Mono-cycle

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Monoline wrapped deals are becoming increasingly competitive in Europe's already tight lending market for road financing.

The latest of these deals closed in Spain, which normally offers little joy for the monolines. That said, the XL Capital wrap on the Eu310 million ($391 million) Autovia del Camino refinancing, which closed at the end of May, was always on the cards, since the monoline wrapped the EIB segment of the debt when it first closed two years earlier. But by extending its coverage to include the debt from the existing lenders, the deal achieved significantly lower margins – around 40bp all in.

Similarly, the earlier Eu412 million M6 Duma refinancing which closed in March – really hammered home the extent to which the current roads market is a borrower's market, when the bond priced at just 27bp over Euribor. More relevant for the project's sponsor, Bilfinger Berger, was an all-in price of less than 50bp for the FSA-wrapped issue, central Europe's first for an infrastructure project.

Two years ago monolines were demanding fees closer to 35bp for such deals. Yet in the current market they are prepared to accept less than 20bp for PPP deals, even when they involve some element of country risk.

The aggressively-priced wraps of today are symptomatic of both the monolines having built large teams that need feeding, and competition with the insatiable appetite of European banks for project debt. "Today a Eu1 billion project is a size that the banks can easily absorb," says Alberto Ramos, managing director of XLCA. " For example, the Indiana toll road has a debt size of Eu3 billion – we thought we had a chance of being involved, but ultimately the banks took it all."

Spain still dominates

Spain has traditionally been Europe's powerhouse in the roads sector. The AS-18 project between Oviedo and Gijon in Asturias syndicated at the end of May, setting a pricing benchmark for a wave of regional shadow tolls currently being tendered by the autonomous regional governments.

The Eu104 million of 25-year senior debt priced at 80bp during construction, rising to 100bp-110bp during operation. By way of contrast, the commercial debt on the Autovia del Camino refinancing priced at 40bp-50bp.

The latter deal was something of a one-off, and is unlikely to be the harbinger of a Spanish refinancing frenzy in the bond markets. Under the original financing, XLCA was at first going to wrap all the debt, but late changes to the terms of the concession made it more practical to wait a couple of years before wrapping the commercial debt.

Spain has been tough terrain for the monolines at the best of times, because of the difficulty rating agencies have had in getting to grips with the country's relationship-based approach to project finance. In the current climate of extremely tight margins, the monolines rarely get a look in.

Two factors make it unlikely that there will be many more refinancings in Spain over the next year, even though many roads will be coming to the end of their construction period. One is that in many cases the cost of refinancing the swaps is greater than any refinancing gain from the drop in margins. The other is that the country's construction companies are too busy working on new projects, inside and outside Spain, to dedicate the resources necessary to take stock and consolidate their existing portfolios.

But while Spain does not look set to be fertile monoline territory, wrapped deals in other European PPP markets are becoming more numerous.

In Northern Ireland, the £131 million (Eu198 million) M1/Westlink project closed in February, achieving what was then the UK's tightest ever spread for an inflation-linked PFI asset. The Bilfinger Berger-led consortium issued £74 million of FSA-wrapped bonds and these priced at 51.5bp over the 2.5% 2036 index-linked Gilt. And the next European road project that is likely to close – Bilfinger Berger's NOK3 billion (Eu385 million) E18 Grimstad-Kristiansand toll road in Norway – may also feature a wrap.

Furthermore, in Austria, the Eu850 million Ostregion project (the announcement of a preferred bidder is expected imminently) features a payment mechanism – 70% of revenues come from availability payments and the remaining 30% from shadow tolls – that is conducive to a wrap. All three shortlisted bidders – Bilfinger Berger, Strabag and Hochtief/Dragados – submitted offers of monoline support with their bids.

Similarly, the long awaited shadow toll bond refinancings in Portugal are expected to provide monolines with a large amount of new business – if the deals themselves can ever get past the government bureaucracy that has delayed them for so long (for more details search 'Portugal' on www.projectfinancemagazine.com).

Where's the volume?

While the monolines are picking up market share, there is concern among some sponsors and bankers that, Spain excluded, European road deals have been much fewer in number than anticipated. Even in those countries where deals have closed, it is uncertain how quickly more will follow: Norway will now evaluate its three projects to date before deciding whether to proceed further with PPP, and project financiers will be hoping that Ireland's teething troubles are now over.

Progress has been particularly slow in Germany. The A-Model programme is slowly building momentum, with bids submitted on 7 June for the A8 Augsburg-Munich project – the first of 12 real toll motorways that the scheme aims to upgrade. And the bid deadline for the second project, the A4 Walterhausen-Herleshausen, is 1 August. But the A5 and the A1 are both behind schedule, with the pre-qualification of bidders delayed in order to concentrate resources on the first two projects.

