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Technical Report

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01

FUNDING OF DEVOLVED ROLES IN ENGLAND'S RAILWAYS



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Executive Summary

This report sets out how devolved roles in England's railways have been and are currently funded. It explores how the relationship between local powers, financial responsibility and accountability has changed over time. Starting with arrangements that underpinned local rail specification by Passenger Transport Executives (PTEs) of services operated by British Rail, through privatisation and franchising, it finishes with the 'de-designation' models for Merseyrail Electrics and London Overground. The report also considers the French regional rail model as a comparator for future arrangements in England.

Reviews of local outcomes achieved across these rail devolution models, primary research, and first-hand interviews demonstrate that the greatest benefits of rail devolution depend not only on the transfer of powers, but also on the right funding and financial context. Local fiscal autonomy - the ability to make meaningful financial choices - rather than simply administering money allocated and controlled by central government, is a crucial ingredient. The benefits this brings include control of the local farebox with stronger incentives for growth, cost effectiveness and local integration across transport modes.

By contrast, direct local influence is limited where it is confined to a consultative role or funding enhancements to a nationally determined baseline service. Even substantial responsibility for managing rail services will remain constrained without the financial freedoms needed to make, fund and be accountable for meaningful choices.

Many of the primary references cited in this report are not available online. For copies, please contact Oscar Rocklin via oscar.rocklin@networkrail.co.uk .



Figure 1-1 - A Class 323 in Greater Manchester PTE livery. Section 20 finances meant that PTEs contributed to the cost of rolling stock for supported services.

Section 20 and the publicly owned railway

From the 1970s until rail franchising in 1997, Section 20 of the Transport Act 1968 enabled PTEs to agree local rail services with British Rail. The PTE paid the difference between the attributed costs for agreed services and the passenger revenue generated from them. In return, the PTE had substantial influence over local service levels, fares, service quality and investment. Exposure to local costs and revenue through Section 20

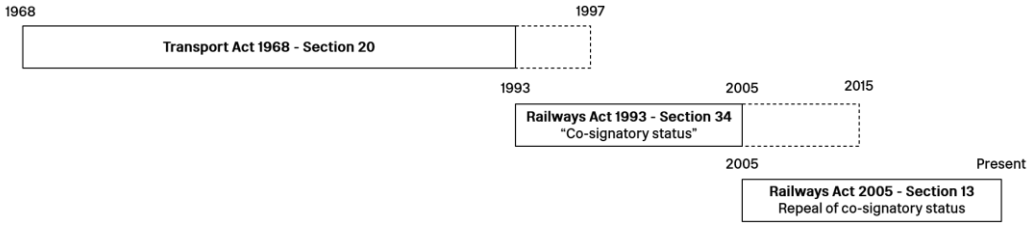
was the mechanism which offered PTEs control of the local farebox for the agreed rail services.

The Section 20 role was funded through a combination of fare income, local taxation and central government rail support. The precise mechanisms changed as the wider local government finance system evolved (and became increasingly constrained). PTE funding moved from visible local rate precepts to levies on constituent councils, while central support was provided through general and transport-specific grants (but not ringfenced to rail). Government grant for the Section 20 role (the Section 20 'bolt-on') recognised that local specification offset centrally funded Public Service Obligation support, but was only a contribution, not a reimbursement of actual Section 20 costs.

The combination of local taxation, central grant, and fares income, gave PTEs sufficient financial autonomy to make genuine choices about the local railway with accountability for their consequences. This promoted direct local investment in new stations, rolling stock, electrification programmes as well as extensive service improvements, in an overall context of cost efficiency. Contemporary evidence records total capital investment in rail by the PTEs of £96.6 million in 1992/93, amounting to around £213 million in 2026 prices, with the Section 20 arrangements providing a mechanism for a direct local financial return on that investment.

These arrangements encouraged PTEs and British Rail to plan the local railway jointly. PTEs had an incentive to increase patronage, control operating costs and invest where this could improve services or reduce future support requirements. Control of fares also enabled rail to be integrated more readily with local bus and other public transport networks, including through multimodal ticketing and coordinated marketing. This benefit was substantially diminished when PTEs lost control of the local farebox on buses with deregulation in 1986.

Detail on the mechanics of the Section 20 arrangements is set out in our sister report: *Section 20 in Practice*.



Privatisation and the Section 34 co-signatory role under franchising

Rail privatisation fundamentally changed both the structure of the railway and the financial basis of the local role. Section 34 of the Railways Act 1993 gave PTEs the right to be co-signatories to relevant franchise agreements, preserving some influence over service levels, fares and quality. However, the separation of infrastructure, rolling stock and train operations introduced new commercial charges and substantially changed how railway costs were attributed.

The resulting increase in attributed costs could not be realistically accommodated in the existing local funding arrangements, noting that local fiscal headroom was also

increasingly constrained. Central government introduced the Metropolitan Rail Grant and subsequently consolidated support through the Metropolitan Railway Passenger Services Grant. This protected local authorities from the immediate financial impact of the newly fragmented regime, offering greater budgetary certainty. However, it also substantially weakened the connection between local decisions and local financial responsibility, because the services were underwritten through central government funding determined via the franchise settlement.

Over the proceeding years the franchising model became increasingly centralised. PTEs withdrew from revenue risk (and local fare-setting) in the second round of franchises. The Railways Act 2005 then removed the right for PTEs to be co-signatories to new franchises, replacing it with consultation rights and mechanisms through which they could propose and fund additional services or other enhancements. In practice, these mechanisms were complex, required central approval and were seldom used. The role of PTEs as a franchise co-signatory concluded when the 2004 Northern franchise ended in March 2016.

This history documents a progressive separation of local influence from the main financial flows supporting the railway. Central funding provided required financial protection to maintain service levels, but its consolidation through the Department for Transport (DfT) reduced the ability of places to vary the local rail offer and removed aligned incentives to deliver value for money or benefit directly from revenue growth. It also undermined aligned incentives for local modal integration.



Figure 1-2 – A Class 144 operated by Arriva Trains Northern, a franchise which included co-signatory status for PTEs, still carrying the Metro livery of West Yorkshire PTE.

Merseyrail Electrics and London Overground

Merseyrail Electrics and London Overground demonstrate two distinct forms of rail devolution within the post-privatisation railway using the ‘de-designation’ process. In both cases, a defined group of services were removed from the national franchising system and placed under locally specified contract arrangements, while most

infrastructure remains part of the national network. However, the financial frameworks underpinning the two models are different, particularly in relation to fiscal autonomy, allocation of revenue risk and control of the local farebox.

Merseyrail Electrics: local control supported by a specific central grant

Merseytravel (the executive transport body for Liverpool City Region) took on contractual responsibility for the Merseyrail Electrics operation in 2003. The concession gives it substantial management influence, with proximity to decision-making and visibility over operations. However, under the current contract revenue risk remains with the operator, meaning that Merseytravel does not have general control of the local rail farebox.

The costs of the concession are substantially supported by a ring-fenced Special Rail Grant from central government. This provides a relatively secure basis for maintaining the existing service, with mechanisms to adjust the grant for certain nationally driven changes. Where Merseytravel initiates a change that increases the required level of contract payments to the operator, it is generally responsible for meeting the additional cost from local resources.

The model provides valuable local management of the railway, but not the same degree of independent flexibility or farebox control provided by the London Overground model. Merseytravel's ability to make significant independent changes is limited by its current fiscal autonomy.

The decision to bring the Merseyrail Electrics operation into local public ownership when the concession ends in July 2028 is intended to provide greater strategic control, including over local fares. Alongside the introduction of bus franchising and growing fiscal freedoms, this has the potential to create better conditions for integrated fares, ticketing and service planning across local transport modes. However, the extent of that opportunity will continue to be influenced by the wider funding settlement available to Liverpool City Region.

London Overground: farebox control within a wider devolved funding system

London Overground operates within Transport for London's (TfL) wider transport and financial framework. Under the current concession model, TfL receives passenger revenue and integrates London Overground in its wider fares, ticketing and customer proposition, including contactless payment and multi-modal fare capping. This gives TfL effective control of the local farebox across modes and enables rail decisions to be considered alongside buses, London Underground and other local transport.

With each group of services transferred to TfL this was initially accompanied by financial settlements reflecting the previous national subsidy or financial position of the services concerned. At the point of transfer a settlement profile was agreed with the DfT whereby the grant reduced over time, before ceasing entirely. TfL has funded substantial improvements beyond the inherited baseline, including increased frequencies, enhanced station staffing, station improvements and new rolling stock. Increased passenger numbers and revenue now go a significant way to cover costs, with the balance resourced as part of wider Greater London transport budgets.

Greater London's relatively broad fiscal base and financial freedoms provide considerably greater flexibility than is available to other English transport authorities. TfL and can draw on passenger income across its network, retained business rates, the Mayoral precept and other local revenues available to GLA. It is free to allocate resources across transport modes, using surpluses from some activities and wider public funding to support services that require subsidy. In 2024/25, for example, London Overground was budgeted to require an operating subsidy of £86 million within TfL's wider financial settlement.

The French regional model

Responsibility for regional services (known as TER) was transferred to regional government alongside a transfer of state funding intended to reflect the operating costs, rolling-stock requirements and nationally determined social fares associated with the transferred functions. Regions became responsible for specifying service levels, routes, timetables and fares within the national framework alongside setting requirements for service quality and providing local passenger information. They bore the financial consequences of providing services beyond the transferred baseline, using local funding.

In the period since the Regions gained increased responsibility over their local rail networks, they have been able to shape the rail offer to better respond to their priorities. The previously declining TER passenger numbers have largely been reversed. The French approach reinforces the principle that transferring responsibility requires an explicit and continuing financial settlement. It also shows the importance of distinguishing clearly between national, regional and cross-boundary services. The experience of contentious inter-regional routes illustrates the risk that services crossing administrative boundaries can receive insufficient attention unless responsibilities and cost-sharing arrangements are agreed from the outset.

Lessons for rail reform in 2026

The evidence examined in this report suggests that successful devolution within a nationally integrated railway requires powers, funding and accountability to be designed together. This can enable control of local rail service specification and control of the local farebox with more effective local transport integration.

For rail reform in 2026, and particularly for informing local commissioning development, it can be concluded that the following principles should apply:

- **Devolving local service specification (local commissioning) should be accompanied with devolved funding.** This means that where local service specification is devolved to an MSA, they should receive a commensurate share of funding which equates to the portion of the national funding that would otherwise have been provided directly from central government to GBR to deliver local services. In effect, any local specification role will offset a funding role that will otherwise fall centrally.
- **Funding should be predictable and adaptable to future changes.** Multi-year certainty is needed for service and investment planning (both for the railway and MSAs), but arrangements must also be able to account for future inflation, changes to cost attribution, national policy, and revenue shocks. Without clear adjustment

mechanisms, financial risk may be transferred to bodies that cannot control or absorb it.

- **Align influence, financial responsibility and incentives**. Places are more likely to scrutinise costs, grow patronage and invest for the long term where they bear a meaningful share of the financial consequences and can retain and reinvest a relevant share of the benefits. Central grant support should therefore not be ringfenced to rail. The Section 20, Merseyrail and London Overground experiences each demonstrate different ways in which local incentives can be created or constrained.
- **Match rail devolution with appropriate fiscal capacity and farebox control**. Transferring responsibility for managing a railway will not realise the full range of local benefits without the local financial capacity to shape it. On London Overground, TfL's broad fiscal base and direct control of passenger revenue across the local transport network allow it to make multi-modal choices across fares and services and to retain the financial consequences of those choices.
- **Provide transparent and auditable cost and revenue information**. Section 20 depended on the ability of PTEs to understand, challenge and audit railway costs. A future local commissioning model will similarly require agreed attribution principles, open-book information and a credible process for resolving disputes.
- **Clear accountabilities**. GBR should remain accountable for safe, efficient and reliable operation of the network. Mayoral Strategic Authorities should be accountable for the local rail offer they commission and fund. How cross-boundary services are dealt with will require clear expectations and cost-sharing arrangements so that operationally coherent services do not become fragmented at administrative boundaries. The Section 20 model offers a strong historic reference point to how this can work effectively.

Overall, past evidence makes clear that local commissioning of rail services through GBR could provide a modern version of the partnership principles previously embodied in Section 20, while learning from later concession models. The opportunity now is to combine a publicly owned, integrated national railway with meaningful local decision-making, transparent financial accountability and the capacity to plan rail as part of a wider place-based local transport network. Achieving this will require more than a permissive power to enter into financial agreements with the railway. It will also require a coherent funding framework that gives both GBR and Mayoral Strategic Authorities (MSAs) the confidence, incentives and resources to make long-term decisions together.

GENERAL ARRANGEMENTS FOR POWERS AND FUNDING IN THE PUBLICLY OWNED RAILWAY

1. Context

Between 1948 and 1994 Britain's railways were publicly owned and operated by British Rail (BR). In 1968, recognising the importance of integrated public transport in towns and cities across Britain, the government enabled the creation of Passenger Transport Authorities (PTAs) and Passenger Transport Executives (PTEs) via the Transport Act 1968. These brought together many previously disparate public transport bodies under one accountable entity, for instance multiple municipal bus companies of the constituent councils and ferries operations. The PTA oversaw and funded the PTE and was generally constituted by elected representatives from the constituent local authorities in the area.

The statutory function of a PTE is *"to secure or promote the provision of a properly integrated and efficient system of public passenger transport to meet the needs of that area".* [1] Initially, five PTEs were established; West Midlands, South East Lancashire & North East Cheshire (latterly Greater Manchester), Merseyside, Tyneside (latterly Tyne and Wear), and Greater Glasgow (latterly Strathclyde). This grew to seven in 1974 with the addition of South Yorkshire and West Yorkshire.

