

International
Presale Report

IIRSA Norte Finance Limited

Expected Ratings

\$226,000,000 due 2024.....‘BB’

Related Ratings

Peru FC IDR* ‘BB’

Peru LC IDR* ‘BB+’

Country Ceiling ‘BB’

*Positive Outlook. FC – Foreign currency. LC – Local currency. IDR – Issuer default rating.

Analysts

Samuel R. Fox
+1 312 606-2307
samuel.fox@fitchratings.com

Greg Kabance
+1 312 368-2052
greg.kabance@fitchratings.com

Johanna Izquierdo
+511 444-5588
johanna.izquierdo@aai.com.pe

Related Research

- Criteria Report, “Recovery Ratings: Exposing the Components of Credit Risk,” July 26, 2005.
- Criteria Report, “Partial Credit Guarantees Help Improve Recovery Rates in Emerging Markets,” Sept. 13, 2005.

The preliminary ratings do not reflect final ratings and are based on information provided by issuers as of July 18, 2006. These preliminary ratings are contingent on final documents conforming to information already received. Collateral may be added or dropped from the portfolio. Ratings are not a recommendation to buy, sell or hold any security. The prospectus and other offering material should be reviewed prior to any purchase.

■ Transaction Introduction

IIRSA Amazonas Norte is a 960-kilometer network of existing toll roads in northern Peru. The proceeds of this financing will cover the costs of expansion and improvements. Upon completion, the road is not expected to generate sufficient revenues to cover its construction costs. In lieu of strong toll revenues, the government of Peru (GOP) compensates the concessionaire for construction progress with annual payments (Certificado de Reconocimiento de Pago Annual de Obras [CRPAOs]) prorated to the advance of works. This transaction will be a securitization of the CRPAOs. All eligible CRPAOs delivered from the GOP to the concessionaire will be sold to the issuer under the CRPAO purchase agreement, until 100% of financing is backed by CRPAOs during the availability period.

CRPAOs are certificates issued by the GOP through the Ministry of Transportation and Communications (MTC). Each certificate evidences an unconditional and irrevocable obligation of the GOP to make a fixed payment in U.S. dollars. The concession agreement (executed for 25 years in June 2005) provides that CRPAOs are freely transferable and that once generated they are not subject to any condition or performance obligation relating the concession agreement.

Depending on interest rates at close, funded proceeds for this transaction will be approximately \$226 million. The deal will capitalize interest payments for the first two years and is expected, therefore, to have a principal balance of approximately \$260 million when it begins paying interest in November 2008.

The transaction will benefit from a partial credit guarantee (PG) to be provided by the Inter-American Development Bank (IDB). The PG will cover the GOP’s payment obligations under the CRPAOs for an amount up to \$60 million.

■ Rating Rationale

Fitch has assigned a preliminary rating of ‘BB’ to IIRSA Norte Finance Limited (IIRSA Norte). Cash flow to maintain timely debt service on the transaction will depend on the GOP’s continued payment on all purchased CRPAOs. While CRPAOs are backed by the full faith and credit of the GOP, on a stand-alone basis, CRPAOs would not receive the same rating as dollar-denominated sovereign debt. The expected rating of the notes reflects the strength of the underlying CRPAO payments and the enhanced recovery in the event of default derived from the PG provided by the IDB.

■ Structural Overview

The transaction will be a securitization of CRPAOs. However, at close, it is expected that only approximately \$28 million of CRPAOs will be available for purchase for works completed by the closing date. The transaction's structure will be designed to maximize efficiencies while waiting for CRPAOs to come into existence.

At close, after paying transaction-related expenses and setting aside funds for the initial purchase of available CRPAOs, remaining proceeds will be invested in a credit-linked note (CLN) provided by Morgan Stanley. The GOP is the referenced entity behind the CLN and default definitions will mirror those of the GOP's 2033 sovereign bond. Cash will be invested in the CLN to help offset the negative spread that would exist between the issuance's interest rate and holding proceeds as cash while waiting for CRPAOs to come into existence. The CLN is expected to generate interest proceeds that will be applied toward the purchase of CRPAOs.

