

CHAPTER 5

The main issues

5.1. In Chapters 3 and 4 we have described the railway estate and the organisation of British Rail and of the Property Board which manage it. In this chapter we deal with what we perceive as the main issues for British Rail in this inquiry. We then go on in Chapters 6 and 7 to consider how their property activities have been managed in the recent past, concentrating particularly on the procedures for decision-making in the major areas of sales, management and development and the results of those decisions. In Chapter 8 we deal with some minor but burdensome aspects of the estate and in Chapter 9 we consider the Property Board's general competence in property matters and reach some conclusions on the effectiveness of their procedures. In each of these four chapters we make recommendations for improvement in the handling of these matters in the future. Finally, in Chapter 10 we set out our views on the future management of the estate, deal with the question of the public interest and summarise our conclusions.

5.2. Before we go further it may be convenient to recall how British Rail are unusual, if not unique, amongst major landowners. Their freedom of action is constrained by three factors:

- (a) Statutory powers and duties.
- (b) Government direction and policy.
- (c) Physical characteristics of the estate.

(a) *Statutory powers and duties*

5.3. British Rail are constituted as a statutory corporation with limited powers to deal with land. Section 3 of the Transport Act 1962 sets out the duties of the Railways Board, the principal duties being 'to provide railway services in Great Britain'. Section 14 of the same Act gives the Board powers 'to acquire land for the purposes of their business and to dispose . . . of any property which *in their opinion* (our italics) is not required by them for the purposes of their business' and 'to dispose of an interest in, or right over, any property which, subject to the interest or right, is retained by the Board'.

5.4. One effect of these provisions is that before any land can be sold British Rail must formally come to the opinion that the land is no longer required for the purposes of the business. Thus, even if it could make sense to do so, they have no power to sell property they classify as operational land (although they may dispose of various interests in that land providing railway operations are adequately protected). Similarly they may not enter into a sale and lease-back arrangement in respect of operational land. On the other hand British Rail are not obliged by statute to sell any land which they no longer require for their operations. Under section 11 of the 1962 Act they may retain such land 'and develop it for use by other persons'; they may also develop operational land for use by other persons where this is compatible with its use for railway

purposes. The section also gives power to purchase land adjoining British Rail land where this is necessary for the development of the British Rail land. British Rail may not incur substantial expense on such development without the consent of the Minister of Transport. (The Minister has power to direct what constitutes 'substantial expense'. British Rail told us that he had not done so, but that their understanding since 1976 had been that expenditure in excess of £2.0 million would be regarded as 'substantial'.) Section 134 of the Transport Act 1968 requires British Rail to 'act as if they were a company engaged in a commercial enterprise' when developing land for use by others. Their ability to act commercially is circumscribed, however, by these statutory powers and duties and also by the requirements of government.

(b) Government directions and policies

5.5. During the annual negotiations on the EFL¹ during which British Rail's investment plans are agreed the Government is in a position to exert—and does exert—pressure to ensure that British Rail follow current Government policy on the disposal of surplus land to the private sector.² This means that the Department of Transport will suggest the sum which it considers British Rail should, in each given year, contribute from their property activities to reduce Government funding. British Rail told us that the Government gave no directions as to how this sum was to be raised from property; thus, within the guidelines of Government policy and the constraint represented by the budget agreed with Government, all subsequent decisions on how to raise the required contribution are taken by British Rail.³

(c) Physical characteristics of the estate

5.6. British Rail inherited the railway infrastructure laid down on a grand scale mainly in the last century. Even in its truncated form it is far from ideally suited to British Rail's needs in the last quarter of the twentieth century, but it remains impossibly expensive to replace or even substantially modify. British Rail can generally not do much to improve the utility to others—and hence the saleability or development potential—of much land no longer required for operational purposes; some is of awkward shape, 'rail-locked', or with access encumbered by adjacent operating requirements, or by considerations of safety. Many closed branch lines are no more than ribbons of mainly rural land inherently unsuitable for other uses. Moreover, railway structures which are no longer needed for the railway are increasingly regarded as part of the nation's architectural and engineering heritage, which can mean that British Rail are not free to demolish them or dispose of them as they see fit.

¹ See paragraph 4.16.

