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Investors embrace traffic risk in long-dated project bonds

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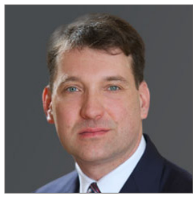

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Investor enthusiasm for long-dated Spanish infrastructure debt was confirmed earlier this year with the successful €557 million refinancing by Autopista del Sol, Concesionaria Espanola, S.A. ("Ausol") of its existing debt. The transaction consisted of a €467 million placement of 3.75 per cent. secured senior project bonds due 2045, a €40 million placement of 3.75 per cent. secured senior project notes due 2045 on substantially the same terms, and a junior loan of €51 million. Ausol holds concessions for operating two sections of the AP-7 highway, running from Malaga to Estepona in southern Spain, and its principal sources of revenue are toll receipts under the concessions. International investor demand for such long-dated paper with exposure to traffic risk was a significant step forward in the continued development of project bonds as a source of infrastructure financing in Spain and throughout Europe. The transaction allowed Ausol to reduce its financing costs and eliminate the risk of refinancing the project's debt.

Cintra Infraestructuras, S.E., a global leader in developing transport infrastructure and part of the Spanish infrastructure group Ferrovial, is the lead sponsor of Ausol, with an 80% ownership interest in the concessionaire. Unicaja Banco, S.A., a Spanish private bank, owns the remaining 20%. The transaction builds on Cintra's track record of financial innovation, following the award-winning refinancing of the outstanding indebtedness of Autovia de la Plata in May 2015 through the issuance of €184.5 million of 3.169 per cent. project bonds due 2041, where Cintra acted as a sponsor alongside Meridiam Infrastructure Finance II S.à.r.l. and Acciona Infraestructuras, S.A.U. It is worth noting that Autovia de la Plata's revenue is generated from availability payments under its concession, which substantially changes the project's risk profile when compared to a concession exposed to traffic risk like Ausol.

The toll road underlying the transaction is part of the AP-7 (Autopista del Mediterráneo), the highway that runs from La Jonquera on the French border to Cadiz in southern Spain, linking the main cities along the Spanish Mediterranean coast and representing one of the most significant tourist areas in the country. Ausol's first concession (Ausol I) relates to an 82.7 km-long section of the AP-7 between Malaga and Estepona, which was granted for a period of 50 years starting in March 1996 and ending in March 2046. It was opened to traffic in June 1999. The second concession (Ausol II) relates to a 22.5 km-long section between Estepona and Guadiaro, and was granted for a period of 55 years starting in July 1999 and ending in July 2054. It was opened to traffic in August 2002.

Ausol I recorded annual average daily traffic of approximately 12,561 vehicles in 2014, and Ausol II recorded 14,161. This represented growth of 12.3% and 10.0%, respectively, over the prior year and a significant performance improvement in comparison to declines in traffic experienced from 2008 to 2013 due to the impact of the global financial crisis. Although the project benefits from the stability of Ausol's long history of operating the asset, the fluctuations of traffic arising from Spain's economic situation in recent years gives the project certain aspects of a greenfield project in its ramp up phase. This stretch of the AP-7 faces limited competition, with the principal alternative being a free national road (N-340/A-7). In its rating evaluation of the bonds, Standard & Poor's noted that the A-7 is heavily congested and is operating close to capacity.

In 2014, Ausol generated €43.9 million in revenue, and in the first 11 months of 2015 it generated €46.2 million. Its revenue is heavily dependent on vehicle traffic levels and tarrifs, with about 95 per cent. of revenue being derived from toll receipts and the balance principally from exploitation contracts for highway service areas.

Ausol used the net proceeds from the issue of the senior bonds, senior notes and junior loan primarily to refinance its maturing existing senior debt relating to the construction, maintenance and operation of the project, as well as payment of related break costs and hedging termination payments.

Net proceeds were also used to fund a capital expenditure reserve account, an expropriation reserve account, and a senior debt service reserve account. The minimum required balances of the capital expenditure reserve account and expropriation reserve account were set at 100 per cent. of projected costs for the 12 months following a given testing date, 75 per cent. of such cost for the next 12 months and 50 per cent. for the 12 months thereafter. The debt service reserve account is required to cover 12 months of aggregate scheduled interest and principal payments payable in respect of the senior bonds and senior notes. In order to enhance the resilience of the structure, the sponsors agreed to fund certain specific expropriation costs and capital expenditures, and supported that commitment with letters of credit.

The senior bond portion of the refinancing was divided into two classes, Class A1 (€320 million) and Class A2 (€147 million). Allianz Global Investors GmbH was appointed to represent the Class A1 senior bondholders. The senior bonds are listed on the Official List and trade on the Main Securities Market of the Irish Stock Exchange. In order to accommodate demand from certain US institutions, Ausol issued a €40 million tranche of the senior debt as a US private placement (USPP) of senior notes, pursuant to a senior note purchase agreement. Ausol's obligations in respect of the senior notes rank *pari passu* with its obligations under the senior bonds. The senior notes are listed on the Third Market (MTF) of the Vienna Stock Exchange.

