Transport Report: Easy Rider

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The drive towards European road project financing these days is packed with promise. The private sector is steering ever more towards toll road projects. But while the volume of projects looks set to keep lenders and sponsors busy for the next few years, not all of yesteryear's risks have dissolved.

In fact, project risks, particularly for toll roads, abound in Central and Eastern Europe, where lenders are still recovering from last year's Hungarian M1 debacle and where governments must now gear up to provide much needed guarantees.

Nowhere in Europe is the infrastructure mania as apparent as in the Iberian Peninsula. This year, the Portuguese road sector has seduced a wealth of foreign investors. The reason behind this renewed fervour ? the arrival of a single European currency, and, more specifically, Portugal's inclusion in the Euro- has cut currency exchange risk out of the picture. Whereas before Escudos could only be raised locally, lenders are now eager to supply the Euros needed for Portuguese projects.

To date, five toll road project financings have reached financial close. In all, there are 14 projects at hand, the majority of which are vast enough to warrant international syndication.

The most innovative aspect of Portugal's toll road program is its development of the shadow toll. For a shadow toll project, the risks are less than on ordinary real toll projects. Instead of relying on traffic, which might avoid tolls by taking alternate routes, this structure relies on government payments based on brackets of vehicle volume using the road. Shadow tolls have been implemented successfully in Finland, the UK, Spain and, now, Portugal. A total of six roads are to be developed in Portugal under the shadow toll guise.

Beira Interior, the first design, build, finance, operate (?DBFO', or ?SCUT' in Portuguese) shadow toll road to be funded, last year, recently reached syndication. The 30 year project involves the construction of a new 82 km section, upgrading 50 km to dual carriageway and operating 66 km of existing road. Construction will finish within the year and it will be operational by 2003.

The local Junta Autonoma de Estradas in 1998 awarded an international consortium the design, build, finance and operate concession. It is led by Spain's Dragados y Construcciones and includes local Soares da Costa, Teixeira Duarte, Alves Ribero, Sopol and Ramalho Rosa-Cobeta.

The debt is split between a Eu387.5 million 20-year bank loan and a Eu358.25 million European Investment Bank (EIB) facility backed by commercial bank guarantees. It is priced at 100bp during construction and 90bp during operation. This is because the sponsors, led by the Spanish contractor Dragados, have offered contingent equity support in the event of project difficulties.

The deal is lead arranged by local and international banks including Caixa Geral de Depositos, Banco Portugues de Investimento, CISF ? Banco de Investimento, Bayerische Landesbank, EIB, EIF and Royal Bank of Scotland.

The second shadow toll road DBFO (SCUT) to reach financial close is the Algarve, which skirts to Spain along a 130 km stretch of Portugal's Southern coast a prominent tourist region. As with the Beira Interior, the deal has an international flavour, with lead arrangers West LB, HypoVereinsbank, BSCH and ICO.

The Spanish contractor Ferrovial, which leads the project through its subsidiary Cintra, raised Eu232 million of 24-year debt for the deal which is split between an EIB facility of Eu129.7 million and Eu102.3 million of commercial bank loans. Priced at 115bp during construction, the margin rises to 120bp from years three-to-five, 130bp from years six-to-ten and subsequently to 150bp.

Development of the Costa de Prata shadow toll road, the third and final Portuguese DBFO road to reach financial close, is being led by Mota, a local contractor. Consistent with the present climate, finance is being sourced from abroad.

The project finance syndicates include Dai Ichi Kangyo Bank, with PWC and BES Investimento advising the group. Local banks BES, BCPA, BCO, Totta & Acores and Totta & Sottomayor also lead syndication.

Eu504 million of 25-year senior debt was raised for the project. It was raised on behalf of a special purpose company Lusoscut, and will be spilt between a Eu210 million commercial bank loan and a Eu190 million EIB facility backed by commercial bank guarantees.

The road runs 102 km from Mira to Porto and is almost open on half this length.

Other roads being tendered under the shadow toll program include the Interior Norte, Grande Porto, Beira Lioral e Alta, and Norte Litoral projects. The Interior Norte is believed to be approaching the final offer stage.