² The Secretary of State for the Environment said in Parliament on 13 June 1979 '... all land which is currently held by public authorities surplus to requirements should be offered for sale as soon as practicable'. (See also footnote to paragraph 1.16.) The Secretary of State for Transport wrote to the Chairman of British Rail on 24 October 1983 setting out the objectives the Government wished the Chairman to pursue. This letter contained the sentence 'The Board should continue to pursue a vigorous policy of property development and disposal'.

³ British Rail told us that the decision to transfer surplus property to BRIL and to dispose of the portfolio by sale was taken by the BR Board without a specific Ministerial or Departmental direction, but in the light of clear indications that the Government expected the BRIL portfolio to be sold as expeditiously as possible.

General

5.7. Accordingly in now reaching our conclusions on the main issues and in the chapters that follow, we have to take account of the fact that British Rail, while enjoined to act commercially, do not in practice have the freedom when dealing with their property that a property development company would have.

The issues

5.8. The first issue is whether the present organisation and management of British Rail is well suited to exploit their estate to financial advantage. Are there clear lines of responsibility and accountability; is there a clear strategy, with programmes that can be monitored, with effective pressures to action? The second key issue is whether the decisions which are taken on the disposal of property—where that option is open—or its retention for development or management are consistent with the financial interests of British Rail.

(a) Organisation and management

5.9. Apart from railway operations there are two ways in which British Rail can exploit their estate to financial advantage. They can identify land surplus to operational requirements and thus available either for disposal or to be developed or managed for income. Secondly, in the case of land which remains in their view essential to the operation of the railway, British Rail can seek to identify or create possible opportunities for making an additional financial return from it.

5.10. Much land has become available through the progressive contraction and rationalisation of the railway network and, during the last five years, the Property Board have been active in identifying surplus properties. The network is now relatively stable and may be unlikely to contract much more in the near future. Accordingly it is already foreseen by British Rail that the amount of land available for release will decline steeply.

5.11. As this occurs British Rail's earnings from property will depend more on realising the commercial potential of operational land, which will become much the larger and the more rewarding of British Rail's commercial property activities. The operational estate is now some 260 square miles, one of the biggest in single ownership in the United Kingdom and only a small part of it has so far been commercially exploited for other than railway business. About half of this estate takes the form of long runs of railway line. Even this is not all incapable of commercial exploitation, as it provides established cross-country routes, conveniently in one ownership, for such things as telecommunications links and pipelines. There then remain some 130 square miles, much of it in city and town centres, which must offer many opportunities for making a material contribution to British Rail's finances.

5.12. The Property Board was established in 1969 with responsibility for advising the railway undertakings on property matters and for the commercial development of property. British Rail told us that the BR Board had taken the view that property management activities should be removed from control of General Managers of the rail regions and made a separate activity to meet the

need for a more professional and businesslike approach. It seems to us that this hiving off of the responsibility for property matters into a separate Property Board, while enhancing the employment of professional and entrepreneurial skills, does not remove from operational management important responsibilities for railway property.

5.13. The Property Board assume responsibility for non-operational land once it has been declared surplus, but the decision as to whether and when such land is declared surplus has to remain with the operational side of the railway. Thus if surplus land is not recognised as such, the fault may lie with the operational side, while if land declared surplus is not fully exploited, the fault may lie with the Property Board. For land remaining in the operational estate it is only when a decision has been taken to offer a facility or promote a development that the Property Board become responsible for carrying out the transaction. Thus if a piece of operational land remains undeveloped, or not developed to the best effect, the fault may lie either with an operational manager or with the Property Board.

5.14. The present allocation of responsibility does not appear conducive to efficient management of the estate. It is essential that those who run the railway at the most senior level recognise a parallel responsibility for managing the railway estate. At present no member of the British Rail Board below the Chairman has a specific responsibility for property, although the Vice Chairman is responsible for maintaining a link with the Property Board. The Chairman of the Property Board is not a member of the BR Board and none of the six supporting BR Board committees is directly concerned with property matters. The body known as the Railway Executive, charged with running what British Rail call the Railway Business, includes the Sector Directors, the Directors of all the main functions and the Regional General Managers. However, there is no member with a responsibility for property alone, although the Managing Director of the Property Board attends their meetings when invited. Nor are any of the supporting Railway Executive Groups (committees) directly concerned with property matters.

5.15. British Rail told us that the Chief Executive of the railway is responsible for the proper management and development of the railway estate as a whole. He has the responsibility for the operational estate with the assistance of the Managing Director of the Property Board, who in turn is responsible to the Chief Executive for the non-operational estate.

