

Public Works Financing
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ITR Death Watch is Premature

A number of news stories warning about the imminent default of the Indiana Toll Road (ITR) are based on a misreading of the numbers, says Nicolás Rubio, President of Cintra U.S. All of the equity is gone, he says. But updated traffic forecasts indicate that the ITR Concession Company LLC still will be able to weather the worst economic conditions since the Great Depression.

“ITR is not in default and is not going to be in default in the foreseeable future,” based on updated assumptions from independent forecasters, Rubio says. “That is a robust project, and we have to believe in the coming years that the economy will pick up again,” says Rubio.

Toll rates in 2006, before privatization, were about 4 cents per mile. That was about a third of the estimated revenue-maximizing rate at that time. Tolls have been increased at the maximum allowed in the concession and now are 5.6¢/mile for cars and 22.4¢/mile for tractor trailers.

Toll transactions in 2010 averaged about 75k/day, according to Macquarie. Peter Samuel, editor of *Tollroads News*, estimates that number is as much as 35% below forecasts done for the state in 2005.

ITR's bank debt is trading at "severely depressed" prices, says a public finance banker who had been exploring the state's interest in buying back the 157-mile road. He has found no takers so it appears that a restructuring will come in 2015, he says, when the nine-year bank loans must be refinanced—and Gov. Mitch Daniels is no longer in office.

Anticipating revenue volatility, the \$4-billion in nonrecourse bank financing in 2006 included an accreting interest-rate swap that back-loads some of the interest liability, until a balloon payment comes due in June 2015. Interest on the swaps started at 3.15% and steps up gradually to 4% over nine years. It then jumps to 4.75% in July 2015 and to 11.29% by 2026.

Co-sponsors Cintra and Macquarie each contributed \$380 million in equity (81% leverage). A bank syndicate provided an acquisition facility of \$3.24 billion, a capex facility of \$665 million to add a lane in each direction as well as electronic toll collection modernization and toll plaza improvements, and a liquidity facility of \$150 million. The liquidity facility is being used to meet the 1.0x debt service coverage required by the banks through 2015, Rubio says.

Cash Flow

In 2010, the concession company's \$268-million interest expense, plus a derivative loss of \$51.9 million from hedging interest rate swaps, converted a small operating profit into a net loss of \$260.8 million, according to a report in *Debtwire*, a *Financial Times* news service.

However, profit and loss accounting typically does not provide a good measure of the health of a cash-flow business like toll roads. EBITDA is the right metric, Rubio says, and it's growing, largely due to toll increases set in the concession, but also because of aggressive cost cutting on toll road operations.

EBITDA increased from \$60.5 million in 2005 under public ownership to \$111.5 million in 2007, \$117.2 million in 2008, \$123 million in 2009 and \$138.9 million in 2010. Annual toll adjustments this year and increased truck traffic indicate the cash flow for 2011 also will increase, says Rubio.

Cash flow is still far below projections. Hopes ran high in October 2005 when the 75-year lease was offered by the Indiana Finance Authority. The auction,

run by Goldman Sachs, was completed in 117 days. Submissions were final and binding, and required a \$50-million bid bond. ITRCC bid \$3.8 billion (40x revenue), which was around \$1 billion more than the next highest bidder, Babcock & Brown.

Based on forecasting in 2005 by Macquarie's traffic consultant, Maunsell, ITRCC expected to achieve a 13% internal rate of return and a 15-year equity payback period. Neither projection is anywhere in sight now.

Refinancing challenge

As refinancing approaches, what typically happens with a troubled toll concession is that the banks, with their backs against the wall, agree to restructure the short-term loans to more closely match the long life of the asset, says Jaime Mariategui, a former stock analyst in Madrid and now a senior banker at Deutsche Pfandbriefbank, a sister to Depfa Bank.

"The capital disappears but hopefully the cash flow grows to a point where the banks are forced to restructure the debt because you've got a strong business," he says.

The ITR debt financing was lead arranged and underwritten by DEPFA Bank, BBVA, Banco Santander, BNP Paribas, Caja Madrid, Dexia Credit Local, and Royal Bank of Scotland, which is the agent bank. After syndication, there were 46 financial institutions lending to ITR.

One potential problem Mariategui sees with restructuring ITRCC's financing—in addition to its size and complexity—is that both DEPFA and Royal Bank of Scotland are now government-owned. Private banks will typically work through a complex restructuring, he says, whereas government-owned institutions typically won't, preferring to deal with the problem quickly. "Government-owned banks are not interested in work-outs," he says.

Depfa is part of the Hypo Real Estate Group (HRE), a German holding company that was nationalized in 2009 after receiving \$102 billion in state support. The EU finally approved the state aid to HRE this month. As part of the agreement, DEPFA will not be allowed to sign new business or accrue profits until re-privatization.

Collateral damage

The focus on ITR could impact plans by Ohio Gov. John Kasich to lease the Ohio Turnpike and use the proceeds to fund large projects throughout the state. Kasich has estimated the lease could be worth \$3 billion. A public finance banker involved in earlier brownfield lease deals suggests it could be much less than that.

One of Rubio's concerns is that the news stories warning of an imminent default of ITRCC will affect public perception of two of Cintra's most important projects: the North Tarrant Express and the LBJ Express managed lanes projects under construction in the Dallas-Fort Worth region.

The reality, says Rubio, is that they are two of Cintra's strongest projects. Both were very conservatively structured during the financial crisis with numerous reserves to survive the worst-case scenario of revenues 50% below forecast over the full term of the lease.

Cintra studied the two projects for four years before winning the concessions in 2009 and 2010. "The potential is amazing," says Rubio. "It ends up being another Highway 407" in Toronto, which paid \$370 million in dividends in 2010 to its owners, Cintra, the Canada Pension Plan Investment Board and SNC Lavalin.

(A P3 financial advisor to governments confirms Rubio's upside potential. He believes the algorithms used by traffic forecasters substantially underestimate the revenue potential of for-profit managed-lanes projects in the U.S.)

All of the 25 toll concessions in Cintra's global portfolio are ring-fenced so the financial performance of one project does not affect the others—portfolio risk is much less than project risk, Rubio says. In aggregate, for example, traffic on Cintra's 25 toll concessions is down just 3% from pre-crisis levels, counting strong projects in Canada, Chile, Spain and Ireland.

Cintra's ability to bid on future projects won't be affected by the performance of any one project. Its parent company, Ferrovial, has \$1.5 billion in investment capacity, says Rubio. And major Spanish lenders Santander and BBVA were among the best performers in the recent stress test of European banks (largely because so much of their business is outside of Spain.)

"I don't think they [Cintra] will have problems in finding partners for new tenders in the U.S.," says an advisor to OHL Concessions, a Cintra competitor. Cintra has good management and good sense, he says. In addition to Macquarie, he adds, "There are now quite a few funds ready to invest in infrastructure."