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Metronet: Tunnel vision?

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The first of the UK Tube bond financings is drawing toward financial close. Metronet's £2.65 billion combined bond and bank debt package to finance redevelopment obligations in the first 7.5 years of its 30-year London Underground concession is expected to finalise in the first week of April. It is the biggest PPP project bond in the UK to date.

The deal is funding through two concession/special purpose vehicles: Metronet Rail BCV ? which will run the Bakerloo, Central and Victoria lines ? and Metronet SSL which will run the sub-surface lines ? District, Circle, Metropolitan, Hammersmith and City and East London.

Metronet Rail BCV Holdings and Metronet Rail SSL Holdings, the ultimate owners of the infracos, are each owned 20% by Bombardier Transportation UK Ltd., WS Atkins, Balfour Beatty, SEEBOARD and Thames Water.

Senior debt is split between a £1.03 billion bond issue, £1 billion of senior bank debt and up to £600 million of EIB loans. Lead arrangers on the commercial bank debt tranches are Deutsche Bank, CIBC World Markets, Royal Bank of Scotland and Abbey National. Leads on the bond issue are Deutsche Bank, Royal Bank of Scotland and UBS Warburg.

After a long roadshow, and some reflected kudos from the successful Tubelines syndication in January 2003, take up on the bond issue exceeded expectations, allowing Metronet to price inside the 85bp over gilts level indicated before launch. The deal was about three times oversubscribed with most of the orders coming from UK institutional investors.

Wrapped by FSA and Ambac, the triple-A rated 29-year bonds were offered in four tranches ? two per special purpose vehicle. Metronet SSL sold £165 million of index-linked bonds, guaranteed by Ambac, and £350 million of fixed-rate bonds backed by FSA. Metronet BCV issued £165 million of index-linked bonds guaranteed by FSA and £350 million of fixed-rated bonds backed by Ambac. Average life on the SLL bonds is 20 years and on BCV 22.5 years.

Final pricing came out at 73bp for the £350 million fixed rate paper and 80bp for the index linked ? coupons were 5.3% and 2.8% respectively. Fees were 62.5bp.

The level of monoline cover combined with receivables flowing from government grants to the issuer meant pricing that is very competitive compared with other recent UK PPP deals.

The 27.5-year bank debt has proved less appetising than Tubelines pulling in 19 takers including arrangers compared with 25 on the earlier deal (although there has to be a limit to the amount of this type of debt the market can take in such a short period). Margin is 145bp to year four and 160bp thereafter. Pricing on Tubelines was 160bp stepping up to 165bp on the 25 year debt after year five.

Banks that joined Metronet at the arranger level include Banca Opi, Bayerische Landesbank, CDC Ixis, Bank of Ireland, Credit Agricole, Dexia, Depfa, HVB, ING, KBC WestLB, KfW and NIB Capital. Co-arrangers are Helaba and NordLB.

Metronet's ability to draw down senior debt is subject to a number of conditions including compliance with representations and warranties, expenditure plans in line with banding requirements, no default, no warning notices from London Underground and ongoing certification from technical advisor Jacobs Gibb.

Furthermore, senior funders are entitled to greater scrutiny of Metronet should a monitoring event arise ? distribution block, default or under/over-performance against cost bandings.

But the biggest comfort and control mechanisms for lenders is the substantial grant funding that Transport for London (TfL) receives from the UK government and a governmental letter of comfort proffering the return of 95% of senior principal should Metronet be stripped of its concession.

The UK Department for Transport sets the level of grant payment that it will make in order to enable TfL to meet its obligations under the London Underground PPP ? around 50% of TfL's revenue will be in the form of Department for Transport grants. The remaining 50% cashflow risk is 95% covered by the letter of comfort from the government.

Ironically lenders can take confidence from the fact that although not legally binding, the chances of a UK government reneging on the letter of comfort are zero in the wake of the Railtrack debacle ? any government that did so would be unlikely to find private sector lenders for a PPP deal ever again.

More ironic however is that given the 95% comfort letter and that much of this deal is a bond financing, initial arguments made by Bob Kiley, commissioner for TfL, for a municipal bond deal, could yet resurface, irrespective of whether the UK government has got the risks and debt off of its books in the strictest legal terms.

With Metronet done, it appears certain that at least a portion of the Tubelines refinancing, mandated to SG and Goldman Sachs, will also be placed in the bond market. But since investors have taken up so much paper recently, and given the ongoing potential for the Tube to again become an open political conflict, timing will prove crucial.

Metronet

Status: Closed April 2003

Description: Second London Underground PPP concession comprising bond and bank debt financing

Concession period: 30 years

Concession awarder: London Underground

Sponsors: Metronet (comprising Bombardier Transportation UK; WS Atkins; Balfour Beatty; SEEBOARD; Thames Water)

Total debt: £2.65 billion

Bank debt: £1 billion

Lead arrangers: Deutsche Bank, CIBC World Markets, Royal Bank of Scotland and Abbey National

Arrangers: Banca Opi; Bayerische Landesbank; CDC Ixis; Bank of Ireland; Credit Agricole; Dexia; Depfa; HyoVeriensbank; ING; KBC; WestLB; KfW; NIB Capital

Co-arrangers: Helaba; NordLB.

Bond debt: £1.05 billion

Lead managers: Deutsche Bank; Royal Bank of Scotland; UBS Warburg

Monoline bond wraps: FSA; Ambac

EIB debt: £600 million

Legal counsel to sponsors:

CMS Cameron Mckenna

Legal counsel to lenders:

Ashurst Morris Crisp

Legal counsel to concession awarder: Freshfields Bruckhaus Deringer

Independent technical advisory:

Jacobs Gibb