Futuras perfect?

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One thing almost every project bond market has is an aversion to construction risk. Latin American markets tend even to shy away from performance risk. So, in tandem with the development of domestic and cross-border appetite for structured sovereign credits, Latin project issuers have frequently depended on government payment mechanisms with little linkage to performance, and strong sovereign support.

Peru, which has enjoyed strong growth in assets in its pension fund and life insurance sectors, resilient growth, and an improvement in its sovereign credit rating, was the natural place to develop a new payment mechanism. The Certificado de Reconocimiento Por Avance de Obra, or certificate acknowledging the right to receive a payment for work, or CRPAO, was a transferable direct obligation of Perus government to repay sponsors for the work they did building a road.

The CRPAO and its progeny

The CRPAO could be dollar-denominated, and was not subject to performance risk (another set of payments, the Pago Anuales por Mantenimiento y Operación, or PAMOs, covered operations and maintenance). The Peruvian government declared them not to be sovereign debt obligations, in part because they are subject to the annual budgeting process, though they must be included in the budget by law once approved.

The first use of the CRPAO was on the IIRSA Norte financing, a $213 million Morgan Stanley-led bond financing for sponsors Odebrecht (49.9%), Andrade Gutierrez (40%), and Grana y Montero (10.1%). The deal, which closed in 2006, was pitched to US investors, and was followed by several more deals that were financed by a mixture of Peruvian dollar and Nuevo Sol investors, Peruvian banks and even some US investors, most notably US investment banks proprietary trading desks.

As Peru moved inexorably into the investment grade territory, foreign holders of CRPAO-backed debt, at least those that did not try and lock in their illiquidity premium by shorting the more liquid Peruvian sovereign, could book some handsome gains. In time Perus pension funds, which initially preferred either large local corporates or resources issuers with foreign sponsors, participated more enthusiastically.

The Peruvian governments main aim was to bring some speed and discipline to the infrastructure procurement process without putting undue strain on its finances. The CRPAO structure made for some intricate financial engineering, mostly because bond proceeds were drawn at once but not used until CRPAOs were issued by the Ministry of Transport and bought by the issuing trust. Much of the underwriters work centred on minimising the negative carry on the bonds through the use of reinvestment agreements and total return swaps.

At least part of the attraction of CRPAOs disappeared when the International Monetary Fund decided that they constituted debt obligations of the Peruvian government, the governments declarations to the contrary notwithstanding. But the government could not in any case expand the use of CRPAOs indefinitely. Even with generous accounting treatment, these commitments would have had to be funded somehow, whether by borrowing or from revenues.

Peru uses a slightly different payment structure for its water sector, the RPICAO, a Soles-denominated, inflation-indexed payment obligation of state-owned water utility Sedapal. The obligation stays on Sedapals balance sheet, backed by a contingent guarantee from the Peruvian government. It appeared on the S/.321 million ($112 million) local currency bond financing that BNP closed for the Huascacocha-Rimac water derivation concession, sponsored by Brazils OAS.

Huascacocha has several features that indicate that Perus capital markets are hurtling towards maturity. The first is that S./108 million of the total is delayed draw, minimising some of the negative carry issues that vexed earlier sponsors. The second is that the transaction, while denominated in Soles, was documented predominantly under New York law, featured an offshore issuer, and could be sold, if need be, to foreign investors. The last is that it as the first commitment by Peruvian pension funds, known by their initials as AFPs, through a dedicated infrastructure debt fund that pools their resources and depends on one fund, in this case Prima, to carry out due diligence.

If Perus pension funds want to keep up with the breakneck pace at which ProInversion, Perus investment promotion and concessions agency, is trying to award infrastructure deals, then they will need to become more accepting of performance and revenue risk. The alternative will be a vast expansion in the capacity of Perus banks to absorb these risks. While Chile, the most obvious forerunner of Perus experience, was eventually able to depend on its banks for smaller concessions, it benefited from foreign-owned banks assigning lower risk-weightings to project debt in Chile, and a longer period of financial sector reform behind it than Peru currently enjoys.

