

Round table discussion with the Argentinian Under-Secretary of PPPs

Introduction

Recently the London office of Norton Rose Fulbright hosted a round table discussion with the Argentinian Under-Secretary for PPPs, who presented Argentina's new PPP pipeline and took questions from a range of contractors, investors, banks, consultants and other interested parties.

The key takeaways from the round table discussion were

- There will be 15 PPP tender programmes across four stages. In total, 60 projects are planned, which will account for US\$26 billion of investment.
- Argentina's four key sectors are
 - Energy and mining
 - Transport communications and technology
 - Water, sanitation and housing
 - Health, justice and education.
- The Government has identified the key risks associated with its PPPs programme and addressed each of these risks individually. The Government is aware of Argentina's history with the international financial sector and has prepared its new PPP programme tailored to mitigate or disaggregate risks as much as possible and make the programme attractive to foreign investment, with different opportunities for investors and funders with different approaches to risk. Where appropriate, the Government based its PPP framework on previous initiatives used by Peru, Colombia, and Chile, as well as new bespoke initiatives.
- The presentation provided a clear view on the pipeline of projects to be tendered during the following years and included the results of the first roads and highways tender carried out in April 2018 (more details in the presentations attached). The risk structure and mitigation measures identified by the Government are addressed below.

Risk structure and mitigation

01 | Contract length

The length of the repayment period reflects a balance between the desire to spread out the instalments and the constraints of procuring long-term debt. It is currently difficult to get debt tenors greater than 15 years for projects of this nature, and so the PPP project terms are being set accordingly. There will also be a possibility for re-tendering when the contract expires, and the project can then be reassessed against any new macroeconomic conditions and demand scenarios.

02 | Country risk and conversion risk

The Government's PPP programme intends to offer a clear incentive to investors and lenders to invest in its projects notwithstanding the recent financial difficulties in Argentina. A key part of its approach to separate the compensation streams between the design and construction of the asset and the operation and maintenance of the asset, to give greater predictability to those investing in either side of the projects.

In terms of capital expenditure, the Government is inviting bids based on construction expenditure denominated in US dollars, and is offering termination payments denominated in US dollars reflecting the value of investment at the point of an early termination of the project, for whatever reason, covering both debt and equity contributions. This is achieved by issuance of monthly certificates, termed Investment Progress Recognition Acts (or ARAIs from the Spanish term *Acta de Reconocimiento de Avance de Inversión*), which are then converted quarterly through the construction period into Investment Payment Titles (or TPIs, from the Spanish term *Títulos de Pago por Inversión*) on behalf of the Ministry of Transport. The TPIs will each provide a fixed US dollar repayment profile for ten years, which will allow the Borrower to support principal and interest payments on its underlying finance documents. In the case of an early termination during the construction period, any ARAIs

which have not been converted into TPIs will also be paid out by the Government, and in addition some payment may also be made in respect of works which are executed but not yet recognised through an ARAI. There may be deductions from such termination payments (e.g. to cover outstanding repair work), but not so as to leave any senior debt outstanding that is not covered through the TPIs. TPIs already issued will be completely ring-fenced from termination.

The ARAIs and TPIs, once issued, are intended to be fully transferable, irrevocable, unconditional and negotiable instruments, with the ultimate backing of the Argentinian state, which should give the prospective concessionaires a lot of flexibility as to how they use them as collateral to raise finance. Since there is limited availability for local bank debt, the expectation is that the concessionaires may look at financing through project bonds, where the funding will be provided against ARAIs/TPIs earned. Short term working capital facilities could be used to fund the EPC contractor's construction works and any VAT until the titles are obtained.

The funding and payment mechanism is similar to the scheme used in Peru. The TPI repayments are made every six months for ten years, with the starting dates for TPI payments being optimised to reduce negative carry. For example, if the construction period is five years, the investment placed in year one will begin to be repaid over ten years starting from year three. Investment placed in year two will begin to be repaid over ten years starting from year four. This will continue until all repayments have been made.

The holders of the TPIs will still hold the risk of being able to recover from the Argentinian state in the event that regular TPI payments are not honoured. The Ministry of Finance however hopes that international bidders may be able to work together with their respective export credit agencies or other similar bodies to seek appropriate cover for this risk, and effectively convert the TPI revenue stream from Argentinian government risk into home-country risk or other investment-grade status, and thereby access domestic sources of funds that wish to invest in Argentina against an overall risk profile that they are comfortable with.

03 | Demand risk and operational risk

Operational expenditure costs will be bid in Argentinian pesos, and will be payable on this basis on a monthly basis through Availability Payment Titles (or TPDs, from the Spanish term *Títulos de Pago por Disponibilidad*).

If the concessionaire provides the required performance guarantees through an on-demand instrument, then only the TPDs will be at risk of set-off or payment deduction;

the ARAIs and TPIs will be immune from set-off or withholding. If the performance guarantees are not from on-demand instruments, then set-off may be permitted against the TPIs but only up to a limited level (15 per cent), while the remaining 85 per cent of the TPI value will remain fixed and not subject to deduction of any kind.

