BRABO 2 – PUSHING COMPLEXITY

ON NOVEMBER 19 2015 TRAMCONTRACTORS, A CONSORTIUM COMPRISING BAM PPP-PGGM AND COFELY FABRICOM, REACHED FINANCIAL CLOSE ON THE BRABO 2 PROJECT. WITH THREE CONCESSION CONTRACTS COMBINING TWO FUNDAMENTALLY DIFFERENT PHILOSOPHIES THE ONLY SUCCESSFUL APPROACH TO A WINNING FINANCING STRUCTURE WAS TO BE A CREATIVE ONE. BY **CARLO LAMARI**, DIRECTOR, ENERGY AND INFRASTRUCTURE GROUP, **CRÉDIT AGRICOLE CORPORATE & INVESTMENT BANK**, AND **ZORAN MANOVIĆ**, **BAM PPP**.

From the outset, the multi-concession agreements approach under a single PPP project made Brabo 2 a challenging exercise to achieve project bankability around an appropriate contractual structure. A number of structural optimisations and smart ideas allowed the consortium to submit the winning bid.

After the preferred bidder announcement in December 2014 it took almost a year to reach financial close. Over this long period of time, the banks provided continued support to TramContractors, working with the sponsors towards making the deal happen. The inner city location, underground works, noise disturbance requirements and interference from third parties made this a complex project from a technical perspective as well.

Project description

The tender for the Brabo 2 project was launched in 2013 as an important part of the so-called "Masterplan 2020" that targets upgrading mobility in the city of Antwerp. The project's key aim was to act as a catalyser of intermodal mobility by allowing for tram access to the historical city centre upon arrival in the city by car or train.

The required tramway works availed to urban planning as it created momentum to a range of overdue upgrades to the inner city's public space with a view to increasing the quality of life, accessibility and safety.

This led three authorities responsible for mobility (Flemish public transport company 'de Lijn' and the Flemish region's traffic and roads agency AWV) and urban planning (the Antwerp Municipality) to decide to join forces and bring to the market Brabo 2, a multi-faceted project with in excess of €200m capital expenditure, integrating 20km of greenfield tram infrastructure works and brownfield road and urban redevelopment including an underground tunnel and parking.

With construction works to be carried out within a contracted period of time and in a compact urban area, the public side's rationale for the determination of this ambitious scope was obvious. Keeping responsibilities in the hands of one party would allow for allocation of interface risks to the private sector and therefore create a strong and much-needed incentive to properly manage them, with the main offshoots being nuisance minimisation, accountability and better value for money.

In principle this was a smart approach, but what about the merits of keeping things simple? Wouldn't the inherent cost of the required financing structure's consequential complexity destroy more than the value gained by the clever approach to interface risk? From the outset of the tender phase it was apparent that key to any winning bid would be a structure aptly dealing with the contemplated concessions framework whilst keeping down complexity. This appeared to involve striking some difficult decisions and having on board a group of funders bringing a flexible attitude.

Notwithstanding the expected complexity, five bidders submitted proposals to the first-round bid. Four of these were then admitted to the BAFO. The bidders needed to find an answer to dealing with two fundamentally different types of concessions.

TramContractors received financial advice from Clairfield Benelux and was assisted by Linklaters in the negotiations with the contracting authorities and the lenders. The funders club is made up of: AG Insurance, Crédit Agricole CIB, KBC and MUFG.

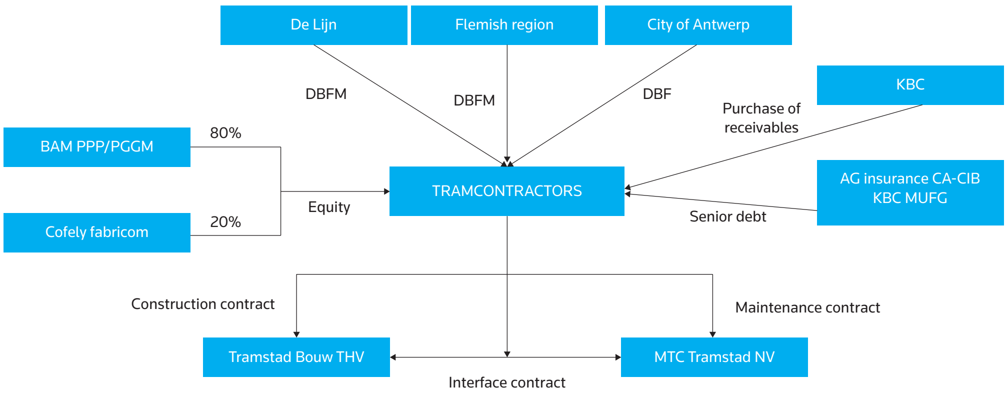
Crédit Agricole CIB arranged the transaction with a Milan/Paris team acting as facility agent and intercreditor agent, while leveraging on local coverage and presence with a Brussels branch acting as account bank. Freshfields Bruckhaus Deringer was the lenders' legal counsel assisting in the negotiation of the project and finance contracts. AON, Turner & Townsend, H3P and KPMG acted respectively as insurance, technical, modelling, and tax and accounting advisers to the lenders.