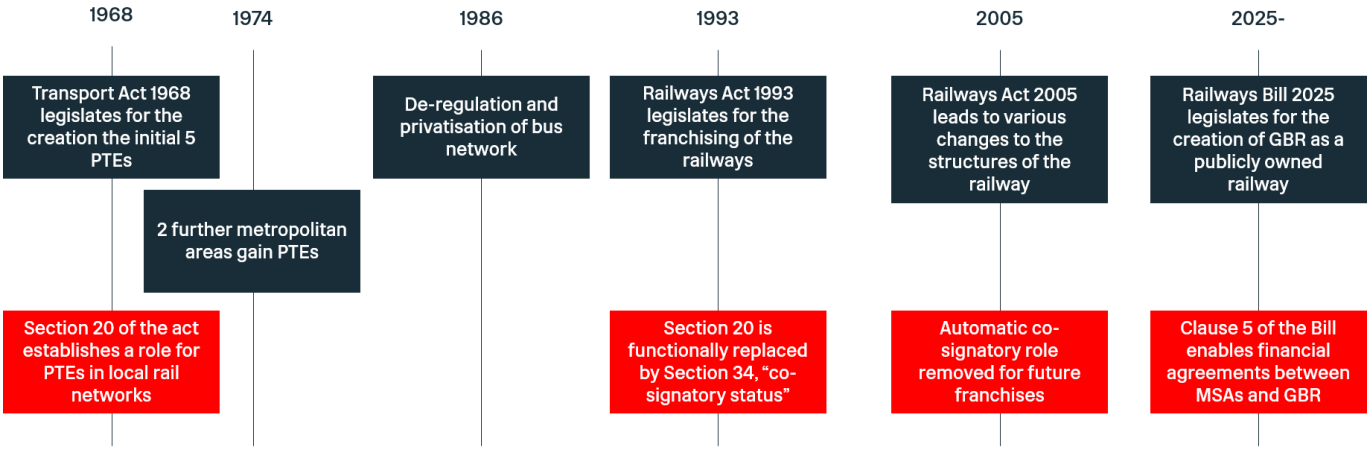


Figure 1-1 - Key legislative changes affecting the PTEs' roles and powers in relation to the provision of local rail services

1.1 Section 20 agreements

Section 20 of the Transport Act 1968 empowered PTEs to enter into agreements with British Rail to secure the delivery of local rail services which would properly contribute to the integrated public transport of their area. This arrangement ended with franchising in 1997. Section 20 rail powers worked alongside other public transport powers to enable the PTEs to realise the 'integrated and efficient system of public passenger transport' they were created to deliver.

Put simply and as described by South Yorkshire PTE in 1988: *"The PTE … has financially supported certain parts of the local railway network since 1977. This support… enables the PTE to specify train service frequency and quality levels, together with the fares to be charged. In return, the PTE pays British Rail, in accordance with a*

nationally agreed formula, the difference between the operating cost for the service specified and revenues from the fares collected." [2]

The mechanism gave PTEs significant influence over local rail services because they carried the financial consequences of the specification they agreed. That included exposure to revenue risk, and the attributed cost and revenue associated with their 'agreed services', enabling the PTE to control the local farebox on rail alongside other local modes of transport. Critically, the amount of the Section 20 payments floated according to actual railway operating costs and fare revenue collected. Outside PTE areas, most Regional Railways services still received government support, which came in the form of the Public Service Obligation (PSO) Grant. This could be topped up by revenue support by local authorities to secure additional services, but this support did not give the local authority control of the farebox. Most of the PSO network did not additionally receive top up local authority support.

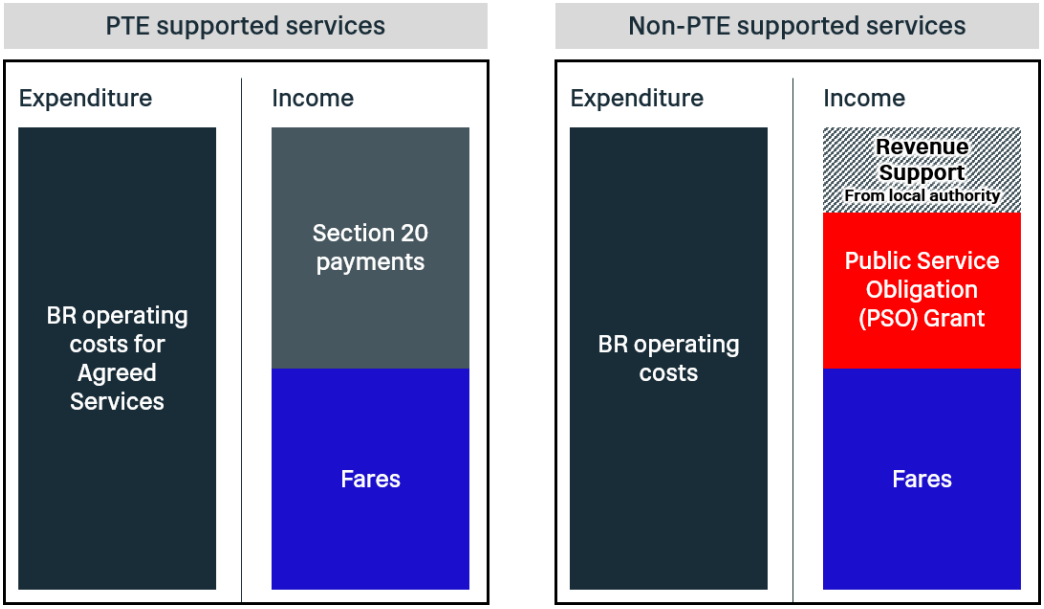


Figure 1-2 – Illustration of how rail services were supported in PTE and non-PTE areas.

The role and functioning of PTEs changed over time, most notably through local government reorganisation which created then subsequently disbanded Metropolitan County Councils (the PTE boundaries were updated to match the Metropolitan County Councils, which also fulfilled the role of the PTA). The deregulation in 1986 and subsequent privatisation of buses significantly reduced the role of the PTEs in the provision of local bus services.

Despite these changes the PTEs' role in relation to the local rail network enabled by Section 20 remained consistent over the period of public ownership. The only significant change to Section 20 legislation was in 1985 to make the power available to all PTEs in general – prior to this, Section 20 was enabled for each PTE via specific statutory order. Generally, there was greater focus on rail after 1986 when powers over the bus network were reduced [3], but all PTEs had entered Section 20 agreements for at least part of the local rail offer before that date. The PTEs continued to exercise their role under

Section 20 until franchising in 1997. A more detailed explanation of how Section 20 arrangements worked in practice is provided in our sister report, *Section 20 in Practice*.

There was no equivalent to Section 20 available in the local transport powers for Greater London. Only after the Railways Act 2005 was a degree of parity in rail powers achieved.

1.2 Post Section 20 arrangements

Following rail franchising, Section 20 was effectively replaced by **Section 34** of the Railways Act 1993. Existing Section 20 agreements remained in place until the relevant rail operations were let to the private sector as franchises in 1997.

Section 34 gave PTEs the right to be co-signatories to relevant rail franchises alongside the franchising authority (Office for Passenger Rail Franchising (OPRAF), later the Strategic Rail Authority (SRA), then DfT). Under this arrangement, the relevant local share of rail financial support to the franchisee came via the PTE. During the first franchise round, five of the seven PTEs chose to retain revenue risk and set local fares, with West Yorkshire and Greater Manchester opting not to do so. No PTE retained revenue risk in subsequent franchises.

Section 34 was repealed by the Railways Act 2005 and functionally replaced by **Section 13** of that Act. While Section 13 retained some previous provisions, including access to data and formal consultation, it removed the automatic right for PTEs to be co-signatories on future franchise agreements. Instead, co-signatory status is subject to the Secretary of State's discretion, and there have been no instances where this has been granted. In practice, some areas have instead used non-statutory partnership agreements with the DfT, without a shared financial role.

The current Railways Bill proposes repealing Section 13 of the Railways Act 2005. The new **Clause 5** broadly maintains existing provisions of Section 13 of the 2005 Act (and Section 20 of the 1968 Act) but applies it more generally to MSAs, as well as PTEs, and focuses on the relationship with GBR, rather than the Secretary of State. It includes provision for financial agreements between local government bodies and GBR, which could include arrangements like those previously available under Section 20.

1.3 Evolving role of PTAs and PTEs

The role of PTAs was replaced by Integrated Transport Authorities (ITAs) in 2008, and this role was subsequently folded into and now discharged by the relevant MSA. Local transport powers in the metropolitan counties still stem from provisions in the 1968 Transport Act and there remain a set of PTE powers which continue to be discharged either via stand-alone executive bodies (such as Transport for Greater Manchester, Merseytravel and Nexus) or directly by the relevant MSA.

1.4 The role and powers of the PTE in relation to the rail network

This section of the report describes the role and powers of the PTE in relation to the rail network in sufficient detail to enable the financial aspects associated with Section 20 to

be understood. It is not an exhaustive explanation of their role, and further details can be found in the reference sources. The role of PTEs was to ensure the provision of properly integrated and efficient public transport for their area of which local rail services formed a part. Rail services themselves were provided by British Rail using network resources, and were not operated directly by the PTE, although there were instances where local rail lines were separated from the national network and re-purposed as light rail where this made sense (i.e. Tyne & Wear Metro, Manchester Metrolink).

The PTE role is best described as agreeing and procuring services from BR, including setting local service levels and fares. PTEs could also define quality standards and invest in improvements to the railway including new infrastructure and rolling stock. [4] [5] The levels of revenue support (i.e. excluding capital investment) by each of the PTEs to support their services are shown in the table below.

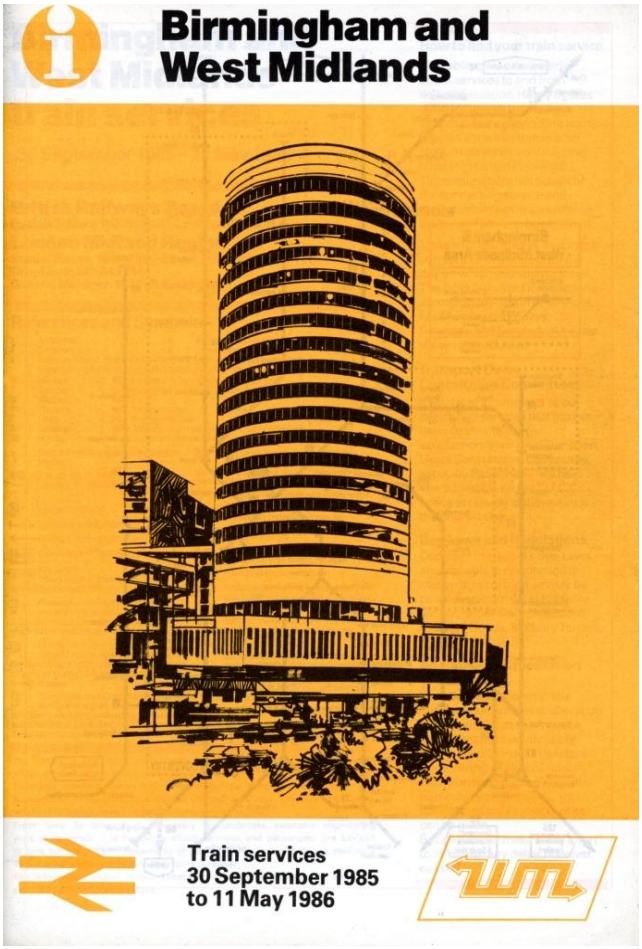
Table 1-1 - Summary of levels of support provided by individual PTEs in 1993/4 and the cost recovery ratio for their agreed services

PTE	Revenue support/ £m	Cost/ earnings ratio (%)
Strathclyde	30	181
Merseytravel	20	184
Greater Manchester	28	256
Centro (West Midlands)	17	205
West Yorkshire	14	237
South Yorkshire	6	215
Tyne and Wear	2	189
Total PTE services	**117**	**195**

Regional Railways HQ, Finance Strategy Executive [6]

1.4.1 Agreeing local service levels

Working with BR and neighbouring PTEs if necessary, the PTE would agree service levels for ‘agreed services’. This included not just the timetable, but also capacity (numbers of carriages) a service was booked to be made up of. Section 20 powers could also be exercised up to 25-miles beyond the geographic boundary of the PTE. [7] The scope of ‘agreed services’ was identified in the Section 20 agreement as the service between specified stations on lines of route, with the PTE taking on financial responsibility for the local service offer between those stations. The PTEs, through their partnerships with British Rail, helped to ensure the sustainability of local lines which may otherwise have been subject to closure. [3] Service levels were regularly reviewed in collaboration with BR to ensure that they were meeting the local transport needs of an area most efficiently, were affordable to the PTE and were operationally practical within the constraints of the rail network. [7]



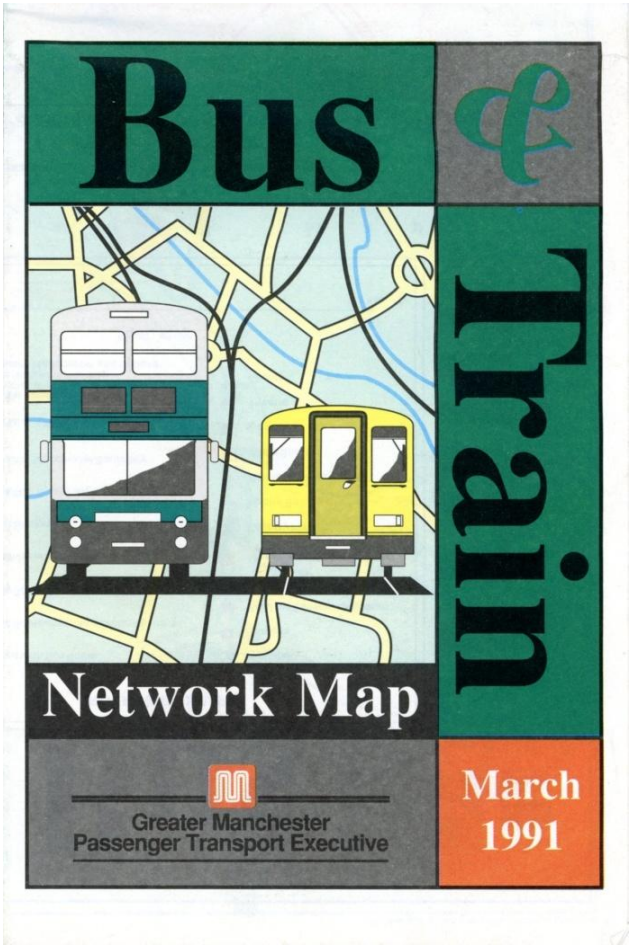


Figure 1-3 – PTEs specified the timetable for their agreed services with British Rail. This enabled them to ensure integration between modes. They supported this by publishing timetables which promoted local services (left – WMPTE timetable book - 1985) and other promotional materials such as integrated network maps (right – GMPTE bus and train map – 1991).

