

# The Italian Job

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Italy could soon see Pavarotti-size tenors hit the project business. With the sell-off of water utilities and plans for increased infrastructure spend, tenors of 25-30 years will finally reach the market. Even in the power business one of the two recent refinancings ? Centro Energia ? extended its tenor by five years.

This is good news for Italian projects in terms of financing diversity. With water up for grabs ? the first concession has been awarded to a Suez des Lyonnais des Eaux consortium for Arezzo in Tuscany and the Latina City tender has just gone out ? 30 year concessions should stimulate longer project tenors and Italy's first project bond financings in the rush for long term cash.

In simple terms, new private sector companies mean new private sector methods of raising funds ? and without government backing.

The move to the asset-backed securities (ABS) market is already underway. Last month Telecom Italia awarded BNP Paribas and WestLB the mandate to structure and underwrite a potential \$3.8 billion telephone receivables-backed program. WestLB's appointment comes as no surprise given it lent Olivetti s2 billion towards the s22 billion buyout of Telecom Italia in March 1999.

If the deal goes ahead it will be the first securitization by a European telco and Italy's first true asset-backed issue.

The concept has been floating around the Italian power business for some time. Securitization was looked at and rejected for both of Italy's recent independent power producer (IPP) refinancings ? API Energia and Centro Energia. With both plants covered by 16-year tenors under the CIP6 subsidised tariff scheme the economics were simply not in place.

That will change ? albeit slowly in the power sector ? once a post-CIP6 market comes into being. CIP6 has been tacitly recognised for deals already brokered under the scheme by Italy's highest administrative court ? the Consiglio de Stato. But the Decreto Bersoni, the law by which the European electricity deregulation directive has been implemented in Italy, has put in place cut-off dates by which these projects must be completed.

CIP6 was a hangover from the past that Italian power sponsors and bankers wanted to keep. The ruling enabled generous power tariffs to be paid to generators with a forced take or pay agreement with then state monopoly ENEL.

The outcome is that 90% of Italian project finance has been and still is in the power sector. While CIP6 created the mechanism for project finance in Italy ? local and international sponsors and financiers fought hard against a cultural background of traditionally risk-adverse Italian banks with little experience of structured deals ? it is also at risk of distorting the changing market.

Bankers and sponsors argue that the predomination of power is symptomatic of the slow pace of deregulation in other sectors. According to a comparative study of the European power sector made by Citibank, Italy ranks ahead of

countries such as France and Spain and is on a par with Germany. Some arrangers claim it is the UK five years ago.

But is the market becoming too power-centric and is CIP6 going to make it more difficult for non-power sponsors to drum up interest in deals in the short-term?

When CIP6 was under the spotlight it was claimed that sponsors had deliberately delayed construction of plants to the late 1990s in order to benefit from both cheaper technological improvements and previously agreed subsidies on tariffs. With a change of profit revenues for developers from 7%-8% to 14%, subsidies began to look both too generous to parts of the Italian establishment and a strong reason to invest for foreign sponsors and bankers.

Conversely, without CIP6 project finance would not exist in Italy and it is only the drawn out process of privatizing/commercialising in other sectors of the Italian market that is holding financial diversity back. Traditionally cautious, Italian banks have been playing catch-up in the project finance business. Even now, few Italian banks, with the exceptions of Mediocredito Centrale in Rome and Turin-based IMI San Paolo, have the capacity to lead arrange a project financing. Most of the other banks tend to play minor roles at syndication level.

With ENEL due to sell-off/decommission 15000MW of generating capacity, the Italian power rush is not going to slow. At least 5000MW from ENEL are expected to hit the market this year.

Most recently, ENEL completed the sale of 26 hydroelectric stations (total capacity 780MW) to the Valle d'Aosta regional authority. The deal is more of an alliance than a sale. The agreement also covers 2500 miles of distribution lines with two new joint ventures ? 51% owned by ENEL ? operating generation and distribution respectively.

