Latin American Project Bond Deal of the Year 2007

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Lima Airport Partners: Split but pierced

Latin American project bond issues were plentiful in 2007. Amid a crowded field, Lima Airport Partners stood out, as much for its structural complexity as its direct benefit to the sponsor.

The $165 million bond financing refinances a more expensive and restrictive construction financing, and provides additional capital for a second phase of construction at the Jorge Chavez international Airport. The financing, arranged and underwritten by Merrill Lynch, was rated at above the foreign currency ratings for Peru.

The financing was structured around one of the most government-friendly concessions in the Americas, and involved no changes to the underlying concession. It included one useful structural innovation: the replacement of a debt service reserve – a drag on sponsor economics – with an insurance policy.

But the most important factor in achieving a coveted investment grade rating was not so much the result of a suite of external enhancements as the ability to persuade the agencies and investors that the revenues available to Latin airport investors have been undervalued by debt markets.

Lima Airport has a good track record. It serves the world's 28th largest city, and handles over 95% of the country's air traffic. A consortium of Alterra (a Bechtel/Changi joint venture, 42.75%) Fraport (the operator of Frankfurt Airport, 42.75%) and Cosapi (14.5%) took on the concession for a small upfront payment in February 2001, after winning the bid in late 2000.

The three winners received approval for a $106 million financing from the Overseas Private Investment Corporation (OPIC) and KfW in the middle of 2001. In 2002, Alterra bought out Cosapi, but its shareholders began to tire of the airports sector, in part because of their experiences with the stalled Costa Rica airport concession. Lima Airport Partners closed on an expanded 16-year $125 million financing for the airport in November 2003. The expanded financing amount reflects the $12 million that the sponsors had to spend in the first two years of the concession and an estimated $1.2 billion investment that they will need to find over the life of the 30-year build-operate-transfer concession.

Corpac, the government-owned airport operator, and the awarder of the concession, struck a hard bargain. It gets to retain 46.5% of the total revenues of the airport, and receives these revenues before any debt is serviced. So while Peru has enjoyed strong economic growth since the airport was awarded, the private operator has not enjoyed the full benefit of this growth.

The OPIC/KfW financing was closed in the aftermath of the post 9-11 slump in worldwide air traffic, and lender caution was reflected in high pricing and restrictive covenants. But the concession produced Ebitda of Eu20 million ($30 million) on revenues of Eu80 million in 2006, and the first phase of the redevelopment of the airport was complete.

In early 2007, Merrill Lynch's Latin America Infrastructure finance group pitched the sponsor a bond refinancing of the

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multilateral debt. The deal would, in essence, monetise the passenger fees paid by users of the airport, fees to which the previous set of lenders had assigned too high a risk premium.
Merrill Lynch proposed raising an additional $40 million against the concession to fund a second phase of construction, including the acquisition of boarding bridges and an extension of the terminal. The financing would build on its $630 million securitization of payment rights for the IIRSA Sur toll road in Peru, which closed in December 2006.

The refinancing is designed to bring Lima's leverage to levels closer to international norms, particularly the booming European market. To do this, the underwriter needed to persuade ratings agencies Fitch and Standard & Poor's (S&P) that the revenues from the airport are solid enough to justify and investment grade rating.
Fitch rates Peru BB+ foreign currency with a BBB- country ceiling, as does S&P. The $165 million bonds are not unique, since other issuers, particularly those with dollar export revenues, often achieve the same rating. Airport issuers, particularly those where revenues do not stay out of the country, find it more difficult to do so.
The financing rests on the idea that the dollar revenues remitted to the concessionaire and promptly paid on to an offshore trust for the benefit of bondholders, and the ringfencing of the concession's health from that of its operator, can boost the rating to the country ceiling.

But the deal was assembled against the backdrop of a looming renegotiation of the concession's terms. While none took place before the close of financing, sponsor and government were negotiating rebalancing the concession to allow for a more generous split in exchange for greater or accelerated investment at the airport. The agencies did not assume any benefits to the concessionaire from the process, though any improvement in Ebitda margins from their present 23% would be very welcome.

The other main innovation in the financing was the replacement of the debt service reserve account, which essentially leaves a large chunk of bond proceeds inert in an account for the benefit of bondholders rather than available for capital expenditures, with an insurance policy. This policy, with a Merrill Lynch subsidiary, costs the borrower a premium, and is available to bondholders if needed.

The bonds priced for a coupon of 6.88%, but were all bought by Merrill Lynch, and serve as food for its derivatives trading operations. Were there to be substantial positive changes to the concession terms or an upgrade to Peru, a long position in the bonds could record substantial gains.

Fraport bought out Alterra's stake in the airport in August 2007, paying $36.8 million. It will look at selling on 40% of its holding to a mixture of the International Finance Corporation and Peruvian investors. Completing the refinancing gives it a much better proposal to send out on roadshows.

Lima Airport Partners
Status: Closed July 2007
Size: $165 million
Location: Lima, Peru
Description: Securitization of revenues from Jorge Chavez airport, the country's largest
Sponsor: Fraport
Sole bookrunner: Merrill Lynch
Maturity: 15 years
Coupon: 6.88%
Traffic study: SH&E
Offshore trustee: Bank of New York
Onshore trustee: Citigroup
Bookrunner legal: Mayer Brown (international) Estudio Rubio, Leguía, Normand & Asociados (local)
Borrower legal: Clifford Chance (international), Rebaza, Alcazar & De las Casas (local)
Insurance: Moore-McNeil

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