Guest Columnist

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Funds for investment

Delivering railway infrastructure using private finance

WHILE even the most ardent commuter or railway enthusiast is unlikely to travel by train every day, approximately 1.7 billion passenger journeys were undertaken by rail in 2018. It is no surprise, then, that railway infrastructure failures are headline news.

Continued investment is a crucial part of ensuring capacity and reliability of the railway. Limited public funds are available for such investment, and difficult decisions have to be made over which projects are prioritised. Increasing the funds available for investment is therefore an ongoing focus for government, and encouraging third party investment is one option available.

Use of private finance in delivering railway infrastructure is by no means a novel concept - almost all railway infrastructure was privately owned up until the early 20th century.

However, the evolution of the railway industry through nationalisation and subsequent privatisation has not established a clear path for deploying private finance in an environment where most of the infrastructure is owned and managed by Network Rail. There is hope that some guidance can be provided by the Williams Review, which is due to publish its conclusions in autumn 2019.

Not all financiers are waiting for guidance from government, and there are some recent examples of private finance being used. While each development is assessed on its own merits, common themes are emerging.

Establishing 'clean' ownership

Establishing 'clean' ownership is fundamental. Without it, the financier cannot obtain the security required to protect the investment.

The land on which Network Rail infrastructure is located is unlikely to be registered with the Land Registry, as registering all NR land would be a mammoth task. And beyond short-term leases, railway land is rarely disposed of, meaning NR would not be forced to.

The time and effort required to undertake a 'first registration' should not be underestimated. Network Rail should be encouraged to commence the registration process at the first opportunity, as understanding the land and its constraints (such as access to the site, rights of way, options to purchase), will be key.

The registration process should highlight any other material issues, and early escalation of these matters will allow the parties to assess whether the issues can be resolved or adequately mitigated.

Structuring the finance

A term sheet should be agreed early, to establish the requirements and the basis on which the financier will invest. This will reduce the risk of unwanted surprises later on.

Among other things, the term sheet will confirm the amount to be borrowed and the repayment period. The total amount to be borrowed may not be fixed at the outset. Development projects often cost more than originally forecast, and a degree of flexibility for withdrawing additional funds may be a requirement of the structure. This will introduce a degree of additional complexity and cost.

> **"The complexity of the process means that each party needs to be collaborative while also driving forward its own part of the project."**

The significant investment required for railway infrastructure projects means that repayment will be over a longer term. This is a major obstacle in a franchising environment, as the structure needs to ensure that successor franchise operators can benefit from (and will repay) the investment. One option is for the financier to lease directly from NR and to sub-lease to the operator.

Without any guarantees of future usage (for example, section 54, Railways Act), additional due diligence will be undertaken and suitable legal protection will be required, to mitigate risks that may devalue the infrastructure and/or make it less attractive to future operators.

The financier risk is greater during the development phase. The type of financial guarantees provided by the borrower will determine the structure for both the development and operational phase.

If the borrower cannot provide security that is independent of the infrastructure (for example, a parent company guarantee), then a more sophisticated structure is required to provide the required financier protection.

Sharpening the tools

Railway industry documentation is not necessarily designed for third party finance, although there are emerging examples of this being done.

A number of the documents require approval by the Office of Rail and Road (ORR) and the Department for Transport, whether by statute or by the terms of a Franchise Agreement. Previously, this has encouraged parties to avoid 'reinventing the wheel' by keeping amendments to precedent documentation to an absolute minimum - but this is no longer always possible if third party investment is needed.

Developing a suite of revised precedent documents takes time (and cost!). However, it is likely to be the most efficient route to achieving agreement between the parties, and obtaining ORR and DfT consent.

The complexity of the process means that each party needs to be collaborative while also driving forward its own part of the project. Appointing a lead party early in the process should encourage regular updates between the parties, and help manage the extensive list of documents required by the ORR and DfT.

Failing to plan...

Without industry standard methods of investing in infrastructure, putting in place a clear plan at the outset is imperative. The prospects of a successful investment are improved when the parties are armed with a plan that includes a strategy for: (1) establishing ownership; and (2) incorporating the commercial terms into a structure that is agreeable to all parties - including the ORR and DfT.

The industry and financiers continue to show an appetite to privately finance railway infrastructure, and we are starting to see 'green shoots' where investments are now being made. If this trend is to continue, the common themes discussed in this article will remain relevant to the parties investing in railway infrastructure. R

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