The concept of 'agreed services' under Section 20 is an important distinction to the revenue support mechanism used by other local authorities at the time (and subsequently). [8] Revenue support was typically an annually agreed sum used to 'top up' service levels (frequency / hours and / or days of operation) beyond the level which BR was able to offer from within its PSO grant. The difference between Section 20 arrangements and revenue support is akin to the difference between a locally franchised bus service network (service levels and fares set by the local transport authority, with control of the farebox and revenue risk), versus tendered bus services (commercial operation 'topped up' with additional operating hours or route additions, but with service levels otherwise determined by bus operators who retain revenue risk).

1.4.2 Fares

Revenue Risk
PTEs held revenue risk for the services they supported ('agreed services'). They set local fares, were exposed both to the risk of changes to revenue (e.g. through changes in demand) and to changes to operating costs.
The enabled PTEs to control the farebox on local BR services.

The PTE set local fares for its agreed services. Typically, PTE fares would be lower than those on equivalent non-supported services. Often PTEs sought to maintain rail fares at a comparable level to bus prices in the area. [9] Because PTEs took full revenue risk and were accountable for local fares there could be local fare changes which were far more dramatic than those we would see today. [10] This could be driven by changes to railway operating costs or to the level of support the PTA (via the PTE) was willing to commit. For instance, in response to a sharp increase in Section 20 operating costs in 1991, West Yorkshire PTE raised the cost of local rail fares on MetroTrain services by an average of 20% in the year. [9] This was driven by a need to increase passenger revenue to offset the increased operating costs and maintain at a consistent level the support which the PTA was willing to offer based on its financial ask of its constituent councils. West Yorkshire PTA was accountable for this decision but the PTE also worked extensively with BR to identify ways to reduce operating costs. [9]

The PTEs also provided multi-modal ticketing products for bus and rail (and other modes where they were available) within their area. The basis of these schemes was, compared to today, remarkably simple when the PTEs controlled the local farebox across modes (i.e. until bus deregulation in late 1986). Examples included the Saveaway ticket in Merseyside, Travelmaster in South Yorkshire, WM Travelcard in West Midlands, Clippercard in Greater Manchester, and the MetroCard and SaverStrip in West Yorkshire.



Figure 1-4 – As PTEs were taking revenue risk on agreed services, they were incentivised to grow revenue. Setting fares also made it much more straightforward to develop multi-modal ticketing products, which that also marketed. On the left is a GMPTE leaflet promoting the 'SaverSeven' from 1976, and on the right is WYPTE's promotion of off-peak fares in West Yorkshire in 1990. *Image: Mike Ashworth Collection*

1.4.3 Service Quality

PTEs and BR could agree a set of quality standards for rail services in their area. These would cover both operational performance and customer experience. This provided assurance that the agreed standards were being delivered. PTEs often funded activities to improve the service quality where this would increase revenue and / or patronage of the supported services. Typically, PTEs were willing to invest in better quality station facilities, as well as higher specification cleaning regimes, at a time when network standards were lower than is typical today.

1.4.3.1 Operational

Operational performance metrics would typically be a measure of cancellations and percentage of trains on time. For instance, in 1992 West Yorkshire PTE agreed targets with BR of no more than 1% of trains cancelled and at least 93% of trains on time within 5 minutes. These exceeded BR's own performance targets for regional services at the time (90% of trains on time and 1% cancelled). These operational targets also covered the percentage of trains which were operated with the specified rolling stock and number of carriages. [9] Given the level of local support, it was reasonable for such local targets to be agreed between BR and the PTEs. The cost of meeting these targets was also incorporated into the operational costs charged back to the PTE through Section 20.

1.4.3.2 Customer experience

PTEs would also set standards for customer experience on trains and at stations. This would cover aspects such as quality of waiting facilities, station staffing, cleanliness, car parking, and maintenance. To achieve these standards the PTE would work in partnership with BR and implement improvements based on who was best placed to deliver. For instance, West Yorkshire PTE invested in five mobile station cleaning teams to improve the presentation of local stations. The PTE also invested in building high-quality passenger shelters across the network and reached agreements with BR on improving the internal and external cleanliness of trains. [5] In a context of revenue risk for local services being owned by the PTE these were all rational responses.

Discussion between BR and the PTEs took place on progress against service quality targets throughout the year. Whilst these would be formally agreed, they were not written into the Section 20 agreements. Payment from the PTEs to BR would be made irrespective of whether the expected quality of service was achieved. Shortly before privatisation trials were undertaken between BR and Centro (WMPTE) to evaluate incorporating a payment mechanism related to service reliability into the Section 20 agreement, which also acknowledged neither party was taking an operating profit. Owing to privatisation this mechanism was never rolled out widely within Section 20 arrangements. However, service quality standards featured heavily in the contracts with franchised train operators (which did include for profit) and those did include financial rewards and penalties. [9]

1.4.4 Investing to improve the rail network

The PTEs invested significant sums to improve the rail network in their area including new services, new stations and on several occasions new lines. This investment would either be direct delivery of projects by the PTEs, for instance constructing a new station car park. Alternatively, PTEs would provide funds to BR for a specific investment project

which would benefit the PTE's services, for instance electrification and re-signalling of a line. In 1992/3 the capital investment by PTEs into the rail network was:

Table 1-2 - PTE capital investment 1992/3 (1992 prices)

PTE	Capital Investment (1992 prices)	Capital Investment (2026 prices)
Greater Manchester PTE	£8m	£17m
Merseytravel	£13.5m	£30m
South Yorkshire PTE	£1m	£2.2m
Strathclyde Transport	£9.19m	£42m
Tyne and Wear PTE	£95k	£209k
Centro (West Midlands PTE)	£49.3m	£109m
Metro (West Yorkshire PTE)	£15.5m	£34m
Total	**£96.6m**	**£213m**

Source: Signals for a Better Future (Association of Metropolitan Authorities and Regional Railways) [11]

Examples of the schemes that were enabled by PTE investment include (1992 prices): [11]

- Leeds to Bradford electrification and re-signalling - funded by West Yorkshire PTE at a cost of £50 million (scheme launched 1994)
- Manchester Airport station and the associated one-mile rail link - jointly funded by Greater Manchester PTE and BR (station opened 1993)
- Electrification to Chester and Ellesmere Port to expand the Merseyrail network - Merseytravel and Cheshire County Council funded £4.3 million of the £10 million cost (completion of electrification in 1994)
- Electrification and new rolling stock for the Cross City line in Birmingham - Centro invested £56 million (scheme launched 1993)

Until privatisation, capital investment by PTEs in rail infrastructure was generally held on PTE balance sheets and depreciated in accordance with normal accounting practice. Privatisation required these assets to be transferred to Railtrack, requiring the PTEs' outstanding financial interests to be bought out. This was achieved when Railtrack was established in 1994. The outstanding book value of each PTE's rail assets was converted into a debt owed to the PTE, with repayments made through the Deeds of Assumption arrangements. Responsibility for these repayment obligations was subsequently assumed by Government before the flotation of Railtrack. From 1997/98, the repayments were incorporated within the Metropolitan Railway Passenger Services Grant (MRPSG), as a component of funding for the PTEs' co-signatory role. [12] Secondary legislation was laid in 1995 to ensure that these repayments were not treated as capital receipts [13]

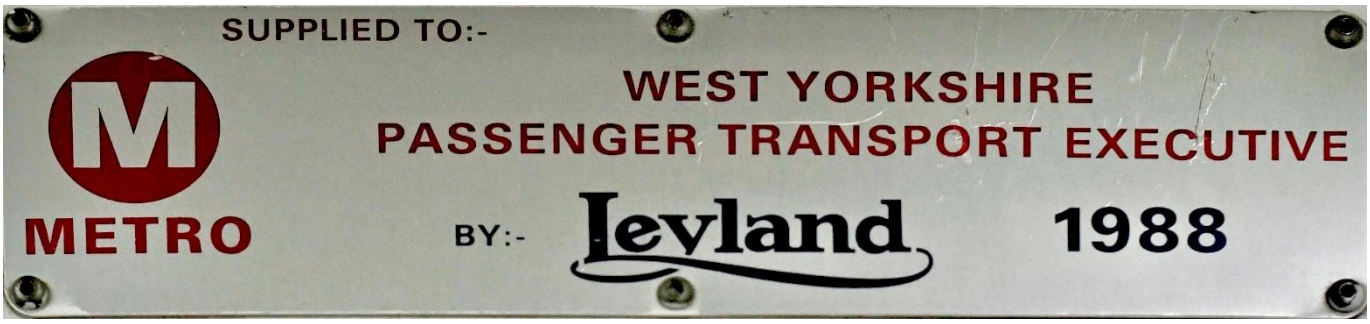


Figure 1-5 – A builder's plate on a Class 155. West Yorkshire PTE invested directly in rolling stock for its services. *Image: Paul Bigland*

The investment by the PTEs into the rail network wasn't limited to infrastructure. The Section 20 arrangements included for rolling stock depreciation charges for vehicles used to deliver agreed services. However, in the 1980s and early 1990s West Yorkshire PTE purchased and leased 56 rail vehicles directly to accelerate new capacity, with a commensurate reduction in Section 20 costs. BR managed the procurement and operation of these trains on behalf of the PTE. As recently as 2011 WYPTE sold rail vehicles to the Porterbrook leasing company (the ROSCO that had managed the vehicles on the PTE's behalf after privatisation) to help fund new stations at Apperley Bridge and Kirkstall Forge. [3] [14] [15]

Capital investments into the rail network were also funded by councils that were not part of a PTA. For instance, the £400k capital costs of building Hornbeam Park station near Harrogate, which opened in 1992, was met by Harrogate Borough Council. [11] However, without control of the local farebox, capital investment made by local government outside Section 20 areas was only on the basis of achieving local policy outcomes, rather than seeing a financial return via increased rail revenues.

RailPlans

The RailPlans were documents jointly produced by some PTEs and British Rail, generally developed through a joint working group. These enabled effective joint investment planning and co-ordination across the PTE and BR, facilitating co-investment and service development. These working groups would consider the following:

- The options for future development of the local network, including initiatives to increase cost effectiveness.
- The operation of the Section 20 agreement and any changes required which would need national discussion.
- The interface with other parts of British Rail and other local authority functions to enable recommendations of necessary actions.

Each RailPlan would review the current policies of the PTA and set out a joint programme with British Rail to achieve those policies. The programme would cover 5 years and roll forward each year. This enabled major investment to be properly evaluated, planned and phased and put the jointly agreed RailPlan on the same basis as British Rail's Corporate Plan. There would be interplay between the two organisation's planning processes. [16] The annual West Yorkshire RailPlans from 1989 to 1992 offer good evidence of the success of this approach.

1.5 Financial framework

1.5.1 Funding of PTAs

1.5.1.1 Overview

Aside from farebox and other ancillary revenue, the PTEs were funded principally by their corresponding Passenger Transport Authorities (PTAs), latterly Integrated Transport Authorities (ITAs). The PTA was the accountable local transport authority. PTA funding has varied over time but is a combination of local taxation and centrally funded grant.

The relative share of funding, and the mechanism by which the local contribution was raised changed significantly over time, reflecting wider changes in local government finance, including the use of Domestic and Non-Domestic rates, the introduction of the Community Charge (commonly referred to as the 'Poll Tax'), and the subsequent move to Council Tax.

Since 1945, the system of local government finance in England has become increasingly complex. As welfare services such as education, social care and social housing expanded after the second world war, it became necessary for central government to increase grants to councils because local taxation alone could not fund the growing requirements. These grants paid by central to local government proportionately grew with increasingly complicated equalisation arrangements applied: areas with relatively high spending needs (as measured annually by a set national formula) and/or a relatively low tax base were allocated more central funding than those with relatively lower spending needs and/or a relatively bigger tax base. Thus, for example, Richmond-upon-Thames (Greater London) and Trafford (Greater Manchester) received a smaller grant per head than Knowsley (Merseyside) or Barnsley (South Yorkshire). [17] [18] [18] [19] [19]

For the period prior to the introduction of the Poll Tax in 1990, the cost of local public transport support via the PTAs was substantially raised through local taxation. Central government support existed, and was generally routed through broader local authority grant systems.

