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Department for Transport

Southern Rail Link to Heathrow Market Sounding

Findings Report - October 2018



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1. Summary

1.1. This report

1.1.1. Nichols/Agilia has prepared this report on behalf of the Department for Transport (DfT) as a summary of the findings from a market sounding exercise that was undertaken during summer 2018, regarding a proposed new Southern Rail Link to Heathrow (SRLtH).

1.2. Southern Rail Link to Heathrow

1.2.1. SRLtH is part of central government's long-term planning considerations for enhancing connectivity, encouraging modal shift and boosting economic growth in the South and West of England.

- 1.2.2. In an announcement on 20 March 2018, the Secretary of State said that the development and delivery of SRLtH should:
- encourage innovative ideas
 - reduce the burden on taxpayers and fare payers
 - support the UK's economic and housing aspirations

1.3. Market led proposals

- 1.3.1. In March 2018, government also launched its market-led proposals (MLP) guidance, which sets out a process for the private sector to propose and develop new rail enhancement schemes.
- 1.3.2. As SRLtH had already been identified as a priority for government through the long-term planning process, it does not strictly meet the criteria of a market-led proposal. However, we used the MLP guidance as a reference framework to help structure discussions during the market sounding process.

1.4. Market sounding purpose

- 1.4.1. The purpose of the market sounding was for government to explore options for bringing forward SRLtH with greater private sector involvement than has conventionally been used for rail infrastructure projects.
- 1.4.2. In particular DfT wanted to explore opportunities to access significant private sector funding sources beyond just rail passenger revenues, including those derived from wider non-rail benefits, and to understand the appetite of the private sector to share the risk of developing SRLtH.

1.5. Market sounding process

- 1.5.1. The market sounding was notified by the DfT through the issue of a Prior Information Notice (PIN) on 8 May 2018. A launch event was held on 24 May at which the Secretary of State for Transport delivered the keynote address.
- 1.5.2. In June 2018, questionnaires were issued to capture the views of organisations that had expressed interest in participating in the market sounding. Some interviews were also held with organisations, possessing a particular set of experiences or capability, to test their views in more detail.
- 1.5.3. The purpose of the questionnaire was to capture views in a consistent way and against a common list of questions. It was structured under 5 key topics:
 1. Your interest in the project
 2. The readiness, maturity and capability of the market (of promoters with current proposals)
 3. The readiness, maturity and capability of the market (of respondents without current proposals)
 4. Structuring the development process
 5. Barriers and enablers to sharing risk of development

1.6. Findings and recommendations

- 1.6.1. Our key findings and recommendations to DfT are set out under the five topic headings.

1. Your interest in the project

- 1.6.2. There was significant interest in the project from the private sector with over 100 organisations expressing initial interest following the launch of the market sounding process. From this we received the detailed views of 27 organisations who responded to the questionnaire.
- 1.6.3. The responses to the market sounding covered a broad range of interests including scheme promoters, train operators, contractors, financiers, management contractors, stakeholders and advisors. This allowed a broad range of ideas and perspectives to be received on the options available for DfT to engage the private sector.

2. The readiness, maturity and capability of the market (of promoters with current proposals)

- 1.6.4. There appears to be significant appetite from private sector promoters to develop and deliver SRLtH. During the market sounding we heard a variety of different ideas for projects/schemes to meet the strategic aims of the Southern Rail Link to Heathrow project.
- 1.6.5. Our findings from this topic are presented in more detail under four themes: funding, financing, scheme requirements and business case development.

Funding

- 1.6.6. There was a general recognition by respondents that the project delivers a positive business case, with sufficient income available to ultimately cover the capital costs, without the need for additional government grants. Depending on the scheme under discussion, promoters had either assumed passenger revenue as the only funding stream, or had included contributions from Heathrow Airport Ltd (HAL) or other sources in their calculations.
- 1.6.7. Some promoters with non-heavy rail schemes identified themselves as wholly self-funding, largely from passenger fare box revenues. These schemes did not have a direct interface with existing train services or infrastructure, and therefore the revenues and costs were more insulated from the risk of integration with the existing rail network.
- 1.6.8. Those promoters with heavy rail schemes assumed that the DfT would take at least some of the risk of funding from passenger fare box revenue, by committing to a usage undertaking or track access agreement with the promoter.

- 1.6.9. Some respondents identified potential additional funding sources outwith passenger revenues, such as from property development or local business levies. However, limited information on the scale or certainty of this funding was available at this stage. It was generally assumed by respondents that HAL would be a contributory funder alongside passenger revenue funding via DfT.

Financing

- 1.6.10. There was interest from the private sector to finance both project development and delivery, recognising that different finance structures would be required to account for the level of project maturity and corresponding uncertainty at the different stages. For the development stage, we heard that there was a smaller and less mature finance market, where interest would be subject to certain conditions including: the level of project certainty; confidence in their proposals being taken forward; and the ability to generate a sufficient return on their investment.
- 1.6.11. Respondents reported that ‘balance sheet’ considerations are complex and require further government guidance. Several respondents identified opportunities for risk transfer that they believed would contribute to the case for the project being ‘off government balance sheet’. This is a complex area and proposals are not mature enough to make any definitive statements at this stage.

Scheme requirements

- 1.6.12. DfT should work with HAL, as a possible additional main funder, to provide more direction to the market on minimum requirements that support their respective business cases. This would help provide a focus for the various ideas and schemes, which are currently at different levels of development maturity and represent a wide range of solutions.
- 1.6.13. For promoters of non-heavy rail solutions, government should consider providing direction using these minimum requirements. As well as being key stakeholders in the success of SRLtH, DfT are ultimately responsible for achieving strategic objectives for the wider rail network.

Business case development

- 1.6.14. DfT should consider the appropriate level of government involvement in owning, assuring or approving the business case, taking into consideration the significant interfaces with the existing rail network, its potential role taking on revenue risk, and the affect on government balance sheet treatment.

3. The readiness, maturity and capability of the market (of respondents without current proposals)

- 1.6.15. There is an existing, mature supplier and finance market for the delivery and operational stages of complex projects. Organisations are used to forming consortia comprising the necessary capabilities from engineers, contractors, operators and financiers. However, this formation of consortia more commonly takes place after development and planning has been undertaken by a client organisation.
- 1.6.16. For most respondents, they indicated that it was too early in the project development process to form firm partnerships or consortia specific to this project.
- 1.6.17. We heard views from different types of finance organisation including those who provide equity finance in the early, riskier stages of the project, and those who provide debt finance to cover the higher costs, but better understood risks of design, construction and operations. Respondents shared the importance of making projects suitably ‘financeable’ during development to ensure the best response from the finance market.
- 1.6.18. We heard that the benefits of early private sector involvement in the business case included the opportunity for greater innovation (technically and commercially), greater ‘ownership’ of the end solution, faster decision-making and better long-term relationships with the supply chain and local stakeholders.

4. Structuring the development process

- 1.6.19. The findings of this market sounding have provided significant input that will help to inform the case for undertaking a development approach that has greater involvement from the private sector. Most parties suggested that an early, single-stage selection process would elicit the greatest interest from the market. Where there is private sector appetite for being involved earlier in the development process, we heard that this is linked to having the option for involvement in the later, more significant construction and operating phases.
- 1.6.20. Several respondents identified examples where the private sector has been engaged much earlier in the development process in the energy and health sectors. A recent example cited in the rail industry is the early involvement of train operators in delivering the Wales and Borders railway. We heard that internationally, it is not uncommon for contractors to be involved in business case development, but that this comes with a competitive advantage in the later stages of the project in order to make it attractive to the market.

- 1.6.21. Government will need to assure itself of the regulatory constraints, benefits and risks of taking a different approach to developing SRLtH, particularly if there is a need for government to retain an operational, financial, reputational and strategic stake in the project's success as a major funder.
- 1.6.22. The risks and benefits of selecting a promoter under early single-stage procurement should be assessed against a traditional multi-staged competitive route. For example, benchmarking of costs during development can be used to ensure value where procurements are single sourced. Procurement lessons from other projects such as Euston Station Commercial Development, East West Rail Ltd and the Wales and Borders railway should be considered, as well as examples from non-rail sectors.
- 1.6.23. DfT should also consider how its own and Network Rail's roles would adapt to optimise the benefits of engaging private sector involvement. This should include consideration of its own resource capacity and capability to both procure and act as a client for a different approach.
- 1.6.24. As it has emerged from the market sounding that government is an assumed guarantor of track access charges for any heavy rail scheme. This means that DfT is likely to be considered as the core funder for balance sheet purposes. DfT should therefore consider the benefits of providing a more detailed output specification with its essential or minimum requirements, to ensure its wider strategic aims are met whilst still encouraging wider market participation. This is in contrast with an approach where the supply market is given freedom to interpret higher-level strategic aims to allow for greater innovation.

