# Sol suppliers

01/03/2010

Peru's project finance market has often been overlooked in favor of its larger neighbors Brazil and Colombia, or the more advanced Chile. Those days are over. A hugely ambitious investment program has sponsors and lender sitting up. The country enjoys fast growth, a burgeoning financing scene, a strong reputation for probity and a fast-growing mining sector, which requires better infrastructure and ever-more energy. In a familiar story in Latin America, this enthusiasm has yet to be tested against the scale of government ambitions.

Peru's drive to improve its infrastructure comes after years in which investments have not kept pace with demand, says Gabriel Goldschmidt, the manager for infrastructure in Latin America at the International Finance Corporation (IFC). Today, the country offers one of the best combination of opportunities and the government has the will and regulatory framework in place to achieve its aims, he believes.

The macro elements supporting a fast expansion of infrastructure are there too with the highest regional GDP growth. The economy grew 1.12% last year despite the global recession, after an impressive 9.84% in 2008 and over 7.5% for the previous two years. The Central Bank is forecasting a further 5.5% growth this year.

The creditworthiness of the country has been improving, with Moody's awarding Peru an investment grade Baa3 rating in December. In reality, the anticipated upgrade made little market impact. Peru was already traded as investment grade, trading very close to Mexico, notes Luis Carrera, head of corporate finance at Banco de Crédito del Peru (BCP).

Even two sets of elections, a regional vote in October 2010 and Presidential elections in April 2011, seem unlikely to derail investor enthusiasm. "The market is very comfortable with Peruvian risk and the evolution of politics," says Cynthia Urda Kassis, New York-based partner at Shearman & Sterling. That's in contrast to 15 years ago under the Fujimori administration, she adds.

The spectre of the re-emergence of left wing Ollanta Humala as a serious political force has diminished and the other candidates are all broadly in favour of free trade and foreign investments, Carrera adds. In fact, regional elections might catalyse project finance initiatives in the provinces. "There will be a drive to boost investment across the regions as authorities seek re-election and want to show voters the investments they have made in construction and public works," he notes.

**Lending looks lively**

Through its investment promotion and concessions agency, Proinversion, Peru has an ambitious schedule of projects. Government studies show $30 billion in spending is needed in roads, energy, water and sanitation, ports and airports to get Peru up to Chilean levels, according to Ricardo Campins, deputy director at the Lima office of the Corporación Andina de Fomento (CAF). This banquet of financing might seem intimidating for a country whose total GDP in 2007 was some $110 billion.

Even without the Peruvian government's attempts to attract investment, private sector activity is spurring infrastructure development. Significant logistics upgrades are necessary to fully tap the potential of the mining sector, points out Rolf Schmitz, executive director in global metals and mining at WestLB in New York.

"Peru is one of the most exciting places in the Andean region for mining. Chile is already dominated by its '800-pound gorilla' companies and has well-developed local bank and capital markets. Peru has very interesting structured finance business opportunities and development is still in the initial stages," says Schmitz. As much as 50% of the capital expenditure on large-scale mining projects in Peru is dedicated to infrastructure, especially transport and power, he points out.

According to Schmitz, WestLB is already in talks with some dozen sponsors, mostly mid-cap and junior miners, for projects in the country. They are coming back in force thanks to improvements in commodity prices. Andean American recently appointed Barclays and WestLB Capital as lead arrangers on a senior debt finance facility of up to $68 million for the Invicta gold and copper mine, he notes.

**Financing diversification**

Demand for financing is also being met by a rapidly developing local bank scene, revolving around the growing sophistication of domestic banks and new players from within the region. Reduced lending from international banks has allowed these banks, as well as pension and institutional funds, to carve out a more significant role in project financing.

"This is one jurisdiction where you have been able to access multiple sources, including local banks, institutional funds and an active and fairly deep local bond market in dollars, for small- and medium-sized projects," notes Urda Kassis. "In other jurisdictions, you haven't had this flexibility and had to take just what's available. This seems to be a good omen for Peru's future pipeline," she notes.

Purely local and foreign-owned local banks turned out to be a mainstay in the global crisis. BCP's Carrera claims that his bank was responsible for a full 50% of the project financing that was completed in Peru last year, saying issuance came in at $1.6 billion, of which BCP financed $820 million, of which $400 million was lent in the last quarter alone. Furthermore, overall figures in the market were similar to 2007 and 2008, he says.

