

# Latin American Project Bond Deal of the Year 2006

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## IIRSA Norte: Structured solution

IIRSA Norte is the first ever PPP financing in Peru, and a landmark use of capital markets technology in financing emerging markets infrastructure assets. It includes several elements that can be adopted by other countries and sponsors. But the financing is also a reflection of Peru's recent improved macroeconomic performance, and will need some adaptation to work elsewhere in the region.

The project is part of the Infrastructure Integration Initiative for South America, and is designed to improve transportation networks between countries, particularly interior regions in the Amazon basin. The government of Peru received funding from USAID to assemble a financeable concession, the result of which shares features of both the UK and Mexican road PPP models, but with significant differences.

IIRSA Amazonas Norte consists of a 960km toll road network in Northern Peru, which links the Amazon region in the east of the country with its more developed coast. The concession, as structured by the Peruvian government, is an attempt to attract private investment within the parameters of the country's low sovereign rating and the network's low traffic volumes.

The other goal in developing the project was to ensure that neither the project nor its financing are considered as public debt of the government, nor will they share cross-default provisions with Peru's sovereign debt. Nevertheless, government payments for the road are approved under the country's annual budget law, and are made through the country's Ministry of Transport and Communication.

The Ministry, in association with Peru's investment promotion agency, Proinversion, awarded the concession to Brazil's Odebrecht and Andrade Gutierrez, and Grana y Montero of Peru. The concession is structured to afford a minimum return to the sponsor and support the project's debt, and retain the upside from possible improvements in traffic levels. It also allows the sponsor to raise financing in the long-term debt market, both in Peru and overseas, at attractive interest rates.

The centrepiece of the IIRSA Norte structure is the certificado de reconocimientode pago anual de obras, or CRPAO. This is an annual payment that does not so much pay a sponsor for making a road available and operational as simply compensate it, in instalments, for carrying out prescribed works on the network. The CRPAO is an unconditional and irrevocable obligation of the state, and is issued as and when a piece of work is complete.

The IIRSA Norte Finance Limited bond issue is at root a securitization of these payment obligations, with some significant enhancements. The structure does not even expose bondholders to construction risk, since the proceeds of the \$213 million debt sale are retained at the Caymans-domiciled issuer. These proceeds are used to buy CRPAOs from a Delaware intermediary, which buys the CRPAOs from the project company, which receives them as work is completed.

The proceeds are reinvested in a Morgan Stanley-provided credit-linked note that references the 2033 Peruvian

government bond. This avoids the negative carry associated with the proceeds not being invested for several years after financial close, but still owing interest. The bonds also capitalise interest until 2008, providing the issuer with further breathing space.

The bonds are now to all intents and purposes structured payment obligations of the government of Peru. Whatever the sponsors' performance under the concession, the bondholder will not lose its principal, and will make at the very least the same yield as if it had invested in Peruvian government debt.

But the bonds have been enhanced to have a credit profile slightly better than that of the government of Peru. The Inter-American Development Bank, among the lending institutions that have supported the IIRSA initiative, has provided a partial guarantee of the government's obligation. This covers the first \$60 million that the government does not pay, and is due within ten days of non-payment.

The IDB guarantee, if called upon, converts into Peruvian sovereign debt, whose maturity varies between 15 and five years, according to how much of the facility is used. The guarantee represents first loss protection to the bondholders, but does not protect the entire principal amount from Peruvian government default risk. But the size of this guarantee relative to the total issue is not set according to IDB policies, and since the guaranteed party is the sovereign, the guarantee comes from the bank's public sector department, which does not have per project limits.

The guarantee product is ripe for development, although possibly not in Peru. In December, the IIRSA Sur concession, a similar network in the south of the country with similar sponsors, closed a \$630 million CRPAO securitisation, which did not feature a partial guarantee. The Sur section was split into two tranches, one due 2018, which had a 6.22%, and one due 2025, which carried a 7.33% rate.

By comparison, the Norte bonds, which mature in 2024, priced on 5 August at 8.75%, or 350bp over the 2025 treasury, or roughly 50bp more than the cost of a 10-year credit default swap for the Peruvian sovereign. However, between the two issues Peru was upgraded, and so while the guarantee, in the eyes of most agencies, provides a one notch upgrade, the covered and uncovered bonds had roughly similar ratings. Sur was BB+/Ba3/BB, while Norte was BB+/Ba2/BB+ (Fitch/Moody's/S&P).

The difference between the two shows that Peru, while a good test-bed for the guarantee, may not be the place to develop it – less developed countries will be better suited for large-scale guarantees. The CRPAO structure has more universal applicability – especially for road sections with low volumes and sponsors with poor credit profiles. It could reappear in many emerging markets.

**IIRSA Norte Finance Limited**

Status: Closed 11 August 2006

Size: \$214 million

Location: Peru

Description: Upgrade of 960km PPP toll road

Sponsors: Constructora Norberto Odebrecht (17.43%), Odebrecht Invesimientos em Enfra-Estructura (32.37%), Constructora Andrade Gutierrez (40%), and Grana y Montero (10.2%)

Maturity: 2024

Coupon: 8.75%

Underwriter and credit linked note provider: Morgan Stanley

Financial adviser to the sponsor: Astris Finance

Partial guarantee provider: IDB

Sponsor legal counsel:

Clifford Chance (international), Roselló Abogados (local)

Underwriter legal counsel: Davis Polk Wardwell

Government concession structure adviser: Chemonics

Funding for concession structuring: USAID

Tax and accounting: PwC

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