The right of way for MNTC

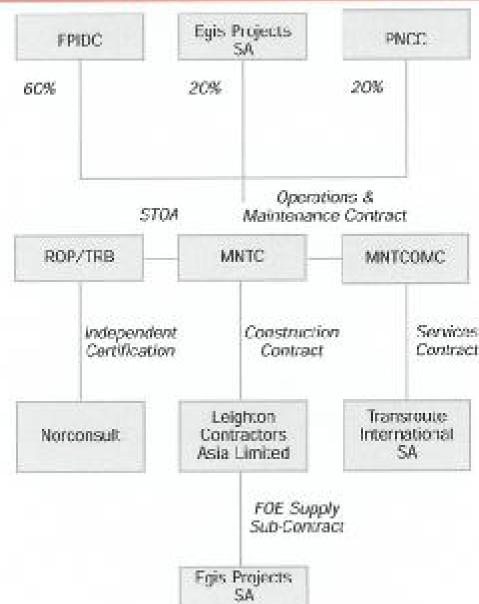
The US$261m 12-year limited recourse finance package for Manila North Tollways Corporation (MNTC) finally reached a conclusion in July 2001 with a signing ceremony at the Malacanang Palace in the presence of the Republic of the Philippines (ROP) President Gloria Macapagal-Arroyo. The presence of the President demonstrated the importance of the project to the revival of the fortunes of the Philippine economy. After all, it was the first project financing for a toll road project in the Philippines and the first project to achieve financial close outside the power sector since the onset of the Asian economic crisis. By Richard Michael and Andrew Kinloch of WestLB Global Structured Finance.

MNTC is the special purpose company established by First Philippine Infrastructure Development Corp (FPIDC) of the Lopez Group, Egis Projects SA of France and the Philippine National Construction Corporation (PNCC) to undertake the expansion and rehabilitation of the existing 83.7km North Luzon Expressway (NLE) running from Balintawak in Metro Manila to Sta. Ines, close to the Clark Special Economic Zone (SEZ).

The BOT concession runs to 2030. The official document is the Supplemental Toll Operation Agreement (STOA), between the Toll Regulatory Board (TRB) and MNTC was originally signed in April 1998. The project financing therefore has taken in excess of three years to reach financial close, a lengthy process even by the standards of the region. However, the project had many important hurdles to overcome and the negotiations themselves traversed a turbulent phase of post-Marcos Philippine history with the impeachment proceedings against President Estrada and the subsequent transfer of power to the current Arroyo administration dominating the headlines.

The main contractor for the US$371m project is Leighton of Australia and the work will involve widening of various key interchanges, resurfacing of the road itself, new bridges and interchanges and the installation of electronic toll collection systems. The road would also be split into two sections in terms of toll collection methods. The northern, and less heavily congested, part would remain a 70 km closed system whereby drivers pay on exit according to the distance travelled. The busiest 13.7km southern portion of the NLE – which currently handles 130,000 vehicles per day - would operate as an open system whereby drivers stop just once to pay a fixed charge upon entry, which will help ease traffic flow. These improvements, due to be completed by the first quarter of 2004, will lead to a dramatic reduction in congestion and journey times and promote economic development in Bulacan, Pampanga and the Clark SEZ. The financing is for what is termed Phase 1 of the project to be undertaken by MNTC. There are two additional phases, which entail new build as opposed to an upgrade of an existing road, but lenders' consent would be required before such additional work could proceed.

Figure 1 - MNTC contractual structure



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One of the key improvements to be made on the NLE is the installation of advanced electronic toll collection (ETC) systems. The ETC and other traffic management equipment is to be supplied under a separate fixed operating equipment supply sub-contract with EGIS (FOE Supply Sub-Contract).

Operational responsibility for the NLE will be transferred upon completion (as verified by Norconsult acting for the TRB) from PNCC to a separate operations and management company (MNTCOMC) with similar shareholdings to MNTC and about 850 employees. The operating company has established a services contract with Transroute International SA, the operations arm of the Egis Group which operates the largest network of toll roads worldwide. Tariffs are set by the ROP, acting through the TRB, according to a formula set out in the concession awarded to MNTC.

The principal parties to the project and their relationship is shown in Fig1.

The project was also notable for involving a strong cast list of financial institutions, with the commercial lead arrangers joined by Asian Development Bank (ADB), International Finance Corporation (IFC), Export Finance and Insurance Corporation (EFIC) of Australia, AB Svensk Exportkredit (SEK), COFACE and the Multilateral Investment Guarantee Agency (MIGA). The Lead Arrangers for the commercial tranches were ABB Structured Finance, Credit Agricole Indosuez, DZ BANK, Dai-Ichi Kangyo Bank, Industrial Bank of Japan, Sumitomo Mitsui Banking Corporation and WestLB. MNTC was advised by JP Morgan Chase.

