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## Research Update:

# High Speed Rail Finance New Senior Secured Debt Rated 'A-'; Outlook Stable

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## Research Update:

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## Overview

- U.K.-based High Speed Rail Finance PLC (HSRF) issued £314.0 million of senior secured rated debt on Dec. 14, 2016, comprising a £184.0 million amortizing bank facility and a £130.0 million bullet repayment bond.
- The debt at HSRF ranks pari passu with all senior secured debt at the sister companies High Speed Rail Finance 1 PLC (HSRF1) and High Speed 1 Ltd. (HS1). HS1 is the operator of the U.K.'s high-speed rail connection between London and the Channel Tunnel.
- We are assigning our 'A-' long-term issue rating to HSRF's debt.
- We are also lowering our long-term issue rating on HSRF1's rated senior secured debt to 'A-' from 'A' and removing the rating from CreditWatch negative.
- The stable outlook on the senior secured debt at both entities reflects our view that the project will continue to deliver strong operational performance, maintain a minimum average debt service coverage ratio of at least 1.4x under our base case, and benefit from a supportive and stable regulatory regime.

## Rating Action

On Dec. 15, 2016, S&P Global Ratings assigned its 'A-' long-term issue rating to the senior secured debt issued by U.K.-based special-purpose vehicle High Speed Rail Finance PLC (HSRF). The outlook is stable. The debt comprises a £184.0 million amortizing bank facility and a £130.0 million bullet repayment bond.

At the same time, we lowered our long-term issue rating on the pari passu debt issued by sister company High Speed Rail Finance 1 PLC (HSRF1) to 'A-' from 'A', in line with the rating on HSRF's senior secured debt. We also removed the rating from CreditWatch with negative implications, where we had placed it on Sept. 26, 2016.

The rated debt at HSRF1 comprises £246.5 million 1.566% index-linked senior secured bonds and £610.0 million 4.375% fixed-rate senior secured bonds, both due November 2038.

The outlook on all rated issues at HRSF and HRSF1 is stable.

## **Rationale**

The ratings reflect our view of the project's operations phase stand-alone credit profile (SACP), which we assess at 'a-'. The project entered into operations in 2007 and there is consequently no construction risk. The operating activities of sister company High Speed 1 (HS1) are financed through a combination of rated and non-rated debt it and its sister companies issue. All senior secured debt issued by these three entities ranks pari passu.

HSRF's debt issue has materially increased the project's total debt and weakened its credit profile, leading to weaker annual debt service coverage ratios and a more back-ended debt repayment profile. Although the decline in the minimum annual debt service coverage ratio (ADSCR) is limited under our base-case assumptions, the increased debt amount does reduce the average coverage ratio. Under our base-case analysis, the minimum ADSCR remains just below 1.5x, whereas the average ADSCR had fallen to 1.69x from 1.79x prior to the new debt issue. In addition, the revised amortization of the debt is relatively back-ended for a project reliant on growth assumptions. The new debt issuance has shortened the concession tail to one year from two years, and includes a bullet repayment of £130 million in December 2039. Consequently, the financial performance of the project, which has an inflation-linked revenue stream, deteriorates under long-term, sustained low inflation rates. We reflect this weakness by applying a one-notch negative debt structure adjustment to the preliminary operations phase stand-alone credit profile (SACP).

In our view, the strategic ownership review recently announced by HS1's shareholders, Borealis Infrastructure (Borealis) and Ontario Teachers' Pension Plan (Ontario Teachers), should not affect the project ratings. The three sister companies (HS1, HSRF, and HSRF1) are special-purpose entities and legally separated from shareholders. Consequently, a change of ownership should not affect HS1's credit quality, all else being equal. Furthermore, we note that there is no event of default in the senior secured debt documentation linked to change in ownership.

For more details on the post-issuance structure, see "Postsale: High Speed Rail Finance PLC," published Dec. 15, 2016, on RatingsDirect.

HS1 operates the high-speed rail line and associated infrastructure connecting London and the Channel Tunnel under a concession agreement with the U.K. government, which terminates in 2040. Operationally, the project benefits from a transparent and supportive regulatory framework that helps to mitigate operational risk and leads to a strong operational performance in terms of safety and track availability. It has a strong competitive position as the sole high-speed rail connection, and about 90% of its revenues come from highly stable, inflation-linked regulated track and station related charges, paid by the two train operators: the domestic train operator, London & South Eastern Railway Ltd. (trading as Southeastern); and the international train operator, Eurostar International Ltd. Regulated revenues are supplemented by

income from unregulated retail, car-parking, and commercial operations. We view the project's market exposure as very low due to the protection afforded by its contractual structure.

