

INFORMED SOURCES e-Preview July 2020

This month's column features an in-depth analysis of a recent major change in the rolling stock leasing market. Something I have found over the years is that the impact of a series of events, covered in this column as they happened, may not be fully apparent until you take the time to pull them together. This is certainly the case with rolling stock leasing.

Another lesson is that something which appears to be a railway problem may really be just a sub-set of a much wider transport issue. This applies to the accessible rail replacement coach impasse, which continues to rumble on. If you think we have problems with DfT's weak grasp on reality, wait until you read about school buses.

Market stress-testing rolling stock leasing

Rail Replacement coaches – RDG's inconvenient truths

New Train TIN-Watch

In recent years, a combination of cheap money, cheaper new trains and the Department for Transport's introduction of quality factors to the evaluation of franchise bids, have made the procurement of new trains a winning tactic in franchise replacement bids. At its most extreme it produced the mass-extinction of existing fleets, for example at Greater Anglia and South Western.

Meanwhile, the collapse of borrowing rates after the 2008 global economic crisis was bad news for pension funds which need a steady long-term return on their investments. With Governments offering lenders negative interest rates, in other words you pay them to hold your money, and the UK government pulling the plug on the Private Finance Initiative, the Pension Funds needed alternative sources of income.

In 2010, the investment arms of Ontario's municipal employees' and teachers' pension funds bought the Channel Tunnel Rail Link concession from the UK government for £2.1bn. While the concession was later sold-on, the investment generated a secure income stream running to 2040.

Railway infrastructure was a starting point. But with what an informed source calls 'a sea of pension money looking for a home, the rolling stock market also had potential. The way to access this potential was through a financial device called a Special Purpose Vehicle (SPV).

In the case of rolling stock, an SPV is a company set up to own and lease a specific fleet of trains. The really clever bit is that that because the debt to fund the trains is provided by pension funds, it is available at significantly lower rates than the classic sources of finance used by the mainstream Rolling Stock Companies (ROSCOs).

For the funders, an SPV owning a fleet of trains tied to a franchise is an attractive proposition. Rental income is effectively backed by government through the franchise agreement.

In 2016, the pioneer of this new approach to rolling stock funding, Rock Rail, completed its first deal. This was for the 25 6-car Siemens Desiro City EMUs for the Great Northern inner suburban services. The ROSCOs simply could not compete with the cost of funding provided by an SPV.

Rock Rail Moorgate, an SPV with debt by Aviva, wiped out the ROSCOs and launched the new wave of rolling stock funding. As the detailed analysis in the column shows, it has turned out to be not so much a wave, as a Tsunami.

Since that breakthrough a further 14 SPV funded fleets have been ordered with a combined value of over £4 billion. The newcomers have taken two thirds of the available business. And that percentage would be higher were it not for Angel's contract to supply Greater Anglia's £900 million Bombardier Avenra EMU fleet.

Sticky

Central to the attraction of an SPV is the choice of operator and rolling stock. As an Aviva associate director explained in a 2017 article 'We like Rock's proposition because they focus on funding strategic core fleets ('sticky fleets') tailored to the specific needs of the network it will operate on'.

Stickiness is the key to minimising risk, as the ROSCOs have found to their cost. The Class 460 Gatwick Express stock, optimised in 1996 for the airport shuttle service, must have looked to have been Super-Glued in place. In fact it had less grip than a Post-It note.

Still, at least owner Porterbrook were able to recoup some of the value in their investment by cannibalising the Class 460 vehicles to lengthen the Class 458 fleet to five-cars as part of South West Trains' Waterloo Capacity Improvement Programme. Under that programme Porterbrook also re-tractioned its ex-BR Class 455 units to provide maintenance capacity for SWT's Angel Trains-funded fleet of new Class 707 Siemens Desiro EMUs.

Then came the SPV apocalypse, SWR went for mass extinction and the leases of the 458s, 455s and 707s turned out to be as sticky as Teflon with a spray of silicone lubricant. If that can happen with the award of a seven year franchise, just consider what might happen under a 15 or 20 year concession, reported to be favoured by the Williams Review. With that timescale, concession management would have the continuity to create a true long term rolling stock strategy and rationalise existing fleets.

This is why SPV funders ring-fence each fleet in a separate company. With its Transport for Wales deal, for example, SMBC Equitix has set up four SPVs. The Core Valley lines will be operated exclusively by the Stadler Tri-mode and Metro tram-train fleets, each with its own SPV. TfW has provided a 25-year usage undertaking for these fleets. That's super-sticky.

So what is the potential effect of COVID-19 on the adhesive properties of rolling stock leases? A note from the Fitch Rating Agency in April noted that in the UK market rolling stock leases typically include 'hell or high water' clauses and will remain unchanged in the short term. However, Fitch believes that existing lease contracts could be amended if the Emergency Measures Agreements are extended, combined with reduced service frequencies.

With the Government chaffing at spending around £700 million a month on EMA for trains currently carrying handfuls of passengers, you can expect growing pressure for operating savings: rolling stock costs are an obvious target. Even when social distancing is reduced, to 1 metre for example, unless ridership returns rapidly you could still meet demand safely with shortened formations.

