

## European Toll Roads 2005: Sector Trends And Credit Developments

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# European Toll Roads 2005: Sector Trends And Credit Developments

The toll road sector continues to be one of the most active public-private partnership (PPP) asset classes in Europe, with a strong deal flow and healthy interest from private-sector participants and investors. This article provides an overview of the main credit issues affecting the sector and the major developments of the last 12 months.

In response to the high level of investor interest in the sector, the legal framework governing the rollout of PPPs in different jurisdictions continues to be refined and--from a creditor's perspective--generally strengthened. This report includes an outline of specific legal developments in Greece that build on lessons learned on recent road financings in that country.

In addition, Standard & Poor's Ratings Services has explored in detail the legal and contractual support for project recovery prospects in Spain (summarized here and reported in full in "High Recovery Prospects for Spanish Infrastructure Concessions", published on June 16, 2005, on RatingsDirect, Standard & Poor's Web-based credit analysis system). We conclude that Spanish infrastructure concessions in general offer high recovery prospects for secured investors. Spain remains a very important European market for toll roads, particularly shadow toll roads, as our selected deal summary demonstrates.

In terms of credit quality, over the past few years the European toll road sector has experienced rating stability. One notable exception in 2005 stemmed from the French government's decision to sell its remaining shares in three of its toll road network operations. Standard & Poor's immediately placed these operations on a negative outlook. These outlook revisions, and the subsequent placement of the ratings on CreditWatch with negative implications, however, resulted from the privatization proposals themselves--and uncertainty about the final outcome--rather than any inherent weaknesses in the sector itself. Nevertheless, this example indicates that although the toll road sector's credit landscape is generally stable, it retains the potential to change abruptly.

Central and Eastern Europe (CEE) is often considered to be a major source of future highway transactions. This view is still perhaps a little premature, but clear opportunities exist because there is an undeniable need for infrastructure investment across the region. Certain countries are developing concession-based road projects but the deal flow remains slow and not without its challenges. Local economics favor shadow-toll or availability-based payment mechanisms, but few countries in CEE can support the aggregate obligations that flow from multiple, multiyear payment mechanisms. A judicious selection of projects is key in this regard, perhaps employing a mix of shadow toll and user-paid toll solutions. Creditor-friendly regimes with strong political support will also play a significant role.

At present, across Europe various road-pricing initiatives are being developed to address some of the problems associated with traffic congestion and the need to ensure that transportation costs are priced efficiently and effectively. These initiatives include distance-based charging regimes for trucks, which are often considered the forerunners of road pricing for all vehicles, and city-based congestion charging schemes. These initiatives are being developed ad hoc, however, in the absence of a coherent Europe-wide strategy. It remains unclear if, how, and when existing single-asset or toll road network concessions will be integrated into the bigger picture. In such a situation, the credit analysis conducted by Standard & Poor's will continue to look carefully at change-in-law risk, the potential for future toll road revenues to be impaired, and the compensation regimes triggered by material changes

to transport pricing policies.

Concessions covering the management and maintenance of city highway networks have demonstrated steady progress during 2005. A number of cities across Europe and beyond are actively pursuing such arrangements, although our analysis suggests that legislative constraints (particularly relating to appropriation) will have to be addressed if broader use of this type of long-term contractual partnering is to be achieved.

## **Legislative And Institutional Developments**

The key legal development affecting the European toll road sector in 2005 was the adoption of a new concession (public-private partnership) law in Greece, designed to better reflect the requirements of private sector participants. The law overhauls the Greek concession bidding and award processes, explicitly permits direct agreements, and aims to streamline permitting and approval processes. In addition, a number of key risk allocation issues (which have caused concerns in earlier deals) are addressed, and greater clarity is provided regarding standard contractual provisions pertaining to the enforcement of security issues and the assignment of rights and receivables. Standard & Poor's expects these developments to have a positive impact on the speed of toll road concession development in the country, which has recently slowed considerably.

Other institutional developments in Europe included public sector reorganization and structural reform in Denmark, leading to the dissolution of the country's counties. Consequently, all concession-related responsibilities previously held at county level have been ceded to the Danish Ministry of Transport.

In Spain, although the new legislative framework for concessions has been in place for a number of years the passing of time and the development of case law has increased the clarity of issues such as termination provisions and related recovery prospects. Our commentary, "High Recovery Prospects for Spanish Infrastructure Concessions", coincides with the development of Standard & Poor's recovery rating scale (see "Recovery Ratings for Project Finance Transactions", published on April 8, 2005, on RatingsDirect). From late 2005, all project finance and PPP default ratings will be accompanied by a recovery rating. Termination payments are an important component of recovery rating analysis.