Metropolitan County Councils fulfilled the role of PTA from April 1974 to April 1986 and so received the public transport element of central grants and locally raised taxation. From April 1986 to April 1990, the PTAs received relevant grant support directly, set local rates in their own right (via a rates precept). This meant that PTAs and PTEs operated within a mixed funding framework, fare income reduced the requirement for subsidy; local ratepayers (Domestic and Non-Domestic (i.e. businesses)) funded a large share of the residual requirement; and central government grants provided either general support to local government or specific support for eligible transport expenditure. [20]

Table 1-3 – How local funding of PTAs in England changed over time

Period	Primary local PTA funding mechanism
1968 – 1974	PTA precept via billing authorities (various)
1974 – 1986	Part of Metropolitan County Council rates precept via Metropolitan District Councils as billing authorities
1986 – 1990	PTA precepts (in its own right) via Metropolitan District Councils as billing authorities
1990 – present	Annual levy on constituent Metropolitan District Councils (continues to apply to transport functions of Combined Authorities that fulfil role of PTA / ITA as successors).

Precepts vs Levies

A precept is issued by a precepting authority (for instance a PTA, County Council, or Parish Council) to a charging authority (i.e. the local authority that issues bills for and collects local taxes). The precept(s) are separately identified on a tax bill, contributing to the overall total. The charging authority collects the tax from residents and businesses and passes the funds collected on to the precepting authority. Under a precept the precepting authority's requirement is visible as a separate item within the local tax demands. This remains common in England for Fire and Rescue Authorities, Town and Parish Councils, and Police and Crime Commissioners. In Greater London, the Greater London Precept covers police, fire, transport (i.e. TfL), and the GLA itself.

A levy is a charge imposed on other local authorities, which then recover the cost through their own general budgets, including any grants and local taxation. Unlike a precept, local taxpayers do not see a separate component in their local tax bill. This is how the core local transport functions of Combined Authorities (as successors to the PTAs) in the metropolitan county areas in England continue to be funded.

1.5.1.2 Creation of the PTA and PTE model, 1968 to 1974

The Transport Act 1968 created the PTA and PTE model and established PTAs as precepting bodies. The PTA for a designated area could issue precepts to the billing authorities within its area to raise the sums on its behalf required to meet the estimated deficit on the Executive's revenue account, or to meet undertakings entered by the Authority. [1]

This early framework gave the new PTAs a direct local funding route. The PTE planned and delivered the integrated public transport functions in accordance with the policies set by the PTA. Fare revenue and other operating income were applied first; and the balance was met through the PTA, supported by the locally raised precept and by grants available through the wider local government finance system. The cost of supporting public transport was separately identified on rate demands, and explanatory material was issued to ratepayers setting out how the transport precept was used. This gave the public transport subsidy a high degree of visibility (and accountability) within the local

taxation system, and ensured the PTA had sufficient financial security and autonomy to effectively plan for its requirements.

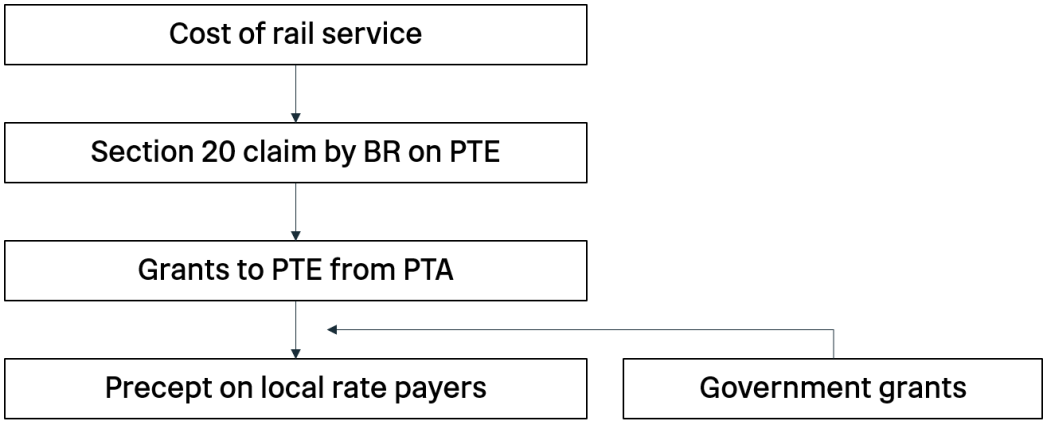


Figure 1-6 - Financial flows during period from 1968 to 1990 (role of PTA fulfilled by Metropolitan County Council from 1974 to 1986).

Government grants came in two forms, Specific and Supplementary grants, to be used for specific purposes, and the Rate Support Grant (including the Block Grant) which was for general local government expenditure. The component of the Rate Support Grant in PTA areas with Section 20 agreements was determined by a national formula, the key metrics of which were loaded train miles or track miles sponsored. This was often referred to at the time as the 'Section 20 bolt-on'. Crucially, this was not a direct re-imbursement of Section 20 costs. [21] Instead, in principle, the Section 20 bolt-on acknowledged that support to local rail services provided via Section 20 arrangements offset the need for central government funded PSO support direct to BR.

In 1974, the overall ratio of government grants to local rates was approximately 17:10. This ratio relates to local government finance as a whole, rather than specifically to PTA transport expenditure, but gives an indication as to the level of central government support. [19]

1.5.1.3 Metropolitan County period and Transport Supplementary Grant, 1974 to 1986

The 1974 reorganisation of local government changed the wider context in which PTAs operated. In the metropolitan areas, the boundaries of the PTAs were aligned with the new Metropolitan County Councils, which took on the role of the PTA. During this period, local transport funding sat within the wider metropolitan county finance framework, with expenditure continuing to be supported by a combination of fares, local taxation, general grant support and transport-specific grant arrangements. [21]

The Local Government Act 1974 introduced Transport Supplementary Grant (TSG), first paid in 1975/76. TSG was designed as a block grant for local transport. It supported both revenue and capital expenditure on roads and public transport, and enabled central government to assist areas with transport costs that were high relative to their populations. The PTAs would bid into central government to be included within the Transport Policies and Programmes (TPP) which was determined by the Department of Transport (now DfT). This would set the TSG level grant which was then paid at a percentage marginal rate on all accepted expenditure (this marginal rate was originally

70%, reducing to 55% in 1983/84). In 1980/81, councils devoted around 63% of TSG to revenue expenditure support. In parallel, capital expenditure on public transport infrastructure could also be supported through specific grants under Section 56 of the Transport Act 1968. [21] [22]

The position changed in the mid-1980s, from 1985/86 the TSG was restricted to capital expenditure on highways and traffic, and investment in local public transport facilities such as bus stations, bus depots and rail electrification schemes ceased to be eligible for the TSG. Major public transport projects could still receive specific central government support under Section 56, but the broad use of TSG to support PTE revenue and public transport capital expenditure was curtailed. [21]

The same period also saw stronger central controls over local transport expenditure. The Transport Act 1983 gave the Secretary of State powers to set the maximum amount of revenue support that a PTA could provide to a PTE, which in practice required PTEs to submit annual business plans to central government. “Rate-capping” was introduced in 1984 and included control over precepts. These changes reduced the extent to which locally elected transport authorities could independently increase support to the rail network through the local rates system. [18]

1.5.1.4 Abolition of Metropolitan County Councils and return to joint PTAs, 1986 to 1990

Following the abolition of the Metropolitan County Councils in 1986, the PTAs were re-formed as joint bodies constituted by representatives appointed by the constituent Metropolitan District Councils. The PTE remained the delivery body and until 1990, much of the PTE’s support continued to come through the PTA transport precept raised from local rate payers and collected by Metropolitan District Councils on their behalf. [20]

Evidence documents that in 1988/89 central government grants supported 48% of local authority service expenditure in West Yorkshire as a whole, however for public transport central government support was much lower, only 8% of West Yorkshire PTA’s funding came from central government, with the balance raised through local taxes on Domestic ratepayers and Non-Domestic (business) ratepayers, 43% and 49% respectively. [20] Similarly in the West Midlands, the PTA received most of its funding from local rate payers. In 1988/89 WMPTE received £41.3m from rates, £13.8m from central government and £11.5m from other sources. [23]

1.5.1.5 Community Charge, levy regime and rail grant, 1990 to 1994

The introduction of the Community Charge in April 1990 (often referred to as the “Poll Tax”) marked a major change in local government and PTA funding. Domestic rates were abolished and the Community Charge was introduced. Non-Domestic rates were replaced by nationally determined uniform Business Rates. Although local authorities continued to collect Business Rates, central government determined the rate and how the receipts were distributed to councils. In effect, Business Rates became a central government grant rather than locally determined taxation. [19]

Community Charge reforms removed the PTA precepting power and replaced it with a levy regime (PTAs formally became levying bodies in 1990). [24] Rather than precepting directly on local taxpayers, PTAs billed their constituent district councils. Each district incorporated the levy within its own budget and recovered the cost through its collection

fund. Each PTA billed its districts broadly pro rata to each district's share of the adult population in the PTA area. [25]

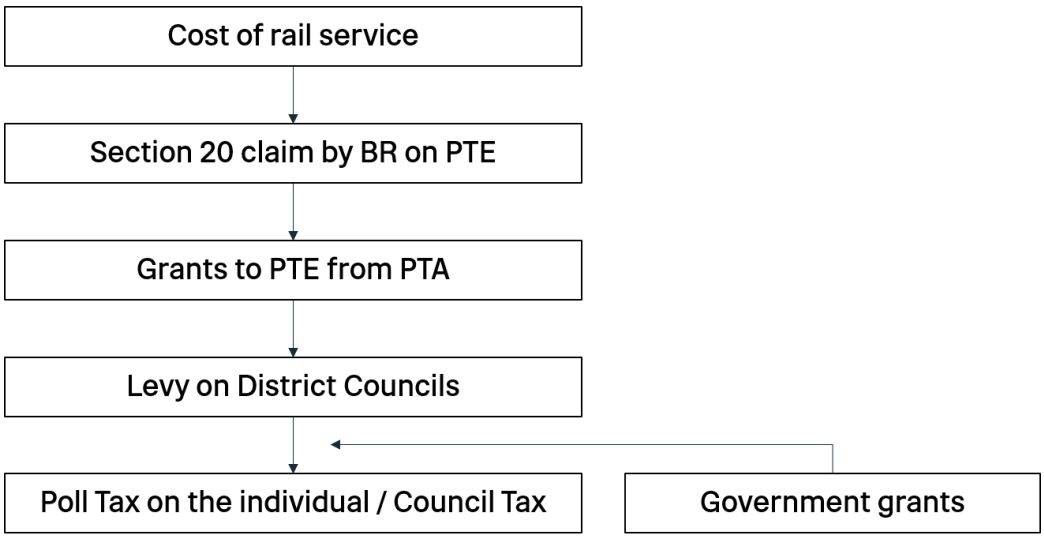


Figure 1-7 - Financial flows from the period from 1990 until franchising in 1997

The reforms also changed the route by which central government support reached PTAs. Prior to 1990, PTAs had their own needs assessment within the grant system and received central government support directly through the relevant assessment. After 1990, the PTA needs assessment was incorporated into the assessment of the relevant metropolitan districts. The metropolitan districts' Revenue Support Grant was increased accordingly, and the PTA then made a claim on the metropolitan districts through the levy described above. In practical terms, the PTA became dependent on the willingness and capacity of its constituent metropolitan districts to pass funding through the levy mechanism. The argument made by the Government for this change was to make the PTAs more accountable to the electorate (since the PTAs were not directly elected). [26] Those opposing the change highlighted that the new arrangements would increase the likelihood of constituent authorities seceding from the PTA, and also reduce the certainty of the PTAs financial position, limiting its ability to properly manage and plan public transport on a county-wide basis. [20]

For rail, the pre-privatisation grant arrangements included a 'Section 20 bolt-on' as part of the Revenue Support Grant, intended to account for revenue expenditure connected with Section 20 rail services, and acknowledging that this displaced national PSO support for local rail services. As described above this was calculated on a national formula based on loaded train miles supported by the PTE, and was not based on actual Section 20 claims, the balance being funded by local taxation. Before 1990, this support went directly to the PTA. After 1990 it was paid to the constituent districts (un-ringfenced), which was then billed by the PTA through the levy. [27] Alongside the change from precepting to levying in 1990, this represented a fundamental change to how the PTE rail role was being funded.

By the mid-1990s around 80% of overall local authority spending came from central government grants, primarily through the Revenue Support Grants, re-distributed income from the uniform national Business Rates and Special and Specific Grants. [28] The share of PTE funding routed from central government also increased during this period.

GENERAL ARRANGEMENTS FOR POWERS AND FUNDING UNDER FRANCHISING

The franchising of the railways in the UK and the associated fragmentation across track and train created significant complexity. Since 1994 there have been multiple layers of legislation, guidance, regulation and contracts. The new private dimension to the railway during this period means that much of the information related to the financial mechanisms is commercially sensitive and not in the public domain, meaning that any description of this period must be built with imperfect information.

This section seeks to describe the financial arrangements since privatisation, however, it should be noted that contemporary and retrospective accounts describe most of these arrangements as challenging to implement in practice. [29] [30] The levels of complexity, fragmentation and loss of clear accountability for decisions meant that they rarely delivered their intended aims and many simply were not used at all. [31] [29]

With a few exceptions, the general trajectory since privatisation has been one of centralisation towards DfT. Several pieces of legislation have been the driving force behind this, in particular the Railways Act 2005, but the shift has also happened organically over time with devolved involvement in the running of England's railways eroded, as funding gradually consolidated through the DfT and local fiscal flexibility (other than in London) declined.

