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Port of Miami Tunnel: Digging deep

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The close of financing for the Port of Miami Tunnel project brings to an end the most tangled PPP procurement process in the US, a market that has produced more tangled PPP procurements than most. The deal spanned the demise of two sponsors, the administrations of two governors, and suffered from the collapse of Lehman Brothers both directly and indirectly.

The project was set to be the first PPP in Florida, and the first availability-based deal in the US. The more straightforward I-595 concession ended up taking both those honours, and provided banks with their education in Florida's approach to PPP. It also softened up the Federal Highway Administration's TIFIA office for the demands of a long-dated availability concession.

The Miami Tunnel could not have happened without TIFIA, a low-cost, long-tenor lender suited to meeting the demands of the availability deal. TIFIA, as on I-595, performs the same role that a long-dated institutional tranche does in Canadian PPPs. The strength of the project's design-build package with Bouygues also recalls the ironclad engineering, procurement and construction contracts that financial sponsors in Canada and elsewhere have used to procure long-dated financing.

But the Miami Tunnel will be best known for the political and financial storms that it overcame. The Florida Department of Transportation (FDOT) first tried to excite interest in the project in December 2005, with an industry meeting in Miami. It issued a request for proposals to bidders in November 2006, after shortlisting all three bidding groups – ABN Amro/Bouygues, Morgan Stanley/FCC and Dragados/Odebrecht.

By March 2007, when bids went in, Babcock & Brown had taken over ABN's North American infrastructure group, including its habit of including the word "access" in its consortium names. Miami Access Tunnel was named preferred bidder on 2 May, with a plan, encouraged by FDOT, to use private activity bonds rather than TIFIA debt to fund construction. Lehman Brothers had provided the sponsors with an underwritten commitment for a wrapped bond, and the sponsors hoped to close by the end of the year.

The first victim of the financial climate was the wrap. The monoline insurers began to falter at the end of 2007, and the sponsors looked instead at an unwrapped deal, though they also began to take seriously the idea of a bank financing or the use of TIFIA debt. The sponsors had a $33.6 million annual availability payment to stay within, and to contend with the city of Miami's lukewarm support for the project. The city was wary of the cost of the project, and its Cuban community objected to the work that Bouygues had performed in Cuba.

Throughout 2008 the project's costs, including fuel, steel and debt, fluctuated wildly, though the sponsors hoped to go to market with a bond deal in September of that year. In July, the sponsors submitted an application for a TIFIA loan. The concession signing deadline, once set for October 2007, had been repeatedly extended, though Lehman's spread commitment had lapsed. Then Lehman Brothers collapsed. Gone, at a stroke, was the project's underwriter and any hope of stable bank debt pricing.

Babcock & Brown's difficulties provided more of a setback than they should have. Again, the personnel running the project found a new home promptly, moving to Paris-headquartered fund Meridiam Infrastructure, whose sponsors include Credit Agricole and Aecom. Other Babcock & Brown staff resurfaced at Amber Infrastructure and Fiera Capital, but Meridiam had the cleanest balance sheet and, crucially, the best set of relationship banks.

FDOT, however, did not feel that it had had enough input into Meridiam's acquisition of the project and announced, in the second week of December, that it would not close the project. The decision may have reflected pent-up frustration at delays to financial close, and also might have reflected the fact that the state's current administration, headed by governor Charlie Crist, did not have the commitment to the project of the previous one, led by Jeb Bush, who viewed the tunnel as a legacy project.

Unlike other projects where the US public sector has turned its back on PPP, opting instead to procure directly, the tunnel was a difficult project for the US contracting community to complete. The city of Miami, for a time sharply critical of the project, now swung behind it vigorously. In April, FDOT went back to Meridiam, saying that it would reopen the process, though saying it would have preferred to reopen the bidding as well, and setting a deadline for financial close of 1 October.

FDOT and the consortium reached commercial close on the project on 2 June, with the TIFIA financing at centre stage. The TIFIA debt is a natural fit for the project, though its inclusion at such a late stage made structuring the deal difficult. But, at 35 years, the same length of the concession, with an ability to defer interest repayments and principal until banks are repaid, and with an interest rate, typically 1bp over the state and local government securities benchmark, or roughly where debt markets were during the frothy period of 2004-7, the financing was crucial to keeping the project affordable.

TIFIA funding can account for no more than a third of the project's cost, and the FHWA prefers that its loans are no larger than those from commercial banks, since it is subordinated – in cashflow, if not in security – to commercial lenders. The total costs of the project are calculated, by including predevelopment work, to be $1.069 billion, though design and construction of the tunnel, according to FDOT, costs $607 million, and the contract is worth Eu440 million ($660 million, when Bouygues announced it), according to the EPC contractor.

The concession involves building, over five years, a 1.2km tunnel between Watson Island, where the MacArthur Causeway, which carries an interstate over Biscayne Bay, is located, and Dodge Island, site of Miami's port. Roughly half the work involves building the twin-bore tunnel, while the remainder consists of upgrades to the roads at either end.

Bouygues is building the project under a fixed-price, date-certain project, one of the few contractors with the muscle to do so, and certainly one of the few that could have stayed committed to its price during the entire period of gyrations in financial markets. Indeed, the availability payments, indexed to inflation, now start at $32.5 million, slightly less than the original bid. Transfield subsidiary VMS is to operate the project under a long-term O&M contract.

While FDOT is likely to influence the extent to which traffic is diverted from existing routes, the project company will not receive any payments linked to traffic volumes. Its fixed costs – providing lighting and ventilation year-round, among other duties – will be higher than for surface routes.