Shadow tolls also appear to fall profitably over the rest of the Iberian Peninsula. Financing for Spain's first shadow toll road deal, the M45 B section, closed recently. The B section is one of three sections of varying lengths awarded by the Communidad de Madrid, the local government. The Pta24.224 billion financing for the Ferrovial and ACS backed concession company is the first to hit the market. The contract, which covers roughly 14 km of a total 40 km road, was announced in October 1998. Close was reached at the end of 1999.

Financing is split into two tranches: facilities of 18 years and 21.5 years. The second tranche is underwritten 90% by joint lead Instituto de Credito Oficial to achieve the necessary appetite for the longer tenor debt. The other joint lead is Banesto, with Clifford Chance advising the lenders. Pricing has been put at around the 100bp mark.

The 25-year concession is based upon a subsidy linked to traffic throughput. Also attached are performance targets, which concern maintenance. The M45 runs south and east of Madrid, in an area already dominated by the M30 and M40 roads. However, the relative density of the infrastructure may explain the shadow nature of the concession. The financing closed fully subscribed with participants rumored to be made up of largely international banks.

General syndication for the highway's 7.6 km Section C is expected soon. The fate of Section A is, however, as yet uncertain.

?The progress and profile of project finance obviously varies by country and sector. But Spain and Portugal are special cases,? comments a banker close to the deals. ?Both countries rank high on the number and value of deals and these projects have a well deserved degree of support. Project finance in this region in particular was driven initially by the need to cut public spending and budget deficits to qualify for economic and monetary union from the outset. Now, the new currency has made foreign players more much confident in extending tenors.?

Greece, however, has not yet qualified to join the euro. Currency exchange risk still persists. Accordingly, private funding has been generously topped up by subsidized loans from the European Investment bank (EIB). This means that the commercial banks take the construction risk and the EIB takes the long-term commercial risk. Five big projects either launched or on the drawing board are financed by a mixture of private and EIB funds.

Financing for one of them, the development of the Elefsina-Spata toll-way in Attica prefecture, has just closed- and with strong international support. Lead arrangers Bank of Tokyo-Mitsubishi (syndication agent), Bayerische Hypo-und Vereinsbank, Commercial Bank of Greece, National Bank of Greece and SG recently closed the general syndication of the project debt facilities.

Banks were invited to support the deal at two levels- as senior lead managers with takes of Eu20 million for fees of 32.5bp and as lead managers with takes of Eu12.5 million for fees of 22.5bp. Bank of Cyprus joined as senior lead manager, while BPI, Comptoire des Entrepreneurs, DePfa and Export Development Corporation of Canada joined as lead managers.

Arrangers are the European Investment Fund and Midland Bank. Co-arrangers are ABN Amro, Agricultural Bank of Greece, Alpha Credit, American Express Bank, Banca Monte Paschi de Siens, Bank of Scotland, De Nationale Investeringsbank, Ergobank, ING Bank and Pireaus Bank.

The financing is split into four tranches. Tranche A is a Eu490 million 20-year EIB loan. Tranche B is a Eu480 million bank guarantee facility. Tranche C is a Eu140 million commercial loan with a 12-year maturity. Tranche D is a Eu85 million 12-year standby facility, and will be available during the construction phase.

The Athens ring-road, as the project is commonly known, is one of the largest infrastructure projects in Greece. But its history has been plagued by delay since 1996 when the Greek State initially granted the DBFO concession to the construction consortium Attiki Odos. Its long-awaited close is thus seen by many as a big step forward for road financing in Greece.

Only a small proportion of European toll roads are operated by private companies ? a fact which suggests that this is an area where investment from purely private sources may not always be the optimal route to guarantee the swift completion of road networks. Nonetheless, as governments temper their budgets and the private sector gets comfortable with toll roads, this may change.

In Central and Eastern Europe, private sector finance has centered on the privatization of basic infrastructure, especially in Hungary and Poland. But the experience has not been entirely positive.

Witness the Hungarian incident. Shortly after Hungary became part of the western economic system in 1989, its government acknowledged the need to improve its road connections with western Europe. As it had no budget resources available, it opted to take the innovative BOT route to develop, as rapidly as possible, the missing link with the West and advance the Hungarian motorway system.

