SPONSOR PROFILE: Bouygues

08/11/2013

Canadas enthusiasm for PPP, not to mention its liquid project bond market, make for some remarkable project financings. The C$142 million ($138 million) bond financing for the Iqaluit Airport in Nunavut was the first availability payment-based financing for an airport and the most northerly PPP ever. (For more on that deal, see Deal Analysis, p13 this issue.)

The bond, for which CIBC was bookrunner, equaled the record low spread on a Canadian PPP bond, and was the second bond financing that Bouygues had closed in Canada. The first, for which Scotia was bookrunner, was for the Royal Canadian Mounted Police E accommodation project. That financing was the first, and to date only, PPP for the federal police force. As the European project bond market has begun to show signs of life, there are indications that the Canadian model is influencing the European market.

Enhancement old and new

The formative experience for Yann Le Saux, director, project finance, at Bouygues Construction, was in the UK private finance initiative market, when monolines dominated long-dated debt financings. I worked on monoline-wrapped bond deals in the UK, including Broomfield hospital, which I think was the last monoline-wrapped deal to close in the UK.

The £162.5 million million Ambac-wrapped index-linked bond for the Broomfield Hospital PFI in the UK closed in December 2007 with a 2.2212% real coupon. The monolines financial health deteriorated from that point, as claims connected to subprime mortgage securitisations mounted. The monoline market never recovered, and while there have been some small signs of activity, it will never reach its pre-crisis level again, says Le Saux.

Still, the UK looks like the best laboratory anywhere for project bond financing structures in the post-crisis, post-Basel III era. The last few months have even seen the return of bond insurance, in the form of the policies that Assured Guaranty wrote on the £102 million Leeds social housing and £63 million Edinburgh student accommodation bonds.

More recently, the Pendleton social housing PFI financing featured the long-awaited debut of the funded subordinated bond enhancement structure, an £72 million bond financing structured by FHW Capital, placed by Investec, and enhanced by the presence of £11 million in Gravis Capital-provided bond debt.

What worth a wrap?

But before any of these financings closed, in May 2013, Bouygues led the group of sponsors that closed the £143.5 million RBC-led bond financing for the Uliving@Hertfordshire student accommodation project. Uliving, for which Meridiam, Bouygues, Derwent Living, University of Hertfordshire, and Legal & General were sponsors, was larger than the other deals, and did not feature any external enhancement.

The Hertfordshire deal suggested that if a UK deal was structured correctly then it could reach the same underlying rating as its Canadian counterparts, but the deal is far from similar to a Canadian PPP. There are a lot of differences, says Le Saux. The university ranks below the top 50, which was a challenge for both the investors and the senior lenders. There was demand risk. There was greenfield risk. The gearing was 75/25, whereas in Canada you can achieve 88/12.

That doesnt mean that you couldnt get S&P to rate a plain-vanilla PFI deal to A- in the future. But Hertfordshire has some unique features compared to traditional UK PFI or Canadian PPP, including a long concession length [50 years], and a £51m upfront payment to the university to build a science building, which was a key criteria on the bidding. Bouygues Construction also put its balance sheet to work on Hertfordshire, providing a parent company guarantee to the Bouygues UK construction contract. (For more on the financing, see the Deal Analysis in Project Finances July/August 2013 issue.)

The 41-year index-linked Hertfordshire bond was listed, but had one investor Legal & General. For August 2012's £66 million University of Essex project Aviva Commercial Finance provided a loan, while Bouygues, Derwent Living and Equitix provided the equity.

For Bouygues, the difference is not always between the bank and bond market, but how many lenders it will need to close a deal with. The two accommodation deals involved one lender each, while the Iqaluit deal involved one principal bookrunner.

The issue we have had since 2009 with the banks is that there is still no real underwriting, says Le Saux. For a deal of a few hundred million Euros youll need five to ten banks round a table, and your difficulties increase exponentially because of the number of parties around the table. However we always manage to find solutions.

Canadian liquidity

At a time when banks in Europe are again offering to go beyond 30 years for favoured clients on solid availability-based PPPs, Canada remains off-limits to European lenders without the funding base to match Canadian players. We have not stopped looking at banks completely in Canada, says Le Saux. For our bids on the Pan-Am Games venues and Regina stadium, which are design-build-finance, we have worked with banks. But in Canada there is no long-term bank funding available.

Asked whether the Canadian market would benefit from a greater use of bilateral private placements for PPPs, Le Saux notes that the Canadian banks stranglehold on the market has its benefits. Having an underwriter offers a lot of comfort in terms of deliverability. Theres a reputational risk when a bank pulls out of a deal. But there might be a saving on skipping the ratings process.