Contractual structure

TramContractors entered into three concession contracts with the authorities:

- *Two DBFM contracts* – The two design, build, finance and maintain (DBFM) contracts for

FIGURE 1 - CONTRACTUAL STRUCTURE



tram and road works were structured along the lines of the typical availability-based PPP contract that the Benelux markets converged to over the past decade. These contracts pay 25 years of partly indexed availability payments. With a standard performance regime and comp-on-term provisions, the only unique and challenging feature here comprised the division of construction works in six sub-projects incrementally being made available, resulting in a substantial amount of availability payments generated during construction.

- *One DBF contract* – The structure of the municipality's design, build and finance (DBF) contract for urban redevelopment, however, proved to be an odd one out in the PPP landscape and effectively more akin to a traditional D&B contract, only distinguishing itself by its remuneration scheme. Rather than receiving a lump sum payment, the project company will, upon delivery of the works, be entitled to a combination of milestone payments and 10-year fixed quarterly annuities not subject to an ongoing performance regime.

The consortium also entered into the following three subcontracts:

- A nominal fixed-price, lump-sum turnkey construction contract for the design and construction of the project with a BAM Group/Cofely-Fabricom construction joint venture. The construction contract provides for a full pass-through to the CJV of the TramContractors obligations and responsibilities with respect to the construction phase under the two DBFM and the DBF contracts.
- A maintenance contract designed to provide for a full pass-through of the operating risk under the project agreements to the MTC Operator, a 50-50 JV of BAM Maintenance Belgium NV and Cofely-Fabricom NV. Upon completion of each of the six sub-projects, the infrastructure responsibility will be transferred to the MTC Operator for the whole project agreement tenor. TramContractors will pass down to the MTC Operator all the service obligations including availability/performance deductions, service specifications and life-cycle/heavy maintenance activities. The scope of maintenance works includes – inter alia – preventive maintenance during construction, cleaning, graffiti removal and performance monitoring. Rolling-stock operation, signalling systems management and the day-to-day operations of the tramline are out of scope, and will be performed by De Lijn.
- An interface agreement with the CJV and the MTC Operator pursuant to which the parties undertake to cooperate with each other and allocate responsibility between the parties in respect of the design, changes, access rights, defects, deficiencies and other relevant matters. The agreement is meant to provide at any time a single point of liability vis-à-vis TramContractors.

Key structuring challenges

For the lenders supporting TramContractors' bid it was crucial to ensure the bankability of the project, aligning the credit risk profile as much as possible to a standard single-asset PPP. It was therefore crucial that in addition to dealing with standard risk allocation measures common to project finance transactions, the structure successfully achieved a ring-fencing of DBFM-related cashflows and security during the operating phase against the 10-year remuneration period of the DBF contract.

This essentially ring-fenced the project from municipal counterparty risk under the DBF contract while protecting the DBF receivables purchaser from operating risk under the DBFM contracts. From the lenders' perspective it was pivotal here that the project benefited from experienced contractors being part of only two groups and acting in different roles at various levels (ie, sponsors, construction contractors and maintenance contractors) contributing to an alignment of interests and a robust project risk allocation.

To make this work TramContractors' successful proposal was based on a main strategic choice suggested by the lenders of opting for a cross-default mechanism between the three concession contracts prior to final delivery of construction works. This option was brought into existence by the authorities after TramContractors' feedback that scenarios seeing partial defaults would overcomplicate the structure and as such have a negative impact on the bankability of the project.

This has allowed for the three concession agreements to be financed as a single project, with all senior funders ranking pari-passu and therefore TramContractors being able to fully optimise drawings during construction. Upon construction completion the financing of the DBF construction cost will be refinanced through a sale of receivables (as detailed below).

