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Research Update:

# High Speed Rail Finance (1) PLC Upgraded To 'A-' On Ongoing Traffic Recovery And Financial Resiliency; Outlook Stable

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## Rating Action Overview

- Sound international traffic performance in line with our base-case scenario, and improved operating and financial performance of revenue counterparty Eurostar Group, as well as continued support from its domestic guarantee underpinning traffic volumes, will allow High Speed Rail Finance (1) PLC (HSRF1) to improve and sustain a minimum debt service coverage ratio (DSCR) above 1.40x.
- We do not expect the regulator's proposal to lower High Speed 1's (HS1's) access charges for the 2025-2030 regulatory period to have a material impact on its credit metrics. Indeed, any negative effects should be more than offset by HS1's strong cost efficiency capabilities and resilient traffic performance.
- In addition, we do not foresee implications from the Passenger Railway Services Bill 2024-2025, which aims to bring franchise rail services under public ownership. We understand the infrastructure railway sector, including HS1, is not within its scope.
- We therefore raised our long-term issue rating on HSRF1 to 'A-' from 'BBB+'.
- The stable outlook reflects our expectation of improving operating and financial performance, driven by operator counterparties' growth strategies, as well as our expectations of a smooth regulatory review ending in January 2025.

## Project Description And Key Credit Factors

U.K.-based special-purpose entity HSRF1 is a finance vehicle for HS1 Ltd. (the project operating company; not rated), the operator of the U.K.'s sole high-speed rail line. HS1 operates under a 30-year concession agreement with the U.K. Secretary of State expiring in December 2040 and is regulated by the Office for Rail and Road (ORR), an independent U.K. transport regulator. HS1 is responsible for the operation, maintenance, and track renewal and associated infrastructure, along with four railway stations served by the route. Most of these are subcontracted to Network

Rail High Speed (NRHS) under a fixed price agreement until 2047. Once HS1's concession ends in 2040, this contract will revert to the Department for Transport (DfT).

The rail line, which connects St. Pancras International station in London with the Channel Tunnel boundary in southeast Kent, provides track access to domestic and international high-speed traffic, plus a small quantity of freight traffic. HS1 has been in operation since 2007.

## Strengths

- A stable and transparent regulatory framework under which revenue generated from track access charges--typically 90% of the project's revenue--is regulated and subject to annual or semiannual increases (depending on the charge component) in line with the retail price index (RPI).
- Domestic train path (allocated time slots or schedules for trains to operate on a railway network) bookings are protected by the U.K. Secretary of State's commitment to fund approximately 53,000 train paths per year. This largely mitigates the project's exposure to domestic volume risk.
- The project's strong competitive position stems from operating the sole high-speed rail connection between London and the Dover-Calais crossing (known as the Eurotunnel) to continental Europe.
- Rail assets play a crucial role in the U.K.'s decarbonization strategy, and we expect it to attract traffic demand.

## Risks

- Bottlenecks at border crossings weigh on station capacity and limit the scope for more international services.
- One-third of the regulated revenue bears full volume risk from Eurostar's international train path bookings.
- The debt repayment profile is relatively back-ended because most facilities will not begin amortizing until 2027 or 2028. The last private placement issued in December 2016 shortened the concession tail to one year from two years and included a £130 million bullet repayment in December 2039.

# Rating Action Rationale

**We anticipate credit metrics to strengthen as international train paths continue to recover in line with our base-case scenario.** Underlying leisure passenger demand remains robust, with about 5.4 million passengers in the first half of 2024--a 6% increase compared to 2023. Train paths have remained in line with expectations, experiencing an approximate 6% increase for the same period. However, we expect to exceed the forward booked timetable (FWT) for May 2024-December 2024, which consists of 17,600 annualized train paths and is equal to 97% of pre-pandemic bookings. That said, we think the pace of traffic growth will depend on overcoming ongoing operational issues. Border control procedures remain the main challenge since it adds on travel time and disrupts passenger flows, particularly in peak times. The Entry/Exit System (EES) is being installed in three locations in St. Pancras and deployment has already started. HS1 is also working to advise passengers on the new requirements, and considering this system is already in use in other modes of international travel, we expect a smooth ramp-up process.

