Zagreb-Macelj: Over engineered?

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The Eu312 million ($390 million) limited recourse debt for the 28-year Autocesta Zagreb-Macelj Toll Motorway public-private-partnership concession in Croatia closed syndication on 31 August after strong take-up from both international and regional lenders. But as popular as it has proved with the banks, the financing is arguably over-engineered.

The deal is the first major Croatian infrastructure project to close commercially since the Bina Istra 1B project bond last year and has set some new benchmarks for Croatian infrastructure financing.

The commercial bank tenor is only three years shorter than the 1B bond - 16 years rather than 19 - which is surprising given the norm in the bond market is a significantly longer tenor than straight debt. However, the financing has been structured to benefit to the maximum from commercial and political risk (PRI) cover from the Federal Republic of Germany, thus pushing up the tenor, lengthening the grace periods and making it more bankable.

The swift bank uptake - just over a month between underwriting and syndication close - for the commercial debt mirrors the low risk. Mandated leads Bank Austria Creditanstalt, HypoVereinsbank, KfW and HSH Nordbank, pulled in 12 further participants at lead arranger level - Banca Opi, Calyon, Depfa, Dexia, Erste Allgemeine, Fortis, KBC, Kommunalkredit, Natexis, NordLB, Oesterreichische Volksbank and Zagrebacka Banka - with takes of Eu16 million each, apart from Dexia and Kommunalkredit with Eu9.25 million each, and KBC with Eu16.5 million.

The Eu312 million debt comprises a Eu100 million Hermes facility (tenor 15 years), a Eu100 million Garantie für Kapitalanlagen im Ausland (GKA, since renamed DIA) facility (tenor 17 years), a Eu100 million Long-Term Commercial facility and a Eu12 million Dual-Currency Working Capital Facility (tenor 16 years).

In effect, the German government is guaranteeing two-thirds of the facilities. The Hermes tranche provides 95% commercial and political risk cover for eligible goods and services. And, the GKA, which acts as quasi-equity, covers 95% of Croatian government obligations to the project company, including Croatia's traffic support payments and debt termination amount payable by the Republic in the event of termination of the concession.

The repayment schedules have been structured to match the progressive cash flow build-up of the project. The Hermes and the commercial facilities provide for fixed repayment amounts, while the GKA facility is repaid on a cash-sweep mechanism (including fixed minimum repayments). Despite ranking behind Hermes and the commercial facilities for repayments, the GKA lenders are secured pari passu with the other senior lenders.

It is the GKA facility that features and initiates many of the benchmarks on the deal - the longer grace periods for borrower defaults, the tenor and greater flexibility over the capitalization of interest. But arguably, the GKA is a piece of financial engineering too far.

Zagreb-Macelj is a fairly straightforward risk prospect with strong Croatian government backing. The development is sponsored 51% by Walter Bau and Strabag, through joint venture Walter Concession, and 49% by the Croatian state.

The project is an upgrade and extension of 60km of motorway (40km of which is old road) from the Slovenian border at Macelj to the Zagreb ring - completion of the motorway will be in stages until the end of April 2007 - and has the added benefit of TENs status. The existing stretch has been tolled in the past by operator Hrvatska Autoceste and therefore comes with a traffic history. In addition, the Croatian government has put up significant revenue support payments, a top-up mechanism if maintenance costs post-construction exceed reserve accounts and a debt termination amount if the concession ends abruptly - all counter-guaranteed by the GKA.

Whether those additional GKA guarantees were necessary is questionable given that perceptions of Croatian government risk are lowering - both Standard & Poor's and Moody's put it at investment grade - and Croatia's acceptance as a candidate for the next phase of EU accession.

And although pricing for the deal has not been officially disclosed, the overall cost of financing is rumoured to be significantly higher - and theoretically it must have been given the quasi-equity status of the GKA - than the European norm for an upgrade project of this type.

With so much risk mitigated by Croatian and German guarantees it is also arguable to what extent this deal is truly a PPP.

Theoretically some risk has been passed down from the project company to the contractor (Walter Motorway, a special purpose vehicle owned by Walter Bau/ Dywidag International and Strabag International) and the operator (Trans-Ceste, a subsidiary of Transroute International).

However, the majority of residual risks remain with the project company including the non-performance of the operator; the risk that the costs of extraordinary maintenance exceed the amounts budgeted; and the risk of losses arising from a non-political force majeure event. And much of that risk is offset by the various guarantees outlined.

Ultimately this deal is all about perception of Croatian risk and in this case the sponsors may have been over-compensated for that risk.

Autocesta Zagreb-Macelj
Status: Syndicated 31 August 2004
Description: Upgrade and extension of existing Croatian toll road.
Debt: Eu312 million
Sponsors: Walter Bau; Strabag; Croatian government
Financial advisory: Bank Gesellschaft Berlin; Fortis Savjetovanje
Mandated lead arrangers: Bank Austria Creditanstalt; HypoVereinsbank; KfW; HSH Nordbank
Legal counsel to sponsors: Freshfields Bruckhaus Deringer and Zuric i Partneri (private); Allen & Overy; Hanzekovic and Radakovic and Partners (government).
Legal counsel to lenders: Clifford Chance; Bogdanovic, Dolicki & Partneri.