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Case Study: Vienna-Budapest M1/M15 privately financed toll road

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Authors: Nigel J Smith[1]

[1] Institute for Transport Studies, University of Leeds

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As with most of the other Eastern and Central European countries in the 1980's, Hungary had a policy for the provision of highway schemes which was subjected to repeated change. A programme to eliminate highway development delays costing approximately 350 billion HUF (about 6.5 billion DM, 1991 terms) over the next 10-12 years was approved by the government. The investment cost of 500 km of new motorways, to be constructed by the year 2000, to meet expected demand for road transport development represents about half of that sum. In 1988 a Road Fund was established drawing 10% of the retail petrol and derv fuel price, and this was to be the source of funding for the road programme in Hungary. However the amount of public money collected by this means was not sufficient to cover the operation and maintenance expenditure of the existing national road network, around 30,000 km.

In common with other countries with economies in transition, the Hungarian government were seriously considering toll roads under private concessions. Traditional financing or tax reform would not raise sufficient money to fund new works. The award of concessions to finance, build, own, operate and transfer new toll motorways offered new opportunities to attract private capital to complement the public funds available for road and bridge investments. Act No. XVI/1991 on Concessions and Bylaw No XXXIX/1992 on Transport Related Concessions enacted by the Hungarian Parliament provided that opportunity. Central and local Government were empowered to award concessions for a fixed period, up to 35 years, to private companies, through international public tendering. The winner of the tendering procedure, the Promoter, has to establish a shareholding concession company, or Special Project Vehicle, SPV, registered in Hungary. Domestic and foreign competitors have equal chances to tender for these projects. A separate Bureau for Motorways in Concession was set up and it prepared tenders for several motorway concessions to be built utilising capital from private sources including the M1/M15.

The Bureau for Motorways in Concession issued an "Invitation for Prequalification", for the M1/M15, the first of its kind, in September 1991. The purpose of this being to select organisations, consortia and companies which are able using their own funds by way of a concession to finance, build, own, and operate sections of the M1 and M15 toll motorways and connected secondary developments, filling stations, shops, restaurants and hotels on rest areas of the motorway. The total length of these sections is approximately 60 km with estimated project costs around $210 million US (1991 terms). The proposal was based on a 43km M1 section closing the "missing link" on the corridor for through international traffic and for a 14km M15 section towards Bratislava. The Hungarian government covered the land acquisition costs only, about 5% of the total investment cost.