**Growth prospects are building for international traffic.** The U.K. is lagging when it comes to direct support or active measures to incentivize growth in rail network users compared to other European countries. However, private investors have demonstrated increasing interest in operating on HS1 tracks. We understand that HS1 is in advanced formal negotiations with European rail operators, signaling the attractiveness of the London-Europe connection and traffic growth prospects. Our base case does not reflect potential new train operators or service challengers mainly because we still lack visibility on their timings and volumes. We could revise our forecast if conversations were converted into formal slot requests. This would trigger a regulatory re-opener to rediscuss track access charges based on additional traffic, costs, and investments.

**Eurostar's creditworthiness is no longer a material concern and limitation for our rating on HS1.** The merger between Eurostar International and Thalys is being used to build a platform for sustainable travel across Europe. Following the debt refinancing earlier this year, which eliminated the high refinancing risk, the management team now has time to focus on its growth plans. Eurostar management has unveiled plans to renovate and increase its fleet by investing in 50 new trains, aiming to reach 30 million passengers by 2030 from the current 19 million. Clearly, this should result in an increase in train paths since investments will expand the existing fleet by 16 trains and renovate the biggest trains, E320s, which have a maximum seat capacity of 894 passengers. In our base case, we partially give credit to the expected growth, with train paths projected to reach close to 20,000 in 2030, representing a passenger growth of approximately two million.

**HS1's operating risks and contractual protections are favorable when compared to its closest rated peers, including Channel Link Enterprises Finances PLC (CLEF).** We think the pandemic tested and proved the strength of the concession agreement and regulatory framework, which allowed HS1 to withstand a unique and unprecedented distress experienced by the infrastructure sector. Furthermore, with more than 10 years of operational track record, we think the life cycle requirements and operational challenges for HS1 are less demanding compared to those faced by CLEF in the Channel Tunnel. This indicates a lower exposure to operational risk, as well as risk of underperformance. We view the complexity of operating an underwater tunnel between two countries as greater, considering its increased exposure to risks such as flooding, fire, breakdown, ventilation, and legal processes. Therefore, we have revised positively our operations phase business assessment down to '3' from '4'.

## Outlook

The stable outlook on HSRF1's debt reflects our view that the project will continue to deliver strong operational performance and benefit from a stable regulatory regime. The outlook also factors in the project's strong competitive position as the operator of the sole high-speed train route connecting the U.K. to Continental Europe, as well as our view that HS1 would become one of the critical infrastructure assets to support the U.K.'s net-zero targets. We expect a minimum ADSCR of 1.4x under our base case as traffic volumes continue to recover.

### Downside scenario

We could lower the rating on HSRF1's debt if the project's financial profile weakens, causing the minimum ADSCR to fall materially below 1.4x, or if the performance weakens under our resiliency scenario. This could occur because of operational underperformance or long-term reduced demand for international and domestic train paths, resulting from limited capacity and insufficient investments to cope with forecasted growth.

We could also lower the rating if the project becomes exposed to additional counterparty risk. Revenue counterparty risk could increase, for example, if existing or new train operators experience a weaker credit quality. Financial counterparty risk could heighten as a result of a downgrade of swap counterparties or working capital facility providers to below the project debt rating level.

### Upside scenario

A positive rating action is unlikely without further significant improvement in our base-case projection of traffic volumes and minimum ADSCR, assuming no counterparty rating constraint. For us to consider an upgrade, we would need to observe a minimum ADSCR of about 1.80x or a restructured debt repayment profile to make it less back-ended.

## Performance Update

**Limited capacity and network reliability could challenge the pace of international growth.** At the moment, there is sufficient capacity in the line, with three or four trains running per hour. However, if not addressed, station capacity could limit additional growth if a new rail operator were to compete during peak times. Management is actively engaging with consultants from third parties to gain efficiencies and increase capacity within the existing infrastructure. We understand with limited renovations, HS1 could handle significantly more passengers an hour by 2025-2026. However, capacity will also have to be increased at the destination, and there may be temporary disruptions to traffic, as is the case with Amsterdam Central Station. In addition, timely route renewals are essential for maintaining network reliability and travel times. Although these works are subcontracted to Network Rail (High Speed) Ltd. and financially covered by regulation, the aging tracks mean more sizeable and costly renewal works would need to take place for the first time. Depending on the scope of works, this could cause delays, inefficiencies, and limit traffic growth.

