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European Rolling Stock Deal of the Year 2012: IEP

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The procurement and financing for Hitachi and John Laings Agility Trains rolling stock venture marks firsts for the UK rail sector and for export credit agency involvement in infrastructure financing. It is the largest UK PPP deal in which an export credit agency has participated, and is the first time that the UK has procured rolling stock using an availability-based PPP structure.

As part of the unbundling and privatisation of the UKs rail network, rolling stock became the responsibility of dedicated rolling stock companies (Roscos), which acquired trains at low valuations and have been attractive assets for financial infrastructure investors ever since. But the Roscos are poor vehicles for a wholesale upgrade to the UKs long-distance train fleet.

UK rolling stock leases require lessees to pay for vehicles regardless of performance or availability. PPP structures require suppliers to meet fixed standards for performance and availability. But they have had limited application to rolling stock, beyond inclusion in larger light-rail concessions and the ill-starred Reliance Rail PPP in New South Wales.

Agility Trains PPP financing, for the Great Western segment of the Inter-City Express Programme, survived a change in government and public scrutiny of its cost structure. If the delivery of its 57 trains proceeds as planned, followed by the second East Coast phase of IEP, then the structure could be hugely influential in rail procurement in the UK and elsewhere.

Procurement started on the IEP in 2007, and the UKs Department for Transport planned from the start to run a funding competition on the deal, as it often does with larger, newer, and more complex assets. But by 2009, when Agility (Hitachi 70%, John Laing 30%) became preferred bidder, the funding landscape had changed. Not only were some of the older options like monoline-wrapped bonds out of contention, but banks ability to underwrite large debt amounts was limited.

The M25 PFI, which closed in the aftermath of the crisis, was able to dispense with direct lending from the UK government, but assembling its large bank group gave marginal members of the group outsize influence over that deals pricing. The immediate response to the crunch from the department and Agility was to split the East Coast train order, which was originally the first phase of IEP, into a number of smaller and more digestible tranches.

Tranching train deliveries would have been an intriguing solution. But each tranche would require its own special purpose vehicle and group of lenders. It would have made ensuring equal treatment of each set of lenders, managing performance risk, and dealing with collateral issues all very complicated. But it would have made opportunistically accessing long-term debt easier.

The arrival of a Conservative-led administration in 2010 intervened, because the coalition government launched a review of spending, encompassing several PPP projects. Unlike a large number of local authorities, whose waste PFIs were unceremoniously cut, the spending review allowed IEP to live. With the arrival of electrification on parts of Great Westerns lines, the sponsors and DfT reversed the order of the two phases, and updated the projects specifications to include both electric and dual-mode electric/diesel trains.

Agilitys final stroke of good fortune was the Japan Bank for International Cooperations decision to support project financings for Japanese sponsors and suppliers, on the back of top-level expressions of political support for Japanese investment in UK infrastructure. The presence of JBIC as a lender, and NEXI covering some of the debt, allowed the sponsors to assemble a lending group to provide just under £2.2 billion ($3.48 billion) in 29-year debt.

JBIC is providing a £1 billion direct loan, though on the same terms as the £800 million in uncovered commercial debt, while NEXI is covering a £150 million bank piece, and the European Investment Bank, which had been involved from early in the process, is providing a £235 million direct loan. Rounding out the package is a £300 million equity bridge loan.

The leaders of the commercial lending group were Bank of Tokyo-Mitsubishi UFJ (documentation), HSBC (financial adviser and hedging and structuring bank), Lloyds (documentation); and Mizuho (modelling, insurance, and technical). During the funding competition SMBC, the Japanese bank most familiar with the PFI market, but a backer of the losing bid of Siemens/Bombardier, came in as a participant, alongside Mitsubishi UFJ Trust and Sumitomo Mitsui Trust Bank. BTMU, Mizuho and Development Bank of Japan provided the equity bridge.

Hitachis willingness to stand behind its contract to deliver the trains is key, although the financing also covers the construction of maintenance depots for the fleet. However, taking the Japanese lenders through the details of the UK PFI programme, and negotiating intercreditor issues, took time. It was a tremendous challenge to develop a deal that is fundable, says Alistair Dormer, chairman of Hitachi Rail Europe, but we put together a structure that leveraged the cheapest rates of funding available.

Agilitys sponsors are standing by for a decision from the East Coast operator about how many trains it requires before launching that financing to market later this year. Also in the market in 2013 is the equally-delayed financing for the Thameslink line. But Crossrail, the UKs next big-ticket procurement, looks set to follow a template similar to IEP. If IEP answers potential criticisms about the cost and performance benefits of PPP structures it will not be the last of its kind.

Agility Trains West
Status
Closed 26 July 2012
Size
£2.485 billion
Description
Provision of 57 trains for the western segment of the Intercity Express Programme under a DBFM contract
Grantor
Department for Transport
Sponsors
Hitachi and John Laing
Debt
£1 billion JBIC loan, £800 million uncovered commercial bank debt, £150 million NEXI-covered loan, £235 million EIB loan, £300 million equity bridge
Mandated lead arrangers
BTMU, HSBC, Lloyds, Mizuho
Grantor financial adviser
PwC
Grantor legal adviser
Freshfields
Sponsor financial adviser
HSBC
Sponsor legal adviser
DLA Piper
Lender legal adviser
Ashurst

Technical consultant
Halcrow
Insurance adviser
Marsh
Model auditor
Operis