2. Transition to the franchised railway

2.1 Section 34 powers

The Railways Act 1993 legislated for the privatisation of Britain's railways via franchising. The Passenger Transport Executive Group (PTEG, now known as the Urban Transport Group - UTG) and the Association of Metropolitan Authorities (AMA) successfully made the case to retain a role for PTE involvement in managing local services. The new role for PTEs was described in Section 34 of the Act, intended to functionally replace the role of Section 20 in the Transport Act 1968. This provided PTEs with the right to become co-signatories to franchise agreements with the train operators alongside the Office for Passenger Rail Franchising (OPRAF), later replaced by the Strategic Rail Authority (SRA) and finally the DfT after the abolition of the SRA. This was generally known as "co-signatory status" and meant that the PTE retained powers to specify, in coordination with OPRAF, service levels, fares and quality standards, similarly to how they would have done pre-privatisation. However, the co-signatory relationship was with a train operating company alongside the franchising body, in contrast to the bi-lateral relationship with a vertically integrated railway provided under earlier Section 20 arrangements. PTEs also retained the ability to invest directly in capital enhancements to the rail network, although the case for doing so was radically altered. In the first round of franchise agreements the PTEs secured continuation of the service levels which were being delivered by BR prior to privatisation. Five of the seven PTEs chose to retain revenue risk and set local fares, with West Yorkshire and Greater Manchester opting not to do so. [25]

2.2 Changes to railway accounting to enable privatisation

Privatisation had fundamentally changed the way costs were attributed on the railway. Whereas under BR the prime user and sole user allocation principles meant that the most profitable sector generally covered the burden of the infrastructure costs, and the PTEs were only attributed marginal costs for their services[1], under the new regime all services were allocated a proportion of the total costs through track access charges levied by Railtrack from April 1994. As a result, the costs attributed to PTEs for their specified services jumped significantly, see Figure 2-1. [32]

Calculating franchise payments

Franchising meant that private companies would bid to operate rail franchises. In the bid the bidders would forecast the cost for operating rail services described in the base service specification as well as the revenue that would be earned. The net impact of these would produce either a subsidy, from the OPRAF to the train operator, or a premium, from the train operator to OPRAF. This role transferred to the Strategic Rail Authority when OPRAF was abolished in 2001 and finally to the DfT when the Strategic Rail Authority was itself abolished in 2006.

Franchisees' main costs were the **access charges** levied by Railtrack for track and stations (latterly Network Rail), the costs of leasing **rolling stock**, and the **general operations and maintenance** related to the franchise, which was largely staff costs. [33]

The access charges (for infrastructure and stations) were initially set to meet the full cost of providing the infrastructure, including renewals and investment, however over time Network Rail would increasingly receive a component of its funding directly from central government grants. The rolling stock leasing charges were set by the ROSCOs at such a level as to make a commercially viable rate of return over the life of the asset.

Beyond these charges, the way in which costs and revenue models were built up for the franchise varied from bidder to bidder. The cost models were commercially sensitive thus this information was not available for inclusion in the compilation of this report.

The bid response would specify the level of subsidy or premium, and for those franchises where the PTE was a co-signatory this would determine the level of PTE funding, which would be agreed with OPRAF. Beyond the initial specification of the franchise, the PTE had very little control over the level of subsidy and no ability to vary the payments in the life of the franchise. [33]

[1] The principles by which costs and revenues were attributed under Section 20 agreements is provided in our sister report, *Section 20 in Practice*.

Figure 2-1 - South Yorkshire PTE area rail costs and revenues 1992 - 2002 [31]



2.3 Changes to grant arrangements to enable privatisation

To account for the sudden increase in attributed costs the government introduced the Metropolitan Rail Grant (MRG). Intended as a transitionary measure, this grant was *"to provide support to metropolitan county passenger transport authorities in England for additional costs… to be met by the authorities in the financial year 1994/95 for the railway passenger services provided by British Rail to the PTEs as a result of the restructuring of the railways… and the introduction of new charging arrangements… and revised principles for the attribution of costs amongst different railway services."*. [32] It approximately covered the increased cost of Section 20 claims in PTE areas, i.e. those above the Section 20 costs under the previous accounting regime, and was paid directly to the PTAs. [34] The grant was required to be paid in its entirety to the train operators. Additionally, the grant was explicitly not to be used to fund any enhancement to the railway. The PTEs were not able to influence how Metropolitan Rail Grant was spent beyond the initial specification written into the franchise agreement. For those PTEs that chose to take revenue risk there would be an agreed amount which would be deducted from the Metropolitan Rail Grant payment, and the PTEs were exposed to risk where the real fare revenue differed from this agreed amount. [32] [35]

The MRG was displaced by an increase in the Section 20 'bolt-on' for 1996-97 paid via Revenue Support Grant to metropolitan districts, which then had to be claimed by the PTAs through increased levies. The situation appears to have become untenable, and Greater Manchester PTE (GMPTE) withdrew from its Section 20 agreement in the 1996/97 financial year at the request of the PTA in May 1995. [36] This was in response to the increased costs and volatility being imposed on local government finances via the levying mechanism, and the uncertainty that government would continue to underwrite the significant additional costs. [37] [38]

Whilst the privatisation process was on-going payments were still made to the relevant BR train operating unit under Section 20, then as each new franchise agreement commenced the payments switched to the franchised train operator to reflect the payments determined within the franchise agreement for the services secured under Section 34. [32] From 1997/98 all local rail services previously provided under Section 20 arrangements had transferred to private franchises. From that fiscal year, government funding for PTE rail functions was consolidated in a new Metropolitan Railway Passenger Services Grant, paid directly to the PTAs. The 'Section 20 bolt-on' was removed from the Revenue Support Grant calculations. [39] This provided greater certainty for franchisees, metropolitan districts, and PTAs, particularly in terms of budget planning. Table 2-1 shows the level of central government support to PTAs for local rail services over the period covering privatisation.

While the consolidation of central government support into the Metropolitan Rail Passenger Services Grant provided greater certainty, it also meant a significant reduction in the scope of local decision-making, since the government was from that point effectively underwriting the PTEs' Section 34 role as co-signatories to franchises. The erosion of local fiscal control as a result of the various changes highlighted in this section together with increasing pressure on local government budgets (any local role outside Greater London in the metropolitan countries still relies on a levying arrangement) has also reduced scope for local decision-making.

Table 2-1 - Support for local authority rail services/ £million

	1993-94	**1994-95**	**1995-96**	**1996-97**	**1997-98**	**1998-99**	**1999-00**	**2000-01**
Revenue support grant (un-ringfenced to metropolitan districts)	111	114	113	175	-	-	-	-
Metropolitan Rail Grant	-	139	73	1	-	-	-	-
Metropolitan Rail Passenger Services Grant	-	-	-	-	248	221	214	204
Deeds of assumption[2]	-	-	-	20	24	24	24	23
Total support	**111**	**253**	**186**	**196**	**272**	**245**	**238**	**227**

DETR Annual Report 1999 [40]

From 2001/02 the responsibility for grants to the PTAs transferred from the DfT to the Strategic Rail Authority, and then subsequently back to DfT from 2006/07. Grants to PTAs (and ITAs and Combined Authorities successively) underwriting the local Section 34 role continued until 2015/16 when the 2004 Northern franchise ended. By this point many perceived the payments as little more than a pass-through from central government, through the PTE, to the train operator. [41]

[2] Note that: 1995-96 payments were made by BR and Railtrack. From 1996/97, the Department assumed responsibility from Railtrack for payments to PTAs arising from deeds of assumption. These are payments to reflected the residual value of PTA's capital grants to fund BR infrastructure prior to privatisation.





3. Changes under the 2005 Railways Act

The role of PTEs in relation to the local rail network were affected by a number of provisions in the Railways Act 2005 and its associated guidance. In particular, the PTEs ceased to have an automatic right to co-specify new franchises and consequently ceased to be a party to franchise agreements once the franchises came to an end.

The Secretary of State had the discretion to allow PTEs to remain as co-signatories; however, they would not expect to exercise this discretion unless a PTE could provide evidence that their presence as a co-signatory added significant value to the management of the franchise and wider DfT objectives of improving performance and cost control. [30] [41] No franchises let after 2005 retained a PTE as a co-signatory. In 2007, Centro became the first PTE to cease being a franchise co-signatory when the London Midland franchise commenced. When the 2004 Northern franchise ended in March 2016 this marked the end of PTEs as co-signatories to franchise agreements in England. [30]

Section 13 of the Railways Act 2005 retains provision for PTEs as statutory consultees on the specification for franchises that include services to, from, or within their area before an Invitation to Tender was issued or, in the case of extensions to existing franchises, prior to DfT entering a new franchise agreement. In addition, PTEs have the right to be consulted at various stages during the life of relevant franchises. Whilst Section 13 is intended as the functional successor to Section 34, few of its provisions have been used in practice. Railways Act 2005 also amended Sections 175 to 177 of the Greater London Act 1999 to similar effect.

Instead, non-statutory contract-based partnership between the Secretary of State and places was pursued to influence the Secretary of State's franchising role in the Northern (2016), TransPennine Express (2016), and West Midlands Trains (2017) franchises.





As part of the consultative process, the PTEs could specify increments – i.e. more services - which they would have to fund through their own means. They could also seek to influence the DfT to increase the base specification and incorporate a higher level of central government subsidy, however such changes would require a central government business case. Similarly, they could request decrements - i.e. a reduction in service - the savings from which the PTE could theoretically spend elsewhere. Both these changes required Secretary of State approval, and the onerous nature of applying for such meant they were rarely used. In the case of decrements, ORR analysis indicated that other than through a full closure of a line it was difficult to realise any substantial savings and the political cost of closing railway lines was too high for this to be credible. [42]

Example of the use of a decrement

TfL requested a service decrement to withdraw DfT sponsorship of the South London Line (Victoria to Bellingham) from 2012. Owing to this the Department made a grant of £24m available to TfL in 2012/13 to reflect the savings over 10 years associated with the change. TfL used this grant to fund the costs of the East London Line extension phase 2 from Surrey Quays to Clapham Junction via Peckham Rye. TfL were responsible for this service and all ongoing costs. Essentially this represented the transfer of these services from the South Central franchise to TfL.

The PTEs were also able to enter into agreements directly with the franchise operator for minor enhancements to the railway once the franchise was let. This could include promotion of local rail services, local information requirements, routine station maintenance, station security or customer service duties. Such agreements would still require approval from the Secretary of State. [43] The costs of such enhancements would be negotiated on a case-by-case basis. Typically, the PTE would discuss with the train operator, who would then develop a cost estimate via their own costs and revenue models, although there is general industry best practise for this. The PTE had limited visibility over the development of these estimates. [30] This general basis for PTE powers to fund local rail services in England's metropolitan areas remains in place to the present day.

There are notable exceptions in London and Merseyside where services have been de-designated from franchising by the Secretary of State, which are described in the next section.[3]

[3] Whilst PTEs continue to exist from a legislative sense and the PTE powers defined in the various pieces of legislation described within this document are still discharged by successor bodies in England the term PTE is no longer used in a public facing corporate identity.

EXAMPLES OF DE-DESIGNATION OF LOCAL RAIL NETWORKS

The Railway Act 1993 allowed for services to be exempted from designation as being subject to franchising under Section 23(1) that act. This is commonly referred to as “de-designation”. It has been applied to the Merseyrail Electrics services and the various services that make up London Overground.

4. Merseyrail

4.1 Background

The Merseyrail network is formed of three lines, the Northern Line, the Wirral Line, and the City Line. The Northern and Wirral lines were created in the 1970s with the construction of the loop and link tunnels as a result of strong local partnership between BR and Merseyside PTE (Merseytravel) under pre-franchising Section 20 arrangements. This joined up several previously terminating suburban railways with tunnels under the city centre, creating a north to south cross city route and an underground loop for trains coming from the Wirral. The Northern and Wirral Lines are both third rail DC electrified, have their own signalling and control centre at Sandhills and are largely operationally separated from the national rail network. These lines are known as the Merseyrail Electrics, and all operate a frequent service of a train every 15 minutes off-peak on each of the branches, with additional services at peak times. The central sections of both lines see a train every few minutes. All trains operate with a driver and guard, and almost all stations are staffed with ticket offices open from first to last train. The trains and stations on both lines are fully Merseyrail branded.

The City Line is different to the other two lines. It is the marketing name used by Merseytravel to describe local services into and out of Liverpool Lime Street high-level station. These lines are an integrated part of wider national rail operations and tracks are shared with other services, including intercity trains. Most of the lines are now electrified but some services are still operated by diesel trains. Services are generally less frequent on the City Line with most stations served either half-hourly or hourly off-peak. Most of the City Line stations are unstaffed and bear some Merseyrail co-branding, trains are not Merseyrail branded, instead carrying the brand of their train operator, in most cases Northern.

Prior to franchising the Northern, Wirral and City Lines were all operated by BR Regional Railways North West and were supported by Merseytravel through Section 20. All local services within Merseyside were considered ‘Merseyrail’. At franchising in 1997, the City Line services were separated from the rest of the Merseyrail network and became part of the North West Regional Railways Franchise (operated by First North Western). The Northern and Wirral Lines formed a standalone Merseyrail Electrics franchise. Merseyside PTE assumed a Section 34 co-signatory role in both franchises, retaining local revenue risk, including setting fares for journeys in Merseyside.

The Merseyrail Electrics services were ‘de-designated’ from franchising in 2003 and are now operated through a concession contract with Serco and Transport UK, the nature of which is described later. The focus of the reminder of this case study is the Merseyrail Electrics operation and for simplicity, from this point on will be referred to as Merseyrail.