The financing breaks down into a $322 million five-year loan from ten banks priced at 300bp, and swapped to a fixed rate of 6.63% and to be repaid entirely from milestone ($100 million) and final acceptance ($350 million) payments from FDOT, and a six-year loan of $22 million, to be repaid from the first year's availability payments. Alongside the commercial bank debt is a $341.5 million 35-year TIFIA loan priced at 4.31% (on 15 October), to be repaid from availability payments, which has a grace period on interest until 2016, and on principal until 2033, and $40 million in capitalised TIFIA interest.

The ten banks are BBVA (documentation agent), BNP Paribas (administrative agent), Calyon, Dexia Credit Local, ING, RBS, Santander, Societe Generale, UniCredit and WestLB. The grouping is notable for including every French bank of any size, although BBVA won its documentation agent title in large part because it performed a similar role on I-595.

As a result of banks' struggles on that deal to understand the appropriations risk of a Florida PPP, as well as the termination regime that would apply, the bank piece was one of the easier parts of the deal to put in place. However, until the tunnel's 2008 hiatus, both deals were being developed in parallel, and much of the earliest attempts to meet banks' concerns.

The project, at least during its construction phase, is likely to consume substantial lender resources. Even if the project does not encounter geotechnical problems that would require a draw on the contingency, it may need waivers to deal with unexpected conditions. BNP, as admin agent, will work hard to earn its title on the deal.

The construction risk on the deal has been mitigated through the use of a $180 million contingency. Bouygues is responsible for the first $10 million of overruns attributable to unexpected geotechnical conditions, while FDOT would be responsible for another $150 million, and Bouygues the final $20 million. Public and private sectors are satisfied as far as they can with preliminary boring that they have the measure of the somewhat porous ground beneath Biscayne Bay.

Government and sponsor spent much of the last several weeks finalising the insurance arrangements for the project, which covers a hard-to-value-asset, as well as the coverage for items such as tunnelling equipment, which has to be imported from overseas. The sponsors were able, as is standard PPP practice, to pass through some of this risk to the public sector.

The TIFIA loan also presented a last-minute surprise. Unlike the margin on the loan, which is set transparently, the process for setting TIFIA's credit subsidy is more opaque. Traditionally, another part of the US Department of Transportation has allocated money to pay for the credit subsidy, but has capped its support at $20 million. The tunnel fee is likely to exceed this cap, possibly by as much as $5 million, a development that surprised the sponsors. If the fee is set to exclude the available funding from USDOT, sponsors might press for greater scrutiny of the fee calculation. Observers note, however, that the fee seems to be more responsive to market conditions than the banks' standard fee and starting margin of 300bp.

The final kink to the financing came in the last weeks before close. FDOT is the only counterparty to the concession agreement, and relies on separate funding agreements with the city of Miami and Miami-Dade county to meet its milestone, completion and availability payment obligations. The city of Miami balked at the required terms of a $50 million letter of credit to back its contributions to the concession's availability payments. Its insistence on holding a vote pushed back the closing date by two weeks.

The city of Miami and Miami-Dade have together contributed rights of way valued at $55 million to the project, and the city has put up the $50 million letter of credit to bank its contribution to the availability payments. This contribution can either be structured as a lump-sum payment of $50 million plus accrued interest, or a smaller set of continuing payments. The county contributes $100 million in cash, that it has funded with the issue of a general obligation bond, and a $75 million letter of credit, which funds its half of the $150 million geotechnical contingency.

The federal government also provided much more support than it would have had to for a project that used TIFIA from the start. One reason for FDOT's decision to use a PAB allocation was that TIFIA debt would have "federalised" the project, by exposing it to a stringent approvals process and restrictions on labour practices and foreign content. To apply for a federal loan without structuring the project around these rules was daunting. The Obama administration's secretary of state for transportation, Ray LaHood, impressed participants with his willingness to assist with a project that had been championed by not one but two members of the Bush family.

For fans of landmarks, the Port of Miami Tunnel is the first availability deal in the US with no toll component at all. I-595 is tolled, but these revenues do not flow to the concession-holder. The distinction is important, since the project is the first chance that the US has had to consider a private delivery method independent of user charges. FDOT notes that despite the financial market disruptions the price it got from Bouygues is half what it budgeted for. Florida, and other states, hope sponsors, will now start making a cleaner cost-based case for private infrastructure provision. Meridiam's lessons from the tunnel project will be more immediate. It is the preferred bidder on the Limerick Tunnel PPP in Ireland.

Miami Access Tunnel
Status: Closed 15 October

Size: $1.062 billion
Location: Miami, Florida
Description: 35-year DBFO concession to build a 1.2km tunnel and associated access roads
Sponsors: Meridiam (90%), Bouygues (10%)
Equity: $80 million
Debt: $322 million in five-year commercial bank debt, $22 million six-year loan and $341 million 35-year TIFIA loan, $40 million in capitalized TIFIA interest
Lead arrangers: BBVA (documentation agent), BNP Paribas (administrative agent), Calyon, Dexia Credit Local, ING, RBS, Santander, Societe Generale, UniCredit and WestLB
EPC contractor: Bouygues
O&M contractor: Transfield
Sponsor advisers: Davies Ward Phillips & Vineberg (legal – transaction), Greenberg Traurig (legal – Florida), Macquarie (financial – bank debt), Barclays Capital (financial – bond option), Arup (engineer), Willis (insurance)
Banks' legal advisers: Milbank Tweed; Rogers Towers
TIFIA advisers: Hawkins, Delafield & Wood (legal), Scully Capital (financial)
FDOT advisers: Jeffrey Parker & Associates (financial) Nossaman (legal), Parsons Brinckerhoff and TY Lin (technical) and Marsh (insurance)