5. Barriers and enablers to sharing risk

- 1.6.25. The most common barrier we heard to sharing the risk of the development process, was the notion of the private sector developing their ideas at their own cost, to subsequently have those ideas opened up to competition. In some cases, this was referred to as the need to 'protect intellectual property'.
- 1.6.26. Some respondents, although not all, saw the current lack of project definition as a barrier to getting involved, stating that they would need a higher level of project definition before taking part in a competitive process. It was suggested that a set of minimum output requirements could include:
 - Trains per hour
 - Availability requirements of the railway
 - Failure rates for the infrastructure on the railway

- Journey times between certain key points
 - Reliability requirements
- 1.6.27. Respondents asked for clear guidance on the next steps as a key enabler to advancing the project. There were several suggestions for what this guidance could include:
- Clarity of how a 'level playing field' would be achieved, given the different levels of maturity of project proposals and also interested parties with no proposals.
 - The required regulatory process and statutory requirements for SRLtH.
 - The future franchise arrangements for SRLtH, for example whether the train service will be delivered by a new or existing TOC.
 - The requirements to become a new Infrastructure Maintainer/Manager.
 - Clarity of roles including who will be the 'procuring authority'.
- 1.6.28. We heard that the confidence and appetite of the market to participate in the next stages of the project would be materially improved by the publication of a process and timescales that sets out how proposals will be assessed. This will enable those interested parties to prepare, resource and engage with partner organisations as necessary.

2. Introduction

2.1. Background

- 2.1.1. In recent years, a number of reviews of the rail industry have made the case for greater levels of private sector investment as a means to continue to enhance the rail network, recognising the need to improve value for money, and reduce the burden on taxpayers and passengers.
- 2.1.2. In March this year, the Secretary of State launched an ‘Invitation for Investors’ asking those who want to invest in rail infrastructure to bring forward proposals for a new southern rail link to Heathrow.
- 2.1.3. To help facilitate this, the Department for Transport commissioned Nichols/Agilia to undertake a market sounding exercise, inviting potential promoters, investors and contractors to share their ideas on how to take this project forward. The DfT issued a PIN on 8 May to commence the market sounding, and an ‘Industry Launch Event’ was held on 24 May, attended by representatives of the rail and finance industries.
- 2.1.4. This report has been prepared by Nichols/Agilia as a summary of the findings from the market sounding exercise. The DfT will separately publish its proposed ‘next steps’ in Autumn 2018.

2.2. Southern Rail Link to Heathrow

- 2.2.1. SRLtH is part of central government’s long-term planning considerations for enhancing connectivity, encouraging modal shift and boosting economic growth in the South and West of England.
- 2.2.2. Western and Southern Rail Links (SRLtH) to Heathrow are both part of a Heathrow Access Programme, for which DfT has set out the following strategic objectives:

Encourage modal shift and reduce road congestion: Providing regular services to encourage air passengers and airport employees travelling to and from Heathrow to transfer from road vehicles to rail, contributing to reduced road congestion.

Reduce environmental impacts: Reducing reliance on private vehicles and taxis in these key markets to deliver net air quality, noise and greenhouse gas benefits as users transfer from diesel and petrol vehicles to sustainable transport modes.

Minimise the impact on current and future passenger and freight journeys and services: The scheme should not be at the expense of non-airport journeys, or undermine the ability of the network to meet future background demand.

Connect communities: Improving connectivity and providing new journey opportunities, especially to areas of high demand and where limited options mean that a low public transport mode share currently exists. To provide greater choice of surface access mode, competitive generalised journey times and increase reliability of journeys.

Boost economic growth and encourage regeneration: Providing greater accessibility to employment locally, nationally and internationally, facilitating catalytic impacts, and improving productivity and outputs in the UK economy.

Enhance our global competitiveness by making Britain a more attractive place to invest: The transport sector makes trade possible. Investors need effective international connections to access new markets, integrate operations into their global supply chains and to conduct business efficiently. The UK is already well placed to meet these needs, but we are in constant competition with other countries to attract global business.

Be deliverable: The safety impact on the enhancement for our railways will be paramount. Government will also be mindful of the implications for, and impacts on, the reliability of the network and the provision of services that delivery of the enhancement might have both during construction and after implementation.

Be affordable and value for money: To maximise operating surplus and reduce the need for public subsidy. To levy contribution to the capital costs of the scheme in order to provide value for money for rail customers and taxpayers.

- 2.2.3. Further objectives for SRLtH were set out by the Secretary of State in his announcement on 20 March 2018, which included encouraging innovative ideas, reducing the burden on taxpayers and fare payers, and supporting the UK's economic and housing aspirations.

2.3. Market Led Proposals

- 2.3.1. In March 2018, the DfT launched its MLP guidance. The purpose was to provide a practical framework that helps potential project promoters and investors engage effectively with DfT to provide credible project proposals. The guidance states that it represents the 'start of the conversation', and that further discussion will be needed to define individual projects.
- 2.3.2. As SRLtH had already been identified as a priority for government through the long-term planning process, it does not strictly meet the criteria of a market-led proposal. However, we used the MLP guidance as a reference framework to help structure discussions during the market sounding process.
- 2.3.3. Several participants in the market sounding asked for clarity on the link between the MLP process and SRLtH. SRLtH can be described as 'tailoring the MLP framework', adding a greater level of granularity and definition which meets the specific circumstances of SRLtH.
- 2.3.4. We also described SRLtH as a 'pathfinder project' i.e. one where the project development or delivery process is still to be fully defined, and that by using the guidance, and engaging with interested parties, the most suitable development and delivery process would take shape.
- 2.3.5. The MLP guidance defines two categories of project:
 - Category 1 MLP – does not require significant government intervention such as funding, changes to franchise agreements, usage guarantees or asset exclusivity.
 - Category 2 MLP – requires at least some government funding or other involvement such as changes to franchise agreements, usage guarantees, or guaranteed asset exclusivity.

We discuss this further in Section 4.3.2.

- 2.3.6. The full MLP guidance document can be viewed here:
<https://www.gov.uk/government/publications/rail-market-led-proposals>

3. Market sounding process

3.1. Objectives

3.1.1. The objectives of the market sounding were to:

- Generate interest in SRLtH, and encourage new, private sector parties to come forward with their ideas.
- Understand the expectations, maturity and readiness of potential market participants in the project, and the factors affecting their level of interest.
- Explore how exploiting benefits of the project (both transport and non-transport) could deliver additional funding, reducing the overall burden on taxpayers and passenger fare payers.
- Test the market's appetite to share the risk of development and the size, scale and scope of the market for potential participation.
- Receive market views and feedback on how the potential development of the scheme could best be undertaken.

3.2. Briefing document and questionnaires

3.2.1. A briefing document explaining the SRLtH market sounding was issued to all attendees at the SRLtH Industry Launch Event. The document can be accessed here:

<https://www.gov.uk/government/publications/southern-rail-link-to-heathrow-market-sounding-briefing>

3.2.2. A link to this document was also emailed to over 100 parties who expressed an interest in participating in the market sounding, along with a detailed questionnaire. In addition, a number of discussions were held with some organisations possessing a particular set of experience or capability, to test their views in more detail. A list of all parties who contributed and the respondents, via questionnaires and/or interviews is included in Annex A.

- 3.2.3. The market sounding was treated strictly as a fact-finding exercise and did not seek to evaluate any particular ideas or organisations. Non-participation in the market sounding will not preclude any party from further participation in this project. Any further stages of engagement would be announced by DfT via issue of a Prior Information Notice (PIN).
- 3.2.4. The detailed questionnaire issued to interested parties was structured under 5 key headings:
 1. Your interest in the project
 2. The readiness, maturity and capability of the market (of promoters with current proposals)
 3. The readiness, maturity and capability of the market (of respondents without current proposals)
 4. Structuring the development process
 5. Barriers and enablers to sharing risk of development
- 3.2.5. The full text of the questionnaire is included in Annex B.