## **Spain: Europe's Toll Road Powerhouse?**

At both state and local level, Spain continues to represent one of the most active proponents of toll road concessions. The promotion of enhanced accessibility and regional development through shadow toll road concessions clearly remains a key objective for many of the country's autonomous regional communities.

In Galicia, in northwest Spain, the regional government is promoting five shadow toll roads. Two of these concessions were awarded in mid 2005: the €100 million (\$121 million) Autovia Santiago-Brion; and the €40 million Autovia de Salnes. Valencia has announced up to nine new shadow-toll road projects as part of its regional infrastructure plan. In June, two of these, CV-35 and CV-50, were awarded to a consortium led by large Spanish concessionaire Sacyr under a €450 million 35-year concession.

In 2005, the regional government of Catalonia in northeast Spain announced four design, build, finance, and operate shadow toll road concessions in a move away from user-paid toll constructs. Bids were received in September for the first of these roads, the €63 million, 27 kilometer Macanet-Platja d'Aro motorway, with others

valued between €50 million and €220 million scheduled to follow in late 2005 and early 2006.

Other regional developments include: the submission of bids for Zaragoza's first shadow toll road project, worth €200 million in Aragon, northeast Spain, in September 2005; a €200 million shadow toll road package in Castilla y Leon, also to the north; and the award of the AS-18 shadow toll road concession, worth €200 million, in Asturias to Sacyr.

Closer to Madrid, but staying at the local-government level, a €400 million bridge facility for Madrid's M-30 ring road closed in mid 2005. This is Spain's biggest-ever PPP financing. Major Spanish concessionaire Cintra was awarded a 30-year concession for the €80 million M-203 user-paid toll road in July 2005.

## **French Toll Road Network Operator Privatization**

On Aug. 31, 2005, Standard & Poor's placed three French toll road network operators on CreditWatch with negative implications. One month earlier, the French government had announced that it sought to raise about €11 billion by selling its shares in three state-owned toll road network operators: Autoroutes du Sud de la France S.A. (A+/Watch Neg/A-1; government stake 51 %), Autoroutes Paris-Rhin-Rhone (A+/Watch Neg/A-1; government stake 70%), and Sanef (A+/Watch Neg/A-1; government stake 76%). In response, Standard & Poor's immediately revised its outlook on these motorway operators to negative from stable, reflecting concerns about the ensuing ownership changes and the potential for post-sale financing structures to degrade existing credit quality. We also published "Credit FAQ: Ratings Approach For French Toll-Road Network Operators Post-Privatization" on July 20, 2005, on RatingsDirect. The subsequent CreditWatch placements reflect continued uncertainty.

Three aspects of the proposed privatization surprised sector analysts:

- Full divestment was not expected. Previous government statements had suggested that continuing part-privatization was the objective, with the government retaining some stake in these mature, strategically important national assets with strong and largely predictable cash flows.
- The timescale associated with the sale was ambitious, with bid submission deadlines in August--traditionally a summer vacation period in France.
- The basis upon which bids would be evaluated was opaque, suggesting a requirement for postacquisition structures to retain credit quality commensurate with sector norms.

So far, 18 offers for majority stakes in these network operators have been submitted, and the government has launched the second round of tenders with Nov. 7, 2005, the deadline for the receipt of binding offers.

The scale and speed of this privatization program is noteworthy and demonstrates the rate at which the credit profile of the European toll road sector can evolve. Under such circumstances, there is a heightened need for timely, independent credit analysis and opinion.

## **Central And Eastern Europe: Opportunities And Challenges**

Project-financed road concessions in CEE continue to develop, albeit slowly. Broad political support, firm commitment to multiyear financing obligations, and procurement transparency, combined with competitive

contract-awarding procedures, will go a long way toward determining whether toll road prospects in CEE realize their full potential.

Poland and Hungary have dominated the sector recently. Phase I of Poland's €700 million A1 motorway, employing an availability/shadow toll payment mechanism, closed in mid 2005--but it was first announced back in 1995, underscoring the relatively slow pace of PPP acceptance across the region and the need for patient and persistent project participants. The Polish Roads Agency subsequently announced that Phase II of the A1 Motorway--a 60-kilometer extension--would also be procured as a PPP shadow toll road concession.

Road concession activity in Hungary is presently focused on its M5 and M6 motorways. Construction work on Phase III of the M5, linking Budapest to the Serbian border, is almost complete. This motorway opened as a user-paid toll road but the toll collection infrastructure was ceremoniously demolished in early 2004. It now operates as part of the country's vignette system, reimbursing the concessionaire from state funds via availability payments. The transaction was refinanced in 2005, extending the syndicated loan facility to €900 million, which makes it the largest infrastructure debt financing in CEE.

