

Strada dei Parchi: First of many roads?

02/03/2011

Italian energy bankers have gorged themselves on numerous PV projects over the last 18 months, while their envious infrastructure peers looked on. However, the close of Italys first project financing of a road concession, Strada dei Parchi, could at last signal a wave of road PPP deals. Strada dei Parchi not only shows that the new regulated asset base model for toll roads is bankable, it finally shows there is a credible road sector beyond general contractor schemes for project finance practitioners in Italy.

A club of seven commercial banks plus Cassa Depositi e Prestiti and SACE signed a Eu570.5 million (\$788.9 million) debt financing for Strada dei Parchi on 25 February. First drawdown is due in March.

The Eu570.5 million debt financing has a tenor of 17-years with a three-year operational tail, is fully amortising and comprises five tranches:

Facility A of Eu280 million to refinance existing activities;

Facility B of Eu200 million;

Stand by facility of Eu40 million;

Revolving working capital facility of Eu30 million;

Performance bond facility of Eu20.5 million provided by the concessionaire to grantor ANAS.

Dexia Crediop and Société Générale led the transaction and provided a Eu180 million bridge. In the long term deal they were joined by BIIS, ING, MPS, UniCredit and WestLB. SACE is covering Eu50 million of SG's Eu90 million ticket and Cassa Depositi e Prestiti has taken a Eu150 million ticket. The EIB could join the financing using its intermediary provisions to lend to CDP. The EIBs participation would reduce the facility size by around Eu5 to Eu7 million due to lower debt margins.

The average all-in debt margin is 300bp, with the margins ratcheting over time. The debt-to-equity ratio is in the range of 75:25, the minimum debt service cover ratio is a healthy 1.4x and the LLCR is 1.6x. The average life of the loans is around 12 years.

The project company, Strada dei Parchi, owns the concession to build, operate and collect tolls for the 166.5km A24 (Rome-Aquila-Teramo) and 114.9km A25 (Torano-Avezzano-Pescara) highways. The two highways are the connection between the Tyrrhenian and Adriatic coasts of the peninsula. Proceeds from the financing fund the 2011-2013 industrial plan of the concessionaire which includes new investment and supplementary maintenance for a total of Eu343 million. A planned servicing of Eu557 million for the complete duration of the concession is also planned.

There were four principal challenges to putting together the financing. Firstly, with no other Italian roads concessions project financed to date, lenders are typically used to providing corporate loans to large concessionaires such as Atlantia (formerly Autostrade) on a utility-like debt to equity ratio of around 60/40.

Second, the most important risk for lenders to mitigate was the construction risk. This is awkward under Italian law

because under its interpretation of EU law the concessionaire needs to put the rolling construction contracts out to public tender. This issue was overcome with the lenders agreeing with the sponsor, Toto Costruzioni, a structure whereby the sponsor accepts construction risk beyond a certain threshold. This effectively turns the lenders exposure into a lump sum turnkey contract.

The third challenge was that the ownership of the concessionaire changed partway through the financing process. Strada dei Parchi was originally sponsored by Atlantia (60%) and Toto Costruzioni (40%) and is a legacy concession that was renewed to the end of 2030. During the structuring process Toto agreed to purchase all of the equity in the company. The financing was a condition of the equity transfer, and approval from grantor ANAS and approval from the antitrust authorities were conditions of the financing. Given the equity transfer, banks had to get comfortable with the medium-sized Italian construction company, Toto (which is in any case one of the most used construction company by Atlantia in its network), as controlling shareholder as opposed to Atlantia, the largest toll road operator in the world.

The fourth challenge was that the project was worked up under the new regulated asset based concession model that was put in place by the government in 2007. As the project was progressing towards financial close in September 2010, with some banks already committed, CIPE (Interministerial Committee for Economic Planning) revised its position regarding termination liabilities. It removed the ANAS take-over provision which was a combination of a termination indemnity paid by ANAS and its assumption of the concessionaires net financial liabilities in case of early termination of the concession. With the new scheme, on early termination of the concession ANAS would indemnify the concessionaire and lenders with a termination payment. Whereas under the old regime banks had accepted ANAS's guarantee as a state guarantee, the new indemnity payment method required legal due diligence as well as a restructuring of the initial base case in order to achieve an acceptable termination value to net debt ratio that delayed financial close by five months.

The regulated asset based model is a model commonly used in the regulation of utility companies to ensure that private companies do not profit unreasonably from the provision of a public good. A ceiling for tariffs is determined depending on the capital expenditure of the project. It is the first time a profit cap has been used on motorway concessions anywhere.

The new regulatory framework introduced a new formula for the tariff calculation. In Strada dei Parchi case, the tariff calculation formula can be summarized as follows:

$$\Delta T = \Delta P \times X + K + Q$$

Where:

ΔP is the annual inflation rate annually assumed by the Italian Government

X is a parameter, determined every five years (at the beginning of each regulatory period) that sets to zero the delta between the present values of eligible costs and the present value of the expected revenues. Eligible costs include the allowed return on the existing RAB;

K is a tariff parameter determined yearly which remunerates the investments completed in the previous financial year (new RAB);

Q is the quality parameter that can be positive or negative depending on the condition of the road surface and the global accident rate.

