annex 2** respectively, please contact:

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3. Franchised Stations LTC calculation methodology

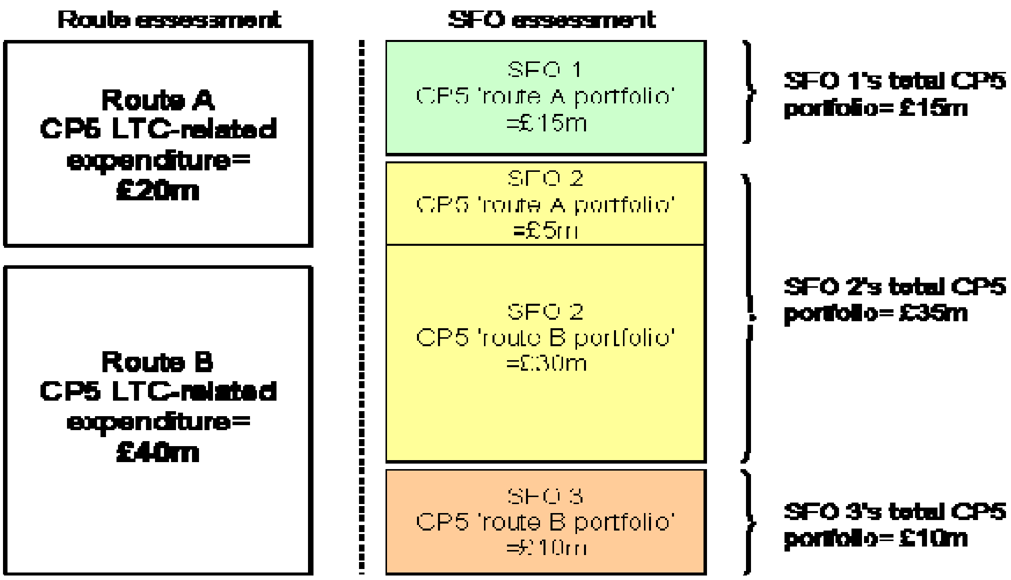
i. Route-level assessment of Station Facility Owner's (SFO) portfolio value

As discussed in our September 2012 consultation, individual franchised station LTCs for CP4 were set so as to provide a reasonable indication of MRR expenditure over the course of the control period at the SFO portfolio level. Consistent with this, we set out a four-step methodology for the calculation of franchised station LTCs for CP5.

This methodology, however, did not fully reflect the route-level focus of our CP5 plans. In the development of our January 2013 SBP, routes and supporting functions led the creation of the business plans for their respective areas. Each route set out its planned outputs, activity and expenditure for CP5, which was a key building block into the SBP.

Unlike our work during previous periodic reviews, our assessment of franchised stations expenditure has been developed on a 'bottom up' route basis for CP5. Within each route, an assessment has been made about each SFO's contribution to the route total. This means that where an SFO's portfolio extends across more than one route, its portfolio total is made up of assessments by each of the routes in which stations are located. Figure 1, below, illustrates the concept of SFO 'route portfolios'.

Figure 1: Illustration of SFO 'route portfolios'



We have, therefore, made some minor refinements to the franchised station LTC calculation methodology (which was originally set out in our September 2012 consultation) to reflect the route-level development of our CP5 business plans, which are summarised in section (ii), below. Our refined methodology makes an assessment of the SFO's forecast 'route-portfolio' of stations for the control period and then allocates it according to forecast spend on each station over a 35-year period[6]. Where a SFO operates across more than one route, the relevant 'route portfolios' are aggregated to form the total portfolio value.

It is important to note that these refinements are purely presentational and will deliver the same results as the previous methodology set out in our September 2012 consultation. We consider that the refined approach, set out in section (ii), below, is less complex and transparently links back to the original route-level SBP submissions.

ii. <u>Step-by-step summary of refined franchised stations' LTC calculation methodology</u>

This section describes the step-by-step methodology that has been used to determine the individual franchised station LTCs. An example of the process is set out in **Annex 3** of this note.

