

# Tunnel visions

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When the Greek State launched an ambitious nationwide road programme in 2001, it could draw on the experience of some, already successfully closed, PPP-style infrastructure projects (such as the Athens Airport, the Rio-Antirio Bridge and Attiki Odos, the Athens Ring Road). The Greek Authorities decided to further develop concession based financing schemes relying on joint funding by the Greek State, EU and private sector investors. Six road projects representing a total investment volume in excess of Eu7 billion have been tendered and all construction works were initially planned to have started by mid-2006 with all project works being finalised by 2012 at the latest.

The purpose of the road programme was to upgrade the existing motorway network in Greece in a move to meet EU standards and to increase road safety. This, most importantly, is true for the PATHE-Road link connecting the cities of Patras, Athens, Thessaloniki and Evzoni to this major Greek road axis.

The programme also includes the construction of new highways, such as the completion of the Korinth-to-Kalamata motorway (KTK) across the Peloponnese, the motorway of Central Greece (E65) and the Ionian Road, the highway link in the Western part of Greece connecting the city of Ioannina to the Rio-Antirio Bridge, and the Thessaloniki Submerged Tunnel (TST), an inner-city immersed tunnel passage to alleviate the significant traffic congestion in Greece's second city.

It took until end of October 2006 before the documents for the first project – the Thessaloniki Submerged Tunnel – were signed and almost one further year to reach the formal concession commencement date on 1 August 2007.

The reasons for the delay in the programme are many. Initially, delays arose from the finalisation of environmental and technical studies on behalf of the tender authorities and there were extended negotiations to finalise project and finance documentation for each concession scheme after preferred bidder stage. Furthermore in several cases the final tender award process was impacted due to legal challenges from losing bidders following announcement of preferred tenderer.

The elections in 2004 brought a change to the ruling party and the government, and the formal approval process that requires ratification of the concession agreement by the Greek Parliament and the necessity to obtain State Aid clearance by the EU (more the latter) turned out to be lengthier than originally envisaged. Lastly, the fact that the eyes of the world were on Greece as host to the 2004 Summer Olympic Games required considerable concentration of many of the Programme's participants on this event.

Despite much negative speculation about construction delays and cost overruns before their ceremonial opening, the 2004 Olympic Games became an overwhelming success. Similarly, the ambitious Greek highway programme is also now showing signs of becoming another success story after passing through a long period of doubts and set backs.

In the last quarter of 2006 the documents of TST and the Ionian Road were signed; followed by KTK, the E65, Maliakos-Kleidi and Corinth-Patras by mid summer 2007. Subsequent to the signing of the Concession Agreement and all major project documents a period of four months is foreseen during which the Greek State has to obtain the ratification of the concession by the Parliament and reach clearance by the EU Authorities concerning state aid (as defined in Article 87(1) of the EC treaty). These are conditions precedent that are in the responsibility of the State in order to achieve the formal concession commencement date. In parallel the concessionaire has to satisfy those conditions precedent required under the finance contracts so that the concession commencement date can occur. Usually this will also be the date when the

first drawdown under the debt facilities becomes possible.

It has turned out that the 4-month time period is hardly sufficient and thus far only TST has achieved the formal concession commencement. However, there are three main factors that should ensure the future success of this road programme and other PPP projects in general.

### **(i) Reasonable risk allocations facilitate financing**

The six projects are based on concession agreements which to a large extent share similar features. An evolution has been evidenced in respect of issues that have a strong impact on the bankability of the projects, substantially as consequence of consultations with the various bidders and their financiers driven by market resonance in relation to the fore-running projects. For instance, the allocation of interest rate risk: In TST the Greek State assumes the risk for interest rate variations from the date of bid submission until the date of the execution of the concession agreement. As indicated above, the signing of the concession agreement does not yet constitute concession commencement or availability of finance and evidence so far shows that it takes several months until the start of the project actually occurs. This leaves the concessionaire with no option but to close complicated interest rate hedges assuming a project start date which is not certain or to bear the full risk of adverse interest variations from the date of signing.

This problematic issue was amended by the tender authorities in relation to all subsequent projects starting with KTK, in a way that the Greek state has extended its respective risk assumption in relation to interest rate variations up until the State has met all conditions precedent which are under his responsibility for achieving the concession commencement date.

