PR23 draft determination:

Supporting document – other income

15 June 2023

Contents

About this document

This technical assessment of Network Rail's other income is one of five supporting documents of our draft determination for the 2023 periodic review (PR23).

PR23 will determine what the infrastructure manager for the national rail network, Network Rail, is expected to deliver with respect to its operation, support, maintenance and renewal (OSMR) of the network during control period 7 (CP7), which will run from 1 April 2024 to 31 March 2029, and how the available funding should be best used to support this.

This strongly influences:

- the service that passengers and freight customers receive and, together with taxpayers, ultimately pay for; and
- the charges that Network Rail's passenger, freight and charter train operator customers pay to access its track and stations during CP7.

Our draft determination sets out:

- our review of Network Rail's strategic business plan (SBP); and
- decisions on its proposed outcome delivery and its planned expenditure to secure the condition and reliability of the network;
- changes to access charges and the incentives framework; and
- relevant policies on managing change and the financial framework.

In addition to **this document**, we have also published as part of our draft determination:

Document type	Details
Executive summaries of our determination	Our key proposals from our draft determination for: • England & Wales • Scotland

Overviews of our determinations	What Network Rail will need to deliver and how funding will be allocated in: • England & Wales • Scotland
Consolidated decisions	A summary of our draft decisions across Great Britain
Introduction	An overview of PR23 and background to our draft determination
Settlement documents	Detailed draft decisions for each of: • Scotland • Eastern region • North West & Central region • Southern region • Wales & Western region • System Operator
Supporting documents	Technical assessments of: • Health and safety • Outcomes • Sustainable and efficient costs • National Functions • **Other income**
Policy positions	How we intend to regulate Network Rail during CP7 in relation to: • Financial framework • Access charges • Schedules 4 & 8 incentives regimes • Managing change

Responding to the consultation on our draft determination

We are consulting on our draft determination and welcome comments from stakeholders on any of our documents which form the draft determination on or before 31 August 2023.

Responses should be submitted in electronic form to our inbox: PR23@ORR.gov.uk. We request stakeholders provide their response using this proforma.

We intend to publish all responses on our website alongside our final determination in October 2023. Annex A to our proforma document sets out how we will treat any information provided to us, including that which is marked confidential.

Next steps

After taking account of stakeholder responses, we expect to issue our final determination on Network Rail's delivery and funding for CP7 by 31 October 2023.

We expect to issue our review notices by December 2023 and, subject to Network Rail's acceptance, issue notices of agreement and review implementation notices. These will give effect to the decisions made during PR23 in time for CP7 to commence from 1 April 2024 and for Network Rail to develop its plans for delivery.

Executive Summary

This document sets out our assessment of Network Rail's 'other income' for control period 7 (2024-29), which is the income that Network Rail receives outside of Network Grant or from track access income. It largely consists of property income but also contains income that Network Rail receives from train operators leasing stations, depots etc.

It is important that Network Rail generates the most efficient level of income that it receives from 'other income' as, all things being equal, if Network Rail increases other income, it reduces the level of external funding that the company requires.

Our early assessment is that Network Rail has not taken enough account of the constrained funding environment when preparing this part of its strategic business plan (SBP). There seems to be a lack of ambition when it comes to property in particular.

Network Rail is forecasting £3.9 billion of other income in CP7[1] which represents 9% of total income[2] in CP7. This is £0.5 billion (12%) lower than CP6, largely due to:

- Reduced property sales income (£0.7 billion lower than CP6[3]). Network Rail receives rental and sales income from its property portfolio. Network Rail has stated that it faces declining property sales opportunities and reduced resource to develop schemes,
- Increased property rental income (£0.2 billion above CP6). Network Rail receives rental income from its managed station and commercial retail portfolio. Network Rail is forecasting an increase from current levels in station usage as passengers return to stations post-pandemic, which increases station retail income, and
- Reduced income from open access operators (£0.1 billion lower than CP6). Network Rail receives fixed contractual contributions from some open access operators and fall outside of regulated track access charges. [REDACTED]

[1] Separately Network Rail are forecasting £1.7 billion of 'other operating income' which includes transactions like the sale of scrap metal. This is not assessed in this report as it is not classified as income in Network Rail's accounts but netted off of expenditure at an early stage.

