

Italian roads look to BreBeMi's example

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Italy's infrastructure market was a notable victim of the Eurozone crisis, which caused a two-year hiatus in road financings. Financial close on the Brescia-Bergamo-Milano (BreBeMi) toll road in April this year was the first signing since the Eu700 million Strada dei Parchi in February 2011.

Projects in the more stable and prosperous northern regions of Lombardy and Veneto, where non-recourse financings have faced years of delays, are finally making significant headway. These deals are attracting a broader mix of lenders and are looking to close this year or next.

BreBeMi featured financing from the European Investment Bank and Italian export credit agency Sace and had to be structured around the weak ratings of domestic commercial banks. Italian lenders still face liquidity woes and high funding costs, and upcoming deals, which are roughly the same size as BreBeMi, may need similar support.

The Eu1.4 billion Tangenziale Esterna di Milano (TEM) must close its financing before the end of 2013 or lose access to financing from the government-controlled Cassa Depositi e Prestiti (CDP) to which it is entitled. TEM is a tolled ring road running round Milan and will connect with BreBeMi.

The Passante di Mestre toll road around Venice has a roughly Eu600 million debt requirement and has already received proposals from banks. Two more roads could well close long-term financings in 2014, after years of delays: the Eu5 billion Pedemontana Lombarda, and the Eu2 billion Pedemontana Veneta

BreBeMi: Precedent or compromise?

Sponsors Autostrade (78.9%) and Intesa Sanpaolo subsidiary BIIS (11.1%) won the 20-year BreBeMi concession in 2002, and construction should be complete in mid-2014. The Eu1.52 billion long-term debt package finally closed on 25 March 2013, after banks had signed commitment letters in July 2011. The 62km motorways ten-year gestation period is becoming typical in Italian toll roads.

The sponsors used Eu546 million in bridge loans from Italian commercial banks, which it frequently had to extend, to fund construction, as well as Eu520 million of equity.

The final package consisted of a Eu398 million 21-year amortising commercial bank tranche from Banca IMI, Centrobanca, Credit Bergamesco, MPS Capital and UniCredit, which the EIB funds off the back of a guarantee of the banks obligations from Italian export credit agency Sace. The banks also provided a Eu251 million loan funded by the Cassa Depositi e Prestiti (CDP).

Sace guaranteed a Eu196 million 21-year bullet commercial bank loan funded by the EIB and a Eu35 million EIB direct loan. The banks also provided a Eu40 million direct uncovered amortising loan and Eu20 million direct bullet loan, and Eu398.5 million in facilities such as VAT, performance bond and a standby facility, which benefited from partial Sace guarantees. CDP directly lent Eu509 million as a 21-year bullet loan, and a Eu251 million direct amortising loan.

The EIB could not lend without the Sace guarantee because the Italian lenders had such low credit ratings. But it funded the banks at a much lower cost than they could obtain from commercial sources. During the negotiations that dragged

on from 2011 to close, lenders costs had threatened to push the margins so high that the project would be unlikely to meet its debt service obligations.

But the final interlocking participation of the banks, EIB, CDP, and Sace, while cumbersome, set an important precedent. BreBeMi was a groundbreaking transaction in many respects, says Franco Vigliano, a partner and head of Italy at Ashurst. It was the first project financing of a toll road, the first project financing including traffic risk and the first infrastructure project in Italy to be financed with no public contribution.

The toll road followers

Behind BreBeMi is a long queue of toll roads waiting to refinance. According to a source at a major Italian bank, Italy developed a very large pipeline of these projects to procure, but when it has come to the time for financing they are in a difficult situation. In the rest of Europe now roads are mostly availability-based. Foreign lenders have withdrawn from lending with traffic risk, especially for greenfield projects, and only Italian banks are left to fund these very large, multi-billion euro projects.

The Eu1 billion Passante di Mestre was built with funding from ANAS, the national state-owned highway manager. The road has been operational since 2009 and only now is the operator nearing close on a non-recourse project financing.

Given that Passante does not feature construction risk and has four years of traffic, it should be able to close on long-term debt in early 2014. The owners of its project company, CAV, are ANAS and the Veneto region. CAV reimbursed some of the construction costs with a Eu350 million bridge loan from CDP (funded by the EIB) and still owes ANAS about Eu600 million.

Non-Italian lenders make up the majority of the eight banks that are likely to lend on the Passante refinancing. BNP Paribas, Crédit Agricole, Dexia, ING, Intesa Sanpaolo, Mediobanca, Societe Generale and UniCredit have recently submitted proposals to the borrower, although one source familiar with the process suggests that banks may be unwilling to lend the full Eu600 million for which the sponsors are looking, because they question how sustainable the projects business plan is.

The Italian government has been unwilling to assume much traffic risk. The Lombard roads can adjust tolls every five years to counteract weak revenues, but the adjustments are infrequent enough that they might not come soon enough to rescue a financing, and run the risk of reducing traffic by so much that it offsets the benefit of the increase in tolls. Sponsors have suggested so far without success that government could increase concession lengths or provide more upfront funding.

Winning permits for Italian roads is almost as tortuous a process as closing financing. Construction precedes financial close, and projects are typically awarded with only preliminary design in place. But winning approval from a grantor for adjustments to design or business plans takes time. Ashursts Vigliano explains that nationally strategic projects require approval from the Ministry of Infrastructure and Transport, then the Ministry of Economy and Finance and then the CIPE, the inter-ministerial committee for economic planning. That all takes place after the losing bidders have finished challenging an award.

