

LLOYDS BANKING GROUP



**The Shaw Report
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23 December 2015

Dear Shaw Secretariat,

Lloyds Banking Group was pleased to hear of the appointment of Nicola Shaw by the Department for Transport; and to see the speed with which the Shaw Commission has grasped the task it has been set.

We believe that the scoping document (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/476944/the-future-shape-and-financing-of-network-rail-the-scope.pdf) captures all the essential facts and asks all the right questions. We've also been encouraged by the fact that the Commission has shown a real willingness to engage thoroughly with stakeholders as it fulfils its mandate.

It is in this spirit of collaboration that we have briefly addressed several of the questions, listed in Annex A (pages 69-70). We have identified, in particular, questions around the RAB model, financial risk and funding, and the key factors that are necessary for a sustainable future model. Our take on these are listed overleaf – but we hope that, in the new year, we'll have an opportunity to explore these ideas in far greater detail in a meeting with Ms Shaw and her Commissioners.

In the meanwhile, please do let me know if anything is unclear in our attached responses; and I look forward to hearing from you regarding next steps.

Yours Sincerely,

Guillaume

Guillaume Fleuti
Managing Director & Head of Corporate Debt Capital Markets and Infrastructure and Energy
Lloyds Banking Group

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LLOYDS BANKING GROUP PLC
SHAW COMMISSION ON NETWORK RAIL
Response in relation to the Scoping Study's list of
questions at Annex A

23 DECEMBER 2015

In Response to the Shaw Commission's consultation on the future shape and financing of Network Rail

Executive Summary

- Lloyds Bank ("LBG") are delighted to have this opportunity to provide input into the consultation of the future financing of Network Rail.
- LBG is a significant funder, both through direct lending and as an arranger of finance, for UK infrastructure. As part of our Helping Britain Prosper Plan, we have provided over £10bn of financing arranged in 2015 against a pledge of £30bn by the end of 2017.
- Through this response we aim to focus on the future financing and funding of Network Rail by addressing questions 21-26 of the Shaw Report.

1) Do you have any views on whether the RAB remains a relevant concept in the Railway, and, if not, what should replace it? (q.21)

- The RAB model remains the foundation block of strategic, regulated assets and is a suitable framework.
- It is a model that is understood by investors and in our view remains a relevant concept for the railway.
- A new concept of RAB could be determined based on a geographical split, whereby a number of de-centralised Network Rails are set up for different parts of the network.
- Potential split via Network Rail's route structure (i.e. Scotland, London North East, London North West, Anglia, South East, Wessex, Western, Wales) could also occur.
- A geographic split would be logical and would replicate an approach taken by other infrastructure assets such as the utility sector.
- Whether or not this adopts the same methodology as current UK utility/airport financing is a point for discussion but the fundamental idea of a regulated asset base remains sound.

2) How should financial risk be managed in Britain's rail infrastructure in the future? (q.22)

- Should the government want to get private capital into the railway, there are two main options available:
 - Full privatisation – subject to a licence from UK Government
 - Concession model - long term concession, 40/50 years
- Either model would be sufficient to attract private capital and investment.

3) Do you have any views on how Britain's railway infrastructure should be funded in the future, regardless of corporate structure? (q.23)

- Debt and Equity should come from the private sector, however given the scale of Network Rail it will require transitional arrangements from government, perhaps in the form of guarantees to build investor confidence in the sector.

4) What positive case studies are there (e.g. international examples in the railway sector, other sectors internationally/in the UK), where more affordable and sustainable funding and financing structures have been implemented, with or without private sector capital input? And how do you think the lessons learnt could be applicable to Britain's railway infrastructure? (q.24)

- The UK is the leading world's RAB based financing destination with a highly established track record of RAB financing in nationally strategic important assets including – Utilities (Gas, Electricity, Water) and Airports (Heathrow, Gatwick).
- One of the key strengths of the UK RAB model is both the transparency of the regime coupled with a proven RAB cycle that has allowed significant financing to occur over multi-RAB periods.
- This provides comfort to investors that the regulatory model is evolutionary in outlook and that any concern over political interference is not an issue.
- Such is the strength of RAB Based financings for strategically important assets that that most privatised European utilities have some form of RAB based element as do many privatised European Capital city airports.
- The nature and form of the RAB is different on a case by case and geographical basis. RAB can therefore evolve and be fully adapted to meet bespoke requirements.

Examples include:

Gas: Scotland Gas Networks, Northern Gas Networks, Southern Gas Networks

Water: Thames Water, Southern Water, Sutton and East Surrey Water

Airports: Heathrow and Gatwick Airport

Electricity: Western Power Distribution, UK Power Networks, Northern Powergrid

5) What are your views on the enabling factors facilitating a sustainable and affordable capital structure for Britain's railway infrastructure? What factors would be required specifically for private sector capital introduction? (q.25)

The five key factors that are required to attract private capital into the railway infrastructure are similar to those required for utilities and are why the UK is the most attractive destination for international investment in infrastructure:

1. Political commitment across Parliaments
 - This is the most important enabling factor and fundamental to establishing investor confidence.
2. Acknowledgement and commitment that private sector capital can earn a realistic rate of return
3. Strong Regulatory Regime with appropriate licence regimes in place
4. Having potential continued Government support via guarantees/direct grants or ultimately as a potential lender of last resort
5. Evolution in regards to ticket pricing and how these funds would feed through to 'son of Network Rail'

6) What are the types of investors that may be interested in investing in Network Rail, any of its functions, or in select parts of it? And for these types of investors, can you indicate: (q.26)

There are a multitude of investors who would have significant appetite for any privatisation of Network Rail – these groups could be broken down into the following categories:

- UK and foreign pension companies
- UK and foreign insurance companies
- Dedicated infrastructure equity investors
- Sovereign Wealth Funds

To highlight the potential investor community, the table below highlights a snapshot of current investors in UK regulated assets.

	<ul style="list-style-type: none"> • Ferrovial S.A • Qatar Holding LLC 	<ul style="list-style-type: none"> • Caisse de dépôt et placement du Québec • Government of Singapore Investment Corporation
	<ul style="list-style-type: none"> • Global Infrastructure Partners • Future Fund Board of Guardians 	<ul style="list-style-type: none"> • Abu Dhabi Investment Authority • The California Public Employees Retirement System
	<ul style="list-style-type: none"> • Macquarie Investment Funds • SAS Trustee Corporation 	<ul style="list-style-type: none"> • Alberta Investment Management • Stitching Pensioenfond ABP
	<ul style="list-style-type: none"> • Sumitomo Corporation 	<ul style="list-style-type: none"> • Osaka Gas
	<ul style="list-style-type: none"> • Morgan Stanley 	<ul style="list-style-type: none"> • M&G Investments
	<ul style="list-style-type: none"> • KKR Infrastructure Fund 	<ul style="list-style-type: none"> • South Staffordshire Water
	<ul style="list-style-type: none"> • Cheung Kong Infrastructure • The Li Ka Shing Foundation 	<ul style="list-style-type: none"> • JP Morgan Asset Management • UBS Global Asset Management
	<ul style="list-style-type: none"> • Cheung Kong Infrastructure • Power Assets Holdings 	<ul style="list-style-type: none"> • SAS Trustee Corporation
	<ul style="list-style-type: none"> • SSE plc • Borealis Infrastructure Europe Ltd 	<ul style="list-style-type: none"> • Ontario Teachers' Pension Plan

