# Backdoor

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So much for German efficiency: over the past five years only a handful of PPP deals have closed in Germany, and not without some difficulty. Restrictions in public law, traditional public procurement solutions and municipal soft loans have all mitigated against the establishment of bona fide PPP deals. In PPP terms, Germany remains very much an emerging market.

Whilst project finance experts outside the country may hold an over-bureaucratised federal system responsible, this is clearly not the case. Since the mid-1990s, Germany has attracted more in-bound US leveraged leases - including lease-in lease-out (LILO) structures and service contracts - than any other European jurisdiction. Given the tax sensitive nature of these transactions, it is difficult to give an accurate figure as to the number of deals closed. Estimates range between 150 and 200 over an eight-year period.

The majority of lessees have been municipalities and state-owned entities that have entered into highly complex agreements for assets such as rolling stock, waste water facilities, waste incineration plants as well as a host of other long-life assets. Moreover, it is rumoured that lessees have even contemplated attaching leveraged leases onto PPP structures. Thus, the German public sector has not shied away from tapping the more sophisticated sources of financing.

Unfortunately, this has now come to end. In June, the US House of Representatives voted in favour of following the Senate in closing the door on all out-bound lease transactions. German municipal and public entities will now have to look elsewhere for financing.

Whether PPP can fill the breach and offer public entities the financing they so desperately need remains to be seen.

**PPP attracts wrong PR**

Nevertheless, the few deals that have come to market have hit the headlines for the wrong reasons. The country's first real toll road project - the Warnowquerung (WQG) - has come under scrutiny since it opened last September. Traffic volumes have been running between 35-40% of base case - some 7,000 vehicles per day - compared with an original figure of 30,000.

This has meant that earlier this year lead sponsor, Macquarie Infrastructure Group (MIG), was forced to write off its entire A$164 million ($119 million) investment in the tunnel. However, low volumes of traffic are not expected to compromise the debt service until late next year. Meanwhile, investigations into the original projections have been undertaken in order to assess the extent of the flaw.

The financing of the project was concluded in December 1999, despite the fact that the participating parties were unaware of the content of the toll ordinance or when it would be signed.

It remains unclear why the projections have thus far failed to mirror the actual base case. Certain industry sources believe that the flaw lies in the demographics of the area. "It seems strange to have a pilot project in an area which is essentially one of the poorer parts of the country with higher levels of unemployment," comments a Frankfurt-based banker.

One of the major problems for the sponsor is that it is legally barred from keeping tariffs down in order to induce traffic, only to raise them once the toll is established. Under German constitutional law, the doctrine of 'equivalence of payment' ensures that no one is charged more in real terms for the present use of an asset than he might have been in the past.

Though the deal may have become troubled, it represents the completion of the first private financing under the F-Model programme. The Fernstraßenbauprivatfinanzierungsgesetz (FstrPrivFinG), which was enacted in August 1994, allows the implementation of certain multi-purpose tunnels, crossings and bridges. The F-Model is essentially a DBFO (Design, Build, Finance, Operate) model, on which the Ministry for Transportation assess the possibilities of toll road financing.

The failure of Warnow to meet expectation has not deterred certain industry experts. "Even though, in the case of Warnowquerung, the traffic study turned out to be substantially wrong, there is a high willingness on the part of the government and public institutions to support these projects," states Dr Daniel Reichert-Facilides, partner at Freshfields Bruckhaus Deringer.

On the other hand, there are those who remain sceptical. "Everyone now wants see what will happen with the second PPP project - the Herrentunnel. Only when that project closes can we talk about real toll roads in Germany," says a German banker.

Construction work on the toll tunnel in Lübeck in northern Germany started in late 2001and is expected to be completed by 2005. The company formed to build and operate the tunnel under a 30-year concession comprises a subsidiary of Essen-based Hochtief Projecktentwicklung GmbH and Wiesbaden-based Bilfinger + Berger BOT GmbH. Both shareholders contributed a total of Eu23 million worth of equity on a 50:50 basis.

The advisor to the project is Landesbank Kiel, which co-arranged the project loan together with Kreditanstalt für Wiederaufbau (KfW). The Eu116 million loan was underwritten 50:50 by these two institutions, and was signed in 2001. In addition to the Eu23 million of equity contributed by the sponsors, the project benefits from Eu88 million of federal infrastructure funding. Thus the total cost of the project is only partially covered by toll payments, while the lending banks also have an equity cushion underneath their senior loan position.

A further project that has run into difficulties, on both a federal and state level, is the Strelasund crossing. Initially slated as a Eu100-150 million PPP project to connect Germany's north-eastern mainland with the island of Rügen, the project was beset by delays. In the end, the Ministry of Transport canned the BOT concession and sought to execute the project by conventional means.

**Taking its toll**

Given the dearth of F-Model deals, much of the attention in Germany has been recently focussed upon the upcoming program of so-called A Model highway concessions, where the German Federal Ministry of Transport (BMVBW) is set to structure and implement a procurement procedure for the new road projects.

