

# Tenerife Light Rail Project

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As light rail projects are slated all around Europe and few seem to make it off the drawing board, Spain has shown the way forward with its largest light railway PPP project to date – the 30-year Tenerife Light Railway. This €230 million (US\$283 million) project that reached financial close at the end of April 2004, has impressed transport practitioners who are well used to being let down by overly ambitious plans of government and local authorities.

However, far too frequently there is an inability to translate an economically viable project into reality. But for all the Tenerife light rail project's successes, the rail system to be constructed is not the one that the island's local authority first dreamt up.

The initial goal was to provide a light rail system linking the capital city of Santa Cruz de Tenerife with the island's airport, and the alignment takes in the metropolitan area of Santa Cruz and Laguna. These two cities have become a single metropolitan area with population densities of up to 50,000 inhabitants per square kilometre. However, it came in at too high a price; the sponsors were forced to reduce the scope of the project, stopping short at Laguna – which is close to the airport in any case, only 2.4km away.

The last Spanish central government refused to co-finance the light rail, but the new socialist party has agreed to back it. Instead of halting the entire project and starting again from scratch for the entire 16.7km stretch, the parties agreed to build 12.3km of the light rail through the most congested part of the city.

Following this success there is now word of an extension project once the first phase has been completed, that would link La Laguna to the airport. While the second phase will not be as large as the first, it will help confirm Spain's commitment to bringing private finance into the public transport sector.

Andrés Muñoz de Dios, managing director of Metropolitano de Tenerife and project director for the Tenerife Light Rail Project, says: 'We have two cities here, Santa Cruz and La Laguna which originally were separate and linked by an old road. Now that has become a single metropolitan area. 'There is still debate whether we should actually have just the one single city or two cities fighting against each other for the title of capital city. This project is going to bring the opportunity for both cities to become the one capital for the whole island.'

Muñoz says the light rail project will also help spur on redevelopment of the less developed areas in the no-man's land between the two cities, but it will be felt most in the tourist sector. 'Fifty per cent of the island population lives there,' says Muñoz. 'It is not a centre for tourism that is on the south and north of the island.' And the experience gained in Tenerife will be valuable for the contracts as while this may be the first light rail project to close in Spain, there are a number of similar projects slated for the near future

- Malaga
- Almeria
- Granada

This project represents a first in that it is the first time that the council – Cabildo Insular de Tenerife – entered into a joint venture of this type with a private sector company. The project may well have wider ramifications for the transport

sector with rumours that the structure used for this private financing could be tailored to pave the way for private finance to enter the Spanish light and heavy rail sector.

The scope of the project was simple enough, to solve the island's congestion problems and the pollution that arose from nose-to-tail traffic in narrow, winding streets. Uria & Menendez associate Javier Illescas who acted as lender counsel to BBVA says: 'Heavy traffic in the Santa Cruz metropolitan area – especially from the suburbs to the city centre – has been a long-standing problem.

The mountains that surround the city centre and the volcanic terrain have limited the areas for expansion of road transportation and construction of parking spaces and hampered the usual underground solutions.

The light rail is expected to absorb much of the suburban traffic to and from La Laguna and other suburbs in between.' The bus service currently handles 20 per cent of the traffic and the sponsors expect the introduction of the light rail system to increase public transport stake to 30-40 per cent.

Sponsors Cabildo Insular de Tenerife signed a contract with Metropolitano de Tenerife (MTSA) – a company that is wholly-owned by Cabildo. The local authority put out to tender 14 per cent of MTSA to a private consortium. The contract was awarded to a SPV made up of French transport giant Transdev, Portugal's second largest construction company Somague and Spanish engineering consultant Ineco.

Responsibility for the construction and operation of the light rail system falls to MTSA, with the partners providing equity and know-how. The consortium is led by Transdev which holds a majority stake of 60 per cent in the stake that is not owned by Cabildo, Somague has a stake of 30 per cent, and Ineco taking the final 10 per cent.

