

# Waiting on New Cairo

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The bidding process for the 250,000 m3 per day New Cairo waste water treatment plant (WWTP) was completed in May and attracted strong interest from both international and domestic companies vying to become the first entrants into the Egyptian PPP market.

The £2.646 billion (\$472 million) project is the first of a series of waste water treatment facilities, drinking water desalination plants and toll roads, as Egypt moves to put PPP at the heart of its infrastructure plans. The pathfinder project has NSGB as financial advisor and will be banked as a club deal with possible multilateral involvement.

With a population of eighty million, the potential for the PPP market is sizeable and interest from foreign sponsors is high, as illustrated by the strong mix of local and international names bidding on New Cairo, which was won by a joint venture of local company Orascom Construction Industries and Aqualia, the water subsidiary of Spanish group FCC (they each hold 50% of a special purpose vehicle known as Orasqualia).

Orasqualia beat three other consortia, and during the pre-qualification stage and final tenders local groups teamed up with international players such as Passavent-Roediger, Befesa, Emasesa, Veolia Water, Mitsui, Babcock & Brown, Berlinwasser, Marubeni and Biwater.

## Lengthening debt tenors

Whilst sponsor equity is not going to be a major hurdle for the development of the Egyptian PPP market, on the debt side the market is more difficult. Locally denominated lending is usually at quite short tenors, and falls well short of the typical 20- to 25-year concession period for PPPs before eventual transfer of ownership back to the Egyptian state.

The domestic bond market is also underdeveloped, and local sovereign issuance is typically in the one-to-four year range. Proponents of PPP would like to see pricing benchmarks created, via the issuance of long-term 15- to 20-year domestic government bonds, and the establishment of an Infrastructure Finance Facility Company (IFFC) to provide long term local currency funding and enable project developers to hedge against exchange rate risk. The basic concept of the IFFC is that investors such as insurance companies and pension funds will buy long term bonds from the banks, giving them access to refinancing for long term deals such as PPPs.

"The challenge for Egyptian banks is that there are few precedents for long-term project lending, and a lack of pricing benchmarks. Large projects have historically been financed in dollars, and a deal like the New Cairo PPP, where tenors could be pushed out to 15 years, is the first of its type," says Tim Armsby, partner at law firm Trowers & Hamlin in Cairo.

"The waste water treatment PPPs are structured with bidders calculating a fixed quarterly sewage treatment charge denominated in Egyptian Pounds. There will however be adjustments made for inflation on an annual basis, while there is also a mechanism to reflect changing interest rates. Bank lenders would generally prefer floating rate interest, while the government wants to see fixed interest rates, and what we are likely to see is fixed interest but re-set every three years," adds Armsby.

Despite the lack of precedents, PPPs are a good lending opportunity for domestic banks, which are very liquid and on average have 50:50 loan-to-deposit ratios. Fortunately, local banks have been relatively untouched by the global banking crisis, partly because during the global boom years of 2005-2007 they were still in the process of restructuring after a previous domestic local banking crisis.

Nevertheless, the benchmark Egyptian Central Bank overnight rate stood at 8.25% in October 2009 – though it had been as high as 11.5% during 2008 – so local currency debt costs will be considerably higher than US dollar project loans.

There are already some positive signs of lengthening tenors in the corporate loan market. In October Al-Futtaim Commercial & Administrative Centres signed an E£2 billion 10-year senior syndicated loan to be used to build the Festival Centre shopping mall in Cairo. HSBC Bank Egypt initially committed E£400 million, Commercial International Bank (CIB) E£350 million, Banque Misr E£350 million, Arab African International Bank (AAIB) E£300 million, Banque du Caire E£300 million, Arab Bank plc E£200 million, and Misr Iran Development Bank E£100 million.

Some of the same lenders are likely to be active in PPP lending in the coming years, in addition to other big commercial banks such as National Bank of Egypt (NBE). The volume of projects planned may test their limits, though local and regional banks will be joined by the local subsidiaries of global banks: HSBC Bank Egypt has a strong E£ deposit base, as does National Societe Generale Bank (NSGB).