## **Liquidity**

We assess the project's liquidity as neutral. The project maintains a 12-month liquidity facility agreement through March 2040, equal to the forthcoming 12 months of scheduled debt service (principal and interest, including amortization and interest of the offsetting swaps). In addition, it maintains a £65 million working capital facility through March 2020 that is more than sufficient to meet its working capital needs. We assume that the project will readily renew or replace the working capital facility at its maturity.

In addition, for the maintenance of the assets and replacement capital expenditure, the project maintains escrow accounts, into which it places the renewals component of the regulated operations and maintenance renewals charge and of the station use charge. The cost-pass-through nature of these charges largely mitigates lifecycle risk. The combined balance on these escrow accounts stood at £77 million in the financial year ended March 30, 2016, and we forecast that this will rise to approximately £120 million at the end of the next control period in March 2020.

## **Outlook**

The stable outlook reflects our view that the project will continue to deliver strong operational performance and benefit from a supportive and stable regulatory regime. The outlook also factors in the project's strong competitive position as operator of the sole high-speed train route connecting the U.K. to continental Europe, as well as our view that the minimum DSCR of at least 1.4x under our base case is sustainable. The rating is supported by the project's strong contractual structure, including advance train path reservation and payment by train operators and an agreement guaranteed by the U.K. government underpinning domestic train paths. These help to provide performance resilience against stressed operating conditions.

### **Downside scenario**

We could lower the ratings if the project's financial profile weakened, for example as a result of operational underperformance or reduced demand for international train paths, causing the minimum average DSCR to fall below 1.4x and a weakened resilience to stress scenarios. A sustained weak inflationary environment could also lead to deterioration in the project's financial performance given HS1's inflation-linked revenue receipts compared with a predominantly fixed-rate debt profile.

We could also lower the ratings if the project becomes exposed to additional counterparty risk as a result of a lowering of the ratings on swap

counterparties or working capital facility providers to below the project rating level, or if the project incurs additional exchange-rate risk due to the issuance of a further tranche of foreign currency-denominated debt with a lower-rated swap counterparty. The account bank counterparty must be rated at least 'BBB-' to not constrain our 'A-' issue rating on the bonds, given the replacement provision provided in the bank account document.

### **Upside scenario**

Following the new debt issuance, a positive rating action is unlikely, in our view, without a further significant improvement in our base-case projection of the minimum average DSCR. An upgrade could hinge on a minimum ADSCR of around 1.8x, or a restructuring of the debt repayment profile to make it less back-ended.

## **Ratings Score Snapshot**

### **Operations Phase SACP (Senior Debt)**

- Operations phase business assessment: 4 (1=best to 12=worst)
- Preliminary operations phase SACP: a-
- Downside analysis: aa (+1 notch)
- Debt structure: Negative (-1 notch)
- Liquidity: Neutral (no impact)
- Comparable ratings analysis: Neutral (no impact)
- Operations Phase SACP: a-

### **Modifiers (Senior Debt)**

- Parent Linkage: Delinked (no impact)
- Structural protection: Neutral (no impact)
- Senior debt issue rating: A-

## **Related Criteria**

- Criteria - Corporates - Project Finance: Key Credit Factors For Road, Bridge, And Tunnel Project Financings, Sept. 16, 2014
- Criteria - Corporates - Project Finance: Project Finance Operations Methodology, Sept. 16, 2014
- Criteria - Corporates - Project Finance: Project Finance Transaction Structure Methodology, Sept. 16, 2014
- Criteria - Corporates - Project Finance: Project Finance Framework Methodology, Sept. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Structured Finance - General: Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- Criteria - Corporates - Project Finance: Project Finance Construction And Operations Counterparty Methodology, Dec. 20, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

**Ratings List**

\* \* \* \* \* High Speed Rail Finance PLC \* \* \* \* \*

New Rating

High Speed Rail Finance Plc (HSRF)  
Senior Secured A-/Stable

\* \* \* \* \* High Speed Rail Finance 1 PLC \* \* \* \* \*

Downgraded; CreditWatch Action

|                               |           |             |
|-------------------------------|-----------|-------------|
|                               | To        | From        |
| High Speed Rail Finance 1 PLC |           |             |
| Senior Secured                | A-/Stable | A/Watch Neg |

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [spcapitaliq.com](http://spcapitaliq.com). All ratings affected by this rating action can be found on the S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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