5.16. We do not believe that these arrangements make for clear lines of responsibility running upwards and of direction running downwards, to enable strategy to be defined and its achievement monitored. It is unsatisfactory that there is nobody below the Chief Executive clearly and effectively accountable for the management of the estate as a whole.

5.17. We were told that the Property Board are active in seeking out opportunities for sale or development, but it is inevitable that there will be conflicts of opinion over individual properties between the operational divisions and the Property Board. The latter will always be in the position of a suppliant. Even when operational managers are anxious to co-operate, different sector

businesses will have interests that must be considered and reconciled. In the last resort the operational needs of the railway—and in particular the safety of its operations—must be accorded priority, but it is necessary to ensure that what are represented as needs are genuinely essential. In the absence of a single focus of responsibility the pressure to reach a solution without undue delay is hard to generate. Responsibility for property matters needs to be managed rather than left to the interplay of interests.

5.18. We accordingly recommend that:

- (a) a member of the BR Board, other than the Chairman or Chief Executive, should be given specific responsibility for property matters, but not necessarily to the exclusion of other responsibilities;
- (b) property matters should be part of the remit of one of the BR Board Committees and property activities should be accepted as an integral part of the Railway Business; and
- (c) a Director of Property should be appointed. He should be a full member of the Railway Executive, with responsibility for maximising the return from the whole British Rail estate.

5.19. The establishment of responsibility for estate management in this way would then permit its more effective direction. There should be a clear statement that the objective is to maximise the return from the estate as a whole and this aim should be embodied in rolling programmes for making more land available for sale or management and for promoting the development of land still required for operational purposes. Within such plans area targets would be set which could then be monitored at each level of management. The operational side of the railway would be required to play a full part in achieving these targets. British Rail should establish clear accountability for property matters at all levels of management and provide for a positive response to the requirements of the Director of Property.

Improving the management process

5.20. We considered how far the valuation of operational land would be a useful means of encouraging operational managers to release it, or to make more effective use of it. British Rail are deterred by the cost and by technical and administrative complications from valuing the generality of operational land. They prefer a selective approach, valuing operational land only when a specific proposal for alternative use is made or when they wish to compare the total cost of a British Rail activity with private sector costs for the same activity. We agree that it would not be practicable to value all operational land, but we do not think British Rail's selective approach goes far enough. We reject the view that the obvious difficulty and likely inutility of attempting to value the site of a major station or 50 miles of railway track justify making no attempt to value operational land except in the limited circumstances envisaged by British Rail. There are many areas of operational land for which an alternative use could reasonably be postulated.¹ We see no reason why such

¹ For example, the areas around stations currently used for car parking and other access to the railway: goods yards etc.

areas should not be valued accordingly and we recommend that this should be done over a period. The results should be used to bring home to the operational managers concerned the opportunity cost of the assets they are using and to assist in judging the cost-effectiveness of their present use.

5.21. We also envisage the private sector supplementing the work of British Rail's own property professionals. British Rail already sometimes use outside surveyors.¹ In 1984 in the course of their Radical Rail Policy Review the BR Board questioned the cost-effectiveness of the Property Board in comparison with the employment of outside agencies.² The question was answered only by the Property Board's assessment, which should scarcely have been enough on its own to determine the issue.

5.22. There is one way in particular in which the private sector can assist in the management of the British Rail estate. The Property Board believe that their staff adequately cover the ground in their own areas and that the private sector already draw attention to opportunities which they perceive. The evidence did not wholly substantiate this belief. We see advantage in the appointment in each area of reputable firms of surveyors, particularly in areas remote from regional offices, to review with British Rail staff the local railway estate and their operational plans. With the prospect of fees and commissions on any transaction which they initiate the best local firms, with their knowledge of local authority intentions and possible development opportunities, would, we believe, then be able to suggest projects which at present are likely to escape notice. We recommend that this possibility should be tested in the first place by trial appointments in selected areas.

5.23. Both the Property Board and local authorities told us of delays and frustrations when dealing with the other on planning matters. The authorities said that this often arose from the difficulty of obtaining decisions on properties distant from the Board's regional headquarters. The Board need to ensure that all local contacts are made and maintained in a manner appropriate to commercial transactions and working with the better local agents may well act as a stimulus in this respect.

