

Cyprus Airports BOT

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After a couple of decades in the making, Cyprus this month made PPP history by closing its first deal - the eagerly awaited €643 million Larnaca and Paphos airports BOT scheme to upgrade the ageing facilities. Now that this deal has closed, it is expected to open the floodgates to similarly-financed infrastructure projects on the island

The deal stands out as the Republic's pathfinder PPP project and is made all the more impressive by the amount of interest it drew from experienced global players - all of whom competed for their roles on the 25-year contract.

Taking the bull by its horns, the Cypriot government opted to kick start its PPP programme with this large, high-risk twin airport deal rather than testing the water with a pilot road scheme - the traditional route adopted by governments.

Despite its fair share of teething problems, the government's gamble has for now paid off and the venture is finally off the drawing board, though it took a long time and often it looked like it was doomed to failure.

Not only will the island benefit from a greater influx of tourists - the economy's main driver - investors and lenders alike will now have confidence to tap into the republic's growing PPP portfolio.

The Communication and Works Ministry (MCW) has already received interest from several domestic and international players following the launch of the US\$445 million Paphos - Polis DBFO highway deal and the shortlist for the Larnaca Port PPP will be announced in the coming months.

Whether or not the Larnaca and Paphos airports project will be recreated (and the industry hope it is not) remains to be seen. In addition, Cyprus' entry into the EU in 2005 is expected to lead to the standardisation of procurement rules which will act as a PPP landmark for future transactions.

Rationale

In 1974, a makeshift terminal building was hastily set up on salt flats near to the south coast resort of Larnaca after the international airport at Nicosia was forced to close following the invasion and occupation of Turkish troops - it subsequently lay on the border of the occupied territory and was never used.

Paphos Airport then sprung up in 1983 to cater for booming tourism on the island's west coast.

IN 1994 - and with very little investment in the two facilities - Larnaca and Pathos were catering for up to 6.7 million passengers per year, both being operated beyond their capacity during the summer months.

Tourism has been the single biggest generator of revenue for Cyprus and 90 per cent of tourists arrive by air.

The prospect of Cyprus becoming an accession country and creating a regional hub reinforced the government's choice to upgrade the aging infrastructure which was in desperate need of redevelopment.

In 2001, the government decided to get underway with tendering for the two deals under a single BOT basis, a move that would avoid burdening the government's limited budget and ensure the schemes be delivered quickly.

The project

The international tender attracted some of the world's leading airport operators and construction companies and in November 2003, the Alterra consortium - headed up by Bechtel and Barclays Private Equity - was named preferred proponent for the deal. The Bouygues-led Hermes group was named as reserve bidder.

Alterra's bid reportedly included an offer to return 48.96 per cent annual gross turnover in royalties to the Cypriot government but negotiations between the government and the group broke down at the middle of 2004.

Problems were said to stem from the consortium failing to renew its financial guarantee by its deadline while other sources say the government pulled the plug on Alterra because it failed to come up with a bankable solution.

A source close to the deal told *IJ News* at the time: 'I suspect that Alterra may have been too aggressive, on the other hand the Cypriots have not been too easy according to their advisors.'

'I expect local politics have contributed to a rocky process too.'

Rather than scrapping the deal - which had first come to light in 1987 - the government picked up the pieces and started afresh with Hermes - which had initially lodged a bid offering just 33 per cent of the revenue to the government.

MCW and Hermes reached a final agreement in May 2005 after reaching a preliminary BOT in January. The group included:

- Bouygues Batiment (France) 22 per cent
- EGIS Projects (France) 20 per cent
- Cyprus Trading Corporation 11.34 per cent
- Hellenic Mining Company (Greece) 11.3 per cent
- Aer Rianta (Ireland) (11 per cent)
- YVR Airport Services (Canada) 11 per cent
- Iacovou Bros (Greece) 5.6 per cent
- Charilaos Apostolides & Co (Greece) 5.6 per cent
- Chambre de Commerce et d'Industrie de Nice Cote d'Azur 2 per cent

The contract entails the development and operation over 25 years of two new terminal buildings and associated infrastructure at both airports, expanding the capacity at Larnaca to 7.5 million passengers per annum and 2 million at Paphos. The company will undertake further expansion of the airports as demand requires.

The new terminals will be opened in November 2008 (Paphos) and November 2009 (Larnaca).

Bouygues' experience in tackling large scale infrastructure deals combined with three airport operators and reputed local contractors (Charilaos Apostolides & Co) and investors (Cyprus Trading Corporation) gave the strength and dynamics the group needed to take on Cyprus' largest infrastructure project to date.

