

IIRSA Norte: Peru's first PPP

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Odebrecht has closed the \$214 million bond issue for the first public-private partnership project ever in Peru. The deal is highly complex – designed to eliminate as much volume, construction, performance and sovereign risk as possible. It serves as a solid, if over-engineered, debut for the country's infrastructure programme, but it is only largely applicable to a country at the same stage of fiscal development as Peru – those at more or less advanced stages may find it difficult to replicate.

IIRSA Amazonas Norte is a 960km network of toll roads located in northern Peru, which link the Amazonian region in the eastern interior of the country with its Pacific coast. The network is considered to be crucial to the economic development of the region, and is presently operational, but does not yet attract high levels of traffic. It is one of four concessions awarded by Proinversion, the Peruvian investment promotion agency.

The concession holder, in which Brazil's Odebrecht holds the most shares, was named the winner on 17 June 2005. The structure of the concession is such that the government makes payments to the concession holder in recognition of the work that it performs, and that the majority of the revenues from drivers on the road will go to the government.

As such, the concession resembles much more closely the OPF financing scheme in Mexico or the General Contractor scheme in Italy – a build-finance project with a little additional risk transfer. But the \$213 million in debt that funds construction relies solely on progress certificates – CRPAOS (certificados de reconocimientode pago anual de obras) – from the Ministry of Transport and Communications. These are issued to the project company upon the completion of predefined construction milestones, and the project company then sells them to an intermediary based in Delaware, which will then sell them to the Cayman Islands-domiciled issuer.

The holders of the bonds of the issuer, however, do not take on any construction risk, since the proceeds of the bonds remain at the issuer level, albeit reinvested in a credit-linked note, provided by Morgan Stanley, which references the 2033 Peruvian government bond. These proceeds are used to buy CRPAOS, which are only issued once work is complete.

The credit-linked note eliminates most of the negative carry associated with the delay in payments until 2008, when the first work on upgrading the road is complete. It does not, however, eliminate Peruvian government payment risk.

The CRPAOS are direct, general, irrevocable, unconditional, unsubordinated and unsecured obligations of the government, but they do not, under the concession agreement, constitute public debt, and do not have a cross-default right with public debt. They are paid by the transport ministry, and approved in Peru's annual budget law.

The bondholder has two sources of comfort. The first is that for such a high-profile transaction the government is unlikely to default. The second is a \$60 million guarantee facility from the Inter-American Development Bank, which bondholders can call upon if the government defaults on a CRPAO obligation. This guarantee is triggered – no questions asked – within ten days of non-payment.

The guarantee comes from the public sector department of the IDB, and is an agreement between the banks and the

government. The bank converts any amounts that the Peruvian government does make good on within 30 days into sovereign debt owed to the bank. This debt will have maturities that vary according to the amount of the facility that is converted, so the first \$15 million that is drawn has a 15-year maturity, while the second \$15 million has a 10-year maturity, and the remaining \$30 million has a five-year maturity.

The guarantee allowed both S&P and Fitch to match their respective BB project ratings with their BB foreign currency ratings for Peru – while Moody's, at Ba2, notched it one higher than its Ba3 sovereign. The IDB guarantee likely provided the project with a one notch improvement, although according to Margaret Walsh, a senior investment specialist at the IDB, the department does not have the per project limits that other guarantors might have. Should foreign or domestic markets not have the appetite for BB paper, and the host government decides to shoulder a greater contingent obligation, the rating could be higher.

The bonds 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. The gap largely reflects the fact that the 144A bonds will not be as liquid. The bonds will capitalise interest until November 2008, when the CRPAO payments commence, at which time the bonds outstanding balance will be \$260 million.

The transaction is notable in achieving a true sale of all of the payment obligations, as well as achieving a high degree of leverage. But all of this structural enhancement only serves to create as faithful a facsimile of the Peruvian government credit as possible. As such, therefore, the financing structure is more the result of Peru's budgetary system than the nature of the concession.

But sponsor Odebrecht, its financial adviser Astris Finance and Morgan Stanley, the bookrunner, deserve credit for their creative use of this revenue stream. IIRSA Norte is as much of an achievement in securitization as in structuring a concession. Certainly, few project bonds could achieve, as IIRSA Norte did, a debt service coverage ratio of 1.

For instance, the concession also features an annual maintenance payment (PAMO) that is payable to the concessionaire and is designed to provide the sponsor with an equity return – it constitutes as much as half as much as the CRPAO payments for a given year. This, like the construction price, was the basis for the bid, and the revenue from tolls on the road will be deducted from it. In the unlikely event that toll revenues exceed the value of both CRPAO and PAMO, then the Transport ministry receives 80% of the excess revenues.

IIRSA Norte Finance Limited

Status: Closed 11 August 2005

Size: \$214 million

Location: Peru

Description: Upgrade of 960km toll road network under a PPP contract

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

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