

Mexican transport - syndication of FARAC Group 1

Ila Halai

01/11/2007

Mexico's economic and financial stability has resulted in a surge of activity on the transport front - particularly in road building - making it an attractive market to foreign sponsors, with the Spanish giants leading the way

Mexico has over the last 10 years been steadily improving the country's transport infrastructure procuring those upgrades in a traditional manner. As the country's economy has developed, so the sector has opened up to public-private partnerships.

Mexican law specifies concessions can only be extended to national companies or legally constituted companies in Mexico. Therefore, foreign investors are required to establish a Mexican firm with a Mexican representative, but can retain 100 per cent foreign ownership.

Spanish firms such as Acciona, FCC, Itinere Infraestructuras (Sacyr Vallehermoso) and OHL are already heavily involved in the country's infrastructure sector. But competition from local companies is on the rise.

ICA is one such local construction firm which has won a number of projects including:

- [FARAC](#) - in partnership with Goldman Sachs Infrastructure Partners
- a 50 per cent stake in [Viabilis Infraestructura](#) that is constructing the Rio Los Remedios-Ecatepec highway
- [Rio Verde-Ciudad Valle PPP](#)
- [Nuevo](#) Nexaca-Tihuatlan highway PPP

The Mexican government's principal strategy to develop new toll roads and maintain existing ones continues to require private investment with a pipeline of deals in the offing.

Mexican toll roads

In 1989, then Mexican president Salinas announced the National Highway Program for that would run until 1994. The programme authorised the SCT to extend concessions to private Mexican entities to build 10,000 miles of highways.

Between 1989 and 1991, the Salinas administration directed around US\$4.6 billion of investment toward road development and improvements nationwide - US\$3.4 billion of which was project financed locally.

By the end of 1994 a total of 50 highway concessions had been awarded, representing 3,300 miles of highways and eight bridges.

Unfortunately, the National Highway Program had several weaknesses - contracts were awarded to the Mexican

companies that offered the shortest concession periods, sometimes as short as 30 months.

Construction cost overruns, failures to meet construction schedules, and failures to meet projected estimates on traffic flows impacted on tolls, driving them up.

As a result, by 1994, Mexico's toll roads were considered by many to be the most expensive in the world.

Most companies financed their toll road concessions with bonds denominated in US dollars and when Mexico's economy slipped in 1995, which resulted in the peso being devalued and doubling the liability of the notes - the impact was disastrous.

The government responded by extending the concessions but in August 1997, the Federal government transferred 21 concessions to the new government entity - FARAC (Fideicomiso de Apoyo al Rescate de Autopistas Concesionadas which translates to Support Trust for Rescue of Commissioned Highways).

FARAC assumed control of highway maintenance and construction and US\$4.8 billion worth of bad debts through the national development bank, BANOBRAS - Banco Nacional de Obras y Servicios Publicos.

The tolls were then used by Mexico's ministry of communication and transport (SCT) to retire debt and finance infrastructure developments in poorer areas.

The roads in FARAC Group 1 represent the first concession package which included four highways to be transferred out of a total of 48 toll roads currently controlled by the body.

Pablo Garcia, director of project finance within the Mexico structured finance team at Grupo Santander, said: 'The Mexican government absorbed a large amount of government-backed debt to "rescue" 48 toll roads in 1994.

'This debt is currently guaranteed by the federal government. Thus by selling these assets they can use the proceeds to repay the proportionate debt and reduce government-guaranteed debt.'

The transfer of the rest of the toll roads will continue in the coming years and SCT is currently designing other concession packages for future tenders.

FARAC Group 1

Group 1 involves the re-concession of a network of four highways covering 558km and is the first group of toll roads to be leased under Mexico's toll road concession rescue programme in the states of:

- Guanajuato
- Jalisco
- Michoacan
- Aguascalientes

The four roads

u0n1rw2i15y3x1uqbmv1htvw31102007121437.JPG



The four highways form the backbone of the central-west region of Mexico and have more than 12 years of operational history. Most of these roads were originally built and operated by ICA.

