PEDEMONTANA – AN INNOVATIVE BOND

THE FINANCING OF THE SUPERSTRADA PEDEMONTANA VENETA WAS MADE POSSIBLE BY AN INNOVATIVE STRUCTURE, ADAPTING PROJECT BOND ECONOMICS TO MEET THE CHALLENGES OF GREENFIELD MOTORWAY CONSTRUCTION. BY VALENTINA VANGELISTA, JP MORGAN, AND UMBERTO ANTONELLI, PARTNER, ASHURST MILAN.

The transaction was the culmination of more than two years of work and represents:

- The highest value unrated project bond to date issued for the construction of a toll road;
- The first unrated greenfield project bond and the first project bond for greenfield infrastructure in Italy;
- The largest European project bond placed to-date without any multilateral credit enhancement;
- One of the first Italian project bonds issued pursuant to Legislative Decree No 50 of April 18 2016 (the Italian Public Contracts Code), part of a package of legislative reforms introduced to facilitate infrastructure investment in Italy; and
- The first toll road project in Italy based on an availability fee concession agreement.

Transaction overview

On November 29 2017, Superstrada Pedemontana Veneta SpA, a project company controlled by Consorzio Stabile SIS Scpa made up of Italian FININC Group and Spanish Sacyr Group, issued €1.57bn of bonds to finance the construction of the Pedemontana Veneta toll road in the Veneto region of Italy.

The bonds issue comprised two tranches: €1.221bn of variable rate senior secured amortising notes due 2047, which pay EONIA+100bp for the undrawn amounts and 5.0% for the drawn amounts expected to begin in August 2018; and €350m of 8% step-up subordinated secured notes due 2027.

Both tranches were listed on the regulated market of the Irish Stock Exchange, with the senior notes being cleared through Euroclear and Clearstream, Luxembourg and the subordinated notes being cleared through Monte Titoli. The notes were subscribed by a diverse global investor base with the senior tranche also being offered to US investors pursuant to Rule 144A of the US Securities Act.

JP Morgan acted as global co-ordinator and joint bookrunner; Banca IMI, Santander and Banka Akros – Gruppo Banco BPM acted as co-global co-ordinators and joint bookrunners and Kommunalkredit acted as joint bookrunner.

Pedemontana Veneta is an availability-based project – ie no exposure to traffic risk – backed by a concession agreement granted by Veneto Region (Baa2/–/BBB) that expires 39 years after the full main axis is opened.

In addition, the project is supported by both an EPC (Consorzio SIS) and an O&M contract (joint venture between Consorzio Stabile SIS Scpa and Consorzio Stabile VIS Scpa), which are based on the back-to-back principle.

It should be noted that the project was initially traffic-based with rebalancing mechanics and evolved into a full availability structure with performance-based adjustments; with this concession amendment, the Veneto Region also received a €300m loan from Cassa Depositi e Prestiti to finance construction grants due to the project.

In particular, pursuant to the concession agreement, the project company is responsible for the availability of the infrastructure and is required to comply with certain quality indicators as well as other service standards, while the grantor bears the risk of variation in toll revenues arising from higher or lower traffic levels during the life of the concession agreement.

Toll revenues are the exclusive property of the grantor and will be collected by the project company, acting as an agent of the grantor, through an irrevocable mandate to collect tolls.

The proceeds arising from toll collection will be managed by the project company through a toll collection account and the issuer will also have a right of set-off over all amounts due to it as an availability fee against any amounts credited to the toll collection account.

Underlying asset description

The Superstrada Pedemontana Veneta (SPV) is a greenfield toll road project that is being constructed in the Veneto region in the north-east of Italy, with a total length of approximately 163km. With a main axis of 94.6km and 68.3km of secondary and access roads, the SPV is intended to improve connections along the so-called Asse Padano, an area in the north of Italy that includes the Piedmont, Lombardy, Veneto and Friuli regions.

Its route runs from the A4 motorway at Montecchio Maggiore in the province of Vicenza, crosses the A31 (Valdastico) motorway and finally connects with the A27 motorway at Spresiano in the province of Treviso. It connects 34 municipalities and the main industrial areas of the Vicenza and Treviso provinces. The project will be completed in September 2020.

The SPV has been designated as strategic infrastructure of national relevance and is part of the so-called European Corridor 5, which represents a multimodal network that will connect the city of Lisbon to the city of Kiev. Thanks to its geographical position, Italy and in particular the Veneto region with its 5m inhabitants have a strategic role in this project.