Determination of SFO's 'route portfolio' expenditure

[6] The approach presented in our September 2012 consultation was to make an assessment of expenditure by station over a 35-year period for each SFO and then adjust it back to CP5 levels, to reflect the forecast level of expenditure across the SFO's portfolio for the control period.

1. For each route, refer to SBP pre-efficient operational property and SISS expenditure submissions.

2. Determine proportion of route expenditure (per step 1) for each SFO and apply proportion to route pre-efficient total to determine:
    a. SFO's total CP5 expenditure; and
    b. SFO's CP5 annual average expenditure.

Determination of individual station LTCs

3. Using a combination of the CP5 'bottom up' workbanks for each station on each route and the CP6-11 'top down' station-by-station model[7], calculate the 35-year annual average expenditure for each station[8].

4. Calculate the SFO's *total* 35-year annual average expenditure value (by summing the individual franchised station values on the relevant route) and calculate the contribution to this total (in % terms) for each station.

5. Apply the % contribution for each station, determined in step 4, to the relevant SFO's annual average CP5 expenditure on that route (determined in step 2b) to calculate individual CP5 franchised station annual LTCs. In aggregate these will form the SFO's 'route portfolio'.

6. Apply generic efficiency overlays to each individual station's LTC consistent with the assumptions used in our SBP. The efficiency assumptions used are 16.64% and 16.63%[9] for franchised and managed stations' operational property expenditure respectively; and 15% for SISS expenditure.

7. To determine the SFO's total portfolio value (across all relevant routes), aggregate each of the SFO's 'route portfolios'.

As discussed, above, the refinements to the franchised station LTC calculation methodology are presentational. We have discussed this refined approach with ORR and would be happy to discuss it with stakeholders if they would find that helpful.

iii. <u>Allocation of SFO's 'route portfolio' to individual stations on the route</u>

Following consideration of responses to our September 2012 consultation, we concluded that we would not move to a portfolio charging structure for the franchised station LTCs in CP5, and would instead continue to raise individual franchised station LTCs. As stressed in our January 2013 conclusions and described above, however,

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[7] This combination applies to operational property only. A 'top down' modelled approach has been used to determine forecast SISS expenditure from CP5 to CP11.

[8] The purpose of taking a 35 year view is to provide a reasonable view of long-term cost estimates, and 'even out' some of the extremes in expenditure which will occur across control periods.

[9] An efficiency assumption of 16.1% for operational property was incorrectly applied to our SBP LTC franchised stations income submission. This is further discussed in section 4(ii) of this document.

franchised station LTCs are in effect set at the portfolio level. Individual station-level LTCs have been calculated on the basis of long-term modelled expenditure. **They should, however, be considered as indicative, since they will not be fully reflective of the specific spend at each station within CP5.**

Steps 3-5 in section 3(ii), above, explain that, for franchised stations' operational property, expenditure has been allocated using a combination of the CP5 'bottom up' work banks for each station on each route, and the CP6-11 'top down' station-by-station model.

The detailed CP5 'bottom up' work banks developed for each route included:

(a) major renewals and repair schemes on a station-by-station basis (identified through application of buildings renewals policy based on asset condition and risk);
(b) TOC-specific expenditure for various stations (e.g. 'inspections of C2C Stations' or 'planned preventative maintenance for First Great Western Stations' based on historic expenditure); and
(c) Route-wide expenditure for various stations (e.g. 'minor emerging works across all stations' based on historic expenditure).

To more accurately reflect station-specific expenditure, (b) and (c), above, were distributed across the stations within each route or SFO's portfolio. Stations were weighted using the same approach as the CP6-CP11 'top down' model, which was developed in accordance with application of the relevant asset policies.

4. Errors in our January 2013 SBP Stations and Depots Income submission

i. <u>Inclusion of SISS expenditure in the LTC calculations</u>

As noted, above, we concluded in January 2013 that we would, in CP5, move the recovery of SISS MRR expenditure from FTAC to franchised and managed station LTCs (it should also be noted that the maintenance element of SISS expenditure at managed stations is currently recovered by the Qualifying Expenditure (QX) charge. We also proposed to move this to the managed station LTCs).