**HS1 is not within the scope of ongoing rail reform discussions, and we expect any positive spillovers on domestic traffic to materialize in approximately 2028.** We acknowledge the numerous opportunities for the rail sector since we think these entities will play a crucial role in countries' decarbonization strategies by offering a sustainable solution for short-haul freight and passenger services. That said, the Passenger Railway Services Bill, which is being discussed in the House of Commons, is still awaiting approval, and we think implementation will take time considering funding will be provided by the U.K. government. Domestic services are still operating below underpinned levels--at about 10%--and we think investments will have to be made for trains path numbers to increase above these levels. Therefore, our forecast reflects these delays and assumes traffic growth after 2028.

We expect the final regulatory review will have limited implications for HS1.

ORR's draft determination was presented on September 30, 2024. The proposal represents a 9% reduction in tariffs, which is higher than the 5% reduction presented by HS1. However, the regulator found that the company's plans were of good quality and cost-efficient. More importantly, it highlighted that the plan and objectives are clearly linked to the expected use of the network and contemplate potential scenarios for growth. Due to the general agreement and understanding among parties, we do not anticipate significant modifications in the final determination, which is expected to be published in January 2025.

## Base Case

### Assumptions

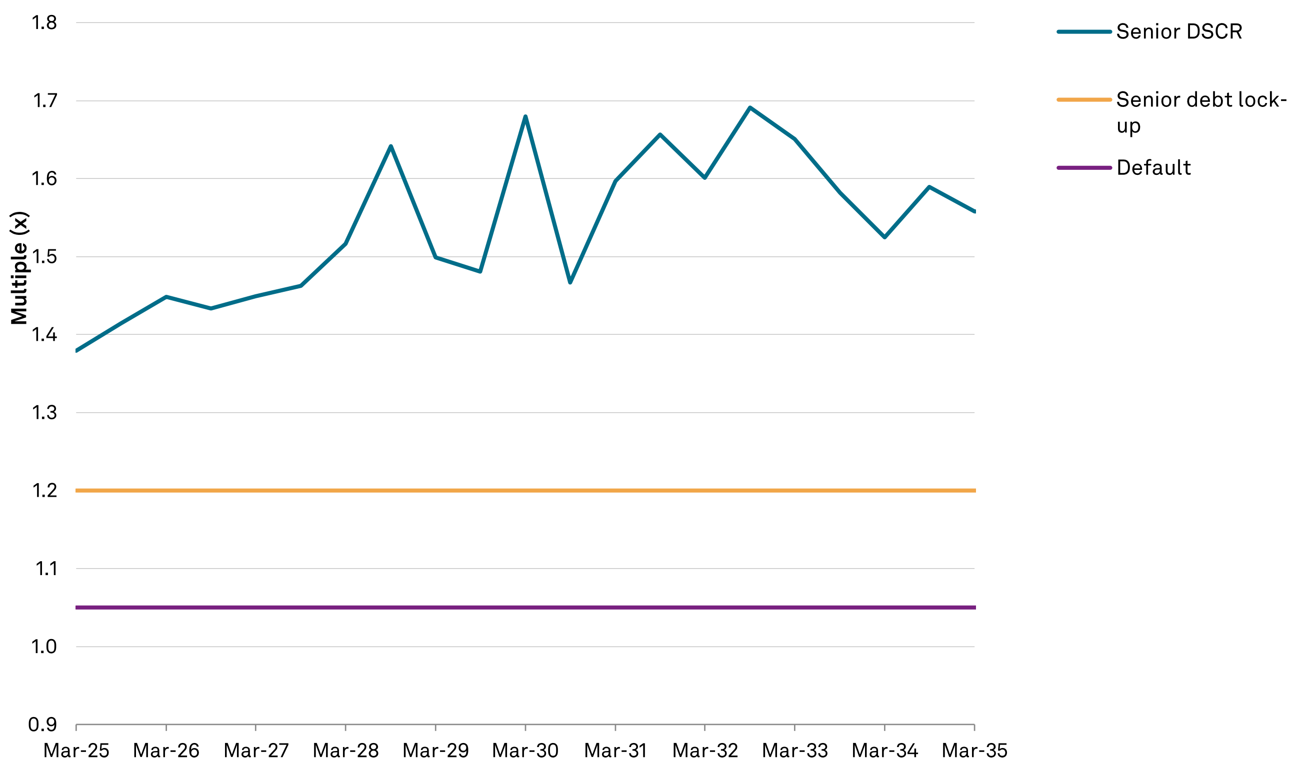
- International train paths: A combination of forward and spot bookings until March 2026, but a higher share of forward bookings. Total train paths in 2024 (12 months to March 2024): 16,597; 2025: 18,183; and 2026: 19,114. Thereafter, we assume growth will be driven by the combination of France and U.K. GDP growth expectations, which is approximately 1.3% combined.
- We do not include potential service challengers.
- Domestic train paths: An underpin amount until March 2028. March 2029: 55,377 train paths per year, which is close to pre-pandemic numbers. Thereafter, we assume growth will be driven by U.K. GDP growth expectations.
- Freight train paths: 450-500 train paths per year.
- Unregulated revenue: We assume retail will remain at about £30 million, while a delayed car park recovery will likely result in revenues reaching pre-pandemic levels by March 2026, but will add £8 million-£9 million. Thereafter we assume revenues will increase with footfall, led by traffic volumes.
- Operating costs: In line with management's forecast, including a pass-through of the operations and maintenance recovery charge, power, and station costs.
- A recessionary period between 2035 and 2038, in line with our assumptions in the peer project, Channel Link Enterprise Finance PLC, which is designed to replicate the stress on the underlying volumes in 2008-2009.
- Cost of letter of credit (LoC): To ensure comparability in our cash flow analysis, we assume the liquidity facility is drawn on an amount equal to the next six months of debt service. We also consider £51 million of the working capital facility as being drawn, in line with the project's actual balance.
- Tax rate: 25%.
- RPI: 3.45% for 2024; 2.29% for 2025; 2.67% for 2026; 2.38% for 2027; 2.66% for 2028-2032; and a 2.00% growth rate thereafter, in line with our macroeconomic forecasts.
- U.K. GDP growth: 1.22% for 2027-2031; 1.70% for 2032-2036; and 1.20% thereafter.
- France GDP growth: 1.30% over 2027-2038.