It's a long time since owning rolling stock was a license to print money. The rise of the SPVs has put the ROSCOs under pressure. But I suspect the bell could soon be tolling for the entire rolling stock sector.

Reality check on Rail Replacement coaches

Last month I provided an update on the Rail Replacement coach accessibility saga and looked forward to seeing the Rail Delivery Group's proposals which were released too late for the June column. That turned out to be fortuitous because RDG's 'Pathway to compliance' is a comprehensive piece of work justifying a report of its own.

What is particularly valuable, is that it sets rail replacement in the wider picture of the overall coach hire business. This is a reminder that the shortage of coaches compliant with the Public Service Vehicle Accessibility Regulations (PSVAR) is not just a railway problem. Rail replacement is a sub-set of a much wider, and more complex, coach industry problem.

Central to the problem is the home-to-school coach market, where it wasn't until early in 2019 that the coach industry realised that its expectation of how PSVAR would apply to hire coaches wasn't the same as that of the DfT. Then it took until November 2019 for an exemption to be granted allowing the use of non-compliant vehicles on home-to-school services procured by local authorities. This covers a period of two years from January 2020, with the potential for a further two years in certain circumstances.

However, that exemption doesn't apply to coaches provided by schools and paid for by parents. If you think the railways have problems over PSVAR with DfT, it wasn't until 30 December, the day before the deadline, that an exemption was announced for these home-to-school services, and then extending only to the end of the summer term on 31 July.

At least train operators have an exemption to the end of the year. DfT clearly expects schools to magic-up a fleet of PSVAR compliant coaches by the start of the Autumn term in September.

In its comprehensive analysis of the situation, RDG argues that, as a minority customer, the exemptions for rail replacement coaches should be aligned with the two/four years already agreed for council-run home-to-school coaches. Since coach operators use the same vehicles for both duties this would help stimulate demand for new compliant vehicles or conversions. However RDG notes that even the full four years is 'extremely ambitious and is likely to need government intervention, probably involving financial support'.

Rail replacement for planned line closures is one thing: rustling up replacement vehicles at short notice when a main line service is disrupted can be difficult. As RDG notes, given the unpredictability of time and place, 'for there to be enough PSVAR-compliant coaches available at any time and at short notice, all coach companies would need increased incentive to replace their stock or retrofit existing stock'.

To guarantee PSVAR compliance for unplanned disruption, RDG believes legislation requiring all coaches to be PSVAR-compliant would be essential. In this event, RDG estimates that an exemption of 'at least eight years' would be required to ensure the availability of sufficient vehicles.

RDG's Pathway document includes a detail breakdown of the available PSVAR compliant coaches, which I publish in the column. So if Transport Minister Chris Heaton-Harris could spare time from composing excruciating puns for his Twitter account and try and get his head round the inconvenient cold numbers we might get some common sense policies applied to resolving this currently intractable problem.

Meanwhile, RDG wants the legal status of the inevitable long-term exemption for rail replacement coaches to be 'clear and unarguable'. This is obviously code for 'get real, Minister'. But my sympathy is with the school heads who, pending the inevitable last minute exemption, won't be able to get their children to school in September.

#### New Train TIN-Watch

Each month I try to add value to the raw data in the table listing the reliability of the new train fleets with some analysis. This month I have looked at delays.

In the Golden Spanners awards, bronze goes to the fleet with the lowest Delay Minutes per Incident (DPI). This is not a consolation prize, because DPI is the metric closest to passenger's perceptions of the service. It also showcases the ability of train-crew and their 'call-a-friend' technical support team in Control to get a train moving quickly again.

I have a table showing the delay minutes in the last Reporting Period, plus the DPI, for each for each fleet. I found it surprising and hope you find it interesting.

#### Roger's Blog

While there are no press-visits or news conferences at the moment, Zoom and conference calls are keeping us all in touch. For example, there was a very useful briefing session for the rail trade and technical press with Network Rail Chief Executive Andrew Haines earlier this month.

In the near future I'm looking forward to a session on how one of the new train fleets is being maintained. It won't be the same as an on-site meeting with a tour of the depot, but it should still provide all the material I need for an interesting article - less the photos.

Talking of Zoom, I must apologise for the poor sound quality of my contribution to last month's Modern Railways Zoom recording which we post on social media. For the first of these previews, which was a last minute decision, I set up my little Netbook on my office desk and despite its modest processor it seemed to cope.

For last month I had Mrs F's MacBook set up in the conservatory and was all set with a green screen and virtual background, when the Mac went technical and I had to revert to the Netbook at the last minute. This time the processor struggled, even without a virtual background, and it showed up in the sound quality.

Recording this month's Zoom video all systems were go. When I say that the virtual backgrounds used by me and my Colleague Ian Walmsley spanned six decades of diesel traction you may guess what I chose!

Meanwhile, there's no shortage of events to report and material to analyse for future columns. I'm also working up an article on innovation. Oh, and the August column will include a full listing of the Informed Sources' Laws in 'photocopy-and-keep' format.

Roger