IBERIAN LAWYER

A question of priorities

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Governments around the world have sought to limit the impact of the global financial crisis on domestic economies by announcing or bringing forward planned infrastructure and construction projects. The situation in Iberia is no different, say lawyers.

Los gobiernos de todo el mundo han tratado de limitar el impacto de la crisis financiera global en las economías domésticas mediante el anuncio o la puesta en marcha de proyectos de infraestructura y construcción. El mercado portugués de la vivienda se ha estancado y en España se ha derrumbado por completo, pero se mantiene la creencia que los dos países pueden no ser capaces que salir del peligro económico, poniendo el énfasis en la obra civil y los proyectos de infraestructura como posible via de recuperación.

The Portuguese housing market may have stalled, and the market in Spain collapsed completely, but hopes remains that the two countries can still build themselves out of economic danger.

Nonetheless, the Madrid government's initial €70bn stimulus bill has proved hit and miss, say lawyers.

The Spanish Treasury also now faces competing investment priorities and the level of infrastructure development first planned may no longer be viable. Spain lost its AAA credit rating from Standard & Poor's in January, and is this year expected to reveal a 10% GDP budgetary deficit, having had a 2.2% surplus in 2007.

Local and regional authorities have sought to promote public works programmes but central and regional governments inevitably now have competing priorities.

"It remains to be seen what impact the current high level of state debt – with less funds available for public spending – will have in connection with the planned infrastructure projects. What is clear is that the level of activity in connection with more traditional sectors, such as pure construction and real estate, will fall quite dramatically," says César Herrero, of DLA Piper in Madrid.

Nonetheless, additional measures were offered by the Prime Minister, Jose Luis Rodriguez Zapatero, in May's state of the nation address, including €600m to modernise the tourism sector, and continued emphasis towards the expansion of the country's high-speed rail network (AVE).

Despite governments' good intentions, a recurring issue remains however the state of the international financial markets and the ability, and willingness of financial institutions to support projects.

"The diversion of public resources to avoid financial collapse has affected public investment in infrastructure and projects. Moreover the restriction of credit has diminished the ability of private companies to address Public Private Partnerships," says Francesc Segura Roda, partner at Roca Junyent in Barcelona.

The current economic and financial situation has resulted in an unprecedented lack of liquidity in the lending market. Financial institutions are now much more demanding than they were previously, in terms of price and permitted leverage, while fundraising in the capital markets has become, on occasions, a burden, say some lawyers.

The result has been a dramatic reduction in financing opportunities, with the banking sector adopting very strict new policies which are having a direct impact on PPP and PFI projects.

Rodrigo Berasategui at Garrigues in Madrid, agrees: “The main impact of the economic crisis has been the contraction of the credit market, resulting in uncertainty over project financing parameters; the increased cost of credit; the difficulty in syndicating deals; the greater relevance placed on developers’ balance sheets; and the virtual absence of competition among the main credit institutions when it comes to financing projects.

” The leading domestic national banks remain active in the market but alongside fewer international players. Among the most prominent now are Barclays, BNP Paribas, HSBC and Société Générale, which do however have well-established and experienced local teams.

“A problem is that the size of the lending market has reduced but the number of projects remains the same if not higher than was previously the case. Banks know that they cannot cover all the deals they are presented with so are being much more selective,” says fellow Garrigues projects partner, José Guardo.

Portugal’s new Contract Code, introduced in July 2008, reduces the upfront financing burden of nonshortlisted bidders, but lawyers still highlight the adverse impact the current climate has on the structuring of infrastructure projects.

“The Portuguese Government’s reaction to the crisis in terms of increasing or deciding to still proceed with a number of public and PPP investment projects has created good opportunities for companies to immediately face the difficulties. However, it is possible that payment and financing problems will still bring new challenges in the near future,” says Albano Sarmento, partner at Barrocas Sarmento Neves.

Public Private Partnerships

Many lawyers nonetheless remain optimistic that the sector will be less affected than others. The belief is that government’s strategies to find their way out of the crisis, and tackle rising levels of unemployment, will see emphasis remain on infrastructure and development projects. Public Private Partnerships (PPPs) remain the most viable project structure for government-sponsored projects, note lawyers.

