Small mercies

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The German economy, if not all of the countrys banks, has weathered the financial crisis better than many of its European neighbours. But its infrastructure and project finance market is in a phase of transition. A forthcoming overhaul of the German landesbanks operations has increased market uncertainty, even as lenders, and sponsors, adapt to the same post-crunch realities as other jurisdictions. The recent A8 II Ulm-Augsburg motorway PPP procurement has brought a number of issues with the A-model transportation programme to the fore.

The South Bavarian procurement review board, or Vergabekammer Südbayern, rejected an appeal from Bilfinger Berger and John Laing against the decision by the South Bavarian Motorway Authority, or Autobahndirektion Südbayern, to award the 30-year concession to a consortium of Hochtief and Strabag. A second appeal is underway, but the Eu400 million ($547 million) project is expected to go ahead as planned with the preferred bidder and lenders say that they are now working towards a financing solution irrespective of the continuing legal discussions.

According to a German lender close to the procurement, the difficulties with the A8 have arisen as a result of a system unchanged since the outset of the financial crisis. This is the first major A-model deal since Lehman and it seems that the government wasnt expecting the increased cost of doing business to be reflected in this deal. Debt is more expensive, the sponsor still expects a good return and everyone is more cautious about risk allocation. The bids were very close, he says. So close that either side would have appealed.

The A-model, remodelled

The increased cost, relative to previous A-model motorway deals, has resulted in government pushing for the creation of a public finance comparator to assess the viability of private concessions compared with state-funded development.

The private-sectors traffic volume projections are said to be at the centre of the debate. Post-crunch, traffic volumes on some of the existing A-model motorways fell to around 20% of the projections included in the base cases of the financing structures and, according to a lender familiar with earlier deals, traffic has not yet recovered sufficiently for the dip to be overlooked. We hope the tail is long enough on the debt and that volumes will recover in the interim, but those inflated projections are now a factor in the A8 discussion and on how future projects will be financed, says one lender.

The outcome of this assessment is unlikely to have any major impact on the A8 project, as advisers believe that it would lead to further litigation and cost more in the long term to terminate the procurement at such a late stage. Politically, the impact would be too big, says one adviser, especially as the road gives access to so many other countries. It could also damage future procurements if governments appear unreliable in following through on its tenders. However, these discussions may have an effect on forthcoming projects. Some of the other A-model deals could be scaled back if a government thinks it can do it cheaper, suggests the adviser.

The German motorway concession procurement process differs from other European markets as only commercial vehicles are required to pay tolls. The state owns and operates the autobahn system but it outsources its tolling operations to Toll Collect. The A-model PPPs are widening and development of sections of the existing A-roads. In earlier deals, the way in which the concessionaires were compensated was somewhat complex as it required negotiation with Toll Collect. The A8 project, when issued in 2009, was intended as a test case for a more simplified model in terms of toll allocation and distribution. The A9, which uses availability payments, and is federally awarded, will be simpler still.

The first round of bidding for the A9 deal is complete and attracted attention from a number of international investors, including Spains GlobalVia, and several domestic sponsors. Max Bögl and a consortium of Vinci and BAM have been shortlisted, and an award is expected by the end of the year. It is the first of the A-model projects to be offered as an availability deal and was originally intended as the test model to complement the new procurement structure used for the A8.

The availability payments will be paid to the sponsor monthly, based on performance. There are also milestone payments during construction, for 85% of the total construction costs, plus a predetermined lump sum. Advisers familiar with the market believe that the A9 process has been held up until the outcome of the A8 award is known.

Social infrastructure has few surprises

Though Germanys social infrastructure pipeline has remained steady, the financings for schools and hospital deals have been smaller-scale, sub-Eu100 million, with a handful of exceptions, and procured under the forfaiting system which involves a pass-through of the municipal credit and lowered debt costs through guarantees on receivables. Larger-scale project finance lenders and sponsors have not had much appetite for the German social infrastructure market as a result, but a number of recent developments could change the level of interest.

Partnerschaften Deutschland, the governments PPP taskforce, is in the process of tendering its first project, a 30-year concession to build and operate the new Ministry of Education and Science building in Berlin. Market watchers also point to a number of hospital and leisure centre deals in the pipeline and a bridge development project in Frankfurt.

This Parnerschaften Deutschland project will test the market for social infrastructure, suggests one adviser. But frankly, there is very little appetite in Germany for these kinds of infrastructure deals at the moment. The two roads deals are attracting a great deal of interest, but they are the exception. Appetite has moved much more towards power and renewable deals, especially for German lenders and the landesbanks that are still active.

Twilight of the landesbanks?

