Infra refinancings find an open window

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A recent spate of issues from infrastructure operating and holding companies has highlighted renewed bond investor interest in the sector. The impending arrival of tighter capital adequacy regulations in the shape of Basel III has reduced the number of active project finance banks. Even before the contours of Basel III were apparent, lenders were turning to infrastructure owners to de-lever assets that they acquired at vast expense before the crunch.

Banks desire for lower levels of exposure leaves a funding gap that sponsors need to fill, whether with equity or other types of debt. Projects that have performed well may be able to fill this gap, but struggling projects have had fewer options. The luckiest borrowers are highly regulated companies with stronger credit ratings, such as UK water firms, which have been able to tap investors in both senior and junior bond markets. But smaller, riskier issuers are also tapping sub-investment grade debt, as their owners attempt to avoid erosion to their equity returns.

Gear down to yield results

The Macquarie-led refinancing of the Moto service station assets, which closed on 18 March, shows how a refinancing can leave a piece of the pie for sponsors, bank lenders and bond investors alike. Macquarie led the group of financial investors that bought Moto in 2006, at the height of the boom. It financed the acquisition through £605 million ($997 million) of five-year debt, of which £41.5 million was junior debt priced at 300bp over Libor, and the rest was senior debt priced at 150bp over Libor. With just £35 million of equity, the debt to equity ratio was 95/5.

Such leverage became out of line with the post-crisis market, but, since management had grown the business and posted consistently rising profit from 2007 to 2009, Macquarie was able to complete a refinancing consisting of senior bank debt, junior bonds, and equity. The debt on the original financing came from 11 banks, and with a significant number of new lenders, 12 banks provided senior debt in the refinancing.

The senior debt facility totals £450 million and seven banks, including Macquarie, HSBC, ING, WestLB, Scotia capital, Credit Agricole and Deutsche provided around 75% of the total debt. The debt has a five-year tenor, the same length as the original mini perm financing and is priced at 325bp over Libor, rising by 25bp each year.

The financing included the first bond issue connected to Moto, some £176 million of second lien notes. The entire refinancing process took almost a year, mainly due to the length of time it takes to get a rating ratings, says Sergio Ronga, a director at Macquarie Capital Advisers debt capital markets advisory group. It was a fairly extensive process where we worked closely with the company to find the optimal solution you overlay that with the ratings process, which these days can take a lengthy period of time given how busy the ratings agencies are, Ronga says.

The bonds eventually gained a CCC+ rating from Standard and Poors, and offered a healthy yield of 11% after lead arrangers Deutsche, Credit Agricole, HSBC, ING sold the bonds at a discount of 96.8%.

Some £25 million of additional equity comes in for the refinanced project, made up of five third-party funds, Motor Trades Association of Australia, AustralianSuper, EPIC Holdings, Westscheme, and Statewide, and three Macquarie-managed high net worth funds. Macquarie initially provided 34% of the original £35 million equity investment in 2006, but by mid-2009 it had sold its stake to virtually 0%. S&P puts the debt to EBITDA ratio at 7.5x during 2011, significantly below the level in the 2006 structure.

The cash generated by the business and distributed to shareholders or reinvested in the business is controlled, reducing the leverage ratio over time as debt is paid back. The structure stipulates that leverage must be below a certain threshold, or bank lenders must be repaid, before any distributions can be made.

The refinancing prompted Standard and Poors to raise its long-term corporate credit rating on Moto to B from CCC+ and remove it from CreditWatch negative. Moto has no mandatory debt repayments until 2012, when the new bank facilities start to amortise, and funds from operations interest coverage would likely be between 1.5x and 1.6x over the next two years, S&P said. If operating setbacks prompted the debt to Ebitda ratio to rise to over 8x, or funds from operations interest coverage fell below 1.5x, S&P would likely take a negative rating action, it said. A positive rating movement would depend on the leverage falling comfortably below 6x on a sustainable basis.

Macquaries Ronga says there is no reason why parts of the refinancing on Moto, like the capital structure, cannot be echoed on other assets. The level of interest from banks at the senior debt level will continue to be strong. The level of interest at the holdco or subordinated level will probably come increasingly from institutional investors, he says. The bank debt still has a significant and relevant role to play in refinancings. That will probably be supported by, rather than replaced by, the capital markets, Ronga adds.

But the high-yield market is extremely accommodating. If you look at the high yield, holco refinancings... Moto is a classic example of whats going on in the market at the moment. People are yield-driven and reasonably forgiving on the risk aspect, says one banker. Recent issuances for UKs Thames Water and Southern Water highlight this thirst. Its only mimicking what is happening in the leveraged buyout market, the banker adds.

Macquarie completed in early April the issuance of £400 million of eight-year secured notes for Thames Water Kemble, which owns the regulated operating company Thames Water Utilities Limited. The bonds were rated at B1 by Moodys and BB by Fitch, and were priced at par for a coupon of 7.75%,

The bonds refinance part of the bank debt that a group of investors led by Macquarie European Infrastructure Fund took out to buy Thames in 2006. The bonds rank pari passu with a new £350 million bank financing.

