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Briefing note

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Rolling Stock Procurement in the UK – the National Audit Office gives its verdict

The National Audit Office examined over £6 billion of rolling stock procurement by the UK Department for Transport in the Thameslink and IEP projects, assessing value for money, competition, choice of financing structure and the effect on the wider UK rail industry

The United Kingdom's Department for Transport (DfT) has recently led something of a rail revolution, taking direct control of the procurement for approximately three-quarters of the new trains forecast to be required in the UK until 2020. Following the completion of the Thameslink and Intercity Express (IEP) projects, the National Audit Office (NAO) ran the rule over this process, with a number of findings that may affect the rail sector in the UK. The full report can be found here.

Background

The DfT has awarded the following rolling stock contracts in the past two years:

- IEP involved the procurement of 866 new carriages for the Great Western Main Line (London to Oxford, Bristol and Swansea) and the East Coast Main Line (London to York, Newcastle and Scotland), through a privately financed project for the supply and maintenance of the bi-mode trainsets. Agility Trains, a consortium led by Hitachi Rail and John Laing, obtained £4.7 billion of financing for the project in two stages, completing in 2012 and 2014;
- Thameslink involved the procurement of 1140 new carriages for the new Thameslink network (from Brighton to Bedford and Cambridge via London), although through a private finance project structure. Cross London Trains, a consortium of Siemens, Innisfree and 3i Infrastructure, obtained £1.8 billion of financing for the project, which completed in 2013;
- the procurement of 585 new carriages for Crossrail (the new cross-London line from Reading and Heathrow to Stratford and Abbey Wood in the East) was awarded to Bombardier in February 2014 as a direct public procurement (from DfT and Transport for London), without

Key points

- The DfT led procurement for around 75% of the UK's rolling stock needs until 2020 in three large projects, two of which (Thameslink and IEP) were privately financed.
- The NAO's views on privately financed procurements may influence upcoming projects including HS2. Both Thameslink and IEP financings were oversubscribed at financial close, showing appetite in the infrastructure markets.
- Whether the projects will deliver value for money is dependent on the DfT and TOCs managing the ongoing elements of the programme effectively, and assumptions, such as passenger demand forecasts, holding true. The NAO recommended the DfT exercise options to require refinancing of both projects to obtain more value.
- The NAO considered that having these procurements led by the DfT, rather than TOCs and ROSCOs, could muddy the DfT's message on rail industry policy, and that clearer guidance is required for the future.

private financing involved. The Crossrail procurement (with a value of approximately £1 billion) was not directly addressed in the NAO's report.

These three projects were the largest rolling stock procurements in the UK's recent history, and the DfT decided to lead the procurement process itself (in consultation with advisers and the wider industry) rather than taking the typical UK approach since privatisation, with train operating companies (**TOCs**) procuring new trains, financed and owned by rolling stock leasing companies (**ROSCOs**). This departure led the NAO to scrutinise the process carefully from several perspectives.

Competition

The DfT's intention in initiating large-scale procurements was to achieve value for money through economies of scale, but the NAO considered it unclear as to whether this was successful, as the alternative view is that competition between manufacturers may have been reduced by the volume of new trains required, creating peaks and troughs in the industry. It is notable that, after winning the Thameslink bid, Siemens pulled out of the competition for Crossrail, citing concerns over the deliverability of existing commitments if it won multiple large orders. Ultimately, however, the NAO found that the level of competition achieved in these procurements compared favourably against competition achieved for rolling stock procurements undertaken since 2000.

Financing

The DfT adopted a PFI type approach in both procurements to allocate risk more favourably and cost effectively, and to utilise its existing budget for other transport priorities. Both projects suffered significant delays, which the NAO ascribed to difficulties in securing finance based on the global recession and eurozone crisis, as well as a governmental spending review. The NAO noted that the DfT dismissed public financing of IEP, and did not consider this option for Thameslink.

It should be pointed out that, despite the scale and complexity of both projects, both were oversubscribed at financial close, demonstrating the depth of private finance appetite for long-term infrastructure lending with appropriate risk-sharing. The current level of competition between banks, capital markets and other investors active in infrastructure and project finance may also lead to refinancing of the transactions, and the NAO noted the potential improvement in value for money to the government afforded by the DfT's option to require a refinancing and receive a proportion of the benefits of reduced costs to the projects. With that in mind, the NAO's views on Crossrail, if forthcoming, will be extremely interesting, as it may indicate whether the switch to public financing for that procurement is seen as an anomaly, with the potential for privatisation of the rolling stock ownership in future.

Wider industry issues

The DfT's leadership of procurement was intended to address structural concerns about the UK rail industry, including the lack of incentive for TOCs to consider the long-term cost to the system when procuring rolling stock for rail franchises (which are relatively short in length compared to asset life). The DfT also considered that the size of the fleets were such that ROSCOs would not be able to finance them alone, and wished to introduce new sources of finance to the rolling stock market.

However, the NAO concluded that there is a gap between the DfT's stated desire to only play a strategic role in public procurement and its actions. The NAO viewed the DfT's direct role in procurement of these trains as potentially confusing existing industry players on how rolling stock would be obtained in future. This will be a critical balance for the DfT to achieve, to ensure the central role played by TOCs and ROSCOs in UK rolling stock market, without limiting the value that new financing participants can add. While there are only a limited number of smaller procurements due in the next few years, the DfT's actions will be seen as a guide for larger future projects, including HS2 and Crossrail 2.

Verdict on value for money

The NAO ultimately determined that it could not conclude on value for money of the IEP and Thameslink projects until the new trains are in service, particularly as value will depend on passenger forecasts being met. However the NAO has listed a number of recommendations for the DfT, including to look for refinancing opportunities for these projects, and to improve the whole industry collaboration to achieve long-term cost reductions.

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