*Artist's impression of the Elazig Hospital Campus*

TURKEY

# Elazig Hospital PPP

June 2017

**The European Bank for Reconstruction and Development (EBRD) and the World Bank's Multilateral Investment Guarantee Agency (MIGA) have developed an innovative risk mitigation instrument which enabled the issuance of Turkey's first-ever greenfield infrastructure project bond.**

This example of innovative financing features a transaction with credit enhancement in the form of risk mitigation from two International Financial Institutions (IFIs). Due to its widespread potential applicability for emerging market infrastructure, the "product" is attracting widespread attention in the sector. It has a strong potential to be repeated in markets where certain underlying project risks are not able to be fully borne by capital markets and investors.

## KEY ACHIEVEMENTS

- First project to benefit from risk mitigation provided jointly by MIGA's political risk insurance coverage and EBRD's unfunded liquidity facilities
- First project bond financing for a greenfield infrastructure project in Turkey
- A1 Bonds were rated Baa2, two notches above Turkey's credit rating[1]
- Vigeo Eiris certified the Elazig project bond as a 'green and social' bond – the first such certification for an infrastructure project in Turkey
- With a 20 year maturity, the bond had the longest maturity for the Turkish Integrated Health Campuses PPP Programme

## PROJECT OVERVIEW

The Elazig Integrated Health Campus project (Elazig) is a €360 million availability payment based greenfield project structured as a public-private partnership (PPP) that forms part of the Government of Turkey's Health Transformation Programme. Tackling unequal access to health care is a key priority of the Turkish government given that the number of hospital beds falls below the OECD average.

As a result, it put in place the Health Transformation Programme to improve, modernise and expand healthcare services across Turkey. To achieve this aim, the Turkish Ministry of Health (MoH) with support from the IFI community, including the World Bank and the EBRD, developed the Integrated Health Campuses PPP Programme (Programme). This ambitious Programme is designed to deliver up to 29 new hospital facilities totalling 42,000 high-quality hospital beds over the next several years. To date, 11 hospitals have reached financial close, several more are awarded and nearing financial close, and the first three hospitals have completed construction.

[1] *Note: Subsequently, in March 2017, Moody's changed the outlook on the Turkish Government's Ba1 sovereign rating to negative from stable, but maintained the stable outlook on the Elazig Issuer (ELZ Finance) with a rating of Baa2.*

The hospital PPPs under the Programme are structured as design, build, finance and maintain (DBFM) 3+25 year project agreements for facilities management. Core medical services remain under the responsibility of the MoH. The project agreement entails: (i) an availability based revenues stream in Turkish Lira from the MoH with suitable inflation and FX protection mechanisms; (ii) a capped deduction regime for both availability and service payments; and (iii) a favourable termination compensation regime providing full coverage to lenders in all termination scenarios, including Project Company default, force-majeure and expropriation.

The Elazig PPP aims to deliver a 1038-bed integrated health facility which includes a general hospital, women/maternity and paediatrics hospital, and psychiatric hospital as well as a 60-unit oral and dental health clinic, all situated in Merkez County in Elazıg Province in Eastern Anatolia. Under the project agreement, upon completion, the Project Company will provide hard and soft facilities management services, as well as clinical support services including laboratories, imaging, sterilisation and disinfection and rehabilitation for the Elazig PPP, which will serve Eastern Anatolia, with a combined population of 1.6 million people, covering Elazig, Malatya, Tunceli and Bingol provinces. Clinical and health care services will remain within the remit of the MoH.

The Elazig project, which closed on December 22, 2016, is notable for its use of innovative financing structures and credit enhancements resulting in the issuance of bonds with an investment grade rating (Baa2 by Moody's) which is two notches above Turkey's sovereign rating. This rating was possible thanks to the risk mitigation scheme developed jointly by MIGA and EBRD. The combination of MIGA's political risk insurance and EBRD's unfunded liquidity facilities proved crucial in enabling the project bond rating to pierce the sovereign ceiling by two notches. The project has drawn the attention of other IFIs who are seeking to provide credit enhancement to projects that are located in countries with below investment grade sovereign ratings as well as institutional investors who are looking for new ways of investing in infrastructure assets in emerging markets.

## THE CRITICAL ROLE OF THE CAPITAL MARKETS

Accessing the bond market was the key aim of Meridiam Eastern Europe S.a.r.l. and Ronesans, the majority owners of the Elazig Hospital PPP consortium (which also included Sila Group, TTT Saglik and Sam Yapi), when they elected to work with EBRD and MIGA to develop this innovative funding approach. Although previous hospital PPPs had been financed exclusively through loans, the sponsor consortium wanted to use capital markets to demonstrate the ability to tap into new investor classes, including institutional investors.

The timing of the transaction was challenging: throughout 2016, as a consequence of the country's political and economic uncertainties, both Moody's and Standard & Poor's had downgraded Turkey's credit rating.