In this context, the Pedemontana Veneta motorway will be an important section of the corridor, and the link to a number of world-renowned industries based in the central Veneto area between Vicenza and Treviso, such as Benetton Group, Geox, Lotto Sport Italia, Diesel, Zoppas Industries, Bisazza, Breton, Manfrotto, Tecnica, Baxi, Vimar, Fiamm (Hitachi Group), Pianegonda, Selle Italia, Della Toffola, Diadora, Pasta Zara, Alpinestars, Dainese.

Construction of the SPV serves the following main purposes:

- Ensuring an adequate response to the demand for mobility generated by the foothill territory, which is the most urbanised and industrialised in Veneto region;
- Ensuring an alternative to local roads currently highly congested;
- Completing the Veneto region's first-level road network, establishing a high-traffic volume motorway infrastructure in place and supporting the polycentric development in Veneto by reorganising the existing infrastructure network; and
- Integrating the network of major roads in the European corridors.

Project participants and contractual structure

The structure in figure 1 chart sets out the contractual relationships between, and ownership of, the main project participants.

- *Veneto region, Grantor of the Project* – The Veneto region is one of the main contributors to Italian gross domestic product (9%) and among the richest economies of the Italian ordinary-statute regions. In recent years, the Veneto Regional Administration has played an active role in sustaining its economy during the crisis with a continued focus on infrastructure investments and some counter-cyclical initiatives.

The region is rated Baa2 by Moody's and BBB by Fitch, reflecting "its robust financial position, including a low debt burden, sound liquidity position, and wealthy and dynamic economic base" (source: Moody's).

- *Consorzio SIS* – Sponsor of the project: 51% owned by FININC Group and 49% by Sacyr Group. The Sacyr group is a Spanish conglomerate, active in construction, concessions and industrial services in Europe and Latin America. It is listed on the Madrid Stock Exchange, with a market cap of €1.3bn and revenues of €3.1bn in 2017. The FININC Group is an Italian group controlled by the Dogliani family, with a diversified portfolio of activities and a main focus on the engineering, construction and concession businesses (INC SpA and SIPAL Spa). INC (through SIS) is currently working on other major public contracts in Italy, such as the macro-lot 2 of the Salerno–Reggio Calabria motorway and the RFI-Italferr (FS, the Italian state-owned railways company) Palermo railway hub project.
- *Circuitus, equity sponsor* – Circuitus is an independent alternative asset management firm headquartered in London and specialised in infrastructure equity investments mainly focused on Europe. Circuitus invests in both greenfield and more mature energy, utilities and transportation infrastructure assets in Europe and selected growth economies, via equity and equity-like securities with medium to long-term horizons.
- *The financing structure* – The transaction involved an innovative bond-only capital structure, with the junior notes providing for a capital cushion to mitigate key senior risks during the construction phase.

The project was fully funded at closing to remove drawdown risk during the construction phase, with an innovative structure to mitigate the cost of carry on the senior note proceeds.

Under this structure, the proceeds of the senior notes were initially deposited in an escrow account and then lent to a credit institution counterparty pursuant to a liquidity management arrangement secured on a pool of collateral assets and documented under the ICMA/SIFMA Global Master Repurchase Agreement.

The liquidity management arrangement allows the issuer flexibility in the use of the issue proceeds consistent with the work's progress subject to certain conditions being met, while reducing the issuer's exposure to an institution that would otherwise be holding the cash proceeds of issuance of the senior notes and minimising the negative carry associated with traditional deposit arrangements.

The notes are financial instruments issued pursuant to Article 185 of the Italian Public Contracts Code and were offered to qualified investors as defined under Article 100 of Legislative Decree No. 58 of February 24 1998 (as amended) and entities controlled by such qualified investors pursuant to Article 2359 of the Italian Civil Code.

With respect to the contractual structure, the main finance documents include:

- The Common Terms Agreement, which contains a series of provisions that are generally common to the noteholders, including issuer's information undertakings, representations and warranties, positive and negative covenants for the benefit of the noteholders, financial covenants, events of default and indemnities;
- The Equity Contribution and Subordination Agreement, which sets out the basis on which the main shareholder/sponsors contribute equity to the issuer, including also provisions concerning the letters of credit that support certain of the main shareholder/sponsors equity injection obligations;
- The Security Trust and Intercreditor Deed (STID), which contains provisions regarding the ranking and subordination of the issuer's creditors, the pre-enforcement and post-enforcement priority of payments, procedures for making amendments and waivers to the finance documents, the entrenched rights of the various classes of secured creditors and the procedures for taking enforcement action against the issuer;
- The Master Definitions Agreement, which contains a series of definitions that apply across the finance documents;

