Panama Canal Rail Link: A+B = IFC

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Financing closed at the end of last year for the Panama Canal Railway Company - a transhipment venture that aims to revitalise a sorely neglected part of the country's infrastructure. Though small, even by the standards of recent foreign investment in Panama, the line forms a vital link in the trade between the Atlantic and Pacific Oceans as well as the development of the country's port system.

The project consists of the acquisition of the existing line across the Central American Isthmus. The capital requirement is split between $60 million for the purchase and a further $30 million in improvements to the line. The 76 km line connects the two ports of Colon on the Caribbean and Panama City on the Pacific. The Panamanian government has awarded the company the concession for 25 years, with the option to extend it for a further 25.

The railway has been in existence since 1855, before the canal. Partially submerged at the time of the construction of the Canal in 1909, it was relaid to avoid the flooding that made up the bulk of the canal works. Its American owners, as part of the Carter-Torrijos Treaties, finally turned it over to the Panamanian government in 1977.

The line has been in steady decline since then, not least because of the slow-down in migration. It had, towards the end of that phase of its existence, been running around one train a week at 10mph, despite constituting the alpha and omega of the country's railway network.

The new development promises a radical overhaul of the railway's function, since transhipment has the potential to bypass the restrictions placed on the size of the ships coming through the Canal. Container ships have rapidly moved from the Panamax limit to larger types of container vessel and it is these rises, as well as the gradual silting up of the canal, that have made transhipment plans viable.

Checks in place ensure that some ships entering the canal are forced to offload at least part of their cargoes, both to make their draught shallower and to ensure that sight-lines are adequate. Some of the new generation post-panamax container ships may be forced to offload all of their cargoes for reloading at the opposite side of the canal.

Project sponsors Mi-Jack and Kansas City Southern Industries seized upon the opportunity. The former is a large-scale supplier of crane equipment while the latter runs a series of rail concessions in the Southern USA, and specialises in intermodal terminal operations.

Both have put around $25 million into the Panama Canal Rail Company, the consortium that won a 25-year concession to run the railway in January 1998. The condition of the railway was such that sponsors conceded their main guarantee was to get the track up to an acceptable operational state.

The Panama Canal Railway Company must redeem 5% of their annual revenues to the Panamanian government until the total value of the investment has been recouped. After this point repayments will increase to 10% of annual revenues. There were some delays to the progress of the upgrade as the government struggled to complete the necessary ancillary work

Financing went ahead after the completion of this process early last year, to accelerate the construction of what was rapidly becoming a greenfield development. The International Finance Corporation (IFC) stepped in to provide the necessary funding, which came in under both the A and B loan programmes, and an equity contribution. The IFC have taken a $5 million stake in the Panama Canal Rail Company.

The loans are split into $15 million on the IFC's account and a further $30 million sold down to ABN Amro, Dresdner Bank and Deutsche Verkehrsbank. The three participants are all keeping their contribution on their books. Tenor for the A loan is 12 years, whilst with the B at 10, with the IFC declining to release the pricing. The semi-annual repayments come after a two-year grace period - essentially after construction is complete.

The IFC, while acknowledging the transaction itself was relatively straightforward, points to the significance of the investment in the regional context. Panama has undergone a great deal of change since the invasion of the 1980s. The economy is effectively dollarised (causing a great deal of comfort for the repayment streams on the project), and the country is gradually beginning to distance itself from its quasi-colonial past.

The rail itself cannot be understood outside of the increase in private sector involvement in the country's ports. Facilities at both ends of the canal are being upgraded by multinationals, including Evergreen and Hutchinson, the latter of which are behind two of the four ports, Cristobal and Balboa, served by the railway.

Equally significantly, transhipment operations could benefit from the establishment of free trade zones within the country - Colon is Central America's largest. Growth in traffic on the Canal is expected to be steady, although neighbours Nicaragua and Honduras are themselves examining dry-canal routes, in effect similar to the Panama rail option. Nevertheless, sponsors expect the company to bring in between $30 million and 35 million in yearly sales, and do not express any disquiet at recent changes in the Canal's ownership.

The Canal was finally handed over to the local Panama Canal Authority in a ceremony at the start of this year. A great deal now hinges on the commitment of the new owners to the maintenance and upgrade of the canal, especially if the route can retain its pre-eminence. By 2015, an estimated 2 million containers will be moving between the eastern US and Asia, with the rail link capable of handling around 40 containers on each one of the three trains on the line.

Whether the project remains viable comes down to a heady mix of political stability, commercial wisdom and fickle world trade patterns.