# Open roads

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Spain's bid to improve transport infrastructure is creating a deal flow that has put the market firmly on the international project finance radar. The Eu1.06 billion loan backing acquisition of toll road operator Avasa marks the sector's largest deal to date. Syndication is currently drawing to a close, boasting a strong profile of domestic and international banks at all levels. This year has also seen financial close of the Barcelona Tramline and the A6 Madrid-Galicia real toll projects. With the first wave of ?radial' tolls hot on their tail, Spanish transport is hungry for investment.

In parallel with Portugal, Spain is attempting to cut public spending. And with transport projects being heavily capital intensive at the outset ?the government is turning to the private sector to progress transport development?, says Miguel Abeniacar, finance director of Dragados Concessiones.

Toll roads are first. They are not a new phenomena in Spain, but until recently have been largely a domestic affair. Construction was either funded publicly or concessions awarded to domestic construction companies. These companies tended towards financing the corporate way, borrowing from Spanish banks prepared to offer them very low rates of interest. There was no need to look further afield.

?But now things are changing,? says one industry player. ?Anticipated size of the deal flow is too large for sponsor balance sheets or domestic bank appetite alone.? International project financiers already have a significant presence in Spain's energy and telecommunication markets but now they look set to get a piece of the transport pie. Margins are going up and new players are moving in.

It is no co-incidence that Spain's markets are opening in tandem with the introduction of the European monetary union. The single currency opens the door to a deep new pool of investors and lenders in a climate free of currency risk.

Deal flow

Avasa has led the way. Iberpistas and Sacyr purchased the one road toll operator in 2000, taking over a 300km road between Zaragoza and Bilbao. The concession was established by royal decree and has been in operation as a real toll since 1981. The government reserved the right to change the toll charges and concession length through implementation of further royal decrees and has acted on this. At the beginning of the 1990s toll charges were put up significantly, remained steady for a decade and then put down again at the start of last year. In compensation the concession was lengthened, now ending in 2026 rather than 2011. A new policy dictates that tolls will increase in line with inflation, although this is capped at both ends.

The Eu1.06 billion currently in the markets takes out Avasa's historical debt and the acquisition financing. Lead arrangers BBVA, BSCH, Dresdner and WestLB secured BNL, Banco Popolare, BBL, Barclays, Caja Madrid and HypoVereinsbank during senior syndication and are now out for a second round. Debt is split into four 12-year term loans. In order for Avasa to retain a sufficient gearing level, the two tranches refinancing sponsor acquisition costs are being channelled through two newcos. These holding companies hold all the shares, split equally, on behalf of their parents. They are ring fenced together with the project company in order to enhance security.

?This deal can be seen as a benchmark,? claims an international banker involved in the deal. ?Both for its size and the subordinated structure that banks have been prepared to take on. Although designed in unique circumstances and unlikely to be replicated it certainly sets a standard.?

Although a significant milestone, the Avasa deal can only be described as having a very low risk profile. ?The road has been running tolled for more than 20-years and Mott McDonald carried out analysis of current conditions of the road, plans for maintenance and revenue forecasts on behalf of the banks,? the source concludes. ?The road is in good condition, with a history of very low traffic flow. Three lanes together have seen an average of 11,000 vehicles per day, compared to up to 60,000 on some two lane roads in the UK.? Pricing is said to reflect a utility style deal profile.

Shadow toll roads are similarly characterised by low market risk. The most significant of these to date is the M45 ring road around Madrid. Three separate concessions were tendered, the largest with a total cost of $160 million. The winning consortiums were made up of major Spanish sponsors, but international lenders were attracted during syndication. ?The M45 has been financed and construction is underway,? says Miguel Abeniacar, director at Dragados Concessiones, which leads one of the sponsor groups. ?We are in the process of raising another tranche to be used to modify a section of the road. This is still under construction and there may be some form of compensation from the government.?

But the emphasis for coming months is going to be real, rather than shadow tolls. ?In Spain, both central and regional governments can tender toll road concessions and the M45 was initiated by the Madrid regional government,? explains Alfonso Querejeta director of EIB lending operations Spain and Portugal. ?However the central government, which has been really pushing a program of road tenders over the last five to six years, intends to keep the focus on real tolls.?

Most industry players voiced confidence that, despite the greater risks of these projects, real tolls in Spain are bankable. This year has seen the first wave of tenders, with tenders awarded for three ?radials'. The concessions incorporate construction and operation of toll routes running from the city of Madrid to a ring road. In addition, each consortia is obliged to build and maintain a section of this new and untolled ring road, the M50. Despite the unusually long concession periods, 50 to 65 years, tenors are not expected to exceed 20 to 25 years. The length of this tail creates investor comfort in the light of exaggerated project start up costs.

The RIV was scooped by a Cintra led group, whilst a consortium comprised of FCC, ACS, Sacyr, OHL, Acesa and Caja Madrid secured both the RII and the bundled RIII/RV. The three projects together will look to the markets to raise debt in the region of Eu1.5 billion.

