The tortoise and the race for market share

01/12/2003

Spain was slow into the European project finance market. No longer. Changes to Spanish project legislation and the ravenous appetite of lenders and sponsors are having the politically and economically desired effect - a complete revamp of Spain's infrastructure and energy sectors.

With a general election looming in March, the Spanish government is powering ahead with its changes to PPP concession law, new renewables tariff rates, the second phase of its current national toll roads programme and the first deal for the National Hydrographic Plan (irrigation systems).

The result of the election is unlikely to make an impact on much of the project market. The moves are all part of Spain's long term Eu103 billion infrastructure investment plan 2000-2010 - essentially a revamp of all existing Spanish infrastructure and a range of greenfield developments.

And lender appetite for project deal flow is matching the politically-driven initiatives with a range of first-time and more sophisticated benchmarks coming to market across sectors ranging from water to roads.

At the heart of the Spanish PPP initiative is the toll road market, where the big domestic developers are jostling for market share. The latest deal to close is the 25-year Autopista Eje Aeropuerto Barajas concession - financing signed on December 11. Sponsors OHL (80%) and ENA (20%) have pulled in a Eu275 million 20.5-year long-term debt facility, underwritten and arranged by Caja Madrid and Banesto towards the Eu350 million total investment costs. The project is a real toll linking the Madrid M40 and A10 to Barajas Airport and its new terminal. A bridge facility has been disbursed until syndication is underway next year.

The Barajas deal is the first in the second phase of Spain's Eu2 billion second national toll road plan and has been swiftly followed by a further five real toll tenders. Bids were due in on 6 November and the eight bidding consortia have thrown up a few surprises. In addition to Spain's big six construction companies - FCC, Acciona, Ferovial, ACS/Dragados (merging), OHL and Sacyr - two medium size construction company led consortia - Corsa/Corvian and San Jose - have joined the competition.

Internal Development Minister Francisco Alvarez Cascos has long promoted medium size company development and both consortia have won several deals at regional level. But the promotion is also confirmation, if any were needed, that international foreign-owned developers are unlikely to break into the Spanish road market in a big way, even with the massive development demands of the next five years.

Second phase real toll concessions

The five new toll concessions - Cartagena-Vera, Madrid-Toledo, Alicante semi-ring road, Ocaña-La Roda, and Santander semi-ring road - have all been offered as real tolls under 36-year DBFO concessions extendible to 40 years, depending on operational performance.

The consortia beauty parade includes: Ferrovial-Europistas-Budimex, with BBVA as financial advisor for three of the five roads (for the other two it has no advisor); the ACS/Dragados-Abertis consortium advised by Caja Madrid, which is bidding for four concessions excluding the Santander semi-ring; Acciona, with different local partners in each road, is bidding for all five and is advised by SCH; Banesto and ACF are advising the FCC-Ploder consortium for all five roads; Sacyr is also bidding for all five roads with ING, Banco Sabadell and Banco Popular advising; OHL is bidding for three roads - no bid for Santander or Cartagena-Vera - with Dexia advising; BNP and PricewaterhouseCoopers are advising the medium-size Constructora San Jose-led, Aldesa, Bruesa, Copisa consortium which is backed by Andalucian savings banks and is bidding for three of the five projects; And BES is advising the second consortium of medium-size construction companies comprising Corsa/Corvian, Comsa, Sando, and BES itself.

Although all five roads have attracted interest there are reservations as to whether the upfront bids (there has been no prequalification stage) will meet Ministry de Fomento (ministry of public works) requirements on all of the projects. Some of the roads - notably the Eu209 million Santander and the Eu383 million Alicante ring roads - may prove difficult to finance without some form of government subsidy because potential income from the tollable section is small compared to the size of investment, and a realistic toll payment to recoup development costs would be unacceptably high. Cartagena-Vera is also deemed by some a difficult deal to finance, with low traffic forecasts, although submitted bids are likely to include a high degree of equity.