TABLE 1 - SOURCES & USES AND PRO-FORMA CAPITALISATION

Sources	€ (m)	Uses	€ (m)
Public grants	915	Construction	2,258
Senior secured notes	871	Insurance, advisor and G&A	36
Subordinated secured notes	350	Tax	8
Equity and shareholder loan	430	Interest and fees during construction	231
Supplier payable	14	DSRA	31
Historical earnings	7		
Total ex VAT	**2,588**	**Total ex VAT**	**2,563**
VAT sale	330	VAT	361
VAT refund	6		
Total	**2,924**	**Total**	**2,924**

Funding source	**€ (m)**	**% total cap**	**Gross margin**
Public grants	915	36%	6.5x
Senior secured notes	871	34%	6.2x
Subordinated secured notes	350	14%	2.5x
Total debt	**1,221**	**48%**	**8.7x**
Equity and shareholder loan	430	17%	3.1x
Total capitalisation	**2,566**	**100%**	**18.3x**
2021E gross margin	**140**		

TABLE 2 - SUMMARY TERMS AND CONDITIONS

Issuer	**Superstrada Pedemontana Veneta S.p.A.**	
Issue	Senior secured notes	Subordinated secured notes
Amount	€1,221m	€350m
Pricing	Undrawn: EONIA + 100bp / Drawn: 5.0%	8.0% with step ups upon certain events
Maturity	30 years	10 years
Ratings	Non rated	Non rated
Call period	Non call life	Non call life
Put period	Non put life	Put option upon COD
Repayment	Sculpted semi-annual amortisation	Cash sweep
Equity funding	Pro-rata to senior drawings	
Reserve accounts	● 6-month DSRA for senior notes ● 3-year MRA (100%, 66.6%, 33.3%)	
Security	First priority security interest in the shares of the issuer, receivables under the material project documents, assets and accounts of the Issuer Claims of the Senior Noteholders to take priority to the Junior Noteholders on a contractual basis	
Covenants	● 1.15x 12-month backward and forward looking DSCR ● 1.20x DLCR	
Cash distribution	● No distribution in the first 18-month of operation ● Funding of DSRA and MRA ● 1.20x 12-month backward and forward looking DSCR ● 1.25x DLCR	
Law	● English law, Italian law for certain security documents	

- The Escrow Agreement, which describes the means by which the escrow agent holds the net proceeds of the issue of the senior notes and the terms upon which it discharges those proceeds to the issuer over time;
- The EPC Direct Agreement and the O&M Direct Agreement, which contain certain undertakings given to the security agent directly by the EPC contractor and the O&M contractor with respect to the EPC contract and the O&M contract respectively;
- The Note Trust Deed, which constitutes the notes and contains a covenant from the issuer to pay all amounts due under the notes, the benefit of which the note trustee will hold on trust for itself and the noteholders in accordance with their respective interests;
- The Project Adviser Services Agreement, which describes the appointment of the project adviser (Bishopsfield Capital Partners Limited) and the roles it will perform in the interests of the senior noteholders;
- The Paying Agency Agreement, which sets out the arrangements regarding payment of principal, interest and other payments in respect of the notes; and
- The Account Bank Agreements, which contain the terms under which the issuer operate the project accounts.

The junior notes are contractually subordinated in right of payment to any of the issuer's senior indebtedness; rank pari passu in right of payment with any of the issuer's existing or future indebtedness other than senior indebtedness that is not subordinated in right of payment to the junior notes; and share, on a subordinated basis, the transaction security with the senior noteholders. The STID also restricts the rights of junior noteholders to take enforcement action against the issuer.

The terms of the subordinated notes, in particular, included a number of innovative features, including an option to allow the investors in the subordinated tranche either to put their notes back to the issuer on the project completion date (scheduled for 2020) or to extend the maturity of their notes until 2027, or a combination of both.

The subordinated tranche also allows the issuer to opt to capitalise interest in accordance with Article 1283 of the Italian Civil Code in certain circumstances. Each of these features needed to be structured so as to comply with the requirements of English and Italian law as well as the operational mechanics of Monte Titoli.