[2] Total income less traction electricity.

[3] In CP6 Network Rail received £569 million (2023-24 prices) for the transfer of the Core Valley Lines in South Wales to Transport for Wales. The reduction in property sales between CP6 and CP7 is largely due to the effect of this one-off transaction in CP6.

[REDACTED]

We consider that Network Rail’s forecast £3.9 billion in other income in CP7 is too low. As set out in this document, we consider that it should be able to achieve at least an additional £0.1 billion in other income in CP7, in particular from its property estate.

1. Introduction

1.1 This supplementary document to our draft determination for the 2023 periodic review (PR23) sets out our assessment of Network Rail's forecasts of 'other income' in Control Period 7 (CP7), which will run from 1 April 2024 to 31 March 2029.

1.2 The assessment in the document relates to the GB-wide network unless otherwise stated. Numbers are also shown in 2023-24 prices.

1.3 Our assessment covers the following items:

- property rental income and revenue generating expenditure;
- property sales;
- investment in joint ventures to develop property schemes;
- depots income;
- managed stations qualifying expenditure ('QX') income;
- franchised stations lease income;
- facility / supplemental charge income (including the 'Crossrail Supplemental Access Charge');
- fixed contractual contributions from open access operators such as Heathrow Express; and
- any other income not derived from regulated charges or government grant.

1.4 In our calculation of Network Rail's net revenue requirement for CP7, we subtract forecast other income from Network Rail's gross revenue requirement to determine the net revenue requirement that is recovered through track access charges and network grant.

1.5 It is important that Network Rail maximises the level of its other income as the more income that it receives, the lower the financial contribution from railway users and funders that it requires. The income that Network Rail receives from its property portfolio is of particular importance as it largely comes from outside the industry, in contrast to say depots income, which is paid by train operators to Network Rail.

1.6 As part of Network Rail's Putting Passengers First (PPF) organisational restructure in CP6, responsibilities for managing Network Rail's property estate was largely devolved to each of its five regions. The company's Group Property team has retained limited responsibility for delivering larger sales and development opportunities. It also acts as the professional head for all common property activities within Network Rail.

1.7 In 2022, to support our analysis we commissioned Savills to review Network Rail's property forecasts for CP7. This will be published shortly.

2. Other income in CP7

2.1 Network Rail is forecasting £3.9 billion of other income in CP7. This is £0.5 billion (12%) lower than the £4.5 billion of other income that we expect the company to achieve in CP6. This includes £3.7 billion of other income in England & Wales, and £0.2 billion in Scotland.

2.2 The main reasons for the variance between CP6 and CP7 are:

- reduced property sales (£0.7 billion lower than CP6); largely due to the one-off disposal of the Core Valley Lines to the Welsh Government in CP6,
- increased property rental income (£0.2 billion higher than CP6), largely due to recovery from the impact of COVID-19 in CP6, and
- reduced open access income (£0.1 billion lower than CP6) [REDACTED]

2.3 Table 2.1 summarises the other income included in Network Rail's SBP for CP7.

Table 2.1 Network Rail's SBP forecast other income – Great Britain

£m, 2023-24 prices	2023-24	CP6 total	2024-25	2025-26	2026-27	2027-28	2028-29	CP7 total	CP7 vs CP6
Property rental	249	1,098	245	253	258	266	271	1,293	+ 18%
Property sales	54	870	62	31	29	29	27	177	- 80%
Total property income	303	1,968	308	284	287	294	297	1,470	- 25%
Depots income	155	736	154	154	154	154	154	770	+ 5%
Managed stations qualifying expenditure ('QX') income	113	545	113	113	113	113	113	567	+ 4%
Franchised stations income	104	540	107	107	107	107	107	537	- 1%
Facility / Supplemental charges	101	496	101	101	101	101	101	507	+ 2%

