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Milan Metro, Italy

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Two availability-based PPP concessions for the Milan Metro are nearing close on debt financings with tenors of up to 21 years. The financing for Line Five will feature a rare project bond tranche, made possible by new legislation and the deal's minimal exposure to construction risk.

Expo Milano, which the Municipality of Milan will host in May 2015, is leading to increased investment in transportation infrastructure that reduces congestion. The [Tangenziale Est Esterna Milano toll road]in the neighbouring Lombardy region is another project designed to deal with Expo-associated visitors.

With the Expo approaching, the sponsors of the Milan Metro Four and Milan Metro Five Extension PPPs faced a 31 December 2014 deadline to sign concession agreements. Both narrowly beat the deadline, and thus avoided losing substantial state grants.

Grantor as controlling shareholder

The €1.86 billion ($2.1 billion) [Milan Metro Line Four PPP managed to sign concession documents] - though these are dependent on the signing of a loan agreement - on 22 December, and financial close should take place this quarter. A group of banks will provide debt with a tenor of 20 years, though cash sweeps should lead to it being paid down 3.5 years before maturity.

Construction began in 2013, but is scheduled to last until 2022 – 24 years before the end of the line's design-build-finance-maintain-operate (DBFMO) concession. The 14.5km Line Four will be the first driver-less metro in Italy, and will use communication-based train control systems in its 47 vehicles.

The Municipality of Milan is project grantor and owns a controlling 66.6% stake in the project company. This dual role is rare in Italy, and made negotiations more complicated. The government had to approve every aspect of the concession, but has more than one decision-maker. One banker involved in the project described negotiations as “slow and fragmented.”

The municipality’s dual role involved complex new governance and accountancy principles, which could be seen as a pathfinder for Italy, noted Marco Cerritelli, partner at CBA Studio Legale e Tributario in Rome.

“Among the innovative governance tools introduced I would mention the *mandato gestorio*, considered positively for the bankability,” Cerritelli said. “This is a delegation of rights conferring to the private partners (contractors and minority shareholders of the concessionaire) power and authority to manage as reserved discretions certain matters connected with the relationship with the grantor.”

The Municipality of Milan is one of the most creditworthy authorities in Italy - almost as strong as the sovereign – and is providing €160 million of the concession's €240 million in equity. The private shareholders, which include Astaldi (9.67%) and Impregilo (9.67%), are contributing equity and a €126 million subordinated loan. State-owned Cassa Depositi e

Prestiti (CDP) is lending €217.5 million, and raised the funding for this loan from the European Investment Bank.

BNP Paribas, Crédit Agricole and Natixis are lending €135 million, whilst Italy's Banca IMI, UniCredit and MPS Capital Services are providing €82.5 million, which CDP is funding. The state has approved €871 million in upfront public grants.

Introducing an institutional tranche

Whilst the greenfield Metro Line Four obtained a lengthy tenor from banks, the Metro Line Five Extension PPP could feature a rare project bond for an Italian infrastructure asset. The debt for the Line Five Extension is expected to close later this month.

The sponsor group for the extension is the same that holds the concession for the first part of Line Five, whose financing closed in 2007. The December 2014 signing of the concession agreement triggered a merger of the project companies for the original 12.6km Line Five and the 6km extension.

Private controlling shareholders Astaldi, Ansaldo and Alstom should fully complete construction for the extension to Line Five by late 2015, minimising investors' exposure to construction risk. The existing line has proven traffic volumes, which makes a long-term bond refinancing for the line more palatable to institutional investors.

A group of nine banks had planned to meet the entirety of Line Five's €600 million debt requirement – until a change in Italy's capital markets laws in 2014 made a project bond tranche possible.

Corporate bond issues previously dominated the Italian bond market, because registering security was too complicated to make secured project bonds feasible. Now bonds are more transferrable because a security interest can be created at the outset in favour of a security trustee and held on behalf of all bondholders. The new laws also eliminated an issuer's 2:1 debt-to-equity restriction.

Squeezing tickets

Late in the second quarter of 2014, bookrunners Natixis and Banca IMI began marketing the listed bonds to institutions, and eight or nine expressed an interest.

A mix of domestic and European insurance companies is in place to fund on a €150 million listed project bond tranche:

- Aviva Investors
- La Banque postale
- SCOR
- Intesa San Paolo Vita
- Unipol

Although the bond tranche could have been larger, the nine commercial banks resisted their tranche being reduced below €450 million.

The bank debt pricing will start between 350bp and 400bp, and the fixed-rate bond tranche will have a spread of between 300bp and 350bp. The tranches are expected to have 21-year tenors. Sponsor equity should be around €150 million. The state and municipality have contributed about €800 million, most of which has been spent on the original Line Five and the extension.

Open to investors

Institutions looking for yield in 2015 may find more opportunities in Italian project bonds.

Antin Infrastructure's solar photovoltaic (PV) portfolio refinancing in December 2014 featured the first project bond to close after the enactment of the 2014 legal reform. The previous project bond was a listed issue for the Andromeda solar

PV financing, which closed in 2010 with enhancement from Italian export credit agency Sace.