Route 407 sets the pace

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When arrangers for the 407 highway in Toronto came to the negotiating table, they had one or two surprising assets up their sleeve. In almost any other toll-road project, investors would have taken one glance at a 99-year concession, an almost new electronic tolling system and a parallel road a couple of miles away, and begun to shake their heads. But in the 407 such risks turned into assets. Says Rick Byres of adviser Nesbitt Burns in Toronto: ?I don't know why the Province of Ontario decided on such a long concession, but it has provided us with enormous flexibility in the financing.? Fears over new technology or traffic levels that would disappoint were also dispelled because of figures from existing parts of the road, he adds, and as a result, financing the 407 turned out to be fast, efficient and profitable.

The winning consortium comprises SNC-Lavalin with Spain's Grupo Ferrovial and Capital d'Amerique. In May, the group, which has recently renamed itself 407 International, bought all the equity of the existing 407 Concession company, which had operated the road since it was opened in October 1997. The C$4 billion ($2.68 billion) 407 International paid, included the right to operate the existing 69km stretch of road and the concession to build, own and operate a 39km extension.

The financing is split into three sections. First, a three-year, C$2.3 billion senior bridge facility arranged in three tranches by the Bank of Montreal, the Royal Bank of Canada and Citibank. The second is a C$150 million junior bridge credit facility arranged by the Bank of Montreal. Both facilities will be gradually replaced by longer term revenues bonds, a process that Byres thinks will be complete before the three years is up. Even so, 407 has some strict deadlines to stick to in the finance agreement.

By May 2001, it must pay back two of three senior bridge facility tranches with the third following by May 2002. Interest on this senior loan is based on a floating rate of one of three base rates: the Canadian dollar prime rate which has a spread of around 100 basis points to 175, the Interbank rate for Canadian dollar bankers' acceptances and Euro dollar rates for Canadian dollar deposits, which both have a spread of between 175bp to 250bp. This produces an effective interest rate of between 6.975% and 8%.

However all these spreads will fall should 407 manage to sell more than C$1 billion worth of bonds in a forthcoming IPO and, fall further still, should it sell more than C$2 billion.

Byres says 407 hopes to raise between C$750 million and C$1 billion in the IPO, most of which will go to re-pay the bridge loans. The remaining proceeds will be deposited as fresh funds into several reserve accounts such as a debt service fund and a construction fund.

The third section of the financing will come from the 407 consortium itself. It will invest C$1.55 billion in the form of a cash injection and the remainder from letters of credit and other subordinated bank debt.

Structuring a financing like this gives the project an air of corporate funding. It has, for example, a single asset with well defined obligations. However the deal is closed ended unlike corporate structures. The ?long tail' of a 99-year concession introduces a new element to road project financing as most concessions for new roads only last between 20 and 40 years. Says Tom Connell of rating agency Standards & Poor in Toronto: ?This has the benefit of having more flexibility when the debt is paid off. It means when it comes to extending the maturity, the amortisation equation is different. With a 20-year concession, you have to begin amortisation almost immediately to get the debt paid off, but with a 99 year concession, you don't have to amortise it for the first 50 years.?

When the sponsors decide to refinance the deal there will be no extra pressure of having the concession running out in a couple of years.

Electronic tolling, a relatively new concept, is built into the risk factor. But the proven technology and the success of the section already built and running, negated a great deal of the risk involved. In addition, before the sale of the highway to 407 International, the State of Ontario secured arrangements with all but one of the other Canadian provinces and some US states, to bill users of the highway from outside Ontario.

This risk is watered down further by more advanced technology beginning to come onto the market which will make billing more reliable. Says Byres: ?There are still a lot of risks involved, but the Province of Ontario took many of these out by building the initial road themselves.?

Byres adds that the history of toll-roads is that the revenue stream that comes from the road does not fall and, at worst, remains flat. ?That means that the bond holders know that they will get their money back and in the worst case, it will only take a little longer,? he says.

Valuable lessons may yet be learned for future toll-road projects. Says Byres: ?First, it is a commuter toll-road, not a point-to-point road. Second, 407 has the mandate to manage and charge in the most efficient way it can.? It does not, in other words, have a government-imposed cap on charges. Third, although it is technically a concession, the 407 deal also acts as a sale because the existing section of highway is being directly sold to another party. Finally, the long concession gives the financiers the flexibility to re-finance in later years. Concludes Byres: ?This is really something other governments could look at.?

Highway 407
Purchase price: C$4 billion ($2.68 billion); C$3.1 billion for the existing road and C$900 million in construction costs and debt service

Sponsors: SNC-Lavalin, Grupo Ferrovial and its subsidiary Cintra Concesiones de Infraestructuras de Transporte, and Capital d'Amérique (a subsidiary of Caisse de dépôt et placement de Québec)

Financing: C$2.3 billion senior bridge facility with a three-year tenor; C$150 million junior bridge facility with a 3.5 year tenor; C$1.55 billion in sponsor equity ? C$775 million in cash, the balance in subordinated debt.

Arrangers: Bank of Montréal for the C$150 million junior bridge loan; Bank of Montréal, Royal Bank of Canada and Citibank for the C$2.3 billion senior bridge loan

Lawyer to the lenders: Davies Ward & Beck

Lawyer to the consortium: Fraser Milner

Financial advisers to the consortium and lenders: Salomon Smith Barney and Nesbitt Burns