

The road to Moscow

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In late August the second of four autobahn concessions was awarded to a joint venture between Hochtief PPP Solutions and Vinci Concessions. The two will renovate and extend an existing road in the state of Thuringen, to create a new 45km stretch of highway which they will operate for 30 years.

Two more of these A-Model concessions will be awarded during 2008, bringing to an end the initial programme of four pilot projects initiated by the Federal Ministry of Transport, Building and Urban Affairs.

With a limited supply of domestic projects slowly moving forward, German sponsors are understandably continuing to increase their international activities, and Russia is coming into view as having huge potential in the near future. But German companies like Hochtief and Bilfinger Berger will be facing tough competition in the Russian market from Austrian construction giant STRABAG, which already generates most of its revenues from the German and Russian markets.

Earlier this year STRABAG set up a Russian project development joint venture with Deutsche Bank, and the combination of the two makes them well placed to not only win business in the booming Russian real estate sector (notably hotels and office buildings), but also to put in a strong challenge on upcoming Russian toll road PPPs.

German deal flow finally picks up

After several years of planning, the A Model autobahns in Germany have finally come to fruition during 2007. Under these schemes, the concessionaire undertakes to widen (from two to three lanes in both directions), refurbish, maintain, operate and finance a number of stretches of motorway across Germany.

The concessionaire is entitled to that part of the statutory HGV toll that is levied while the vehicle is on a particular stretch of autobahn, plus an initial subsidy if required.

When inviting tenders, the German government allowed bidders to make a list of possible negotiating points in their tender documents, but understandably bidders felt that making too many representations would undermine their chances of winning. Thus it is felt that the government succeeded in attracting competitive bids in spite of leaving project sponsors to carry the traffic risk.

The past five years has seen a global environment of exceptional appetite for infrastructure assets, leading to aggressive bids from project sponsors, thin bank debt margins, and high secondary market prices for assets. But after the bursting of the private equity bubble earlier this year, followed by the global disruption on financial markets over the summer, it remains to be seen whether the risk appetite will be so strong going forward.

To some extent the four pilot projects in Germany have benefited from a scarcity effect, with all the big PPP players wanting to establish themselves with the A-Model programme. But if Germany is going to press ahead with a sizeable programme of motorway extensions the A-Model may yet have to be altered.

A-Model – a template for the future?

"In the A-Model schemes, a high level of traffic risk is transferred to the project companies, and therefore also to the lenders," says Dr Christian Knuetel, partner at Lovells in Frankfurt. "The concessionaire bears full traffic risk, subject to very limited carve outs, and there is no floor to be paid if the road is available but there is no HGV traffic."

"The A8 project reached financial close in April, a preferred bidder was recently named on the A4 concession, and there are two more A Model projects likely to be awarded during 2008," says Knuetel. "However, it is not yet clear whether the concession structure used on these four projects, which carry quite a high level of risk relative to projected returns, will be suitable for toll road projects in the future."

The concession on the A8 between Augsburg and Munich was awarded to Autobahnplus, and involves the widening of 37 kilometres of motorway, with a construction cost of around Eu250 million. The A8 is an important corridor in southern Germany belonging to the Trans-European Network (TEN).

The Autobahnplus consortium comprises BAM PPP (part of the Royal BAM Group of The Netherlands), Trapp Infra Wesel (VolkerWessels), Fluor Infrastructure, Berger Bau and Egis Projects. The A8 client is the Motorway Authority for South Bavaria on behalf of the Federal Ministry of Transport.

Tolls are paid on trucks over 12 tons, depending on the number of axels and emissions, and vary between Euro 9 cents and 14 cents per kilometre. The toll is not levied by the concessionaire, but by the national electronic system Toll Collect, and passed on via the government entity VIFG to the concessionaire.

In the last week of August the preferred bidder was announced on the second A-Model motorway concession, this time the Hoselberg stretch of the A4 motorway which runs between Gotha and Eisenach in the state of Thuringen.

The winning consortium comprises Vinci Concessions and Hochtief PPP Solutions, and the two will not only do renovation work, but also build a 25 kilometre extension to the motorway, with the four year construction period beginning in October.

Strong tender competition

Names such as Vinci and Hochtief will also be likely to put in competitive bids for the next two A-Model concessions, though they are likely to face some tough competition from players such as Bilfinger Berger and STRABAG.