They have been leased over a 30-year concession and received bids from six teams in July this year. The original bidders were (in order of payment received):

- Goldman Sachs and ICA - US\$4.094 billion - financial adviser Grupo Santander
- IDEAL and Macquarie JV - US\$4.036 billion - financial advisers Credit Suisse and JP Morgan
- Abertis - US\$3.905 billion - financial advisers Barclays and Scotiabank
- Global Via - US\$3.894 billion - financial advisers HSBC, WestLB and Caja Madrid
- OHL - US\$3.635 billion - financial adviser BBVA
- CCR-Brisa-Hermes - US\$2.695 billion - financial adviser Merrill Lynch

The Goldman Sachs-ICA team won the process in August 2007 with its bid that was underwritten by Grupo Santander.

Primary syndication was launched in Mexico and New York on 21 August 2007 with the lender commitment deadline for 14 September 2007. The loan agreement between the top tier banks and the borrower was signed on 26 September 2007.

The sponsors formed a limited liability partnership - Red deCarreteras de Occidente - to act as concessionaire and borrower of the loan facility.

Hugo Garcia at KPMG in Mexico City told *IJ News* about investment opportunities, saying: 'I feel this is a self-reinforcing effect. Foreign investors turn their attention more and more to Mexico every time a new road or infrastructure deal comes to the market.

'Bear in mind that the Mexican government recently issued a 2007-2012 National Infrastructure Plan that calls for investments - public and private - in infrastructure for US\$250 billions.'

Toll road overview

Maravatío - Zapotlanejo

This four-lane, 309.7km highway (see image below) started operations in October 1993. It provides an east-west axis across the Occidente-Bajío-Centro region and connects cities in the states of Michoacán and Jalisco, including Zamora, Zacapu, Ocotlán and Morelia.

It is also a vital section of the most direct route between Mexico City and Guadalajara, the two largest cities in Mexico.

u0n1rw2i15y3x1uqbm1htvw31102007113451.JPG

Guadalajara - Zapotlanejo

This highway (see image below) was constructed in the 1960s as a two lane toll road, with two additional lanes added in 1994. It has a total length of 26km and is one of the most important access roads to the City of Guadalajara as it connects the toll roads Maravatío-Zapotlanejo and Zapotlanejo-Lagos de Moreno with the city.

The toll highway is the main access road that connects the Occidente-Bajío-Centro region to Guadalajara, Jalisco's capital.

u0n1rw2i15y3x1uqbm1htvw31102007113908.JPG

Zapotlanejo - Lagos de Moreno

This road (see image below) started operations in 1991 and has a total length of 118.5km. It is a four-lane, divided highway which provides direct communication to the Altos de Jalisco region with other towns such as Tepatitlán, San Juan de los Lagos, Jalostotitlán and Lagos de Moreno, which have strong economic links with Guadalajara.

u0n1rw2i15y3x1uqbm1htvw31102007114032.JPG

León - Lagos - Aguascalientes

This toll highway (see image below) started operations in 1992 and has a total length of 103.9km. It is a four-lane, divided road and connects the states of Guanajuato, north of Jalisco and Aguascalientes.

u0n1rw2i15y3x1uqbmv1htvw31102007114307.JPG

Financing

Grupo Santander closed syndication on the 37.2 billion peso (US\$3.4bn) debt for the first of the FARAC roads packages - bringing in a number of banks as MLAs and bookrunners on 26 September.

Santander acted as coordinator on the debt and initially underwrote the whole facility when it launched syndication.

Grupo Santander's Pablo Garcia says: 'This was a very ambitious strategy by Santander. We underwrote the full amount of the loan with our own balance sheet, and given that there was a very short period of time between closing and payment date, Santander wanted to avoid disbursing the full amount of the loan on our own.'