CRPAOs will be generated only as construction advances on the road. The construction process has two phases. The first phase is expected to be complete by March 2008, with the second phase completed approximately one year later. The CLN will amortize on a synthetic schedule that mirrors the expected generation of CRPAOs. If construction proceeds as expected, every time a CRPAO comes into existence, cash from amortization of the CLN will be available to purchase it.

CRPAOs will be bought at a discount. The discounted purchase will be necessary to balance the securitization's gap between assets and liabilities that will arise as the notes accrete from an issuance level of approximately \$226 million toward the peak debt level of approximately \$260 million. The price of discount will be set by comparing the present value of assets with liabilities and will vary between 8% and 14% depending on when the CRPAO has been purchased in the construction phase. The discount can be considered an additional equity contribution by the sponsors. The price will be predetermined and will not be exposed to market risks.

■ No Construction Risk

If construction fails to advance on schedule or is abandoned completely for whatever reason, CRPAOs would never be available for purchase, and the securitization would never be fully collateralized by

CRPAOs. This possibility does not create additional risk for noteholders, because in lieu of CRPAOs as collateral, the notes will be backed by the CLN and a letter of credit, which together are expected to be sufficient to cover outstanding obligations at all times.

In addition, once issued, CRPAOs will not be subject to any type of performance obligation on behalf of the concession company or sponsors. CRPAOs will not be affected by a termination of the concession agreement. Explicit in their definition, CRPAOs are transferable and are similar to bearer bonds in the United States. Once issued, the GOP's obligation to pay will be completely delinked from the completion of construction on the road, its operation and maintenance, or even traffic volumes.

■ Consequences of Construction

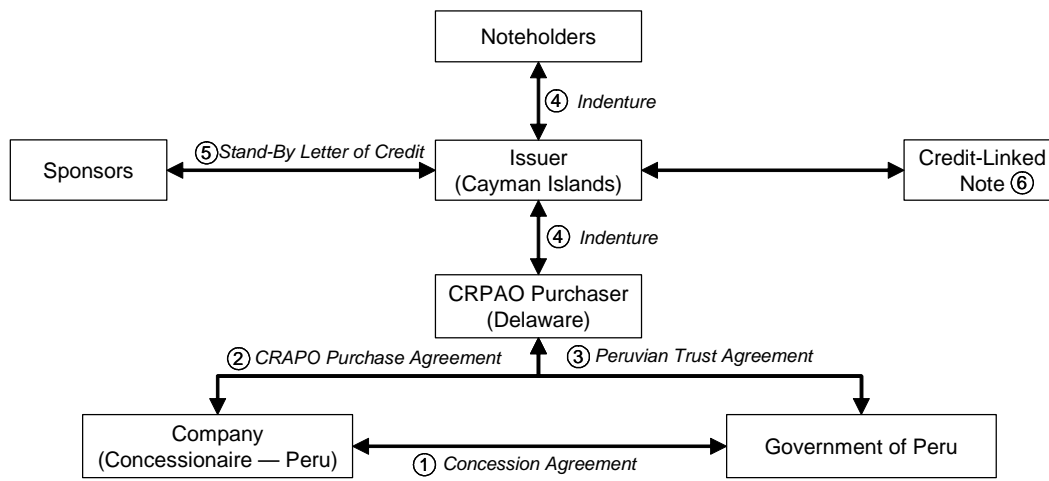
Delays

Delays do not prejudice noteholders. However, continuing construction delays will have consequences in the structure of the transaction and will negatively affect the sponsors. If the maximum allowed delay trigger is tripped, the structure prohibits the purchase of additional CRPAOs. The maximum allowed delay represents the maximum duration of delay that would cause the cumulative amount of CRPAOs purchased to be less than the amount required to repay the debt. At transaction's close, the maximum delay will be 12 months. Over the corresponding availability period of each construction phase, the maximum delay will shrink to three months.

