N3: South Africa's largest BOT closes

01/11/1999

Funding has been agreed for the R3.5 billion ($570 million) N3 Toll Concession (N3TC) in South Africa - the largest project financing yet agreed for a South African infrastructure development.

A total of R2.1 billion has been assembled to finance the project, whereby a consortium, including constructors Grinaker, LTA and Murray & Roberts, will take over existing tolled sections of the 418km road and has undertaken to improve, and toll, the untolled sections of the route. The concession has a 30-year life.

In addition to the equity guarantees provided by the shareholders, and a 20% equity share taken up by institutional investors, the loan commitments have been split into four sections. The first, of roughly R300 million, has been provided by the European Investment Bank and the second and third sections, coming from the Development Bank of South Africa and a commercial facility taken up by BoE and life assurer Southern Life, total R350 million. The final R950 million-section comprises a Consumer Price Index (CPI) facility placed by Rand Merchant Bank (RMB) to pension funds. This has been underwritten and is awaiting approval from the relevant institutions' boards.

The financial advisers for the deal were Sumitomo in London and RMB in Johannesburg. Legal advisers for the South African National Roads Agency were White & Case, for the lenders Denyz Reitz, and for the consortium Ashurst Morris Crisp. Standard and Poors affiliate CA-Ratings gave it an indicative rating in July of zaA (South African National Scale), the highest awarded by a S&P affiliate on project finance.

The project was designed to offer a quick improvement to the route between the industrial centre of Johannesburg and the port of Durban, the busiest transport corridor in the country. Its most unusual feature is an up-front payment of R1.38 billion, equivalent to the government's existing debt on the road, to the National Roads Agency for the right to toll existing roads, the largest contribution to the project's debt requirement. It does, however, guarantee a revenue stream for the period of upgrading the remaining sections of the route.

The government, struggling with a road debt backlog of R7 billion, is anxious to raise the necessary capital as quickly as possible. The 1997 Moving South Africa report, produced by the Department of Transport, identified large future increases in transport use, and noted that maintenance spending on an already run-down network was unlikely to increase at the same rate.

The N3 is one of three major projects in South Africa under consideration - the other two are a coastal toll road linking Port Edwards and Port St Johns, and a road linking Pretoria to the Trans-Kalahari highway to Maputo. The N3TC beat three other bidders to the contract, in part by stressing their commitment to skill transfer and empowerment programmes. Empowerment groups hold 40% of the project's equity, and the N3TC could create up to 25,000 new jobs.

A further piece of construction work, the 100km De Beers pass through the Drakensberg Mountains around Harrismith, is directly linked to the attainment of specified traffic levels. This work will possibly begin in 2010, but only if usage levels justify it - although the debt requirement has been included at this stage of financing.

The pass would render redundant sections of the N3 that are set to be immediately renovated as part of the contract, but these sections are in such a poor state of repair that work is urgently required to bring them up to legal standards.

The extent to which new tolling of the upgraded sections will be accepted is the main indicator of the project's viability. The road skirts Lesotho, the location for possible alternative journeys, and the composition of the traffic, as well as its origin and destination, were prime risk determinants.

Charl Kocks, from Standard and Poors' South African affiliate C-A Ratings, which rated the project, says that the N3 is expected "to generate very, very strong traffic flows". He says that traffic risk did not dominate the analysis - "it was no more prominent than usual for a toll project."

Passive toll avoidance may be a less serious threat than concerted local action on the part of residents. Local residents, unable to use an alternative route, disrupted the operation of the N4 in August at Nkomazi. Aware that this strengthened the position of local pressure groups in the alteration of toll structures, the N3 operators have attempted to offer reduced rates to residents from the start.

The environmental risk on the project was another conceivable stumbling block, especially for the De Beers section, which involves blasting through a substantial stretch of the Drakenburg Mountains. It also had to take into account South Africa's liberal environmental laws, which allow objections to construction work from non-residents and can easily raise impediments.

Tolling has been used on several of the country's roads since 1996, and N3TC says it has the toll structure in place to avoid the possibility of driving traffic onto alternative routes. The CPI-linked part of the project debt has been chosen because post-completion revenue streams will be based on toll revenues whose levels are raised in line with inflation.

One significant component of the operating risk comes from the damage to the roads from overloaded vehicles. As Tim Ivins, head of N3TC, puts it; "there is no sound economic sense in getting involved in this project if we do not make a sustained effort to prevent overloading". N3TC has had to put in place a convincing system of moving and static weigh-bridges in an attempt to avoid a repeat of the widespread (and often commercially inspired) violation of limits that contributed to the N3's poor condition.

None of the players involved with the deal believe that this will be the last such project in the country. A preferred bidder will be announced shortly for the N4 West tolled section, and levels for the N1 and N2 have been encouraging, if not dominated by the long-distance cargo traffic that provides the highest revenues. The South African government is unlikely to look at a road project in isolation either: within weeks of the N4 announcement it had already set up a development corporation for the 'Maputo Corridor' that the road served.