

International  
Presale Report

Peru Enhanced Pass-Through  
Finance Limited — IIRSA Sur

Expected Ratings

\$467,419,832 Class A-1 due 2018 ..... 'BB+'  
\$152,568,991 Class A-2 due 2025 ..... 'BB+'

Related Ratings

Peru FC IDR ..... 'BB+'  
Peru LC IDR ..... 'BBB-'  
Country Ceiling ..... 'BBB-'

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

- Special Report, "Republic of Peru," Sept. 8, 2006.

The preliminary ratings do not reflect final ratings and are based on information provided by issuers as of Dec. 6, 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 Sur is a 2,500-kilometer toll road network in the southern regions of Peru. The roads combine paved and unpaved portions and traverse the country to ultimately connect several coastal ports with the Brazilian border. The road is divided into five segments, each awarded its own concession. The proceeds of this financing will fund the paving of more than 700 kilometers on segments two and three.

Upon completion, the roads are not expected to generate sufficient revenues to cover project costs. In lieu of strong toll revenues, the government of Peru (GOP) will compensate the concessionaire for construction progress with annual payments (CRPAOs) prorated to the advance of works. This transaction is a securitization of the CRPAOs. All eligible CRPAOs delivered from the GOP to the concessionaire will be sold to the issuer under a CRPAO purchase agreement until 100% of the financing is backed by CRPAOs.

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 August 2005) provides that CRPAOs are freely transferable and that once generated they are not subject to any condition or performance obligation relating to the concession agreement.

Funded proceeds for the two tranches of this transaction will be approximately \$620 million. Tranche A will pay no interest for the first 1.5 years and will then amortize through 2018. Tranche B will pay no interest payments until 2018 and will then amortize through 2025. Total CRPAOs expected to be purchased over the life of the transaction will provide cash flows in aggregate of approximately \$1.2 billion to noteholders. Transaction proceeds of approximately \$620 million equal the present value of the expected cash flows prorated to each tranche's size and expected interest rate.

■ Rating Rationale

Fitch has assigned a preliminary rating of 'BB+' to Peru Enhanced Pass-Through Finance Limited.

Cash flow to maintain timely debt service on the transaction depends on continued payment by the GOP on all issued CRPAOs. CRPAOs are backed by the full faith and credit of the GOP. While legally different from public debt, Fitch views the difference in probability of the GOP honoring one obligation over the other as immaterial. The rationale behind the rating of notes is similar to a government

passthrough. Included in the securitization package is an insurance policy from a highly rated provider that is structured to act like a six-month liquidity reserve. Fitch believes this facility provides an additional timing cushion and allows for some degree of corrective action in the event that CRPAOs are inadequately budgeted.

## ■ Structural Overview

This transaction will be a securitization of CRPAOs. However, it is expected that only approximately \$100 million of CRPAOs will be available for purchase shortly after closing. The transaction's structure is designed to minimize inefficiencies while waiting for CRPAOs to come into existence.

At close, after paying transaction-related expenses and purchasing available CRPAOs, remaining proceeds will be invested in an InterAmerican Development Bank (IDB) note and the Merrill Lynch cash management agreement (the CMA). Cash is invested in the IDB note in order to comply with Peruvian security regulations while waiting for CRPAOs to come into existence. The IDB note and the CMA are 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 for segments two and three of IIRSA Sur will proceed in three phases for each. Overall construction for both segments was initiated in July 2006 and is expected to be completed in July 2010. The IDB note 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 IDB note will be available to purchase it.

## ■ Construction Risks and Noteholder Return on Investment

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. Material delays beyond six months would eventually cause a termination in the CRPAO purchase agreement. Under this scenario, noteholders' expected return (and risk profile) will be altered. In normal circumstances, where the roads are fully constructed and CRPAOs are generated as scheduled, the stated return can be expected, and noteholders are solely exposed to the risks of the

GOP honoring CRPAOs. If delays cause a termination of the CRPAO purchase agreement, noteholders will be collateralized with a combination of existing CRPAOs, the IDB note and the CMA. Interest and amortization of the IDB note and cash flows from the CMA would pass through to investors, providing them with a partial redemption of the notes and a lower overall return. The adjusted return and risk profile would be commensurate with a transaction partially collateralized by the Merrill Lynch underwritten CMA and an IDB obligation. If CRPAOs are no longer available for purchase, the CMA would provide investors with a return of London Interbank Offered Rate (LIBOR) + 25 basis points on all amounts not previously invested in CRPAOs.

Once issued, CRPAOs are not subject to any type of performance obligation on behalf of the concession company or sponsors. CRPAOs are not 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 obligation to pay by the GOP is completely delinked from the completion of construction on the road, its operation and maintenance, or even traffic volumes.

## ■ Summary of CRPAOs

Upon achieving a construction milestone, a CRPAO will be issued and purchased. Construction, which began in the summer of 2006 and has already advanced to be able to produce approximately \$100 million in CRPAOs, is expected to be finished in 2010. CRPAOs are expected to be issued throughout this period.

CRPAOs generating in aggregate, approximately \$1.2 billion of cash flow, are expected to be issued and acquired throughout the construction period. Each CRPAO will begin to pay 30 months after its issuance, semiannually in May and November, for a period of 15 years. Annual payments from IIRSA Sur related CRPAOs are expected to equal approximately \$70 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*, 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.
- A default on CRPAOS does not cross-default public debt.

