# Highway 431: Ready refinanced

01/09/2006

Israel's first public-private partnership deal – the NIS1.8 billion ($400 million) Highway 431 financing – has closed. The project goes forward at a time when political tension in the region is at a historic high, and both the financing and its underlying contracts demonstrate a determination to play to local market strengths.

For sponsor Danya Cebus, a subsidiary of Africa-Israel Investments, the project is the first on which it has taken a lead sponsor role. It also demonstrates the ability of Israeli lenders, led by Bank Hapoalim, to take on the entirety of a large-scale financing's debt requirement. But the project also attracted one foreign lender – HSBC – a detail that Israel's Ministry of Finance (MOF) is anxious to highlight.

Highway 431 is a 20km stretch of road that runs south of Tel Aviv, from Rishon LeZion, past Ramle to Modi'in. It connects Highways 1, 20 and 6, the last of which is the Cross-Israel Highway. Cross-Israel was the last private road financing in Israel – a BOT concession financed in 1999 with a mixture of Canadian and Israeli expertise.
In early 2004, the MOF launched a tender for the 431. The section is designed to reduce pressure on roads in Tel Aviv, and will not be tolled.

The bidding documents – issued in Hebrew with a convenience translation to English – called for bidders to submit semi-annual availability payments for the road. Danya Cebus beat three other groups – Shafir Civil and Marine Engineering, New Kopel and Gandir Investments; A. Arenson, Ramet with Roichman Bros' Shomron Infrastructures; and Ashtrom Engineering and Construction with Solel Boneh Building and Infrastructure.

The winner's payment of NIS58 million was well inside the NIS75 million estimate of the MOF. The MOF also estimated, at the time the concession was awarded in April 2005, that the road would cost NIS1.4 billion. Since then, as a result of a spike in demand for labour and raw materials in the region, the cost has increased to NIS1.793 billion.

The project's funding requirement includes a government grant of NIS400 million, to be contributed in stages as parts of the road reach completion, but this was envisaged in the bid. The MOF is assuming interest rate and inflation risk, by indexing the semi-annual payment to both the Israeli base interest rate, and a basket of price indexes, including the consumer price index, the construction price index and the pavement price index. Such support, while less common in other PPP jurisdictions, is a clear sign of the priority that the MOF assigns to the project. The MOF is also paying a shadow toll of NIS0.02 per passenger km.

The MOF had originally suggested that it might provide some kind of hedge to lenders funding in US dollars, based on the reasoning that the Israeli market in cross-currency swaps is as illiquid as the market for interest rate and inflation protection. Cross-Israel, for instance, used a dollar debt element.

Nevertheless, Danya Cebus spent NIS140 million to start construction work early – more than the NIS132 million that it is contributing in equity. However, if the grant is included as quasi-equity, the final capital structure is not as highly levered as this number suggests. HSBC is funding a bridge loan to the reception of the grant payments from the MOF – this NIS419 million, 2.5-year facility is exposed to construction risk, but not operational risk or refinancing risk.

The final element of the construction financing is a NIS1.242 billion construction loan from Bank Hapoalim (44%), United

Mizrachi (36.5%), and First International Bank (19.5%). This debt, like the HSBC bridge, has a 2.5-year tenor, and is priced at around 150bp. The debt is primarily exposed to performance risk on the construction contract, for which they have the known credit of Danya Cebus as guarantor, and refinancing risk. Construction risk is tangible, if manageable – the six-lane highway includes 70 bridges over its 20km length, but the contractor is experienced with the work and the country.

Refinancing risk, on the other hand, is less easy to deal with. Between the country's banks, which provide short-term construction debt, and the institutional lenders, which provide 20 years-plus debt but do not lend to low-rated construction projects, there is a considerable gulf. And Israel's economy is such that construction lenders cannot assume institutional appetite for project debt two years down the line. According to Izchak Hevron, senior vice-president and CFO at Danya Cebus, the alternative was raising debt for construction and operation in either the bank or institutional market at extremely high rates.

And so the sponsor and its adviser, Shrem, Fudim, Kelner Finance & Projects, obtained commitments in advance that a group of institutions would refinance the debt with a 21.5-year loan, provided the project becomes operational and has a sufficiently robust rating of at least AA-. Local agency Maalot has provided an indicative rating of AA+ and if the rating holds up, then the debt will be priced at well inside 150bp over the Galil CPI-linked basket of Israeli government bonds.

The lenders for this NIS1.236 billion loan are Clal Insurance (the former Mivtachim pension fund), the new Mivtachim Pension Funds, Harel Insurance, Menora Insurance and, lastly, Bank Hapoalim, which is remaining in the deal in part to reassure its fellow lenders on both facilities.

The sponsor is also able to reduce its equity contribution to NIS98 million, and the debt would achieve a debt service coverage ratio of 1.2x.

The traffic component of the project is not likely to be sufficient to swing the rating a great deal, since the traffic payment is unlikely to make up more than 10% of revenues.

And future concessions do not look like increasing the amount of risk that the MOF lays off onto the private sector. The 531 PPP concession, for which a tender is imminent, is likely to feature a higher level of grant, albeit with lower pricing on the debt component.

**Hayovel Lines Ltd**
**Status**: Closed 24 July 2006
**Size:** NIS1.793 billion
**Location**: Israel
**Description**: PPP financing for 20km road
**Sponsor:** Danya Cebus
**Lead arranger**: Bank Hapoalim
**Construction lenders**: Bank Hapoalim, United Mizrachi, First International Bank
**Grant bridge lender:** HSBC
**Long-term lenders**: Clal Insurance, Mivtachim Pension Funds, Harel Insurance, Menora Insurance, Bank Hapoalim
**Sponsor financial adviser**: Shrem, Fudim, Kelner Finance & Projects
**Sponsor legal adviser**: Herzog Fox & Neeman
**Lender legal adviser:** Yehuda Raveh & Co
**Government legal adviser**: Levy, Meidan & Co
**Government financial advisers**: BDO Ziv Haft and TASC