Australia's Peninsula Link road PPP

Robert Lovell

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The Peninsula Link PPP project in Australia stands as a landmark transaction of Q1 2010 and represents growing confidence in the international long-term lending market.

The deal demonstrated the first use of the availability payment model for a road project in Australia - spearheading a move towards a new generation of road PPPs in the country.

The big-ticket Transport deal was closed in a record time of less than a month with a club of nine international commercial lenders and equity investors including Australian superannuation funds and Bilfinger Berger.

RBS arranged a financing package for the Bilfinger-led Southern Way consortium, which unlike other recent PPPs did not rely on state support for either syndication or refinancing.

Peninsula Link was also the first project to be delivered under the new Victorian Major Transport Projects Facilitation Act - the legislative regime introduced to facilitate the Victorian government's Transport Plan.

Background & Procurement

In December 2008 the Peninsula Link PPP was one of several major projects identified in the state government's Aus$38 billion Victorian Transport Plan.

The plan noted the growth in Frankston and the Mornington Peninsula - located south-east of Melbourne - with the local population expected to increase from 262,000 in 2006 to more than 324,000 by 2026.

The report stated that the Aus$2.5 billion EastLink project had boosted the south-east's economy and reduced traffic on surrounding roads, but that more needed to be done to improve traffic flow through Frankston and provide for growth.

The Victorian government's Linking Melbourne Authority (LMA) managed the procurement of the Peninsula Link road [Projects Database] that would connect EastLink with the Mornington Peninsula Freeway.

The LMA had onboard Clayton Utz as legal adviser and PwC acting as financial adviser.

In April 2009 the authority called for expressions of interest for the toll-free highway PPP.

By May that year, the following five teams had lined up:

- **ConnectSouth** - Fulton Hogan and John Holland
- **Peninsula Gateway Consortium** - Leighton Contractors
- **Urban Connect** - Acciona and BMD Constructions
- **Southern Way** - Abigroup

- **Connect 11 Partnership** - Thiess and McConnell Dowell

The authority then shortlisted three teams in June and issued an RFP in July to the following bidders:

- **ConnectSouth** - John Holland, Fulton Hogan and Macquarie Bank
- **Southern Way** - Abigroup, Bilfinger Berger and RBS
- **Connect 11 Partnership** - Thiess, McConnell Dowell and Commonwealth Bank

In January the LMA named the Southern Way consortium preferred bidder, and financial close quickly followed on 5 February 2010 - a record closing time for an Australian PPP.

Project Details

Peninsula Link is a 27km 4-lane freeway standard road between the Frankston Freeway-EastLink Interchange at Carrum Downs and the Mornington Peninsula Freeway at Mount Martha.

The 25-year concession will provide a new link for Melbourne's south-eastern suburbs and the Mornington Peninsula. It includes 11 local road connections and more than 35 bridges, which will cut travel times between Mount Martha and Carrum Downs to just 17 minutes.

The Southern Way consortium will DBFOM the road for 25 years in exchange for the payment of an availability charge - by the Victorian government - rather than user-pay tolls.

Despite the availability charge model PPPs being well established in the Australian social infra sector, road PPP projects in Australia have traditionally required the private sector to assume patronage risk.

The Southern Way consortium comprises:

- Abigroup
- Bilfinger Berger
- Royal Bank of Scotland

RBS acted as financial adviser to the sponsor, while Mallesons Stephen Jaques acted as legal counsel.

Key features of the scheme include:

- 27km of freeway standard road, 11 local road connections, more than 35 bridges and 18,000m² of retaining walls
- 22km walking and cycling path starting in Patterson Lakes and connecting with other popular paths in the area partnerships with Centre for Education and Research in Environmental Strategies (CERES) and McClelland Gallery and Sculpture Park
- planting of 1.5 million plants, shrubs and trees along the freeway corridor

Early works started in mid-2009 via a separate D&B tender process for partial works at Lathams Road.

On reaching financial close the Southern Way team started construction work - expected to take three-and-a-half years to complete.

Financing

Despite the financial market constraints, the Aus$759 million (US$658m) project achieved fully committed debt and equity funding.

RBS took a lead role in assembling the fully underwritten debt and equity financing package for the Southern Way consortium.

The final project documentation included significant developments in the market position for state financial support in relation to refinancing and market disruption risk - most recently established on the Victorian Desalination deal - returning much closer to pre-GFC positions on many issues.

In total nine MLAs provided a senior debt package of around Aus$600 million (US$520m).

The bank club comprises:

- ANZ
- Bank of Ireland
- Bank of Tokyo-Mitsubishi UFJ
- BBVA
- Grupo Santander
- NAB
- RBS
- SMBC
- WestLB

The debt was financed on a hard mini perm structure over a seven-year tenor. The debt to equity split is 80:20 and the debt service coverage ratio is about 1.7x.

The margins on the loan are:

- Libor +290bp - during construction
- Libor +260bp - post-construction

Allocations are all Aus$100 million and below, with the commitment fee around 50 per cent of the margin. The project is likely to be refinanced by year five.

Freehills acted as legal adviser to the lenders.

Bilfinger Berger Project Investments provided a third of the Aus$159 million (US$137m) equity, while the remainder has been provided by Australian superannuation funds - including Prime Super - and advised by Access Capital Advisers.

