Projects & Procurement - Turkey

Infrastructure investment through private equity funds

Contributed by **Bilgiç Attorney Partnership**

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Authors

Ekin İnal

Hasan Alper Tüzün

Introduction

As an emerging economy that has embarked on major infrastructure projects, Turkey is exploring alternative ways to fund these projects. Traditionally, they have been predominantly financed by bank debt (including foreign, domestic, and multilateral sources). Among recent large-scale investments, the third bridge over the Bosphorus Straits in Istanbul has been financed by a syndication of seven banks under the build-operate-transfer model, Turkey's first nuclear power plant in Akkuyu is being financed by a syndication of 26 domestic and foreign banks, and the public-private partnership model is being used in healthcare investments such as the Isparta City Hospital project.

However, there are questions about whether there are limitations to bank debt financing in a setting with such a large number of landmark infrastructure projects. Following the recent establishment of a new legal framework, private equity investment funds can prove to be an alternative tool for financing the construction and development of future infrastructure projects. With a flexible fund structure and tax advantages, investment funds specialised in infrastructure run by skilled and experienced managers could attract both domestic and foreign investors looking to diversify their portfolio of investments.

Managing private equity investment funds

Private equity investment funds are regulated by the Capital Markets Board's Communiqué on Principles of Private Equity Investment Funds (III-52(4)), promulgated under the Capital Market Law (6362). The Capital Markets Board has adopted a flexible fund structure based on the Luxembourg, Netherlands and Guernsey models.

A 'private equity investment fund' is defined as a pool of assets without legal personality, which is established and managed by a portfolio management company or private equity portfolio management company – both entities are regulated by the Capital Markets Board – based on the principle of fiduciary ownership. Participation units in private equity investment funds can be sold only to qualified investors. Private equity investment fund assets enjoy ring fencing (ie, assets enjoy immunity from confiscation, interim injunctions and bankruptcy).

Private equity investment funds are established with a fund constitution and are represented by the board of directors of the founder. After registration of the fund constitution, the founder must apply to the Capital Markets Board for the issue of participation units. Unlike a share certificate, a participation unit has no nominal value. The value of a unit is calculated yearly by dividing the net asset value of the private equity investment fund by total units outstanding. No public marketing of participation units is allowed; they can be sold only to qualified investors – defined by Capital Markets Board regulations as institutional investors with a portfolio exceeding TRY1 million (approximately $400,000) – and also to 'angel investors' which hold an individual participation investor licence issued by the Treasury. The minimum amount of commitment in a private equity investment fund is TRY5 million (approximately $2 million). This amount must then be invested in permissible investments (which are defined in the communiqué) within a year. To permit the founders to align their interests with investors, the communiqué allows the founders to acquire up to 20% of the participation units.

Investors may exit by selling their units to the private equity investment fund for cash. However, if stipulated in the fund's documents, redemption may be limited to termination of the fund or delayed by the private equity investment fund if there is insufficient liquidity, or if divesting the fund's portfolio interests is not economically feasible.

A founder may delegate the management of a private equity investment fund to another private equity portfolio management company. Managers may charge fees to the fund, which are set out in the fund documents. The communiqué provides for flexibility in relation to various key fund terms, including the closing date, distribution waterfall and investment and divestment periods.

Funds will be terminated in the following circumstances:

- on the date specified in their constitutions;
- upon the founders' loss of eligibility;
- deterioration of its financial status;
- bankruptcy;
- insolvency;
- inability of the fund to fulfil its own financial liabilities; or
- if the Capital Markets Board determines that the fund's existence would not benefit investors.

Investments

The communiqué includes a broad list of investments that can be undertaken by private equity investment funds. Target companies must have potential for growth and must be in need of financial, managerial or technical resources or assistance. The communiqué also includes a list of prohibited investments, such as investments in commodities, short sales or derivative transactions (other than risk hedging). The target company must be a limited or joint stock company established under Turkish law. Limited companies must be converted into joint stock companies within a year of the initial investment by the private equity investment fund.

Private equity investment funds may:

- establish target companies;
- directly or indirectly acquire shares of target companies;
- invest in debt instruments issued by target companies or participation units issued by other private equity investment funds;
- invest in shares of companies listed on the Emerging Companies Market of the Istanbul Stock Exchange; and
- provide mezzanine financing to target companies.

Other than these types of private equity investment, a private equity investment fund portfolio may also include certain investment vehicles (ie, permissible investments) listed exhaustively by the communiqué, including:

- shares of joint stock companies – including those in the privatisation programme;
- public and private debt instruments;
- foreign public and/or private debt instruments or equity;
- bank deposits;
- investment funds; and
- warrants and certificates.

At least 80% of total fund value must be comprised of private equity investments. However, if investments in small and medium-sized enterprises exceed 10% of the fund's total value, the required private equity investment percentage is 51%. A grace period of one year may be requested if a private equity investment fund fails to comply with this requirement.

Financing

Private equity investment funds are allowed to use bank debt not exceeding 50% of the total value of the fund. A fund's assets can be encumbered, although a general rule protects them from enforcement and bankruptcy. The consequence of a default on a secured loan therefore remains unclear.

Tax advantages

Income from a private equity investment fund is fully exempt from corporate tax. Investors in a fund may also deduct the amount of their investment from their tax base up to a cap of 10% of their taxable income in the case of both individual and corporate taxpayers and 20% of the taxpayer's shareholder equity in the case of corporate taxpayers.

For further information on this topic please contact Ekin İnal or Alper Tüzün at Bilgiç Attorney Partnership by telephone (+90 212 386 1305) or email (einal@bhukuk.com or atuzun@bhukuk.com). The Bilgiç Attorney Partnership website can be accessed at www.bhukuk.com.

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