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Deal Analysis

PROIN: Wraps are back

The Mexican state of Mexico has completed the Ps4.07 billion ($315 million) Promotora de Infraestructura Registral wrapped bond financing for an upgrade to its property registry. The financing is split into a Ps2.77 billion tranche with a full guarantee from the Overseas Private Investment Corporation (OPIC) and a Ps1.3 billion tranche with a partial guarantee from the Andean Development Corporation (CAF).

The financing marks the latest attempt by a bilateral agency to extend its reach into capital markets. The OPIC guarantee is its first for a Mexican Peso deal, and its first for a sub-sovereign borrower. It provides a respectable replacement for the stricken bond insurers, replacing a monoline wrap with a guarantee from the US government. And it creates a new niche for the monolines, as reinsurers of this government's exposure.

The structure has obvious uses in the private infrastructure industry, where there is a plethora of transport and power issuers, in particular, that would welcome an opportunity to issue debt with an OPIC guarantee. But the deal needs to be adapted to the legal circumstances of the countries in which it is applied, and OPIC needs to be comfortable with the strength of its reinsurance for the product to truly take off.

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In 2006 the state of Mexico, which constitutes a relatively prosperous doughnut-shaped area around Mexico City, or the Distrito Federal, started work on a project to upgrade its property registry. The project involved the digitisation of the system by which the state's residents recorded property ownership and transactions. It involved moving a predominantly paper-based system to one based on a central database.

The state spun the record-keeping function into a new decentralised agency, the Instituto de la Función Registral del Estado de Mexico (IFREM), whose debt would be categorised separately to the state's direct obligations. The new agency's functions would be supported from the fees levied on users of the registry, which predated the spinning off and the modernisation project. IFREM, by volume, is one of the busiest property registries in the world.

In 2007, the state and its adviser, LatAm Capital Advisors, an MBIA subsidiary, looked at structuring a traditional monoline-wrapped bond issue for the project. At the same time, MBIA had been turning increasingly to OPIC to reinsure its exposure on deals in jurisdictions such as Chile. When, by 2008, MBIA's rating had tumbled to such a level as to make the original plan untenable, the adviser turned the concept on its head: An OPIC direct guarantee with MBIA reinsurance.

The reinsurance takes the form of a facultative reinsurance agreement between OPIC and MBIA, and the financing's underlying rating must meet MBIA's underwriting standards.

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In practice, this means the deal should be investment grade, even though MBIA's rating of B3/BB+ (Moody's/S&P) is not, and its newly-formed US municipal finance business National Public Finance Guarantee is Baa1/A. OPIC does not, however, require an investment grade rating, meaning that a lower-rated credit with, say, a US sponsor rather than simply a US reinsurer, might be eligible.

The OPIC guarantee is denominated in dollars, and the financing mitigates this risk in part because the policy is a right-way hedge. Any deterioration in the ability of IFREM to service its obligations would probably be accompanied by a more general decline in Mexico's economic condition and a fall in the value of the Peso. The guarantee is sized to cope with smaller upward fluctuations in the Peso's value.

OPIC has also insisted that the proceeds of the issue be deposited in a state of Mexico fund modelled on the Banobras-run *Fondo Nacional de Infraestructura* (Fonadin), and used, if not entirely for the modernisation project, for other infrastructure projects within the state. The state of Mexico, as one of the most prosperous and well-run in the country, took easily to the arrangement. The challenge for other states will be convincing guarantors and investors that they have similarly robust plans in place.

The tranche with a partial guarantee from CAF was required because of OPIC's exposure limits, and is structured as a revolving, or replenishable, commitment to make good up to 30% of the series B principal amount. The CAF tranche received a slightly lower AA(Mx) rating (Fitch and S&P), compared to the AAA(Mx) rating on the OPIC-wrapped series. The CAF series garnered a higher coupon – 10.13%, compared to the series A's 7.86% – and a broader and less risk-averse group of investors, including the more sophisticated afores and insurance companies, as well as a small number of private banking clients of the bookrunners, HSBC and Banamex.

The biggest stumbling block for the deal was waiting for the outcome of a court case in the state of Sonora, which would decide whether the debt of a decentralised agency would be considered a direct obligation of the state.

Promotora de Infraestructura Registral

Status: Closed 23 August 2010
Size: Ps4.07 billion ($315 million)
Location: State of Mexico
Description: Wrapped bond issue that finances upgrade of state's property registry
Sponsor: State of Mexico
Debt: Ps2.77 billion series A with OPIC guarantee, Ps1.3 billion series B with partial CAF guarantee
Underwriters: Banamex and HSBC
Maturity: 20 years
Coupon: Series A 7.86%, Series B 10.13%
State's financial adviser and structuring agent: LatAm Capital Advisors
State legal counsel: Jauregui, Navarrete y Nader
Guarantor and underwriter counsel: White & Case
Revenue consultant: HDR

The biggest stumbling block for the deal was waiting for the outcome of a court case in the state of Sonora, which would decide whether the debt of a decentralised agency would be considered a direct obligation of the state. The eventual decision, that such debt be considered a contingent obligation, satisfied the state of Mexico enough for the deal to go ahead.

The PROIN deal also marked a change in diet for the country's institutional investors. Mexico's pension funds, or afores, and life companies are restricted in practice to a small number of blue-chip and government issuers, and find it particularly difficult to buy high-quality assets with longer maturities. At 20 years and with a high rating, the PROIN deal was exactly what the afores, nursing substantial losses on their monoline-wrapped portfolios, were looking for.

The next step for the guarantee product will be its application to privately-held infrastructure assets. MBIA has a substantial record of closing toll road bond financings in Mexico, and its earliest steps in developing the product were to see if it might be applied to a refinancing of the bank debt of the FARAC I concession. At the time the size of the debt requirement and the concession's leverage militated against a successful conclusion. Given sponsor ICA's success in paying down some of the FARAC debt with CCDs – listed infrastructure equity – the portfolio of roads might again be a candidate. ■

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