“The credit crunch and the need to instil money in the market make public investment attractive. By sharing risks with the private sector, governments bring comfort to banks that were previously reluctant to give credit,” says Lino Torgal, finance and projects partner at Sérvulo in Lisbon.

PPPs are especially significant in this context, he adds. “The same effect on the financial market can be achieved with less public investment. Banks are willing to give credit to significant projects as long as the state is involved. Less public money is demanded but this can have a disproportionate effect on the economy.”

New ways are clearly required to counteract the more stringent requirements to obtain project financing, agrees, Manuel Protásio, finance partner at Vieira de Almeida in Lisbon.

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"Shrinking liquidity is a reality that impacts on the availability of funds, tenure of loans and contractual and risk management conditions in general. In Portugal, the role of Caixa Geral de Depósitos – the State owned bank – is increasingly crucial in order to raise funds for projects, not to mention the increasing influence and importance of the European Investment Bank (EIB)."

The role of the latter is also highlighted by Luís Branco at Morais Leitão Galvão Teles Soares da Silva & Associados (MLGTS). "Of course the financial conditions are now more stringent on the borrowers but the EIB is still providing significant support to many projects, which helps 'push' the commercial banks – especially Iberian ones."

Those projects that reflect national or regional development strategies remain attractive to bidders while others, based completely on demand, supply prices or with uncertain revenue streams, have been to some extent set aside, say lawyers.

"Some energy – wind and photovoltaic – and central and regional government-promoted infrastructure projects are still being considered and analysed by banks due to predictable tariff schemes and proven technology, as are those with limited traffic/demand-risk and publicly backed payments," says Carlos Marina Garcia-Barón of Gómez-Acebo & Pombo.

The Spanish government's decision to approve €8.5bn for infrastructure projects (PEIT) reflects continuing investment levels particularly in transport, with a clear focus on new road and highway and high-speed rail schemes.

Barcelona likewise continues to move forward with the €6.8bn Line 9 airport extension to its Metro system, which will be the longest in Europe and, possibly, the largest European PFI infrastructure project launched in the past year; a deal combining the buy-out of unfinished infrastructure and a new private concession.

"We think that these are times for innovative and challenging lawyers to create added value for clients. It is, without doubt, a time for challenges and for people who enjoy facing them, a time for groundbreaking transactions and advice," says Juan Pérez Rivarés at Uría Menéndez in the city, which advised on the deal alongside teams from Garrigues, Clifford Chance and Cuatrecasas.

Lawyers in Portugal are also optimistic as the government pushes forward significant transport schemes, many of which are also now benefiting from state guarantees to ease private investors funding concerns.

"Notwithstanding the worldwide economic and financial market crisis, the Portuguese Government has decided to maintain the projected schedule of implementation of the new infrastructure programs," says Diogo Perestrelo, partner at Cuatrecasas Gonçalves Pereira.

Over the past year, the Portuguese State has launched new PPP tenders for seven new highways, totalling over 2000kms, the €8.5bn expansion of the country's high-speed rail link ultimately connecting Madrid to Lisbon and Oporto to Vigo – with the first project (Poceirão Caia) reaching 'best and final offer' (BAFO) stage soon – as well as new hospital and hydroelectric dams. In addition, work will soon start towards the construction of Lisbon's new €4.9bn international airport to the south of the city, and a new bridge crossing the Tejo River. Significant upgrades are also expected to the national power and telecoms transmission networks.

An important consideration for many schemes has been the division of projects, notes Miguel Lorena Brito, partner at F Castelo Branco & Associados, in order to capture more private investors, but also to reduce the government's exposure to the collapse of any one contractor or sponsor.

Sector restructuring

Lawyers across Iberia note that despite such activity, prolonged domestic recessions will inevitably impact on the continuing viability of many of the major infrastructure and construction companies.

Since 2008 many have undergone severe restructuring and refinancing processes to cut or ease huge debt figures following rapid expansion in recent years, through credit extensions and subsidiary divestitures. Among Spain's leading players alone, Ferrovial last year recorded a €838m loss and has struggled to refinance its €15bn debt ever since it acquired UK airports operator BAA in 2006 – elements of which it has now had to put up for sale.

