Tel Aviv 431 shadow toll highway

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The Israeli project finance market has come of age with the close of a record-breaking project - the US$402 million (NIS1.81 billion) financing of the 431 highway, the southern section of the Tel Aviv ring road

Even though the country has been plunged into chaos with fierce fighting on the northern border with Lebanon, transport infrastructure carries on with significant deals being closed and tenders released.

Israel's largest shekel-denominated financing of an infrastructure asset closed in July after one year after preferred bidder, with a consortium of banks and investors securing the US$400m contract for the 20km shadow toll road.

The 431 PFI motorway closed on Monday 24 July 2006, eight months after the preferred bidder - Danya Cebus - had started construction.

The deal is as impressive for its unusual financing structure as for its groundbreaking scale.

Unlike the Cross-Israel highway, built by Danya Cebus and AECON, for this project Danya is acting on its own.

The deal is the largest to date for the amount of Shekel financing raised - and financed entirely on a local currency basis.

Another of the headline makers is the participation of HSBC as arranger - a development that highlights the possibility for international investors to act in the Israeli market, despite the many political and security risks that the country faces.

Background

In March 2004 the inter-ministerial tender committee issued tenders for the construction of the 431 road. The Israeli state intended to develop a shadow toll road and the tender was of FBOT (finance, build, operate & transfer) type.

Authorities opted for a 25-year contract to build, operate and maintain the road. Under the shadow toll structure the developer will receive income from three sources:

- a construction grant
- a series of fixed rate semi-annual payments
- a unitary fee for every vehicle that will travel on the road

Construction was initially scheduled to start in mid-2005. Four groups of companies passed the prequalification stage:

- Shafir Construction and Gmul Energy
- Ashtrom Solel Boneh and Housing and Construction
- Arenson, Ramet and Reuchman Brothers Shomron Infrastructures
- Danya Cebus and AECON

The Israeli government originally intended to release the PFI 431 tender - along with the tender for the upgrading of the Ben Gurion Airport-Tel Aviv Highway -in 2003. However the PFI431 was delayed due to some unspecified 'points of contention'.

However, the intervention of the transportation minister Avigdor Lieberman and accountant general Yaron Zelikha made the release possible. The tender committees finally received a green light, and proceeded at an accelerated pace.

Zelikha then stressed the need to accelerate the development of construction projects in the country, as a fundamental factor for the growth of the Israeli economy.

The project

The 431 road would allow lateral access to the Cross Israel Highway (highway 6). It would work as the southern part of a fast suburban highway surrounding Greater Tel Aviv metropolitan area (Gush Dan).

As a result, the road would connect three main highways in Israel:

- Highway 1 - the Jerusalem-Tel Aviv highway
- Highway 20 - the Ayalon Highway
- Highway 6 - the Cross Israel highway

The road would then run from the centres of Rishon-Letzion in the west and Modi'in in the south-east.

Within three years, the contractor would build a dual carriageway with three lanes for each direction, and a separate strip for a railway running parallel to the road. The new road would be 20km long and would include over 10 intersections.

Financing

A US$400 million investment was required to develop the project. The state proposed a payment model comprising these three elements:

An establishment grant - of US$90m (NIS 400 million). To be paid in installments during the establishment, on the basis of completion of elements and opening of sections.

A fixed periodic payment - of US$13.5m (NIS 59 million) to be paid every 6 months throughout the operation period. They are subject to fulfillment of parameters of road availability and quality of service.

Variable payments (shadow toll) - 2 agorot (US$0.04) to be paid per each kilometre traveled per vehicle, starting from the opening date of the entire road to the traffic.

Danya Cebus - a subsidiary of Africa Israel Investment - won the contract in July 2005. By then, its partner AECON had left. This made the project more unique - the first and largest of its kind to be built by a fully Israeli contractor.

The negotiations for the financing lasted 12 months - another record within the country - and led to an innovative financing model.

Investment bank Shrem, Fudim and Kelner led the negotiations as financial adviser of Danya Cebus, getting a number of parties involved: Israeli banks, HSBC and Israeli institutional investors.

What they had to face was a low rating for the project. The risk of construction default was high, therefore it was difficult to allocate a line of credit to kickstart the project.

Project Finance financial consultants at Shrem, Fudim and Kelner saw the possibility to split the financing, in a way that would allow both short-term and long-term debt to be secured.

They were capable of obtaining a split rating as well, through the local branches of Moody's and Standard and Poor's.

That meant that the construction period and the operational period were rated in two different phases - allowing the borrower to be more transparent about risks and benefits of the project.

The indicative rating for the project at the date of publication of the tender documents was AA-.