If the maximum allowed delay is breached, a termination event under the CRPAO purchase agreement will have occurred and no additional CRPAOs would be acquired. Under this scenario, remaining cash flows off the CLN that otherwise would have been used to purchase CRPAOs will be passed through to unwind the notes directly.

Unwinding the notes will be possible using cash flows from four sources: existing CRPAOs; remaining payments on the CLN; cash available in the collateral account; and a letter of credit. Given that CRPAOs will be bought at a discount, their value as collateral will be fundamental to the solvency of the transaction. In the event CRPAOs cease to be acquired and the deal's collateralization never matures, a stand-by letter of credit will be in place to compensate investors for expected shortfalls.

Contractual Agreements



- ① The concession agreement governs the relationship between the government of Peru (GOP) and the company in which unconditional dollar-denominated obligations (CRPAOs) are delivered in exchange for construction completion milestones.
- ② The CRPAO purchaser, a Delaware entity, will purchase the CRPAOs from the company under the CRPAO purchase agreement.
- ③ The corresponding obligation resulting from the CRPAOs will be paid from the GOP to the CRPAO purchaser via the Peruvian trustee; this transfer will be governed by the Peruvian trust agreement.
- ④ The indenture will govern the issuance of the notes in addition to disbursements between the issuer and the CRPAO purchaser.
- ⑤ The sponsors will provide support during the availability period via a letter of credit, which will compensate investors in a mandatory redemption of the notes following a termination event under the CRPAO purchase agreement.
- ⑥ Provided by Morgan Stanley, referencing the GOP's 2033 bond. Remaining proceeds will be invested in the CLN to offset potential negative carry. Amortization and interest earnings from the CLN will be used to purchase CRPAOs.

CRPAO – Certificado de Reconocimiento de PAGO Annual de Obras. CLN – Credit-linked notes Source: IIRSA Norte and Fitch.

■ **Summary of CRPAOs**

Upon achieving a construction milestone, a CRPAO will be issued and purchased. Construction, which began in the first quarter of 2006 and has already produced approximately \$28 million in CRPAOs, is expected to be finished toward the end of the first quarter of 2009. CRPAOs are expected to be issued throughout this period.

CRPAOs generating, in aggregate, approximately \$460 million of cash flow are expected to be issued and acquired throughout the two phases of the construction period. Phase 1 eligible CRPAOs will begin to pay in October 2008. Phase 2 eligible CRPAOs will begin to pay one year later. Both will pay semiannually in April and October, for a period of 15 years. Annual payments from aggregate CRPAOs are expected to equal approximately \$30 million.

■ **Status of CRPAOs in Relation to Public Debt**

- CRPAOs are expressly stated to be direct, general, irrevocable, unconditional, unsubordinated and unsecured obligations of the GOP, and the GOP pledges its full faith and credit for punctual payment of all amounts.
- The concession agreement specifically states that the CRPAOs will not constitute “public debt” as defined in accordance with Article 75 of the Peruvian Constitution.
- The concession agreement requires the GOP to provide for the payment of the CRPAOs in the annual budget law.
- CRPAOs will not rank pari passu or be considered subordinated or senior to or be subject to a right of cross-default in relation to public debt, because CRPAOs are not a part of the Sistema Nacional de Endeudamiento (SNE) legal regime.

Public Debt

- Administered through Ministry of Economics and Finance's (MEF) portion of annual national budget.
- Governed by the SNE.
- Paid from funds allocated the in national budget.

CRPAOs

- Obligations of the MTC (or other relevant ministry). Appears as a line item in the MTC budget.
- Receive allocation under the MTC's portion of the national budget, which is approved annually.
- Governed by the Sistema Nacional de Presupuesto (SNP), a different legal regime than the SNE, although both the SNP and SNE appear in the annual national budget.