## Key metrics

- The minimum ADSCR is 1.38x (March 2025) and median ADSCR is 1.56x.
- The minimum ADSCR is consistent with a minimum stand-alone credit profile (SACP) of 'bbb+' given the project's operations phase business assessment of '3'.

Chart 1

**High Speed Rail Finance (1) PLC--Base-case DSCR***




DSCR--Debt service coverage ratio. All data S&P Global Ratings-adjusted. All dates as of March 31.



## Downside Case

## Assumptions

- International train paths: Slower recovery for the next year at -30% of our base-case traffic assumptions. From March 2026 onward, we forecast flat recovery at 18,000 train paths, plus a two-year shock starting in 2034. The shocks reflect the effect of an incident, such as a tunnel fire, resulting in temporary partial tunnel closures with 20% capacity constraint.
- Domestic train paths: Train paths at the underpin level of 52,806 per year through the life of the project.
- Freight train paths: Stress follows international traffic volumes.
- Unregulated revenue: 20% below our base case.
- Regulated costs: As per the base case.
- RPI: One percentage point above our base case for 2025-2029. Thereafter, in line with the base case (including the recessionary period 2035-2039).
- Cost of LoC: We assume SONIA at 6% throughout the life of the project.

## Key metrics

- The project has proven its robust performance under our downside conditions, and we expect this to support our resiliency assessment of very high, which provides a two-notch uplift to the SACP.

## Rating Score Snapshot

| **Senior debt issue rating** | **A-** |
|---|---|
| Asset class operating stability | 2 |
| Operations phase business assessment | 3 |
| Preliminary operations phase SACP | bbb+ |
| Downside resiliency assessment and impact: | Very high (+2 notches) |
| Median DSCR impact: | Neutral |
| Debt structure impact: | -1 notch |
| Liquidity impact: | Neutral |
| Refinancing impact: | N/A |
| Future value modifier impact: | N/A |
| Holistic analysis impact: | N/A |
| Structural protection impact: | N/A |
| Counterparty assessment impact: | Neutral |
| **Operations phase SACP** | **A-** |
| **Parent linkage and external influences (senior debt)** | |
| Parent linkage: | Delinked |

| **Project SACP:** | **A-** |
|---|---|
| Extraordinary government support: | N/A |
| Sovereign rating limits: | N/A |
| Full credit guarantees: | N/A |

DSCR--Debt service coverage ratio. N/A--Not applicable.