Germany's F-Model programme is also years away from delivering any significant deal flow. In May, a German court suspended the tender for the Upper Mosel Crossing citing environmental concerns, and no other projects look like closing any time soon.

Other markets, primarily in eastern and central Europe, that were also expected to pick up have provided bitty deal flow. A shortlist is expected in late summer for Slovakia's pilot D1 Lietavska Lucka-Turany project, which should have an investment cost of around Eu500 million. The Czech Republic has committed itself to pursuing a PPP programme, but this is still at a very early stage: so far, it has resulted in an 8 June bid deadline for advisory mandates on the Eu370 million D3 Tabor-Bosilec motorway section.

Romania, Bulgaria and Serbia all have a smattering of projects, but many bankers have expressed doubts about whether the documentation on some of these is of a high enough quality to move them along swiftly. And Poland has rejected PPP as a procurement option altogether, although a refinancing of the A2's Eu235 million commercial debt package closed in 1997 is being touted in the bank market.

The most surprising lack of deal flow has been in Hungary, where the M5 and M6 financings – and subsequently the M6 refinancing earlier this year – looked like spawning a rash of further projects. Despite the initial enthusiasm, Hungary suspended its PPP road programme last year, opting instead to go through the state-owned road operator AAK for the financing of future projects.

This plan still means business for the monolines. AAK will raise Eu1.18 billion through a wrapped bond issue, with Eu320 million coming through an EIB loan. A further Eu400 million will be raised at some point in the future, either through bonds or a loan. MBIA and Ambac are the monolines for the debt, while Deutsche Bank and Citigroup are managing the bond issue.

The deal has been on the table since the middle of 2005 and originally would have meant raising Eu3 billion, but was scaled back after a Eurostat ruling late last year that the debt would have to appear on government's balance sheet. The government hopes to get the debt back off its balance sheet with an IPO of between 20% and 40% of AAK's shares on the Budapest Stock Exchange, raising HUF30 billion (Eu111 million) in the process.

Economic reality will bite

Although many road deals across Europe have fallen foul of empty political promises, budgetary realities are beginning to force the hands of some governments. Eurostat's ruling on Hungary is a reminder of the position in which countries with big infrastructure investment needs find themselves. By including AAK borrowing on the government's books, Hungary's budget deficit balloons from 3.6% of GDP to 6.1%. As such, European PPP is something of a waiting game, in which the deals will come eventually, as soon as countries learn how to tender them properly.

"It's inevitable that it will take a while for any country to get the wheels in motion," says Richard Threlfall of KPMG. "What has changed is that a lot of governments that in the past said they saw no need for PPPs are now embracing them due to tightening purse strings."

Threlfall believes the sector is at a turning point where, after years of expectation, there are enough projects now coming through to create momentum for PPP.

This would appear to be the case in France, which has just appointed the Eiffage/Sanef consortium as the preferred bidder for the Eu1 billion A65 real toll concession. Advised by Ixis CIB, the consortium will replicate the landmark A41 financing, which closed in December last year, by using an eight-year mini-perm with view to a quick refinancing once construction is complete.

Such an approach is made possible by the long, 55-year length of the concessions, and means that down the line the monolines will come into play, despite the traffic risk inherent in the real toll structure. Traffic risk is not as problematic in France, because people are accustomed to paying for the use of motorways. Nevertheless, availability payments for some future projects are under consideration and may be used for the next project, the A88, which is still in its preliminary planning stages.

A pipeline is also developing in the Benelux countries, which would feature the Coen tunnel in the Netherlands and the Oosterweel Link and the Westeschelde projects in Belgium.

Even Greece, which has not closed a PPP project since 2000, despite launching a programme for real tolls the following year, looks like closing two big deals before the year is over – the Eu500 million Thessaloniki submerged tunnel and the Eu450 million Maliakos Kleidi motorway. With preferred bidders just selected for the Eu1.2 billion Ionia Odos scheme and the Eu800 million Corinth-Tripoli-Kalamata road, and bids due soon for two more projects, Greece might yet prove a lucrative market if it can surmount the court challenges that have blighted its programme.

Greece took some of the lessons from these challenges on board last year in shaping a PPP law for smaller accommodation projects. This highlights the point that for most of Europe, roads and infrastructure act as a bridgehead for the establishment of PPP in general. As has happened in Spain, low road volume means low overall PPP volume.