## PROJECT TIMELINE

**Key dates in the procurement timeline are shown below:**

**September 2010**
The MOH issued a request for qualification for the project

**September 2011**
The MOH received a single final proposal from a consortium comprising Sila Group, Senturkler Holding and Medical Park

**July 2014**
Project agreement agreed between MoH and the project sponsors

**March 2015**
Sponsors start discussing credit enhancement

**November 2015**
Indicative rating assessment commenced

**November 2016**
Final Baa2 rating to A1 Bonds assigned by Moody's

**December 2016**
Financial close

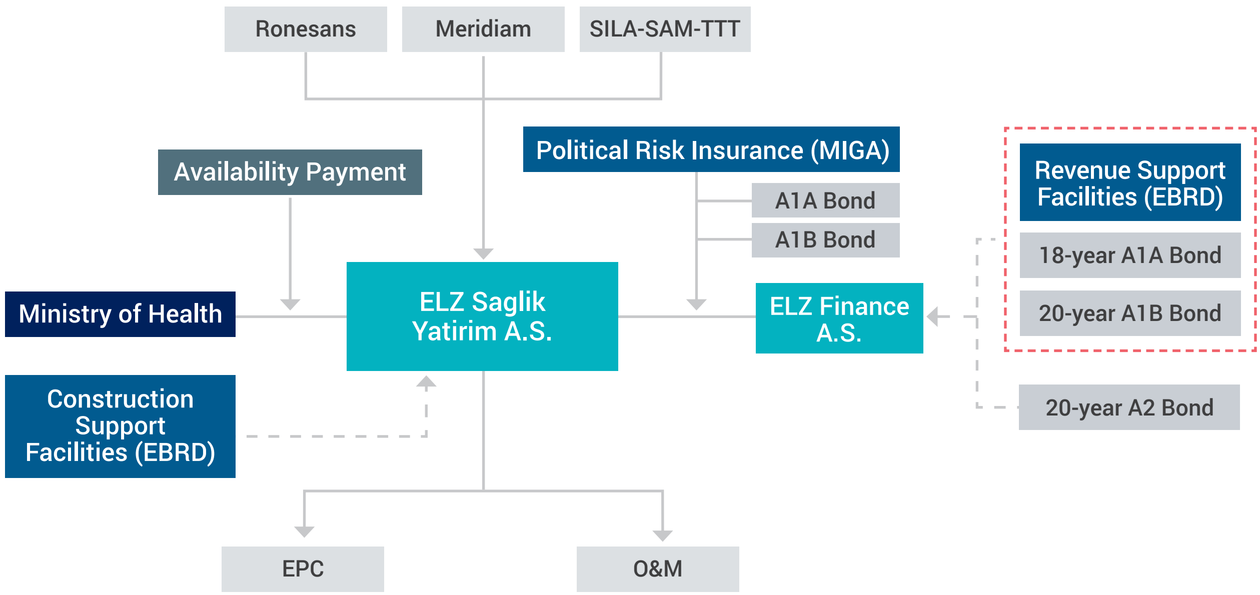
## OVERVIEW OF THE RISK MITIGATION STRUCTURE

An investment grade rating was critical to the bonds' successful placement. Two constraining factors were counterparty risk of the EPC Contractor and the MoH. Although MIGA's political risk insurance addresses key political risk, lengthy claims periods until arbitral award resulted in a need for additional support to backstop debt service until final compensation could be paid.

Rather than provide a wrap for the entire bond, EBRD and MIGA, using the complementary features of their products, were able to address key risk to provide the needed credit rating uplift.

## CONTRACTUAL STRUCTURE

The diagram below illustrates the main contractual components of the project structure.




## FINANCING STRUCTURE

Financing for the €360 million project comprised senior debt of €288 million and equity of €72 million. Senior debt was issued in the form of bonds by ELZ Finance (the Issuer) and the proceeds on-lent to the Project Company under a typical Issuer-borrower arrangement.

The €288 million privately placed, Euro-denominated fixed rate long-term project bonds were structured in two tranches, and issued in Luxembourg. Junior funds are provided by the project's shareholders.

The €288 million project debt comprised:

- €83 million in 18 year senior secured A1A Bonds
- €125 million in 20 year senior secured A1B Bonds
- €80 million in 20 year secured A2 Bonds

The bonds were issued as deferred draw feature bonds enabling the issuer to draw the funds gradually during construction as funds are required, thereby lowering financing costs.

The A1 Bonds have the benefit of EBRD liquidity facilities and the MIGA political risk insurance guarantee (see following section). MUFG acted as bookrunner and HSBC as lead arranger. International Finance Corporation underwrote the A2 bond, which remained unenhanced.