(b) Financial interests of British Rail

5.24. The second key issue is whether British Rail's disposition, stemming both from their cash needs and from clear indications of Government policy, to sell surplus property sooner rather than later is consistent with the Property Board's aim to apply the concept of 'optimum estate management' in handling their portfolio.

5.25. Under optimum estate management choices as to when to sell and how long to retain properties should in principle be made so as to maximise cash receipts over an appropriate period of time. It is arguable that by definition this principle must work to British Rail's financial advantage, although there can still be dispute about the length of time over which (and the rate at which) future income should be discounted to arrive at its net present value. In practice

¹ For example, in relation to developments and sales, and on an *ad hoc* basis for special reviews— as for station trading at Birmingham New Street and Waterloo.

² See paragraph 4.30.

the cash flow pressures imposed on British Rail by a tight EFL may override the conclusions arising from applying the concept of optimum estate management and may be expressed simply in the form of short-term cash requirements. In accord with our terms of reference we have considered how far the outcome is consistent with British Rail's financial advantage.

5.26. The disposal of the BRIL portfolio may be seen as a test case. The policy British Rail originally applied to the BRIL estate was inflexible—sell everything in accordance with an arbitrary timetable. Late last year they introduced more flexibility by agreeing that the sale of individual properties might be somewhat delayed¹ if that enhanced their value, providing, however, that cash targets were met. The acceptance by British Rail that a longer time in which to sell the BRIL properties may be desirable implies that they recognise the disadvantages imposed by the original BRIL timetable. It seems to us that the Property Board should also take full account of marriage value and potential development value. A sale in a short time-scale, when the vendor acknowledges that a somewhat longer period could enhance the value, implies some degree of discount on open market value (as defined) and thus an element of distress in the sale.

5.27. While it was no doubt necessary to set a timetable for BRIL in order to get disposals under way, it seems likely that the rigid and detailed programme that was laid down placed the Property Board at a bargaining disadvantage. Given the magnitudes involved a forecast shortfall in the EFL was not a sufficient justification for this timetable, as British Rail had other means of making the necessary adjustments to their budget. Any sudden call for cash is likely to work contrary to best business practice in property management. Thus while it is true that BRIL sales achieved more in money terms than was originally estimated, this was mainly because the estimates took insufficient account of the effect of inflation over the period and were overtaken by changes in the property market. It is difficult to believe that these sales so far have yielded as much as they might have done.

5.28. Similar issues arise on the handling of the Property Board's residual portfolio for which British Rail accept the need for a measure of flexibility, provided again that their cash requirements are met. In this context they have always recognised that their preference for cash could not justify 'distress sales'; but even sales conforming to the RICS definition of 'open market value' (which requires *inter alia* 'a reasonable period to expose the property to the market') may not take sufficient account of the possibilities of realising marriage values or potential development values. We think it is important that the professional judgement of the Property Board should be applied to assessing the scope for enhancing realisable values of this kind. Appropriate use should also be made of discounted cash flow analysis, although we note in Chapter 6 that the way the Property Board used the NLF rate to discount estimates of rent in a period of inflation had the effect of applying a low real rate to choices between selling and retaining property and may thus have unduly favoured retentions in some cases. In any case the Property Board have expressed some preference for retentions (contrary to British Rail's disposition to sell) as a means of securing future income to cover the continuing costs of estate management.

¹ See footnote to paragraph 3.32.

Summary

5.29. In sum we recognise that Government policy requires British Rail to dispose of surplus land 'as soon as practicable' and we support their view that they should concentrate their efforts on their mainstream business. The concept of 'optimum estate management' should not override these considerations. On the other hand we believe that British Rail's short-term cash needs can be pressed too far and that they should not see themselves as in a commercial survival situation, needing cash so urgently that they are justified in liquidating property immediately at almost any price. To be consistent with British Rail's financial advantage, the options in selling or managing surplus property should be subject to proper analysis, particularly taking account of the scope for enhancing realisable values. To dispose of surplus land and concentrate on the main business is sensible; to do so in an ill-considered way and risk unnecessarily incurring loss is not.

5.30. British Rail should conduct the management, development and disposal of their property in accordance with a consistent and stable policy. Within the general policy of disengagement and disposal their cash requirements should be programmed with enough flexibility between one year and another to allow the exercise of professional judgement on the lines we have indicated, while avoiding sudden adjustments to meet short-term pressures.