Off the rails

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As high-speed rail project financing activity picks across western Europe, there are signs of some convergence between financing structures. EU regulations and the nature of continental rail travel are combining to encourage grantors and sponsors to take a more unified approach, and this flows through to the way deals are financed. But given that one of the main selling points of high-speed rail is its boost to a countrys economic competitiveness, there are limits to the trend towards convergence, even within the EU.

France and Spain are ahead of the curve compared with their near neighbours, Portugal and the UK, which have made recent tracks in the market. But the challenges inherent to rail financings namely that they rarely earn a respectable return for private sector sponsors combined with the general restrictions on liquidity and higher costs of debt have resulted in a significant shift to purely availability-based projects and an increased reliance on the European Investment Bank (EIB) for umbrella funding. The EIB, at least, takes the notion of integrated European high-speed rail networks seriously.

Spain: State and sponsors live with the status quo

The Spanish high-speed rail network is well developed, with four major lines already in operation and more or less consistent expansion since the early 1990s. The governments plan to have 10,000km of track available by 2020, with the capacity to take trains travelling at up to 350km per hour, is already underway and it has tendered Eu8.4 billion ($12 billion) in contracts to renovate the older lines to accommodate the faster trains, in addition to new lines between Girona, Barcelona, Tarragona, Valencia, Alicante and Murcia.

There are two forthcoming, interconnected high-speed rail PPP projects, one in the Andalucia region, which is expected to cost around Eu250 million, and another along the countrys east coast between Valencia and Tarragona, costing around Eu5 billion. These two projects, part of a 1,600km line, are due to be tendered this year, though some sponsors believe the governments time-frames are ambitious. The projects will form part of Spains greater network and connect to the border with the French network.

Financings for high-speed rail in Spain have tended to be for consortiums made up of Spanish local government, the state infrastructure company ADIF, and state rail company RENFE. The private sectors role has tended to be confined to carrying out construction contracts. A consortium of FCC and Acciona, for instance, has recently been awarded a Eu148.8 million contract for additional works on the Pajares rail tunnel part of the Leon Asturias network.

Felix Corral, director of concessions at FCC, has witnessed a number of significant changes in the Spanish high speed rail market over the last year. Debt has become much more expensive, which makes projects more expensive for the grantor, he notes.

The Spanish government-owned borrowers that are procuring new HSR lines are prepared to absorb increases in the cost of debt and other limiting factors spawned by the credit crisis, because Spains high-speed rail network is high on the political agenda. For high speed rail deals, it all depends on how much the awarding authority wants the project to go ahead and how much capital is it willing to put into it. Indeed, the political and economic climate in Spain might even be making the bidding process more straightforward for the private sector bidders.

Sponsors bring their experience with similar asset classes such has conventional or light and underground rail to bear on how they approach high-speed rail risk, though HSR typically lacks robust ridership models. Unlike the roads projects, there is not enough analysis and experience of ridership to make sound projections for high speed rail projects, says Rafael Nevado, director of contracts for Globalvia. Although decent HSR patronage might materialise, and make deals with ridership risk feasible, few sponsors believe anything but availability deals to be worthwhile exposure in the current climate.

Were Spanish grantors to try and persuade the countrys sponsors to take on more long-term risk in high-speed rail they would find that the private sector has its own balance sheet constraints. In terms of financing, we try not to consolidate the debt of projects, says Corral.

Grantors will also find that sponsors and lenders are much less accommodating of long project lead times, where lenders must hold their financing terms. Says Nevado: Before the financial crisis, companies could take on more of the financing risks, but it has become very important to ensure commercial close and financial close happen simultaneously.

The market players that move with the most ease between countries are the equipment manufacturers, which have been aggressive in their development of new markets. Asian manufacturers, specifically those from Korea, China and Japan, have made enthusiastic pitches for new work in the Americas. But in Europe, three European manufacturers Siemens, Alstom and CAF and one Canadian supplier Bombardier dominate. But while there is now a pan-European equipment market, European high-speed rail sponsors have tended to stick to their own respective domiciles.

Cross-Manche risk transfer models

France has a very appealing pipeline, says a Spanish lender, and the Spanish concessions companies are eager to be a part of it, but the French market particularly the rail market is difficult for foreign sponsors to enter. In this respect, the countrys ambitious high-speed rail PPP programme shares a characteristic with its other PPP procurements the almost complete dominance of bidding by the countrys three large sponsors Bouygues, Eiffage and Vinci.

