TRANSPORT FOR LONDON

FINANCE AND POLICY COMMITTEE

SUBJECT: RAIL VALUE FOR MONEY STUDY (MCNULTY REPORT)

DATE: 27 JULY 2011

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1 PURPOSE AND DECISION REQUIRED

1.1 The purpose of this paper is to advise the Committee on the main findings of the report ‘Realising the Potential of GB Rail’ and their impact on TfL. The report is the final report of the rail value for money study, sponsored jointly by Department for Transport (DfT) and the Office of Rail Regulation (ORR), and published by Sir Roy McNulty on 19 May 2011. Although London Underground was outside the scope of the study, many of the findings have implications for both Rail and Underground services as set out in Table 1. This paper is intended to stimulate discussion on the implications of the study and how London’s railway can, in the report’s own words, “earn its licence to grow” by reducing costs at a time of growing demand.

1.2 A similar paper was noted by the Rail and Underground Panel at its meeting on 12 July 2011.

1.3 The Committee is asked to note this paper.

2 BACKGROUND

Final report

2.1 The report finds that although rail demand has grown 57 per cent since privatisation and many costs are fixed, unit costs have remained unchanged. It recommends means to reduce unit costs by 30 per cent by 2019, saving up to £0.7-1bn per year without cutting the network.

2.2 The means to achieve the 30 per cent reduction are:

(a) savings already factored into ORR’s Control Period 4/Control Period 5 efficiency targets for Network Rail = 15 per cent;

(b) better train utilisation (i.e. more passenger km per train km) = six per cent;

(c) clarity on industry objectives, strategy and outputs = one per cent;

(d) better leadership, structures, interfaces and incentives = one per cent;

(e) more revenue generation = one per cent;

(f) better asset and supply chain management = five per cent;

(g) better programme management = one per cent;

(h) savings related to safety, standards and innovation = one per cent;

(i) savings via reforms to Human Resources, working practices, pay and training = two per cent; and

(j) less double counts in the above = minus three per cent.

2.3 Delivery of savings may require some significant changes to industry structure, working practices and customer service.

Findings and Recommendations

2.4 A Rail Delivery Group (RDG) will provide leadership for the reform agenda. It will be chaired by Tim O'Toole (First Group) with David Higgins (Network Rail) as vice chair and comprises Chief Executives of TOC/Freight Operating Company owner groups. RDG's terms of reference state that Government and ORR will not be members of the group but they will be invited to provide input to the group on key issues. TfL needs to ensure that it has an input to the group. RDG will oversee development of the Initial Industry Plan, to be published in late September 2011, which forms the industry's input into DfT's HLOS2, itself to be published in July 2012. A White Paper will also be published by DfT in November 2011, to set out how McNulty's recommendations will be implemented.

2.5 The report notes that comparative capacity utilisation in Great Britain is relatively low and asserts that its improvement, combined with means to shift demand away from the high peak, is a means to reduce the peak vehicle requirement and hence costs. Better train utilisation is the largest single cost saving item in the report, other than the already committed Network Rail efficiencies. The measure of capacity utilisation used, passenger miles per train mile, can give unflattering comparisons for operators where relatively 'flat' timetable profiles across the day take advantage of low marginal costs of running off peak services. The study notes there has been a bias towards capital spending in the way the industry works and some cases timetabling solutions would avoid the need for infrastructure enhancements.

2.6 London and South East performs well in terms of net cost to Government compared with regional railways and long distance services with a net cost per passenger mile of 4.8p compared with 31.1p for regional franchises. Publication of official profit and loss accounts at TOC level will improve benchmarking opportunities.

2.7 The HLOS and Statement of Funds Available processes will be retained with an additional metric of cost reduction. Future Route Utilisation Strategies will emphasise making better use of existing capacity and addressing gaps with minimal additional funding. The report focuses almost entirely on financial costs and revenues with little attention given to social or economic benefits of passenger services. The Secretary of State for Transport has announced that future appraisal guidance will give greater prominence to financial costs and affordability.

2.8 Network Rail is currently devolving responsibility for infrastructure management and maintenance to route level businesses to bring a more local focus. Greater alignment between Network Rail and operators could range from joint ventures to vertical integration. Greater Anglia is the next London and South East franchise to be relet and will be considered for vertical integration when the longer franchise is relet in 2014. The Anglia zone includes the North London Railway infrastructure as well as the future Crossrail route into Liverpool Street.

2.9 Greater devolution of budgets and accountability to bodies such as PTEs and local authorities is proposed. The focus is on the Northern franchise where net unit costs are high and government sees scope for cost reduction through local management. A DfT consultation on rail devolution is expected before the autumn 2011. In addition, franchises will become longer and less prescriptive than at present.