In January 2013 we also published our SBP which included a breakdown of the operational property and SISS elements of franchised and managed station LTC income in CP5. On further analysis, the SISS component of CP5 stations LTC forecast income made provision for the recovery of renewals expenditure only, with maintenance and repair expenditure continuing to be recovered by FTAC and QX.

As a result of this omission, for those franchised stations where we are contractually responsible for the maintenance and repair of SISS assets, the charges will be understated in the attached draft price list in Annex 1 (with a corresponding 'overstatement' of the relevant operators' FTACs[10]). In the case of the managed station LTCs, they will also be understated, with corresponding overstatements of

[10] Our draft FTAC price list was published as part of our March 2013 FTAC conclusions and can be accessed at http://www.networkrail.co.uk/fixed-track-access-charges-consultation.pdf

FTAC income (for the repair element of forecast CP5 SISS expenditure) and QX (for the maintenance element of forecast CP5 SISS expenditure).

As part of our response to ORR's Draft Determinations, we will seek to correct this omission and reflect all relevant SISS expenditure (i.e. MRR) in the next version of the draft price list, which we anticipate providing following ORR's Draft Determinations. We do not consider that this omission will result in a material increase in the SISS component of the relevant franchised and managed station LTCs.

ii. Efficiency assumption

An efficiency assumption of 16.1% for operational property was incorrectly applied to our SBP franchised and managed station LTC income submission. As a result of this error, annual CP5 franchised and managed station income in our SBP submission was overstated by £0.75m and £0.15m respectively.

We have rectified this error in the draft LTC price lists by using the correct efficiency assumption of 16.64% and 16.63% for franchised and managed stations' operational property respectively. It should be noted that this assumption could be subject to further change, following ORR's Draft Determinations. Should this be the case, we will reflect the revised efficiency assumption in the next version of our draft price list.

5. Other considerations

i. Non-standard recovery of operational property and SISS MRR expenditure

We are aware that, in some instances, there are specific provisions within some Station Access Agreements relating to the recovery of operational property MRR expenditure, which may not be recovered by the individual franchised station LTC (for example, it may instead be recovered by the station lease charge or FTAC). We have reflected these arrangements to the best of our knowledge in the preparation of the draft price list, but accept that there may be other specific cases that have been missed. **We would welcome further engagement with SFOs where you consider this to be the case, such that we can amend the draft price lists accordingly.**

As we highlighted in our January 2013 conclusions, over the past year Network Rail has undertaken comprehensive surveys to establish what SISS equipment exists at each franchised station and whose responsibility it is to carry out the associated MRR activities. As noted, above, while this version of the draft franchised station LTC price list includes the recovery of SISS renewals expenditure only, we would welcome further discussions with SFOs in any instances where they believe the inclusion of SISS renewals expenditure in an individual franchised station's LTC does not reflect the responsibilities set out in the Station Access Conditions Annexes, for that particular station.

In addition it should be noted that the draft LTC price list in **Annex 1** relates to the recovery of MRR expenditure only at franchised stations. Where there are negotiated arrangements in place with SFOs to recover other aspects of expenditure via the LTC at a specific franchised station, the CP5 LTC will be discussed with the SFO on a case-by-case basis.

6. Next steps

Following the publication of ORR’s Draft Determinations, expected in June 2013, we will update our draft franchised and managed station LTC price lists which will take account of ORR’s expenditure and efficiency assessments.

The updated price lists will also include the recovery of SISS maintenance and repair expenditure in CP5, which as discussed, above, are not included in the current draft franchised and managed station LTC price lists.

As highlighted, above, we have endeavoured to reflect specific contractual arrangements in the preparation of the franchised stations LTC price list attached at Appendix 1. Over the coming weeks, however, we would welcome further engagement with SFOs where they consider individual station charges do not reflect specific provisions within their Station Access Agreements. This will enable us to investigate accordingly and where appropriate, reflect in the updated version of the draft franchised station LTC price list, following ORR’s Draft Determinations.

Ultimately, all decisions with regards to track and station access charges for CP5 will be made as part of ORR’s Final Determinations in October 2013.