

# The high way

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Toll roads are rarely considered the pick of the crop for Asian project finance bankers. But with a marked slowdown in Asian business for project finance banks this year, road developments planned in Australia (particularly in and around Sydney), the Philippines and South Korea, are increasingly appealing to financiers. Even China, a country that once gave road projects a bad name, is being touted as a market for toll road financings in the near future.

If there is one thing that Asian toll road projects have in common from country to country (cars and tarmac aside) it is that they have little in common. Contractors and operators in one market are generally not seen in another. Similarly concession structures, financing and banking appetite vary significantly from country to country.

One reason for this, Richard Michael, director in WestLB's project finance team in Hong Kong points out, is that Asian road schemes borrow little from other relatively well known concession models. ?Tariff setting, tenors, contractual terms and so on are all pretty different from country to country because of the differing regulatory environments,? he explains.

In the 1990s the South Korean government (South Korea is Asia's most active road building market with an astonishing 40 projects planned or underway) did undertake study tours before putting together its Private sector Participation in Infrastructure (PPI) framework in place and toll road templates are based on this PPI framework. However, as John Walker, president of Shinhan Macquarie Financial Advisory (SMFA) in Seoul notes, ?the concession structures don't slavishly follow any particular overseas format.?

The result is a headache for the region's infrastructure bankers who thus cover a wide array of different road markets. Differences in standard concession features, of course, lead to major differences in project economics. In Malaysia, for instance, where concession structures were developed on entirely domestic lines, there are wide differences compared with more familiar international norms, including tariff schedules that tend to be fixed rather than consumer price index linked.

Ed Sandrejko, director, infrastructure and specialized funds at Macquarie Infrastructure Group notes one common trend across the Asia-Pacific ? for longer concession periods. ?People involved in road projects now realize that short concession periods, for example 10 years, don't allow enough time to get things right. The problems of short concession periods were shown in the experiences of several Mexican toll road schemes,? he says. In Australia, Asia's most mature toll road market, concession lengths are 25 to 30 years plus.

Equally, it is impossible to group countries together by virtue of having the same dominant toll road operators and contractors. A handful of toll road operators, investors and contractors do have pan-Asian ambitions. Michael notes that French operator Egis has been involved in a number of deals across the region and Sandrejko says that Macquarie Infrastructure Group (besides the normal focus on OECD countries) is also looking at opportunities in South Korea and China. But the current regional market share of international operators is fractional.

On the contracting side, groups including Australian contractor Leightons, France's Vinci, ABB, Transfield, Hopewell have each been involved in a large number of Asian road development schemes. But foreign contractors are locked out of Malaysian road projects and rare in Korean developments.

## Banking appetite

The financial difficulties faced by a number of previous road projects in Asia have made the banking sector wary of further exposure in certain jurisdictions. In Thailand and Malaysia transport projects have run into financial difficulties soon after finance close. Markets where there are planned, bankable road projects (from an international financier's perspective) are: South Korea, Japan, the Philippines, Hong Kong and Australia.

Yet opportunities for foreign banks in both South Korea and Japan will be scant. Korean road projects there are aplenty but, to date, only one toll road has had any form of foreign debt financing (the Daegu-Pusan Expressway). Even then the expressway's foreign debt tranche was only \$100 million in size, representing just 5% of total project cost.

Mature economies may look more attractive from a country risk perspective, but road projects have not necessarily performed better. ?The Route 3 Expressway in Hong Kong is a good example. Traffic forecasts are well below predicted volumes,? says a banker in the territory.

It is in Malaysia that the financial markets are currently most circumspect regarding road projects' debt gearing, coverage ratios, and economics in general. ?Most projected income flows have been plainly wrong,? says Roger Ng, head of debt capital markets at Deutsche Bank, Kuala Lumpur. As a result, toll road financial forecasts have had to become considerably more conservative to bring them in line with market skepticism.

Given the nature of Malaysia's project finance landscape, it is the debt capital markets rather than banking sector which are expected to be the source of future road project funds. One financier reports that several highway projects, notably the SILEX road scheme, have been earmarked for the bond market but are not moving forward due to investor sentiment and, ?an economic rationale that just couldn't be justified.? In fact, road projects on hold have been a feature of the Malaysian market for years. ?Road builders used to blame funding problems on the Asian economic crisis but four years on these arguments are starting to sound pretty thin.?

## Brownfield favourites

It is almost a law of road project financings that the most successful are for brownfield rather than greenfield developments.

One of the more celebrated road deals to date in the region, the \$371 million Manila North Tollways Corporation (MNTC) transaction to reconstruct the North Luzon Expressway, was a brownfield project involving the rehabilitation and widening of an existing road. ?It was also one of the very first limited recourse road deals outside of Australia, in which banks took on real market risk,? says Aldrin Li, vice-president at Mizuho Corporate Bank Hong Kong. The deal was highly structured with investment and guarantees coming from both multilateral agencies (ADB, IFC and MIGA) and ECAs (EFIC, Coface and SEK).