The construction of the line was divided into six contracts:

- Two for the alignment awarded to Necso-Comsa and Dragados-Tecsa
- One for the depot to FCC
- One for the rolling stock that went to Alstom
- One for the power supply that went to Efacec
- One for the railway systems to Ikusi-Efacec Finance

BBVA acted as mandated lead arranger for the syndicate of banks – led by vice-president José Ramón Vizmanos and associate Javier Rodríguez de Colmenares. BBVA also acted as book runner and agent. Dexia Sabadell and The Royal Bank of Scotland acted as arrangers. Caixa-Banco de Investimento and Santander Central Hispano were co-arrangers; and Caja Canarias acted as lead manager.

The banking syndicate provided MTSA with the bank guarantees necessary for receiving a credit facility of US\$150 million from the European Investment Bank (EIB). The credit facility is split into a medium-term and a long-term tranche. BBVA also provided MTSA a credit facility of €5.25 million (US\$5.9 million) to pre-finance part of the equity to be contributed by the private consortium and two interest rate swaps to provide MTSA with partial hedging to cover against interest risk. BBVA underwrote the transaction on 16 December 2003 and the syndication process was closed on 26 April 2004. Tranche A of the debt for the construction was for €40.13 million (US\$49.7 million) Euribor plus 50 basis points maturing in eight years.

Tranche B – the project risk tranche – was for €86.6 million (US\$107 million) priced at Euribor plus 95 basis points. BBVA's Javier Rodríguez de Colmenares said: 'The Tenerife light rail project is a 30-year guarantee, but we have structured it in a 15 plus 15 year plan because in year 15 we will recalculate the base case and if there are ratios under the fixed rate, Cabildo Insular de Tenerife will inject funds into the project until the target ratios are reached. Alternatively, Cabildo Insular de Tenerife will have the option of repaying all the debt in year 15 or injecting equity or subsidies in order to re-establish the ratios. 'Regarding the two interest rate swaps, the swap hedging the interest risk of Tranche B includes a swaption in year 15 offering the SPV alternative options – either break the interest rate swap with no additional costs, or continue with the fixed rate until year 30. Moreover, the financial structure allows the island council to avoid deficit restrictions through off balance sheet treatment under ESA-95 rules.' The Spanish banker says: 'There was another

facility of an equity bridge for Metropolitano for the equity funds that had to be injected into the project by the private sponsors - Transdev, Ineco and Somague – for €5.25 million. Once the light rail is operating, they will be repaid. This has been contra-guaranteed by three letters of credit issued by the relationship banks of the three sponsors. Transdev is guaranteed by BNP Paribas, Somague is guaranteed by the Portuguese bank BCP, and Ineco is guaranteed by Santander.

LegalSpanish law firm Uria & Menendez advised established client BBVA in its role as lead arranger on this landmark transaction. JR Knowles and LAM Abogados advised MTSA. The European Investment Bank was advised by Landwell and the private consortium by DAE Abogados. Uria & Menendez associate Javier Illescas says the deal stands out as a ground-breaker and claims the deal structure will be recreated in future projects. Illescas says: ‘Our firm has participated in other similar projects like the Seville underground – Metro de Sevilla – but the Tenerife Light Rail structure has not been reproduced there, nor in any other significant infrastructure project in Spain – yet. Andres Rebollo of PricewaterhouseCoopers and Alma Gomez of JRK advised Cabildo on financial and legal aspects respectively.

ConclusionThis is the largest light rail project to get off the ground in Spain and looks to be the first of a number to come. Indeed, there is talk about a new stretch of light rail linking La Laguna with the airport, in Tenerife. ‘Several public authorities are currently looking to new PPP and PFI structures for significant projects. The Tenerife example will surely be a reference when considering those alternatives.’ While light rail projects around Europe have often stumbled at the first hurdle, Illescas says that was never going to happen in Tenerife due to the determination of the local authority to address the public transport problems and solve the issue once and for all – using private finance to foot the bill. ‘Projects fail for many reasons,’ says Illescas. ‘PPP initiatives are prone to failure as they require the public and private sector to reinvent themselves in certain ways and depart from their long lasting experience. The efforts and determination of the Cabildo Insular de Tenerife to launch this project have been key for launching the project. ‘It is quite remarkable in Spain to see a public authority acting as a sponsor in a project financing. The island council, BBVA and the other banks have perfectly adapted to this rather new situation.’

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