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PPPs – What does it take for Road Projects?
Philippines Case Study

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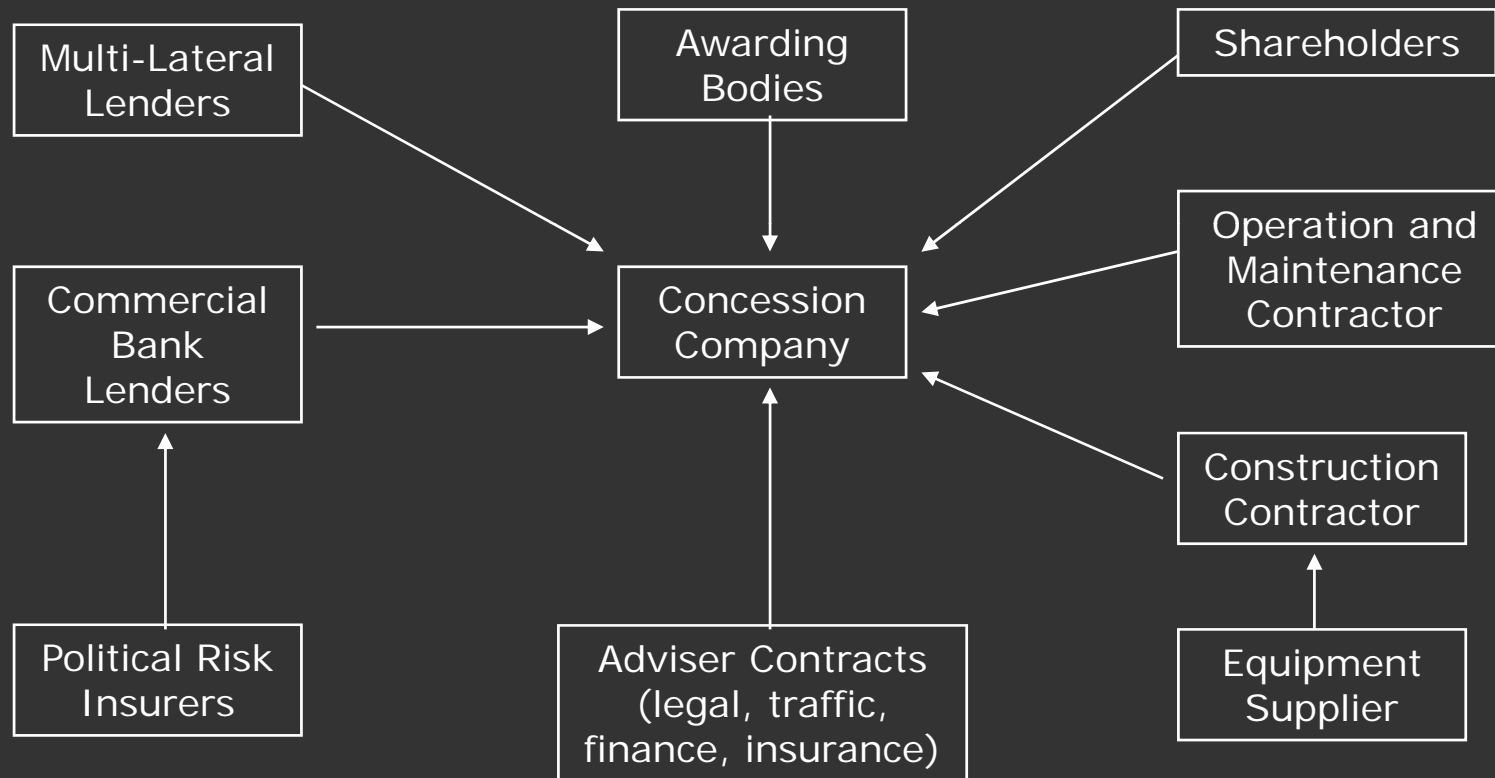
Areas to be Covered

- Overview of Project
- Key Bankability Issues
- Summary

Project Overview

Aim:	Attract private sector participation in infrastructure development, more specifically to expand and improve a key road, enabling increased traffic flows to be accommodated and regional economic progress to be boosted
Project type:	Limited recourse (no government guarantee), BOT-type
Project description:	Rehabilitation, expansion, operation and maintenance of a major expressway
Location:	Philippines
Concession duration:	Approximately 30 years
Status:	Operations commenced February 2005
Original financing:	Multi-lateral lenders, international commercial banks
Political risk insurance:	Multi-lateral and bilateral export credit agencies
Shareholders:	Local and quasi-governmental infrastructure companies, international toll road operator and international construction contractor

