Asia Pacific Projects Update

CASE STUDY: THE UK'S INTERCITY EXPRESS PROGRAMME

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PPP FINANCING TO REPLACE THE EXISTING INTERCITY 125 AND 225 ROLLING STOCK ON THE UK NETWORK

The Intercity Express Programme (IEP) is the UK Department for Transport (DfT) program to replace the older intercity trains currently running on the rail network in mainland UK with new trains in a major public-private partnership (PPP) project that is both the biggest privately financed rolling stock deal in history, anywhere in the world, and one of the largest, most ambitious and complex PPP projects to date.

This article outlines how PPP financing has been successfully applied in the procurement of this unique project to provide a new generation of trains to serve the long distance routes on Britain's rail network. It was written with input from Trevor Sturmy, Head of PF Infrastructure for Europe and SSA at HSBC, who was the lead for the financial advisory team on the private sector side. DLA Piper's team (led by the author) provided legal advice on the private sector side.

The contract is for supply and maintenance of the replacement rolling stock, and with the Agility Trains Consortium, consisting of Hitachi Rail Europe and John Laing Investments, in February 2009, appointed preferred bidder by the DfT in February 2009. The solution selected by DfT was the Hitachi Super Express Train (SET) initially to be built and assembled by Hitachi in Japan with later SETs being assembled at a state-of-the-art new facility to be constructed for the project at Newton Aycliffe in Darlington, UK.

IEP is the most significant rolling stock investment program in the UK for 30 years, creating 730 new jobs in the rail industry, 200 in construction and thousands more in the supply chain.

Given the size of the overall program, the transaction has been split into two: (i) an initial funding for the Great Western Mainline (GWML) fleet, which has now reached financial close; and (ii) a second financing for the East Coast Mainline (ECML) fleet for which a commercial close has been achieved, and for which financial close is targeted for 2014.

The main scope of the IEP GWML is the design, manufacture, commissioning and bringing into service of the new SETs alongside the construction and maintenance of new depot facilities at Bristol Stoke Gifford, Swansea, and also the major overhaul of the existing North Pole depot in West London. IEP ECML will additionally involve the construction of a large new depot at Doncaster.

The SETs, based on the recently introduced Javelin Trains on the High Speed 1 line, will consist of both electric and bi-mode units (able to both power themselves and to use electric power when available), and are to be fully in service by 2018.

TRANSACTION HISTORY

The competition for the project was launched in early 2007. HSBC was selected as financial advisor and DLA Piper as legal advisor, along with Deloitte (tax and accounting) and Aon (insurance) to assist in the development of the project. The DfT's advisers, PwC (financial), Freshfields Bruckhaus Deringer (legal), Mott Macdonald (technical) and Willis (insurance), had been appointed at an earlier stage.

Following a change in government in May 2010, and after a value-for-money review was undertaken by Sir Andrew Foster in July 2010 and the UK Government's comprehensive spending review in Autumn 2010, DfT confirmed its intention to proceed with the IEP project in March 2011. This announcement was made alongside the related announcement to electrify the GWML to Cardiff.

In advance of presenting the project to the wider funding market, a group of structuring banks was selected to develop the financing package and documentation. The structuring bank group comprised of the following institutions (along with allocated roles):

- The Bank of Tokyo-Mitsubishi UFJ Ltd (documentation)
- The European Investment Bank (EIB)
- HSBC Bank plc (hedging structuring)
- The Japan Bank for Industrial Cooperation (JBIC)
- Lloyds TSB Bank plc (documentation)
- Mizuho Corporate Bank Ltd (modelling, insurance and technical).

A process to select bank advisers was undertaken at the start of the structuring bank phase, with Ashurst being selected to act as lenders' legal adviser, Halcrow advising on technical matters, Marsh looking at insurance issues and Operis providing the financial model audit.

The competition for the required 29.5-year bank financing was launched in March 2012 with a significant part of the funding being provided by the structuring banks, plus the addition of:

- Mitsubishi UFJ Trust and Banking Corporation
- Sumitomo Mitsui Banking Corporation
- Sumitomo Mitsui Trust Bank Ltd.

The commercial facility was split between a £150 million Nippon Export and Investment Insurance (NEXI) covered tranche and £850 million uncovered tranche. The commercial bank financing sits alongside a £1 billion facility provided by JBIC and a £235 million EIB facility.

