Toll tussles

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Its like waiting for the bus, none for ages and then three come along at once,? quips one banker of the renewed activity in the Australian road building business. While few bankers wait for buses to go anywhere, it has certainly been a very busy few months for project finance departments with an eye on Australian infrastructure developments. Two sizeable greenfield roads projects have come to market in recent weeks: the A$1 billion ($590 million) Cross City Tunnel and A$1.5 billion Western Sydney Orbital (WSO) projects, a third is just now entering the bidding stage, the A$815 million Lane Cove Tunnel scheme.

The last greenfield roads project to be financed in Australia was the Eastern Distributor scheme, back in 1997, and a number of important developments in the roads concession model have taken place since then.

Market sources say that it is not possible to discern the emergence of a new standard financing template in response to these developments. For one thing the financing arrangements for Lane Cove will, of course, depend on the winning bidder selected (four consortia have formed in response to the tender process). At the same time, the other two projects in the market now are quite different roads, deserving their own distinct financing arrangements.

The Cross City project involves a relatively complex construction process centered on two separate 2km-long tunnels, which will link Sydney's eastern suburbs to the west, bypassing Sydney's Central Business District. WSO, on the other hand, at 40km, is a larger scheme but also simpler from a construction point of view, says Paul Shew, associate director of project and structured debt at Westpac. ?And whereas Cross City has relatively certain traffic figures, WSO is more of a growth play,? Shew says.

There are four lead arrangers for WSO's financing: RBS Australia, Bank of America, National Australia Bank and WestLB. ? One interesting feature of the WSO project?, says Jason Jacques, director in RBS's project finance department, ?is that it is a 40km road with many on and off ramps, and the tolling will be distance-based, at 25c per km.? Few vehicles are expected to travel the whole length, so instead its characteristics are essentially those of numerous sub-markets. ?In a sense you get the risk diversification of a portfolio of road assets in one project,? Jacques remarks.

While both WSO and Cross City are bank debt funded, Cross City is thought to have a shorter tenor than the WSO transaction (WSO's financing details are still under wraps until financial close is reached). ?Along with Deutsche Bank, Westpac has underwritten a A$580 million term loan for the development. This is a seven-year bullet deal and therefore a shorter-term facility than with previous roads deals,? says Christina Tonkin, head of project and structured debt at Westpac.

China Construction Bank, meanwhile, is arranging a A$220 million bridge loan for the borrower, as one of the principal sponsors, Cheung Kong Infrastructure (CKI) will inject equity at the back end of the project. It is understood that the bridge loan is backed by a CKI corporate guarantee. Westpac will also provide an A$42 million loan to finance Deutsche Asset Management's equity stake in the venture, and together with Deutsche Bank, a A$25 million performance bond.

One reason for the shorter term, says Tonkin, is to facilitate syndication to Asian banks attracted by CKI's sponsorship. ?Certain banks in Asia will not readily go beyond a seven-year term,? she notes. ?But the financing is also designed for flexibility and the tenor of the facility fits naturally with when equity is likely to look to refinance. Both M2 and Melbourne Citylink were refinanced shortly after their ramp up periods.?

The trend towards shorter-term financings may turn out to be a more general phenomenon for roads projects. Jeremy Brasington, director, global structured finance, at ANZ, thinks so. ?What we are acknowledging,? he says, ?is that all these roads projects will get refinanced, probably looking to the capital markets a few years after construction for new capital.?

The recent refinancing deal for an older Australian toll road, Transurban City Link in Melbourne (arranged by Westpac, ING, HSBC and CCB and led by ABN Amro) demonstrates the considerable value in refinancing. ?The financing margin for the original deal was about 1.5%,? notes one banker involved in the deal, ?whereas the quasi-corporate refinancing involved a margin of less than half that.?

This difference in pricing was admittedly exacerbated by the fact that technology risk was a factor when pricing the original City Link deal ? the project saw the first use of multi-lane electronic tolling. But the refinancing was also able to attract a different part of the financing market. ?When refinanced Transurban had a hard credit rating, and the term, originally construction plus ten years, was now down to five,? says the banker.

Financings for typical Australian Public Private Partnership (PPP) projects, in clear contrast, are benefiting from longer and longer maturity financing arrangements, Brasington observes.

Ironically Cross City was designated a PPP project by the New South Wales government. ?But if you want to call Cross City a PPP, then PPP becomes a fairly meaningless term,? says one banker. Patrick St John, a partner at law firm Freehills' Sydney office agrees. ?There has been a bit of rebadging here. Even though one or two new roads deals may be labeled as PPP projects by government there is not a huge amount of difference with the traditional model,? St John says.

In broad terms the three road projects underway in New South Wales at the moment follow a toll road concession framework in use for over a decade. ?These are really just BOOT [build-own-operate-transfer] style projects based on a 25- to 35-year concession period and a transfer to government at the end of the concession term,? notes Peter Doyle, a project finance partner at Mallesons' Sydney office who has worked on a number of tollroad-related financings.

