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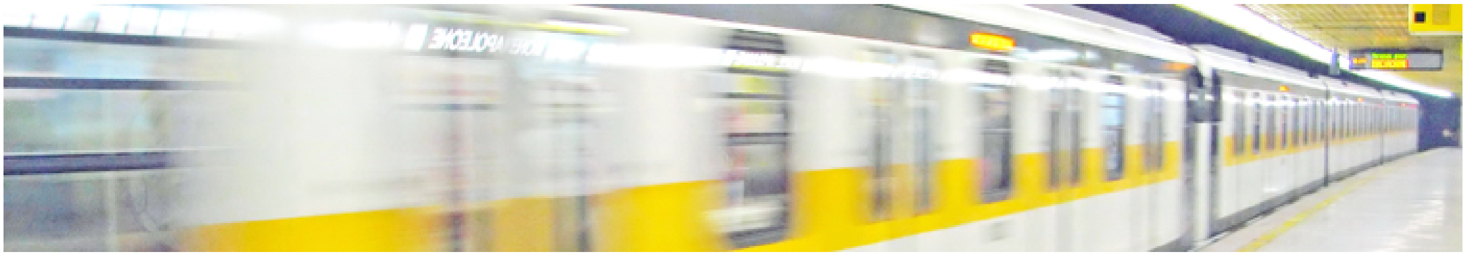

Milan’s Metro5 project

26 MAY 2016

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Metro5 S.p.A. is the concessionaire for the design, construction and operation of Line 5 of Milan underground network (referred to in this article as the "Project").

The successful completion of Metro5 is significant for a number of reasons. First of all it is the most visible public–private partnership (PPP) transaction in the Italian market in recent years and the first combination of a project finance loan and a project bond under the new Italian Project Bond law. Furthermore, the Project has captured the interest of a large number of banks and investors active in the European infrastructure market, confirming the bankability of well-structured PPP transactions and also the appeal of long-term, Italian sub-sovereign risk for foreign players.

Project description

The Project relates to the construction and operation of the fifth underground line of the Milan network connecting the stations of San Siro and Bignami, in the West and North of Milan respectively.

Line 5 is an underground driverless light metro system, comprising 19 underground stations for a total length of circa 12.8 km. A fleet of 21 four-body trains carry out the service.

Line 5 crosses a densely populated area which currently suffers from serious shortcomings as regards public transport. It also serves the Milan soccer stadium, located in the peripheral quarter of San Siro, where massive events often take place.

The construction of this infrastructure has been split in two lots, with different construction periods:

- Phase I (from Bignami to Garibaldi FS): construction started in August 2007 and the commercial operation of the entire stretch started in March 2014;
- Phase II (from Garibaldi FS to San Siro Stadium): construction started in August 2010, the commercial operation of five stations started in April 2015 (in time to serve the Milan Expo 2015 event), while the remaining five stations were

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completed in October 2015.

The sponsors are Astaldi, Alstom Ferroviaria, Ansaldo STS, AnsaldoBreda and AT M (the Milan public transport operator, which also acted as EPC contractors).

From two concessions to a unified structure

To accommodate the phased approach to the Project, the construction and operation of the two lots have been regulated under two independent concession agreements, with two separate SPVs (Metro5 and Metro5 Lilla, ultimately owned by the same sponsors) and different financing structures.

The Project started in June 2006 when, after a public tender, the Grantor and Metro5 signed a concession agreement for the design, construction and operation of Line 5, from Bignami station to Garibaldi station (Phase I). The original concession agreement envisaged possible extensions to the infrastructure.

In December 2007, a credit facility agreement was signed ("Original Financing") between Metro5 and a group of banks for a total amount of €275.6 million with the sole purpose of financing Phase I.

In July 2010, the Grantor decided to extend the Line 5 from Garibaldi Station to San Siro Stadium. Thus, on 2 February 2011, the Grantor and Metro5 entered into a new concession agreement for the construction and operation of the extension of Line 5 (Phase II). In order to preserve the interests of the existing lenders under the Original Financing, Metro5 established Metro5 Lilla (an SPV fully owned by Metro5) that became the concessionaire for the Phase II, thus creating a perfect ring fence around the two concession agreements.