4. Your interest in the project

4.1. Introduction

- 4.1.1. We asked respondents to describe their interest in the project, and their view of the DfT's Strategic Aims for the Heathrow Access Programme.

4.2. Summary of responses

Respondents

- 4.2.1. Table 1 contains a summary of the number of responses we received using the respondent categories defined in the questionnaire.

Category	No. of respondents
An existing promoter (or consortium member) who had been working on a proposal(s) for SRLtH before the market sounding PIN was issued.	6
A new potential promoter (or consortium member) who is interested in developing a proposal(s) for SRLtH, but whose interest is new since the market sounding PIN was issued.	3
A potential funder who is interested in contributing to the overall cost (recognising that this funding may be conditional on certain project outputs being realised).	0 (see discussion below)
A contractor who is interested in the design and construction of the project.	10 (of which 1 is also a potential promoter)
A financier who may be interested in providing part of the project finance.	9 (of which 5 were also contractors or promoters)
An advisor who is interested in the project.	1

Category	No. of respondents
A stakeholder with a keen interest in the success of the project but not one of the above roles.	3
Other interests or specialisms.	1
	Total: 27

Table 1: Number of responses received

Strategic aims

- 4.2.2. Generally, the respondents acknowledged and understood the Strategic Aims set out by the DfT in the Briefing Document, and made some additional suggestions:
- SRLtH should be deliverable in an efficient timeframe, which allows the private sector to meaningfully engage, recognising the significant resource demands of such projects.
 - SRLtH should align with HAL's long-term objectives.
 - The project should attract new investment to the local area and support growth in exports.
 - The project should aim to provide sufficient clarity and definition from development to elicit an optimal response from the finance and construction markets.
- 4.2.3. Respondents also shared their views on the importance of getting the procurement stage right, suggesting:
- The DfT should run an effective and efficient procurement exercise in which the private sector sees value in participating.
 - The Strategic Aims should encourage bidders to innovate technically (as well as commercially) in striving to best satisfy the DfT's objectives.

4.3. Analysis

- 4.3.1. We heard from respondents with a broad range of views and interests in the project, including several promoters of specific projects. To analyse common findings from this range of views, we refined our categories of responses into the following:
- Heavy-rail infrastructure promoter (specific solution).
 - Heavy-rail infrastructure transport service provider (non-specific solution).
 - Non-traditional infrastructure and transport service promoter (non-heavy rail).
 - Organisations with different backgrounds in finance, project management, design/contractors that were not offering specific solutions but were interested in being potential development partners.
 - Key stakeholders.
 - Advisors.
- 4.3.2. The respondents with non-heavy rail proposals identified themselves in their responses as 'Category 1 MLP', due to not requiring government funding. They identified, however, that they would need other forms of government assistance such as with statutory planning, and political support for their solution. As a consequence these proposals should be regarded as Category 2 MLPs, depending on the level of government support required and the degree of interaction with existing transport interchanges.
- 4.3.3. For heavy rail proposals, interfaces with the existing rail network (including infrastructure, systems and operations) are required. Involvement from government is likely to include, as a minimum, changes to existing franchise agreements and usage guarantees for the infrastructure. Using the MLP guidance means these proposals would also be regarded as 'Category 2 MLPs', and may require government to take a more significant role and to retain a level of risk during development and delivery of the project. Government involvement will also be an important factor in determining balance sheet outcomes for SRLtH.

4.4. Recommended next steps

- 4.4.1. Given the broad range of interests received during the market sounding, government should consider providing more direction to the market on the minimum requirements of key funders and stakeholders.
- 4.4.2. The feasibility and deliverability of project proposals could then be compared against these minimum requirements before the market developed their schemes further. For example, this could include whether proposed schemes would deliver successful transport connections within Heathrow Airport.
- 4.4.3. Government should consider the alternative ways, identified by respondents, for involving the private sector in the development of SRLtH. This should consider the need to ensure value for money offered by different approaches, funding certainty, and the needs of key stakeholders, and local authorities. It should also consider the risks to government of taking such approaches and whether additional safeguards would be needed.

5. Readiness, maturity and capability of the market to deliver the project (of promoters with current proposals)

5.1. Introduction

- 5.1.1. This section includes a summary of the responses from existing promoters of schemes for SRLtH who had already considered their proposals before the launch of this market sounding.
- 5.1.2. We asked respondents to describe their organisations and capability, their ideas on commercial structure, their technical solution, their approach to funding and financing, and their appetite to develop the business case.
- 5.1.3. Where we received information on technical and commercial solutions, we used this as an indicator of the readiness and capability of promoters, rather than as a comparison of different schemes.

5.2. Summary of responses

Interest and capability

- 5.2.1. Respondents indicated different reasons for their interest in the project. These included a desire to see local regeneration, housing and connection of communities; better transport connections; the opportunity to innovate in the design and delivery of a new railway; the opportunity to be involved in the early decision-making and financing of a major project; and a desire to ensure a profitable new railway.
- 5.2.2. Most respondents provided answers on behalf of their own organisation. In some cases, promoters had already begun working with partner organisations and responded on behalf of several companies.

- 5.2.3. All promoters recognised that a range of capabilities is required to deliver the project; whilst some capabilities existed within their own organisations, other capability would need to be procured on a competitive basis.

Commercial structure

- 5.2.4. Some parties had already begun to develop a commercial structure, taking the allocation of risk, profitability and value-for-money into account. Mostly the heavy-rail promoters assumed that passenger revenue risk should sit with government via either a usage undertaking or track access agreement backed by the DfT.
- 5.2.5. We heard various ideas about how to ensure the revenue risk to both DfT and the promoter was appropriately allocated, including the suggestion of a ‘cap and floor’ structure whereby only the extremes of revenue fluctuation would be a risk or benefit to government.
- 5.2.6. The promoters of alternative solutions (non-heavy rail) had more self-contained commercial structures and had assumed that revenue risk would be retained by the private sector promoter.

Financing the project

- 5.2.7. We heard that there is interest from the finance market (both equity and debt) to finance both project development and delivery, recognising that different finance structures would be required to account for lower levels of project maturity and associated uncertainty at the earlier stages.
- 5.2.8. The benefits of involving equity financiers earlier in the development process were cited as:
- A focus on resolving material issues and getting to clarity of risks and responsibilities as soon as possible, which would ultimately lead to a more timely and better value for money response from the debt finance market for construction and operation.
 - A focus on driving timescales based on a ‘time is money’ culture, ultimately bringing greater efficiency and reduced cost to the project.
- 5.2.9. Making the project ‘investable and bankable’ was suggested as an additional strategic aim, if private finance is deemed to be a priority objective. We heard that during the early development stages, seeking input from the finance market could help structure the project in a more attractive way, reducing the time taken to find financial backers and achieve financial close. This in turn could help deliver the project more efficiently and quickly, and lead to a more competitive private finance deal, providing better value for money.

- 5.2.10. However, we heard that the appetite of the finance market could be greatly increased or diminished, depending on the next steps to develop the project. Respondents highlighted some of the desirable aspects that would affect the interest of the finance market including:
- Greater level of project definition.
 - Clearly defined project boundaries and risk allocation.
 - A well-structured and well-understood risk profile.
 - Clear government commitment to delivery.
 - Certainty of timescales.
 - Certainty of the roles of key organisations, their governance and decision-making processes.
 - A long-term steady income stream.
- 5.2.11. A number of respondents indicated that they would be interested in either financing the project themselves (in part), or taking the lead in structuring the finance package.
- 5.2.12. In our questionnaire we asked respondents for their views on government accounting ('balance sheet') treatment. Most respondents did not answer this question, probably due to the complex nature of determining a commercial venture as either 'on' or 'off' balance sheet. However, a small number of respondents said they believed that the project could be classified as 'off balance sheet' given an appropriate transfer of risk to the private sector. Given the complexities, this will need to be explored in more detail.