Carrera points out that local banks have access to internal funding in US dollars because locals hold both soles and the greenback. "We have not used foreign credit lines. Almost all our funding has been local in the last several years," he notes. Pension funds, which collect premiums in soles, regularly use cross-currency swaps and options to ensure dollar availability, he notes.

Jean-Valery Patin, a vice-president at BNP Paribas, adds that these young institutional funds are collecting some $2 billion in assets per year and are increasingly seeking to diversify away from government debt, making them a highly attractive target for arrangers of project finance for Peruvian projects.

The presence of these funds has given wings to the local bond market. "Any local AAA-rated company or project can get funding in Peruvian capital markets without any problem for deals of up to $400-500 million," says Carrera. "Pension fund and institutional funds are really becoming a part of the picture. And for projects which only have local revenues, traffic and construction risks are most appropriate for local currency investors," agrees Patin.

Outsiders recognise the growing role of local banks and their increasing sophistication. In the past, local banks stuck to corporate bond business, says Isaac Deutsch, deputy general manager and group head Latin America structured and corporate finance at Sumitomo Mitsui Banking Corporation. Increasingly, these banks are moving into new areas of financing, such as transmission lines and power plant deals. The dynamic between local and foreign banks is co-operative, he believes: "Local banks know markets and clients and we bring the technical and structuring skills".

And foreign banks stress the limits of the locals. Local lenders don't have the expertise to analyse risk, especially in more challenging deals where revenues are less predictable, such as a greenfield port, says Patin.

Moreover, the total portfolios of local banks are small, with the largest having a loan portfolio of about $12 billion, estimates Jeanne Del Casino, vice-president and senior credit officer at Moody's. Moreover, local banks are directing lending towards the lucrative consumer and mortgage segments, she says.

Bigger Latin fry are moving in, as Colombian and Brazilian companies win project concessions in the country. The arrivals of the likes of Petrobras, Votorantim and Camargo Corrêa have brought in Brazilian banks while Colombia's ISA is persuading Bancolombia to take a more active role. This has been a very noticeable trend, Deutsch says. The banks are following core client relationships and their regionalisation helps them grow at a time when domestic growth may be constrained by anti-trust issues, he notes.

For larger deals with longer tenors where local and foreign banks have been absent, multilaterals say they have stepped in. In large financings and at tenors of 10-15 years or more, it remains very, very rare to see commercial banks, says Goldschmidt.

Proinversión is also working to attract new sources of money by setting up infrastructure funds. CAF and the Inter-American Development Bank were invited to advise the government on the launch of such a fund, says Campins. The government is committing $100 million, the selected fund manager, Brookfield Asset Management, is co-investing $100 million and local pension funds are committing roughly $220 million, he says. CAF and the IDB are both going through internal processes to participate and he expects CAF will contribute in the region of $40 million. The fund will comfortably reach its initial target of $400-500 million, he predicts.

International banks say they are stepping up lending again too. "We went through a period of tight restrictions on how much capital we could use and each deal was scrutinised with priority given to core clients," admits Deutsch. "But that has, for the most part, ended," he says. European retail banks that had been dipping their toe into the project finance market have probably gone forever, leaving a core of large banks that are committed to the project finance business, adds Schmitz.

**Transport: Beyond the CRPAO**

The transport sector has one of the most proven track records and concessions for toll roads have already been a key area of activity. Moody's, for example, rates three such projects. The contracts through 2008 for the concession were generous, exposed bondholders to little revenue risk, and featured a quasi-sovereign guarantee: when Moody's raised Peru's sovereign rating, the three road concession projects were also upgraded.

If construction milestones are hit, the concessionaire gains the right to collect fixed annual construction payments denominated in US dollars in the form of an unconditional payment certificate, or CRPAO, issued by the government, explains Laura Barrientos, a senior credit officer at Moody's. That payment stream can be aligned with the bond schedule, she says. This has enabled the government to put together projects in regional and more remote areas, whose revenue profile would not be attractive to lenders. The government, however, wants in future to transfer more risk to the private sector.

One of the largest ongoing projects is the five-section Corredor Vial Interoceánico Sur, a highway to link the Pacific coast of Peru with the Atlantic coast of Brazil. Patin points to BNP Paribas' use in 2007 of a hybrid structure on the $562 million financing for section four. The structure avoids negative carry, which can be pronounced for a greenfield project with a long construction period. The deal used a credit default swap and a total return swap.

Projects for this year include the completion of the Autopista del Sol to the Ecuadorean border and on to Guayaquil from the northern city of Sullana, slated for the last quarter. Last year, a $165 million road concession for the adjoining portion of this road was awarded to Vias Del Sol, featuring Ecuador's Hidalgo & Hidalgo and Peru's CASA, for a section that terminated in Sullana. That 25-year build-operate-transfer concession covered rehabilitation and operation of 475km of road.