A funding competition was also run for the Equity Bridge facility, with the most competitive terms being offered by:

- The Bank of Tokyo-Mitsubishi UFJ Ltd
- Development Bank of Japan Inc
- Mizuho Corporate Bank Ltd.

Tripartite negotiations between the banks, the consortium and the DfT took place to finalise both the project and finance documentation, with financial close being achieved on 25 July 2012. A simultaneous commercial close was also achieved on the IEP ECML program.

SERVICE SUMMARY

Agility Trains is responsible for delivering all the services (i) required under the Master Availability and Reliability Agreement with the DfT, and (ii) for making the SETs available to the Train Operating Companies under the Train Availability and Reliability Agreement (TARA).

Transfer of train and depot delivery, and train operation and maintenance, is passed down from Agility to Hitachi under the two key subcontracts as follows:

- Supply of 57 (GWML) SETs, plus supporting maintenance and depot facilities, under the Manufacture and Supply Agreement
- Provision of all ongoing train and depot maintenance services under the Train Service Agreement.

PAYMENT MECHANISM

Payment is based on availability, with Agility being responsible for providing the SETs each day for service under the TARA, for which it is compensated by way of SAPs paid by the Train Operating Companies. In the event Agility does not meet the performance regime relating to availability "off the depot", availability in service, reliability and standards of cleanliness and presentation, SAPs will be subject to deductions.

FINANCING PLAN

The complex financing arrangements for IEP involve multiple tranches of senior debt and an equity bridge facility. The project also included substantial FX and interest rate swaps at close.

Notwithstanding challenging financial markets, Agility and its advisors helped create a structure that enabled approximately £2.5 billion of senior debt to be provided with a long-term tenor approaching 30 years by four groups of lenders, which included JBIC's first lending to a UK PPP project and Nippon Export and Investment Insurance's (NEXI's) first insurance product for a UK PPP.

The total project financing requirement at close is circa £2.5 billion, consisting of £2.2 billion long-term project financing plus £280 million mix of share capital and shareholder loans. The shareholder loans are deferred and supported by an Equity Bridge Loan.

The £2.2 billion senior debt funding, maturing at the end of 2041, is made-up of the following tranches:

- £1 billion JBIC facility
- £235 million EIB facility
- £150 million NEXI covered commercial bank facility
- £850 million uncovered commercial bank facility.

KEY TRANSACTION POINTS

Delivering IEP presented the sponsors and their advisors with perhaps a unique set of challenges in achieving financial close:

Macro challenges: In supporting Agility in the competitive procurement process and preferred bidder negotiations over a four-year period, Agility responded to major challenges including structuring the deal to reflect the collapse in the banking market and a change in government whilst maintaining value for money.

Pathfinder: There is no precedent for PPPs in heavy rail in the UK. IEP therefore breaks new ground on almost every key issue in creating a novel contractual structure to accommodate this first-time use of a PPP structure for the procurement of rolling stock – the deal has to remain bankable whilst at the same time balancing the interests of DfT, Agility and its sponsors, Hitachi and funders, and fitting within the existing rail industry framework of provision.

Transformational: The train availability based structure is genuinely novel in the heavy rail market. It is the first time a "no train no pay" structure has been used and will drive exceptional performance.

Two packages simultaneously: In addition to financially closing the Great Western element of IEP, Agility achieved a simultaneous commercial close of the East Coast element, requiring the tailoring of the contractual arrangements to deal with a lengthy period between commercial and financial close.

Innovative "change" regime: As these are moving assets providing a key public service, DfT required considerable flexibility in respect of the deployment of the trains. This ranges from amendments to the passenger timetable at one end of the spectrum, to redeployment of trains to different routes and use of new depots at the other. This is a major challenge within the constraints of a project finance deal. As such there were detailed negotiations to ensure that the interests of all were adequately and innovatively protected in respect of any such variations.

Multisourced funding: The project, not only the first heavy rail PPP in the UK but also the first PPP to involve commercial funders alongside JBIC, EIB and NEXI, required the integration of different precedents across funding markets for a range of technical and policy areas, managed through bespoke and complex intercreditor arrangements.

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