Concessionaires will be entitled to recover toll revenues or other ancillary revenues from the use of the road, and may factor this in to their anticipated O&M cost budgeting for bid purposes, but in principle the Government is willing to provide a fixed availability fee through the TPDs to the concessionaire, therefore mitigating demand risk. Some projects may only be issued one level of TPDs, whilst other projects may be issued with multiple TPD levels, some of which are triggered by user growth, allowing for the risk to be shared to some degree.

04 | Source of funding risk

The PPP framework uses a trust (the PPP Trust) as a vehicle for payment and guarantees. BISE, a state-owned Argentinian development bank, will act as trustee. The PPP Trust will principally receive money from fuel taxes and contributions from excess traffic. The PPP Trust will have the mandate to pass this on for road infrastructure repayments due under TPIs and TPDs. The PPP Trust will also hold a register of TPI holders.

There will also be a 12 month reserve account in US dollars to guarantee payment under the TPIs. Failure to maintain a 12 month reserve account in US dollars will lead to a TPI default, and where there are two instances of TPI default, the PPP contract may be terminated. The Government will also be under a direct obligation to the holders of TPIs to make contingent contributions to the reserve account to ensure that it is at the level required to secure payment of all TPIs.

05 | Real FX risk

As the Argentinian peso may depreciate or appreciate in value the Government will make available a contractual hedging mechanism which can be applied during the construction period. For instance, where the local currency appreciates in value and the US\$ funds raised through project finance are not enough to buy local currency for the sub-contractors, the PPP Trust will cover anything over a threshold of a 10 per cent increase so that the project will always be able to access sufficient local currency.

Similarly, where there is a depreciation in value, any excess US dollars that the concessionaire holds will be payable back to the PPP Trust, and held by the PPP Trust to compensate for future currency appreciations elsewhere.

The Government noted that there had been a 20 per cent devaluation in the currency between the date of bid submission and evaluation on the first round of PPP projects, so this is a very real issue for bidders to consider. This mechanism follows an approach previously used on Chilean PPP projects.

06 | Sovereign spread risk

The Government also provides a reciprocal mechanism to hedge sovereign risk spread (SRS), which is applied between bid and financial close dates. In recent months, the SRS was at 550 basis points and then reduced to 350 basis points, but then increased to 450 basis points.

In light of the volatility, Argentina is asking the bidders to price their bid submissions on a reference value, and then gives the bidders approximately two months from execution of the project documents to close out the finance. The Government will cover the volatility risk during this period by adjusting the TPIs so that the equity return is kept constant.

07 | Excess liquidity capture

The Ministry of Finance will also offer various investment instruments, tailor-made to match the liquidity profile needed by the concessionaire. This is to attract any excess liquidity on finance raised during the construction period and provide an investment rate that is convenient for both parties. This approach is unique to Argentina.

08 | Dispute resolution mechanisms

In the case of disputes, the Government acknowledges that a range of independent dispute resolution methods may be necessary, and these will include reference to a technical panel, local courts or to international arbitration.

09 | Transparency risk

The Government is taking an admirable approach to the question of transparency. All project information, including presentations, contracts, tender documents and tender results are to be made available free of charge on the PPP Under-Secretariat website. There will be a high level reporting mechanism imposed by the anticorruption office and the OECD Competition Commission, with follow up from the National Audit Office of Argentina.

Pipeline of projects tendered under the PPPs programme

	Energy and mining		Transport, communications and technology			Education, health and justice	
	Energy efficiency	Electrical transmission	Roads and Highways	Rail roads	RER	Penitentiary Facilities	Hospitals
Description	Public lighting replacement to LED lights	Construction of new high voltage transmission lines	Road design, construction, expansion, improvement, maintenance, operation, managing and financing	Improvement of existing tracks and construction of new tracks	Interconnection of metropolitan railway stations in Buenos Aires	Construction or remodelling of penitentiaries in Buenos Aires	Construction or remodelling of hospital's in Buenos Aires in Neuquén
Magnitude	National	More than 3,000km in lines	More than 2,800km in highways and 4,000km in safe roads	665km in railroads	20km in railroad to interconnect the existing 790km of railroads and 241 stations	5,800 inmates	176,000 m ² in hospitals
Term	12 months	33 months	36–60 months	48 months	50 months	24–36 months	24–36 months
Tender	2018 Q3	Stage 1 2018 Q2 Stage 2 2018 Q3 Stage 3 2019 Q4	Stage 1 2018 Q1 Stage 2 2018 Q3 Stage 3 2019 Q1	2018 Q3	Stage 1 2018 Q2 Stage 2 2018 Q3 Stage 3 2019 Q1	2018 Q4	Stage 1 2018 Q4 Stage 2 2019 Q1 Stage 3 2019 Q3

	Water, sanitation, and housing					
	Water pipe systems	Water treatment plants	Water purification systems	Wastewater management	Irrigation	Housing solutions
Description	Construction of the Norte water pipe systems	Expanding water-treatment plant in the City of Santa Fe	Construction of purification plants in AMBA and Gran Rosario	Power generation in wastewater treatment plants	Development program of new irrigation areas	Housing Development Program (ProDevi)
Magnitude	Benefits more than 2.6 million users	Benefits 520,000 users	Benefits 2 million users	Benefits 500,000 users	108,000 hectares	102,000 houses
Term	60 months	24 months	60 months	36 months	60 months	36–48 months
Tender	N/A	N/A	N/A	2018 Q4	2018 Q4	2019 Q1

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