Despite the strength of the German economy, its banking operations are troubled. Our bank market is fragmented, explains one lender. There are too many banks doing the same business and a lot of the landesbanks are no longer needed.

The landesbanks were each backed by strong regional ratings but this grandfathering expired in 2005 for many of them, including WestLB, he continues, although some existing liabilities are still protected for another 15 years or so. But now these institutions have to fund themselves, and compete with other active institutions such as Deutsche Bank, Commerzbank and UniCredit, for example, which is proving challenging.

One of the problems facing the landesbanks is that their savings-institution owners traditionally restricted the growth of their retail business, which has made it hard for them to build up a low-cost funding base. Though some of those restrictions have been loosened since 2005, some of the landesbanks have been unable to establish a business model that could generate broader revenues in the long term.

WestLB is at the front of the line for restructuring. The European Union Competition Commissioner requested a restructuring plan for WestLB, which was delivered by the bank in time to meet a 15 February deadline. The owners a consortium of German savings institutions and the regional government of North Rhine Westphalia have three options: To sell parts of WestLBs operations, to shrink its existing operations to those which directly support the owners interests, or a co-ordinated closure of the whole bank.

The EU recommendations are expected to result in at least the divesting of WestLBs international assets and interests, which would necessarily include its multi-national project finance portfolio. Whether there is buyer appetite for parts of the business remains to be seen, but Bank of Tokyo-Mitsubishi UFJs wholesale purchase of Royal Bank of Scotlands project finance portfolio for $4 billion last year (which also was accompanied by the transfer of key staff) has been mooted as a model and underlines appetite at some lenders for increased exposure to European project finance. The EU focus also extends to HSH Nordbank and BayernLBs activities, and follows the German government bail-out of Hypo Real last year.

Opinions are divided over whether the WestLB situation signals a general decline of the landesbanken. Some of the others are going to be at the same stage in a couple of years time when their respective state guarantees expire, says one lender. The ones which have specific German domestic interests are likely to be safer than those which have invested heavily abroad. Some of them were required by their owners to have a German angle either in support of a domestic client or provider. Helaba is looking pretty profitable and Nord/LB too.

Foreign affairs

Despite the turmoil surrounding domestic institutions, sponsors and lenders do not think that the infrastructure deal-flow will be adversely affected. There are plenty of lenders willing to become involved in forthcoming deals, says a lender at a German commercial bank. At the moment, there are a small number of lenders that have a competitive edge. There will be more opportunities for foreign lenders to enter the German market, but at the moment the problem is access. Language, regulatory understanding and a lack of physical presence in Germany is delaying some bigger international banks for now, but the foreign sponsor appetite is growing and their go-to relationship lenders will soon follow.

There is a particular Spanish interest in the German market, as evidenced by the takeover bid from Spains ACS for German company Hochtief. Thats one way to gain access, says the lender. GlobalVia is also actively bidding on German projects. The pressure on the Spanish construction groups from their shareholders to diversify and invest in new regions, while the Spanish domestic market is so fragile, makes Germany a prime target.

German sponsors are resistant to sharing the domestic market in this kind of international climate, says a lender at a landesbank. They can still afford to be aggressive on bidding for projects on home turf, even though ACS, Bouygues, Vinci and so forth pose some stiff competition.

Though Hochtief has strenuously resisted the takeover in a number of ways, including a 9.5% equity issue in Decemeber, ACS has to date succeeded in acquiring 33.5% of Hochtiefs shares. After acquiring more than 30%, ACS in now in a position to continue to buy Hochtief shares in the open market. The irony is that, despite Spains flagging economy, its largest sponsors have substantial international assets and do not entirely rely on their domestic economy. But the German banks are in the opposite position, because their domestic interests are likely to be the anchor for their future prospects.

Market circumspection

Although both the A8 fallout and the wider banking restructurings are causing some degree of market chatter, there is a pervasive sense of calm in the German infrastructure market.

The A8 was tendered at the worst possible moment for raising debt, says one lender. Government was naive, perhaps, in thinking that it could be done as competitively as before, but it will see from the A8 studies where the process can be streamlined and there is a greater appetite for availability deals in the meantime anyway, at least until were recovered enough to start taking traffic risk again.

The WestLB situation and its potential impact on the German bank market is also unlikely to have any long-term effect on the infrastructure deal flow, as foreign lenders are already looking to fill the gaps; though their involvement may cause initial friction with domestic bedfellows.

Our economy is doing well where others are not, says a German adviser. Sure, there are problems in the short term, but the German infrastructure market has been built on conservative investment for the most part and so our long-term outlook is pretty stable.