Intercity Express Programme, UK

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The successful financial close of the first phase of the Intercity Express Programme is an achievement for the entire UK infrastructure sector in many aspects. The most significant of which is; the delivery of an essential piece of rail infrastructure which combines the expertise of a broad range of domestic and foreign infrastructure players.

IEP has been through several ups and downs during its four year plus procurement journey. At one stage it was understood to be on the brink of being written-off due to its sheer size and debt requirement, a hefty £7.5 billion (US$12bn), before it was scaled down to a more realistic £4.5 billion.

Over its four year procurement term, the project has witnessed the global financial crisis, a UK general election, and the subsequent appointment of the country's first post-wartime coalition, and a stringent value for money test. Yet the project emerged unscathed by it all and reached financial close on its first phase in July 2012.

Advisers who worked closely on the deal said that it was well-structured and eventually bankable which led financiers, especially foreign ones, to provide full support to the project.

IEP aims to replace an ageing fleet of InterCity 125 trains on the East Coast Main Line and Great Western Main Line, as well as other train sets on long distance services from London to places including Cambridge, Oxford, and Hull. Spread over two phases, the total £4.5 billion IEP comprises trains, maintenance depots, and route upgrades, with the UK's Network Rail responsible for undertaking the infrastructure upgrades to allow the new trains to operate on the network.

The chosen Agility consortium led by Hitachi will deliver the new train fleet dubbed "The Hitachi Super Express." Hitachi will build a factory in Newton Aycliffe, County Durham in the north east of the UK to build the trains.

The Project - An early beginning

The idea for the Intercity Express project was first conceived in 2005 and was launched to the market for bidding in 2007. The estimated £7.5 billion project received a good response from experienced players in the rail sector who applied as part of consortiums. In November 2007, the UK Department for Transport (DfT), procuring authority for the project, whittled down the bidders list to just three; Alstom-Barclays Rail Group; Express Rail Alliance (Bombardier, Siemens, Angel Trains and Babcock & Brown); and Agility Trains consortium (Hitachi, John Laing). However, Alstom decided to withdraw from the bidding process shortly after in February 2008.

While Alstom's reasons for doing so were not clear, the company said in a press release issued at the time: "Alstom follows a specific process in assessing potential business opportunities, based on financial and technical input." Based on which it decided to withdraw but added that it would continue to focus on "other major opportunities in the UK rail market for rolling stock, signalling and maintenance." However, interestingly Alstom is not involved in either of the two on-going rolling stock procurements (Thameslink, Crossrail) in the UK.

Alstom's consortium partner Barclays Private Equity, though, continued to show interest in the project and teamed up with the Agility consortium later that year to bid on the project. In early 2009, DfT announced the selection of the Agility Trains consortium as preferred bidder while the Siemens-Bombardier consortium was kept as reserve bidder.

After the preferred bidder stage the project experienced a series of delays in 2010, as mentioned above, owing to the financial crisis, change in government and reassessment of the financial feasibility of the project. Preparation of electrification plans along the network are also said to have added to the delay. But in 2010 it became clear that the UK government was in favour of taking priority rail projects such as this one and Thameslink forward. In 2011 Philip Hammond, then Transport Secretary, gave the go-ahead for the project to resume its procurement process. This was after the project costs were re-evaluated and brought down to £4.5 billion from the previous estimates of £7.5 billion.

The £4.5 billion IEP is a hybrid between a PFI and dry lease structure. It covers DBFM of around 125 trains over a period of 30 years, including four for construction. The IEP train fleet will comprise electric and bi-mode trains, some five vehicles long and others nine vehicles long.

As part of the contract, Agility Trains' sub-contractor Hitachi Rail Europe will provide 596 carriages of electric and bi-mode trains for the Great Western Main Line (Phase 1) and the East Coast Main Line (Phase 2). The fleet of 92 trains will be maintained in a number of newly built and upgraded maintenance facilities, including new depots in Swansea, Bristol, west London and Doncaster. Construction at new Hitachi factory in Newton Aycliffe, County Durham is expected to begin in 2013 and will be fully operational by 2015.

The first IEP trains will enter revenue-earning service on the Great Western Main Line in 2017 and on the East Coast Main Line by 2018. Financing discussions for the second phase of IEP are also expected to begin in due course.

Financing - an appetite for long-term lending?