Likewise, Sacyr Vallehermoso recently sold its Itinere Infraestructuras to Citi Infrastructure Partners, having previously sold its troubled stake in French real estate company Eiffage, and negotiated the sale of its 20% stake in oil company Repsol, in order to manage its €18bn debt. Other players, such as ACS and Acciona, have also made significant sales but nonetheless still face heavy debt burdens.

But while some companies have managed to avoid structural problems by selling assets, or undertaking equity swaps with creditors (such as Metrovacesa), others have been less fortunate. Martinsa-Fadesa, a leading real estate construction company, filed for insolvency last summer with debts of €5.2bn, making it Spain's largest-ever insolvency and the first of a publicly-listed company.

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Manuel Protásio, Vieira de Almeida

"Some companies have successfully refinanced or sold or are really close to doing so, mainly due to the regulated or typical nature of their businesses, but others may find it difficult to get fair prices for businesses based on demand and industrial activity," says Carlos Marina Garcia-Barón, partner Gómez- Acebo & Pombo, which is representing Martinsa- Fadesa.

Whether the process of restructuring and refinancing of Iberia's main construction and infrastructure companies is now sufficiently well advanced to avoid continuing insolvencies, is still not however certain, say many lawyers.

"The situation is still quite uncertain and even more so as regards listed companies, consequently, the filing of further insolvency proceedings eventually resulting in changes of ownership among the major construction and infrastructure Spanish players cannot be disregarded," says César Herrero at DLA Piper.

José Antonio Magdalena, partner at Legalia agrees that the restructuring process cannot yet be considered finished. "In principle, the most important companies have already taken the necessary measures to restructure their business. Nonetheless, in Spain, some regional financing institutions still need to take some severe decisions that may yet have a serious impact on some of the main construction players"

Others point to different issues affecting specific parts of the construction and infrastructure sectors and suggest that we are entering a new period of uncertainty. Companies' prospects continue to be linked to individual projects.

Soares da Costa, one of Portugal's major contractors, has for example seen a recent increase in its share price over the possible advantage it has in securing Portugal's first high-speed rail PPP, notes Manuel Protásio at Vieira de Almeida.

"With nearly 150 bankruptcies in Spain in March of this year, it's difficult to say that the process is sufficiently advanced, however, it seems that the larger construction companies have reduced their debt and have been able to cushion their exposure to the real estate crisis through diversifying their business model and through international expansion," adds Victor Casarrubios, Counsel at Jones Day in Madrid.

Restructuring and refinancing efforts are crucial to face the problem, but are not sufficient alone, believes Torgal at Sévulo. "These companies need the market to recover and to be back in action. Again public projects can play a very important role here.

Although it is not foreseeable in the short term that the real estate market will fully recover, construction companies can be involved in significant public project transactions, helping the overall reaction of the economy."

Expansion

A clear trend among many major construction and infrastructure companies is that in the face of the evident domestic economic issues, many are clearly placing increasing emphasis on international opportunities. A large number are now active throughout Europe, particularly across Central and Eastern Europe where countries' modernisation programmes are benefiting from substantial European Union Cohesion and Structural Funds.

"Certainly, the Iberian governments are trying to foster the construction sector by means of significant infrastructure projects, but at the same time, most of the main construction and infrastructure companies are making a big effort in their international divisions," notes José Antonio Magdalena at Legalia.

Increasingly both Portuguese and Spanish companies are also active across Latin America – Brisa, Portugal's leading motorway operator recently announced that it wants to increase its 18% stake in Brazilian toll road operator CCR, and where Spain's OHL has also increased its profile.

But it is towards the US that many of the leading players are specifically now looking, including to capitalise on opportunities presented by President Obama's $787bn (€579bn) US Stimulus Plan, which places a heavy emphasis on transport and infrastructure and energy and renewables schemes.

"Looking overseas, the fact that the US Stimulus Plan will be implemented before the Spanish one, together with the recent internalisation of Spanish companies, leads us to believe that it will offer attractive opportunities to Spanish blue-chip construction and infrastructure companies," say Luis Vázquez at Uría Menéndez.

A number of Iberian infrastructure companies are already active in the US, including Cintra, which secured the landmark €1.17bn Chicago Skyway concession in 2004, followed by a 75-year, €2.45bn lease on the Indiana Toll Road in 2006. More recently Abertis, alongside Criteria Caixa and Citi Infrastructure Investors, paid €8.2bn to secure the largest privatisation ever in the US for an infrastructure asset – the 70-year old Pennsylvania Turnpike. But also active are Acciona, ACS, Brisa, Dragados, FCC and OHL, while others such as Global Vía are now entering the market.