The issue, part of a £1 billion medium-term note programme, followed recent similar deals from airport company BAA and Anglian Water. More recently, holding company Southern Water (Greensands) priced £250 million of senior notes in mid-April, which also mature in 2019. The bonds were rated BB- by Standard and Poors and B+ by Fitch, and priced at 8.5%. The bonds were part of a larger £450 million refinancing, with the remaining £200 million financed through bank debt. Greensands, a consortium whose main stakeholders are JP Morgan, Challenger and UBS, bought Southern Water at the end of 2007 backed by £731 million of bank debt.

The lower yields on bonds issued by UK water companies Thames and Southern compared with Moto reflect the more stable credit environment in the regulated core infrastructure sector.

The long tail

More secure issuers with assets acquired after the crunch have also taken advantage of the current buoyant capital markets conditions. Gatwick Fundings £600 million debut bond issue in February replaced part of the debt taken on when Global Infrastructure Partners and other shareholders bought the UK airport from BAA in late 2009. Gatwick is the countrys second-largest airport by passenger volume, carrying 32.4 million people in the year to March 2010. BAA is the owner of UKs Heathrow and Stansted airports, and it sold Gatwick in the face of an adverse UK competition commission ruling. BAA was itself one of the first UK regulated infrastructure businesses to access bond markets through a holding company, when it issued £325 million of 7.125% bonds due 2017 in November 2010.

The Gatwick transaction featured £600 million of class A notes, £300 million of notes due in 2028 with an expected maturity of 2026, and £300 million notes due in 2043, expected maturity 2041. The bonds were issued with a coupon of 6.125% for the 15-year notes, and 6.5% for the 30-year notes. There was also a £620 million bank debt portion and

£350 million of capex and revolving credit facilities. These both have a four-year term and rank pari passu with the bond tranches. The bonds received BBB+ credit ratings from Standard and Poors and Fitch.

Of the £1.2 billion raised, £850 million was used to refinance the bank debt at Gatwick Airport Ltd, and the remainder was used to meet expenses and pay shareholders an extraordinary dividend. GIPs fellow sponsors on the deal are Abu Dhabi Investment Authority, National Pension Service of Korea, CalPERS and the Future Fund of Australia.

Gatwick Funding falls outside the group of deals eyeing miniperm deadlines, and according to Deepak Agrawal, principal at GIP, the shareholders began working towards a refinancing as soon as they felt comfortably in control of the asset. When we undertook the financing in 2009, although it was a five-year financing, we did not get the optimum capital structure, he says.

While the transaction presented no immediate refinancing risk, the leverage was low, interest rates were high at that time and there was a lack of availability of longer tenors, Agrawal says, adding: From day one, the objective was that once we had full understanding of the operations and had finalised our new business plan, we would start talking towards putting a long-term capital structure in place.

In its report, Fitch said its BBB+ rating factored in the refinancing risk when the senior bank facilities reach maturity in December 2014. Fitch said that given that it is Gatwick Fundings first exposure to capital markets and the borrowers financing strategy is inherently new, it remains to be seen whether either company will have sufficient access to debt when required in 2014. The agency took comfort in the owners move to refinance promptly, as well as the resilience of the asset and high level of visibility of the regulatory framework, it said.

The refinancing structure contains a trigger if senior debt-to-RAB ratio (RAR) rises above 70% and the default level is at 85%. There is also a trigger when the senior interest coverage ratio falls below 1.5x, with a default level at 1.1x. There is also a provision for the issuance of further debt, including class B bonds and junior ranking bank facilities. No junior debt has been issued as of now. When you are doing a bond with a 30-year life you need to preserve flexibility for what might happen, say five or 10 years down the line, Agrawal says.

Pruning the hedge

Interest rates have fallen significantly since many of the deals coming to market were originally financed.

The long-term profile of infrastructure deals and their subsequent sensitivity to interest rates means companies may consider unpicking interest-rate swaps as part of the refinancing process. Given the current low interest rates, it may be appropriate to restructure the swap and take the mark to market hit on the difference between todays levels and the higher interest rates previously put in place, says Matthew Vickerstaffe, global head of infrastructure and asset-based finance at Socgen.

Consistently, both on interest rate hedging and on RPI hedging arrangements, there is that dynamic going on as part of any refinancing strategy, he says.

According to another market source, borrowers usually try to avoid making any upfront mark to market repayments. So there is an element of that mark to market being restructured in the new swaps, he says. Hedging aside, in addition to the attraction of low interest rates, participants are well aware that a wave of refinancings are to come to market in the next few years. Amongst them, port refinancings are expected to place demands on liquidity, and while margins are still higher than pre-crunch levels, some projects may want to move now to avoid the crush.

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