The bookrunners offered the MLAs tickets of 3.3 billion peso (US\$300m) in upfront fees of 110bp and underwriting fees of 10bp. The deadline for commitments was 14 September 2007.

Grupo Santander brought in the following bookrunners:

- Dexia
- Banorte
- HSBC
- Nord/LB

The MLAs are:

- Inbursa
- Banobras
- ING
- WestLB

The financing package is without wrapped debt or any kind of financial guarantee and has been termed a 'typical project finance security package'.

The financing is a 3 tranche all peso financing:

<i>The facilities</i>	<i>Amount in Peso and US\$</i>	<i>Tenor</i>	<i>Pricing</i>
acquisition facility	31.0 billion pesos (US\$2.830bn)	7 years	Year 1: TIIE + 165bp, Year 2-3 + 185bp, Year 4-5 + 200bp, thereafter + 225bp
liquidity facility	3.1 billion pesos (US\$283.05m)	7 years	Year 1: TIIE + 165bp, Year 2-3 + 185bp, Year 4-5 + 200bp, thereafter + 225bp

capex facility	3.0 billion pesos (US\$274m)	7 years	Year 1: TIE + 165bp, Year 2-3 + 185bp, Year 4-5 + 200bp, thereafter + 225bp
----------------	------------------------------	---------	---

The loan arrangers (and amount) for the acquisition facility were:

- Grupo Santander - US\$352.11
- Dexia Group - US\$343.90
- NordLB - US\$343.90
- Banorte - US\$343.90
- HSBC - US\$343.90
- Inbursa - US\$419.20
- Banobras - US\$227.86
- ING Bank - US\$227.86
- WestLB - US\$227.86

The loan arrangers (and amount) for the liquidity facility were:

- HSBC - US\$34.39
- Inbursa - US\$41.92
- Banobras - US\$22.78
- Grupo Santander - US\$35.22
- Dexia Group - US\$34.39
- NordLB - US\$34.39
- WestLB - US\$22.78
- Banorte - US\$34.39
- ING Bank - US\$22.78

The loan arrangers (and amount) for the capex facility were:

- Banorte - US\$33.29
- ING Bank - US\$22.06
- WestLB - US\$22.06
- HSBC - US\$33.29
- Grupo Santander - US\$34.10
- Inbursa - US\$40.56
- Dexia Group - US\$33.29
- Banobras - US\$22.06
- NordLB - 33.29

The acquisition facility for the assets is drawn on the financial close to make the initial payment to the government and to pay for other expenses.

The liquidity facility is available to make required payments on senior loans (including net payments under the Hedge Agreement) during the life of the financing package and if the cash flows from the concessionaire are not enough to cover these payments.

The capex facility is available to finance planned maintenance and capex to meet the concession title specifications (excluding required expansion work).

The three facilities have a bullet-type amortization at the end of maturity. The borrower will make expected principal amortization payments of the senior loans through a step-up cash sweep mechanism applied to any available free cash flow [\[Projects Database\]](#).

The cash sweep for all three tranches is:

- year 1-2: 25 per cent
- year 3-4: 50 per cent
- thereafter: 75 per cent

Garcia said: 'The financing was groundbreaking. This is the largest ever private peso financing ever done in Mexico. Many banks and companies did not believe that such a large amount of Pesos could be raised in the local banking market.

'This transaction evaporated these concerns for companies and the Mexican authorities for future projects and investments.'

Total equity is US\$1,437 million and total senior debt is US\$3,387 million. The debt:equity ratio is 66:34.

The financial adviser to the sponsors is Grupo Santander with Allen & Overy and Ritch Muller providing legal services. Steer Davies & Gleave is traffic consultant. Financial advisers to the government are Citigroup and Deloitte.

Conclusion

This first FARAC deal breaks many stereotypes and myths about the limits of the peso market for financing and investing. Financiers remain optimistic that it will open up a pipeline of opportunities for investments and investment strategies for Mexico.