However, during the negotiations stage, it emerged that the rating for the operational period - once the construction had been completed - was set at AA+.

This rating suggested a higher solidity of the project, making it more attractive to a range of financial institutions.

Ishay Erel, managing director at Shrem, told IJ news: 'The higher rating for the operational stage allowed us to get institutional investors involved to secure long-term financing.'

At the date of close, 24 July 2006, Bank Hapoalim was heading a banking syndicate as MLA. The syndicate agreed to provide US$380 (NIS 1.69 billion) million in senior debt, divided between

- Bank Hapoalim - US$120m (NIS 550 million)
- Mizrahi Tefahot Bank - US$100m (NIS 445 million)
- HSBC - US$100m (NIS 445 million)
- First International Bank of Israel - US$60m (NIS 250 million)

The financing is split between two phases:

construction is financed by the syndicate of banks, which are providing a 30 months loan. Planning will last one year and in two and a half years work will be completed.

Once the road is completed, HSBC will be repaid with a US$40m grant from the Israeli state, and a group of investors will buy the remainder debt, of US$270m (NIS 1.2 billion), providing long-term financing for 25 years.

Although HSBC is directly repaid by the government, it is claimed that it suffers from the same risk - the construction phase - that the others banks have.

The investors providing the long-term financing are:

- Clal Insurance Enterprises Holdings - US$76m (NIS 340 million)
- the nationalised former Mivtachim pension fund - US$76m (NIS 340 million)
- Menorah Holdings Ltd. and its subsidiary, the new Mivtachim Pension Funds - US$63m (NIS 280 million)
- Harel Insurance Investments - US$60m (NIS 270 million)
- Bank Hapoalim - US$24m (NIS 110 million)

CFO of Danya Izchak Hevron said: 'We called it a 'Take Out Plan', because the debt - and therefore the risk - is then shifted away from the institutions that provided short term financing.'

Conclusion

Danya Cebus will carry out over 65 per cent of the construction work - through its subsidiary Netivei Hyovel - and the rest will be done by subcontractors.

Construction work was started prior to the financial close, Danya has used its shareholders' equity - around US$22m (NIS 150 million) - confident that financial close would be reached soon.

Danya thought that by starting work prior to the financial close they could add value to the project.

Hevron said, 'by the time the financial close was signed we had already completed the set-up phase. We are very confident that we will finish work earlier than the scheduled date.'

The split financing is though the strongest point about this project. It allowed every part involved to be more competitive.

Both the banks and the institutional investors were able to secure a better price - as they provided financing to the best of their capabilities.

The banks focused on the short-term financing, and the institutional investors - more competitive in loans - provided the long-term debt.

Besides that, by the financial close date all the players knew exactly were their resources would go. The banks gained security through prior knowledge of the investors that would later assume their debt.

Erel said: 'This deal is significant because we anticipated the future, by starting work in advance and elaborating the take-out plan.'

Legal advisers of Danya was Herzog, Fox & Neeman. Banks were advised by Yehuda Raveh, and the government was advised by Joseph Levi.

The project condensed the lessons and the experience from other Israeli projects. This is then considered a turning point for the PFI sector in Israel - while other major projects are currently being developed.

The Israeli government is developing the transport sector with an anticipated NIS90 billion programme including the Haifa bypass..

Erel pointed out what limits business in the country: 'We definitely need foreign capital - to supply the local banking system.

'As well as that, we need more foreign developers. There still is a great of risk and guarantees needed, which local firms cannot always cope with. However, there also is a amazing number of projects to be developed.'

The project at a glance

Project Name	PFI 431 shadow toll highway
Location	Israel
Description	20km shadow toll road south of Tel Aviv
Sponsors	Danya Cebus
Operator	Danya Cebus
EPC Contractor	Netivei Hyovel
Project Duration (Including construction)	25 years
Construction Stage	Work started eight months prior to the financial close
Total Project Value	US$402 million
Total equity	US$22m
Total senior debt	US$380m
Senior debt breakdown	Bank Hapoalim - US$124m, Mizrahi Tefahot Bank - US$100m, HSBC - US$100m, First International Bank of Israel - US$56m - subsequently the debt will be purchased by five Israeli institutional investors
Senior debt pricing	Israeli government bonds plus 150bp
Debt:equity ratio	95:5
Mandated lead arrangers	Bank Hapoalim
Participant banks	Mizrahi Tefahot Bank, HSBC, First International Bank of Israel
Legal Adviser to sponsor	Herzog Fox & Neeman
Financial Adviser to sponsor	Shrem Fudim & Kelner
Legal adviser to banks	Yehuda Raveh
Legal adviser to government	Joseph Levi
Date of financial close	24 July 2006