£m, 2023-24 prices	2023-24	CP6 total	2024-25	2025-26	2026-27	2027-28	2028-29	CP7 total	CP7 vs CP6
Other income	12	80	15	15	15	15	15	74	- 8%
Open access income	18	118	5	5	5	5	5	24	- 79%
Total	**806**	**4,483**	**803**	**780**	**783**	**790**	**793**	**3,949**	**- 12%**

Source: Network Rail

2.4 Detailed tables for England and Wales, and Scotland are in Annex A.

3. Property rental income

3.1 Network Rail receives rental income from its property portfolio, including its managed stations, commercial estate and advertising boards. As shown in Table 3.1, Network Rail has included £1.3 billion of rental income in its CP7 SBP. This is an 18% increase on CP6, largely due to the recovery from the impact of the COVID-19 pandemic on retail at stations. For example, in the peak of the pandemic in 2020-21, property rental income was £70 million against a regulatory baseline of £240 million.

3.2 Table 3.1 below provides more detail for the property rental line from Table 2.1.

Table 3.1 Property rental income in CP6 and CP7

£ million, 2023-24 prices	CP6 total	CP7 total	Variance	%
Retail income	534	667	+ 134	+ 25%
Other property income	43	36	- 8	- 18%
Advertising income	141	209	+ 68	+ 48%
Total managed stations income (a)	**718**	**912**	**+ 194**	**+ 27%**
Commercial income (b)	351	344	- 7	- 2%
Roadside advertising (c)	28	37	+ 8	+ 30%
Total rental income (a + b + c)	**1,098**	**1,293**	**+ 195**	**+ 18%**

Source: Network Rail

Managed stations income

3.3 Managed stations income comprises retail, other property and advertising income at the major railway stations that are operated by Network Rail. In Network Rail's CP7 SBP, managed stations income is forecast to be £912 million, an increase of £194 million (27%) above CP6 levels (£718 million).

3.4 Retail and advertising income at Network Rail's managed stations is forecast to grow by 1.5% per year in CP7. This forecast was based on passenger demand forecast modelling undertaken by Network Rail in collaboration with DfT and the rail industry. A significant proportion of managed stations income is dependent on passenger numbers. However, we note that some stations have retail units such as food outlets and restaurants that serve local communities and not just railway passengers. This type of stations demand is not accounted for in the rail passenger forecasts.

3.5 The passenger demand assumptions which underpin the managed stations income are shown in Table 3.2. We note that the recent passenger usage statistics show that current passenger journeys are higher than this, which suggests that Network Rail's forecast is conservative.

Table 3.2 Passenger demand forecasts in CP7 versus 2019 levels

	2024-25	2025-26	2026-27	2027-28	2028-29
Passenger demand levels vs. 2019	89%	91%	91%	95%	95%

Source: Network Rail

3.6 Other managed stations property income includes car parking, retail storage facilities and roadside advertising. This income is forecast to grow by 0.5% per year across CP7 in Network Rail's SBP. We have not identified any concerns with these forecasts.

3.7 Operational railway decisions can affect retail income at Network Rail's managed stations. For example, the Victoria decongestion and Liverpool Street gateline projects will reduce the number of retail units to improve passenger flows around these stations[4]. These changes are forecast to reduce retail income by around £21 million per year. We recognise that these operational decisions are complex, and that Network Rail is aiming to improve the passenger experience through these projects. However, we question whether Network Rail has made the correct trade-offs.

[4] We note that the Liverpool Street redevelopment may generate air rights for Network Rail from commercial development above the station. No income has been assumed for this in Network Rail's CP7 SBP.

4. Property sales

4.1 Network Rail's SBP includes £0.2 billion of property sales income in CP7. This is a £0.7 billion (80%) decrease from CP6, largely due to the one-off effect of the disposal of the Core Valley Lines (CVL) to the Welsh Government for £569 million (in 2023-24 prices) in CP6. Excluding the disposal of CVL, property sales income is forecast to decrease by £0.1 billion (41%) in CP7.