#### Public Debt

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

#### CRPAOs

- Obligations of MTC (or other relevant ministry).
- Appears as line item in the MTC budget.
- Receive allocation under the MTC portion of the national budget that 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

- Law 28880, part of the Ley de Endeudamiento, which was recently passed in September 2006, states that once they are approved in annual budget, the MTC (or other relevant ministry) is unable to redirect allocation of CRPAO funds.

#### 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 International Monetary Fund (IMF) and part of multiyear macroeconomic budgeting presentation.
- Designed as 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.”

- Government guidelines state that 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 aggregate annual CRPAO payments will be about \$100 million.
- CRPAO-backed financings are expected to be placed locally in the Peruvian pension fund system, suggesting any nonhonoring of obligations by the GOP would increasingly affect local interests.
- Peruvian regulators count CRPAO investments as investments in public debt and apply balances toward sovereign-exposure limitations.

#### All CRPAOs Are *Pari Passu*

- CRPAOs issued in respect of every concession in Peru are *pari passu*.
- By law, the GOP cannot discriminate and budget to 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 any given CRPAO issued could only be legally successful if the entire concession and infrastructure programs were abandoned.

#### ■ Budgetary Process and Liquidity Reserve

Aug. 30 is the approval deadline for following year’s budget. CRPAO payments are in April and October. There is an eight-month window between the time the budget is approved and when a CRPAO payment is disbursed. In addition, the transaction’s insurance policy, acting as a six-month liquidity reserve, extends the window to 14 months between the time the budget is completed and the transaction’s reliance on CRPAO cash flow to maintain timely debt service on the notes. In the event CRPAO payments are insufficiently budgeted, a cushion exists to take necessary corrective action.

CRPAOs are always connected to infrastructure construction projects. The actual budgeting for their payment occurs approximately two years after their generation (two years after completion of a given construction milestone). However, the relevant ministry must preapprove overall funding of their

programs directly with the MEF and ProInversion. As such, infrastructure projects are coordinated (and prioritized) at the macro level, and ultimate payment is a “soft” budget item years in advance.

## ■ Sovereign Summary

Fitch recently upgraded Peru’s long-term foreign currency issuer default rating to ‘BB+’ from ‘BB’ as the sovereign’s creditworthiness has benefited from favorable trends in the global economy that have underpinned rapidly growing exports, notably of metals and such nontraditional exports as textiles and agro-industrial goods, as well as strong output growth averaging approximately 5.5% per year since 2002. As a result, key sovereign financial ratios have been improving, evidenced by 2006 forecasts for net external debt (NXD) to current external receipts (CXR) of 39% (close to the ‘BB’ median), general government debt to GDP of 33% (below the ‘BB’ median of 42%) and external financing needs to official reserves of a comparatively low 4.8%. Furthermore, inflation remains subdued, while the fiscal accounts are expected to report a surplus for the first time in 2006.

Fiscal restraint, liability management operations and the sizable balance of payments surpluses since 2001 have allowed net repayments of public external debt and official foreign exchange reserves to rise to record levels. As a result, the public sector’s NXD-to-CXR ratio has been declining rapidly and is expected to reach around 27% by the end of 2006, a material improvement from Fitch’s forecast of 35.9% at the time the Rating Outlook was revised to Positive from Stable in November 2005. Although this ratio remains well above the 12.8% forecasted median for Fitch-rated ‘BB’ sovereigns, it is steadily converging toward the median. Furthermore, the government’s external debt burden has been partially mitigated by its astute debt reprofiling operations, which have reduced the public sector’s financing requirement to no more than 3% of GDP per year over the medium term, assuming the nonfinancial public-sector deficit is maintained at the targeted 1% of GDP.

The smooth political transition also supports creditworthiness as President Garcia’s inaugural

speech and his cabinet choices point toward the general maintenance of Peru’s macroeconomic policy framework that has served it well in recent years. The focus will continue to stress maintaining macroeconomic stability underpinned by responsible fiscal policy. In addition, he stated that the government should also be focusing on attracting private investment and strengthening the country’s export capacity. Although some of the new policy initiatives have a “populist” tilt, it appears that the overall emphasis of Garcia’s economic program is pro-market. All of these factors have helped maintain a stable business environment during this transition period.

Peru remains vulnerable to a global economic downturn and a consequent commodity price correction. Metals prices—specifically, for copper, gold, molybdenum and zinc, which figure heavily in Peru’s exports—have experienced a spectacular rise since mid-2003. While a downward price correction for metals has begun, global supply and demand fundamentals appear sufficiently robust to alleviate concern about a sudden commodity price shock in the near term. Furthermore, the improvement in Peru’s macroeconomic fundamentals suggests that the country is in a better position to cope with such a shock than in the past.

Given the underlying structural weaknesses of Peru’s economy (e.g., a narrow economy and export base, as well as subpar social development indicators), the transition to investment grade will likely take some time to achieve. While Fitch expects the trend in export and economic diversification to continue, the diversification and financial cushion achieved thus far are not yet consistent with an investment-grade rating. Further reductions in NXD, particularly net public external debt, and a broadening of exports and sources of economic growth, would bode well for sovereign creditworthiness, as would further evidence that political shocks will not derail current economic policies and prudent fiscal policy in particular.

For a more detailed analysis on Peru, please see the sovereign report dated Sept. 8, 2006, on Fitch’s Web site at [www.fitchratings.com](http://www.fitchratings.com).

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