Funding the project

- 5.2.13. We defined 'funding' as the ultimate source of capital contributions to meet the cost of a project. In addition to passenger revenue as the main source of funding, some respondents assumed that HAL would be a funding contributor, but were unable to comment on the scale of this, given the early stages of project development.
- 5.2.14. Some promoters identified potential alternative funding sources for SRLtH. The most developed solution was based on parallel (but separate) commercial agreements with local landowners, capitalising on the land-value uplift which could result from the new railway. However, the funding stream would not be available up front and is subject to uncertainty due to potential property market fluctuations.

- 5.2.15. Funding contributions from other sources, such as 'park and ride', Community Infrastructure Levies (CIL), Section 106, and commercial development around stations were also cited as possible income streams worthy of greater investigation as the project progresses. During the market sounding we did not hear of any significant up-front funding contributions which could be utilised to directly fund delivery.
- 5.2.16. There was a general assertion by respondents that the project delivers a positive business case, with sufficient income available to ultimately cover the capital costs, without the need for additional government subsidy. Depending on the scheme under discussion, promoters had either assumed passenger revenue as the only funding stream, or had included contributions from HAL or other sources.

Development of business cases

- 5.2.17. For heavy rail solutions, there was some interest from respondents in paying for the development of their own Strategic Outline Business Cases (SOBCs). However there was less interest in paying to develop the Outline Business Case (OBC) unless there was a clear mandate to subsequently deliver the project, i.e. the reward would have to exceed (not just match) the outlaid costs in developing an OBC.
- 5.2.18. Some promoters had already commenced the development of their own business cases, with a view to these being used to promote and seek support for their particular proposals.
- 5.2.19. For the non-heavy rail solutions, it was indicated that a greater level of government political support for their proposals would be required prior to investing further in the development of an SOBC.

5.3. Analysis

- 5.3.1. The market sounding did not elicit any new promoters or transport solutions which were not otherwise already known to government or Network Rail. However, the process provided a good opportunity to understand the market's capability, their appetite for risk and their assumptions about funding and financing.
- 5.3.2. For any heavy rail scheme, primary funding stream is likely to come from passenger revenue, although some potential alternative funding sources were identified, including from residential/commercial development. However, it should be noted that the alternative funding sources do not provide additional up-front funding; they are likely to be longer-term in providing returns, and are uncertain and subject to the variations of the property market.

- 5.3.3. A key difference between the heavy rail and non-heavy rail promoters was their desire to take on passenger revenue risk. Heavy rail promoters' solutions rely on close integration with the existing rail network and they were generally reluctant to take on passenger revenue risk due to this being more under the control of DfT franchising and access arrangements. From a finance perspective, this was seen as high risk and unattractive as a source of capital repayment, and subsequently would increase the finance costs of the project.
- 5.3.4. The non-heavy rail proposals had more opportunity to manage passenger revenue risk (and subsequent cost of finance implications) due to being independent of the heavy rail network and associated franchising arrangements.
- 5.3.5. The topic of 'balance sheet treatment' is something which clearly requires greater guidance and discussion with government. However, for those parties who believe they have an 'off-balance sheet' solution, the onus will be on them to explore the relevant legislation and guidance and make a case for their proposition.

5.4. Recommended next steps

- 5.4.1. There is significant interest and capability within the private sector to deliver SRLtH. This will now need to be assessed against the strategic aims for the project, and the next steps clearly set out by government.
- 5.4.2. Where the funding from passenger services is dependent on integration and extension of existing services, this is likely to require DfT having strong involvement in the business case rather than relying on a promoter to develop this independently. DfT should therefore consider the appropriate level of government involvement in owning, assuring or approving the business case, taking into consideration this integration with the existing transport network, and its potential role in retaining risk on the level of passenger revenue.
- 5.4.3. If DfT is assumed to be a key funder, they should consider working with HAL as an additional funder to provide more direction to the market on the minimum requirements that support their respective business cases. This would help provide a focus for the various ideas and solutions, which are at different levels of development maturity.
- 5.4.4. Taking into consideration the range of options being proposed, DfT should consider what level of minimum requirements it wants to set out and which proposals have the potential to meet them. This would then help guide the proposals and development process that the government should take forward.

6. Readiness, maturity and capability of the market to deliver the project (of respondents without proposals)

6.1. Introduction

- 6.1.1. This section contains a summary of responses from organisations who expressed an interest in the project but had not developed any specific proposals prior to the market sounding.

6.2. Summary of responses

Interest and capability

- 6.2.1. We heard from a number of organisations who expressed interest in and had the capability to get involved in the development and delivery of the project, some with a track record of forming and working within consortia.
- 6.2.2. Most respondents indicated that it was too early in the project development process to form formal partnerships or consortia specific to this project, and that a greater level of project definition, clearer timescales and process would be required before this could happen.

Commercial structure

- 6.2.3. Some parties suggested that the development of the commercial structure should be part of the competitive selection process i.e. it could be on the basis of evaluating both technically and commercially innovative responses.

Financing the project

- 6.2.4. The majority of respondents believed there to be significant interest and capacity in the market to finance delivery and operation of a project like SRLtH. We heard of a lesser, but still significant, interest in financing the earlier development stages. Some respondents indicated an interest from their own organisations to contribute towards the financing of the project.
- 6.2.5. However, we heard that it was too early in the project's development to develop a full financing proposition for construction and operation; we heard that the finance market generally gets involved later on when there is a greater level of project definition and understanding of risks.
- 6.2.6. Respondents identified that financing of project development is a less mature market than financing of construction and operations. We heard that the appetite to finance development would be based on having the opportunity to finance the later, more significant, construction phase.
- 6.2.7. We heard from different types of finance organisation. Finance organisations who provide equity in the early, riskier stages of the project, and finance organisations who provide debt to cover the higher costs, but more well-understood risks of design, construction and operations. Respondents shared the importance of developing projects to be 'financeable' for later delivery to ensure the best response from the finance market.

Funding the project

- 6.2.8. We did not hear of any significant sources of alternative funding which could be made available to SRLtH (other than those listed previously in section 5).
- 6.2.9. Local authorities indicated that they may be able to discuss the use or development of local land for the project, should this be appropriate and in line with their own aspirations.

Developing business cases

- 6.2.10. Given the relatively new proposition by government in the MLP framework for the private sector to get involved in business case development, we found that some organisations were not yet ready to commit their own expertise to this. However, it was recognised that there are specialists in the market who are able to undertake business case development in partnership with delivery organisations. Some organisations had international experience of developing business cases.
- 6.2.11. The benefits of early private sector involvement in the business case included the opportunity for greater innovation (technically and commercially), greater 'ownership' of the end solution, faster decision-making and better long-term relationships with the supply chain and local stakeholders.

- 6.2.12. We heard a suggestion that early, transparent, engagement with the equity finance market during the development of the SOBC could help the scheme to be structured in a more financeable way which would bring benefits later in the development process.
- 6.2.13. Some respondents suggested that government should underwrite the cost of the market developing business cases in the circumstances where those parties are not then subsequently selected to deliver the project. Others saw the cost of SOBC development being similar in scale and commitment to 'bid costs'. Their internal approval processes would consider whether the bid costs are proportionate to the likelihood of being selected to take the project forward.
- 6.2.14. An alternative view was that there is insufficient market interest to fund business case development, given the inherent risk and the costs involved, and the opportunity cost of bidding for other projects, and therefore the business case should be funded and delivered by government.
- 6.2.15. It was also suggested that government is in the best position to develop and own the business case, given their close involvement in ensuring the benefits would be delivered through control of franchise services.

6.3. Analysis

- 6.3.1. There is significant market interest in being involved in the delivery of SRLtH and a range of risk appetites. We have heard that the rail and finance markets have the capability, and are ready and willing to deliver, given the right conditions.
- 6.3.2. The market is used to forming consortia for the delivery stage of complex projects, in which designers, construction contractors and financiers collaborate to manage and share risks. The market could be invited to form similar consortia earlier during the development stage, to capitalise on the expertise of the different parties to seek to add value and efficiency to the later project stages.
- 6.3.3. The incentives for earlier market involvement in the development stage need to be considered alongside the benefits this might be expected to yield in the longer-term delivery of the project, and the risks to government of potentially engaging 'too early', before the scope of the project is sufficiently understood.

6.4. Recommended next steps

- 6.4.1. Given the likely dependence on passenger revenue funding and integration with existing franchises, DfT should consider the relationship between the private sector developing SOBCs and their ownership of benefits. Where DfT needs to retain control over project benefits, it should take this into account when determining its involvement in development of SRLtH business cases.
- 6.4.2. The project delivery market is mature with several capable organisations ready to form consortia to deliver complex projects. DfT should consider this when assessing the options for involving the private sector in development.

