Projects & Procurement - Turkey

Turkish government's debt assumptıon programme

Contributed by **Şahbaz Attorney Partnership**

September 02 2014

Author

Ekin İnal

In an attempt to increase the bankability of big-ticket projects, the government has promulgated a regulation(1) on foreign debt assumption by the Treasury. This is expected to help overcome financial issues in largescale energy and infrastructure projects, such as the third bridge project in Istanbul, and healthcare public-private partnership projects undertaken in different cities.

The Treasury's assumption of foreign debt was first introduced in 2010 for certain public entities. It was then extended to build-operate-transfer (BOT) and build-lease-transfer (BLT) projects that exceed a certain threshold, through an amendment to Public Finance Law 4749. Accordingly, in case of early termination of the implementation agreement in a BOT or BLT project, the Treasury may take over the project company's outstanding financial obligations, either partially or in full, including derivative instruments. To qualify for debt assumption, the minimum investment amount must be TRY1 billion in BOT projects (approximately $465 million) and TRY500 million ($232 million) in BLT projects.

Debt assumption is available only for public entities with a special budget or those within the master budget (eg, the Ministry of Health). Thus, debt assumption is not available for the third airport project in Istanbul, as the General Directorate of State Airports Authority (the tendering authority) is not one of these public entities.

Process

Debt assumption is agreed under a separate agreement signed by the Treasury, the project company and lenders.

Project-awarding public authorities must file a written request with the Treasury if they wish the project to include a debt assumption guarantee. The request must be submitted before the tender announcement is made. The public authority must have no outstanding debt to the Treasury.

The Treasury and the Council of Ministers must approve the scope and terms of the debt assumption, which then becomes part of the tender documentation. The regulation specifically states that the debt assumption agreements will not be published in the *Official Gazette*, which has caused some controversy. In response to criticism, the Treasury has issued a press release stating that disclosure of the terms of debt assumption would compromise its negotiating position in future projects.

What does debt assumption cover?

The debt assumption becomes effective upon termination of the implementation agreement and expiry of the timeframe under the debt assumption agreement. It covers the project company's outstanding foreign debt and other financial obligations and costs, including any derivative instruments purchased to obtain the debt (eg, interest rate or currency swaps). The debt assumption agreement will detail the scope of financial obligations and costs to be assumed. The regulation also states that it does not cover equity or cash-flow financing, or any increase in costs incurred due to the project company's fault.

The debt assumption may cover outstanding interest payments (contractual and default) if the shareholders of the project company provide the Treasury with a joint and several guarantee of no less than the highest instalment to be paid under the loan agreement plus 10%.

The Treasury may also assume the refinancing of the existing loan, subject to the Council of Ministers' approval.

Although project bonds are not excluded from the scope of debt assumption, they are not explicitly covered either. Both the Public Finance Law and the regulation were drafted to apply only to bank financing. It is therefore assumed that debt assumption does not encompass less conventional financing tools, such as project bonds.

Amount of debt assumption

The Public Finance Law states that debt assumption may be partial or full, without providing any further guidance. The regulation provides that debt assumption will cover 85% of the financing in case of termination due to the project company's fault and 100% of the financing in case of termination for any other reason, together with 100% of the financing costs in each case.

The amount of obligations arising from derivative instruments must not exceed 10% of the total financing. The Treasury will determine the exact amount up to this threshold.

The upper limit of debt assumption by the Treasury in a given fiscal year is specified in the Budget Law. However, the Council of Ministers may double this amount. In 2014, the upper limit is $3 billion.

Following termination, the exact amount of debt assumption is notified by the lenders to the Treasury. The Treasury, at its sole discretion, may choose to repay the debt in accordance with a repayment schedule or make a lump-sum payment.

Existing projects

The regulation exempts projects which were launched as at December 2012 from the thresholds set out in the regulation. Accordingly, partial debt assumption by the Treasury and the debt assumption upper limit will not apply to these projects. This gives the government extensive leeway to offer full debt assumption to existing big-ticket projects, without being subject to the budgetary threshold.

Comment

Although it has been heavily criticised for compromising fiscal discipline, the regulation demonstrates the government's willingness to continue with its ambitious growth agenda at any cost. The government also seems to have learned from past experience, when tenders for the privatisation of power and gas distribution assets were cancelled because bidders failed to secure financing. It remains to be seen how foreign lenders will react to this further step and whether it will be sufficient to overcome the international 'credit crunch'.

For further information on this topic please contact Ekin İnal at Şahbaz Attorney Partnership by telephone (+90 212 386 1305), fax (+90 212 269 3835) or email (einal@cshukuk.com). The Şahbaz Attorney Partnership website can be accessed at www.cshukuk.com.

Endnote

(1) Regulation on Turkish Treasury's Debt Assumption 28977, promulgated in the *Official Gazette* (April 19 2014) .