When looking at Mexico, it pays to bear in mind the following:

- Mexico has investment grade (which was recently upgraded)
- Mexico has political stability and a friendly environment for private investment
- Mexico has had financial stability over the last 11 years
- Mexico is a neighbor to the largest economy in the world and a reliable transport network is useful to Mexico and the US, as a great deal of trade passes through the country en route to the US (a flow that is slowly also starting to reverse)

The outlook for road infrastructure in Mexico is positive and exciting for the next few years with the three main areas of investments up and running at full speed: real toll concessions, PPPs and the sale of existing assets.

Mexico's SCT is now gearing itself up for two new FARAC deals which it is to announce this year - FARAC II and FARAC III - with tendering slated for 2008.

With a pipeline of deals in the offing and an excellent peso-denominated financing successfully closed, this deal sets the scene for a vast investment in Mexico and a great deal of project finance work for the future.

The project at a glance

Project Name	Mexico Toll Roads Lease - FARAC Group 1
Location	Mexico
Description	The first group of toll roads to be leased under Mexico's toll road concession rescue programme or Fideicomiso de Apoyo al Rescate de Autopistas Concesionadas (FARAC). Group 1 involves the re-concession of a network of four highways covering 558km in the states of Guanajuato, Jalisco, Michoacan and Aguascalientes.
SPV name	Red de Carreteras de Occidente S de RL de CV
Sponsors	Goldman Sachs Infrastructure Partners
	ICA
Project Duration (Including construction)	30 years
Total Project Value	US\$4,825

Total equity (Tranche 1)	US\$1,437
Total senior debt	US\$3,387
Debt:equity ratio	66:34
Acquisition facility	US\$2,830
Maturity	7 years
Pricing	Year 1: TIIE + 165bp, Year 2-3 + 185bp, Year 4-5 + 200bp, thereafter + 225bp
Loan arrangers	Grupo Santander - US\$352.11 Dexia Group - US\$343.90 NordLB - US\$343.90 Banorte - US\$343.90 HSBC - US\$343.90 Inbursa - US\$419.20 Banobras - US\$227.86 ING Bank - US\$227.86 WestLB - US\$227.86
Liquidity facility	US\$283.05
Maturity	7 years
Pricing	Year 1: TIIE + 165bp, Year 2-3 + 185bp, Year 4-5 + 200bp, thereafter + 225bp
Fees	40bp commitment fee
Loan arrangers	HSBC - US\$34.39 Inbursa - US\$41.92 Banobras - US\$22.78 Grupo Santander - US\$35.22 Dexia Group - US\$34.39 NordLB - US\$34.39 WestLB - US\$22.78 Banorte - US\$34.39 ING Bank - US\$22.78
Capex facility	US\$274
Maturity	7 Years
Pricing	Year 1: TIIE + 165bp, Year 2-3 + 185bp, Year 4-5 + 200bp, thereafter + 225bp
Fees	40bp commitment fee
Loan arrangers	Banorte - US\$33.29 ING Bank - US\$22.06 WestLB - US\$22.06 HSBC - US\$33.29 Grupo Santander - US\$34.10 Inbursa - US\$40.56 Dexia Group - US\$33.29 Banobras - US\$22.06 NordLB - 33.29
Legal Adviser to sponsors	Allen & Overy Ritch Muller
Financial Adviser to sponsor	Grupo Santander
Traffic Consultant to sponsors	Steer Davies Gleave
Financial adviser to government	Citigroup Deloitte
Date of financial close	26 September 2007

Thank you for printing this article from IJGlobal.

As the leading online publication serving the infrastructure investment market, IJGlobal is read daily by decision-makers within investment banks, international law firms, advisory firms, institutional investors and governments.

If you have been given this article by a subscriber, you can contact us through www.ijglobal.com/sign-in, or call our London office on +44 (0)20 7779 8870 to discuss our subscription options.