And even with the presence of the big Canadian banks as underwriters, Le Saux is effusive about the capabilities of Canadian institutions. Canadian bond investors are quite familiar with these types of risk, and the way these transactions are structured. The questions that we get from them are very precise. A mature market brings lower pricing and a more demanding investor base.

Bouygues has relied upon banks to close complex financings. The $1 billion Port of Miami Tunnel financing, which closed on 15 October 2009, featured a $341 million 35-year loan from the US Department of Transportation, and $322 million in five-year debt from 10 banks.

The tunnel deal was repeatedly delayed, both by political wrangling and the demise of Bouygues original co-sponsor, Babcock & Brown. Meridiam stepped up as equity provider, and now appears as a co-sponsor on several Bouygues-developed projects. But the Miami deal provided a good showcase for Bouygues Construction. Complexity is an important differentiator, says Le Saux. The Port of Miami Tunnels geological risk made it extremely challenging to build.

Still, the Canadian bond market is mature enough that it can accept increasingly complex and protracted construction processes. If Iqaluit was being built in a normal place it would be fairly simple and take maybe 18 to 24 months. But in terms of logistics, you have only a few months every year during which boats can access the city, and procurement are far more complex than in the South. Not everybody is eager to test these conditions. Its more straightforward on the [UK] student accommodation, though not low-tech those buildings are true zero-carbon.

The liquidity and dependability of the Canadian market, even compared with the UK, has given rise to the notion that Canadian bond structuring sets the pace for deals in Europe. Im not sure whether its a matter of geography or simply pre- and post-crisis. In the UK before the crisis the security packages requested by the lenders and financial sponsors were less onerous for the contractors than they are today.

The alternative argument is that Canada happened to bring several projects to market during the aftermath of the 2008 crisis. The turning point in the market was probably McGill. When we closed on the RCMP E deal [in April 2010] we offered a security package that included a letter of credit. But other elements such as the cap on liability were closer to the UK market at the time. McGill created a distortion in the market that affected what ratings agencies asked contractors to put on the table. When we were preparing the financing for our bid for the Surrey Outpatient Care & Surgery Center we could already see that they were getting more demanding.

Size and ticket size

Still, in this atmosphere of tighter credit requirements, Bouygues, with a rating and a solid relationship following of well-rated banks, was well-placed to offer the required enhancement. The other large French contractors have also prospered, despite the liquidity issues that French banks suffered in 2011. Some of them are bulking up their facilities management capabilities in advance of a hoped-for increase in activity in Europe.

Bouygues Construction manages its long-term exposure to PPP projects by retaining a minority equity stake, enough, it says, to give comfort to clients and co-sponsors that the deal is properly and robustly structured, while avoiding having to consolidate a projects debt. Given this combination of construction phase balance sheet support and large equity requirements, it has a long track record of working with financial sponsors.

We always work with financial sponsors. Were an experienced PPP developer, a contractor, and a minority investor. We usually try to stay below the 20% because we dont want to tie up too much capital long-term, though we still take on development risk, and remain a part of the project company. In Canada, Bouygues has closed three deals with InfraRed Capital and its predecessor HSBC Infrastructure, while in the UK it has worked with Barclays Infrastructure, InfraRed, Meridiam and Equitix.

Shortly before Project Finance spoke with Le Saux, Bouygues closed another market first the long-awaited first securitisation of a Dailly obligation on a French PPP. The L2 Marseilles financing featured Eu164.5 million in bonds placed to Allianz, though the deal split into roughly equal tranches, with one tranche directly exposed to project risk, and the other benefiting from a pledge of French government-guaranteed Dailly receivables, thanks to the presence of Crédit Agricole as a fronting bank. (For more on that deal, see Deal Analysis, p16 this issue.)

The French governments habit of dividing payment obligations into guaranteed and unguaranteed streams effectively means that government is doing some of the financial engineering that sponsors typically have to do when assembling enhanced bond issues. In this instance, though, government is retaining all the benefit of reduced debt costs.

If you look at what happened in the UK before PF2" notes Le Saux, the government was being asked to pay a premium on 100% of the debt, even though there was a very remote possibility that a lender would lose 100%. The French model still features a small at-risk tranche, enough to encourage a project company to perform. But the government only pays a premium on that piece.

The French model has proven popular with banks and encouraged lenders from Germany and Japan to offer competitive and long-term debt packages to project sponsors. Before governments elsewhere talk about a world-beating Canadian model, they may be wise to look to developments back in Europe.