The Expo-Milano push

The state has encouraged sponsors to raise construction financing largely on their own balance sheets, though it has been prepared to offer some grant funding. Governments increased helpfulness comes as it struggles to tackle traffic issues ahead of the Expo Milano that runs from May to October 2015.

The 32km TEM toll motorway connects the A4 and A1, and BreBeMis traffic is dependent on TEM being ready to feed traffic into it, so TEM will face sanctions that include liquidated damages if it does not enter operations on time. Construction for BreBeMi is due to be complete by 30 June 2014, while TEM has been under construction since 2012 and is due to be operational by 31 December 2015.

If TEMs sponsors do not close the financing they will lose Eu330 million of government grant funding, on top of the CDP

financing commitment of the same size.

Delays and a Eu580 million equity requirement have led to changes in TEMs shareholding structure. The municipally-owned shareholders struggled to meet capital calls and the consortium now features new private sponsors. In November the Gavio Group acquired 17.7% stake from Impregilo for Eu67 million. Intesa is a sponsor, an adviser and most likely a lender on TEM, as it already participates in its bridge financing.

Mandated lead arrangers Banca Popolare di Milano, Banca IMI, Intesas BIIS, and UBI-Centrobanca have provided two bridge loans of Eu120 million each since 2012. Additional lenders on the Eu1.4 billion long-term debt package should include Mediobanca, and a small number of international lenders are looking at the deal, including BBVA. The EIB may provide up to Eu600 million indirectly.

Pressure from the Expo could spur two more financings next year. The 157km Pedemontana Lombarda network, which is a trans-European transport network (TEN-T) and part of the pan-European Corridor 5, could well close in the second half of 2014. The road will connect Bergamo, Monza and Brianza, Milan, Como and Varese. The sponsor consortium includes municipal operator Serravalle, Equiter, BIIS and UBI.

Pedemontana Lombarda has a cost of about Eu5 billion and will be the subject of two engineering, procurement and construction contracts. An Impregilo-Astaldi consortium won one of these contracts in 2008 and construction on that part is mostly completed. A Strabag-led consortium won the other Eu2.3 million contract, for 75km of road, in 2011 but has not yet completed design work. The project should be eligible for about Eu1.3 billion of grants, but it has yet to reach out to lenders.

Sponsors Sacyr, Vallehermoso and Fininc won the Eu2.1 billion 94km Pedemontana Veneta project in 2011 and are approaching banks on its long-term debt financing. But the project has faced difficulties in lining up regional funding. Government promised Eu370 million in early 2014, but the Veneto region is disputing overdue central government grants of Eu173 million.

Long debt, short tax breaks

According to a banking source, for debt with a low-investment grade BB+ rating, pricing is a minimum of 400-500bp at the start and tends to feature step-ups....The pricing is being pushed up by the cost of funding more than the risk on the project.

Concessions for some of the toll roads are extremely long. For example TEM holds a 50-year post-construction contract. The Este-Monselice hospital PPP, which closed in September 2013, had a senior debt tenor of 21 years, which was acceptable to Italian banks because it had a tail of at least four years.

For the commercial bank debt on both TEM and Passante, banks may prefer to make mini-perm loans as a bridge to the capital markets. The general idea is to go for the hard mini-perm structures to bridge a long-term bond financing. This is very much the flavour of the market, says Vigliano of Ashurst. However none of the projects are yet at a stage where they could tap the market and put together a project bond. TEM, Pedemontana Lombarda and Pedemontana Veneta are part of the TEN-T network and so eligible for the EIBs project bond credit enhancement.

In October 2012, Italy's then Monti-led administration passed laws that exempted unlisted bonds and those issued by small businesses from withholding tax and made registering a security interest liable to a fixed registry tax of just Eu168. While these changes have increased transactions in the bond markets generally, large toll roads face wider practical challenges. The main point is finding the underwriters and subscribers, says Ashurst's Vigliano. There is a great deal of talking and pension funds, insurance companies and infrastructure funds are expressing their interest. But in reality there are not so many with the experience and the readiness to take on the risk.

The Monti government also introduced tax breaks for strategic infrastructure projects. On 22 June 2013 Article 18 of the Legge di Stabilita 2012 came in to effect. Projects still in construction are eligible, as are any new projects, and they could pay no tax both during construction and some of their operational phases.

One Italian banker says: I see many projects going through the process of obtaining approval, but it is not something which actually fixes all the issues alone. The compensation has many limitations, including that the public contribution and tax deductions can only compensate up to 50% of the total cost of the project. If the project is not sound enough from the beginning it is not this law that will make it viable.

The other notable restriction under the tax break is that financing must be signed (though not necessarily drawn) within 12 months of the date of approval of final design, or for projects which have passed that milestone, 12 months from the date of government approval of the amendment to the corporate/VAT tax break. Given the delays that are typical in the toll road market and increased upfront government support, bankers suggest that the tax breaks will not be vital.

The rest of the 2014 pipeline

Elsewhere in Italian transport, 2014 could witness close on Metro 4 and Metro 5 extension projects in Milan, after their common sponsors picked arrangers for a refinancing of the original 2007 Metro 5 debt package, combined with new debt for the extension.

There might be some important projects we have been discussing for years that achieve financial close in 2014. said Enrico Lucciola, senior underwriter for energy and infrastructure at SACE. It will not be a super year, but compared to 2011 and 2012, which really were poor years, it is looking much better undoubtedly. Lucciola also emphasised that SACE has not been asked for a guarantee on TEM or Passante, suggesting that market appetite for uncovered commitments is healthier.

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