Azul del Villar, infrastructure and project finance analyst at Fitch Ratings, says that the government has been reconsidering requirements for roads and reviewing tenders, leading concessions to be delayed. A number of large transportation projects are slated to be tendered ahead of regional and national elections, however. The Achamanqui-Tingo road in Amazonas and the Panamericana Sur from Ica to the border with Chile are still on the list for this year.

A second package of airport upgrades is estimated to require investments of $237 million and will cover six regional

airports, while there is a separate plan for the upgrade of Cuzco's international airport, as the gateway to the popular tourist site, Macchu Picchu.
Plans for a long-mooted surface train system in Lima are moving ahead. The project was initiated in the first Garcia government (1985-90) and part of the infrastructure is ready, notes Campins. CAF is supporting the project with a $300 million loan, representing half of the total for the project, he notes. The government will build the system and then launch a concession for the supply of trains, as well as for operations and maintenance, he notes.

One banker believes that the history of the Lima train deal is a rare example of a Peruvian deal that has had a chequered history. The original plan was for the concession to include the construction portion, but tight conditions meant that bidders were not forthcoming and the government had to go back to the drawing board.

**Camisea leads the field**

Probably the most promising sector, both for foreign lenders and Peruvian funds, is hydrocarbons, both oil and liquefied natural gas (LNG). The development of the Camisea gas field in the Peruvian Amazon has spawned not only a number of pipeline deals but a series of industrial and manufacturing projects.

The most significant Camisea project is the $3.8 billion Peru LNG project, entailing a pipeline and liquefaction plant, sponsored by Hunt Oil (50%), Repsol, SK (both with 20%), and Marubeni (10%). Financing for that deal has also helped kick-start the bond market. BCP placed $200 million in debt at the end of last year for the project. It was the sector's first program of corporate bonds and the largest such placement in Peru for five years, notes Carrera. The deal obtained an annual compounded rate of 6.88% for a 15-year period.

The gas fields are sparking huge amount of investment in upstream projects, with spending on infrastructure improvements estimated to cost in the billions of dollars in coming years, notes Deutsch. Last May, the Conduit-sponsored Kuntur Transportadora de Gas, which won the bid for the Gasoducto Andino del Sur pipeline, appointed Sumitomo and Goldman Sachs to work on the roughly $1.5-2 billion project. The pipeline will feed power plants, petrochemical facilities and petrochemical facilities among others, Deutsch notes.

Financing for the Andino pipeline has not closed, Deutsch says. The huge amount of demand for gas projects is not being met by onstream supply, as there is a lag in proving up reserves, he notes. "There are more projects right now than reserves to support them," he says. This is slowing down all related projects, from pipelines to fertiliser and petrochemical plans.

**Energy and distribution**

The government is pushing forward in the energy generation and transmission sector, and not all of this work is dependent on Camisea gas. The most important outstanding deal is for the Chilca-Marcona-Montalvo transmission line project, estimated at $250 million. Qualification bids have been pushed back to March, however. BNP Paribas and WestLB closed a $78 million financing in December for ASA Iberoamerica's Abengoa Transmisión Norte to build five transmission lines and expand sub-stations.

The seven-year balloon financing, proves that banks are willing to provide longer tenors, says Antonio Pichardo, director in global metals & mining at WestLB. Peru's electric market is highly-regulated by the Ministry of Energy and Mining, which recently approved a comprehensive, well-structured transmission line programme, providing assurances to private investors and international banks, helping the arrangers to reach almost 100% over-subscription. Societe Generale, HSBC, Scotia Peru and BCP all participated, notes Pichardo. The construction period is slated to end in just over one year and there is a good chance that local institutional funds will be able to provide financing of more than 10 years when the lines are operational from 2011, he notes.

Other significant sectors include water treatment and irrigation. Peru has enormous potential for agribusiness, which is limited by the availability of water, says Campins. CAF is participating in the first stage financing of an irrigation project in Olmos, which includes a dam and tunnel to carry water from the Andes to the western part of the country. A second phase will include hydroelectric capacity and the third stage irrigation for 40,000 hectares, he notes.

There is genuine enthusiasm on Peru and the combination of strong economic growth and a government that is willing to listen to investor demands has stoked their interest. Gas supply problems, the volatility of commodity markets and the fragile economic recovery, however, continue to hang over these deals.