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Research Update:

High Speed 1's Finance Vehicles' Debt Affirmed At 'A-'; Then High Speed Rail Finance PLC Debt Rating Withdrawn

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Overview

- U.K.-based High Speed 1 Ltd. (HS1), the operator of the U.K.'s high-speed rail connection between London and the Channel Tunnel, continues to exhibit strong operational and safety performance, along with robust financial ratios under our base case and downside case.
- HS1's transparent and supportive regulatory framework protects the project from any potential negative financial impact from Brexit and terrorism incidences that have contributed to a decline in international train paths.
- The secured operating group is ring-fenced from the activities and credit quality of its shareholders, as well as from the £500 million of holding company debt issued at Betjeman Holdings Ltd. when HS1's ultimate shareholder changed in September 2017.
- We are therefore affirming our 'A-' long-term issue ratings on the senior secured debt issued by HS1's finance vehicles, High Speed Rail Finance (1) PLC (HSRF1) and High Speed Rail Finance (HSRF).
- We subsequently are withdrawing the ratings on HSRF's debt at the company's request.
- The stable outlook on HSRF1's debt 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 Nov. 30, 2017, S&P Global Ratings affirmed its 'A-' long-term issue ratings on the senior secured debt issued by U.K.-based special-purpose entity High Speed Rail Finance (1) PLC (HSRF1). The debt 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 is stable.

At the same time, we affirmed our 'A-' long-term issue ratings on the senior secured debt issued by HSRF1's sister company, High Speed Rail Finance PLC (HSRF). The rated debt comprises a £184.0 million amortizing and £130.0 million bullet private placement (PP) notes, with maturity of March 2039 and December 2039, respectively. HSRF also has a total of £565 million of unrated PP issuance. The ratings on HSRF's rated debt were subsequently withdrawn at the company's request as there is no ongoing contractual requirement for HSRF to maintain a rating. The outlook was stable at the time of withdrawal.

HSRF1 and HSRF are finance vehicles for High Speed 1 Ltd. (HS1, the project operating company) and all senior secured debt issued at HSRF1, HSRF1, and HS1 ranks pari passu. HS1 is the operator of the U.K.'s sole high-speed rail line, along with the four railway stations served by the route. The rail line connects St. Pancras International station in London with the Channel Tunnel boundary in the South East of Kent, providing track access to domestic and international high-speed traffic. HS1 operates under a 30-year concession agreement with the U.K. Secretary of State through December 2040, and has been in operation since 2007. Its operations are regulated by the Office of Rail and Road, an independent U.K. regulator.

Rationale

The affirmations follow our review of the project's operations, which continue to exhibit strong operational and safety performance. Financial performance is robust and in line with our expectations, underpinned by HS1's transparent and supportive regulatory framework. We consider that HS1 is well protected from any potential negative financial impact from Brexit and terrorism incidences, the latter of which have contributed to a 2.1% reduction in international train paths in 2017, as well as our expectation of additional material reductions in 2018. The project's exposure on international routes is mitigated by its strong competitive position as the sole high-speed rail connection between London and Continental Europe, via the Channel Tunnel. Additionally, all train operators are obligated to book train paths up to 12 months in advance, for which payments are made irrespective of whether the service is run.

HS1's financial strength is enhanced by nonregulated retail and car-parking income from its four stations, which directly contributes to cash flow available for debt service. Nonregulated income increased to £32 million year on year to March 2017, representing 20% of the £162 million received from regulated activities and 13% of cash flow available for debt service. Our ratings are not supported, however, by the assumption of nonregulated activity growth.

The ratings are unaffected by the change in the ultimate shareholders of the HS1 group, which occurred on Sept. 7, 2017, and we do not anticipate a change in the strategic direction of the regulated business. The £500 million of new holding company (holdco) debt issued at the time of the acquisition at Betjeman Holdings Ltd. sits outside of the ring-fenced operating group, and is fully subordinated to the senior secured debt. We do not assign a public rating to the subordinated debt. A small portion of the holdco debt proceeds were used to prepay £19.6 million of the £98 million bank facility at HS1, which has been factored into our financial analysis with minimal impact on ratios.

The project demonstrates relatively robust financial performance under our base case, with a minimum annual debt service coverage ratio (ADSCR) of 1.44x

in March 2025 and an average ADSCR of 1.55x. Under our downside analysis, the ADSCR remains above 1.20x at all times.

Financial performance under our base-case and downside-case assumptions is not impacted by the new £58 million 3.14% revenue retail price index (RPI) swap (settled twice a year), which was issued at Betjeman Holdings Ltd. and transferred to HS1 post completion of the shareholder acquisition. The revenue RPI swap is intended to lock in a minimum inflation increase on the underpinned domestic revenues. Our inflation assumption in both scenarios is close to the 3.14% revenue RPI swap rate, and does not result in material ratio fluctuations. We treat net swap payments as scheduled debt service, under our project finance criteria (see "Project Finance Framework Methodology," published Sept. 16, 2014, on RatingsDirect). Following the recent security trust and intercreditor deed amendment, the company does not treat cash flows associated with the revenue RPI swap as debt service in its own financial ratio calculations, but instead offsets the RPI-linked income against operating cash flows.

The amortization of the debt is relatively back-ended for a project reliant on international train path growth assumptions, and we reflect this weakness by assigning a one-notch negative debt structure adjustment to the preliminary operations-phase SACP.

For more details on the transaction, see "High Speed Rail Finance 1 PLC," published Nov. 30, 2017, on RatingsDirect.

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). To ensure comparability in our cash flow analysis, we assume that the liquidity facility is fully drawn and the reserve account is cash funded. In addition, the project 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.

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 revenues. The cost-pass-through nature of these charges largely mitigates life cycle risk. The combined balance on these escrow accounts stood at £91 million in the financial year ending March 30, 2017, and we forecast that this will rise to over £120 million at the end of the next control period in March 2020.

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 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 ADSCR of at least 1.4x under our base case is sustainable. The ratings on HSRFI's debt are supported by the project's strong contractual structure, including advance train path reservation and payment by train operators, as well as an agreement guaranteed by the U.K. government underpinning domestic train paths. These factors help to provide performance resilience against stressed operating conditions.

Downside scenario

We could lower the rating on HSRF1's debt 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 ADSCR to fall below 1.4x along with a weakening of performance under our downside scenario. A prolonged period of materially high inflation could also lead to deterioration in the project's financial performance under our ADSCR calculation, which treats the net revenue RPI swap payments as scheduled debt service, although we view such a scenario as unlikely.

We could also lower the ratings, if the project becomes exposed to additional counterparty risk, as a result of a fall in 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-' rating on the notes.

Upside scenario

A positive rating action is unlikely, in our view, without further significant improvement in our base-case projection of the minimum ADSCR. For us to consider an upgrade, we would need to observe a minimum ADSCR of about 1.80x, 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

Related Research

- High Speed Rail Finance 1 PLC, Nov. 30, 2017
- Bulletin: U.K.-Based HSRF And HSRF1 Debt Ratings Unaffected By Sale Of Indirect Holding Company, Helix Holding Ltd, Sept. 12, 2017
- New Issue: High Speed Rail Finance PLC, Dec. 15, 2016
- Research Update: High Speed Rail Finance New Senior Secured Debt Rated 'A-'; Outlook Stable, Dec. 15, 2016

Ratings List

Ratings Affirmed

High Speed Rail Finance (1) PLC		
Senior Secured	A-/Stable	

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

Ratings Subsequently Withdrawn

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

NR--Not rated.

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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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at 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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