The regime places a lot of power with the grantor ANAS. ANAS negotiates with each concessionaire for each project the projected IRR for the sponsors that is preserved through a five-yearly equilibrium mechanism depending on the toll receipts. The new tariff comprises a profit cap that maintains the difference between allowed costs and allowed revenues, with any surplus handed over to the public purse. It also comprises a yearly cost parameter allowing the concessionaire to recoup investments in the previous financial year.

Offsetting the profit cap, the new regime removes a large portion of traffic risk but places the cost of delays in

construction on the concessionaire from the time of regulatory approval a fairly sizable risk given the length of time to close these projects and EPC inflation. Any income from roadside services will be added into the allowed revenues, where it was potentially an additional source of profit under the old regime. On Strada dei Parchi, for instance, there is marginal income from the rent of petrol stations.

The new regime should be more bankable because sponsors and lenders are not taking naked traffic risk for the life of the concession and are mostly exposed to performance risk and escalating operating cost risk beyond allowable costs.

They are still taking some traffic risk, however, and they are also taking model risk. Where lenders and sponsors are most exposed is on a severe downside scenario where the traffic is far lower than projected by ANAS. In such a scenario the elasticity of demand for the toll road could be so elastic that a bad loop is created at the five-yearly equilibrium points of higher tariff and lower traffic and eventually to too few vehicles travelling at the greatest allowable tariff. This problem is most severe for greenfield toll projects, so it is no surprise that Strada dei Parchi is a brownfield project with several years of traffic and toll data, showing an extremely limited elasticity of traffic demand to changes in tariffs, GDP or oil prices.

Given the successful close of Strada dei Parchi, 2011 could mark the beginning of a wave of road concessions in Italy. The trouble facing financiers is that many of the concessions face more challenges than Strada dei Parchi. Lenders face a dichotomy in the market between new greenfield projects, which have no traffic data and are therefore much more prone to traffic model risk, and legacy concessions that require funding for large capital expenditures but with only a short period remaining on the concession. Lenders therefore have a choice of whether it is better to take concession renewal risk or the greenfield traffic risk.

The Friulia-led Autovie Venete is an example of a legacy concession it expires in 2017. Banks are currently considering Eu1.8 billion (\$1.3 billion) debt backing its A4 Venice-Trieste highway widening programme. Given the large sum of capital involved and the short time to recoup the cost through tolls, a large equity balloon will be paid to the sponsors by the awarding authority or by way of a purchase price from a new concessionaire. Financing these balloons has proved difficult given the states refusal to directly guarantee their payment and the reluctance of CDP to guarantee their payment using its FGOP provisions.

An alternative to a balloon, where work is required but the concession is nearing its end is for the concessionaire to renegotiate an extension or new concession with ANAS. This is likely for the Torino-Ivrea-Valle D' Aosta (expiring in 2016), Autostrade del Brennero (expiring in 2014), Autostrade Meridionali (expiring in 2012) and Autostrade Centro Padane (expiring in 2011).

Some projects, however, combine both these most challenging aspects a greenfield project with a balloon. This is the route chosen for the BreBeMi (Brescia, Bergamo and Milan motorway) project, whose 19.5-year concession leaves insufficient time for the toll receipts to recoup the capital cost of the works. BreBeMi, which is sponsored by Intesa Sanpaolo (of which BIIS is a subsidiary) and Autostrade per l'Italia, together with 25 other regional private and public shareholders, was also cursed with originally progressing under the old concession regime then swapping to the new regime and connecting to the delayed Milan ring road (TEM).

Many of the projects in the immediate pipeline had their concession agreements negotiated in the period from 2000 to 2007 when financing conditions were particularly favourable, so are going through the process of agreeing new terms with CIPE to account for higher debt funding costs.

So while Strada dei Parchi proves that the regulated asset base model is bankable and has settled the termination liability issue, lead times are likely to remain long. Has or will the new concession model set out what it hoped to achieve? While it will stop sponsors from over profiteering on toll receipts, the balancing mechanisms still do not entirely remove traffic risk from lenders. It is therefore difficult to conclude that the new model is anything more than a fudge to overcome the fact that under Italian law availability payments cannot be made to road projects. Either toll road must stand on their own economically or they must be supported by upfront grants or back-end balloons. Still, Strada dei Parchi shows that while difficult road project financings in Italy are possible.

Strada dei Parchi SpA

Status: financial close 25 February 2011, drawdown due in March

Description: Eu570.5 million debt financing for Italys first project financed road concession

Sponsor: Autostrade per l'Italia; Toto Costruzioni

Original mandated lead arrangers and joint coordinators: Dexia Crediop, Société Générale

Hedging coordinators: Dexia Crediop, Société Générale

Lenders: BIIS, Cassa Depositi e Prestiti, ING, MPS, UniCredit and WestLB (SACE was a guarantor on a portion of facility B)

OMLAs and lenders legal counsel: Legance

OMLAs and lenders Technical adviser: Steer Davies Gleave

Insurance adviser: Marsh

Model auditor: PwC

Sponsor legal counsel: Chiomenti

Thank you for printing this article from IJGlobal.

As the leading online publication serving the infrastructure investment market, IJGlobal is read daily by decision-makers within investment banks, international law firms, advisory firms, institutional investors and governments.

If you have been given this article by a subscriber, you can contact us through www.ijglobal.com/sign-in, or call our London office on +44 (0)20 7779 8870 to discuss our subscription options.