7. Structuring the development and competition process

7.1. Introduction

- 7.1.1. We sought views on how to structure a development and competition process for SRLtH. We also asked for views on the appropriate depth and timing of a more detailed output specification.

7.2. Summary of responses

How to structure the development process

- 7.2.1. The majority of respondents expressed views regarding the development/procurement process, with most proposing that an early, single-stage selection process would elicit the greatest interest from the market. Several respondents cited 'Pathway D' (as described in the Briefing Document) as indicative of their preferred approach.
- 7.2.2. Where there was private sector appetite for earlier involvement in the development process, this was linked to having a preferential option for involvement in the later, more significant construction and operating phases. Several respondents identified examples where the private sector has been engaged much earlier in the development process in other industries such as energy and health. A recent example cited in the rail industry is the earlier involvement of train operators in the procurement of the Wales and Borders concession. We heard that internationally, it is not uncommon for contractors to be involved in business case development, with an incentive of a competitive advantage in the later delivery stages of the project.
- 7.2.3. Several respondents indicated their interest in the development, design, delivery, operation and maintenance as a complete package of work, suggesting that this would bring the greatest level of innovation and efficiency i.e. by involving one party early, with a vested interest in the ultimate outcomes of the project, and a 'stake' in project success.

- 7.2.4. Some respondents preferred a two-stage process; on the basis that early development of the project required different skills and expertise to the design, delivery and operation. Multi-stage procurement was however not favoured by the majority, and was described by some as “unnecessarily bureaucratic”. Some parties stated that they would not have an appetite to develop the project unless they were given an option to also design and deliver it. In cases of multi-stage procurements, they would prefer to delay their involvement until the higher-value design and delivery stages.
- 7.2.5. Several respondents identified that a two-stage procurement could be made more attractive if involvement in the early development stages did not preclude bidding for later stages.
- 7.2.6. Respondents suggested the desirable features of a development process are:
- Clarity of and adherence to timescales with a clear end-to-end process.
 - Ease of access to the ‘procuring authority’, to Network Rail and DfT.
 - Ease of access to any relevant data held by DfT, Network Rail, and other key stakeholders.
 - Clarity of roles and responsibilities.
 - Clarity of evaluation criteria to minimise subjectivity.
- 7.2.7. Respondents also suggested the undesirable features of a development process are:
- High and unrecoverable costs of participation.
 - Too many bidders being allowed to progress at each stage.
 - Slow pace of decision making or unreliability of adherence to programme.

Drivers and timing of a development process

- 7.2.8. Respondents identified the following arguments for undertaking an early procurement process:
- Better compliance with EU Procurement law, which does not specify the stage at which public works must be competed.
 - Lower cost for bidders, meaning that more are likely to participate.
 - Greater innovation opportunities due to a less prescribed solution. A greater likelihood of 'disruptors' which could change the way the industry does business.
 - Lower cost of bidding means higher margins for contractors, which enables them to deliver greater innovation. Tight margins result in risk-averse behaviour which is not conducive to finding innovative solutions.

Output specifications

- 7.2.9. During discussion with some respondents, we clarified that government had made a presumption that in order to run a competition for development of a scheme, some form of output specification would be required. We heard a range of views as to how detailed such an output specification should be.
- 7.2.10. Generally, we heard that the output specification should be determined early and be protected from major changes, allowing for maximum innovation through the later development stages.
- 7.2.11. However, some respondents were keen to see a competition based on the strategic aims only, and not an output specification, with the evaluation based on 'outcomes to society'. Such a competition might compare different ideas, whilst remaining agnostic to specific solutions.
- 7.2.12. A high-level output specification was suggested to include maximum and minimum thresholds for the following key criteria:
- Trains per hour
 - Availability requirements of the railway
 - Failure rates for the infrastructure on the railway
 - Journey times between certain key points
 - Reliability requirements

7.2.13. Where respondents called for a more detailed output specification, suggestions included:

- Clarity of route requirements and markets to be served.
- Recognition of the transport needs of the wider country and sub-region, not just the South-West London/Heathrow markets.
- Consideration of passenger ticket prices, and integration with national and regional fare structures.
- Consideration of wider objectives including housing and employment locally and nationally.
- Consideration of attracting new investment, supporting exports.
- Carbon impact and reduction.
- A weighting between transport benefits and wider economic benefits.

7.3. Analysis

7.3.1. The market was broadly consistent in its response as to how to structure the development and competition process, in particular:

- They want to see a greater level of project definition, but not so much so as to stifle innovation.
- They want to compete early in the development process, and to compete only once.

7.4. Recommended next steps

7.4.1. Government will need to assure itself of the regulatory constraints, benefits and risks of taking a different approach to developing SRLtH, particularly if the requirement is for government to retain an operational, reputational and strategic stake in project success. For example, the benefits of selecting a promoter under an early single-stage procurement would need to be demonstrably better value than a traditional staged competitive process.

7.4.2. The lessons learnt from other similar projects such as Euston Station Commercial Development, East West Rail Co and the Wales and Borders railway should be considered, as well as examples from other sectors.

- 7.4.3. The findings of this market sounding have provided significant input that will help to inform the case for undertaking a development approach that has greater involvement from the private sector. Government should consider the capabilities and resources required within the DfT and Network Rail to ensure the benefits of an alternative approach are realised.
- 7.4.4. As it has emerged from the market sounding that government is an assumed guarantor of track access charges for heavy rail schemes, this means that DfT is likely to be considered as the core funder for balance sheet purposes. DfT should therefore consider the benefits of providing a more detailed output specification including essential or minimum requirements, to ensure its wider strategic aims are met whilst still encouraging wider market participation. This is in contrast with an approach where the supply market is given freedom to interpret higher-level strategic aims to allow for greater innovation.

8. Barriers and enablers to sharing risk of development

8.1. Introduction

- 8.1.1. We sought views from the respondents on the barriers which would prevent them from participating in a future competitive process, and whether there were any particular undertakings or enablers from government which would encourage the development of scheme proposals.
- 8.1.2. We also asked for views on an idea of Network Rail providing a ‘comparator scheme’, and whether respondents had any particular concerns regarding Intellectual Property.

8.2. Summary of responses

Barriers

- 8.2.1. The most common barrier we heard to sharing the risk of the development process, was the notion of the private sector developing their ideas at their own cost, to subsequently have those ideas opened up to competition. In some cases, this was referred to as the need to ‘protect intellectual property’.
- 8.2.2. There is some market appetite to develop ideas at risk, however, a high number of competing bidders would be a significant barrier as it reduces the likelihood of their organisation being chosen to take their ideas forward.
- 8.2.3. Some respondents, although not all, saw the current lack of project definition as a barrier to getting involved, stating that they would need at least a high-level project definition before taking part in a competitive process.
- 8.2.4. A lack of a clear development process was also cited as a barrier, in particular the risk of delay or slow decision-making causing the private sector to lose confidence in the development process. This would make it difficult, for example, to form joint ventures or find finance partners. Some respondents indicated that they could have developed relationships with financiers further, if the development process and timescales were more readily available.

- 8.2.5. We heard that a lack of a development framework would make it difficult for parties to assess and apportionment risk between themselves and others. We heard that in order to encourage participation in the project, the roles of the respective parties would need to be clarified, as well as the appropriate apportionment of key risks such as changes to political stakeholder support, revenue risk, Development Consent Order (DCO) risk, and ground condition risk.
- 8.2.6. Subjective or poorly defined evaluation criteria were also cited as a barrier to participation. Although some parties would welcome less specific criteria, it was suggested that there should still be a clear process for selecting parties, even if on a subjective basis.

Enablers

- 8.2.7. The most common enabler cited by respondents was the need for a government-backed ‘usage’ or ‘track access’ undertaking which would guarantee income on any new route, and insulate the private sector from passenger revenue risk. In the cases of the alternative non-heavy rail proposals, the enabler was sufficient political support from government.
- 8.2.8. Another enabler suggested was to ensure alignment of the strategic aims for SRLtH with those of key stakeholders, such as HAL and the local authorities.
- 8.2.9. Respondents asked for clear guidance on the next steps as a key enabler to advancing the project. There were several suggestions for what this guidance could include:
 - Clarity of how a ‘level playing field’ will be achieved, given the relative maturity of some project proposals.
 - Guidance on the required regulatory process and statutory requirements for SRLtH.
 - Guidance on the future franchise arrangements for SRLtH, for example whether the train service will be delivered by a new or existing TOC.
 - Guidance on the requirements to become a new Infrastructure Maintainer/Manager.
 - Clarity of roles including who will be the ‘procuring authority’.

