

Latin American Water Deal of the Year 2005

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Although small, the \$38.5 million financing for the Antofagasta desalination plant in Chile features an innovation – an expandable IDB B loan – that could be a major assistance to other water sponsors in getting projects off the ground in Latin America.

Antofagasta is located in Region II in the northern part of Chile. The city has extremely limited sources of water. Most of its land area is within the Atacama Desert, which has no measurable rainfall, and Antofagasta's population is expected to grow by 40% from 2000 to 2020.

Water for Antofagasta and other towns in the region is brought in from the Andes via a 400km. pipeline across the desert. The catchment area feeding this system has reached its limit and cannot supply the additional water needed to support the natural population growth as well as the needs of an expanding mining industry, the region's primary economic base.

The concession awarder, and offtaker, for the project is local utility, Empresa De Servicios Sanitarios De Antofagasta (ESSAN). However, the Chilean water industry is regulated by the Superintendencia de Servicios Sanitarios (SISS), which sets the rates that utilities can charge based on a formula that reflects the cost of service. ESSAN decided that since the area's population was due to increase so substantially, a desalination plant was the cheapest option to make up the projected shortfall.

On 17 October 2000, ESSAN awarded a 20-year build-operate-transfer (BOT) concession to Desalant, a project company wholly-owned by the OHL Group through its environmental/water subsidiary Inima Servicios Europeos de Medioambiente.

The project is to be built in four phases, each producing 13,000 m³/day, or 150 litres per second, and also includes intake piping and an 11km delivery line. It uses reverse osmosis technology, and will produce potable water. There are several other similar facilities in the area, including several run by Cascal, a Nuon/Biwater joint venture, and one by OHL, which treat brackish, rather than sea, water.

Despite demand for water in the region and a 20-year concession, the project was unlikely to be able to access local capital markets. Consequently, the IDB was approached at an early stage in the deal.

In addition, OHL worked with relationship lender Dexia Sabadell Banco Local, Dexia's Spanish subsidiary, to put in place a bridge facility to supplement the \$26 million in equity from the sponsor. This enabled construction to start prior to an IDB financing.

The fundamentals of the project are sound – among the mining companies that are potential customers of ESSAN are subsidiaries of BHP Billiton, Anglo American and UK listed Antofagasta. But the project's credit profile underwent some strain due to the privatization of ESSAN in 2003.

Antofagasta (the miner) paid \$185 million to buy ESSAN, which enjoyed turnover of \$39 million equivalent in 2002, through its FCAB Railway subsidiary. The move made sense for Antofagasta, given it is a major customer of the utility. The privatization meant checking that the change in ownership did not undermine the Desalant concession documents. It also meant that the desalination concession did not enjoy the implicit support of the government.

However, the strategic alignment between the owner of the offtaker and the offtaker's customers makes lenders a little more comfortable. The project also benefits from a relative abundance of gas-fired electrical capacity, adding, albeit in a limited fashion, to the project's economics.

As the financing progressed over the next few years, it became apparent that OHL would find it difficult to close the deal without offering some form of support to the project. Word leaked out from participants that the sponsor was having trouble making up its mind. It was a luxury that it could afford however, since the corporate parent was guaranteeing the bridge loan.

The IDB approved the A and B loans in December 2003, and Dexia, since its role predated in some respects that of the IDB, was mandated to provide the B loan. The two are not large sums – the A loan on the IDB's account is \$7 million and the B loan amounts to \$7.8 million. The debt amortizes in a mortgage-style profile.

But the most important feature of the B loan is that the documentation includes the possibility that the sponsor can raise additional debt under this facility. The plant can be expanded in 13,000 m³/day increments, and the concession includes tariff structures that accommodate such expansions. The assumption on the part of the IDB is that such expansions are likely to require fresh debt, and would likely require its consents, and so its best option was to include expansion language in its own documentation.

Desalant SA

Status: Closed April 2005

Size: \$38.5 million

Location: Antofagasta, Chile

Description: 600 litres per day reverse osmosis desalination plant

Sponsor: OHL

Equity: \$26 million

Arrangers: Dexia, IDB

Debt: \$7 million A loan, \$7.8 million B loan

Maturity: 14 years (A loan), 12 years (B loan)

Sponsor legal: Simpson Thacher & Bartlett (international), Carey Y Cia (local)

Lender legal: Fulbright & Jaworski (international), Yrarrazaval, Ruiz-Tagle, Goldenberg, Lagos & Silva (local)

Independent engineer: RW Beck

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