Dutch motorway – the 14-year itch

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Of all the stories *IJGlobal* publishes, the most pleasing are the launch of new projects. So it was with delight earlier this week that we wrote about a European motorway PPP being brought to market in the Netherlands.

Splendid stuff. Dutch to the rescue once again with a greenfield project. Raise a glass of jenever (ghastly stuff) and toast their good health – saviours of the European primary market [2008-present].

But hold on, what's that you're saying… a 14-year concession?

Jenever hurled down the drain (achieving results cleaning products can only dream of), cork reinserted in earthenware bottle, escaping vapour triggering fire alarms and gag reflexes in equal proportions.

So, what's this all about? From the public side, it makes perfect sense. Widening and improvement work to the A9 comes as part of the SAA programme – the Schiphol-Amsterdam-Almere highway redevelopment plan – and this short concession dovetails nicely with future ambitions.

While the A9 upgrade caters for needs in the immediate future, in some 14 years' time Rijkswaterstaat reckons it will require greater capacity again. To avoid a tussle with the incumbent SPV, towards the end of that concession RJW will launch a new project for the next phase, possibly flipping operations on the recently upgraded section into the new offering.

In this scenario a shorter concession makes perfect sense – to the public sector.

And it's not alone… a 14-year tenor comes as music to lenders' ears, especially on core infra – one banker was catty enough to suggest tenor-constrained banks will be performing backflips at the chance of doing something other than wind and solar. “If I were ABN Amro, I'd be bidding my arse off on this one,” he guffawed.

However, the same cannot be said for third-party equity providers for whom shorter concessions raise questions over the viability of securing a return over such a short timeframe.

Manipulating models…

While a 14-year concession will not entirely rule out third-party equity, it will set alarm bells ringing for the investment committees, and it will fall to the analysts to manipulate financial models to a point where they get the numbers to stack up, providing an IRR of 12-14%.

Furthermore, due to the shorter timeframe, it will be harder for the co-sponsors (equity funds) to sell on to the usual suspects – pension funds and insurance players – as they tend to be more interested in concessions of 25-30 years.

These days there is a lot of churn in the secondary market with assets being flipped every five years, or so. This will be tough when you only have 14 years to play with in the first place. And nobody is going to buy into a project when there is, say, five years left to run.

An immediate reaction would be to suggest that the contractors pony up the cash themselves, but most of them come up empty-handed after rummaging down the back of the sofa.

Perhaps they should have been smarter with money when they had the opportunity. Over the years, it has been somewhat galling for the – shall we say – “less smart” developers to watch infra funds trouser the lion’s share of the upside while the contractor uses its cash to bid for the next project, prioritising growth the old fashioned way.

And with cash being king for developers these days, it’s unlikely they will want to tie up a wedge – what little they do actually have – even if it’s for only 14 years.

One thing we are likely to see – and remember it is only for the A9 with its particular circumstances – is a shift in gearing. It would be infinitely more manageable if it were to progress at 90:10 rather than a more traditional / cautious 80:20.

This would pave the way for a mezz debt tranche – which will have every lender under the sun fighting tooth-and-nail to win.

It’s all fund and games…

Rijkswaterstaat has set a fairly ambitious schedule for the A9 – but that’s fair as it tends to stick to its timelines. It has already published the PIN and it should make it to financial close very late 2018, or more likely some time in early 2019.

Debt will sort itself out with consummate ease and may even result in some banks making a glorious return to the space, strutting back into the arena for the one infra deal where the concession matches their limitations.

As to equity, it is fair to assume that it will find a way – especially given the amount of dry powder out there looking for an infra home. We may even see some unexpected characters creep on to the scene.

“The funds may not be able to make their return over the 14 years,” says one source on the ground. “But they are working on a level playing field. If they have a minimum IRR, they will put it in the financial model and the authority will just need to pay more.”

There are two options available. RJW can pay higher unitary payments which will allow the debt to be amortised earlier and give a return to equity; or keep the unitary payments at a normal level, but have a balloon payment at the end of the concession – the expense of which can be flipped into the new project.

Infrastructure funds are entirely comfortable playing in the Netherlands, it just remains to be seen whether they can become comfortable with 14 years.