8.2.10. Respondents were also keen to have access to a greater range of information, perhaps provided via a 'data room' or similar. This following additional information was identified:

- Asset condition and planned renewals.
- Health, safety and environmental information, including local planning & heritage constraints.
- Network Modelling information and train pathing scenarios, including passenger predictions.

Network Rail Comparator Scheme

8.2.11. The notion of developing a Network Rail 'comparator scheme' was generally not popular with respondents to the market sounding. Whilst they could see some merit in de-risking the development process for DfT, it was generally seen as an inefficient use of time and money.

8.2.12. During discussions, we suggested that a Network Rail comparator could be used as an informative source of data and technical or operational solutions during the development phase. Respondents general view was that this is already the role of Network Rail as System Operator.

Intellectual Property

8.2.13. As discussed previously, there were significant concerns about the protection of ideas by the private sector. We heard that parties would be significantly dissuaded from developing innovative solutions during the early development stages if there was a risk that their ideas would subsequently be shared and open to wider competition.

8.3. Analysis

8.3.1. Any development process which is promoted by government, will need to take account of the concerns regarding 'sharing' of ideas or Intellectual Property, if optimal solutions are to be found.

8.3.2. Given that most private sector respondents are incentivised commercially to participate in projects, or will need to work closely with other commercial organisations, it is important that the next steps of the development process recognise and respect commercial drivers. Slow decision-making, lack of resource consideration or unpredictable process outcomes are all potential barriers to private sector organisations gaining corporate approval to participate.

- 8.3.3. There is also a trade-off that needs to be understood by DfT between providing greater levels of guidance on the next steps, and inadvertently ‘narrowing’ the opportunities to add value during the development process through innovation.

8.4. Recommended next steps

- 8.4.1. The confidence and appetite of the market to participate in the next stages of the project should be materially improved by the publication of a process and timescales that will enable those interested to prepare, resource and engage with partner organisations. DfT should consider this factor in their publication of next steps, and include further guidance on how SRLtH will be developed, and competed.

9. Annex A – Market sounding participants

9.1.1. Our special thanks to those who contributed to the market sounding:

Arcus Infrastructure	Mace
Bechtel	Maglev
Costain	MTR
Dentons	Siemens
Dragados	Spelthorne BC
Dragados/Iridium	SPL Powerlines
East West Rail Ltd	Surrey CC
Ferrovial/Cintra	Thames Valley Berkshire LEP
Hawkins\Brown	Thames Valley Chamber of Commerce
Heathrow Airport Ltd	Transmission Investment
Heathrow Southern Railway	TXM Rail
Hounslow Council	Vinci
KBR	Windsor Link Railway
Laing	

10. Annex B – full questionnaire



Southern Rail Link to Heathrow - Market Sounding Questionnaire

On behalf of the Department for Transport

June 2018

Introduction

Purpose

The Department for Transport (DfT), together with its advisers Nichols/Agilia, are conducting a Market Sounding with potential promoters, funders, financiers, developers, and other industry participants to assess the market interest in the Southern Rail Link to Heathrow (SRLtH) project.

The purpose of this Market Sounding is to collect ideas and views from interested organisations that will help shape the next stages of the project, and in particular, inform the project development and any future procurement process. The scope of the Market Sounding does not include the review, assessment or comment on specific ideas or schemes.

The aims of the Market Sounding are to:

- Understand different interests of the market in the project
- Build a picture of the potential market; its size and characteristics
- Explore the potential for unlocking alternative sources of funding
- Test the appetite to share risk through the development stages of the project
- Understand the merits of different development and procurement routes, to inform the next stages of project development

This questionnaire

This questionnaire forms a key part of the Market Sounding. Its purpose is to invite views and insight from interested parties in a structured format. We may contact you after receipt of your questionnaire to seek further information or clarification through a structured meeting. Nichols/Agilia will assimilate non-attributable responses from respondents into a summary report for DfT. We hope this means you will express your views openly. The DfT intends to publish the non-attributable Summary Report in Autumn 2018.

To provide respondents with some relevant background, we have produced a Market Sounding Briefing for SRLtH (the 'Briefing Document'), which is referred to throughout this questionnaire. This Briefing Document

includes information on government's new approach to rail investment, the Strategic Aims of the SRLtH project, and future business case considerations.

Please return your questionnaire, preferably as a Word document or PDF, indicating your acceptance of the terms and conditions below, to heathrowrailsouthern@nichols.uk.com by Friday 6 July 2018.

Who should participate?

You have received this questionnaire because you expressed an interest in participating in the Market Sounding. Please note that non-participation in this questionnaire or the Market Sounding will not preclude any party or organisation from participating in any later competition process and that any further stages for the project will be announced via a separate DfT Prior Information Notice (PIN).

We would like to hear from any interested party, regardless of their current level of involvement in a proposed scheme. The questions are structured as follows:

	To be answered by promoters (or a consortium representative) <u>who have developed a proposal(s)</u> for SRLtH.	To be answered by any other interested party who <u>have not developed a proposal</u> for SRLtH.
Section 1: Your interest in the project	Yes	Yes
Section 2: Readiness, maturity and capability of the market (for those with current proposals)	Yes	-
Section 3: Broader maturity and capability of the market (for those without current proposals)	-	Yes
Section 4: Barriers and enablers to sharing risk	Yes	Yes
Section 5: Structuring of the development process and competition stages	Yes	Yes
Section 6: Other considerations	Yes	Yes

Strategic Aims

The DfT's Strategic Aims for the Southern Rail Link to Heathrow (as well as the Western Rail Link to Heathrow) are to:

- **Encourage modal shift and reduce road congestion:** Providing regular services to encourage air passengers and airport employees travelling to and from Heathrow to transfer from road vehicles to rail, contributing to reduced road congestion.
- **Reduce environmental impacts:** Reducing reliance on private vehicles and taxis in these key markets to deliver net air quality, noise and greenhouse gas benefits as users transfer from diesel and petrol vehicles to sustainable transport modes.
- **Minimise the impact on current and future passenger and freight journeys and services:** The scheme should not be at the expense of non-airport journeys, or undermine the ability of the network to meet future background demand.
- **Connect communities:** Improving connectivity and providing new journey opportunities, especially to areas of high demand and where limited options mean that a low public transport mode share currently exists. To provide greater choice of surface access mode, competitive generalised journey times and increase reliability of journeys.
- **Boost economic growth and encourage regeneration:** Providing greater accessibility to employment locally, nationally and internationally, facilitating catalytic impacts, and improving productivity and outputs in the UK economy.
- **Enhance our global competitiveness by making Britain a more attractive place to invest:** The transport sector makes trade possible. Investors need effective international connections to access new markets, integrate operations into their global supply chains and to conduct business efficiently. The UK is already well placed to meet these needs, but we are in constant competition with other countries to attract global business.
- **Be deliverable:** The safety impact of the enhancement for our railways will be paramount. Government will also be mindful of the implications for, and impacts on, the reliability of the network and the provision of services that delivery of the enhancement might have both during construction and after implementation.
- **Be affordable and value for money:** To maximise operating surplus, to reduce the need for public subsidy. To levy contribution to the capital costs of the scheme in order to provide value for money for rail customers and taxpayers.

Terminology

Financing in this context means the provision of either equity or debt capital to meet the cost of the development and construction phases, which then needs paying back over time from the cashflows of the project, with a return, at a later date. It spreads the need for funding over time.

Funding in this context means the ultimate source of capital contributions to meet the cost of a project, which are not paid back or are recovered through other means. Contributions can come from multiple funders who derive their own benefits from a project. These benefits may be either related to the use of the railway (transport benefits) e.g. fare paying passengers or railway access charges, or non-transport related from parties who benefit from new rail infrastructure e.g. developers, local authorities, airports.