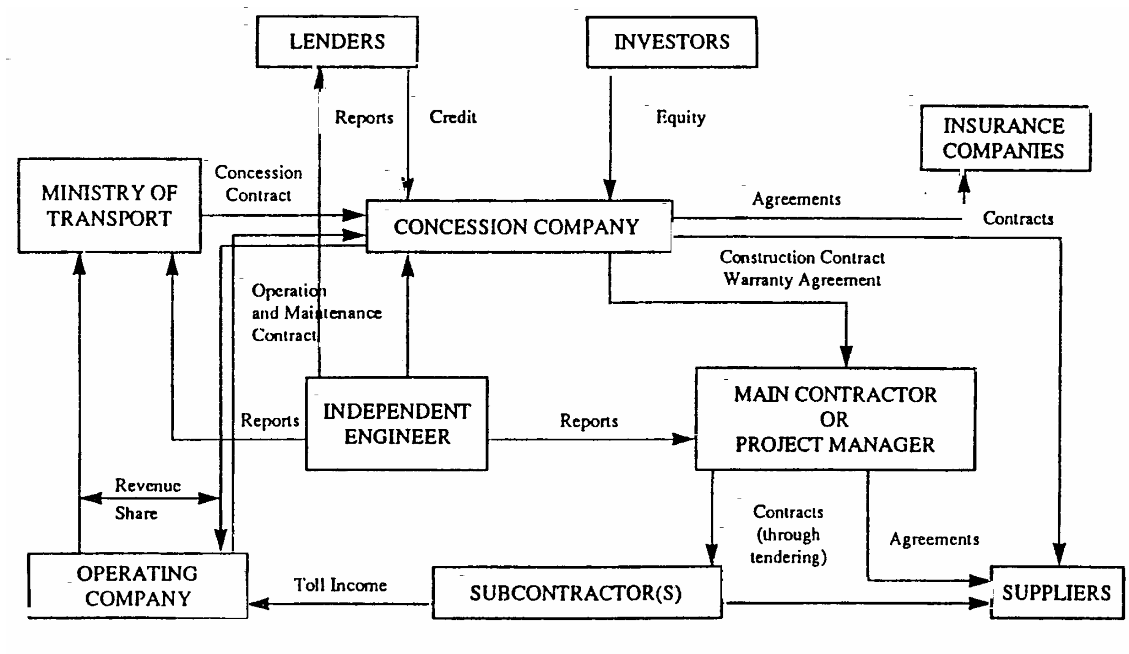

Fig 1: Organisational chart and contractual outline structure of a motorway concession

The tender documentation, finalised in co-operation with BCEOM French Engineering Consultants and Morgan Grenfell and Co Ltd., UK, who were engaged as principal financial advisor to the Ministry, was issued to the selected tenderers in mid March, 1992 with a draft of the concession agreement included in the tender documentation. The tenderers had 150 days to prepare their final tenders which were presented on 17th of August 1992. The four bids were studied and evaluated by an expert committee against a set of criteria announced in the tender documentation earlier. The two preferred tenderers were selected mid November 1992 and the final negotiations began in December. The tender submitted by a Transroute led Hungarian European Expressway Consortium was declared winner of the competition. The process is shown in the figure below. The Concession Agreement between the Ministry of Transport, Communication and Water Management of Hungary and the Promoter was signed in April 1993. In compliance with the agreed terms, the SPV Elmka, also known as the First Hungarian Expressway Concession Company, was created early in July and registered as a shareholding company in September 1993.

Following signature all the secondary agreements, including the construction contract, the independent engineers consultancy agreement, the operation and maintenance contract, the credit agreements, the security and insurance agreements, had to be negotiated and drawn up in co-operation with the lenders. The European Bank for Reconstruction and Development, EBRD, provided support to the Banque Nationale de Paris, the leading bank in the foreign debt financing syndicate, during the whole tendering procedure. The participation of EBRD was crucial to securing the foreign financed debt given that most of the revenues would be collect in Hungarian Forints which at that time were non-convertible. The international debt was based in deutshemarks and US dollars from 11 commercial banks. The Hungarian Forint debt financing of HUF 12,000m was co-financed by the national bank of Hungary the

Nemzeti Bank and EBRD. Thorough negotiations led to the signature of an amendment to the concession agreement in December 1993. Meanwhile, the Board of Directors of EBRD approved the participation of the Bank in financing M1-M15 Motorway project up to 129 million ecus in different forms, including equity, in July 1993.

The Independent Engineers, Howard Humphreys Ltd, UK and UTIBER Kft Hungarian consultants, had been selected by the Promoter in the tender. Mainly Hungarian subcontractors had been engaged by Strabag Osterreich AG, the main contractor for the construction works. The syndication of the commercial loans completing the debt financing package of 320 million ecus limited recourse project financing was organised successfully by Banque Nationale de Paris in December 1993.

The Works

Construction commenced in January 1994. Notwithstanding the economic difficulties in Hungary during 1995 (inflation reached 30%), construction progressed according to programme and budget. In January 1996, amidst heavy snowfall, the last part of the M1 Motorway linking Budapest with Austria was opened by the Prime Minister of Hungary. All parties congratulated themselves on having achieved the goal of financing and building this motorway section in such a short time with virtually no cost overruns. The M1/M15 project was heralded in the project finance world as a major success.

Operation

In 1991, the first traffic studies were prepared by a number of reputable international organisations. Although there was little relevant historical data available as prior to 1989, traffic between Hungary and Western Europe was severely restricted, there was confidence that significant traffic growth could be expected. A number of the stakeholder organisations undertook independent traffic forecasts and all were supportive of these projections. Since traffic on the existing road increased rapidly during 1992 and 1993, this optimism seemed to be upheld.