According to Christian Scherer-Leydecker, partner at Norton Rose, "These projects could mark the breakthrough of PPP in the German infrastructure sector after the realisation of only two projects over the past ten years. It is clear that it is not only the construction industry which is calling for implementation of these projects as soon as possible, but other sectors are also keen to move ahead with PPP."

The initiative aims to award contracts based on the A model. Under the A model, the multilane extension of existing motorway sections as well as their maintenance, operation and financing is assigned to private investors. The state provides some 50% of the upfront subsidy to cover the infrastructure costs of passenger vehicles, whilst the repayment of private funds comes from toll fees paid by heavy goods vehicles.

The first three concessions are likely to be the A1 from the Buchholz motorway junction to Bremen intersection; the A5 from Baden Baden to Offenberg; and the A61 from Frankenthal to Hockenheim. Routes with low levels of traffic have also been identified. The A57 from the Struemp Motorway intersection to the Cologne Nord intersection, having been slated as one of the first concessions, is not expected to take part in the scheme at all.

In February, the German media reported the government's decision to cancel the proposed truck toll collection system, despite the thousands of man-hours spent and millions invested in the project. However, in a last ditch attempt to salvage the contract, Deutsche Telekom-led sponsor, Toll Collect, agreed to pay millions as well as introduce engineering giant, Siemens, as a co-sponsor in the consortium.

The Eu700 million financing by HypoVereinsbank, WestLB and Credit Lyonnais of the Electronic Toll Collection project hit the skids due to a succession of roll out dates having been missed. In the end Toll Collect - which also includes DaimlerChrysler and French motorways operator Cofiroute - stated that it could not implement a fully operational system until 2006. This proved the final straw for the Minister of Transport, Manfred Stolpe, who confessed to the government's need for money.

The missed deadlines have cost the government an estimated Eu3 billion per annum in lost revenues. Fortunately for the sponsor, a revised deal was put on the table, which took the government's new demands into consideration. It is expected that the toll system will become fully operational by 1 January 2005. Though, according to certain industry sources, there may even be further delays.

**Schools in this summer**

Despite the slow progress in the transportation sector, school and hospital deals are moving apace. In June, PPP was given a boost through the completion of a school project in Offenbach, near Frankfurt.

The project - partnered by SKE GmbH, a subsidiary of French-owned Vinci Group - comprises a 15-year concession to manage, refurbish and maintain 100 schools in and around Offenbach. The tender for the facility management services contract was originally launched early last year. It is estimated that the schools will save in the region of Eu88.4 million, with a cost benefit of some 19%.

Other municipalities are now expected to follow suit. The next school project to come to fruition is rumoured to be a Eu11 million refurbishment and expansion of two schools in Witten, Nordrhein Westfalen. Although the selection process was meant to have taken place in February, it is now expected in July.

In January, HSH Nordbank arranged a Eu20 million loan with a 25-year maturity for the refurbishment of 13 schools in Monheim am Rhein, Germany. The preferred bidder for the 25-year concession is Hermann Kirchner Projektgesellschaft mbH, a consortium of Kirchner and Serco.

Even putting these smaller deals together is fraught difficulties, given the various levels of bureaucracy that need to be dealt with. According to Christian Bunsen, partner at Freshfields Bruckhaus Deringer, "To put together these pilot projects is not an easy thing. Schools, for example, need a lot of convincing: you can't just sign them up. Everyone is afraid to be the first."

**Future PPPs**

Although Germany's track record in relation to PPPs is hardly impressive, there are very few who do not believe in its potential. This is highlighted by the glut of information now emanating from Germany in the form of think-tanks, papers, books, conferences and articles. In September 2003 Freshfields Bruckhaus Deringer and PricewaterhouseCoopers published a research opinion on the use of PPP structures in the public construction sector. The five-volume document - which was submitted to the German Minister for Transport - now serves as a primer for PPP projects in Germany.

As one Frankfurt-based banker muses, "I think a lot people involved in PPP are still trying to get to grips with this document. I must admit I haven't finished reading it."

However, attitudes to PPP vary from state (Land) to state. Nordrhein Westfalen remains one of the most progressive, with its own dedicated think-tank and highest number prospective projects. Though this should not come as a surprise, given the population density of the area.

Baden Wurttemberg has recently issued a statement from local government backing PPP projects. On the other hand, Bavaria has been a little more reluctant to move forward on the issue.

Whilst certain states may have some success in driving PPP deals forwards, changes to the legislation need to be made. It is not just public procurement law that needs to be reformed, but tax law, budgetary law and municipal law for the smooth running of projects. "There are certain states that still use construction contracts from the 1920s, which limits the flexibility to do these deals," says a German project financier.

In spite of this, industry experts remain unusually bullish. "In the UK, PPP came in through the front door; in Germany, it will come through the back door," muses Bunsen.