Metro5 Lilla funded the construction costs through: (i) equity, (ii) public grants, (iii) bridge loans and (iv) delaying the payment terms to the construction consortium.

The Grantor and the concessionaires, Metro5 and Metro5 Lilla (individually known as the "concessionaire") agreed to consolidate the two existing concessions into a single agreement ("convenzione unica") thereby establishing unified regulation of the entire infrastructure.

This process of moving from two separate concessions to a new unified structure represented one of the most challenging aspects of the Project's financing and required some complex restructuring.

In particular, Metro5 had to manage almost in parallel the following activities, involving different parties:

- Merger between Metro5 and Metro5 Lilla;
- Entering into a convenzione unica replacing the two stand-alone concession agreements;
- Negotiation of unified EPC and O&M contracts replacing the existing ones; and
- Arranging a new financing package tailored to the financing needs of the unified project and appropriate for the convenzione unica.

Financing structure: the combination of project loan and project bond

The financing required (excluding VAT) was around €1.6 billion and has been funded by a combination of: (i) public grants (circa €824 million, VAT excluded), (ii) operating cash flow, (iii) sponsors' equity and (iv) funding from banks and institutional investors.

Articles 157 and following of the Italian Code of Public Contracts allow special purpose entities and companies that have been awarded PPP contracts to issue project bonds. However, some important changes were made by Law Decree 133/2014. In particular, although project bonds remain reserved to qualified investors, this category has been extended to companies controlled by qualified investors.

Moreover, in 2014, changes to the tax regime applicable to security instruments and the interest payable on project bonds were introduced, namely:

- the issuance and the transfer of any security instrument relating to project bonds is subject to fixed registration taxes of €200;
- the interest on project bonds is subject to a concessional tax rate of 12.5 per cent (instead of 26 per cent).

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Additionally, the bankability provisions originally applicable only to the banks financing provision of infrastructure or of a public service, are now extended to the bondholders.

In light of these changes, the sponsors and the mandated lead arrangers (MLAs, that is, the banks which arranged the financing) decided to offer an institutional tranche to investors.

The financing envisages the combination of a €150 million institutional tranche and a €430 million project financing ("Project facilities").

The Project facilities included: a €350 million base facility, a €30 million stand-by facility and a €50 million VAT facility and were provided by: Banca IMI, BBVA, BNPP, CACIB, MPS, Natixis, Societe Generale CIB, UBI Banca, UniCredit. Cassa Depositi e Prestiti also participated as lender with a quota of €100 million.

The institutional tranche, which is unrated and unlisted, has been privately placed with: Aviva, Intesa Vita, La Banque Postale AM, SCOR e UnipolSAI.

The hedging strategy is also atypical for this transaction. In addition to the novation of the four existing deep-in-the-money swaps entered into in 2007 in connection with the original financing, new hedging contracts have been entered into by Metro5 in order to hedge 80 per cent of the interest rate risk of the term facilities provided by the banks until 2030, taking into consideration the cash sweep effect.

Furthermore, as the notes are exposed to the floating interest rate risk, Metro5 entered into specific swaps dedicated to the institutional tranche. Since the notes do not benefit from the cash sweep mechanism, the relevant swaps tenor expires in 2035. As a consequence, this hedging product is likely to become an "orphan swap" for the lenders that are also hedge providers. Specific protection for the orphan swap providers has thus been included in the intercreditor agreement.

Contractual structure

The contractual framework is quite standard for similar non-recourse transactions and allows Metro5 to allocate the main risks to third parties both during construction and operation through, among others: a single EPC contract (contractors are the same sponsors) and a specific operation and maintenance agreement (O&M) contract (with AT M, one of the sponsors). Those commercial contracts grant a strong pass-through of the concessionaire’s obligations and risks under the convenzione unica.

The convenzione unica is a typical PPP concession agreement for the design, construction and operation of public works. It is regulated by the Italian Public Contracts Code and is one of the first examples of PPP in Italy with a benefit/ cost sharing mechanism between the grantor and the concessionaire linked to the actual terms of the underlying financing. Under the convenzione unica, the regulatory financial plan is rebalanced to take account of any material deviation of the actual financing structure from the financial assumptions on which the regulatory financial plan is based.

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