Administration of Funds

- Once approved in annual budget, there is limited ability of the MTC to redirect allocation of funds. Certain budget items, such as purchases (office equipment, etc.) and uncommitted investments (new works, etc.), are discretionary within the budget. Others, such as salaries, CRPAOs and related payments are not and once budgeted cannot be redirected.
- Ley de Presupuesto de la Republica states these types of funds are "intocable," or "untouchable."

Visibility to the Sovereign

- IIRSA Norte and other in-process CRPAO-backed public private partnerships (PPPs) are listed as line items in a letter of intent provided to the World Bank and part of the multiyear macroeconomic budgeting presentation.
- Designed as a new PPP framework to promote infrastructure development in Peru.
- ProInversion (the concession regulator of the GOP) has a large pipeline of infrastructure projects (water, schools, hospitals, jails, roads, telecom, etc.) that the CRPAO design will make "bankable."
- Annual CRPAO payments cannot exceed 0.5% of GDP, suggesting that the GOP's concession program is not likely to become an overly demanding part of debt obligations. 2005 GDP was approximately \$80 billion.
- The GOP's annual public debt service is approximately \$3.4 billion, and the annual CRPAO payment for this project will be about \$30 million.

All CRPAOs Are Pari Passu

- CRPAOs issued in respect of every concession in Peru are pari passu.
- By law, the GOP cannot discriminate and pay the CRPAOs on one concession that may be more politically attractive over another that has not fulfilled its promise.
- Political pressure to drop support for IIRSA Norte's CRPAOs could only be legally successful if the entire concession program were discontinued.

■ Sponsor's Letter of Credit

At the transaction's close, each sponsor will put up their pro rata share of the letter of credit, which will be issued in U.S. dollars by a bank with a credit rating of at least 'A'. The letter of credit will be subject to an annual renewal. In the event the renewal does not take place, the letter of credit will be drawn. At the transaction's close, the maximum necessary availability will be approximately \$14.5 million and will reduce over the life of the construction cycle as CRPAOs are generated and purchased.

■ IDB Partial Guarantee

The \$60 million IDB PG will be between the IDB and the GOP. The IDB's Public Sector group has underwritten the product. This is the first IDB Public Sector originated PG Fitch has rated. In spirit, PGs originated from either the Public or Private Sector groups of the IDB are very similar. However, differences between the two include the following:

- Reimbursement obligations will be between the GOP and the IDB. The issuing trust will have no obligation to repay the IDB and, therefore, organic recoveries are not shared, as they could be in Private Sector contracts.
- The Public Sector contract is not written under any specific law. Private Sector contracts are typically written under New York law.

In general, the guarantee is straightforward. It does not have the characteristics of an insurance policy, such as an untimely claims-paying process or burden of proof. If there is a default on payment of a CRPAO by the GOP, the IDB will disburse on a draw within 10 business days after relatively simple administrative obligations are fulfilled.

If a draw on the IDB facility is repaid by the GOP within 30 days, the facility will be replenished to the predrawn amount. After 30 days, the amount drawn

will be automatically converted into a loan between the IDB and the GOP. The term of the loan will be between five and 15 years, depending on its size. Failure by the GOP to repay this loan will not cross-default other IDB lending to Peru, nor will it affect future disbursements under the guarantee.

There are several conditions for a draw. Other than the administrative task mentioned, most conditions would have been satisfied at, or soon after, the transaction's close, as follows:

- If a draw is converted to loan, the interest rate must be agreed upon prior to any additional disbursements. This agreement will be in place upon the signing of the contract.
- Certain opinions addressing the validity and enforceability of the CRPAOs must be received prior to any IDB disbursement. These opinions are also part of eligibility criteria in the CRPAO purchase agreement and, therefore, the condition has been satisfied upon a CRPAO's inclusion into the deal.
- Similar to other multilateral products, this PG is subject to IDB environmental standards. In this deal, in order for a CRPAO to be generated, the Peruvian regulator must sign off on the advance of work. Part of the regulator's signoff includes assuring that environmental standards have been met. The IDB will accept the regulator's approval for its internal standard and, therefore, any CRPAO in existence has, by definition, already met IDB environmental standards.
- Nominal annual fees on the PG must be paid in order for a disbursement to occur. A reserve account will be funded at transaction's close to cover one year of fees. Additional amounts, to the extent necessary, are paid at the top of the transaction's waterfall and can be covered by disbursement from the IDB. The size of the fee is not considered material in its effect on the value of the overall coverage.