The structure of the US$261m debt package is as shown in the table below:

Institutional Tranches US$146m	Amount
ADB	US$45m
IFC	US$46m
EFIC	US$55m
Commercial Tranches US$115m	**Amount**
MIGA Covered Loan/SEK	US$47.5m
COFACE Covered Loan	US$35m
ADB CFS Loan	US$25m
L/C Facility	US$7.5m

The sheer number and variety of lenders inevitably gave rise to some complex inter-creditor issues, but these were ironed out and the final structure did not necessarily reflect the position of the lowest common denominator, as might have been the case. Some of the principal risks facing lenders and the way in which they were mitigated are as follows:

Market risk: A key aspect of the lenders' due diligence was of course the revenue projections, as the project was taking almost full market risk post-completion. An independent review was carried out for lenders by the traffic consultant Babtie. A fundamental strength of the deal was the fact that this was not a typical greenfield transport project. The NLE has been in existence since 1977 so there is a base of existing traffic; furthermore the latent demand for the road is relatively easy to assess, given the long tailbacks that exist at the Balintawak entry point.

As would be expected, the tariffs charged by the existing operator PNCC are uneconomic and a starting tariff for MNTC will be significantly higher in nominal terms. At the time lenders were assessing the deal, the tariff per kilometre was just 0.26 Pesos and drivers would be expected to pay 2.22 Pesos (for the closed part of the system where drivers pay on exit on a per kilometre basis) once private operations started in 2004. However, from an affordability point of view even this increase would not fully compensate for inflation since the PNCC tariff was first implemented, so in real terms the road would be less expensive than in 1977. In addition the tariff is comparable with other toll roads in Metro Manila, such as the South Luzon Expressway and the Manila-Cavite Coastal Road.

There was some concern expressed amongst lenders over the potential for a negative reaction by the driving public to a sudden large nominal increase in tolls. However, there are examples of similar hikes being imposed with no real trouble. In addition, the negative impact of the number of vehicles using these roads was relatively minor, confirming our consultant's view that demand was broadly inelastic. MNTC intends to overcome any potential adverse reaction through a carefully planned publicity campaign ahead of the takeover from PNCC. This campaign will stress the value of the improvements in journey times, which could be

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at least halved, the quality of the road and the fact that in real terms tolls are not increasing compared with the original opening tariff.

The other main driver of the market study was the competition to the NLE. There is already a parallel non-tolled route, the MacArthur Highway, but anyone who has experienced travel along this road will know that it is not a viable alternative for most vehicles, as it is a narrow road passing through various small towns and is crammed with jeepneys on relatively short journeys. Journey times would be at least double those on the NLE. There are also long-standing plans for a rail link along much of the NLE's route, the North Rail project. Even if this project were to finally get off the ground in the near future, it would be completed well after MNTC commences operations and is not regarded as a direct competitor, given its emphasis on long haul freight business.

In conclusion, the lenders were able to get comfortable with the level of market risk assumed, as the benefits of the NLE upgrade were readily identifiable.

Right of way: A key consideration in any project in the Philippines is the acquisirion of the right of way. MNTC was fortunate in that no squatter population had taken over any of the land to be acquired and that in general the land, given its proximity to the existing NLE, had not been suitable for any significant industrial or residential developments. Nevertheless, not all the land has been acquired, whether through negotiation or expropriation, at the time of writing and the responsibility for purchasing the land rested ultimately with the ROP itself. The lenders therefore had to build in controls to ensure that MNTC had all the land it needed prior to first draw. Overall the issue of the right of way is manageable compared with many other projects in the country.

Completion: This was not of particular concern in this project, given the fixed price Construction Contract with Leighton and their successful track record in completing projects on time in the Philippines. The operational risks associated with the handover from PNCC are also manageable given the experience of Egis Group, the continued interest of PNCC as shareholder in MNTC and the carefully planned transition arrangements put in place for the construction period. There will also be some continuity in staffing on the road, as a number of selected PNCC employees will move over to MNTCOMC.

Forex: Given the mismatch of Peso revenues versus US Dollar debt service obligations, lenders needed to be comfortable that they were not taking on any significant exchange risk. The STOA, unlike for example the Manila water concessions, provides explicitly for a partial pass through of forex movements once operations start and the starting tariff is fully hedged against any depreciation of the Peso.

Regulatory: The tariffs themselves are not subject to the whim of the authorities as the formula is set out in the STOA and adjustments are automatically allowed every two years, with a simple newspaper announcement preceding the tariff adjustment. There is also scope for interim adjustments to cater for large movements in the exchange or domestic inflation rates.

An important aspect of the STOA are the provisions for senior debt to be covered in the event of termination by the ROP/TRB whether due to default on their part or force majeure.

One of the main issues lenders had to grapple with was the STOA itself, which was not sufficiently clear or as detailed as it could have been on several key areas, particularly in relation to the consequences of any step-in rights being exercised by the lenders. It was necessary to clarify many aspects of the STOA with the TRB and this was one of the most time consuming elements of the structuring work. The potential gaps in the STOA were filled to the satisfaction of the lenders and the document does provide in effect a considerable degree of comfort that the ROP will allow MNTC to operate without interference. In addition, the ROP has generally a good track record in terms of honouring its obligations towards the private sector.

In conclusion, MNTC represented a significant milestone in the development of the project finance market for the Philippines. As mentioned, it was the first Philippine project financing outside the power sector to close since the crisis and it was the first toll road to be financed on a limited recourse basis in the country as well as being the first in Asia since the crisis. The sound structure of the deal was evidenced by the support given by the large number of ECAs and MLAs as well as the commercial banks.