Potential deals do not always translate into concrete projects - Madrid's R1 and R6 projects - the missing spokes linking the centre of Madrid to the ring road - are unlikely to ever be built. And speculation is that at last one of the current concessions - probably Santander - may be restructured and retendered along with the remaining three outstanding concessions (eight in total) in the new year,

The winning bids are almost certain to be financed as bullet structures. Spain's banks have traditionally been able to support 20-year plus debt, but the length of the concessions is such that the miniperm structure - used earlier in the year on the R4 and R3+5 projects - with a bond refinancing once the roads are operational, has become the structure of choice.

Similarly, Spain has a highly regulated toll concession system - not unlike France - in which project termination payments (RPA) are set down in law at different rates depending on the nature of the default. The RPA covers worst case scenarios with a maximum and minimum limit and has now been extended to all other infrastructure project sectors. The RPA system, combined with the potential 40-year length of the latest concessions, mitigates much of the risk on the bullet profile of miniperms.

The smaller domestic Spanish banks have also expressed worries over capital adequacy ratios being introduced under Basel II banking reform which makes long-term debt more difficult to offer given the expected terms of set-aside provisions. And it was only when the biggest road deal of the year - the Eu1.6 billion acquisition facility to fund Sacyr's buyout of state toll road company Empresa Nacional de Autopistas (ENA) - was restructured as a bullet that the transaction got away in syndication in October.

ENA privatisation

A controversial deal since the winning bidder first offered Eu480 million more than the Eu1.1 billion minimum asking price, ENA finally sold well and in its restructured form addressed many of the concerns that dogged its original incarnation in June.

The first ENA offering comprised two 22-year tranches - Eu400 million at 125bp to refinance existing ENA concession company debt (ENA holds four toll road concessions totalling 472.3km) and Eu1.2 billion at 150bp to fund the buy-out of the holding company.

And although withdrawn from the market in July after Moody's and S&P downgraded ENA to sub-investment grade, the lead arrangers - Santander Central Hispano (SCH), BBVA, Credit Agricole Indosuez (CAI) and Ahorro Corporacion - had already got sub-underwriting commitments from three banks.

The rating agency concerns were over the fact that the project lenders would have seniority over the Eu754 million owed to existing unsecured bondholders across the ENA concession companies that were the subject of the original rating. Consequently the downgrade did not trouble the would-be project lenders - particularly given a 15-20-year old existing income stream to analyse and that most of the Group's motorways are now fully operational and in use.

However, the 22-year term implied two potential hurdles to local selldown in its original form. First, the local Spanish banks' concerns over Basel II. And second, the long tenor implied a capital markets refinancing at which point the sponsors would have to tap the very same retail investor base that had bought the ENA concession bonds. It was therefore in no-one's interest to alienate the existing bondholders - a fact that the ratings agencies wanted in black and white in the form of ringfencing.

In ENA's new incarnation that ringfencing was achieved with bondholders having seniority over project lenders. And local bank worries over long term lending were dissipated with a seven-year term and an extra 20bp in pricing over the shorter period.

The new structure comprises a Eu1.2 billion seven-year term loan to acquire the holding company priced at 170bp for the first five years (the concessions will legally be allowed to merge at end of year five when refinancing is most likely) rising to 190bp thereafter. And a Eu400 million seven-year revolving credit for the concession companies' debt priced at 145bp. Both tranches are structured as bullet repayments and while there is a no dividend to the shareholders and a cash-sweep from day one on the Eu1.2 billion tranche, the short tenor and seniority of the bondholders means there will be a large amount of outstanding debt to pay in five or seven years making refinancing a must.

Despite the ratings agencies' inability to get comfortable with ENA, bank take-up on the revamped deal was very strong - 41 banks in total. And given the bullet repayment structures there were clearly no worries over ENA creditworthiness - if there were, the banks would have walked away from the refinancing risk.

The same is true of the majority of the bidding sponsors with the asking price. At the beginning of the year many estimates valued the company as low as Eu600 million. On 29 April 2003, concession awarder Sociedad Estatal de Participaciones Industriales (Sepi), advised by BBVA and with independent valuation from PricewaterhouseCoopers, announced that the minimum price was Eu1.1 billion. And although the Acesa-Brisa group pulled out at the last minute due to concerns that the price was excessive, four competing consortia - led by Acciona-FFC, Sacyr, Ferrovial and OHL respectively - presented bids.