Fewer sales opportunities

4.2 We acknowledge that Network Rail has a limited property portfolio, that it has made a number of property sales in CP5 and CP6 and in previous control periods, and that much of its estate is now harder to develop. However, we consider that Network Rail has been cautious in this area, and that there are more opportunities which it could consider. [REDACTED] More opportunities may also arise if Network Rail were to revisit hurdle rates for sales schemes.

4.3 Network Rail has shared with us its pipeline of around 100 property sales opportunities, of which the majority are below £5 million in value. These could generate around £250 million of income if they are all completed in CP7, however not all will, so Network Rail has assumed a lower figure in its forecasts.

4.4 We will continue to work with Network Rail to understand its forecast and the remaining sales opportunities, including whether it has been overly cautious in this area.

Limited resources and capital to develop commercial opportunities

4.5 The Putting Passengers First (PPF) reorganisation in CP6 devolved most of Network Rail's property function to its regions. There has also been a reduction in the resourcing of property teams, which Network Rail has stated has affected its ability to develop larger schemes. We are concerned that the reorganisation to regions resulted in a loss of expertise, and that, initially at least, there was a lack of leadership for developing commercial opportunities of Network Rail's estate.

4.6 It is important Network Rail's group property team provides clear leadership to the regional teams which are still relatively new and less experienced in developing sales opportunities. We are concerned that there is a focus on retail income to the detriment of sales.

5. Revenue generating expenditure

5.1 Network Rail undertakes some renewals activities such as renovating retail units which generate income ('revenue generating renewals'), and also enters into joint ventures to develop property schemes on Network Rail land. Network Rail has included £0.3 billion of expenditure for these two areas of investment in its CP7 SBP, a £27 million (8%) reduction on CP6.

5.2 As shown in Table 5.1, 'revenue generating renewals' are forecast to reduce by £67 million (25%), whilst investment in joint ventures is forecast to increase by £40 million (56%) in CP7 compared to CP6.

Table 5.1 Revenue generating expenditure in CP6 and CP7

£ million, 2023-24 prices	CP6 total	CP7 total	Variance	%
Revenue generating renewals	268	201	- 67	- 25%
Joint venture working capital	71	111	+ 40	+ 56%
Total revenue generating expenditure	**339**	**312**	**- 27**	**- 8%**

Source: Network Rail

Revenue generating renewals

5.3 Network Rail has included £201 million in its SBP for 'revenue generating renewals' which is expenditure to generate additional income, for example, renovating commercial units in its managed stations.

5.4 The proposed CP7 spend is £67 million (25%) lower than in CP6. This includes a range of schemes at different levels of maturity. It seems clear to us that some are at an early stage of planning, without detailed understanding of expected costs. The additional revenue that these schemes will generate in CP7 is expected to be around £30 million, with further benefits materialising in later control periods. Network Rail has stated that each scheme has a strong business case, although it has not shared this detail.

5.5 Given the funding constraints facing Network Rail in CP7, we question whether it is appropriate to allocate scarce resources on projects that are at an early stage of development, and which do not generate returns for a number of years. We are also not clear if Network Rail has considered schemes which generate more short-term returns.

Joint Ventures

5.6 Network Rail enters into joint ventures with property developers to build commercial and residential properties on its land. For example, the Solum joint venture with Kier Property has built 218 housing units under 3 separate schemes.

5.7 Network Rail has included £111 million of expenditure for joint ventures in CP7 an increase of £40 million (56%) from CP6.

5.8 [REDACTED]

5.9 In our view, Network Rail's SBP does not sufficiently justify spending £111 million on property joint ventures in CP7. We are concerned about the lack of visibility of returns achieved on previous joint ventures, the pipeline of work and its expected benefits). [REDACTED]

6. Property forecasts in Scotland

6.1 Network Rail is forecasting £85 million of property income in Scotland in CP7. As shown in Table 6.1, this includes £78 million of property rental income and £7 million from property sales. Property rental income is forecast to increase by £10 million (16%), and property sales are forecast to decline by £9 million (57%) compared to CP6.

6.2 Network Rail Scotland has identified further opportunities including development opportunities in Glasgow and land disposals which are not currently included in its SBP. We also note that Network Rail sold its railway arches portfolio in England & Wales in CP5, but not in Scotland. We think that Network Rail should assess whether there is a case for such a sale.