Project Risks

One of the major project risks was getting fully committed finance in a post-GFC world. This was mitigated through the choice of delivery method - availability payment structure - rather than tolling.

The private sector takes no patronage risk, and is therefore guaranteed an income stream, subject to availability and meeting the agreed key performance indicators.

Brendan Lyon, executive director at Infrastructure Partnerships Australia, said: "Peninsula Link shows that the use of public private partnerships has matured in Australia and has innovative applications beyond the traditional toll-road model.

"Changed economic circumstances demanded a rethink of the way projects are funded and delivered. Victoria has stepped away from a cookie cutter approach to PPPs, allowing the state's economy to benefit from the early delivery of projects using innovative models like the availability model and the guarantee of debt funding."

The tender process was also structured so that the desirability of fully committed finance was emphasised, but there was flexibility, in the event that this was not possible.

The authority was able to remove refinancing risk, by obtaining optional pricing from tenderers, based on who took the risk.

The state took the option of removing refi risk, by accepting the relevant option from the winning consortium.

Market disruption risk was assumed by the state, in carefully defined circumstances, and subject to certain caps and conditions.

Geoff Daley, head of infrastructure advisory at RBS, said: "In the midst of the global financial crisis, the state provided support for the financing of the desalination project that was necessary at that time. Now, only six months later, we've delivered to the state a risk allocation on financing which has assisted the government to move the PPP market away from reliance on such support."

Road availability was one of the key issues in determining the extent of the quarterly fee to which the consortium would be entitled.

Although the consortium takes the primary risk for keeping the road available after opening, the state acknowledged that there were events for which the consortium should not take the risk of fee abatement.

These included a list of 'permitted closure events' such as scheduled maintenance, incidents which had been rectified as contractually required, breach of contract or reckless acts or omissions of the state, suspension of the activities because of native title or heritage claims, certain defined changes in law, issues with key approvals, industrial action caused by the state, excluded works carried out by the state.

One of the innovative technical features was the 'paymech' that would drive significant incentive to keep the road open and in a condition required by the KPIs.

The mechanism had to work both legally and commercially, and also be streamlined and capable of easy understanding by the market.

In particular, it was critical to ensure that the KPIs reflected the O&M standards required by the state. This required significant effort to ensure that the technical specifications and the commercial structure - the KPIs in the paymech - were consistent.

As with EastLink, there was significant focus in the tender documents and evaluation criteria on urban design. Each of the three shortlisted consortia devoted significant effort to address this criterion.

The bidding process for Peninsula Link was very competitive, and was completed in 10 months from initial approach to the market to financial close.

Marko Misko, major projects partner at Clayton Utz, said: "On the right projects and despite the changed financial market conditions, PPPs are able to help governments deliver much needed infrastructure quickly to the community and achieve better quality infrastructure assets. They are better able to harness private sector technological and cost innovation over the longterm."

The speed reflects a streamlined approach to the documentation and evaluation processes adopted by the state, and a strong willingness on the part of the private sector to do the deal.

Conclusion

The Peninsula Link deal is a reassuring indicator for the health of the sector and the willingness of the private sector to invest in public infrastructure projects, provided they are structured on the right basis.

The risk allocation, streamlined documentation and efficient tender, evaluation and negotiation processes employed by the LMA have all received favourable industry comments.

The LMA - and its advisers - ensured that these factors would be designed to balance between protecting the state's legitimate interests, and presenting a project which would be appealing to market and attract decent bids.

This was the first time that a road project has been delivered on an availability basis in Australia and it required significant innovation.

Peninsula Link represents the next generation of road sector PPPs in Australia and incorporates the lessons learnt from previous similar projects over the last decade.

The project at a glance

Project name	Peninsula Link PPP
Location	Melbourne's south-eastern suburbs and the Mornington Peninsula, Victoria, Australia
Description	Development of a 27km 4-lane freeway standard road between the Frankston Freeway-EastLink Interchange at Carrum Downs and the Mornington Peninsula Freeway at Mount Martha
Sponsor	Southern Way: • Abigroup • Bilfinger Berger • RBS
Design and construction contractor	Abigroup
Operations and maintenance	Bilfinger Berger Services
Concession period	25 years
Construction stage	Construction work underway
Construction duration	3.5 years
Total project value	Aus$759 million (US$658m)
Total equity	Aus$159 million (US$137m)
Equity Breakdown	• Bilfinger Berger Project Investments - one third • Australian superannuation funds - including Prime Super
Total senior debt	Aus$600 million (US$520m)
Senior debt breakdown	• ANZ • Bank of Ireland • Bank of Tokyo-Mitsubishi UFJ • BBVA • Grupo Santander • NAB • RBS • SMBC • WestLB Allocations are all Aus$100 million and below
Senior debt pricing	• Libor +290bp - during construction • Libor +260bp - post-construction
Debt:equity ratio	80:20
DSCR	1.7
Mandated lead arrangers	• ANZ • Bank of Ireland • Bank of Tokyo-Mitsubishi UFJ • BBVA • Grupo Santander • NAB • RBS • SMBC • WestLB
Legal adviser to sponsor	Mallesons Stephen Jaques
Financial adviser to sponsor	RBS

Legal adviser to banks	Freehills
Legal adviser to government	Clayton Utz
Financial adviser to government	PwC
Date of financial close	5 February 2010