Algarve: Bonds the game

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Launched on July 2, bond refinancing for the SCUT do Algarve shadow toll in Portugal has closed backed by a monoline wrap from newcomer to the European market XL Capital Assurance. Priced at 55bp over 20-year Eurobor mid-swaps with an expected average life of 20.1 years, the deal is the first long-term Euro infrastructure bond, with a tenor of 26 years.

Total financing is Eu256.5 million comprising the Eu126.5 million bond issue and a Eu130 million EIB loan. The triple-A XL wrap covers both the bond and EIB debt and without the wrap the deal was rated triple-B+ by Standard & Poor's ? investment grade.

The bonds were sold through special purpose vehicle Dutch BV ? Algarve International. Under Portuguese securities law a bond issuer is required to have a two-year trading record, so a domestic issue was out of the question.

The transaction was originally financed for concessionaire Cintra (owned by Ferrovial) with 24-year debt a year ago. HypoVereinsbank and BSCH (joint bookrunners on the project bond) funded the loan along with ICO and WestLB. The deal was always intended to be taken out by a bond issue but was nevertheless a typical SCUT deal with an Eu232 million facility comprising a Eu102 million commercial bank loan and a Eu129.7 million EIB tranche guaranteed by the same commercial banks. Consequently, the refinancing bodes well for further similar Eurobond take-outs on other SCUT deals ? planned or unplanned.

Original loan pricing was 115bp during construction moving up to 120bp, 130bp and 150bp during operation. And despite the slightly longer tenor, sources close to the deal claim the bond is cheaper, even allowing for the cost of the monoline wrap. Much of the issue went to a UK money manager, lesser amounts to German insurance companies and a single ticket in Austria.

The bond was also a reaction to a perceived lack of liquidity in the debt market given the close of the Eu1.2 billion IP5 toll road in April. And the argument for further similar deals is strengthened by the fact that Cintra competitor Lusoscut (owned by Mota) was considering the option in its bid for the Grande Porto SCUT.

The Algarve SCUT will provide a dual carriageway link along the south coast of Portugal and through traffic will be encouraged to use the road on completion of Brisa's A2 real toll motorway to Lisbon.

Although the Algarve involves construction of a new 38km section of road, plus connections and interchanges with the existing network, 64% (91.5km) of the concession is already built and operating as the IC-4 motorway and will be transferred to the concessionaire in October 2001.

Standard & Poor's points to a number of credit weaknesses in the underlying deal that the XL wrap overcame. Debt service coverage ratio is low in the first year of repayment (2004) at 1.09x, before volume derived payments start to accrue. In addition, toll payments made in January, May and September are badly matched with debt service payments and could create liquidity difficulties if the project becomes stressed.

Most importantly ? demand for the road is highly seasonal. The Algarve is subject to two phases of traffic flow ? domestic economic use and seasonal tourist traffic. Flow is therefore cyclical ? a fact partially mitigated in the credit risk profile by the shadow toll system which sizes payments according to the total traffic for the preceding year.

Nevertheless, in the four-year construction period the concession receives only limited fixed payments based on the existing open length of road. Payments will be Esc10 million per kilometre for new road and Esc4 million per kilometre for existing road transferred by the government.

On the upside there is strong support from the Portuguese government because the concession agreement automatically inflates tolls at 90% of Portuguese CPI. And the project assumption of a 2.4% initial increase in traffic volume per year post construction is conservative ? traffic growth in Portugal has exceeded 5% per year for the past decade.