The planned A$1.8 billion Mitcham to Frankston road scheme in the Scoresby Corridor on the other is expected to be a more genuine PPP project. ?Notably, revenues for Scoresby will be based on an annual charge and won't be volume based,? says Brasington. Expressions of interest for the project are due in next month.

The development is located in Victoria, highlighting a different attitude to the PPP concept compared with New South Wales. ?It's hard to know at this stage how different the project model will be in Victoria,? says Nick Grambas, a project finance partner with Mallesons' Melbourne office, ?but we expect the general principles won't change fundamentally.? One difference that is expected will be the revenue collection system. ?We might, for example, see a shadow tolls system,? says Grambas.

If there has been an evolution of the roads project model in New South Wales, it has been both in the amount of risk government has tried to pass on to the private sector and the amount of financial benefit government expects to receive back. This follows criticism from the Auditor General that the private sector enjoyed too high returns from previous road schemes, and the government too little.

?Government,? agrees Doyle, ?has clearly become more hard line in allocating risk, having learnt from its experience in Eastern Distributor and other earlier toll road deals.? In current and future roads projects (at least in New South Wales), therefore, the government now seeks an upfront payment for the grant of the concession and to share in any upside if the project performance beats certain revenue benchmarks. The Cross City Tunnel project is the first toll road project put to tender to the private sector on this basis.

Westpac's Shew also points out that the Roads and Traffic Authority (RTA) will get a percentage of the traffic upside that increases as the upside increases. The Lane Cove deeds now take the government's demands one step further. ?In the Lane Cove tender documents the RTA made clear, for the first time, that it also wanted to share in any benefit deriving from a refinancing,? says another banking source.

St John at Freehills believes these greater demands may not simply relate to the RTA's experience with earlier roads projects, but also to a change in legal adviser to the government. Blake Dawson Waldron was previously the state's legal advisers for road projects such as Eastern Distributor. But government worked with Clayton Utz in putting together deeds for the 2000 Olympics projects and Clayton Utz has become adviser to government for the latest batch of roads projects. ?Its interesting to note that the new concession deeds are much more similar in style to the Olympic project deeds than the pre-1998 roads project documents,? explains St John.

While the upside for sponsors and investors has diminished somewhat, the risks are also better understood. ?All three new roads projects in New South Wales include some form of electronic tolling,? notes Richard Cooper at National Australia Bank, ?but this is now well proven technology.?

One more recent development affecting the economics of these projects, notes Tonkin, has been the steep rise in insurance costs over the last 18 months, post September 11. ?Insurance for tunneling ventures has risen particularly sharply,? she says. ?Australia is a relatively small insurance market, with a limited number of re-insurers and this clearly affects the sorts of rates that are coming from the primary insurance companies,? Tonkin notes.

Both the bank and bond markets greeted the Transurban refinancing with enthusiasm. The original size of the bond placement was increased to accommodate stronger than expected demand, says a source at ABN Amro.

But the scale of road finance now required from the bank market raises questions about available banking appetite, the more so because they are all Sydney-based road schemes.

This has been a key concern for banks underwriting the Cross City Tunnel and Western Sydney Orbital financings. ? Syndication managers in on the two deals are certainly a bit nervous,? notes one project financier. On the other hand, Westpac's Tonkin says, ?the timing is good ? this a time of year when bankers want to get deals under their belts. And we still have a good number of institutions ? 30 or so ? active in the Australian project finance market to take on new project transactions.?

The recent performance record for roads schemes is also good. ?It would be fair to say that all of the toll roads are performing well, particularly when compared to RTA forecasts or bank forecasts that are sometimes less optimistic than the more publicly-quoted equity upside forecasts,? says Jacques at RBS Australia. He adds, ?City Link, in Melbourne, had some well-publicized teething problems, 99% of it was working perfectly, and last year Transurban was able to get their aggressive refinancing away and pay out the lenders to the original 1996 facility.?

Lane Cove is not expected to be as affected by concerns over bank market appetite as Western Sydney Orbital or Cross City. ?Lane Cove won't be financed until the next semi-annual period, or perhaps even after that, so market appetite should be fairly strong,? Brasington says.

Lane Cove Tunnel is a similar development to the current Cross City development. ?Its an even more mature traffic story than Cross City with similar demographics. In fact it's perhaps even better placed than Cross City because the tunnel is the missing bit in the road network in that part of Sydney,? says one banker.

With bids just going in, and possibly a second stage of bidding in the works, banks were reluctant to say how the financing might reflect the relatively safety of the Lane Cove traffic projections. ?The financing structure will very much depend on which group and bank adviser wins the deal. If, for example, ABN Amro wins, one can expect a heavier emphasis on capital markets financing from the outset,? says one observer.

Bankers are at odds over how long it will take government to digest the Lane Cove bids or how the authorities will begin to whittle down the number of tenders. ?There is a state election coming up in New South Wales, which may delay the process. Bidders have also had a bit more scope to play around with the RTA's original spec which means government will want longer to examine the bid documents. What we expect is for the government to select a preferred bidder plus a back up,? says one financier.

Tonkin also expects a two-stage bid. ?We would anticipate a shortlist and a rebid as the government seeks to cherry pick the elements it likes from each bid.?

Back to contents