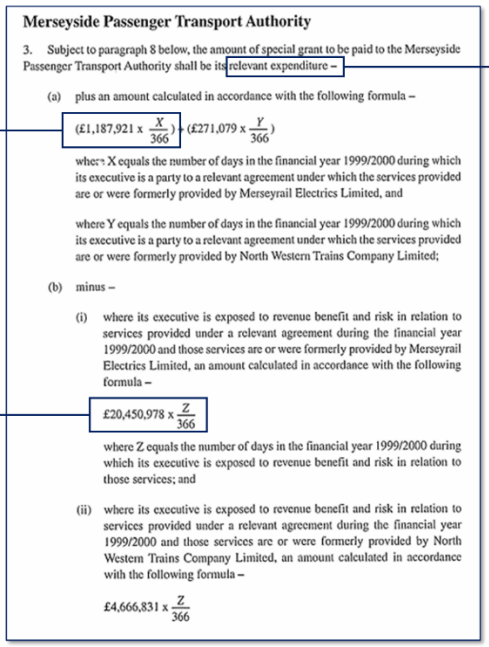
Figure 4-1 – PTEs regularly invested to improve the local rail network. Shown here is a 1992 trade-press advert from Merseytravel promoting its investment into the Merseyrail network.

4.2 Franchised operation

Since privatisation Merseyrail has been its own franchise, reflecting the self-contained nature of the 'electrics' network. Train crew and rolling stock operate on only Merseyrail services and all stations, bar a handful, are served only by Merseyrail. Upon privatisation Merseytravel, the PTE, used its powers under Section 34 of the Railways Act 1993 to become a co-signatory to the new Merseyrail franchise, contributing to service specification and taking a form of revenue risk. [44] Services were maintained at pre-privatisation levels and the required level of subsidy to operate the PTE's services formed part of the franchise bid and was documented in the franchise agreement. As described earlier, central government funding in the form of the Metropolitan Rail Grant (MRG) was routed through Merseytravel to cover the subsidy payment. [45]

Portion of relevance to Merseyrail Electrics
This relates additional sum relates to agreed administration and management costs that the PTE incurred from being a co-signatory

This subtraction from the grant amount represents the agreed value of the yearly revenue that would be received by the PTE. Variances between the actual revenue received by the PTE and the agreed amount represents the revenue risk taken by the PTE.



Merseyside Passenger Transport Authority

3. Subject to paragraph 8 below, the amount of special grant to be paid to the Merseyside Passenger Transport Authority shall be its relevant expenditure –

(a) plus an amount calculated in accordance with the following formula –

$$(£1,187,921 \times \frac{X}{366}) + (£271,079 \times \frac{Y}{366})$$

where X equals the number of days in the financial year 1999/2000 during which its executive is a party to a relevant agreement under which the services provided are or were formerly provided by Merseyrail Electrics Limited, and

where Y equals the number of days in the financial year 1999/2000 during which its executive is a party to a relevant agreement under which the services provided are or were formerly provided by North Western Trains Company Limited;

(b) minus –

(i) where its executive is exposed to revenue benefit and risk in relation to services provided under a relevant agreement during the financial year 1999/2000 and those services are or were formerly provided by Merseyrail Electrics Limited, an amount calculated in accordance with the following formula –

$$£20,450,978 \times \frac{Z}{366}$$

where Z equals the number of days in the financial year 1999/2000 during which its executive is exposed to revenue benefit and risk in relation to those services; and

(ii) where its executive is exposed to revenue benefit and risk in relation to services provided under a relevant agreement during the financial year 1999/2000 and those services are or were formerly provided by North Western Trains Company Limited, an amount calculated in accordance with the following formula –

$$£4,666,831 \times \frac{Z}{366}$$

Relevant expenditure – i.e. all PTE costs related to providing rail transport as documented in the franchise agreements

Merseytravel, with funding from the MRG, and its other regular funding sources provided 98% of the subsidy for the franchise. [44] The Office for Passenger Rail Franchising (OPRAF) retained sole responsibility for specifying the services beyond Merseytravel PTE's boundaries. [44] In practice, Merseytravel had no day-to-day role in the management of the franchise or control over the quality of service provided by the franchise train operator. [46]

4.3 From franchise to local concession

This situation was considered far from optimal and in the early 2000s Merseytravel successfully made the case to central government for greater control of the Merseyrail network. A range of options were considered, right up to full control of the infrastructure and train operations. The decision was taken to only hand over management of the train operations on the basis that it would not be practical to transfer the infrastructure to Merseytravel. Despite the network being largely self-contained in terms of operations there remained significant synergies in keeping the management of the infrastructure part of the national network, in particular from a maintenance standpoint. Merseytravel

has consistently maintained the position that the Merseyrail infrastructure should be devolved to them. [47]

In November 2001, the Strategic Rail Authority and Merseytravel established a methodology to transfer the responsibility for the provision of the Merseyrail Electrics franchise to Merseytravel. This was in line with the Strategic Rail Authority's Strategic Plan and was supported by the Minister of State for Transport. [48] To enable this, two statutory instruments were required. The railway passenger services on the network were exempted from designation as being subject to franchising by the Merseyrail Electrics Network Order 2002 under section 23(1) of the 1993 Act.

The Merseyrail Electrics Network Order 2003 Articles 3 and 4 modified the duties imposed by Section 76 and 77 of the Railways Act 1993 (general duties of the Rail Passengers' Council and Rail Passengers' Committees respectively) in relation to railway passenger and station services provided exclusively on the network so as to provide for the involvement of the Merseyside PTE in place of, or alongside, the Strategic Rail Authority. The order specified that passenger services on the network were to be provided on and after 20th July 2003 by an operator under a concession agreement with the Merseyside PTE, rather than under a franchise agreement with the SRA.

Merseyrail Electrics was let on a 25-year concession in 2003, with five-year review periods. It was let to Merseyrail Electrics 2002 Ltd, a Serco & NedRailways joint venture, the latter transitioning to Abellio then Transport UK.





4.4 The form of the concession agreement

The contract to operate the Merseyrail network was let as a concession. To increase the participation of bidders in the tendering process, the form of the concession was similar to rail franchises which were being let at the time, reflecting the fact that this was the dominant form of contract in the rail industry. The tendering process was largely run by the Strategic Rail Authority, on behalf of Merseytravel, as this was where the bulk of expertise in rail operating contract procurement resided.

4.4.1 Revenue and cost risk

The private operator is paid set Contract Payments, the level of which were determined during the bidding process and were then written into the concession agreement. At a

high level, these payments represent the subsidy required for the operation of Merseyrail – i.e. the additional payment required from the public sector to cover the difference between fare revenue and ongoing operational expenditure. Revenue risk largely sits with the operator, who collects and retains all fare revenue. The exception to this is where the operator sells Merseytravel's own products through its ticket offices, for instance the Saveaway passes, in which case the revenue would be passed back to Merseytravel. [49] The operator was protected from certain external impacts to revenue, such as changes to Railcard schemes, but general demand risk remains with them. The concession agreement set the level of regulated fare rises and should Merseytravel wish to vary fares from this level it would represent a change under the no net gain/ no net loss mechanism. In effect this dilutes Merseytravel's control of the farebox on local rail services during the period of the concession.

The operator is also exposed to cost risk relating to costs which are deemed within its control, for instance maintenance or staffing costs.





4.4.2 No net gain/ no net loss

The agreement contains a no net gain/ no net loss regime to protect the operator from changes outside its control. Where such changes do occur, the Contract Payments are amended from those submitted in the bid to cover the additional cost or saving generated. One example of such a change would be where Merseytravel requests additional capacity. In this instance the operator would forecast the cost and revenue changes associated with this additional capacity which would then be agreed with Merseytravel and the Contract Payments would be adjusted accordingly for the duration over which the additional capacity was specified for. [49] There are also defined external events which trigger changes to the contract payment through the no net gain/ no net loss, such as changes to Network Rail's access changes.

4.4.3 Profit share

The concession agreement includes a profit share mechanism to cover instances where the operator makes a profit greater than its forecast. Higher profits can be achieved through 3 primary ways:

- Reduced operational costs from efficiency gains in the operation of the network
- Increased revenues driven by ridership being higher than forecast
- Higher performance payments arising from meeting and exceeding the requirements of the performance regime

The profits above a certain threshold are shared between Merseytravel and the operator. [49] There is no provision for loss sharing within the Concession Agreement.

4.4.4 Performance regime and incentivisation

The concession agreement has a comprehensive performance regime to incentivise the operator. It specifies the required levels of service and includes prescriptive metrics on service quality, including for instance how many degrees off vertical a poster can be before it is deemed non-compliant to the regime or the number of pieces of litter over 5cm found within a station. [49] The operator is also incentivised to reduce ticketless travel, which stood at between 17% and 18% at the start of the contract. Merseytravel will provide bonus payments to the operator if it meets or exceeds the requirements of the performance regime. These payments do not represent a change to the Contract Payments.

4.5 Funding Merseytravel's role

4.5.1 Day to day funding of Merseytravel's rail functions

In terms of ongoing payments to Merseytravel, these follow similar principles to those set out in the MRG (which funded Section 34 co-signatory roles), which is described earlier in this report. Since the responsibility for Merseyrail Electrics transferred from the Strategic Rail Authority to Merseytravel, Merseytravel has received a Special Rail Grant from the DfT, Table 4-1 sets out these payments from 2002/3-2023/24. This Special Rail Grant is a payment to Merseytravel to cover its relevant expenditure in relation to the concession. The value of the grant is based on yearly Eligible Contract Payments which are determined based on the Contract Payments documented in the financial model which formed part of the concession agreement. [50] As described above, the Contract Payments can be altered through the no net loss/ not net game process.

Should the Contract Payments which Merseytravel is making to the operator change due to a decision taken by Merseytravel, it must cover the additional costs or would receive the savings which it can invest elsewhere in the local transport network. An example of the former would be where Merseytravel requested Merseyrail to increase service frequencies or to reduce fares from the regulated fares level set out in the concession agreement. [50]

If a change to the Contract Payments occurs due to a national policy decision or action by Network Rail, for instance changes to access charges, the DfT may be responsible for covering the additional costs or would receive any savings. This takes the form of an adjustment to the Special Rail Grant payments.

For events which are outside of the operator's, Merseytravel's or DfT's control, for instance COVID-19, these may represent a Force Majeure event and the PTE has in the past negotiated additional payments from DfT on a case-by-case basis. [50]

Table 4-1 - Special Rail Grant payments as set out in Merseytravel's published accounts 2002/03 - 2023/24. All values in nominal terms.

Financial Year	Value of SRG transferred to Merseytravel
2023/24	£124,518,000
2022/23	£106,547,000
2021/22	£99,132,000
2020/21	£97,842,000
2019/20	£96,215,000
2018/19	£87,033,000
2017/18	£81,729,000
2016/17	£78,874,000
2015/16	£81,522,000
2014/15	£95,438,000
2013/14	£98,610,000
2012/13	£89,209,000
2011/12	£92,275,000
2010/11	£86,498,000
2009/10	£85,276,000
2008/09	£78,607,000
2007/08	£92,014,000
2006/07	£78,607,000
2005/06	£72,780,000
2004/05	£73,139,000
2003/04	£25,690,000 (Concession commenced 20 July)

Where Merseytravel receives payments from the operator as part of the profit-sharing mechanism, it retains these, rather than being passed onto the DfT. Merseytravel resources the performance regime out of local funds.

Given the fiscally constrained context for the PTE, this arrangement means the DfT effectively retains substantial influence over service levels on the Merseyrail network. In practice if Merseytravel wanted to significantly increase service levels or cut fares it would not currently be able to cover the additional costs itself and would need to request funding from DfT. This constrained context is reflected in the fact that service levels on the Merseyrail network remained largely unchanged since when the concession agreement was signed in 2003.

To determine the Eligible Contract Payments (ECP), the following formula is used:

$$ECP = (FP - FM) + TAA + SCA + RSMM + C$$

where:

- **ECP** means the costs to Merseytravel of funding the Contract Payments which are to be met by the Special Rail Grant in such payment period;
- **FP** means the Fixed Contract Payment payable by Merseytravel to Merseyrail in that payment period;
- F**M** means Force Majeure Payments (if any) for such payment period (which can only have a positive value);
- **TAA** means the Track Access Adjustment payment (if any) for such payment period (which may have a positive or negative value);
- **SCA** means the Station Charge Adjustment payment (if any) for such payment period (which may have a positive or negative value);
- **RSMM** means the Rolling Stock Mandatory Modification payment (if any) for such payment period (which may have a positive or negative value); and
- **C** means a component of the Eligible Contract Payments (which may have a positive or negative value) which is adjusted to account for any variations to payments transferred across from previous periods

4.5.2 Enhancements

For enhancements to the Merseyrail network, for instance new stations or the extension to Headbolt Lane, the capital cost has been funded by a combination of Merseytravel and central government. The capital funding from Merseytravel has included devolved capital and local revenue funds available to Liverpool City Region CA. For such projects, the operator will also develop a forecast of any ongoing operating cost and revenue changes associated with the enhancement, e.g. additional station staff. These additional costs will be agreed with Merseytravel and the operator, which then may form a change to the Contract Payments to the operator. Any changes to the Contract Payments would not be passed on to the DfT.

In practice, Merseyrail Electrics 2002 Ltd has consistently made sufficient profits to trigger the profit-sharing mechanism within the Concession Agreement. This has meant that where enhancements have led to an increase in operating expenditure which has not been covered by a corresponding increase in revenue the parties have been able to reach agreement as to the reduction in the level of profit that both parties receive. This has provided a pragmatic local financing mechanism.

