

# New Haus rules

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After years of slow progress, the dealflow in German Public Private Partnership (PPP) projects is at last gathering pace, with market participants forecasting that over Eu10 billion worth of business will be put out to tender by 2009.

And after years of false starts and faulty models ? particularly in transport ? local governments have finally produced some template deals. Such financings, combined with funding tensions between the Länder and the Federal government, look like grabbing the attention of even the most conservative politicians.

The Finance Ministry of North Rhine Westphalia already has its own in-house PPP centre, and is at the forefront of the development of PPP structures in Germany. And in neighbouring Hesse, the recent Offenbach schools PPP project is viewed as a blueprint which other States are likely to emulate.

German construction firms which have suffered from the lack of public spending on new buildings and renovation work, are committing considerable resources to PPP. They are willing to take risk on their balance sheets, and are comfortable with fair-sized equity commitments.

## Sponsors to the fore

The two dominant PPP sponsors in Germany are currently Hochtief and Bilfinger Berger. Last year Hochtief won the Offenbach Schools Phase II tender, and was also awarded a contract for the construction and operation of city hall in Gladbeck. Meanwhile Bilfinger Berger won the tender for the Unna Kreishaus administrative buildings.

A number of other smaller players are also active. For example, the city of Witten in North Rhine Westphalia has signed a Eu13 million (capital investment amount only, to which is added a 25-year operating contract) schools renovation and expansion project, to be carried out by PPP SchulManagement, an entity set up by Cologne based Strabag Projektentwicklung. And in Rhein-Eftkreis the planning, building and 25 year operation of a special school for the disabled was done via PPP, with capital cost of Eu15 million. This was led by VIVO GmbH.

In the field of schools, administrative buildings and hospitals alone, PPP projects totalling Eu6 billion are expected to be put out to tender by 2009. ?The pipeline is filling up,? says one player. ?There will be several large administrative buildings and schools tendered this year, in addition to the first prison PPPs in Duesseldorf and Magdeburg.?

?We saw a lot of business last year, with ten projects with a project volume of Eu1.5 billion, of which Hochtief is doing Eu500 million, and this year we will see a real take off in business, with ten to twenty projects to be procured, mainly schools, town halls, and some prisons,? says Bernward Kulle, Managing Director at Hochtief PPP Solutions in Essen. ? And deals are likely to be spread right across Germany.?

Indeed Hochtief recently re-organised what had been its Infrastructure Development unit, part of Hochtief Projektentwicklung, into the new Hochtief PPP Solutions, which began operating on 1 January.

?We are bundling our concession and PFI/PPP BOT businesses in Europe and the Americas, to initially hold six projects out of an overall portfolio of eighteen,? says Kulle. ?This involves bundling the business units for social infrastructure, such as schools and public buildings, plus transportation infrastructure, such as toll roads.?

Hochtief is building a new city hall in Gladbeck. And one of the original German PPP projects in which it is involved, the Herren Tunnel in Luebeck, is now nearing completion and is due to open in the second half of 2005.

### **East meets West**

And starting on 1 January, Hochtief PPP Solutions began the refurbishment and operation of 49 schools in the eastern part of the Offenbach rural district, in the state of Hesse. The project has a total value of Eu410 million.

In the Offenbach Schools deal, during the first five years the specially created project company Hochtief PPP Schulpartner, will invest Eu100 million in refurbishment work. All works will be completed during this period. Hochtief will also operate the schools over a 15-year period via a project company in which it has a 94.4% stake, with the balance held by the Offenbach rural district.

The financing includes a factoring structure, with a sale of receivables made to lead arranger West Immobilien Bank (part of WestLB), and to Hessische Landesbank (Helaba), which also took a piece of the loan. Freshfields advised the public sector entity in Offenbach County.

The Offenbach local government also tendered out the western schools, known as Phase I, to SKE, part of the French Vinci Group. This process was complete a few months ahead of Phase II, and SKE began its refurbishment work on 1 October. Debt for Phase I was provided by Depfa Bank, and bankers say that structurally Phases I and II were basically the same. For the Phase I deal, SKE's legal adviser was White & Case, while the public sector authority's legal adviser was once again Freshfields.

‘The Offenbach Schools project sets a positive example, and could be the breakthrough for PPP schools projects in Germany,’ comments Ulrich Helm, partner at Lovells in Frankfurt, which advised Hochtief on the deal.

‘The factoring scheme used in Offenbach Schools involves a bank purchasing, at a certain discount, the receivables of the project company that are to be paid by the local authority,’ adds Christian Bunsen, partner at Freshfields Bruckhaus Deringer in Frankfurt. ‘Thus the project company can pre-finance the construction phase, and debt will be retired over fifteen years using the regular payments from the authority.’