In early 1996 the last part of the M1 motorway linking Budapest with Austria was completed to keen applause throughout the project finance world. The cheers, however, were swiftly muted. The tolls charged for the 42km led motorists to shun the new smooth asphalt and instead clog the old winding road. Traffic on the M1 was substantially lower than expected, and the project was, in the minds of many, soon consigned to the junk pile of project finance failures.

Traffic forecasting is itself a risky business, particularly in areas with unstable base economies, where traffic growth is a function of macroeconomic growth, which is itself uncertain. Moreover, determining with accuracy a driver's willingness to pay a toll is a tricky task, particularly in emerging markets where people are unaccustomed to paying market prices of services and have limited buying power.

?Forecasting is not at the best of times a precise science,? says John Carr of PWC. ?You have to consider the economics of the country, then factor in the requirement to pay tolls, as well as the other alternatives available to motorists.?

The EBRD has asked the Hungarian government to make up for any revenue shortfalls, and is negotiating a restructuring of the project finance. The refinancing package is to be completed soon.

The Hungarian government concluded that future projects will need state backing, with finance from the central budget, bank loans and aid from the European Union. Perhaps the role of the government in facilitating transport projects is inevitable after all.

Indeed, the emerging market in central and eastern Europe has its own financing demands which contrast with those of Western Europe whose economies are on average more durable.

?We need a more robust financing option,? says Nigel Purse, a Partner at PWC. ?This should consist of a mixture of public and private finance. Public-Private partnership is critical to the success of many projects, particularly in central Europe.?

On the other hand, financing toll road projects in developed countries is an entirely different matter. ?The lessons learned from the Hungarian M1 experience are important,? continues Purse. ?But its issues are not directly relevant to the western European market, given its historically stable macroeconomic path, predictable growth patterns, and sound legal structure.?

The Polish poise, it seems, has been swayed to prudence by the Hungarian setback. Yet sponsors and lenders alike now appear confident that their ventures will be profitable.

Then again, its been six years since the Polish government approved a plan to build more than 2,000 km of privately financed motorways. And in those six years, just 100 km have been completed. The project, one of Europe's biggest ever, was greeted at the time as a great opportunity for the construction industry. But obviously it wasn't enough for the private sector to actually mobilize any cash.

The construction firms have spent the last six years lobbying the government for more funding, or at least for some state investment guarantees. And with Poland's appalling roads starting to hold back the economy, the government finally agreed.

Earlier this year, the government accepted a draft amendment to the law on toll roads that will allow public money to be used for motorway building. As a result, the public sector can cover up to half the cost of building each motorway, whereas before the use of public revenue was limited to the purchase of land.

It seems that the Poles, like the Hungarians, have accepted that they cannot rely solely on private financing for their roads. Traffic forecasts for the northern A1 toll road are relatively low. The Gdansk Transport Company, which holds the license for the first stretch of the road, needs more state input before is can repay the loans it took out to finance construction. The new amendment, likely to be approved later this year, should allow work on the A1 finally to go ahead.

In bold contrast to this trend, construction of the Warsaw-Berlin A2 route is on course according to the old rules. The first 150 km stretch ?will be constructed without state budget financing, though there will be a state guaranteed bond issue,? comments a banker close to the deal.

The first stretch should be finished by 2005, and then the company, Autostrada Wielkopolska SA, will start work on the next stretch, to Poland's western border at Swiecko.

The story behind this confidence is simple enough. The Berlin-Warsaw route is one of the busiest in Poland and the company has managed to attract good investors. ?This is the largest project in Poland, financed by private funds,? says a banker familiar with the project. But players are still mindful of why investors backed out of projects in other parts of the country, where the prospects weren't so good.

The cost of construction for a 150 km stretch of the road is Eu622 million. Deutsche Bank and Credit Lyonnais have been mandated by Autostrada to arrange project debt financing for the road. The non-recourse facility amounts to Eu280 million. The credit has a 5-year drawdown period and a maximum repayment period of 12 years, giving a maximum tenor of 17 years. However, a cashflow sweep mechanism is likely to reduce the actual maturity to about 14 years. The balance of the financing will be paid down by shareholder equity, subordinated debt and other financings raised with a Polish government guarantee.

The syndication's launch is expected later this month. And with it, another high-geared drive towards a fertile future for European road financing.

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