2.10 The review recommends that fares should be rebalanced within an overall total to balance demand and supply and peak pricing is recommended as a means of spreading demand. Research for TfL/DfT and Network Rail, in 2007, showed that peak pricing would need to introduce fare differentials of up to 25 per cent to deliver a four per cent shift in demand. In addition it could adversely affect people in particular market segments. An electronic season ticket trial is proposed on a London commuter route as well as accelerated introduction of smartcard ticketing. The study recommends engagement with TfL over Travelcard pricing to raise the effective cap on high peak fares.

2.11 The report proposes that station staffing is reduced. Accelerated implementation of smartcard ticketing and installation of retail facilities will reduce reliance on ticket offices. Driver Only Operation should be the norm except where technically not possible. The report also makes recommendations around staff salaries and working practices. It encourages greater part time working to take account of the fact that demand is concentrated in the peaks.

3 IMPLICATIONS FOR TFL

3.1 Opportunities and risks to TfL are set out in Table 1.

Table 1: Opportunities and Risks for TfL

Opportunities	Risks
The Rail Delivery Group will lead the implementation process, though its decision-making powers are unclear. TfL has an opportunity to influence this group through industry contacts but also needs to ensure it has an input to the group.	Introduction of peak pricing could result in large increases in high peak fares in order to materially shift demand which would affect people on low incomes with little choice over their travel times. The fares proposals could also limit the Mayor's role in setting Travelcard prices.
London's subsidy is low relative to that of regional services and we should highlight this point to make the case for continued investment.	London services are not seen as a problem in terms of their net cost. Neither the report nor government to date have focused on devolution to London compared to the northern cities.
The review proposes greater devolution of budgets and accountability to regional bodies such as Passenger Transport Executives (PTE). The Mayor and TfL could take this opportunity to press the case for devolution in London as well.	Less prescriptive franchises are recommended, but the Mayor has previously expressed the concern that this would be inappropriate for London as this could lead to franchisees cutting commercially unviable off peak services and station facilities.
The focus on timetabling solutions to reduce the need for capital enhancements means TfL could press the case for better use of underutilised train paths in the peaks to make best possible use of available capacity.	Capacity utilisation measured by passenger miles/ train miles means that operators running frequent off peak services may appear inefficient even though the costs of running such services are marginal.
If Anglia is selected for vertical integration, TfL should work closely with Network Rail to ensure that London Overground and Crossrail services are not disadvantaged.	Potential 'vertical integration' between Network Rail and Train Operating Company (TOC) in the Anglia region (which includes Overground and Crossrail) could disadvantage TfL's operations by a lack of focus on their business needs.
Greater flexibility around ticket office hours could provide an opportunity for a more customer focused service proposition..	The focus on costs and revenues fails to capture social and economic impacts of rail services. Making the case for enhancements in London could be more difficult in this context, with no 'licence to grow'.
Steps to improve efficiency and productivity across the rail industry should help to reduce TfL's unit costs.	A perception that the 'bias towards capital spending' needs to be corrected may make it more difficult to obtain funding for enhancements to improve peak capacity in London, through the High Level Output Specification (HLOS2) process for example.
The need to reduce costs of enhancement projects and focus on better sponsorship and asset management may provide an opportunity for TfL.	Cost and revenue sharing between TOCs and Network Rail could lead to the more commercial long distance operators receiving favourable treatment compared to inner suburban operators.
The study recommends introduction of a systems authority and a more flexible approach to standards which could reduce costs across the industry.	Publication of route level accounts would highlight apparently higher operating costs where service quality standards are higher.

4 CONCLUSIONS AND NEXT STEPS

4.1 The value for money report creates risks and opportunities for TfL in relation to devolution, HLOS and TfL's rail operations. It is essential that TfL develops a process for inputting its views to the RDG as TfL, in common with other funders including DfT, is not a member of that group. TfL will take part in value for money related workstreams as they occur, including DfT's review of fares and its review of where subsidy is spent. It will also respond to ORR's consultation on the up-coming Periodic Review covering the 2014-19 period.

4.2 TfL has attempted to demonstrate in the value for money of its recommended HLOS2 schemes, as well as means to reduce costs, that taken together is a "licence to grow". It will engage with the industry and key stakeholders on the case for rail investment in London, as described in the paper 'Devolving Responsibility for Rail Services in London' considered by the Committee at its meeting on 25 May 2011.

4.3 A White Paper on industry structure will be published in November 2011. TfL will liaise with the DfT to influence its content and will comment on the final paper. TfL will work to influence the devolution consultation so that London services are included within the scope of any consultation.

5 RECOMMENDATION

5.1 The Committee is asked to NOTE the paper.

6 CONTACT

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