Balance sheet treatment refers to how the finance related to a scheme is categorised within government budgets. Finance that is ‘on balance sheet’ counts towards government debt/deficit according to government accounting rules. As a result, budget has to be found, from within existing government spending plans, to cover spend upfront. Finance that is ‘off balance sheet’ means it does not count towards government debt/deficit, and effectively means that the cost can be spread over time. Even where private finance is used, it can still be ‘on balance sheet’ from a government perspective. The accounting treatment is related to the level of risk that is taken between the public and private sectors (i.e. strong risk transfer to private sector would tend to allow assets and the finance related to them to be ‘off balance sheet’).

Market-led proposals (MLP) guidance is the guidance issued by the DfT on 20 March 2018. A market-led proposal is a project promoted by the private sector which addresses an opportunity which is endorsed by government, but might not otherwise be taken forward by the DfT. The guidance provides the overarching framework for harnessing private sector involvement in projects. As SRLtH has been identified by DfT as an opportunity, it is now in the ‘Determine’ stage (see Project Stages below).

Project stages in this context are Determine, Develop, Design and Deliver. These are taken from DfT’s Rail Network Enhancements Pipeline (RNEP) and MLP guidance.

‘Project development’ or ‘development process’ are general terms to refer to the early stages of the project, prior to commencing on-site delivery. It may include different competition or procurement stages.

SOBC and OBC are the Strategic Outline Business Case and Outline Business Case, as defined in HM Treasury’s Green Book Guidance.

Terms and conditions of the Market Sounding

Before participating in the Market Sounding, we require that you confirm acceptance of the following terms and conditions:

1. In line with the principles set out in the Rail Network Enhancements Pipeline, the Department is under no obligation to progress SRLtH. Our engagement with any participant is on a ‘without prejudice’ basis and without any obligation or expectation. Our engagement with any participant does not constitute any implied or express support or favour either for any proposed schemes or for SRLtH more generally.
2. The Department has not, and will not at this stage, make any undertakings to any participant whether in relation to future funding streams or commitments to any proposed schemes or a SRLtH scheme, or in any other way.
3. Any statements made by, or on behalf of, the Department shall have no effect, save where made expressly in writing.
4. The Department remains committed to the principles of openness, transparency, impartiality, propriety and integrity.
5. The Department does not currently recognise any Intellectual Property right (“IP”) attached to the concept of SRLtH or any proposed scheme. The Market Sounding process is not seeking detailed descriptions of proposed schemes. If you consider that you have IP in any concept or design, etc., it will not be necessary to share it with the Department at this stage.
6. The Department is bound by the provisions of the Freedom of Information Act 2000 (“The Act”). Where it is reasonable to expect that information, if released, would be likely to prejudice the interests of any person, the Department will treat the information as confidential, insofar as section 41 (information provided in confidence) or section 43 (commercial interests), of The Act apply.
7. The Department will, at all stages, seek to protect its duties to secure the optimal solution for passengers and taxpayers. In any future project development process, any SRLtH scheme would need to demonstrate its case against the specified evaluation criteria, including a value for money appraisal, affordability, viability and strategic fit. The evaluation criteria for SRLtH have not been defined.

8. The Department is cognisant of the rules on state aid and relevant procurement law and will comply with them.
9. The Department reserves the right to invite any participant to a follow up meeting to seek further information, context and/or clarification of their views and/or proposal. This will be decided on a case by case basis.
10. By answering this questionnaire, you are deemed to have accepted these terms of engagement unless you state otherwise. If there are any issues that would preclude you from responding to the questionnaire, please notify the Nichols/Agilia team via email to heathrowrailsouthern@nichols.uk.com.

Section 1: Your interest in the project

In this section we would like to understand the nature of your interest in the project and the Market Sounding. Please provide:

- a. Lead respondent name, phone number and email address. Please note that we may wish to discuss your responses in greater detail and may wish to contact you to arrange a follow-up meeting.
- b. Your organisation and key area of business.
- c. An indication as to whether you are answering this questionnaire with your own personal views, or on behalf of your organisation/consortium.

Question 1. Which of the following describes your interest in the project?

- a. An existing promoter (or consortium member) who had been working on a proposal(s) for SRLtH before the Market Sounding PIN was issued.
- b. A new potential promoter (or consortium member) who is interested in developing a proposal(s) for SRLtH, but whose interest is new since the Market Sounding PIN was issued.
- c. A potential funder who is interested in contributing to the overall cost (recognising that this funding may be conditional on certain project outputs being realised).
- d. A contractor who is interested in the design and construction of the project.
- e. A financier who may be interested in providing part of the project finance.
- f. An advisor who is interested in the project.
- g. A stakeholder with a keen interest in the success of the project but not one of the above roles (a to f).
- h. Other interests or specialisms; please describe them.

Question 2. DfT has shared its Strategic Aims for the project, listed above. In your view, what should be the priority objectives for this project?

Section 2: Readiness, maturity and capability of current proposals

You may want to answer this section if you are an existing promoter (or consortium member) with a proposal for a scheme. If not, please go to Section 3.

In this section we want to understand the readiness, maturity and capability of proponents of existing SRLtH proposals, and their fit with the Strategic Aims. We also want to understand the potential for unlocking funding which may reduce the cost of the scheme to the taxpayer and/or fare payer, and the appetite to share risk with the DfT in developing and delivering the project.

To help inform any future development or competitive process, we also want to gain a high-level understanding of your proposals and the capability of the organisations involved. We want to understand the key drivers and incentives and likely output specification for your proposal, rather than use the detail of the proposal itself. The assessment of scheme proposals may take place at a later stage.

If you are part of a consortium, we ask that you coordinate your responses with the other members to avoid duplicate submissions for the same proposal.

Organisations and capabilities

Question 3. Please can you describe what attracted your interest in the project, and your aspirations for being involved?

Question 4. Please indicate if you are working alone or with other organisations. If a number of organisations have worked together to develop your proposal, please list the organisations and describe the roles of each party.

a. If your organisation is working alone, would you consider working with other parties? For example:

- Funders
- Financiers
- Engineering and other contractors

- Advisors

Question 5. Please describe the current capabilities within your organisation or consortium to develop and deliver your proposal, and who provides the capability. For example:

- Technical capability including knowledge of statutory planning, infrastructure project set-up, programme planning, design, delivery, operations and safety management.
- Capability to identify and quantify costs and benefits.
- Capability to develop a business case using the 5-case business model: Strategic, Economic, Commercial, Financial and Management case. (See the Briefing Document for more information on expectations of business case development).
- Capability to develop a financing and funding structure with support from potential investors, including identification of key assumptions: commercial model, private funding sources, financing, regulatory fit, public funding subsidy, government assurances.
- Capability to manage principal stakeholders, such as local planning or transport authorities, Network Rail and the ORR.

Question 6. How progressed is your proposal in terms of development of a commercial structure, for example on allocation of basic risks between different parties (e.g. cost, revenue and demand risks)? If you have developed a commercial structure, please can you provide us with details?

Outline of your proposal

Question 7. Please provide a short summary of your proposal, including where possible:

- Key features of your proposal including assumptions about the type and scale of infrastructure intervention required and the envisaged end-to-end capacity.
- The key benefits of your scheme. Please can you indicate the nature (for example economic, financial, social) and likely scale of these benefits?
- Your thoughts on a preferred route at this point and whether your project is reliant on achieving a preferred route. What leads you to believe this could be the optimal solution?
- Your approach to delivering the necessary infrastructure such as packaging the works and/or interaction with Network Rail.

- What existing rail network assets, if any, your proposal envisages utilising.
- Your approach to train operations, maintenance and any renewals envisaged within your proposal.
- Any non-rail government priorities, for example, housing that your scheme could help deliver.
- Any other key features or dependencies.

Question 8. For each of the Strategic Aims, please identify the extent to which your current proposal has addressed these, or how you would seek to address them at a later stage.

The Strategic Aims are described in the introduction above.

Financing

Financing in this context means the provision of either equity or debt capital to meet the cost of the development and construction phases, which then needs paying back over time from the cashflows of the project, with a return, at a later date. It spreads the need for funding over time.

Question 9. Please describe your approach to financing, or a plan if you have one, for your proposal.