The structuring of the project was further complicated by the implementation during the tender phase, of the new accounting standards of the European System of Accounts (ESA 2010). The main implication of ESA 2010 to PPP transactions is that if Eurostat deems the public sector not having transferred appropriately certain project risks to the private sector or having retained certain control over the project, the project's public liabilities should ultimately be consolidated in the country's balance sheet.

Whereas the DBFM counterparties imposed ESA neutrality vis-à-vis their contracts as an absolute condition to close the deal, the municipality contented itself with the deferred nature of its payment obligations while accepting to take its liabilities under the DBF contract on balance. One of the implications was that De Lijn, which was originally expected to hold a 26% stake in the project company, eventually ended up not taking any share in TramContractors' equity, now fully owned by the private sector.

Financial structure

In order to optimise the financing of DBF related cashflows, the consortium set up a structure more common to export and real-estate finance seeing TramContractors entering into a receivables sales agreement with local lender KBC on financial close. Under this agreement the latter is committed to pay up-front to the project, on construction completion, an agreed net present value of 100% of the 10-year fixed annuity then payable by the Municipality of Antwerp under the DBF contract.

Proceeds from the forfaiting agreement will be applied in full in repayment of the Forfaiting Bridge Facility. The pro-soluto sale of receivables implies that the Forfaiting Agreement will be unsecured and with no recourse to TramContractors. The innovative element to this approach is that it is embedded in a DBFM context.

TramContractors made the strategic move, during BAFO stage, to count exclusively on the funding support from the commercial banks, notwithstanding the EIB was keen to provide liquidity to the project. Not having been given the opportunity to enter into a timely and in-depth discussion with the EIB on the various possible financing avenues before bid submission, TramContractors considered it too much of an operational risk to bid with a groundbreaking financing structure without having beforehand the blessing of a lender as influential and opinionated as the EIB that would have been involved only during the preferred bidder phase.

TramContractors was supported here by the dynamics of the markets during the summer of 2014. Whilst the credit margin differential between the EIB and the commercial lenders was rapidly shrinking, the latter completely overtook the Luxembourg based multilateral in terms of willingness to accommodate structural optimisations that ultimately resulted in a lower priced bid. After the preferred bidder announcement it took almost a year to reach financial close, with banks providing continued support to TramContractors.

Consequently, the project's €230m funding mix comprised the usual long-term and short-term project finance facilities combined with the receivable sales mechanism:

- A €93.5m term loan facility, sized on the basis of the operating phase DBFM cashflows and divided into two pari passu tranches i) a €62.3m floating-rate tranche provided with equal shares by Crédit Agricole CIB and MUFG and ii) a €31.2m fixed-rate tranche provided in full by AG Insurance. The two tranches have essentially the same features, with the main difference being the pricing. As usual in structures combining banks and investors, the main elements of discussion during the negotiations were the voting rights and the make-whole payments ranking in the cashflow waterfall.
- A €3.3m standby debt service reserve facility (DSRF) to match a six-month term loan facility debt service funded by Crèdit Agricole CIB, MUFG and AG Insurance with equal shares.
- A €47m milestone bridge facility sized to pre-finance milestone construction payments due to be paid by the authority under the DBF contract and provided with equal shares by Crédit Agricole CIB and MUFG.
- An €18m equity bridge facility to bridge the shareholders equity contribution to the project provided with equal shares by Crédit Agricole CIB, MUFG and AG Insurance.
- A €71m forfaiting bridge facility bridging the proceeds from the receivable sales provided in full by KBC.

All floating-rate facilities except the DSRF were fully hedged against Euribor fluctuation by plain vanilla interest rate swaps.

All the above resulted in a robust financing structure. The fully amortising 27-year and seven-month term loan facility allows for a nine-month debt free tail vis-à-vis the project agreements tenor. It also allows for base case cover ratios of 1.19x minimum average debt service cover reserve (DSCR) and 1.21x minimum loan life cover ratio (LLCR) and a maximum gearing of 90/10 at construction completion. From the funders' perspective, the debt sizing criteria set in the summer of 2014 are in line or even better than recent comparable transactions seen in the Benelux area.

With a broad panoply of options to structure the financing within a complex contractual context, the consortium allowed for creativity to win the bid, but cut complexity where required to deliver it. ■