Widening London's M25

Freeing a city for generations to come

On any given day along the M25 motorway that skirts London's famed bridges, clocks and towers, traffic may be at a standstill. By evening, some 200,000 vehicles will have traveled sections of the motor system's nearly 117-mile length.

But soon, several sections of the heavily used M25 will be widened, thanks in part to a gritty team of government officials and PwC professionals who wouldn't let the project die in the midst of the worst financial crisis of our time.

Their efforts led the project to be selected *Project Finance International's* European Public Private Partnership (PPP) 2009 Deal of the Year.

The busiest of roads, the busiest of times

Bypassing the greater London area, the M25 ranks as the 2nd longest ring road in Europe and is an essential conduit for the region's daily commuters, casual travelers, visitors and goods. According to the British government's 2002 Orbit transportation study, nearly 20% of the United Kingdom's road freight either begins or ends its journey in the southeast of England, putting the M25 at the centre of the UK's supply chain. UK transportation planners have forecast double-digit traffic growth in the busy corridor, on top of the projected spike accompanying the London-based 2012 summer Olympic Games.

Not surprising then, that a "Design, Build, Finance and Operate" (DBFO) project to widen and operate several sections of the lengthy motorway was of critical importance to the UK Highways Agency (a part of the UK's Department of Transport). The widening and operation effort would be a significant PPP project totaling over £6 billion, requiring many years to plan and build and having a contract that would include 30 years of operation and maintenance.

Expanding a motorway in a shrinking economy

Large construction projects such as this are difficult enough to push through in the best of times. Regulatory requirements, environmental and stakeholder concerns, a complex and far-reaching competitive bid process, high-stakes contracts and financing, the vagaries of public opinion—any and all of these can exert pressure on a project. But the worldwide financial meltdown that came to a head in the midst of the M25 widening effort was unprecedented.

In mid-September 2008, just as the bid competition was coming to an end and a planned financing competition was set to begin, Lehman Brothers collapsed. Within days, the world financial markets unraveled. Banks reeling from the collapse were suddenly unwilling or unable to take on billions of pounds of capital project financing with the expectation that they could quickly sell portions of the debt to other institutions as they had done in the past.

PwC senior manager Ian Shore found himself managing a project suddenly uprooted by the global financial crisis. "We were looking to raise £1.3 billion in finance," he recalled, "That was on the basis of having a small number of banks who would each underwrite a big portion of it. But the underwriting market fell away just at the time we'd appointed the preferred bidder.

It takes a new approach to funding to get through the world's financial meltdown

It was a dire turn of events. Both PwC and the Highways Agency recognized that a strong government position

would help secure the financing. This led to the Department publicly committing up to £500 million in financing to back the project—a promise it never actually had to fulfill. The commitment was enough to convince the banks to begin negotiations. Then the PwC team stepped forward, approaching every single bank that was active in the market at the time, about 30 in all. Of that group, a club of 16 was formed to raise sufficient levels of financing. “Normally for a project of this size, it would have taken three,” said Shore, “This was an awful lot of banks to manage.”

But concessions and innovations were still required to get the deal done. Even with the selected bidder increasing its equity position in the project, the 16 banks willing to participate during such dark days weren’t happy. They wanted more of a guarantee that the bidder would be able to meet its interest payments.

Steady guidance that calmed nerves and sparked innovation

PwC again turned to its experienced team for ideas. The result was a rebate mechanism to increase the cash needed to fulfill the banks’ lending requirements without increasing the bidder’s return on investment to windfall levels. Under the rebate mechanism, the government would back the arrangement with cash to meet the bank’s requirements, but that cash would be rebated to the government if the project were moving forward on schedule and the cash were not needed.

The team also offered guidance to the government on the terms under which gains would be shared if refinancing occurred—also necessary to avoid the possibility of excessive profits for the selected bidder due to the unusual market situation.

All of this was happening in real time, under conditions not seen since the 1930’s. But if misfortune is the mother of invention, then innovation was certainly in the cards here as the team dealt with yet another obstacle: the possibility that the Highways Agency might not achieve the best underlying rate on the massive amount of debt. This had to do with the project being so large when virtually everything else in the fall of 2008 was on hold. The amount of debt being raised had the potential to move markets.

What the PwC team did about it was another stroke of innovative thinking. “We recommended that the Agency pre-hedge,” recounted Shore. “We helped negotiate a process in which the Agency would place hedges in advance of the financial close.” It was a financial approach that would allow the Highway Agency to achieve the best rate while also allowing the banks to finalize their due diligence and approvals for the lending.

A lifetime of more hours, less rush

In the end, the innovations, financial expertise and close collaboration among the Highways Agency, and the PwC team helped the project keep moving. Soon, commuters and freight using the M25 will be moving faster too.

“It will have a huge impact on the quality of life for millions of Londoners,” said Shore, laughing. “Except me. Because I don’t have a car at the moment.”

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