Despite winning with a bid of Eu1.586 billion, Sacyr ended up paying Eu1.622 billion due to the increase in ENA's capital and reserves between January and September 2003. Has it bought well? According to Sacyr EBITDA expected from ENA's concessions will rise by between 60-70% at the end of the current seven year financing. And the income that ENA will generate over the lifetime of its concessions will amount to Eu25.8 billion giving a rate of return on capital invested of 10%.

Regional roads

With ENA financed and new bank lending capacity in the new year, the winning bids for the latest round of national real tolls are expected to be announced before the upcoming national election in March. Pricing on the deals is likely to be around the 130bp-140bp range - in effect mirroring the Radiales earlier in the year.

But it is not just the national market that is witnessing a boom. In the regional market a number of new mandates are expected in the coming year.

The nearest deal to closure is the Autovia de los Vinedos two-stage shadow toll - a regional road bond deal. Both stages have been tendered as DBFO schemes with Acciona lead sponsor on the first stage (the Eu210 million 75km Consuegra-Tomelloso stretch) and Dragados on the second (the Eu200 million Toledo-Consuegra stretch). Caja Madrid is financial advisor on the first stretch, which is backed by EIB funding with an XL Capital wrap. Banesto is advisory on the second stage and is in negotiations with a number of monolines.

Caja Madrid is also advising on Eje Llobregat - a 30 -year construction and operation concession for a 20km stretch of shadow toll road of the C16 Barcelona to Puigcerda route. The concession was awarded in November to FCC, Copcisa, Comsa and Copisa. Total investment is around Eu190 million and Caja Madrid is currently in the process of completing the final design of the financing, which will be launched to the market in first quarter 2004.

Regional deals tend to be shadow tolls - like ring roads at national level, local real tolls are deemed politically unacceptable - and the EIB continues to play a major role in propping up regional credits. The multilateral is also backing the Eu300 million Pamplona-Logrono road in the north-east. Credit Agricole and Caja Ahorros de Navarra will be providing bank debt with XL Capital wrapping Eu150 million of EIB exposure.

Despite the EIB's willingness to back regional roads some of the local governments are developing alternatives. In the Basque region a combination of shadow and real toll is used through a 100% publicly owned company that is structured to raise private funds. And the region of Galicia is rumoured to be in the market specifically for a foreign PPP adviser with a view to developing alternative strategies.

PPP and PPP-style development

Although to date Spanish PPP has been primarily a toll road market, the first part one of the biggest PPP-style water deals in Europe has just closed. The country's National Hydrographic plan has been kickstarted with financing for the Canal Primario Segarra Garrigues - the main channel from the Segarra river for the irrigation of 65,000 Ha in Lerida, Catalonia - signed last month. Sponsored by CASEGA (ultimately 100% government owned) and structured by Caja Madrid, the Eu445 million project comprises Eu222 million in government lending with the remainder coming from the community of farmers that use the water. The 12-year project debt totals Eu115 million and was syndicated among 18 domestic banks.

A further Eu1 billion for secondary channels will be in the market next year once the Canal is completed. This may be at least partially funded by a future flow deal that Dexia and Caja Madrid are working on which will be similar to that arranged by Dexia for EMASESA (see www.projectfinancemagazine.com) in 2002.

The growth of PPP lending in Spain has also been given a boost by Spain's new PPP concession law which came into force on 24 August 2003 and has been met with relative enthusiasm by the ratings agencies. According to Standard & Poor's positive credit factors include the right to economic equilibrium for all concessions, the contractual provision of minimum profit levels in case of force majeure and the possibility of guarantees from the granting authority on capital markets transactions.

The new law clarifies a number of key points that affect risk evaluation and on the lending side goes a long way to fostering a developed PPP market - critical if Spain is to meet its planned 2010 investment ceiling.

Significantly, the new law is only a piece, although perhaps the most important one, of a wave of legislative reforms across all infrastructure sectors. The role and extent of the rights of banks in financing the construction and operation of public works are much more defined and in the event of a project going into administration no security right is needed to ensure the lending banks' priority.