Table 6.1 CP7 property income forecasts in Scotland

£ million, 2023-24 prices	CP6 total	CP7 total	Variance	%
Property rentals	68	78	+ 10	+ 16%
Property sales	16	7	- 9	- 57%
Total property income	**83**	**85**	**+ 2**	**+ 2%**

Source: Network Rail

Our view on property income in CP7

6.3 We summarise below the areas of property income in Network Rail's SBP where we have a different view to Network Rail:

- *Managed stations income*: Network Rail should update its forecasts for the latest rail industry passenger demand forecasts, as they look conservative compared to recent rail usage.
- *Property sales*: Network Rail's plan is not sufficiently developed. We expect further opportunities to be included.
- *Revenue generating expenditure*: Network Rail has not sufficiently justified why investing in such schemes should be a priority in CP7. [REDACTED]

6.4 For the reasons identified above we consider that Network Rail's property income in CP7 should be higher than assumed in Network Rail's SBP. Our draft determination includes an additional £0.1 billion of property income over CP7 for Great Britain (£90 million for England & Wales and £10 million for Scotland). We consider that this is a challenging yet realistic assumption.

7. Our views on non-property income

7.1 Network Rail has included £2.5 billion of non-property income in its CP7 SBP. This is a small (£36 million, 1%) decrease from CP6. This category encompasses a range of activities including depots and stations leasing, managed stations recharges (‘QX’) and Network Rail High Speed 1. These activities are largely unregulated. These are summarised in Table 7.1.

7.2 The numbers below relate to GB. There are some areas which do not apply to Scotland because Scotland does not generate income in these areas, for example facility / supplemental charges and open access income. Table A2 in the Annex sets out the Scotland forecast in more detail.

Table 7.1 CP7 non property income forecasts

£m, 2023-24 prices	CP6 total	CP7 total	Variance	%
Depots income	736	770	+ 34	+ 5%
Managed stations qualifying expenditure (‘QX’) income	545	567	+ 22	+ 4%
Franchised stations income	540	537	- 3	- 1%
Facility / Supplemental charges[5]	496	507	+ 11	+ 2%
Other[6]	80	74	- 6	- 8%
Open access income	118	24	- 94	- 79%
Total	**2,515**	**2,479**	**- 36**	**- 1%**

Source: Network Rail

Depots income (£770 million in CP7)

7.3 Network Rail receives income for providing access to train operators to its light maintenance depots. These charges are set through commercial agreements that are not linked to control periods.

[5] Covering supplemental charge income including the ‘Crossrail Supplementary Access Charge’ or ‘CSAC’

[6] Including NR HS1 income and insurance premiums.

7.4 Network Rail has forecast it will recover £770 million of depots income in CP7. This is an increase of £34 million compared with CP6, which Network Rail has noted is due to reduced charges given throughout the COVID-19 pandemic. We have discussed these forecasts with Network Rail as part of our review. We did not identify any material issues.

Managed station qualifying expenditure (QX) income (£567 million in CP7)

7.5 Managed station qualifying expenditure (QX) gives rise to charges ('QX charge') by Network Rail to train operators to recover the day to day running costs of providing services and amenities (such as cleaning or refuse collection) at the stations it manages. The charge comprises a 'fixed' element, recovering direct costs such as station staff and cleaning costs, and a 'management fee' element which recovers overhead costs and allows for a reasonable profit. Only the management fee is regulated by the ORR[7], with the remainder of the charge decided through commercial negotiations between Network Rail and train operators.

7.6 Network Rail has forecast £567 million of managed station QX income in CP7, a £22 million (4%) increase on CP6. The forecast is based on an average of CP6 levels with a growth in CP7 based on CPI forecasts.

Franchised station lease income (£537 million in CP7)

7.7 Stations lease income covers property rental income from franchised stations such as retail and car park income. This income, which ORR does not regulate, represents a share of income received in 1994-95, and is index-linked to RPI inflation.