The senior bonds and senior notes are amortizing, maturing in December 2045, three months prior to the expiration of the Ausol I concession. Ausol does have the flexibility to re-lever through the issuance of new senior debt, provided that, after taking into consideration the new debt, neither the senior historical debt service coverage ratio nor the senior forecasted debt service coverage ratio are less than 1.50:1, and that the senior debt leverage ratio is below a certain threshold (which declines over time). An issuance of additional senior debt is also subject to the junior loans no longer being outstanding or being repaid with the proceeds of the new issuance.

The security package covering Ausol's obligations under the senior bonds and senior notes includes first ranking pledges granted by Ausol over credit rights arising under the concessions (including payments made in connection with termination of the concession), as well as credit rights arising from certain of its bank accounts and insurance policies. The sponsors granted first ranking pledges of their shares in Ausol. The pledges are governed by Spanish law. Lenders under the junior loans benefit from second ranking pledges over the same assets.

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Standard & Poor's rated the senior bonds and senior notes "BBB", with a stable outlook, based on their expectation of a steady recovery in traffic volumes in light of an anticipated recovery in the Spanish economy, as well as Ausol's stable track record in operating the asset. Under its base case scenario, Standard & Poor's calculated a minimum annual debt service coverage ratio of 1.36x, and an average annual debt service coverage ratio of 2.32x.

At financial close, Ausol drew down €51 million of junior loans under a junior facility agreement granted by several Spanish banks. Its obligations in respect of these loans rank junior to its obligations in respect of the senior bonds and the senior notes. The rate of interest of the junior loans is fixed at 7 per cent. per annum, moving up to 10 per cent. following the ninth anniversary of the Issue Date. Payment can only be made on the junior loans when sufficient funds are available under the waterfall. In the event Ausol's senior historical debt service coverage ratio is 1.20:1 or less, a payment lock-up will be triggered. In either situation, the applicable interest rate will accrue and be capitalised at a PIK Rate, which is 2 per cent. per annum higher. Junior lenders enforcement rights are limited.

Ausol, the shareholders, the senior bondholders, senior noteholders and junior lenders also entered into a security trust and intercreditor deed that governs, among other things, priority amongst the creditors, enforcement procedures and decision-making procedures.

The various financing agreements are all governed by English law, with the exception of the security documentation and the status of the senior bonds which are governed by Spanish law. Financial close was reached on 17 March 2016.

Banco Santander, S.A. acted as sole bookrunner for the senior bond offering. Mayer Brown International LLP and Uría Ménendez Abogados, S.L.P. were legal advisors to Ausol, while Allen & Overy advised the bookrunner. BNP Paribas Trust Corporation UK Limited acts as bond trustee and security agent for the senior bonds.

The Ausol refinancing took place against a backdrop of evolving institutional support in Europe for the development of project bonds as a tool for generating capital markets financing for infrastructure development goals in the areas of transport, energy and information and communication technology. In July 2012, EU Regulation 670/2012 was published, calling for the rapid establishment of the 2020 Project Bond Initiative through a joint effort by the European Investment Bank and the European Commission. €230 million of unused EU budgetary resources from existing programmes was authorized for redeployment to a pilot phase of the initiative, with €200 million going to transport, €10 million to energy and €20 million to high-speed broadband. The objective was to use these funds as provide credit enhancement to projects and ultimately leverage €4 billion in debt financing through the capital markets. In the intervening three years, 10 project bonds have reached financial close with EIB support, provided via letters of credit issued by the EIB that can be drawn in the case of cash shortfalls occurring under various circumstances specific to each project (e.g., construction cost overruns, failure to satisfy debt service coverage ratios, failure to service debt, etc.). According to an analysis prepared by Moody's Investor Services, this enhancement has resulted in ratings uplifts of between 1 and 2½ notches.

Following an independent evaluation of the Project Bond Credit Enhancement (PBCE) product published in December 2015, the European Commission staff issued its conclusion that the pilot phase had been effective in demonstrating the utility of the PBCE tool, and facilitated the development of a project bond market in Europe. The staff acknowledged that in the intervening years the global surplus of liquidity had generated competition among investors for well-structured projects, and that the private placement market had developed sufficiently to address the current pipeline. Indeed the development of this market allowed the Ausol transaction to close on favourable terms without PBCE enhancement. The staff recommended the continued deployment of PBCE, with a shift in focus to areas where the EU can add the highest value, with a focus on improving certain technical aspects of the product, and extending it new types of projects (such as rail).