However, during construction there significantly lower corridor traffic flow, about half of what was projected for 1993/1994. Whereas the traffic specialists expected border traffic growth rates of 5 to 6% per year, traffic declined during 1995 and 1996 and remained roughly constant thereafter. A major factor was the failure to realise that the traffic generated by Hungarians who visited Austria in order to experience the West and to buy products which were not available in Hungary, would disappear once life normalised in Hungary. Further this was compounded by a false assumption that holiday traffic mainly from the former East Germany would continue to grow.

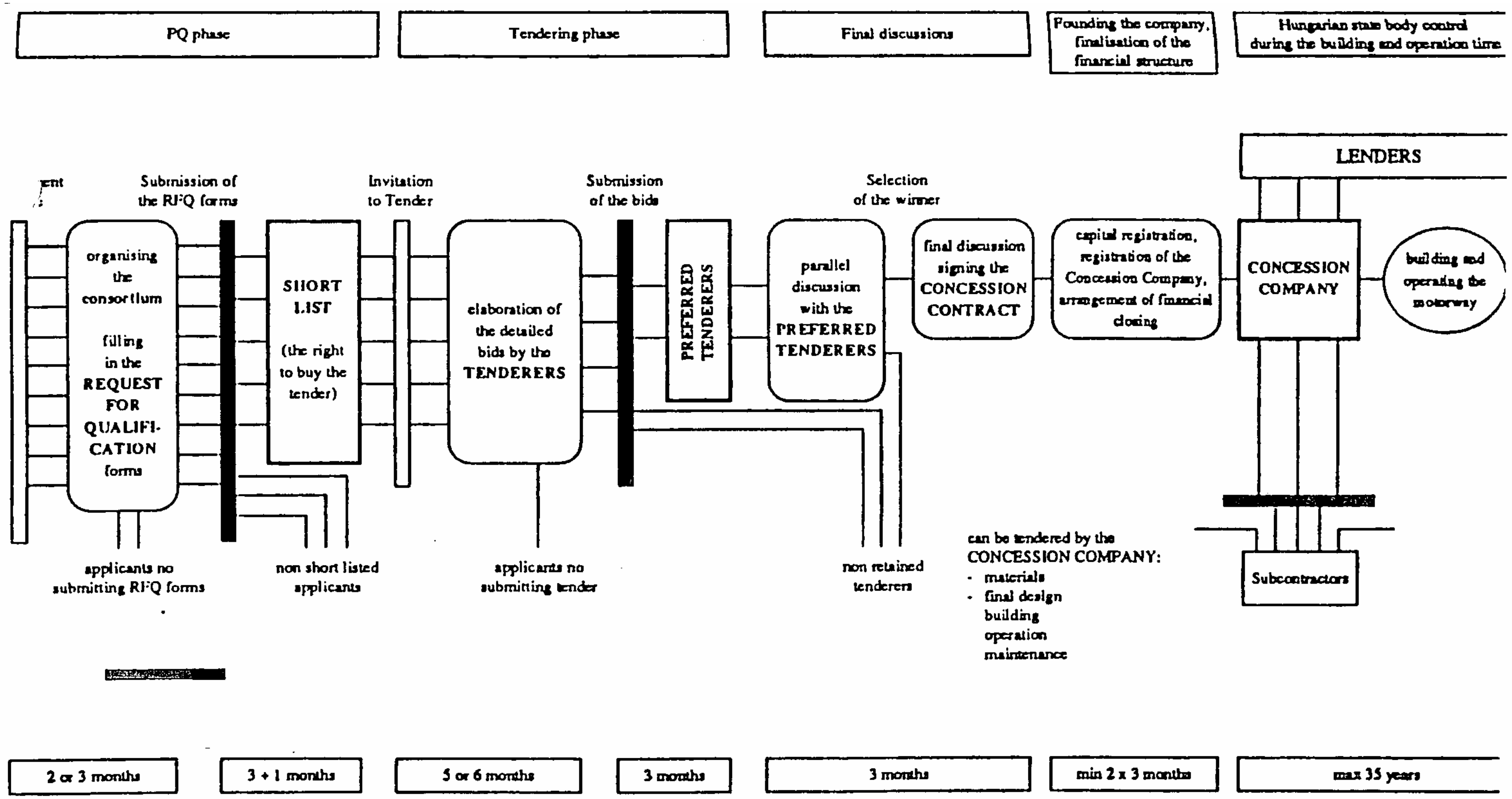

Fig 2: Awarding a Motorway Concession in Hungary

In setting the toll rate, the SPV Elmka, applied a revenue maximisation policy. It was assumed that rich West European drivers would be prepared to pay a higher per km toll than those who applied in West European countries. The fact that these rates would be a deterrent for most Hungarians was accepted by the Government as a consequence of implementing a 100% privately financed project.

In November 1996 litigation was instigated by the Hungarian Automobile Club against Elmka on the grounds that the toll rates, at about 0.15€/km, were excessively high by comparison with other international rates; they were about double the average European rate. It should also be remembered that the average income per capita in Hungary was only 40% of the average for Western Europe. Although the M1/M15 project was a private venture it relies upon government support but in this case it was treated as purely a private sector problem. Elmka lost the case in December and was obliged to pay back about one third of the toll but it was not required to reduce its tariffs. Interestingly in 2001, after Elmka had ceased trading, the Highest Court in Hungary overturned this ruling in Elmka's favour.

After the court ruling the lenders reacted by declaring an event of default and required the construction of the M15 to be stopped. Over the next six months an interim agreement was concluded. The lenders and shareholders agreed to this interim solution because they wanted a long-term solution, allowing the essential financial restructuring to take place well before the first payment of interest and principal in June 1998.

Re-nationalisation