‘As far as the bank is concerned it is not project risk, but corporate risk, and since the cashflows from the authorities are so certain they are able to give extremely good lending conditions to the project company,’ Bunsen explains. There is risk if the sponsor goes bust during the construction phase, but once built it would be easy, in the case of bankruptcy, to get another FM company to step in and do the job.

### **Unna establishes the second pole**

Another high profile deal to close in 2004 was that for new administration buildings for the Unna district in the state of North Rhine Westphalia. This was won by Bilfinger Berger, which will do the construction work as well as operate the buildings for 25 years.

In the Unna Kreishaus deal, the financing was in the form of conventional project debt, as opposed to using a factoring structure. The public sector does not guarantee debt repayments, but project revenues depend on the sponsors meeting instead various performance benchmarks.

‘There are now two basic structures for PPP financings in Germany,’ explains Peter Rambold, Manager at PricewaterhouseCoopers in Frankfurt, which acted as adviser to Bilfinger Berger.

‘The first is based on the credit quality of the public offtaker, and uses a forfaiting model. Local authorities in Germany are generally not rated, but from a legal perspective they cannot go bankrupt, and are top class borrowers for the German banks. Where the public sector has to step up to service the debt come what may, they can achieve very tight lending margins which could around 20bps, because the lenders are taking very little risk.’

‘The second structure, as used in the Unna Kreishaus deal, is more a project financing, where banks lend to an SPV and

take project risk," says Rambold. "In these deals the lenders need to carry out due diligence and price the debt accordingly."

"In the second, the strength of the sponsor becomes very important, because they have to meet the performance benchmarks," he adds. "However, from a performance point of view, the German construction and Facilities Management (FM) industries operate at a very high standard, so there are a sizeable number of top quality players suitable for PPP projects."

For Unna Kreishaus, Bilfinger put up Eu2.2 million in equity, while the balance of the funding was a non recourse loan from mandated arranger KfW IPEX Bank, the newly-established commercial unit of KfW Bankengruppe. KfW IPEX is expected to be heavily involved in PPP in the coming years.

Market participants expect factoring to be the usual structure for schools, administration buildings and hospitals, rather than project debt, which will be more expensive.

But project financings do not require the public sector authority to get permission from their supervisory authorities, unlike in factoring-type deals, where the local authority has agreed to pay out over the life of the deal. Thus in Länder which are less supportive of PPP, the project finance structure will be more likely to get a deal off the ground.

### **Transport still looks for a Model**

The other main area of focus for German PPP in the coming year will be the refurbishment and extension of stretches of autobahn and main roads.

The new Federal system of collecting tolls across Germany is now up and running. Toll Collect ran into many delays, but was finally introduced from 1 January 2005, and the system has been functioning efficiently.

Trucks weighing more than 12 tonnes pay an average of 12.4 cents per kilometre, depending on vehicle size and exhaust emission standards. This system will now make it relatively easy to introduce shadow tolls, and earmark certain revenues for a given stretch of autobahn.

"The concessionaire will receive a share of the tolls paid by trucks using this particular stretch of road, so there is some traffic risk, but these projects are widenings of existing motorways, and so cashflow analysis can be based on many years of traffic data on a particular road," comments one banker.

Another factor that should make the new A-Model road projects bankable is that 50% of the construction cost will be paid out of conventional Federal funds earmarked for transport infrastructure. Since tolls, thus far, apply to trucks and not private passenger vehicles, the Federal Government is willing to pay partially for road widenings.

The construction companies will likely be interested in these tenders, and with 50% Federal financing will be looking at traffic risk involving the flow of heavy trucks on only the remaining 50%.

For the A Model roads, renovation, addition of extra lanes, and new motorway extensions are planned. These do not require any new law, in contrast to the F Model projects, which are used on bridges, tunnels and mountain pass flyovers. The Warnow Crossing in Rostock is a high profile example of an F-Model project.

The Ministry of Transport has twelve projects planned for the first wave of A Model deals, and the first bids should be solicited late in the first quarter or early in the second quarter of 2005.

The A8 in Bayern and the A5 in Baden Wuerttemberg are two of the expected early projects, though there will also be road projects in States such as Thuringia, Lower Saxony, and North Rhine Westphalia.

Bankers anticipate that around Eu6 billion of A Model roads could be put out to tender before the end of the decade. And with such a volume of business coming through the pipeline, they expect to see a larger number of banks getting involved in PPP in Germany.

Up to now, a small number of German banks have patiently worked on a handful of tunnel, school and administrative building deals, often encountering delays of several years. ?There has been too much waiting- we were already waiting around for A Model road tenders two years ago, but the first tenders are now expected in the second quarter of 2005,? comments one banker.

And another positive signal for the development of the market is that the Federal Ministry of Finance in Berlin is currently scheduling a round of discussions with private sector participants on what is planned to be a PPP Acceleration Act. This will facilitate PPP by amending various laws on issues such as procurement and taxes, which are currently holding up market development in Germany.

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