4.5.3 Future arrangements

On 17 July 2026, Liverpool City Region Combined Authority took the decision to bring the Merseyrail Electrics operation into local public ownership when the existing concession ends in July 2028. [51] This decision offers Merseytravel greater long-term strategic control, and will enable better integration with buses, ferries, and future mass transit as part of a locally integrated multi-modal public transport network. This extends to the ability to set local fares on Merseyrail services. As franchising of the local bus network progresses, this will provide Merseytravel with control of the farebox across local modes, realising significantly better conditions for local multi-modal ticketing arrangements, as well as modal co-ordination responding to local needs and opportunities. [52]

5. London Overground

The London Overground network was established in stages between 2007 and 2015. Services operate primarily over Network Rail infrastructure, with the exception of the Windrush line (East London Line) Core section, which is owned by TfL. London Overground is an integrated part of TfL's wider network with each line having its own identity, as part of the broader London Overground and TfL branding framework. The London Overground lines appear on the ‘tube map’ and are covered by TfL’s fares and ticketing policies, including Oyster, Contactless validity and fare capping.

London Overground operates a frequent service on all lines, with trains operating at frequencies of 15 minutes or more at most stations. All stations managed by London Overground are staffed from first to last train and all trains are driver-only operated. Most stations retain staffed ticket offices. Their opening hours have in many cases been reduced over time to match periods when customer demand for this facility is highest.

5.1 The formation of London Overground

5.1.1 Mildmay, Suffragette and Lioness lines

In the mid-2000s, transferring operation of the Mildmay (North London), Suffragette (Gospel Oak-Barking) and Lioness (Watford DC) lines to TfL appeared an attractive prospect for both central government and the Greater London Authority (GLA), given the poor performance and customer offer at the time of the Silverlink Metro franchise and the fact that these services were contained almost entirely within the London area. Through the amendment to Section 175 of the Greater London Authority Act 1999 made by the Railways Act 2005, Transport for London (TfL) was provided the power to enter into agreements with the Secretary of State in relation to railway services to, from or within London and permitted to enter into financial agreements with the Secretary of State in relation to said services.

On 14th February 2006, it was announced by the Secretary of State for Transport that TfL would take over responsibility for the three lines that then formed the Silverlink Metro network from 11th November 2007 with these becoming the first part of the London Overground network. Like Merseytravel, TfL was required to appoint a private entity to operate the lines as a concession rather than a franchise. The form of the concession agreement was broadly similar to the Merseyrail concession described earlier. The London Overground agreement specified a revenue sharing arrangement with 90% of ticket revenue being retained by TfL and 10% by the operator. This arrangement was adjusted in 2016 upon commencement of the second Concession with TfL receiving 100% of revenue from that point (in effect providing full local control of the farebox). The London Overground agreement was therefore more prescriptive than the Merseyrail one with TfL retaining more direct operational involvement in the network through a more extensive performance and KPI regime.





An Official Journal of the European Union (OJEU) Notice inviting expressions of interest was issued on 24th February 2006. Meanwhile, Silverlink County services were split out and transferred to the new London Midland franchise.

In June 2007, TfL announced that the concession was to be awarded to MTR Laing. The Concession Agreement was signed on 2nd July 2007 between Rail for London (RfL) and MTR Laing (operating as London Overground Rail Operations Limited – LOROL). Following a two-year extension, this concession ended on 12th November 2016. Arriva Rail London took over as the concessionaire on 13th November 2016. The concession was later re-let, and First Rail London Limited took over as concessionaire on 3rd May 2026.

5.1.2 Windrush line

The Windrush (East London) line opened in 2010, combining sections of a former London Underground line, disused railways and existing Network Rail infrastructure. The funding for the construction of the line came from the European Investment Bank who provided a £450 million loan to TfL. [53] Ahead of the opening of the line, London Overground assumed management of 10 stations between New Cross Gate and West Croydon inclusive, taking these over from Southern, the previous train operating company, on 20th September 2009. Rail for London (RfL) as a subsidiary of TfL took 125-year leases from Network Rail within the ‘regulated footprint' normally let to Train Operating Companies (TOCs). TfL via RfL then sub-let this to the relevant concessionaire for the duration of the concession, originally LOROL, and now First Rail London. [54]

The extension of the line along the South London Line from Surrey Quays to Clapham Junction was opened in 2012. This phase was constructed using a combination of DfT and TfL funding, who provided £64 million and £15 million respectively. [55] This was one of the few instances where the decrements process within the Railways Act 2005 was used. In this instance, following TfL’s request for a service decrement to the Southern franchise’s service level requirements, the DfT made a grant of £24 million available to TfL in 2012/13. This reflected the savings over 10 years associated with the DfT withdrawing sponsorship of the South London Line and Victoria to Bellingham services from 2012. TfL used this grant to fund the costs of the Phase 2 extension from Surrey Quays to Clapham Junction. TfL was then responsible for this service and all ongoing costs. [56]



5.1.3 Weaver and Liberty lines

In 2013, the Government decided that TfL would be allowed to take over the West Anglia Inner services (Liverpool Street-Shenfield and Romford-Upminster), now known as the Weaver and Liberty lines.

TfL and LOROL, the operator of London Overground at the time, had agreed heads of terms to operate the Weaver and Liberty line services from the transfer date on a 'cost plus' basis against a tightly scoped specification for the period to the end of the concession in November 2016. At that point the entirety of the London Overground, including West Anglia Inner services, would be re-let under a new Concession Agreement. [57]

As with the transfer of Silverlink Metro, a 'Terms of Transfer' document recorded the basis on which responsibility for Weaver and Liberty line services were transferred from the DfT to TfL.

The Railways (North and East London) Exemption Order 2015 was laid before Parliament on 18th February 2015 and came into force on 31st May 2015 to exempt the Weaver and Liberty lines from the requirement for services to be provided under a franchise agreement. The services transferred to LOROL on the same day and coincided with the transfer of Liverpool Street-Shenfield services to the Elizabeth line concessionaire at the time (MTR). [57]

In addition to assuming control over the train services from Abellio Greater Anglia, it was proposed that Abellio Greater Anglia's 99-year leases over the Weaver (Liverpool Street-Chingford/ Cheshunt/ Enfield Town) and Liberty (Romford-Upminster) line stations and Elizabeth line eastern stations (except Stratford) be surrendered. [57] Of the 25 stations on the Weaver line, TfL became responsible for 23 stations while Liverpool Street and Cheshunt remained the responsibility of Network Rail and Abellio Greater Anglia, respectively as TfL services through those two stations would remain in the minority.

Again, RfL leases the stations from Network Rail and then sub-lets these to the relevant concessionaire for the duration of the concession.

TfL carried out a full rolling stock fleet replacement on both lines, introducing high-capacity Class 710 rolling stock on the London Overground routes to Chingford, Cheshunt, Enfield Town and Romford to Upminster. After completion of the manufacturing competition and award of the Manufacturing & Supply Agreement and Train Services Agreement, a financing competition was run to seek a lessor to finance the manufacturing of the trains and lease them to TfL. London Rail Leasing Limited was appointed as lessor in early 2016. Costs were incurred by the lessor and not by TfL with TfL only starting to pay rentals to the lessor once the trains were accepted. Full replacement of Class 315 and Class 317 units was completed in October 2020. [58]





5.2 Financial arrangements

Prior to the transfer of its routes, Silverlink Metro had annual ridership of 20 million passenger, passenger income of £24m, total costs of £50m set to rise to £60m in 2006/07 and 530 employees. Thus, when the Mildmay, Suffragette and Lioness lines were transferred from TfL the franchise was in receipt of a subsidy payment from DfT. [59]

Upon transfer, the funding responsibility for the former Silverlink Metro network passed to TfL. It was agreed between the DfT and TfL that TfL would receive a grant payment from the Department which was set at a similar level to the subsidy payment which had been provided for Silverlink Metro prior to the transfer. The grant payments for these services ran from 2007/8 to 2015/16, after which point TfL took over sole responsibility for funding the services concerned. [60]

For the Weaver and Liberty lines, the previous franchise indicated that revenues exceeded costs, based on the level of service provided. Because of this a one-off transfer sum of £63 million was agreed to be paid from TfL to DfT, with no payment being due the other way. Following transfer, TfL invested to improve both customer facilities (stations, rolling stock, etc) and the service proposition. As a result, the London Overground Weaver and Liberty lines were operated at a loss, which was covered by TfL. [61]

5.2.1 Funding of TfL

DfT and TfL agreed Terms of Transfer and a Grant Memorandum which meant that TfL received a grant payment from DfT following the transfer of Silverlink Metro services. However, this payment was pegged to the level of payment which the previous franchise received based on the service they operated – i.e. unstaffed stations, older trains and lower frequencies. TfL significantly enhanced the network, through station improvements, additional staffing and more frequent services to name a few. Passenger numbers increased significantly over this period, but not by as much as the increased expenditure. As a result, TfL provided significant funding each year for the London Overground network, partly from Olympic sources and partly by reallocating existing funds.

Prior to 2018, TfL received an annual settlement in the form of the GLA Transport Grant, provided under Section 101 of the Greater London Authority Act 1999 and comprising two elements, a general grant to support TfL's day-to-day operating activities and an investment grant, which supported delivery of TfL's investment programme. In 2014 these totalled £846 million and £909 million, respectively. [62] The general grant was not modally ringfenced and was TfL's to deploy across its range of responsibilities.

In financial year 2017/18 the GLA's revenue support grant and TfL's investment grant were rolled into the business rates retention system under the GLA's wider pilot. [63] Then in the 2019/20 financial year the government, Mayor of London and London local government agreed that the GLA would forgo the Transport Grant entirely as part of the new 2019/20 business rates retention pilot. [64] This came into effect on the 1st April 2019 and remains in effect. From this point TfL's primary source of non-fare revenue for operations and most investment was retained business rates and TfL received no central government funding for its day-to-day operations. Although TfL has achieved operating financial sustainability, government funding for major capital expenditure is still required. In the last two years the DfT has contributed £815m to support the capital programme (£5m in 2024/25 and £810m in 2023/24). [65]

TfL makes an operating surplus on some parts of its day-to-day operations, for instance London Underground. This surplus alongside retained business rates income is used to support other parts of TfL's operation such as the London Overground. This arrangement provides financial freedom to manage and co-ordinate TfL's transport network in the most effective way across modes. In the financial year 2024/25 TfL budget for London Overground stated a total revenue of £284m, total expenditure of £370m thus requiring an £86 million operating subsidy. [66] The divisional income is shown in Table 5-1.





Table 5-1 - TfL divisional income

Division	Revenue/ £ m	Operating Costs	Net contribution
London Underground	2,799	2,409	+390
Elizabeth Line	677	576	+101
Buses	1,643	2,381	-738
Streets and other operations	1,135	1,110	+25
London Overground	284	370	-86
DLR	159	160	-1
Trams	17	48	-31

2024/25 TfL Budget [66]

Table 5-2 below shows the key sources of TfL's income and their expenditure. As can be seen, fare revenue and other income sources such as the Congestion Charge do not cover day to day operating costs, leaving a financing requirement of £ 2.56 billion. This is covered through public funding, largely retained business rates and a portion of the Mayor's council tax precept. [67]

Table 5-2 - TfL financial statement for the year 2024/25

Item	2024/25 Budget
Income (inc. fare revenue, Congestion Charging, but excluding grants and retained business rates)	7,109
Operating costs	-8,156
Net operating income and expenditure	**-1,047**
Other	
Debt servicing	-430
Revenue resources used to support capital	-1,083
Net service income and expenditure	**-2,560**
Transfer (to)/from reserves	101
Financing requirement	**-2,460**
Specific grants	8
GLA funding from transport reserve	37
Retained business rates	2,170
22-23 General services grant	-
Collection fund deficit	
HM Government revenue support	-
Council tax requirement (Mayor's precept)	244

2024/25 TfL Budget [66]

FRANCE

6. France

This example is included to offer a context for how devolved responsibilities for local and regional rail services has been working in a different national and institutional context. France is one of the closest and most effective comparators for future arrangements on the UK railway. The Rail Delivery Group has also published a report titled *International Approaches to Rail Devolution*, a comparative study examining rail devolution models across five European countries.

6.1 Devolved government in France

6.1.1 The structure of devolved government in France

The French government comprises the Prime Minister, appointed by the President of the Republic, along with ministers and ministers of state. Led by the Prime Minister, the French government sets out and implements nationwide government policy. Central government is represented in France's regions and départements by Prefects, who hold authority over all the offices of central government in each area of the country.
The French parliament, which comprises the National Assembly and the Senate, draws up and passes laws, and holds the government to account.





France has a variety of local authorities at regional, departmental and municipal level. At each level, councillors are elected for a six-year term by direct election, and it is they who in turn elect the President of the Regional Council, the President of the Departmental Council, and the local Mayor.

Municipalities (communes) may join forces with each other to form intermunicipal bodies (communautés de communes, or communautés d'agglomération). Since 2014, the latter may be formed in mainland France to jointly conduct economic, transport, university, research, and innovation policy.

Traditionally, decision-making in France has been highly centralised. Most decision making sat with central government, and even at local level each département was headed by a Prefect, appointed by central government, alongside the locally elected council. However, in 1982, the national government passed legislation to decentralise authority by giving a wide range of administrative and fiscal powers to local elected

officials. [68] In March 1986, regional councils were directly elected for the first time, and the process of decentralisation has continued. In March 2003, a constitutional revision has very significantly changed the legal framework towards a more decentralised system and has increased the powers of local governments. However, France is still one of the most centralised major countries in Europe, with a similar level of centralisation to the UK, making it an effective comparator.