Although IEP was solely financed by bank debt, the financing structure was innovative nontheless with significant support from export credit agencies like Japan Bank for International Cooperation (JBIC), Nippon Export and Investment Insurance (NEXI) and eight other lenders.

Without a doubt one of the main challenges that the project faced on the financing side was securing long-term debt of the volume that it required. "The sheer size of the debt requirement made the deal complex and eventually it was multi-sourced so bringing all the different financiers onto a common platform added to the challenge and complexity," said one source that worked closely on the financing.

The project ran a funding competition and good interest was seen from both domestic and foreign players. Finally, eight banks came together to provide commercial debt of around £850 million for an unusually long-term debt tenor of 29.5 years, the long-list of banks comprise:

- The Bank of Tokyo-Mitsubishi UFJ (also financial documentation)
- HSBC (also hedging documentation)
- Lloyds TSB (also project documentation)
- Mitsubishi UFJ Trust and Banking Corporation
- Mizuho Corporate Bank (also modelling/insurance)
- Sumitomo Mitsui Banking Corporation
- Sumitomo Mitsui Trust Bank
- Development Bank of Japan

Lenders chose to remain tight-lipped on the exact ticket sizes for the commercial debt due to a strict confidentiality clause set by the UK's Department of Transport owing to the sensitivity of the high-profile project. Lenders were also reluctant to reveal spreads but sources have said pricing was kept "realistic."

In addition to commercial debt, an equity-bridge loan of £280 million was provided, which included contributions from the Development Bank of Japan. JBIC raised the largest portion of debt, co-financing alongside the commercial banks, with a contribution of about £1 billion. The deal holds special significance for JBIC since it is understood to be the bank's first project finance loan to the UK rail sector. Japan's Nippon Export and Investment Insurance (NEXI) also joined the list of lenders by providing £150 million in overseas untied loan insurance covering part of the portion financed by the commercial banks.

The European Investment Bank contributed £235 million towards the project. The sponsor consortium injected equity into the project, split between them as follows:

- Hitachi Rail Europe - 70 per cent
- John Laing Investments– 30 per cent

This £2.5 billion financial close concluded the first phase of financing for the £4.5 billion scheme, the rest is to follow in due course. While the consortium is understood to have considered plans to include a bond issue or series of issues to be combined with bank debt, anchor lender JBIC was apparently not in favor of these over fears of a failed issue leading to concession termination.

Having raised a healthy debt pile, the project has in fact gone ahead to prove that there is appetite for long-term lending providing deals are well structured and bankable. Although it still remains to be seen what route the other rolling stock projects choose to take.

IEP has set a precedent for future rolling stock PPPs in the UK such as the forthcoming Thameslink and Crossrail schemes. "The project is possibly one of the biggest privately financed rolling stock PPP projects in Europe," said one source working on the project. While IEP was solely financed by banks, both commercial and international financial institutions, Thameslink and Crossrail might have to look into diverse/alternative sources of funding including capital markets and pension fund solutions as banks' appetite for long-term loans remains limited.

A milestone of sorts

The UK is no stranger to successfully closing PPP deals, so to that effect this project is no game-changer, however what is to its credit is the tough times it has managed to sail through, not to mention the renaissance of sorts it might have created in the long-term bank lending space.

Experts also believe that while outside the UK there has always been a trend of export credit agencies supporting infrastructure projects it is encouraging is seeing these players shift away from the traditional oil & gas sector projects to the rail sector.

The UK needs to continue investing in rail and rolling stock to refurbish the ageing infrastructure, so to that extent IEP sets a good example by proving it can be done. Closely following in the footsteps of IEP the £1.85 billion Thameslink Rolling Stock PPP is moving towards financial close this year, and the Crossrail scheme which is targeting close in 2014. It will be interesting to see what sort of financing the government is able to attract for these projects. Also the recently announced £40 billion infrastructure loan guarantee is expected to provide a fillip to some of these projects.

Advisory Roles

For the authority, PwC was financial adviser, Freshfields Bruckhaus Deringer gave legal advice while Mott MacDonald provided technical advice.

For the sponsors, HSBC provided financial advice while DLA Piper was legal adviser.

On the commercial lenders side, Ashurst gave legal advice and Halcrow acted on the technical side.

Operis conducted the model audit for lenders and sponsors.