Uruguay's big PPP and LNG ambitions

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Uruguay has attracted little attention from international investors during the last 30 years. It is highly dependent on trade with Argentina, which has been shut out of project finance markets for over ten years. Uruguays economy is larger only than Surinames in South America. Many sponsors have as a result bypassed Uruguay in favour of larger and more established neighbours.

The countrys 2002 banking crisis was a spill-over from Argentinas default, and resulted in Uruguay being stripped of its investment grade status. The crisis shook investor confidence, but the country eventually regained the trust of Fitch, Standard & Poors, and Moodys Investors Service, which now assign BBB-/BBB-/Baa3, either with a stable or positive outlook. The economy grew by 3.9% in 2012 and by 6.5% in 2011.

Despite this change in fortunes, the state retains control of most infrastructure. Private companies used to operate local rail, tram and waterworks systems, before renationalisation in the late 1940s. But state-owned entities like rail operator Administración de Ferrocarriles del Estado, the Montevideo Waterworks Company, utility UTE and telecoms operator Ancel have enjoyed a prominent position, resulting in few opportunities for private sector involvement in financing or operations.

But Uruguay now wants to change its approach. Private companies Movistar and Claro, for instance, entered the telecoms market, while the country passed legislation in July 2011 that paved the way for projects to be procured using design, build, finance and maintain (DBFM) concessions.

Uruguay has historically operated and financed energy and most of its infrastructure with public resources, observes Ana-Maria Vidaurre-Roche, structured and corporate finance lead infrastructure specialist at Inter-American Development Bank (IADB). The private sector, however, is becoming more involved, with the opening up of the power sector by state-owned utility UTE a good example. It has allowed private companies to enter the market and opened the door for private finance, too.

The DBFM legislation has facilitated UTEs wind power procurement programme, which it opened up to the private sector. Three deals El Libertador, Palmatir and Akuo Energy have already signed.

Winds of change

The main barrier to closing financing was producing a bankable power purchase agreement (PPA). UTE needed to make sure that its contracts would inspire enough confidence for sponsors to embrace the DBFM legislation in wind, which was unproven.

But the proposed PPAs did not follow international market standards and required clear allocation of risk for the duration of a financing, Vidaurre-Roche of the IADB says. None of the multilaterals or international lenders able to offer the long-term financing needed were interested, so it required a lot of close work with the offtakers to find a solution. The El Libertador and Palmatir deals have a project financing structure, with the developer assuming construction risk and the IDB assuming project risk. The financing for Palmatir closed in April this year and the financing for El Libertador will close in the next few months, says Vidaurre-Roche.

WPE, a subsidiary of Argentinas IMPSA, is developing 65MW El Libertador, located in Lavalleja, which will use 44 of the sponsors Vensys turbines. Palmatir, for which Abengoa is sponsor, is located in the department of Tacuarembó and will use 25 Gamesa 2MW turbines.

The debt packages for the two are the IADBs first project financings in the power sector in the country. The IADB is providing a total of US$107.7 million in long-term loans, split $66 million for El Libertador and $41.7 million for Palmatir. Palmatir will also feature a $73.6 million direct loan from US Ex-Im, based on the Gamesa turbines US origin. France-based Akuo Energy closed a US$88.5 million 15-year package in March for its $128 million Florida wind project in March, with Proparco ($38.5 million), FMO and DEG participating.

UTE avoided offering the more complex and sometimes controversial feed-in-tariff and dispatch to the grid in favour of a fixed-price 20-year PPA with project companies. The UTE PPA needed some work to bring it up to international norms, particularly with respect to termination, says Bulent Osma, a managing director at P50 Capital, which advised US Ex-Im on Palmatir.

UTE has shown great flexibility in the contracts, making adjustments to issues such as liabilities and termination clauses, to help make them bankable, adds Juan Manuel Mercant, a partner at local law firm Guyer & Regules. This has resulted in a great many contracts between UTE and the private sector. The PPAs include strong support provisions, including fixed tariffs for 20 years, with all the UTE payments guaranteed by the government, so the model is very stable.

This model should travel to the solar sector. In May UTE asked for solar power bids, and said that it received four proposals for a total capacity of 166MW. While it has yet to finalise a structure for its solar PPA, solar generators will receive concessions of up to 30 years and a tariff of $91.5 per MWh for projects completed before 1 June 2014, dropping to $86.6 per MWh after that.

This strong support system is combined with relative political stability, so risks associated with retroactive tariff cuts or the expropriation of private sector assets should be relatively low. Uruguay has a long-standing tradition of honouring its obligations and an excellent record in servicing its foreign debt.

Gian Franco Carassale, a senior investment officer at the IADB, says that the bank thinks that the country is likely to achieve its energy targets and go even further. So much so that the energy could potentially be sold to neighbouring countries such as Argentina and Brazil, he says.

