

ConnectEast: Hard terms

20/12/2004

The largest urban road project financing ever undertaken in Australia, and what arrangers claim is the largest global road transport project in 2004, has closed in Australia.

The deal funds ConnectEast Group's planned 40km multi-lane toll road (including twin 1.5km tunnels), which will be kitted out with electronic free-flow tolling technology. The road will run from the Eastern Freeway in the eastern suburbs of Melbourne to the Frankston Freeway in Melbourne's south-east. ConnectEast is the special purpose vehicle formed to invest in the Mitcham-to-Frankston project and adjacent roads.

Mandated lead arrangers for the debt financing were BOS International, Commonwealth Bank of Australia, SG and UOB. KBC also joined as lead arranger.

The debt includes three facilities, an equity bridge facility of A\$290 million (\$223 million), a 49-month construction facility of A\$2.072 billion (the largest facility to enter syndication in the Australian market this year) and a bank bond facility of A\$7.5 million. According to Eric Lapstun at SG, the construction will convert to a three-tranche term debt facility on completion of construction. The three tranches are: a A\$828.8 million six-year loan paying a margin of 165bp over BBSW, an eight-year A\$828.8 million loan carrying a margin of 175bp and a A\$414.4 million 10-year loan priced at 190bp.

The deal has now been launched into sub-underwriting, with a general syndication expected early next year. "So far, the feedback from the bank market has been very strong," says Jim Miller, executive director at Macquarie.

Almost simultaneously, ConnectEast has raised equity funding of A\$1.12 billion in an IPO led by Macquarie Bank, ABN Amro Rothschild and CBA's Commsec unit. Additionally, deferred equity tranches of A\$290 million will be injected into the deal in 12 months, replacing the bridge. A\$30 million of the deferred equity has been subscribed to by Macquarie. The remaining A\$260 million is subscribed for by Thiess and John Holland. Private investors were allocated 25% of the IPO but had their applications scaled back after the offer closed oversubscribed. The IPO was Australia's largest underwritten IPO in 2004, says Lapstun.

Investors pay for the stock in two installments, 12 months apart, of A\$0.55 and then A\$0.45, and therefore A\$605 million of equity is injected into the financing at the start, and A\$495 million 12 months later. "This is the first time a partly paid structure has been used to finance a project," comments Miller.

A distribution reinvestment plan will also fund the road over a fixed distribution period. "The reinvestment plan will amount to about A\$300 million in coupons," says Miller. ConnectEast says it will pay an annual dividend of 6.5¢ a share until 2010. The equity distributions are 100% tax deferred during construction.

Banking appetite for ConnectEast risk will have been aided by the positive history for toll roads in Australia. "The positive reaction from banks is probably also a result of there being very few underwritten financings for new projects in the Australian market this year," says Miller. "A number of refinancings have made their way to the bank market, but as these deals are for known projects with well-understood risks, the margins are typically lower," he adds. Even so, other banks say the ConnectEast deal does carry a slight pricing premium because of its size and the need to attract a wide pool of bank commitments.

Richard Hoskins, a partner at Mallesons Stephen Jaques (representing the sponsors), says the final structuring was relatively simple compared to the options considered. "The sponsors did look at hybrid deals, mezzanine facilities and bond alternatives. But in the end they opted for a fairly traditional bank package because they believed that would deliver

the best pricing." Sponsors dropped the bond option partly because of the issue volume that would have been required. "Our analysis suggests it would not have been price efficient," says another source involved in the financing.

ConnectEast was awarded the concession by the State of Victoria to finance, design, construct and operate the Mitcham-to-Frankston project for a concession period of 39 years. The Southern and Eastern Integrated Transport Authority (SEITA) is the project vendor on behalf of the Victorian Government. The project is labelled by the state as a public-private partnership (PPP) project under the Partnerships Victoria scheme, but Hoskins suggests it is structured as a straightforward BOT venture. "There is no revenue stream from government as would be the case in a classic PPP project," the lawyer observes.

The risk allocation structure is very similar to that used in the A\$1.5 billion Western Sydney Orbital road project, says Hoskins. However, compared to the Transurban City Link, which was completed in the mid-1990s, government has achieved a reduction in its obligations to the private sector. "Unlike the City Link project, there are virtually no restrictions on what alterations the government can make to the surrounding transport infrastructure," comments Hoskins.

The sponsors have also had to enter into greater commitments in terms of toll road users' customer service. ConnectEast will be fined if it does not meet certain key performance indicator targets with regard to customer service levels. A reserve account has been established to ensure that potential fines do not result in financial difficulties for the company. As the project represents a good deal for the government, it is expected to be a template for future toll road projects in the country.

Apart from the freeway, ConnectEast has also undertaken to build two non-tolled public roads, the Ringwood Bypass and the Dandenong Southern Bypass. These bypasses will be handed over to the State upon completion of construction and will not be operated by ConnectEast. The sponsors aim to complete construction by November 2008.

ConnectEast Group

Status: Closed

Size: \$A3.795 billion

Location: Australia

Description: Financing for 40km multi-lane toll road in Melbourne

Sponsors: Macquarie Bank and Thiess

Lead arrangers (debt): BOS International, CBA, SG and UOB

Lead arrangers (equity): Macquarie Bank, ABN Amro Rothschild and Commsec

Legal counsel to sponsors: Mallesons Stephen Jaques

Legal counsel to lead arrangers: Allens Arthur Robinson

Legal counsel to Victorian State Government: Minter Ellison

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