The €450 million M6 concession reached financial close at the end of 2004, with successful debt syndication six months later. This concession also employs an availability-based payment mechanism. Phase II of this project is in the early stages of procurement.

The Hungarian government has ambitious plans for ongoing private investor participation in its road sector, as indicated by recent attempts to structure a debt-financed purchase of the asset-management rights for a number of Hungarian motorways by the State Motorway Management Company. Outstanding questions regarding the accounting treatment of this debt have slowed progress, however, and are likely to scale back some of these ambitions.

Political risk and exposure to potential legal challenges remain key credit considerations for a number of CEE transport and infrastructure projects. In April, the Bulgarian opposition party suggested that the recently signed 35-year, €700-million Trakia Highway concession could have breached procurement rules, and that this could form the basis of legal challenge. In May, a change of government in Romania brought the 25-year, €500-million, 40-kilometer section of the Bucharest to Brasov under the spotlight, with Romania's new Prime Minister questioning the basis of procurement.

## **Truck Tolls, National Road Pricing, And Congestion Charging**

### **Truck tolls**

A number of European countries have introduced--or are considering the introduction of--nationwide motorway tolling schemes for trucks. In April 2005, EU ministers agreed on a framework for lorry road-user charging (LRUC)--the "Eurovignette" proposal. The policy objective is to ensure that road use better reflects its full costs and remains sustainable. To date, LRUC initiatives have been launched in Switzerland (2001), Austria (2004), and Germany (2004-2005). The Czech Republic, Slovenia, and Croatia are at various stages of procuring LRUC technologies.

LRUC is not without its critics, however. Opposing Member States include those on the periphery of main freight routes, such as Portugal, Estonia, and Malta, and the timetable for Europe-wide truck tolling remains unclear. LRUC was on schedule for implementation in the U.K. in 2008, but in July 2005 the government announced the

cancellation of this project, stating that the initiative had been overtaken by broader, long-term plans to introduce nationwide road pricing for all road users. It remains to be seen whether other European countries advance their LRUC proposals or, like the U.K., decide to wait until wider plans for road pricing have been developed.

### **Congestion charging**

The situation regarding the widespread introduction of city tolling schemes also remains confusing. Despite the continuing success of London's congestion charging scheme--the toll was increased by 60% to £8 (\$14) per day in July 2005, and plans have been developed by Transport for London (AA/Stable/--) to extend the charging zone to the west in 2007--and considerable public and political debate, few other European cities have followed suit.

After extended legal proceedings, the Swedish National Roads Administration finally received the go-ahead to introduce a pilot congestion charging scheme in Stockholm from January 2006. The pilot will run for only seven months, however, after which time a referendum will be held to decide the future of scheme. An earlier congestion-charging referendum in Edinburgh, Scotland, in February 2005 resulted in a 62% vote against the initiative. Although other cities, most notably Cardiff in Wales, continue to develop their thinking regarding city tolling, concrete implementation proposals remain largely absent.

### **Toll road concessions**

The three broad road-pricing initiatives described above (truck tolls, nationwide road-tolling schemes, and city-based congestion charging) are being carried forward across Europe ad hoc, in the absence of a coherent strategy or overarching transport-pricing policy. It is not clear if, how, or when existing single-asset road concessions or privately operated toll road networks will be required to integrate or become interoperable with these new road-pricing developments. In the absence of clarity, it is important that lenders to toll concessions continue to ensure that concession-related cash flows remain undisturbed by these new developments, or that suitable compensation arrangements find expression in contractual documentation.

## **Urban Highway Maintenance Concessions**

Following on from the successful launch in January 2005 of the £250 million concession for the management and maintenance of 700 kilometers of urban roads in Portsmouth in the U.K. comes a considerably larger scheme for the city of Birmingham, incorporating 2,500 kilometers of roads and worth £2.2 billion. Bids are due to be received this December. Other parts of the U.K. advancing similar plans are reported to include the Isle of Wight and Lincolnshire. Internationally, city-based highway management and maintenance trials are being undertaken in Hong Kong and Australia.

In Continental Europe, cities in Spain, Hungary, the Czech Republic, Poland, and Italy have become acutely aware of the failing state of their urban highway networks and are considering long-term, PPP-style management and maintenance concessions. In March, for example, Rome announced that it was considering PPP-style road management and maintenance concessions of 5,000 kilometers of its road network.

Despite the interest, preliminary soundings suggest that some appropriation-related issues have yet to be resolved. Legislative amendments may be required in a number of countries if wider use is to be made of city-based highway maintenance concessions.

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