Overview – Project Structure



FUNDING

PROJECT PROCUREMENT

Key Documents

Project Documents:

- Concession Agreement – awarding bodies and concession company
- Awarding bodies clarification letter
- Construction Contract
- Equipment Supply Sub-Contract
- Operation and Maintenance Contract

Financing Documents:

- Common Terms Agreement
- Facility Agreements
- Political Risk Insurance documents
- Master Security Agreement

Key Bankability Issues

- Clarification of aspects of Concession Agreement
- Traffic forecast – Market Risk
- Land Acquisition
- Setting of Tolls
- Political Risk
- Peso revenues and US\$ debt – Foreign Exchange Risk

Clarification of Concession Agreement

Background:

- Relevant enabling legislation was Philippine BOT Law enacted 1994 and Presidential Decree 1112 (Tollway Operations Decree of 1977)

Issue:

- Original concession agreement awarded several years prior to close and later supplemented
- Some aspects of the concession did not take into account third party financing or were drafted in a way that did not give third party lenders the level of clarity they required

Resolution:

- Clarification letter agreed between the awarding body, the concession company and the lenders which had legal effect and acknowledged lender step in rights

Traffic Forecast – Market Risk

Issue:

- Key to bankability of a toll road project such as this is the level of projected traffic flows given this is the principal source of revenue
- Lenders concerned to make sure cash flows robust and are based on realistic levels of traffic flow
- Shareholders view of traffic is typically less conservative than lenders view
- Advantage of this project was that the existing road had a 20 year history as a tolled road – enhanced the credibility of traffic figures

Resolution:

- Early involvement of shareholders financial adviser and lenders' traffic adviser is key to minimise issues later
- Operational history a key mitigant

Land Acquisition

Issue:

- Length of expanded project road and widening of sections being rehabilitated meant that further land had to be acquired for project
- Land to be provided at awarding bodies cost but crucial issue was one of timing
- Under the concession agreement it was the concession company's responsibility to acquire additional land, though it had benefit of certain compulsory purchase powers
- Shareholders wished to achieve project and finance document signature as soon as possible but lenders did not wish to lend to the project until all land had been acquired

Resolution:

- Completion of land acquisition made a condition precedent to funding but not contract signature
- But drawdown did not occur until a significant period had elapsed after project signature

Setting of Tolls

Issue:

- Concession Agreement gives the concession company flexibility to set tolls within parameters (cannot exceed Authorised Toll Rate)
- Authorised Toll Rate adjusted every 2 years to take into account movements in currency and inflation rates
- Lenders wished to have a degree of control over how toll levels are set, both to make sure they are not set at a level which will deter traffic and to ensure that any toll reductions or discounts offered will not reduce revenue below an acceptable level

Resolution:

- Lenders have a degree of control over the Concession Company's ability to set toll rates within the Common Terms Agreement

Political Risk

Issue:

- Project being developed during a time of political unrest in Philippines (e.g. change from Estrada to Macapagal-Arroyo administrations)
- Presence of multi-lateral agencies in the project seen as a partial mitigant but a number of commercial lenders were still uncomfortable with Philippine country risk
- Particular concerns regarding exchange control restrictions given project revenues in pesos and debt in US\$

Resolution

- Political risk cover procured by the shareholders from export credit agencies covering matters such as war, expropriation, change control restrictions

Peso Revenues and US\$ Debt

Issue:

- Income from toll revenue in peso but debt provided in US\$
- Lenders concerned that project is exposed to exchange rate fluctuations (e.g. during project negotiation exchange rate changed from approx. 40 peso to US\$1 to 50 peso to US\$1)
- Some mitigation provided through the Authorised Toll Rate adjustment mechanism (every 2 years) but always a timing issue

Resolution:

- Both onshore and offshore accounts required to be maintained by the project company
- Regular transfer of funds from peso to US\$ accounts to ensure as much of the project cash as is practicable is denominated in US\$
- Strong cash flow projections acted as a buffer to the impact of sensitivities

Summary

- Project was successfully financed on a limited recourse basis despite the uncertain economic and political climate
- All parties had to take a pragmatic view on issues in order to adapt to changing circumstances
- Now operating successfully with strong traffic flows

Points to be considered for future projects

- Information sharing to aid understanding of issues
- Need for the awarding body to understand the "key issues" for both sponsors and lenders
- Need for some degree of flexibility on the part of the awarding body to deal with changing circumstances/lender positions
- Appropriate risk transfer
- Thorough understanding of the land position – who should control any land acquisition programme?
- Experienced advisers

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