The new law has also created real potential for a growing project bond market, with detailed regulation on the issuance of bonds by concession-holders. Bond issues may now be used provided their maturity does not extend beyond the duration of the concession. And the size of the bond will not be constrained by the general limits applicable to ordinary corporations (generally, in the case of unsecured bonds, these are limited to the equivalent of capital plus reserves). Similarly, all the usual security given to lenders has been outlined in black and white.

New provisions have also been introduced that should result in participative loans becoming more popular in PPP market. Participative loans are a type of hybrid financial instrument, deemed equity for borrowers for certain purposes and pure debt for lenders. Although deeply subordinated and with restrictions applicable on voluntary prepayments, participative loans are a recurrent feature in non-PPP project finance deals in Spain.

The new law is also designed to foster the use of securitization techniques - to date the only securitization-like structure in Spain's infrastructure market has been for EMASESA. Concession-holders' future tariff income, commercial rents and even a public administration's commitments to make capital contributions to a concession-holder, can now be securitized, although authorisation is still required from the administration that awarded the concession.

Holders of securitized issues are afforded protection against the issuer's bankruptcy and treated like mortgage creditors. And recognising that securitization structures usually have longer tenures, the law even permits the term of a concession to be extended by 20 years if necessary in order to repay the holder of securitized issues that remain outstanding.

The practical impact of the new Act still significantly depends on the attitude of the contracting public authorities towards its application - by no means certain at regional government level. But it looks likely that it will stimulate a trickle effect into secondary PPP markets like healthcare - Madrid alone has plans for six new hospitals - as and when the headline infrastructure deal flow slows.

IPPs hit the brakes

The legislation developed for Spain's PPP renaissance has also impacted in the energy markets - notably at municipal/ regional level. Furthermore, Spain's incumbent power companies have just received a windfall from the government - the ability to regain Eu1.5 billion in lost revenues to captive clients in 2001-2002 through corporate securitization techniques.

But for would-be IPPs in Spain the market is looking dead for the foreseeable future, despite the financial close of its two first IPPs this year - AES Cartagena and ESB Bizkaia (for details on both see www.projectfinancemagazine. com). Failure to secure long term tolling contracts has forced most US developers to abandon their planned CCGT plants in Spain. However even with a tolling contract IPPs are not popular with long-term lenders. And, like the toll road sector, any future IPPs in Spain will likely be financed through miniperms.

Cartagena is a case in point. Although syndication of the Eu665 million project financing for the 1,200MW CCGT AES Cartagena plant finally came in oversubscribed in August, the deal struggled in its first attempts, despite the fact that lenders could take comfort from the project being fully contracted for up to 24 years under the terms of a long-term tolling agreement with Gaz de France, signed in July 2002.

Furthermore, the fact that the project was being built in Spain should also have given investors comfort. The market was successfully liberalised in 1998, there are no economic or political risks and there is a high demand for electricity - demand is expected to increase by 3.75% a year until 2011, which will lead to a capacity gap in the short to medium term.

The problem was not AES' credit standing but the structure itself. The debt-equity split stood at 90/10 when first put out to market and project leverage was deemed too aggressive and reduced to a safer 80/20 debt to equity ratio. And like the toll road sector the arrangers - ABN Amro, Crédit Agricole Indosuez and SG - were forced to structure Eu493 million of the total Eu665 million project debt as a mini-perm. Although common in the US, the mini-perm structure is still rarely used in the EMEA power project finance market. While the structure provides the incentive to refinance and is attractive to sponsors by merit of enhancing early project internal rate of returns, it is also attractive to those lenders interested in booking shorter-term assets.

A further Eu172 million was sold in ancillary facilities, including a VAT tranche, working capital tranche, cost overrun tranche, letters of credit and three performance bonds. Spanish development bank, Instituto de Credito Oficial (ICO), was granted mandated lead arranger status as a result of its substantial commitment to the project, while ANZ, ING, WestLB and BBVA came in as senior lead arrangers and CIC as arranger. Citibank joined the banking group as manager post signing.