Vigencias futuras and the banks that love them

The experience of Peru to date offers some intriguing lessons to Colombias infrastructure industry, not least because Colombia plans on using a very similar instrument to the CRPAO to spur infrastructure construction. It has taken an existing concept of multi-year spending commitments vigencias futuras that are direct obligations of the government of Colombia, and applied them to infrastructure concessions. Like the CRPAO, they would also be good candidates for a bond market financing.

But Colombias backdrop is a little different. For starters, it is home to two large financial groups Bancolombia, and the various constituents of Grupo Aval with the ability to finance vigencias futuras with bank debt, and the resources to handle large projects. Bancolombia, along with the Central American Bank for Economic Integration (CABEI), closed a $350 million project financing for AEIs Jaguar power project in Guatemala, its most ambitious move outside its home market in project finance to date. Avals two largest bank holdings, Corficolombiana and Banco de Bogota, could each finance a $200 million project on their own. Both Corficolombiana and Bancolombia have asset management arms with an interest in project equity participations.

The banks profess some worry at the scale of their exposure to Colombias construction industry. Absolutely, we need to be worried about the extent of our risk concentrations, says one structured finance banker at a Colombian institution. But the country has great infrastructure needs, and the Colombian financial sector is pretty healthy. The long-running ties between the big banks, construction companies, and especially the large municipal utilities such as Empresas Publicas de Medellin make the bank market the obvious first call for sponsors.

Colombias banks and contractors have long enjoyed a lock on infrastructure finance in the country, partly because foreign capital had long-standing concerns about Colombias stability. Now foreign sponsors, particularly in power and transport, are eyeing Colombia with interest. Foreign lenders are more cautious.

Under Colombias previous administration, led by Alvaro Uribe, infrastructure was not a priority, and took a back seat to government efforts to loosen up the economy and bring Colombias political violence under control. Inco, Colombias concessions agency, had a fractured relationship with the National Planning Department, and suffered from a rapid turnover in staffing. It lost one director general Álvaro José Soto to a scandal over bidding irregularities in September 2009, and has had two more heads since then.

The new administration of Juan Manuel Santos is set to follow Uribes business-friendly security and economic policies, and his new transport minister, Germain Cardona, has promised a more thorough approach to project procurement, including a national infrastructure agency. Throughout this upheaval, Inco, advised by the International Finance Corporation, has brought three sections of the flagship Ruta del Sol road to market.

Ruta del Sol as test tube

Ruta del Sol, roughly 993km of existing highway and 70km of new work, stretches from 70km north-east of Bogota to the port of Santa Marta on the countrys Caribbean coast. It symbolises the recent administrations wish to knit Colombia together more closely, after a long period during which large parts of the country were outside the governments control. The roads, more an expression of political will than current economic lifeline, would not be natural candidates for a real toll concession.

A combination of the roads need for subsidies and the financial crisis, prodded Inco to split the road into three and support its construction using vigencias, which will be issued when roads reach certain construction milestones. Ruta del Sol is not the first time that an infrastructure project benefited from these payments. Phase III of Bogotas bus rapid transit system, the Transmilenio, used them as the basis for a roughly $150 million Citi-led securitization, on which law firm Posse Herrera & Ruiz advised. But Transmilenio is a government-owned entity, is already in operation, and the receipt of vigencias is not tied to construction milestones. But the bonds, which were sold to local investors, and their sale proved that vigencias are acceptable in principle to pension funds.

The first, and shortest section of Ruta del Sol, of 80km, went to local construction company Solarte, and uses what is essentially a short-term build-finance structure. Solarte is understood to have raised the roughly Ps180 billion ($100 million) in debt for this section from Bancolombia.

The second section, 528km in length, went to a consortium led by Odebrecht, of Brazil, and Corficolombia, part of Grupo Aval. Corficolombia has provided the consortium with a Ps200 billion bridge loan, and is likely to be the sponsors first call for a long-term financing. The project company, Concesionara Ruta del Sol, won the concession in April 2010 and has roughly 12 months to close a financing.

The third section went to Yuma Concesionaria, a consortium of Impreglio, the Bancolombia-managed Fondo de Capital Privado Ruta del Sol, Infracol and Cl Grodco. Under the concession contract, which has a net present value of $672 million, Yuma will be responsible for expanding and improving a 464km section from San Roque to Ye Cienaga. The concession lasts 25 years, or until the concessionaire hits its targeted NPV.

