A Financing Fare

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Construction of the stand-alone fare-box monorail in Las Vegas, due to open in 2004, has started. A success here could set a precedent for the financing of future infrastructure deals across the US.

Syndication for the $650 million non-recourse bond financing, led by Salomon Smith Barney, closed on September 21 oversubscribed. The contract for construction of the vehicles and overall system design has been secured by Bombardier and is to be an urbanised version of the Mark VI that this construction company supplied for Walt Disney World in Orlando. Granite Construction will assume responsibility for civil works.

Owned by special purpose vehicle The Las Vegas Monorail Company (LVMC), a joint venture between the two gaming corporations MGM and ParkPlace, the 6.4 Km of dual elevated monorail will link nine stations along the East Side of the city, notably including the convention centre. The fully privately financed construction is the first of three phases in, a state vision that will eventually link in the city train station and airport. It is planned that these next two stages will be state funded, although Greg Carey of Salomon Smith Barney commented that LVMC, perceived as a not-for-profit company serving the local community, could well become involved to some degree if the existing project proves to be successful.

Despite both this wider plan and the fact that the State of Nevada Department of Business and Industry issued the tax-exempt bonds on behalf of LVMC, there has been no financial guarantee whatsoever accorded by the state. Nor has there been any from the involved gaming companies or hotels. Investment has been made solely against the success of the project and the debt is to be serviced entirely through advertising, estimated to bring in $6.5 million a year, and fare revenues. Projected passenger flow was based on forecasting drawn up by URS Corporation and confirmed independently by seven other companies, including Deloitte and Touche and representatives from both MGM and ParkPlace. Kam Walker of the LVMC stated that he expects the density to be similar to that of the New York Metro in Manhattan.

Financing comprised three tiers: the first of these was a senior tranche at $450 million of term and capital appreciation bonds insured by Ambac Assurance Corp. SSB brought in only Bank of America as a co-underwriter of this tranche, which was rated triple-A thanks to Ambac and Baa3 and BBB-minus underlying by Moody's and Standard & Poor's, respectively. Fifteen investors put in bids for the second tranche that consisted of $149 million worth of term bonds at three different lengths, which begin maturing in 2007 and have a top yield of 7.75% in 2040. The final tier of $48.5 million is split between stakes bought by the major hotels that the monorail will serve and debt issued to the construction companies.

The enthusiastic reception of the market to this deal reflects both the perceived strength of the credit and that it is a unique deal with very specific circumstances, allowing a variety of innovative components to be brought together for the first time. Geoff Yarema of Nossaman, Guthner, Knox and Elliot, who represented MGM and ParkPlace in the negotiations, pointed to the completely out-sourced maintenance as a significant attraction. Moreover, as Gregg Carey of SSB highlighted, much of the right of way, often one of the most significant financial burdens in such infrastructure constructions, was donated either by the hotels or the county.

It must be noted, however, that the confidence and enthusiasm displayed by investors has not spread to all quarters and the proposed deal has raised some strong, if isolated, voices of doubt.

Wendell Cox, a public purpose consultancy based in Illinois have published a report outlining potential pitfalls. The central notion of this paper is that, without some kind of shadow payment or backing from the hotel, there is no way that the monorail can raise the projected fare revenues. In a city where visually unique streetscapes are conducive to walking and taxis are both quick and efficient, it is unlikely that the most expensive stretch of monorail in the country will attract more than four times the ridership of the existing Las Vegas Strip Bus route. Moreover, the monorail is to run only along the east side of the city, at the back of a string of hotels, the depth of which, combined with that of the street, suggests that it is unlikely to be used by anyone not directly intending to use those resorts.

The report goes on to point to the fact that, although URS are one of the premier transport consultants in the world, the unique circumstances meant that there was very little to base the projections on, particularly for considerable time span of 35 years it has claimed to. A source involved in the production of the report stated that there had been rumors of an undisclosed agreement that the hotels serviced by the rail would provide some form of subsidy. However, the source continued, if this is the case, but has not been made official, and thus could be withdrawn at a later stage, the ability of LVMC to service the debt would be seriously strained. In the event of a financial failure, the report concludes, it is even possible that local and state taxes may be raised in order to keep the monorail going as part of the state system mentioned above.

Only time will tell whether these voices have any grounding. That syndication for the institutional tranche closed oversubscribed, there is a healthy extent of liquidity in the deal and high levels of tourism in Las Vegas will remain a constant for the foreseeable future all point to an attractive financing proposition. Certainly investors were not deterred and neither were the construction companies, demonstrated not only by their willingness to effectively buy into LVMC but also to sign up to the design-build-equip contract. This mode of contract is increasingly seen in large-scale infrastructure projects across the US, shifting all construction risk and responsibility for environmental mitigation to the contractors. Further, Bombardier is to operate the system for an initial five years with an option for an additional 10.

Although created within a set of very unique circumstances and thus unlikely to ever be replicated exactly, if this deal succeeds it could become a benchmark for the future public-private financing of state needs in the US.