M1/Westlink – Northern Ireland’s first PPP highway

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The M1/Westlink DBFO project - won by a Bilfinger Berger-led consortium last year - is crucial to Northern Ireland's economy as the key access route into the Irish Republic.

Now financing on this project has been finalised - with a £62.7 million European Investment Bank loan and a £62.7 million FSA-wrapped bond issue - the project is set to become Ireland's first major road concession.

Having embraced and built upon the U.K. Highways Agency's (HA's) tried-and-tested DBFO road concession framework, the Northern Irish government has drawn upon the UK's 10-year experience in PFI transactions to contractually structure the "Roads Service DBFO Package 1" (RSDBFO 1) - known colloquially as the M1/Westlink project. However, the project differs from the traditional HA model in two key respects regarding the payment mechanism.

First, the payment mechanism is entirely availability based. The principal source of revenue will be monthly payments from the Northern Ireland government, which means that lenders are not exposed to any traffic risk. This is a departure from recent DBFO highway concession projects in England - where a blended payment mechanism (part availability, part shadow tolls) has been adopted.

Second, the Northern Irish project allows for revenues foregone during construction to be recovered during the operational phase of the project - providing compensation in case of construction delays.

This favorable payment mechanism combines with a supportive 30-year concession framework and experienced construction contractors to support an investment grade underlying rating of "BBB". A payment guarantee from monoline insurer Financial Security Assurance uplifts the transaction to an insured rating of 'AAA'.

Rationale

The M1/Westlink is a strategic traffic corridor in the UK province of Northern Ireland, forming part of the Trans-European Road Network. It provides the main access route from the capital, Belfast, to the south and west of the province, and to the Republic of Ireland.

Within Belfast, it provides access to the largest commercial area in Northern Ireland, as well as the key commercial and passenger facilities of the Port of Belfast, and Belfast City Airport. The concession grantor is the Department for Regional Development (DRD) within the Northern Ireland administration.

Project

The concession comprises four complementary highway improvement projects designed to upgrade, increase capacity, and relieve congestion on the motorway network to the west of Belfast.

Scheme 1 entails widening 2 km of the M1 to create a dual three-lane motorway, the grade-separation of two existing at-grade roundabouts on the M1 motorway, and the widening of 2.4 km of the A12/Westlink to create a dual three-lane road. This represents the largest element of the overall project (79% of a total budgeted capital expenditure of £114.8 million), and is also the most technically challenging scheme in terms of the new build combined with the need to continue traffic operations during construction work.

The less complex Scheme 2 involves the provision of two new on-ramps to the M2 in the Antrim area.

Scheme 3 entails the widening of 6 km of the southbound carriageway of the M2 to dual three-lane motorway, and the replacement of three over-bridges. This represents a significant cost element (£17.4 million, or 15% of the overall M1/Westlink capital cost), although the necessary road widening should present no particular challenges to experienced highway contractors.

Finally, Scheme 4 involves upgrading sections of the central reservation barrier on the M22. These works represent a minor component of the project (£4.9 million, or 4% of the overall M1/Westlink cost) and present no significant construction challenge.

One departure from the risk allocation matrix typically seen in English DBFO road deals involves Northern Ireland's contracting-out regulations, which do not extend to statutory utilities such as gas, electricity or water companies. Highway Management (City) Ltd. (ProjectCo), therefore, cannot liaise directly with statutory utilities. Instead, Roads Service (an executive agency of the DRD) retains responsibility for liaison with utilities to effect, for example, the diversion of pipes or overhead cables. Standard & Poor's view is that this is unlikely to seriously impede the project's construction work program completion

Contractors

Highway Management (City) Finance PLC (the Issuer) will issue debt and onlend the proceeds to ProjectCo - an SPV and the key contracting entity. Highway Management (City) Holding Ltd. (HoldCo) - another SPV - will act as holding company for the Issuer and ProjectCo and will contain the contributed pinpoint equity, which will be nonrecourse to the shareholders, who are:

- Bilfinger Berger BOT Ltd. (75%)
- John Graham (Dromore) Ltd. (15%)
- Northstone (NI) Ltd. (10%)

Together, these project participants are experienced and qualified to complete the requisite construction works and associated operations and maintenance obligations to specification, on time, and within budget. Indeed, the international and local experience of the construction joint venture, combined with a comprehensive package of third-party contractual support measures, sufficiently mitigates the construction risks associated with the M1/Westlink project at the 'BBB' rating level.

Transaction

Similar to most PFI projects, the M1/Westlink transaction is highly geared, with 89% senior debt (excluding payments received during the construction period). Senior debt comprises a £62.726 million, 30-year index-linked bond and a £62.696 million, 28-year index-linked EIB loan. The final maturity for the bonds, which have a sculpted repayment profile to match cash flows, is December 2036. The EIB bank loan, which has an annuity repayment profile, matures in September 2034. Senior debt principal repayments commence in March 2010.

Pinpoint equity of £50,000 is injected by shareholders at financial close, in addition to the £10.7 million of subordinated debt.

Three months before completion of construction, a £10.7 million committed equity bridge, provided by Royal Bank of Canada will be injected to fund the debt-service reserve at construction completion, with six months of principal and interest payments for when debt service begins in earnest. This alignment of the sponsors' interest with that of senior debtholders provides further support for the robustness of the structure,at its assigned 'BBB' underlying rating.

Further structural support comes in the form of two reserve funds that ProjectCo will establish to manage potential cash flow interruptions and fund expenditures that will occur later in the term of the concession. These reserve funds include the six-month debt-service reserve account (DSRA) that will be in place throughout the operational period, and a major maintenance reserve account (MMR) based on the next three years' estimated maintenance expenditure.

Dividend distributions are subject to a distribution lockup test of 1.125x annual debt-service coverage ratio (DSCR), and 1.15x debt-life coverage ratio (DLCR), in line with comparable PFI projects.

Financial analysis conducted by Standard & Poor's has illustrated that under the base-case cash flow forecast, the average senior DSCR is 1.25x, with a minimum of 1.19x (in 2036). As above, this is broadly comparable with other PFI/PPP availability-based road projects rated low investment-grade by the agency.

Stress test results, achieved under various down side scenarios (including breakeven analyses), indicate that ProjectCo's cash flows are reasonably robust and the project remains able to withstand some degree of delay or cost overrun, without relying on ProjectCo or the third-party credit support providers.

Conclusion

Despite the M1/Westlink project diverging from the standard HA DBFO transaction framework, it has successfully achieved investment grade preliminary underlying ratings as well as an insured preliminary 'AAA' on the proposed debt.

The potential credit risks that could arise from a challenging construction program being undertaken - in difficult ground conditions while maintaining the traffic operations - has been offset by a strong contractual structure, the largly derisked (availability-based) payment mechanism and an experienced consortium of construction contractors.

Similarly structured road concessions could also enjoy investment grade ratings - an important consideration for Northern Ireland's roads sector going forward.

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