7.8 Network Rail's SBP assumes £522 million of franchised stations lease income in CP7, which is a small decrease of £3 million compared with CP6. The decrease is due to a minor error in the Eastern region's forecast, meaning that overall income is not forecast to decrease.

[7] This is covered separately in our PR23 draft determination: policy position: access charges

Facility and Supplemental charges income (£507 million in CP7)

7.9 Network Rail receives facility charges income to recover the capital expenditure and financing costs for the construction of rail infrastructure assets on behalf of third parties.

7.10 Supplemental access charges for recovery of capital expenditure and financing costs for the connection of third party infrastructure to the national railway. A component of the Crossrail supplementary access charge ('CSAC') is based on our determination of Network Rail's cost of debt. This matter is covered in our PR23 draft determination: policy position on the financial framework.

7.11 Network Rail's SBP assumes £507 million of facility and supplemental charges income in CP7, which is a small increase of £11 million compared with CP6.

Other miscellaneous income (£74 million in CP7)

7.12 Other miscellaneous income mostly comprises net income that Network Rail High Speed receives for HS1 activities, and the provision by Network Rail of insurance cover to train operators. Network Rail has forecast that it will receive £37 million of income from Network Rail High Speed, which is a decrease of £7 million compared with CP6 totals, largely due to reduced profit on its contract with HS1.

7.13 Network Rail has forecast that it will receive £36 million of income from providing insurance to train operators, a £1 million increase from CP6.

Open access income (£24 million in CP7)

7.14 Open access fixed contractual contributions are paid by certain open access train operators for access to Network Rail's infrastructure. These charges fall outside the standard track access regime and are set outside of the regulatory framework.

7.15 Network Rail's SBP includes £24 million of open access income in CP7. This is £94 million (79%) lower than in CP6 income. [REDACTED]

Annex A: England and Wales and Scotland tables

Table A.1 Network Rail's SBP forecast other income – England & Wales

£ million 2023-24 prices	2023-24	CP6 total	2024-25	2025-26	2026-27	2027-28	2028-29	CP7 total	CP7 vs CP6
Property rental	234	1,030	230	237	243	250	255	1,215	+ 18%
Property sales	46	855	61	30	27	27	25	171	- 80%
Total property income	**280**	**1,885**	**291**	**267**	**270**	**277**	**281**	**1,385**	**- 26%**
Depots income	139	662	138	138	138	138	138	688	+ 4%
Managed stations qualifying expenditure ('QX') income	105	502	105	105	105	105	105	526	+ 5%
Franchised stations income	101	525	104	104	104	104	104	522	- 1%
Facility / Supplemental charges[8]	101	496	101	101	101	101	101	507	+ 2%
Other income[9]	11	77	14	14	14	14	14	71	- 8%
Open access income	18	118	5	5	5	5	5	24	- 80%
Total	**755**	**4,265**	**758**	**735**	**737**	**745**	**748**	**3,723**	**- 13%**

[8] Covering supplemental charge income for example the 'Crossrail Supplementary Access Charge' or 'CSAC'.

[9] Including NRHS income and insurance premiums.

Table A.2 Network Rail's SBP forecast other income – Scotland

£ million 2023-24 prices	2023-24	CP6 total	2024-25	2025-26	2026-27	2027-28	2028-29	CP7 total	CP7 vs CP6
Property rental	15	68	16	16	16	16	16	78	+ 16%
Property sales	8	16	1	1	1	1	1	7	- 57%
Total property income	**24**	**83**	**17**	**17**	**17**	**17**	**17**	**85**	**+ 2%**
Depots income	16	74	16	16	16	16	16	82	+ 12%
Managed stations qualifying expenditure ('QX') income	8	43	8	8	8	8	8	41	- 4%
Franchised stations income	3	16	3	3	3	3	3	15	- 3%
Facility / Supplemental charges	0	0	0	0	0	0	0	0	N/A
Other income[10]	1	3	1	1	1	1	1	3	+ 1%
Open access income	0	0	0	0	0	0	0	0	N/A
Total	**52**	**218**	**45**	**45**	**45**	**45**	**45**	**226**	**+ 4%**

[10] Including insurance premiums.