The Colombian capital markets are open to transport assets. Concesionaria de Occidente, which operates a 50km road between Pereira-La Victoria, had a Ps162.5 billion Interbolsa-led issue out to market in July, consisting of bullet tranches with maturities of between three and 10 years. Its sponsors are Conalvias (93%) and Patria (7%), and it first won the concession in 2004, with construction set to be complete in 2011. The bonds refinance construction debt and fund interest and capex reserves.

But Occidente represents an outgrowth of existing practice: fund a road with short-term corporate borrowings, wait for traffic to materialise, and then pay down debt and fund additional work on the road. The Ruta del Sol system is designed to encourage sponsors to build the road quickly, in 10km increments, to buy as much of the land for the road as they can without using the cumbersome compulsory purchase system, and to bid the lowest NPV possible.

But Colombias pension funds, the cornerstone of the Peso bond market, and known by the same initials, AFP, as their Peruvian counterparts, have little appetite for construction risk or novel structures. If a vigencias-backed bond followed the Peruvian template, then proceeds would stay in escrow until used to purchase vigencias, meaning that they would only be used when construction risk was no longer an issue The vigencias might sidestep construction risk, but a greenfield deal would be a hard sell, even with the Transmilenio precedent.

The pension funds, flush with cash, have many opportunities to support operational assets with familiar domestic sponsors. Bank lenders, though, will be more than happy to lend against such instruments.

But Colombias robust economy is presenting the sponsors with another financing option the overseas Peso market. The market is relatively untried, though the Colombian government closed a $550 million 11-year global peso issue in July at 6.75%, and these bonds are believed to be trading at yields of nearer 6.2%, as investors assume that, with a sovereign upgrade to investment grade, they will realise quick trading gains. If sponsors can find enough US funds with an appetite for structured sovereign risk vigencias-backed bonds they might be able to tap a funding source that can compete on price with the Colombian bank market, which would demand pricing of CPI plus more than 500bp. Ruta del Sol 2 is set to come to market in November, and will be the section to watch for capital markets hopefuls.

The pickings for the foreigners

Assets with dollar revenue streams can expect enthusiastic support from international banks. WestLB, with $57 million, and BES, with $50 million, provided the bulk of the $160 million financing for Grupo Maritime TCB and Grupo Empresarial del Pacificos Buenaventura container port on Colombias Pacific coast. The debt package also included an $18 million 10.5-year mezzanine C loan from the International Finance Corporation and the EMP-managed Central American Mezzanine Infrastructure Fund, a $25 million 13-year A loan from the IFC, and a13-year $10 million B loan from the Corporación Interamericana para el Financiamiento de Infraestructura.

The Inter-American Development Bank is believed to be looking at providing a senior financing for OPAIN, the Areports de Paris-led concessionaire for Bogotas El Dorado international airport. Ecopetrol, Colombias national oil company, has hired BNP Paribas to advise on a multi-sourced and export credit agency-heavy financing for Reficar, a new roughly $5 billion refinery that it plans to build near Cartagena. The refinery was once set to be a joint venture with commodities trader Glencore, but Ecopetrol dissolved the joint venture and bought out Glencore in May 2009.

This division between international dollar bank and domestic peso business is likely to persist, unless a foreign institution cares to spend substantial time and effort cracking open the wallets of Colombias pension funds. But even if it takes time to develop a domestic project bond market, some benefits to the Ruta del Sol process are already apparent. As one adviser close to the process notes, Weve got some heavy-hitting international players involved in the larger two sections, and this should bring some discipline to the local contracting market.

The Colombian banks efforts to corral local sources of financial equity for the projects also offer grounds for optimism. Colombia currently has more infrastructure fund hopefuls than suitable assets, with Inverlink, Ashmore and Brookfield all managing Colombia-focused ventures. These funds are likely to focus on smaller deals, particularly in the energy space. If pension funds gain exposure to infrastructure through bank-arranged equity, rather than debt, it will be a real tonic for Colombias infrastructure market.