Although a difficult deal, pricing was reasonable at 140bp during construction and 130bp - 180bp during operation - 130bp to140bp within the eight-year loan period and 170bp to 180bp if the deal is not refinanced within this period. In the event that the deal is not refinanced within the eight-year period, a cash sweep will run until payout.

Land for the project has been concessioned out to AES for 23 years by the Spanish ports authority. The concession was signed in 1998 and runs until November 2021. If the concession is extended to 2028 - which looks likely - and Gaz de France comes in as an equity holder, AES's refinancing prospects should be significantly improved.

Both Cartagena and ESB are one-offs for the foreseeable future. Most Spanish CCGT projects are now being developed by the cash-rich incumbents and are unlikely to be project financed. In fact the only recent power deal to close in the market is the BBVA and Royal Bank of Scotland-led Eu325 million Elcogas refinancing signed in the second week of December - ironically Elcogas was Spain's first project finance deal and originally closed in 1994 with great difficulty.

Winds of change

While the IPP sector looks still borne, Spain's wind sector is booming with the next three months expected to see close of a large number of acquisition financings by Japanese and UK generators.

Spain has been the most the most successful European renewables market in terms of scale of financings. The Marubeni and J-Power joint acqusition of Sistemas Energeticos Cando (SEC) from Gamesa has set the template for many of the upcoming deals

Closed in March 2003, SEC is the first non-recourse wind acquisition facility in Europe and a pivotal structure in the way Spanish wind is financed. The deal comprises a Eu57.15 million term loan and a Eu4.5 million working capital facility lead arranged and underwritten by Dexia (45% take) with ING (25%), KBC (25%) and Banco Urquijo (5%). Pricing on the 13.5-year debt was 130bp initially, ratcheting up to 145bp after three years.

The SEC deal is made more complicated by the fact that under Spanish civil law the assets of the acquired company cannot be used as security against debt raised to finance the takeover. Consequently the deal was done through SEC HoldCo, a special purpose joint venture which has purchased all the shares of SEC. Lender security in the short term is therefore corporate-based with no recourse to the assets.

Nevertheless, the deal was structured as non-recourse in the expectation that HoldCo and SEC will formally merge by next March at the latest - thus giving recourse to the assets. And the merger is a certainty structured into the project. If it does not happen the margin on the deal climbs 35bp. After 18 months the margin goes even higher at which point a cash sweep kicks in to pre-pay the facility and the deal goes into refinancing.

The importance of SEC is that is indicative of a market in the throes of maturity. The traditional Spanish one-off SPV deals of the past look set to be replaced by corporate structures and refinancings for consolidated renewables companies. And as the market matures further and attracts more newcomers, similar deals seem certain in the build up to an M&A battle for market share.

In simple terms the majority of future wind financings will have economies of scale. The long awaited Eu800 million Dragados deal being arranged by WestLB and Caja Madrid has been put back to next year. But the 496MW Biovent Energia deal in Castilla y Leon is expected to close in the coming month. Biovent is a joint venture between Iberdrola (85%), Gasindur (10%) and savings bank Caja Duero (5%). Iberdrola already has other wind farm projects in the region, which it has given over to the joint venture, and it expects to generate 3,834MW of energy from wind farms by 2006.

The Eu515 million umbrella project financing funds development of 15 wind farms in Castilla y Leon. Credit Agricole Indosuez, BBVA and SCH are joint leads and a further Eu500 million in Biovent projects in the period until 2005 is expected.

The size and maturity of the market is mirrored in the energy ministry's new wind power tariff methodology, which is no longer as generous as it has been in the past. Developers can choose between a flat-fixed-rate tariff or pool-price-plus-premium rate. Under the new fixed rate tariff generators will receive 90% of the final consumer price in years 1-5 of operation, 85% for years 6-16 and 80% thereafter. The pool-plus rate is fixed at market rate plus 40% of the consumer price, thus creating a floating total price somewhere in the 80%-90% range of final consumer price.

On the upside rates will no longer be reset each year by the energy ministry but run for the life of the project under a set of fixed formulae. On the down side, to be eligible for pool-plus rate - traditionally favoured by wind sponsors - generators must schedule power into the grid on a day ahead basis, difficult for all but the biggest with dispersed wind risk.