STRABAG itself faces strong competition from German project developers in the Austrian market, where the Bonaventura concession, involving part of the A5 highway from Vienna to the Czech border (and on to Prague), is being developed by a consortium led by Hochtief PPP Solutions.

Hochtief has more of a global focus, having been very active with toll road projects in countries such as Chile, Argentina and Australia. Within Europe, in July Hochtief was part of a consortium (along with Vinci) which won two Greek highway concessions with a total investment volume of Eu3 billion.

Similarly, Bilfinger Berger has taken a global approach to sustaining growth, and has a sizeable portfolio of projects in Australia and Canada. Its track record in Europe includes the M6 in Hungary, as well as being one of the sponsors of the Roads Service Project DBFO 1 in Belfast, Northern Ireland.

In contrast, STRABAG has maintained a strategic focus within Europe, and has developed road projects in Ireland (via the DirectRoute consortium in Limerick), as well as being one of the largest general construction companies for both buildings and infrastructure.

German and Austrian sponsors look to Russia

But Russia is a special area of interest, and as the biggest foreign construction company, STRABAG is well placed to take advantage of PPP opportunities.

"The volume of project finance in Russia, including PPPs, is so large that we do not want to be looking for financing for each project individually, and by teaming up with Deutsche Bank we will be in a stronger position to win new business,"

says STRABAG spokesman Christian Ebner. "STRABAG is already the leading foreign construction company in Russia, and the Russian government is planning many thousands of kilometres of roads using the PPP model."

"Having STRABAG involved in a project which is being financed by Deutsche Bank gives added certainty that a project will come in on time and with high construction quality, and it also gives Deutsche the opportunity to move a little earlier in the development cycle, while from the STRABAG perspective coming to tender processes or to potential developers with just a construction package is different to coming with Deutsche Bank behind them with financing," says Victor Makshantsev, Director, Head of Real Estate & Infrastructure Projects Russia and CIS at Deutsche Bank in Moscow.

DB Development will act as a fee developer, working on behalf of a third party developers of hotels, office buildings or infrastructure. But it will also be able to identify direct investment opportunities for both Deutsche Bank and STRABAG.

"Deutsche Bank may also, in some cases, be a co-investor in a project where DB Development is acting as a fee developer, and STRABAG may also invest directly, in addition to providing the construction package, though these equity investments would come directly from Deutsche Bank or STRABAG, rather than being made by the joint venture," Makshantsev explains.

In addition to real estate, the joint venture will pay particular attention to infrastructure projects using the PPP approach.

"The PPP market is quite young in Russia, but it is developing rapidly," says Makshantsev. "For example, the tender process is underway for a 30-year toll road concession in St Petersburg, and there is a high level of interest from all the major European construction companies. And over the next year there will be a tender process for the first section of the \$11 billion motorway between Moscow and St Petersburg."

One area where having a strong financial partner is likely to be very useful is the provision of mezzanine debt. Projects that might normally have a 70:30 debt to equity ratio can reduce the amount of equity to more like 15% with the inclusion of a mezzanine tranche, and given the vast amount of financing required by Russian projects mezzanine debt could be in short supply.

Deutsche Bank is likely to be one of the best placed banks not only to do the risk assessment required for mezzanine lending, but also with the strength to use its own balance sheet to win business.

Spreads on Russian corporate and project debt tightened relentlessly during 2005 and 2006, though they have ballooned out again as a result of the recent global upheaval on the financial markets. Nonetheless, bankers still have a positive view of oil-rich Russia, and spreads are likely to move in again once the markets settle down.

It is notable that, while relations between Russia and the UK go from bad to worse, German sponsors, construction companies and finance arrangers are doing a vast amount of business in Russia. They stand to be the major beneficiaries of the Russian PPP programme, in spite of the groundbreaking work done by UK companies within the European PPP sector.

Within Germany, one factor which could expand the possibilities for PPP would be the extension of the national toll system to passenger cars, instead of just trucks. Even if this happens, the existing concessions will only be entitled to revenue from trucks, but future projects would generate much bigger cashflows. It would be fairly easy to extend the current system, where trucks pay Toll Collect, which collects tolls on the whole German motorway system, and passes the cashflows on to government entity VIFG GmbH. VIFG can then allot revenues to various concessions across Germany.

The use of PPP in German transport projects has been a slow process, with a long wait between the F Model Warnow Crossing in Rostock and Herrentunnel in Lubeck until the award of the first A Model concessions in 2007.

In the absence of any sizeable flow of projects at home, the German sponsors will continue to chase revenue growth internationally.

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