The French history of high-speed rail development probably accentuates this imperviousness to outside involvement. Its TGV system has been the envy of its neighbours for decades, and was famously demonstrated by the need for Eurostar trains to slow down upon exiting the UK end of the Channel Tunnel. The UK has come some way in bridging the gap, most recently with HS1, the 30-year own and operate concession for the 110km line from the newly regenerated St Pancras station to the Channel Tunnel. Borealis and Ontario Teachers Pension Plan submitted a winning bid of £2.1 billion,

The deal included a number of sweeteners from the UK government and transit agreements with French and German operators, and the sponsors locked some very keen pricing both for the market and for the asset class with margins on the two-tranched mini-perm financing said to have been between 125bp and 175bp over Libor. The HS1 deal also benefited from a number of tariffs mandated by the UK government as part of the 2005 Railway Regulations.

The borrower receives an inflation-indexed investment recovery charge (IRC) for the time that rolling stock is on the HS1 line. An operations, maintenance and renewal charge (OMRC) also applies, based on a multiple of discrete per-minute rates for trains using the domestic and international routes.

Operators also pay a traction electricity charge for the additional cost of the power used to run some trains, if it is procured on their behalf. A congestion tariff is payable if capacity is reduced because of congestion, while a freight supplement is due for the excess costs attached to heavy loads, and there is a pass-through of the cost of any carbon reduction commitments, not to mention a number of other service charges specific to additional services offered.

So, while the UK is moving towards a performance and regulatory asset-based regime, the French state rail company, Réseau Ferré de France (RFF), is looking to transfer some volume risk to the private sector, though its regime has to date been primarily availability-based. The 2011 French deals, Vincis Tours-Bordeaux project and Eiffages Bretagne-Pays de la Loire, differ in their approach. The Eu7 billion, 300km Tours-Bordeaux line is one of very few current deals to feature elements of demand risk and has been hailed as testament to the strength of both the Vinci-led consortium and to the French procurement system. The deal will feature up to Eu3 billion in commercial bank debt in addition to EIB- and state lender CDC-provided tranches.

However, commercial bank debt commitments are not the only considerations for the grantor, RFF. Though consortiums led by Vinci and Bouygues were said to have greater bank debt commitments, RFF awarded the Eu3.4 billion Bretagne-Pays Loire line to Eiffage in part because it promised a shorter construction period, and Eiffages bank commitments are understood to have been credit-approved, unlike its rivals. Eiffage is said to be in the final stages of closing with a club of European banks on the Eu1.3 billion in funding not covered by the state and the EIB to fund the 25-year availability concession.

Portugal struggles to maintain momentum

Portugal is the least developed of the western European high speed rail markets, and despite an impressive debut with its first PPP, Poceirao-Caia, which reached commercial close in May 2010, the programme has been significantly hampered by Portugals political and economic uncertainties.

According to Armindo Pinho Martins, the general director at the project company ELOS (a consortium led by Brisa and Soares da Costa) the first project is now moving on following some post-close tweaking which was resolved in February. We have had some minor reform of the concession contract, transferring some environmental risk to the private shareholder.

The changes included a change in the guarantees on the EIBs Eu600 million loan, from the government to a group of commercial banks and for the sponsor to assume all of the archaeological and environmental risks associated with construction. In return, it received a slightly increased availability payment, from an NPV of roughly Eu147 million to Eu155 million.

The margins on the 20-year commercial loans, supported by the EIB commitment, began at 300bp during construction, increasing to 350bp over the life of the debt. When compared with the spreads on the recent UK and French project loans, the impact of sovereign risk on the financing is apparent. Even before the recent political and economic turmoil, the Portuguese programme faced some significant challenges. Portugal has a lot of experience with highways, but as yet there is little experience in railways, says Pinho Martins. The project finance model can be easily adapted to every sector, however, and the projects only include the infrastructure, not ridership risk.

Bids for the second of the Portuguese high-speed rail PPPs were submitted last year, but the procurement was cancelled due to Portugals economic situation. It happened right at the time of Irelands bail-out, says a source at Spanish sponsor, It was disappointing but it was well accepted and understood across the market. Portugals availability regime, when sanctioned by the countrys accounts court, and when the country can afford it, is popular with sponsors.

However, since the resignation of Portugals prime minister Jose Socrates in March 2011, after the countrys parliament rejected his proposal for austerity measures in the country, the programmes future is even less certain. Sponsors were expecting the project to be retendered imminently; The problem now is that there is a political vacuum, says Pinho Martins. The last government was very keen on progressing with these projects, but we dont know what the next governments agenda will be, and there wont be an election until June.

European community?

The divergences between procurement and financing processes, even between countries in the Eurozone, does not engender a lot of hope for an integrated pan-European network plan, but plentiful political impetus is at least bringing deals to market in rapid succession. If governments want to reap the environmental benefits of high-speed rail compared to air travel, they will need to impose as much discipline on procurement as possible. And private sector sponsors say they are a necessity in ensuring that projects are delivered promptly and operated efficiently.

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