- a. What sort of finance structure is envisaged (e.g. asset backed, PPP-type structure, regulatory, etc.)?
- b. What sources of finance do you envisage and in what amounts/ proportions?
- c. What is the anticipated form of repayment and how are the finance costs, and cost of capital, assumed to be recovered?
- d. What risks would the providers of finance be taking in providing the finance?
- e. What challenges do you perceive in raising finance, on a value for money basis, for the project? For example:
 - Do you believe that there is sufficient interest in the debt and equity finance market for the project?
 - Are there alternative sources of finance that could / should be considered?
 - Is the size of the financing requirement a factor?
 - Any other institutional constraints e.g. sector/ country exposure, resource constraints?

Question 10. What are your assumptions about balance sheet treatment?

- a. Have you considered whether your financing plan will meet criteria for off-balance sheet financing for government?
- b. What principles, assumptions and/or dependencies, if any, underpin that analysis?

Funding

Funding in this context means the ultimate source of capital contributions to meet the cost of a project, which are not paid back or are recovered through other means. Contributions can come from multiple funders who derive their own benefits from a project. These benefits may be either related to the use of the railway (transport benefits) e.g. fare paying passengers or railway access charges, or non-transport related from parties who benefit from new rail infrastructure e.g. developers, local authorities, airports.

Question 11. What appetite do you have to fund the development of an SOBC and/or OBC yourself?

- If none, please indicate why this is the case, or whether there are actions that DfT / NR could reasonably undertake which might change this standpoint, and at what point in the project lifecycle?
For example:
 - A change to the staging, number of participants and/or risk associated with a future competition
 - Structured incentives or criteria
 - A defined output specification

Question 12. Please describe your current assumptions regarding the sources of funding for your proposed scheme.

- a. What are the sources of funding you have envisaged? What scale/proportion of contribution from your own organisation or consortium is assumed?
- b. What revenue streams (rail or non-rail) have you assumed will be part of your funding sources? Would they be provided up front or spread over time? If so, what are they and who holds the risk on this source of revenue materialising?
- c. What challenges do you perceive to attracting non-government funding? What are the key enablers, including from government and other stakeholders, and risks that would be involved?

If you have answered the questions in Section 2, you may wish to omit Section 3.

Section 3: Maturity and capability of the market (for those without current proposals)

You may only want to answer this section if you are not an existing promoter of a scheme.

Organisations and capabilities

Question 13. Please can you describe what attracted your interest in the project, and your aspirations for being involved?

Question 14. With reference to delivering the Strategic Aims, please describe the capabilities within your organisation. For example:

- Technical capability including knowledge of statutory planning, infrastructure project set-up, programme planning, design, delivery, operations and safety management.
- Capability to identify and quantify costs and benefits.
- Capability to develop a business case using the 5-case business model: Strategic, Economic, Commercial, Financial and Management case. (See the Briefing Document for more information on expectations of business case development).
- Capability to develop a financing and funding structure with support from potential investors, including identification of key assumptions: commercial model, private funding sources, financing, regulatory fit, public funding subsidy, government assurances.
- Capability to manage principal stakeholders, such as local planning or transport authorities, Network Rail and the ORR.

Question 15. Would you consider working with other parties to deliver the Strategic Aims? What role would you see yourself and other organisations undertaking?

Financing

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Question 16. What are your views on how to finance SRLtH, on a value for money basis?

- a. What finance models are appropriate, for example asset backed, PF2-type structure, regulatory, etc.?
- b. What sources of finance would be appropriate?
- c. What sort and levels of risks should providers of finance take?
- d. Do you believe that there is sufficient interest in the finance market for the project?
- e. Are there alternative sources of finance that should be considered?
- f. Any other institutional constraints e.g. sector/country exposure, resource constraints?

Funding

Funding in this context means the ultimate source of capital contributions to meet the cost of a project, which are not paid back or are recovered through other means. Contributions can come from multiple funders who derive their own benefits from a project. These benefits may be either related to the use of the railway (transport benefits) e.g. fare paying passengers or railway access charges, or non-transport related from parties who benefit from new rail infrastructure e.g. developers, local authorities, airports.

Question 17. What are your views on how to attract private funding? For example:

- What challenges do you perceive to attracting private funding? What are the key enablers and risks?
- What are the range and scale of sources of funding for the project?
- Do the potential benefits mean that you would consider providing a funding contribution to the development and construction of SRLtH? What is the possible scale of this contribution and what enablers are required? Would this be an up-front contribution?

Question 18. In your view is there a market appetite to produce privately funded SOBCs and OBCs?

Section 4: Structuring the development and competition process

Some example development and competition/procurement pathways are set out in the Briefing Document on pages 11 and 12, for illustrative purposes.

DfT want to hear the market's views about how to structure a successful and appropriate development and competition/procurement process. Such a process will need to:

- Identify the optimal balance of assessment criteria and incentives whilst ensuring compliance with legislation and value-for-money criteria.
- Deal with key considerations such as accounting treatment (whether a scheme is on/off balance sheet may affect value for money considerations), risk transfer at different stages, and key undertakings required of the DfT, for example, the confirmation of train access paths.
- Be commensurate to the size and nature of the possible market associated with the project.

Question 19. Do you have a proposal for a development process that you would like to put forward for consideration?

- a. What are the key features?
- b. Do you believe this is compliant with relevant legislation and would secure value for money?
- c. How does this interact with the key development stages of the project, as described in the RNEP?

Question 20. How might the DfT reasonably structure a development process to gain the best value from proposals? What are the drivers and timing for this? For example:

- What are desirable characteristics that you would wish to see in a development process, with reference to the different RNEP stages?
- What would encourage or dissuade you from participating in the development process or the project?
- How can the development process ensure that best value is achieved from proposed schemes?

- In your view, what are the appropriate roles for the DfT and Network Rail at the different project stages?
- At what stage do you think procurement should take place and what do you have any views on the approach to evaluation of the submissions?

Question 21. What should the DfT consider in creating the output specification for the project? At what stage should this specification be determined, and what inputs would you be willing to provide ahead of any formal procurement?

Question 22. What is your view on the appropriate roles and balance of risk between the private sector and DfT during the production of the Strategic Outline Business Case (SOBC) and Outline Business Case (OBC)?

Section 5: Barriers and enablers to sharing risk

We are interested in the market's appetite to take on the development risk of the project by contributing their time and resources.

Through this Market Sounding, we want to understand if there are any barriers to unlocking these aspirations, and what would encourage parties to come forward with funding contributions.

Question 23. What do you consider are the key barriers to parties sharing the risk of the development process?

- a. Do these change as the development progresses?
- b. What enablers can the DfT put in place?

Question 24. What are the key barriers to parties participating in a future competitive process?

- a. What enablers can the DfT put in place?

Question 25. What, if any, undertakings or enablers are scheme proposals likely to require from government? For example:

- Access to a procurement 'data room'?
- Interface agreements, for example, with Network Rail?
- Related to the financing/ funding of the scheme?
- Particular use of assets or train paths?
- Asset condition information?
- Passenger service information?
- Franchise or network information held by DfT or System Operator?

Question 26. The Department has considered commissioning Network Rail to develop a ‘comparator scheme’ which would be shared at key stages during its development. Such a model could be used to help the DfT de-risk the development process and enable more effective assessment of the relative benefits and dis-benefits of alternatives.

- a. Would this approach affect your appetite (positively or negatively) to be involved in the process? Do you have any further comments you would wish to add?
- b. What might make this useful for you, and at what stage of the development process?

Question 27. We are interested in the appetite of the market to take on the preparation, submission and cost/risk of the statutory planning process (e.g. a Development Consent Order (DCO)? What, in your view are the barriers and enablers to this?

- a. What roles, if any, could other parties play in the planning process? For example, DfT, Network Rail or Local Authorities.
- b. At what stage of the process should this be considered and what decisions or undertakings would you require of government / Network Rail beforehand?

Question 28. Do you have any particular concerns regarding Intellectual Property (IP)?

- a. Do you consider that you have any IP rights associated with any concept or design? Do you expect to have them in the future?
- b. If yes, please indicate whether you have shared this, or intend to share this with DfT?
- c. Are you seeking or will you seek exclusivity for your ideas and at what stage would that be required?

Section 6. Other input to the sounding

Please feel free to raise any further points that you believe should be considered in relation to progressing development of this project, including examples of best practice. We are particularly interested in examples of similarly complex major schemes to SRLtH.