This export proposal is in its infancy but could receive a major boost from UTEs planned $1.25 billion LNG regasification plant near Montevideo. In May, it selected GDF Suez as the preferred bidder for the DBFM concession for the 10 million cubic metres per day plant. Under the 20-year concession UTE will pay GDF $14 million per month. The Montevideo LNG plant also attracted bids from Enagas (Spain), Hoegh LNG Holdings (Norway) and a joint venture of Kogas and Samsung Heavy Industries.

The GDF-Suez deal is perhaps the most important project of the last five years, Mercant observes. Not only is it one of the biggest projects in terms of value but, as Uruguay has yet to discover any oil and gas, it will be a big help in diversifying the energy matrix. There is also the potential to export to Brazil, and possibly beyond, in the future.

PPP ambitions

While energy has benefited from the 2011 DBFM legislation and strong contractual support, use of the model elsewhere in infrastructure has been minimal to date. Uruguay requires upgrades to its transport and social infrastructure assets and wants to shift their financing from the public to the private sector.

The 2011 legislation does not limit DBFM to energy. It can be used in road, rail, waste disposal and treatment and social infrastructure to create a de facto public-private partnerships (PPP) framework. Whether a standardised PPP contract will emerge as with the UTE offtake structure is unclear but the government has suggested that rail, ports, airports and new convention centre projects could all use DBFM concessions.

So far, only one DBFM project a $72 million prison has actually launched to market, while the $800 million Rocha deep water port in Aguas Profundas is expected to be a build, operate and transfer PPP, but is still under evaluation. The prison tender opened in February, and has a deadline of July.

The 2,000-inmate prison will be procured as a 22.5-year concession with quarterly payments. The payment mechanism, compared to UTEs, is more complicated. The project company will receive an availability payment as well as a fee per inmate-day, which is updated to reflect changes in labour costs. Payments will also be adjusted reflect the quality of services that the project company provides and allow for compensation in the event that the government asks to expand or modify the prison, for instance to deal overcrowding. The government will retain responsibility for most security.

While the DBFM model is untested for infrastructure in Uruguay, observers are positive that the initial structure of the contracts and the overall economic backdrop are encouraging. Unlike other countries, Uruguay has done its homework: achieving macro-economic stability, putting in place a comprehensive PPP law, getting advice from multilaterals and PPP experts, and training the public and private sector, remarks Vicente Alcaraz, a lecturer in PPP at Madrid Polytechnic University, who recently wrote a paper on Uruguays PPP potential.

If Uruguay wants to close landmark financings in infrastructure, as it has in wind, it will need to find a way of marrying local and international expertise. Undoubtedly many local sponsors will look for foreign partners with PPP experience, Alcaraz continues. For foreign investors, Uruguay is also an attractive market. Even though it is small in comparison with its neighbours, like Argentina and Brazil, it offers stability and good macro-economic perspectives. Some Spanish companies have already shown their interest in the PPP pipeline in Uruguay.

The first wave of deals will need to attract at least an element of commercial and international bank financing, something that has been absent from the wind financings to date. Commercial banks credit processes will be a crucial way of testing the viability of the PPPs availability and performance payments.

The regulations are in place for PPPs and the IADB has been looking at potential projects in the ports and waste management sector, explains the IADBs Carassale. The government is gradually engaging the private sector for infrastructure under different contractual schemes and in sectors with limited participation in the past, such as tendering wind energy contracts, the recently-launched solar programme, and a PPP scheme in the port sector.

Finding finance

Uruguays framework, then, is less of an issue than local financing capacity. The GDF-Suez project, for instance, with an initial capital expenditure of $400 million, is expected to be financed with non-recourse debt. The wind and solar proposals would require hundreds of millions of dollars. But while domestic commercial banks do not have the resources to meet these requirements, international institutions will struggle to competitively fund long-dated commitments to projects in an untested and small market like Uruguay.

Given the generosity of the government contracts on offer, say market observers, the current crop of deals may provide potential returns to lenders of between 6% to 8% on the financing. Most risk in this crop will come from government counterparties rather than operations. Development banks, export credit agencies and multilaterals have so far been at the fore.

Many of the financings have come from foreign banks, especially foreign multilaterals or export credit agencies, Guyer & Regules Mercant comments. The local banks do not have the capacity to provide the required debt while many of those involved in the projects are international and so can benefit from export support from their domestic development lenders and agencies. However, local banks may act as agent banks.

Madrid Polytechnic Universitys Alcaraz believes that the initial batch of PPPs could probably be financed without any involvement from multilaterals. We feel nevertheless that multilateral involvement can bring a lot of value to PPPs, by providing comfort to the private sector, he adds. Even in a country that has a good track record such as Uruguay, the participation of multilateral banks can reduce the cost of capital for sponsors and private lenders.

The early indications from the wind sector are that the DBFM legislation is viable and, should the pathfinder projects in solar and social infrastructure prove to be successful, adaptable. The countrys challenge will be to attract debt in greater volumes from a wider variety of lenders and, ultimately, try and shift more risk to private developers.