Next in the pipeline will be another wave of ?radials' and some toll roads around Sargosa. July 2002 is the date pencilled in for launch. Other transport sectors are also starting to demand investment and one local banker expects a major initiative with high-speed rail links. ?At the moment they are generally being funded with public money, but at some point they will turn to private investment.?

The recently signed Barcelona Tram project marks the first in a line of urban rail deals up for large-scale project financings. A consortium including Alstom, FCC and Acciona won the 27-year DBFO contract to develop a tram system connecting the city centre with surrounding towns of Cornella, Hospitalet, Sant Joan Despi, Sant Boi, Sant Just Desvern and Esplugues. SG acted as lead arranger and joint financial adviser with Banco de Sabadell on the Eu247 million project. The EIB signed up to a Eu136 million guarantee facility. ?This project was a good example of securing a variety of financiers,? says Alfonso Querejeta. ?It will hopefully set a benchmark.? Underground projects are also under discussion in a number of cities.

Future of finance

Estimates suggest that a total of around Eu114 billion is needed to finance the planned infrastructure development in Spain. A significant portion of this is earmarked for the country's flagging transport infrastructure. The EIB is expected to make a significant contribution, but this still leaves a considerable amount to be sought in the debt markets.

International banks will increase their activities in Spanish transport. Higher margins on riskier deals will allow them to compete with Spanish banks. Querejeta agrees that activity in Spain is picking up. ?Although there is obviously greater market risk in financing real tolls, the appetite is there. The cluster of sponsors picking up concessions are very active internationally and the fact that they are willing to put up levels of equity as high as 15 to 20% provides considerable comfort for lenders.?

Dragados has plans to expand its focus on its own backyard. And Cintra, the concession arm of Ferrovial, will also be naturally drawn to transport projects in Spain. The recent 40% purchase of Cintra by Macquarie Infrastructure Group ? the world's biggest toll road operator ? is described as a very significant moment in the company's history giving Cintra a boost in terms of financial strength, financial appetite and technical expertise. However, according to Cintra, the Macquarie presence will not have any direct impact on individual financing packages.

In addition to sponsor strength and Spain's history of tolling, many players suggest that the peculiarities of Spanish legislation provide allure for bankers. ?Legislation for financing toll roads in Spain stems from the 1970s,? explains Pedro Michelana, head of project finance at BBVA. ?There is a specific stipulation that allows lenders to call in a government guarantee in the event of project default.? This step in clause covers the value of the whole investment.

In a sign that large scale project financings are becoming high profile, the government is displaying flexibility and working to progress legislation. ?For the first time in Spanish history, the Ministry of Public Works allowed bidders for the Madrid radial concessions to decide whether they wanted to have this support,? states Francisco Clemente, head of treasury and project finance, Cintra Concessiones. Sponsors could put forward a financing package proposal that either took a guarantee into account or not. Cintra, who led the winning consortium for the RIV, have opted to retain the comfort. It is believed that one of the other concessions, however, will be in the markets raising debt without the benefit of this fallback.

Bonds away

The European bond markets are expected to play prominent role in future financings. Their long-term structure and maturities make them well suited to transport projects, which can securitise issues against future revenue collection. And ?there is certainly a history of pension funds with long term appetite across Europe,? points out one London based banker, ?and this is growing.?

Clemente is also positive about this development. ?Cintra has a lot of experience in financing motorways in many countries and wide expertise in tapping capital markets. This trend will grow across Europe in coming years. Markets such as Spain and Portugal are becoming increasingly similar as the European capital markets internationalise.?

The bond route is often not taken until after construction. Risks in infrastructure projects are heavily concentrated in the initial stages. Pricing on long term bonds and their ability to attract enhancement will thus be more favourable to financing engineers once this phase is over. Moreover, institutional investors are likely to be less flexible than banks in the event that the project needs more funds or the debt should be restructured.

Javier Rodriguez Arias, head of project finance at Credit Agricole Indosuez in Madrid believes that this is likely to be the case. ?Bonds will play a large role in financing transport projects, but at a second stage. The typical picture would be that project financing should be refinanced with bonds after roughly 2 to 4 years.? Other players, however, suggest that bonds could feature in some new-build projects, as well as refinancings. They point to instances of DBFO roads in the UK funded through capital markets right from the start.

Size and timing can also be factors when choosing a route. ?Avasa's debt was too big for a single bond issue,? says a banker close to the deal. ?A combination of bank and bond debt could have been possible but it was quicker to put together one package. An existing debt of the project's ran out in July and the bridge loan in September so the deadline was tight.? The source goes on to suggest that the debt will be taken out in the capital markets at a later date. ?The successful bank financing has awarded the deal an international profile, which will certainly be a comfort for the shareholders when they go out to the capital markets. It probably won't happen for three or four years, though.? n