■ Quantifying Credit for the PG

At face value, the \$60 million PG covers 23% of the \$260 million obligation, which would be sufficient to allow the issuer rating (IR) to gain one rating notch over the issuer default rating (IDR) of the transaction. Adjustments to this valuation include the following:

- The IDB guarantee only covers missed payments by the GOP on CRPAOs. By design, the PG is therefore not accelerable. The entire \$60 million

cannot be drawn upon in the first instance of GOP nonpayment. In the worst-case scenario, in which the GOP completely abandons payments on its CRPAO program, it will take two years to fully draw on the PG (CRPAO payments are approximately \$30 million per year). The present value of \$60 million after applying a two-year discount at a rate reflecting the provider's credit quality is approximately \$55.8 million or 21.5% of total debt.

- An additional adjustment reflecting the joint probability of default of the GOP and the IDB as PG provider is minor.
- IDB PG fees to be paid out of any disbursement are \$150,000 per year. This amount is not material enough to effect the valuation of the PG as credit enhancement.

For more information on how Fitch views partial guarantees see the criteria report, "Partial Credit Guarantees Help Improve Recovery Rates in Emerging Markets," dated Sept. 13, 2005.

■ Sovereign Summary

Strong export and GDP growth and the consequent improvement in external and public-debt dynamics underpinned Fitch's revision of the Outlook on Peru's sovereign ratings to Positive from Stable in November 2005. Fitch currently rates Peru's foreign and local currency IDRs 'BB' and 'BB+', respectively. Fitch expects real GDP growth to reach between 5.5% and 6.0% this year, compared with 6.7% in 2005. Based on preliminary data, growth decelerated to 6.0% during the second quarter of this year from 6.8% in the first quarter. Buoyant domestic demand and better than anticipated prices for Peru's commodity exports underpinned growth in the first half. However, growth in the second half of the year could come under pressure as the market takes a wait-and-see stance with respect to the new government's policy initiatives. Nevertheless, APRA's support of the passage of the free trade agreement with the United States bodes well for the general maintenance of the current policy framework.

A solid balance of payments performance has been reflected in international reserve accumulation of \$330 million during the first half of 2006 and Peru's low external financing needs of about 8% of reserves. Similarly, reserve accumulation, combined with the reduction of debt service achieved through the government's debt reprofiling operations, boosted Peru's liquidity ratio to 214% at the beginning of

2006. While this compares favorably with a median of 165% for 'BB'-rated sovereigns, when adjusting the liquidity ratio to include resident foreign currency bank deposits in the denominator, the liquidity ratio falls to around 93%, highlighting the risks associated with high, albeit declining, dollarization. The government's debt reprofiling operations have also reduced the public sector's financing requirement to a manageable 3% of GDP over the medium term if the

current fiscal stance is maintained. Furthermore, the authorities do not intend to tap international debt markets in 2006.

For a more detailed analysis on Peru's see the sovereign report dated Nov. 8, 2005, on Fitch's Web site at www.fitchratings.com.

Copyright © 2006 by Fitch, Inc., Fitch Ratings Ltd. and its subsidiaries. One State Street Plaza, NY, NY 10004.

Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. All of the information contained herein is based on information obtained from issuers, other obligors, underwriters, and other sources which Fitch believes to be reliable. Fitch does not audit or verify the truth or accuracy of any such information. As a result, the information in this report is provided "as is" without any representation or warranty of any kind. A Fitch rating is an opinion as to the creditworthiness of a security. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed, suspended, or withdrawn at anytime for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from USD1,000 to USD750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from USD10,000 to USD1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of Great Britain, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.