"Spanish construction and infrastructure groups decided back in 2007/2008 to put greater emphasis abroad and are very active and trying to be perceived as domestic players in Europe and, of course, the Americas, where huge road and railroad projects have been announced and awarded," says Garcia- Barón at Gómez-Acebo & Pombo. "These investment plans offer genuine opportunities for Spanish companies in the medium/long run and so has been understood by domestic and international banks that have agreed to finance the same."

Indeed, one of the successes of Iberian companies around the world is not only their construction and bid expertise, say lawyers, but that they are able to offer a combined "package": product plus finance plus structure to implement it.

Some in Portugal, question however the attraction of the US to domestic companies relative to their Spanish counterparts, which instead continue to place an emphasis on better-known, and perhaps less-developed markets - Brazil, Angola, North Africa and the Middle East.

"I do not think that the US stimulus Plan will offer genuine opportunities for Portuguese companies. But on the other hand, I think that the current context should be used to try to restructure the construction sector, namely in order to prepare for a sustained likely recovery for 2010," says Pedro Pinto of Lisbon's Pedro Pinto Reis & Associados.

Commitment

As to whether opportunities remain across the sector, lawyers remain confident. Governments remain committed to established infrastructure programmes, and are even increasing the emphasis towards new rail, road and other transport schemes, with an emerging integrated Iberian market, say some.

"Infrastructure is a field which the Spanish Government is still confident will help resolve the current crisis and create employment," says Juan A. Pérez Rivarés / José Luis Vázquez (Spanish lawyers, Uría Menéndez). "Accordingly, we expect the infrastructure sector to be increasingly active in the coming months."

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Filipe Lowndes Marques , MLGTS

The Government has recently approved a new Stimulus Plan (Plan E), albeit focused more towards small and medium-size companies, but has also committed new funds (in excess of €20bn in 2009) towards the Spanish Strategic Plan for Infrastructure and Transport begun in 2005 – 9,000km of new AVE railway line is planned over the next decade. In addition, note lawyers, further related opportunities may still include the privatisation of public utilities such as water company Canal de Isabell II, and Spain's airport operator Aena – although neither are imminent.

"A pending debate is also emerging over the possibility of developing liberalised passenger rail transportation services using the AVE network it is not only a hypothetical issue but also a controversial one as RENFE currently has the monopoly," say Javier Menchen and Pablo Silvan, partners at Ramon y Cajal.

The Portuguese government also remains committed to established programmes, say lawyers, with the current economic malaise even bringing forward the implementation table of some, such as the new high-speed rail and longstanding Lisbon airport projects.

"The Portuguese Government has put in place several measures intended to help boost the infrastructure sector, including the provision of State guarantees to banks financing projects. It is a bit surprising, though, that notwithstanding the existence of this tool, deals are still closing without recourse to it. In my opinion it is the participation of the EIB in most Projects that is contributing to a more favourable climate," says Filipe Lowndes Marques at MLGTS.

Some may be more optimistic about the opportunities presented by public construction projects, rather than infrastructure concessions. "It does seem that there will be private operations of sales of infrastructure assets, as long as they can be financed and the seller is disposed to sacrifice part of the price that he thought he would have been able to achieve," says Lucas Osorio at Lovells.

Others focus on what this may mean for sector companies. Those with a tested core business, capable management and sound international expertise for developing complex and financially demanding projects will be crucial, say some. Others inevitably also highlight opportunities for new investors as established operators continue to sell assets.

"Although the volatility of values makes it difficult for buyers and sellers to agree on pricing, the fact is that there are good opportunities in these sectors – due to divestments in non-strategic assets or even forced due to solvency difficulties – which foreign investors with fresh money may take advantage of," says Jesús Zapata at DLA Piper.

Experts are less certain however whether governments can merely "build" themselves out of their current economic difficulties.

"Although it is quite clear that public projects will not solve the crisis by themselves, Iberia's governments clearly understand – as others do across Europe – that public investment is essential to overcome the current situation. Investing in public projects is probably more effective and less costly than investing in any other area," says Torgal at Sérvulo.