As mentioned above, both the senior and junior notes benefit from a typical project financing security package, including:
(i) A pledge over the project company's shares owned by controlling shareholder Consorzio SIS;
(ii) Italian law general privilege (privilegio generale) over certain of the issuer's movable assets and future assets pursuant to Article 186 of the Italian Public Contracts Code, including receivables under the concession agreement;
(iii) English and Italian law pledges over the issuer's project accounts, but excluding the distribution account;
(iv) An Italian law assignment by way of security (cessione dei crediti in garanzia) in relation to certain of the issuer's receivables under the concession agreement;
(v) An Italian law assignment by way of securities of the issuer's receivables under certain project contracts, other than, among others, the concession agreement; and
(vi) An Italian law assignment of receivables under the shareholder loans.

Pursuant to Article 185 of the Italian Public Contracts Code, the security package was created in favour of the security agent, Bank of New York Mellon, acting in its capacity as representative (rappresentante) of the noteholders.

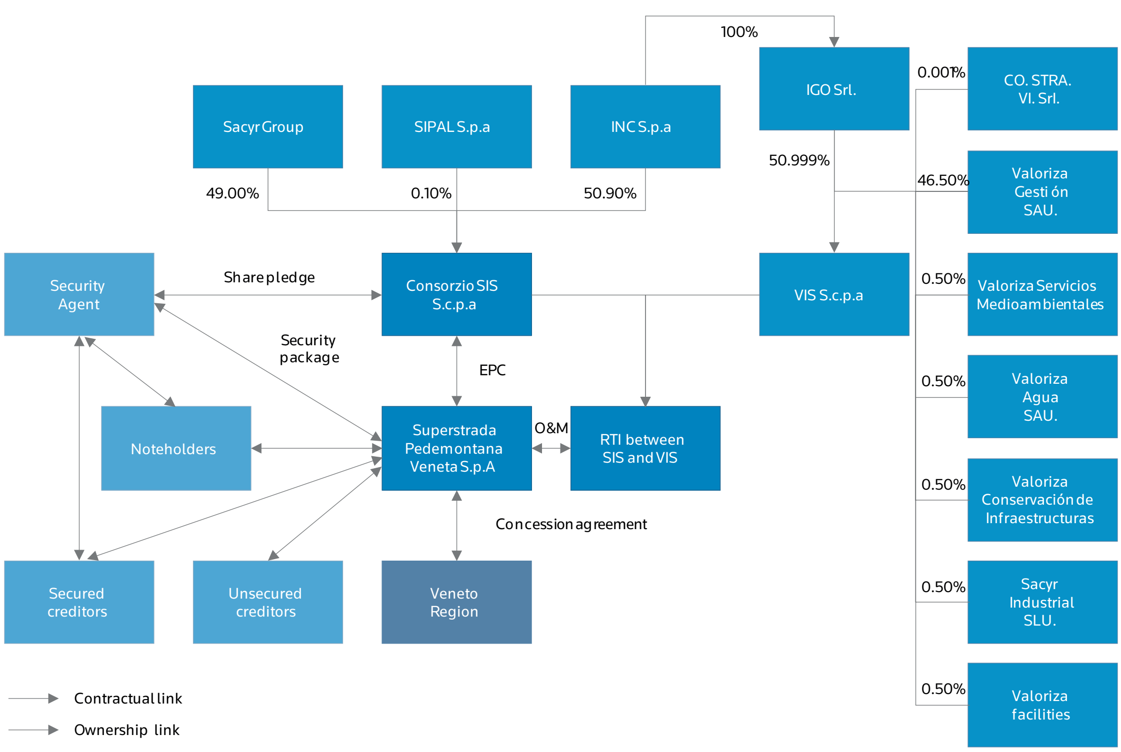
It is a concept similar to the English law security trustee that was implemented in the context of the law reform of the Italian public contracts code of a few years ago, allowing notes transfer without the need to enter into deeds of amendment of the security package. The noteholders exercise their rights under the security documents through the security agent, which allows for a straightforward transfer of the notes in the secondary market.

In addition to the above, in certain circumstances provided under the concession agreement, which mirrors the applicable provisions under the Italian public contracts code, the security agent may exercise step-in rights and designate a company to substitute the issuer under the concession agreement.

Key highlights

- Bespoke two-tranche structured financing with comprehensive covenant package and structuring features mitigating investors' risks;
- Delayed drawdown financing structure to mitigate investor funding risk;
- Innovative and highly replicable capital structure with a junior tranche providing a capital cushion during construction and put option from remaining excess funding exercisable on completion date;
- Thorough market-sounding process with a large number of global investors in both the senior and the subordinated tranche;
- A wide range of global investors taking construction risk without EIB PBCE credit enhancement;
- Diversified investors pool – 32 investors with tickets ranging from €0.5m to €225m. ■

FIGURE 1 - CONTRACTUAL STRUCTURE



Source: JP Morgan