Project finance banks should soon have an opportunity for further involvement in the Philippines road market with the Cavite road project in Southern Manila. According to one source, the project is small, with a total cost of about \$100 million, and is an extension of an existing toll road system. The IFC is currently doing due diligence for possible involvement in the project and a similar level of multilateral and ECA support as seen in the MNTC financing is expected.

In Malaysia the only new roads with a good chance of getting financing are those feeding heavily off existing road structures. Falling into this category is the RM950 million (\$250 million) New Pantai Expressway, which has Macquarie Bank as financial adviser. One source involved in structuring the deal says the project is likely to be financed in the next few months via the local bond market. The source expects a RM650 million bond with the rest of the funds coming from equity.

The source admits that careful explaining will be required to ensure a successful issuance. ?But for New Pantai it will be easier to demonstrate a traffic growth profile whereas investors and ratings agencies look on totally new developments with a great deal of cynicism,? the source says.

Only in Australia can both greenfield as well as brownfield road projects be financed with relative ease. While one of the most competitive financings of recent times is for a mature road, Transurban's CityLink, almost all Australia's toll roads are now performing well. "And traffic is still ramping up on many roads", says Peter Matthews, head of structured finance at WestLB's Sydney office.

If banking appetite for road projects was far weaker only two years ago, the situation has changed because of the sector's strong performance, adds Matthews. Four bank groups are bidding for the A\$1.7 billion (\$915 million) Transurban refinancing and the margins are reported to be extremely tight. As a result, a number of well-known infrastructure banks interviewed by Project Finance have declined to bid.

Banking interest exists despite the fact that the bidding for the road concession itself is invariably very aggressive. "It is almost always the case that the shortest concession and highest payment offer to state wins the contract," says an observer, "as the construction process is nearly identical from sponsor group to sponsor group." A key risk mitigant for banks is the level of high level of sponsor equity, typically about 40% to 50% of project cost.

At least three more large road financings are expected between now and 2004: the A\$640 million Cross City Tunnel, the multi-billion Western Sydney Orbital and the A\$800 million Lane Cove tunnel.

The preferred bidder for the Cross City project was announced in February. The winning group comprises Baulderstone Hornibrook, its parent Bilfinger Berger, Deutsche Bank and equity partner CKI Group. Construction of the tunnel is slated to begin this year.

All the financings are expected to follow the same format: bank debt and equity finance during construction quickly followed by a long term, limited recourse bond issue post completion to replace the bank loans.

John Walker at Shinhan Macquarie Financial Advisory, believes that Korean road projects, like their Australian counterparts, will increasingly be financed through the debt capital markets. "Over the next five years I expect more and more road projects to tap the bond market. In the next two years the larger projects may go to the bond market, but in this time period there won't be a heavy volume of roads-related bond issuances," Walker says.

The real challenge in the Korean market is not getting funding, says Walker, but rather getting limited or non-recourse funding. Last year, SMFA arranged the first limited recourse road infrastructure financing in Korea (for the Soojungsan Tunnel development). Without giving deal specifics, Walker says his firm is working on another limited recourse road development, which is expected to close before the end of this year.

Soojungsan was the scene of another first as Macquarie Global Infrastructure Fund (MGIF)'s investment in the project made it Korea's first foreign equity-purchased toll road. The project cost approximately Won 100 billion (\$80 million) in total of which MGIF's acquisition (comprising both debt and equity) amounted to Won 25 billion. Walker says that the fund is looking at investing in another two or three Korean toll road concessions. "We are," he says, "focusing on brownfield assets."

#### Going offshore

With the exception of road projects in the Philippines, most financings involve a heavy domestic component.

Korea's Kangnam Beltway may turn out to be a major exception to the rule, despite the fact that only one other Korean road project has raised foreign debt. 50% of the total loan amount of the eventual transaction (it is estimated that the project will cost about \$1 billion) may come from offshore funds, says a Tokyo-based banker, a possibility which is already raising eyebrows amongst other foreign bankers. The option of part financing the project with a Samurai bond has also been raised.

The idea is all the more remarkable because the road project will not get support from the central government, usually a base requirement before a foreign financier will consider a Korean infrastructure loan. Makoto Inoue, vice president, at Mizuho's Hong Kong infrastructure department, points out, however, that the local government guarantor is Seoul city, a

different animal from most Korean local authorities given its considerable fiscal resources.

According to Inoue, Kangnam's sponsors may look offshore for such a large proportion of their financing needs because of the interest rate differential between Korea and, in particular, Japan. Even so, most financiers find it hard to believe that the deal makes economic sense given the foreign exchange risks and the costs of a currency swap. Supporters of the offshore fundraising scheme suggest that the expansion of the Korean currency swap market has brought down swap prices sufficiently to make the deal work.

No banks have yet been mandated to arrange the foreign financing (it is highly likely that the mandate will go to a Japanese institution). Korea Development Bank is the onshore arranger. n

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