Overall the concession agreements are considered to be fairly balanced and according to Western European standards. They draw on the experience made on the previous projects awarded in Greece and highlight the willingness of the Greek state to promote bankable projects. Furthermore they document the political will to attract the interest of the private sector whilst not seeking to pass to it unreasonable risks. A further positive element, the compensation formulae, for instance, describe in a transparent and detailed manner the amounts owed by the state to the lenders in a variety of default cases, thus dealing with significant risks inherent in such projects in a bankable manner.

The concessions carry a tenor of 30 years and in all cases the Greek state puts significant and diversified financial support in place to subsidise the projects. A common element of all projects is a State Financial Contribution, a non-repayable grant to support construction costs. The payment is linked to the achievement of partial deadlines part of which are set by the state and others to be defined as part of the bid-evaluation criteria. In some of the projects the state supports the operating cash flow by way of combining toll revenues from existing (brownfield) sections of a motorway as part of the concession scheme to enhance the debt service capacity of the new (greenfield) sections to be constructed. In other projects the tender documents provide in addition for the possibility to include direct cash payments by the State after the construction period in form of an operation subsidy. Revenues exceeding the initial assumptions will have to be shared with the State. The amount and the timing of the operation subsidy or the structure of the revenue sharing have been part of the bid evaluation criteria thus being subject to the competitive selection process.

### **(ii) Solutions to withholding tax issues**

A key issue for all infrastructure projects in Greece, is to find a way around the Law 128 levy and to avoid potential withholding tax costs. In a traditional financing based on one or more syndicated project loans, withholding tax (generally 35%) would apply for all non-Greek resident lenders. In order to avoid this, lending needs to be made out of a country that has a double-taxation treaty in place with Greece (e.g. for UK based lenders the tax rate is zero percent). Alternatively, the 0.65 % p.a. Law 128 levy can be avoided if the European Investment Bank (EIB) is involved or when the financing is structured as a so-called, bond loan.

The law on bond loans, securitisation of claims and real property claims and other provisions – the Bond Loan Law (law 3156/2003) – was ratified in June 2003. The law provides the framework for corporate financings by way of issuance of bonds which despite the name remain a bank debt rather than a true capital markets instrument. Incurring debt on the

basis of a bond loan structure not only allows cheaper funding but also provides benefits with respect to the arranging of security.

Under a bond loan financing, the loan is represented by a certificate (the bond) which makes it a negotiable debt instrument. The clauses in the documentation of a bond loan in many cases carry features which are similar to and typical for a syndicated loan, although there may be more documents required and the issuance of physical bond certificates will make the administrative procedures with respect to the handling of the bonds more complex. However, the bond loan structure can provide in many cases cost advantages and last but not least more easily facilitates the involvement of international, non-Greek resident financiers.

While the financing of TST features traditional senior project finance facilities provided by commercial banks and an EIB loan supported by commercial bank guarantees, the Eu850 million financing for KTK has broken new ground. For the first time a bond loan structure was selected for an infrastructure financing and can thus be more freely syndicated to a wider group of international financial institutions. The EIB also contributes significant funds to the KTK project assuming direct project risk as there are no commercial bank guarantees in place.

**(iii) The establishment of the new PPP Law**

In the wake of these large road projects and obviously capitalising on the experience thereof, the Greek Parliament passed law 3389/2005, the PPP-Law, in September 2005, which sets the framework for future PPP projects up to a total contract value of Eu200 million. This is another firm statement in favour of a collaboration of public and private entities to realize construction projects of public interest. As the Greek Minister of Economy and Finance, George Alogoskoufis, puts it: "We believe that public-private-partnerships (PPPs) will have a key role in the creation of new infrastructure and the provision of better services to the citizens of Greece.... We recognise the need to make Greece an attractive PPP market for domestic and international participants, such as contractors and banks."

There are a number of aspects in which the new law strives to ensure a transparent procurement process, eliminates procedural obstacles and intends to provide guidelines generally accepted by market participants. Amongst others the necessity for ratification by law was abolished. Within the Ministry of Finance two committees (a Special Secretariat for PPPs and the Interministerial Committee for Public Private Partnerships) were established with the purpose to follow up on potential PPPs, to build up the relevant expertise in order to function as a centre of competence and to approve PPP projects. This all shall result in boosting the realisation of necessary infrastructure investment despite the constraints on the public budgets. Throughout all sectors the existing deal pipeline is promising with a number of pilot projects currently out to tender.

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