## SUMMARY OF A1 BONDS

| FEATURE | A1A BONDS | A1B BONDS |
|---|---|---|
| **Principal** | €83 million | €125 million |
| **Maturity Date** | 2034 | 2036 |
| **Issue Date** | 2016 | 2016 |
| **Credit Rating** | Baa2 (stable) | Baa2 (stable) |
| **Environment, Social and Governance** | Green and Social | Green and Social |

## THE RISK MITIGATION SCHEME PRODUCT EXPLAINED:

### Political Risk Insurance Guarantee – MIGA

MIGA provided a 20-year political risk insurance guarantee for the benefit of the project's A1 Bonds that is designed to mitigate the risks of:

(i) currency inconvertibility and non-transferability;

(ii) breach of contract; and

(iii) expropriation.

### Subordinated Liquidity Facilities – EBRD

As part of the credit enhancement, EBRD provided two undrawn contingent subordinated liquidity facilities totalling a combined €89 million. These EBRD facilities comprise:

1) Construction Support Facility (CSF) during the construction period via a Letter of Credit to provide timely liquidity to the EPC Contractor in certain events, including construction delays, replacement costs and senior bond recovery in the event of termination during construction. The CSF, sized at 15 per cent of the EPC's Contract value, mitigates EPC Contractor counterparty risk during the construction phase by providing an unfunded liquidity facility issued in a form similar to a standby letter of credit for the benefit of the Project Company on behalf of the EPC Contractor. The CSF can be drawn to fund any breach by the EPC Contractor of its payment obligations towards the Project Company under the EPC Contract, most likely to occur in the event of: (i) liquidated damages arising out of construction delays, (ii) EPC Contractor replacement costs; and (iii) senior bond recovery in case of termination due to EPC Contractor default.

2) Revenue Support Facility (RSF) covers debt service and other costs under certain circumstances during the operational period in the event of MoH non-payment. The financing structure includes a subordinated, standby revolving facility that functions in a form similar to a debt service reserve facility, ensuring timely debt service in case of MoH default on its payment obligations. The RSF is sized to provide approximately three years debt service on average to complement MIGA's political risk insurance by servicing debt payments to bridge MoH's obligations or prepaying bondholders until the arbitration process is completed, after which MIGA honours its payment obligations. As the EBRD risk mitigation only covers counterparty non-payment risk, the RSF cannot be used to support debt payments in case of cash flow shortfalls arising from operational and underperformance reasons.

## MOODY'S RATING

In November 2016, Moody's assigned the A1 Bonds with an investment rating grade of Baa2 with a stable outlook. Moody's stated that the rating is mainly the result of the two credit enhancement products: the MIGA political risk insurance guarantee and the EBRD liquidity facilities.

Moody's stated that other factors supporting the rating are:

(i) the availability-based scheme that protects the revenue-stream from price or volume risks;

(ii) a favourable compensation regime for senior debt on termination including in cases caused by the Project Company;

(iii) strong financial metric and debt service coverage ratio compared to peer projects;

(iv) standard project finance and PPP features, further supporting predictability of the debt service;

(v) no major constraint on construction and work schedule.

## JOINT IFI SUPPORT OF THE PROGRAMME AND SCALABILITY POTENTIAL OF THIS RISK MITIGATION PRODUCT

EBRD and MIGA's joint risk mitigation scheme product is one step forward demonstrating the commitment of IFIs to work together to address the infrastructure gap and to try to crowd in private capital. A key aim of EBRD and MIGA will be to replicate the product in other PPP markets and to promote its standardisation and replication.

While Elazig Hospital PPP is the first project to benefit from the support of this product, the product could also work in other markets particularly where:

- → the PPP project is located in an emerging market country with a sub-investment grade sovereign rating 1-3 notches below investment grade. There are currently 20 emerging market countries in this range. Given fiduciary rules governing institutional investors such as insurers and pension funds that preclude investment in sub-investment grade projects, uplifting PPPs to investment grade will be required to attract such investors to participate in projects;
- → there is public sector counterparty risk and strong project fundamentals backed by well-defined availability-based schemes and transparent termination regimes. This may include projects in the transport and power sectors.

While the product was used for a greenfield project, the CSF and RSF can be used separately, enabling the product to work for both greenfield investments and brownfield projects requiring refinancing.

The risk mitigation scheme product used for the Elazig PPP represents a breakthrough in the way it addressed gaps in the existing toolkit of credit enhancement products used by IFIs.

Finally, such unfunded facilities of this type can also address IFIs' balance sheet constraints while leveraging the participation of private market funding from institutional investors, a critical factor in the goal to close the infrastructure financing gap.



Global Infrastructure Hub

**Office Address**
Level 23, 68 Pitt St
Sydney NSW 2000

**Postal Address**
PO Box R1947, Royal Exchange
Sydney NSW 1225 Australia

**Tel** +61 2 8315 5300
**Email** contact@gihub.org
**www.gihub.org**