FitchRatings

FITCH DOWNGRADES NETWORK RAIL TO 'AA'; OUTLOOK NEGATIVE

Fitch Ratings-London-29 June 2016: Fitch Ratings has downgraded Network Rail Infrastructure Finance Plc's (NRIF) GBP40bn multi-currency note issuance programme to 'AA' from 'AA+'. The Outlook is Negative. Fitch has affirmed the GBP4bn short-term commercial paper notes at 'F1+'.

The rating actions follow the downgrade of the UK sovereign credit rating (see 'Fitch Downgrades the United Kingdom to 'AA'; Outlook Negative' dated 27 June 2016 at www.fitchratings.com).

KEY RATING DRIVERS
NRIF's ratings are linked to the UK's ratings (AA/Negative/F1+) due to the Financial Indemnity from the Secretary of State for Transport (SoS), whose liabilities are sovereign obligations of the UK. The Financial Indemnity is an unlimited, irrevocable and unconditional obligation terminating on 3 October 2052.

Under the Financial Indemnity, the SoS has up to 20 business days to meet a claim relating to a note principal repayment, and up to 5 business days to meet a claim relating to a note interest payment or, following the side letter implemented on 19 March 2012, a CP principal payment. The Financial Indemnity states that should NRIF have insufficient cash to cover any upcoming note or CP-related obligation, either the Programme Administrator or Security Trustee is required to submit a claim directly to the SoS. The Note Programme and CP Programme Administrator (Network Rail Infrastructure Ltd) has the continuous obligation to check that any Debt Service Prefunding Accounts have sufficient cash to meet all debt service and repayments of Prefunded Debt due. If there are insufficient funds in the Debt Service Prefunding Accounts, the Administrator must make a claim under the Financial Indemnity.

As such, Fitch is comfortable that the structural support provided by the SoS is sufficient to ensure full alignment of NRIF's ratings with those of the UK sovereign.

In order to reduce financial counterparty risk related to the account bank, HSBC Bank plc (HSBC, AA-/Stable/F1+), NRIF enters into repurchasing agreements with the bank. Under these agreements, prefunded bond redemption amounts deposited by NRIF with HSBC are secured by high quality, liquid government/supra-national debt security collateral posted by the bank, such as UK Gilts or US Treasury bonds. The posted collateral is marked-to-market on a daily basis. Fitch considers that this mechanism would significantly reduce counterparty risk if HSBC's creditworthiness deteriorates in the future.

Following the reclassification as a Central Government body, Network Rail Infrastructure Limited's (NRIL) financing requirements (including the funds needed to repay maturing NRIF obligations as they fall due) for the period to March 2019 are covered by a GBP30.875bn loan facility provided by the UK's Department for Transport (DfT). Therefore, NRIF is not expected to raise additional debt under the note programme or the CP programme, unless the loan facility provided by the DfT is withdrawn or the DfT fails to send funds as and when due. In addition, the Framework Agreement between Network Rail and the DfT says that the DfT will make a decision as to whether to extend the Loan Facility Agreement by April 2017.

RATING SENSITIVITIES

Given that the SoS irrevocably and unconditionally guarantees the full discharge of NRIF's debt service commitments, any further change in the UK's rating would lead to a corresponding change in the notes' ratings.

Contact:
Primary Analyst
James Hodges
Analyst
+44 20 3530 1278
Fitch Ratings Limited
30 North Colonnade
London E14 5GN

Secondary Analyst
Ana Relanzon Camino
Analyst
+44 20 3530 1158

Committee Chairperson
Stephane Buemi, CFA
Senior Director
+44 20 3530 1236

Media Relations: Francoise Alos, Paris, Tel: +33 1 44 29 91 22, Email: francoise.alos@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
Counterparty Criteria for Structured Finance and Covered Bonds (pub. 14 May 2014)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=744158
Rating Criteria for Infrastructure and Project Finance (pub. 28 Sep 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=870967