Transaction

There was huge appetite from the banking community to participate in the revenue-based deal and by July 2005, a syndicate of banks including ING, RBS, SG and West LB won the mandate to undertake financing for the project.

A spokesman for Bouygues Batiments said: 'Bringing the deal to financial close in 10 months was one of the most challenging aspects of the scheme.'

'Not only is Hermes a very large consortium but is it the first concession project in Cyprus, and a very visible venture locally.'

The financing package for the deal features a 80:10:10 debt/equity ratio with the four co-arrangers splitting a 20 year senior debt facility of around €482m (US\$619m) priced at more than 100bp above Euribor - it's a straight term loan with a regular repayment schedule.

The banks also provided a mezzanine loan of €60.25m (US\$77.4m) while the sponsors - members of the Hermes consortium - are injecting €60.25m (US\$84m) of equity into the project. West LB, RBS and SG acted as joint bookrunners and syndication for the senior debt facility is already underway.

The concessionaire is returning 33 per cent of the revenue to MCW while it is taking the bulk of the traffic risk, most of which is revenue ramp-up risk. The concession agreement also provides for a certain amount of protection in unique circumstances - a measure established in the aftermath of 9/11.

Although the traffic flow dipped after the terrorist attacks and were also affected by invasions of Iraq and Afghanistan the airports have a

strong existing traffic base.

By the time Cyprus had entered the EU in 2005, the deal was too developed to adhere to EU procurement regulations. The project incorporates a number of UK style PPP elements which were able to be tailored specifically for the deal - avoiding being tied down to EU standardisation.

Looking ahead, Pinsent Masons partner Catherine Workman, advising MCW on its PPP programme said: 'The government has worked very hard to deal with the sophisticated EU procurement rules since 2005 and it will continue to be challenging going forward.'

The consortium was advised by ABN Amro (financial) and Norton Rose (legal) and the banks by Freshfields (legal), Mott Macdonald (technical and traffic) Miller (Insurance) and PKS (model audit).

PWC and Pinsent Masons advised the grantor - Cyprus ministry of communication (MCW).

Conclusion

By kick starting its PPP programme with a sophisticated, high risk twin airport deal it was hardly surprising that the Cypriot government failed to get the scheme off the drawing board for so long.

Having failed to complete negotiations with the Alterra consortium in 2004, the government dusted itself off and tried again with the experience of Hermes - a move that saw the project financing put in place and close within 20 months.

The twists and turns that the Republic's pathfinder PPP threw up will give the government firm grounding for developing its PPP market even as it grapples with sophisticated procurement rules as a new EU member.

Now the airports package is complete, all eyes will turn to Cyprus' next PPP over the coming months to see whether the recently tendered Paphos - Polis highway DBFO will attract as much domestic and international interest as the airports package.

And if industry rumours are true, an impressive list of bidders are already lining up for the scheme, as investors and developpers alike move in on what promises to be an exciting PPP market.

Project Name	The Development and Operation of Larnaka and Paphos International Airports
Location	Cyprus
Description	Concession to design, build, finance and operate two new terminals in Larnaka and Paphos for 25 years.
Sponsors	Hermes Consortium (see below)
Operator	JV between YVR Airports Services (Vancouver Airport) and EGIS Projects
EPC Contractor	Bouygues Construction
EPC Sub Contract 1	Iacovou Brothers
EPC Sub Contract 2	Charilaos Apostolides
Project Duration (Including construction)	27.5 years
Construction Stage	2.5 years
Total Project Value	€643m (US\$826m)
Total equity	€60.25m (US\$77.4m)

Equity Breakdown

Bouygues Bâtiment International	22 per cent
EGIS Projects	20 per cent
Cyprus Trading Corporation	11.3 per cent
Hellenic Mining Company	11.3 per cent
Aer Rianta International	11 per cent
YVR Airport Services	11 per cent
Charilaos Apostolides & Co	5.6 per cent
Iacovou Brothers	5.6 per cent
Chambre de Commerce et d'Industrie de Nice Côte d'Azur	2 per cent

Total senior debt	€542m (US\$619m)
Tenor	20 years
Senior debt breakdown	Senior debt: €482m (US\$619m) Mezzanine: €60.25m (US\$77.4m)
Senior debt pricing	More than 100bps above Euribor
Debt:equity ratio	80:10:10
Mandated lead arrangers	ING Bank Société Générale Corporate & Investment Banking The Royal Bank of Scotland West LB
Legal Adviser to sponsor	Norton Rose
Financial Adviser to sponsor	ABN Amro
Legal adviser to banks	Freshfields
Legal adviser to government	Pinsent Masons
Financial adviser to government	PwC
Technical and commercial adviser to government	EC Harris
Date of financial close	12 May 2006

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