Negotiations were on-going when 1998 the government faced a general election. In May the ruling party lost its majority in Parliament and was replaced by a new coalition government which had pledged to either abolish or nationalise concession roads. Pressure from EBRD for a solution resulted in an initiative from the shareholders, led by Caisse des Dépôts et Consignations, in the form of an alternative proposal that was submitted to the Government in December 1998. This proposal required only a limited two year bridging cash flow guarantee and consisted of creating a public-private partnership with Elmka for tolling and operating the whole of the M1. However this was not accepted. Finally agreement was reached in April 1999 to transfer Elmka's debt into a sovereign debt under more favourable terms and that Elmka should be superseded by a fully state owned SPV NyuMA. The shareholders of Elmka suffered substantial losses, estimated at about €60m, and received no compensation. The toll rates were reduced by nearly 50% which resulted in an increase in traffic of between 15% and 20% but an overall reduction in revenue of over 45%.

On January 3rd 2000 the government introduced a vignette type of access/toll system on the entire length of the M1/M15 motorway. NyuMa and the state owned company operating the M3 toll in Hungary and the Motorway Directorate were merged to form the State Motorway Management Company, SMMCo, which is still functioning. This system does not comply with EU directives and is difficult to enforce with an estimate 20% of traffic travelling without holding a valid vignette. Latest figures for the generated revenues show a figure of HUF 15,000m for 2003 does not cover the published state operation and maintenance cost of HUF 21,000m.

Lessons Learnt

The fact that traffic is substantially below expectations does not mean that the project has become a "white elephant", rather it continues to form an integral element of the Hungarian motorway system. Indeed it is hard to see how this project might have been delivered if private finance had not been used.

This case study clearly demonstrates that the most important success factor is the commitment and full and sustained support of the Client/Principal. It is interesting to speculate whether the fact that the project had been 100% financed with private funds without any recourse to the State allowed the Client to take a slightly ambivalent attitude towards the project.

Although it is natural to focus on the differences in the traffic consultants' forecasts and the over optimistic projections prepared by the macro economists, neither of these discrepancies would invalidate the viability of the concession. As it was the financial structure put up by the lenders and promoters proved to be relatively robust. It would even have allowed sufficient time to put a financial rescue package in place in the form of new cash from the shareholders and reductions in margins and increases in grace and maturity periods by the lenders.

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