## Operations counterparties

- HS1's revenue comprises approximately 90% regulated revenue and 10% nonregulated revenue. The latter is generated by multiple station retail units and car park users. Our rating does not depend on any individual nonregulated customer.
- Regulated revenue comprises the fixed investment recovery charge (IRC), the operations and maintenance recovery charge (OMRC), and the qualified station expenditure charges (QX). HS1 passes the OMRC and QX charges through to the train operators, hence the IRC fuels HS1's profitability.
- Most of the IRC (approximately two-thirds of the total cash flow) is provided by the domestic train operating companies (TOC) and is directly underpinned by the U.K. government under the agreement, effective since January 2015. Furthermore, the DfT maintains step-in arrangements that enable it to take over a failing domestic TOC and directly operate its service. We therefore view the domestic TOC as a material and irreplaceable counterparty, with credit quality in line with our view of the U.K. government (unsolicited; AA/Stable/A-1+).
- HS1's regulated revenue is generated by two TOCs: Southeastern and Eurostar. TOCs running on HS1 tracks must enter into a track access agreement with HS1 and pay a regulated charge. We view the project's exposure to IRC counterparties as material and our analysis to assess HS1's dependency on these counterparties adopts a rating to principles approach. Under this, we determine the overall revenue counterparty credit quality by calculating the weighted average creditworthiness of the two revenue counterparties in proportion to their regulated revenue contribution. The revenue counterparty credit quality under this approach does not constrain the debt rating.
- We consider the operations and maintenance counterparty, Network Rail High Speed (NRHS), to be irreplaceable, and we weak link the issue rating on the project's debt to the credit quality of NRHS, which is not a rating constraint. NRHS retains performance risk and the responsibility for safety under railway regulation, in line with the operator's role in transport projects. NRHS' payment and performance obligations benefit from a guarantee from its parent company, Network Rail Infrastructure Ltd. (Network Rail). Network Rail is funded by the debt program of Network Rail Infrastructure Finance PLC, which is a government-related entity, and which we rate in line with our rating on the U.K. government.
- U.K. Power Networks (UKPN) operates the electricity distribution infrastructure and supplies electricity under a finance lease agreement (through 2057) with HS1. The electricity distribution market is wide in the U.K., and we believe that UKPN could be replaced, if necessary, without material disruption. We therefore do not weak link the debt rating on the project to the credit quality of UKPN.
- The ratings on the project debt are weak linked to the ratings on the swap counterparties and working capital facility providers because the terms of the swap and liquidity facilities do not

fulfil our criteria requirements for collateral and timely replacement. However, the rating on these counterparties does not constrain the rating on the project's debt.

## Liquidity

- We assess the project's liquidity as neutral. The project maintains a 12-month liquidity facility agreement through March 2040, equal to the upcoming 12 months of scheduled debt service, including swaps (£160 million liquidity facility as of March 31, 2023, fully undrawn). In addition, as of the same date, HSRF1 had £33 million undrawn out of a £84 million working capital facility.
- For the maintenance of assets and replacement capital expenditure, the project maintains escrow accounts where it deposits the renewals component of the regulated revenue.

## Other modifiers

- We apply a one-notch negative debt adjustment because the amortization of the debt is relatively back-ended.

## Related Criteria

- Criteria | Infrastructure | General: Sector-Specific Project Finance Rating Methodology, Dec. 14, 2022
- Criteria | Infrastructure | General: General Project Finance Rating Methodology, Dec. 14, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Structured Finance | General: Global Derivative Agreement Criteria, June 24, 2013
- General Criteria: Global Investment Criteria For Temporary Investments In Transaction Accounts, May 31, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- Channel Link Enterprises Finance PLC, June 27, 2024
- Brightline Trains Florida LLC's $2.219 Billion Senior Secured Debt Assigned 'BBB-' Rating; Outlook Stable, May 8, 2024
- High Speed Rail Finance (1) PLC, March 7, 2024
- High Speed Rail Finance (1) Outlook Revised To Positive On Foreseen Operational And Financial Strengths; Rating Affirmed, Sept 13, 2023

- ESG Materiality Map: Transportation Infrastructure, July 20, 2022

## Ratings List

**Upgraded**

| | To | From |
|---|---|---|
| **High Speed Rail Finance (1) PLC** | | |
| Senior Secured | A-/Stable | BBB+/Positive |