Despite the development of the bigger wind projects the days of the smaller, one-off deal, albeit limited, are not yet over. Caja Madrid and SCH recently acted as joint leads on Aerogeneradores del Sur - a club deal for sponsors Enerfin (80%) and Vendaval Promociones Eólicas (20%). The project entails construction and development of two wind farms, La Herrería and Pasada de Tejada, with a total capacity of 54.4MW, located in Tarifa, in the region of Andalucia. The total investment cost is Eu54.4 million and is being financed with a debt to equity ratio of 85:15 over a period of 14 years.

Caja Madrid has also been appointed, together with SCH to structure and finance Galicia Vento, a Eu100 million 4-wind farm project totalling 128MW in Galicia. Terms and conditions have yet to be finalised.

Italian regas Spanish-style?

The regasification sector is looking as healthy as renewables. The Bilbao regas deal (Bahia de Bizkaia (BBG)) signed in March - the first limited recourse gas deal under Spain's new liberalised regulatory environment. And two more LNG regasification projects - Sagunto and El Ferrol - are underway, adding to the three terminals currently operated by Enagas (Cartagena, Barcelona and Huelva).

The market and monoline structures used on BBG - and to be used on Sagunto - now look set to be the template for Italy where Spain's Endesa wants to buy into LNG regasification terminal projects. Planned Italian deals include Rovigo LNG; Brindisi and Livorno.

Spain's programme to expand natural gas capacity is driven by rising demand, partially due to the construction of combined cycle gas turbine plants to meet its growing electricity needs. Total demand for household and industrial gas is forecast to double between 2002 and 2011.

Although the consumption of gas has increased substantially over the past five years, Spain is still way below the consumption of other EU countries. In 2001, Spain consumed less than 5% of the total gas used in the European Union. This is very low compared to 24% and 21% for the UK and Germany, respectively. Although population size, local gas reserves (in the case of the UK), other sources of electricity production and weather conditions account for a portion of this difference, there is still significant room for growth in Spanish gas consumption.

Sponsors on BBG were Repsol, BP, Iberdrola and the Basque government. The project comprises the construction and operation of an LNG regasification plant with an initial capacity of 400,000 m3/h, plus an expansion of 400,000 additional m3/h.

The financing was provided by the EIB through a Eu200 million MBIA-wrapped loan with a limited guarantee from the sponsors of the project during the construction period. Uria y Menendez acted as counsel for the sponsors with Gomez Acebo y Pombo acting for MBIA.

The plant has tolling arrangements (Regasification Services Agreements) with the sponsors and with BBE, an adjacent power plant. The plant's users source their LNG through long-term Sales and Purchase Agreements with Atlantic LNG, in Trinidad. LNG will also be sourced from Nigeria although BBG is not involved in those arrangements.

The demand risk is also mitigated by the fact that the plant will receive payments from the gas system as long as it is available for production. Special attention was paid to the calculation of the system remuneration and settlement system as well as third party access. MBIA and EIB shared the security package, which was adapted to the specific transaction and Spanish legal requirements including, for the first time, the choice of Spanish law for the insurance policy.

Technical risk on regas is limited. The regasification process is straightforward and does not involve complex equipment. The BBG project has been designed to operate 24 hours a day, 365 days a year and the plant requires very little maintenance. Foster Wheeler conducted a study on availability, and concluded that the project should achieve an overall availability of 98.3%.

Regasification plants look set to remain the choice of the Spanish government for allowing gas supply into the Spanish market - primarily because of the difficulties in increasing the France-Spain inter-connection and the uncertainties surrounding the Medgaz project (the new pipeline between Algeria and Spain).

Sagunto will be the next regas deal to come to market in the new year. EIB under counsel from Squire Sanders and MBIA, under counsel from Gomez Acebo & Pombo, will repeat the structure used in BBG. The Reganosa regasification LNG plant in Ferrol (sponsored by Caixanova, Caixa Galicia, Grupo Tojeiro, Sonatrach and Union Fenosa) is theoretically out to mandate and is likely to take the commercial bank route.