Figure 6-1 - Map of the Regions of mainland France and Corsica

6.1.2 Fiscal and financial devolution in France

Most public expenditure in France is from central government, with just 20% of total public expenditures accounted for by sub-national governments in 2018. According to the OECD, an organisation representing the world's largest economies, in 2016, 51.7% of local resources are raised by taxes set and raised locally or by shared taxes. Local authorities are free to set the total amount expected of direct local taxation, subject to compliance with the rules of budgetary law defined by the State. [69] [70] In France, the main local taxes are:

- Property tax
- Land tax
- Business tax

The share of local spending funded by taxes raised locally remains higher than the share in the UK, where locally funded expenditure in 2025-26 represented just 32.1% of total local authority spending. [71]

Grants from the French state represent nearly 30% of local authorities' resources.4 These allocations serve three purposes:

- **Compensation** – for general expenditure and powers transferred from the French State to local authorities.
- **Equalisation** – between regions, explicitly aimed at reducing the inequalities in local authorities' resources
- **Guidance** - Some allocations are intended to encourage local authorities to develop their action in favour of certain government policies, for instance environmental policy, urban policy, tourism policy, etc.

Compensation is the main principle applied to the grants paid by the state to local authorities. There are 4 primary state grants:

- Global Operating Grant (DGF) which is a lump sum grant to contribute to **general costs of the local authorities**. It is equivalent to the Revenue Support Grant in the UK.
- General Decentralisation Grant (DGD) compensates for the **costs associated with the transfer of powers from the state to local authorities**. This was created through the Decentralisation Act.
- A grant to compensate for reductions and losses due to the abolition of the certain local taxes by central government.
- The VAT compensation fund to cover the liability of local authorities to national tax.

The amounts are set each year by the state. The DGF and the DGD are un-ringfenced. The state can also give direct subsidies for investment projects. [72]

As various tax reforms have been carried out, VAT has become an important source of compensation for local authorities. The DGF of the Regions was replaced by a fraction of national Value Added Tax (VAT) since 2018 and VAT now represents a significant part of their operating revenues (51% in 2023). In total, local authorities now receive around 20% of the national VAT receipts. [73]

6.2 The French rail industry

France’s first railway line opened in 1827 and grew rapidly over the subsequent century. The railways were developed by several private companies, such as Compagnie du Nord, Compagnie Paris-Lyon-Mediterrannée, Compagnie du Midi and Compagnie de l’Est. On 1 January 1938, France’s five largest private railway companies joined the State network, creating the Société Nationale des Chemins de Fer Français (SNCF), with over 500,000 employees.

In 1981, the first section of high-speed line opened between Paris and Lyon. From that first line France has developed an extensive high speed rail (TGV) network, with high-speed lines to the Atlantic coast (1989), Lille (1993), London (1994), Brussels (1996), Marseille (2001), Strasbourg (2007), and Bordeaux and Rennes (2017).

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[4] The remaining share of local authority resources is derived from other revenue sources, such as fees and charges, asset income and transfers. Consequently, the proportions of locally raised taxation (51.7%) and state grants (c.30%) do not sum to 100%.

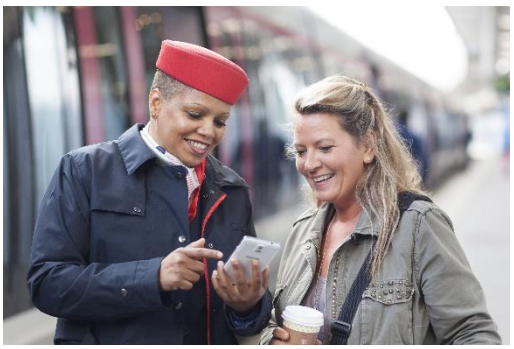


Figure 6-2 – TER train operating in the region Region Sud - Provence-Alpes-Côte d'Azur

As part of the French government's decentralisation policy, TER regional express trains were created as a business unit within SNCF in 1984 and publicly launched in 1987, with the goal of improving regional rail services across France.

Since 2001, the European rail network has been gradually opening up to competition, under the direction of the European Union. This has been implemented progressively within the framework of European directives known as "railway packages".

- **2001 - 1st railway package**: This first directive defined the essential functions (allocation of train paths and pricing) and the conditions for opening up international freight to competition.
- **2004 - 2nd railway package**: The second railway package expanded on the conditions for opening up the international freight market and defined the conditions for opening up domestic freight.
- **2007 - 3rd railway package**: This third package concerned international passenger transport
- **2017 - 4th railway package**: This was the final stage in the opening up of the European railway market, and focused on domestic passenger transport.





Mobility Organising Organisations
The mobility organising authorities - i.e. the State, the Regions, the metropolitan communities - are responsible for organising integrated transport within their areas. They are the main commissioners of upgrades carried out on the rail network. The mobility organising authorities finance the modernisation and development projects that SNCF Reseau carries out.

They are equivalent to PTEs in the UK.

The terms of the EU rail market liberalisation packages were transposed into French law in the 2018 New Rail Pact. This law opened French passenger rail transport up to competition, introducing market liberalisation in different ways for different service types. It covers three segments of the rail transport market:

- High-speed (LGV) lines and long-distance services
- Regional trains (TET) — short- to medium-distance routes operated INTERCITÉS brand, for which the French State acts as the mobility organising authority (AOM). They are broadly equivalent to CrossCountry services in the UK
- Paris-region commuter lines and regional trains (TER) governed by agreements with regional mobility organising authorities.

Responding to these changes, SNCF was reorganised to provide full separation between infrastructure management and passenger operations. This structure is shown below:

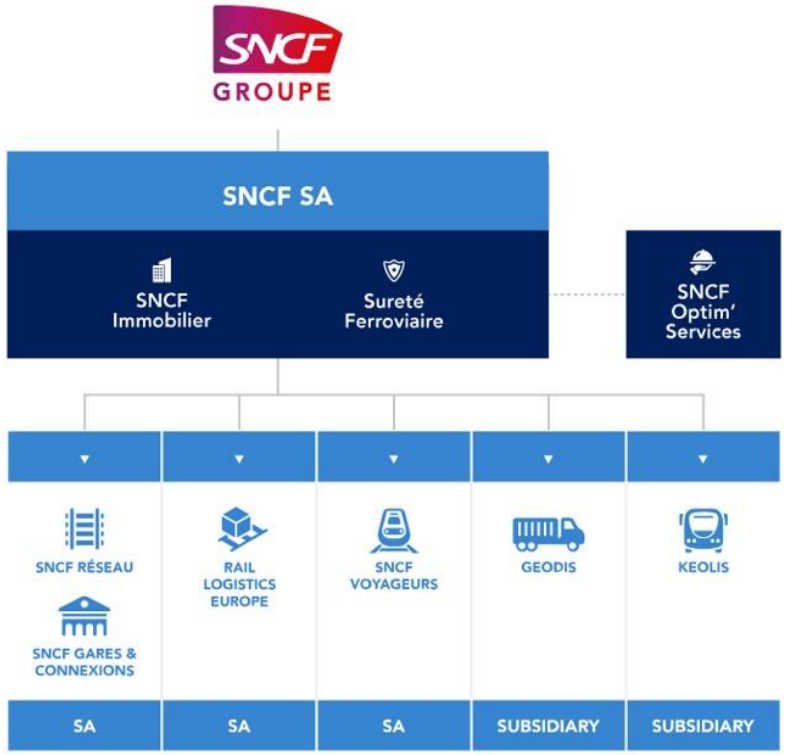


Figure 6-3 - SNCF corporate structure

SNCF Reseau is the infrastructure manager of the French railway network. Its functions are comparable to Network Rail's in the UK. Indeed, many of the elements of the EU directive to separate track and train were based on the UK's post privatisation railway structures.

SNCF Voyagers is the passenger train operations arm and continues to operate almost all passenger trains in France, across all types of service including TGV and TER.

6.3 The relationship between the railway and devolved government in France

6.3.1 Background to regional involvement in passenger rail

In the early 1990s, French regional passenger train services (TER) were planned at a national level by SNCF and partly funded by contributions from regional councils for the purchase of rolling stock and a contribution to the operating deficit. Patronage on TER services had decreased by 12.2% between 1989 and 1993. At the national and regional government level there was a desire to improve the service offer and performance of the TER network. In 1993 a national Senate report considered options to enhance the regional railway traffic (the “Haenel Report”). The regions also wanted to negotiate the quality of service, which required transparency of SNCF’s operating costs and the ability to upgrade rolling stock and infrastructure.



Figure 6-4 – An example of a TER train bearing the branding of the Region, in this case Region Sud - Provence-Alpes-Côte d'Azur and their local transport brand Zou!

To address these issues, trials were conducted to experiment with the devolution of regional passenger transport policy powers from the national to the regional level. Between 1997 and 2002 seven Regions volunteered to trial decentralisation of TER planning functions. Under the trial, these Regions were directly allocated funds from the State for the transfer of powers for the organisation and financing of regional rail passenger services (TER). These arrangements were made permanent under the SRU Law of 2000, which came effect on 1st January 2002. [74] TER had existed as a business unit and public facing brand for regional train services for some decades by this point, creating a clear distinction between what was a regional service and what was a national service. This made it easier to determine which services came under the new powers of the Regions.

Where a decision had to be made as to which Region the services sat with this was informed by:

a) which Region was the service wholly or primarily contained within
b) which Region did the primary point on a service sit in (i.e. the major city which was the main destination for passengers on a given route)

There were of course boundary cases where such a determination was more complicated, for instance inter-regional services which served 2 major destinations in different regions, or small lines which crossed regional boundaries but served no-major destinations. In these instances, bespoke arrangements would be put in place, such as tri-partite agreements and cost sharing. Such services were, and remain to this day relatively contentious. Analysis has shown that on lines which cross regional borders, services tend to be poorer and the infrastructure in a worse state of repair. [75] [76]

There has also been an ongoing “TER-ification” of services whereby SNCF has re-classified previously Intercities services which were supported by the state as TER services which are expected to be supported by the Regions. This has led to contention as Regions expect associated financial transfers for the state which has not always been forthcoming. [77]





6.3.2 Roles and responsibilities on today’s railway

In broad terms the roles of the various levels of government in France in relation to the railways are: [74]

- The State (national government) is responsible for national and international rail transport (TGV, Eurostar, Thalys) and inter-regional passenger services.
- The Regions are in charge of the provision of regional passenger trains (TER) and inter-departmental coaches. With regards to TER services, the Regions are always the mobility organising authority.
- The Departments are in charge of the organisation of intercity coaches, buses, and school buses within the departmental territorial limits.

The Regions commission TER services in their area and determine the following: [78]

- The service level:
  - Number of train kilometres
  - Routes
  - Schedules
  - Number of trains running
- Ticket prices (within certain constraints of the national ticketing system)

- Quality of service
- Passenger information

Historically the regions would determine these aspects in collaboration with SNCF (both Reseau and Voyagers). However, under the Fourth Railway Package, since 2024 the regions have been required to issue public invitations to tender for regional passenger rail services and thus these decisions are now made by the region in advance of any tenders being issued, to avoid putting SNCF Voyagers into an advantageous position compared with other bidders. However, the Regions can still collaborate with SNCF Reseau on the:

- Impact of the planned timetables on network operation
- Feasibility of planned projects
- Transfer or creation of maintenance depots

TER services are heavily subsidized by the regions, who on average cover 75% of the costs. Passengers pay just 25% of the cost through fares. [78] As a point of comparison, on Northern which is the UK train operator which has most characteristics in common with the TER network, passengers cover 37% of the costs.[5]

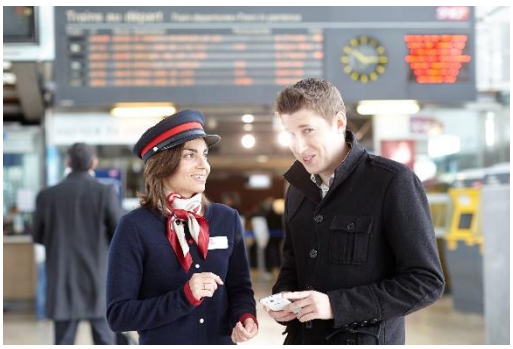
6.3.3 Payments to SNCF for operation of TER

Between the passing of SRU Law in 2000 and the opening up of TER services to competition in 2024 the Regions were required to enter into an exclusive negotiations with SNCF for the operation of the services. The contracts and mechanisms by which SNCF Voyagers was paid for the operation of TER services was very similar to how British Rail was paid by the PTE under Section 20 agreements prior to franchising.

SNCF would produce a forecast of costs each year, however the Regions would have to fund all of TER's actual operating costs less the ticket revenue for those services, even if they differed from the original forecast. [79] The agreements would also contain penalties and incentives relation to performance, for instance the number of trains run as booked. [80] This form of contract remains the case for agreements made with SNCF prior to 2024, although some had revenue sharing mechanisms. [81] These contracts had a maximum duration of 10 years and all will expire before 2034, after which point every TER line must be operated by a provider selected through a competitive bidding process. [82] The new contracts are intended to involve meaningful transfer of operating risk to the operator. [83]

[5] Note that like in the UK, where Network Rail receives a direct government grant on top of the subsidy to train operators, SNCF Reseau also receives direct government support. This takes the form of a grant of €14.3bn over the period from 2023-2027, as well as the French state assuming over €35bn of SNCF's debt, thus reducing its debt financing costs by around €500m per year. (SNCF Reseau)





6.3.4 Funding of the regions for rail services

With these powers and responsibility for funding TER service having been transferred from state to regional government, French law required that the Regions received compensation for the additional powers. This compensation consisted of:

- The state contribution to the on-going operation of the services transferred.
- The amount of the additional funding necessary for the renewal of the fleet of rolling stock assigned to the transferred services.
- The amount of the funding required corresponding to the compensation for the social tariffs implemented at the request of the State.

This level of compensation was set initially during the trials in 1997, then re-assessed when the decentralisation of powers was made permanent in 2002. It then rose in line with the standard growth rate for the DGF. The regions assumed the financial risk related to the additional level of service they wanted to offer.

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