The deal will not help quieten accusations of paying tacit lip service to European deregulation. As one Italian banker claims, ?There are political implications ? not least employment ? and Italian players will be well positioned to buy in to any government sale.? And on the financing side, syndication of projects is likely to remain a predominantly Italian affair. Because of Italian withholding tax there are constraints on funding locally and in the past only those deals using the EIB as a tax shield have managed to get around the problem. In addition, 0.25% is paid in lieu of project registration cost whereas if the investor is abroad 3.4% of security costs is payable.

Similarly, Italy's new PFI legislation ? the Merloni ter ? shares the name of one of Italy's major industrials: arguably a bit like getting Lord Sainsbury in the UK to draw up supermarket competition regulation.

But if the Italian market is to remain a predominantly Italian affair ? and given the UK privatization experience there are those that would argue that is a good thing ? for banks and sponsors with an Italian presence, the power market remains on the top list of European buys ? particularly the IPP sector.

The CIP6 stimulus has kicked in for both refinancings and new IPP projects. Italy's most recent deals include API Energia, Centro Energia and now ISE Piombino.

All have spawned renewed banking confidence in Italian power business after a difficult 1999.

Syndication for the \$680 million refinancing for API Energia closed oversubscribed at the end of September 1999. Because of CIP6 jitters, final draw down was held off until February 2, 2000.

Sponsor of API Energia is an international consortium combining Anonima Petroli Italiana (API), Texaco and ABB. Lead arrangers for the financing are Mediocredito Centrale, ABN Amro, Banca Nazionale del Lavoro and Greenwich Natwest. Banca Intesa, Dresdner Kleinwort Benson, Mediobanca, Paribas and UniCredito Italiano are the co-arrangers.

In mid-March, Centro Energia also signed off on a deal that combined both risk-sharing on two combined cycle plants

and economy of scale ? in effect a hybrid of single plant and genco refinancings.

Sole lead-arranged by BNP Paribas, with co-arrangers Banca Nazionale del Lavoro, Mediocredito Centrale and Credit Agricole Indosuez coming in at L100 billion a piece, the L514 billion deal brought together two plants originally financed separately in 1998 ? Teverola and Ferrara (formerly known as Communanza) ? in a risk sharing agreement that enables revenue streams from one plant to make up for shortfalls in the other.

The result ? a drop in overall price of debt for sponsors Foster Wheeler Italiana and Grupo Merloni of between 20bp and 25bp and an extra five years on the tenor.

Most recently, ISE Piombino is out to market. An Edison-EdF joint venture, ISE's latest deal is for a L400 billion 162MW steel gas fired plant (of similar technology to the FINEL Taranto plant finance in 1996).

The project is lead arranged and underwritten by BNP Paribas and BCI with around 20 banks, predominantly domestic, taking a piece. Chiomente is legal counsel for the sponsor and Grimaldi Clifford Chance for the banks. Signing is due at end of May.

More refinancings ? for Sarlux and ISAB (both in excess of \$1 billion) ? are already underway and expected to come to market before year-end.

And according to Franco Baseotto, head of project finance at Foster Wheeler Italiana, there are also good prospects for the development of greenfields for the year 2000: BNP Paribas and Mediobanca are planning to bring the s2 billion Sulcis gasification combined cycle plant to market this year.

Similarly, new deal flow will be helped by Italian power players diversifying into new markets. ENEL chief executive Franco Tato is embarking on an ambitious program of diversification into water and telecoms.

ENEL's interest in water began last year with the acquisition of Acquedotto Pugliese. And syndication has just begun for the 51% ENEL-owned WIND mobile telecom project lead mandated to ABN Amro, Banaca Commerciale Italiana, Citibank, Schroder Salomon Smith Barney, Dresdner Kleinwort Benson, JP Morgan and BNP Paribas.

Edison has also applied to the communications ministry for a telephone licence for a fibre-optic network based around its present infrastructure and has started a water joint venture with Bechtel.

With sponsor diversification will come financial innovation. But for the coming year at least, the use of alternative sources of off-balance sheet finance in the project business is going to be slow. The most promise is in the water and toll roads business. But until the first deals close, Italy is going to be about power, power and more power.

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