### **PPP programme**

PPPs are a key element of the Egyptian government's economic reform agenda. A PPP Central Unit was set up by the Ministry of Finance in 2006, and in addition to establishing an overall national policy framework it gets involved at the micro level by drafting and issuing standard project documentation, contracts and PPP laws.

The actual procurement process is still conducted by the relevant government ministry (housing, transport, healthcare), but there is draft legislation to give the PPP Central Unit greater involvement in the procurement process.

The Ministry of Finance has taken the lead in drafting the new PPP law, which is likely to be presented to Parliament during the first quarter of 2010.

"The new law is important for the development of PPP in Egypt, since it will clarify a number of issues, such as the way the tendering process is conducted, addressing the bankability of projects, and the role of the government in supporting PPP projects. The various ministries have different levels of understanding of PPP, and the new law will strengthen the role of the Central PPP Unit in the procurement process." says Mohamed Ghannam, partner at law firm Helmy, Hamza & Partners in Cairo.

In PPP deals such as hospitals, which are highly complex and very different to traditional procurement procedures, closer direct involvement of the central unit is expected to speed the process up.

Under the Five Year Plan 2009-2013, the main areas identified are social infrastructure (education & health) with 12 projects valued at \$6 billion, six waste water projects costing \$2.2 billion, and 14 transportation projects valued at \$7 billion. The overall planned total is \$15 billion over five years.

A number of other water treatment PPPs are likely to complete the tender process during 2010, in addition to deals in other sectors such as hospitals and roads.

The waste-water treatment plant for 6th October City launched prequalifying in October 2009. It involves taking over an existing 100,000 m3 per day plant and building a new 150,000 m3 per day plant, on a 25-year DBFMOT basis. The lead advisor is Ernst & Young, with a consortium of Ecroy, DHV & Chemonics Egypt as technical advisor, Trowers & Hamlins as legal advisor and Ch2mhill as environmental advisor.

A much bigger deal will follow, with invitations for prequalifications also launched in October for the Abu Rawash WWTP in the Giza Governate. This will involve upgrading the level of treatment from primary to secondary for the whole 1.2 million m3 per day capacity of the existing plants, and then operating the facility for 25 years.

Another deal moving forward is the Alexandria Hospitals PPP comprising Smouha Maternity University Hospital and blood bank, and the 223-bed New Mowassar University Hospital with neurology and urology/nephrology centres of excellence. This is a key PPP Pilot project, and falls under the Ministry of Higher Education.

The invitation to tender was issued on 19 October and final bids could be in by the second quarter of 2010. Bidders can make offers for either project or both. The DBFOM contract comprises two years for construction and 18 years for operation. Financial advisor to the government is IFC, with Mott MacDonald as technical advisor and Trowers & Hamlin as legal advisor.

In the roads sector the key pilot PPP is the 34km Rod El Farag Access road, which will connect the existing ring road around Cairo with the Cairo to Alexandria Highway. The contracting authority is the Ministry of Transport, which will sign a 20- to 25-year contract to build, operate and maintain the road. KPMG has already been appointed as the Rod El Farag transaction advisor. Prequalification is expected in Q1 2010, with final bids in Q2 and expected financial close in Q3. Bankers say that this schedule could slip, but do hope to see the deal signed by the end of 2010.

### Going forward

The initial wave of PPPs is likely to be quite conservative on leverage, and typical debt-to-equity ratios could be 70:30 or even 60:40 in some cases. Thus there will be a need for a considerable amount of equity. One encouraging sign is the interest from private equity and sovereign wealth funds. For example, Dubai-based private equity investor Infrastructure Capital Group, which focuses on both real estate and infrastructure, was a member of one of the consortia which bid on the New Cairo WWTP.

Equity investors are attracted by the good macro economic story in Egypt. GDP growth had been running around 7% for several years, and even with the global crisis is expected to come in at around 4.5% for 2009.

But the fairly rosy economic picture is complicated by a high inflation rate, which spiked up to a 19-year high of 19.7% in May 2008, though has since come down. Egypt has a sub-investment grade sovereign rating – BB-plus from Fitch and Ba1 from Moody's.

It was in December 2006 that IFC signed its first PPP advisory agreements with the government of Egypt. The New Cairo WWTP was one deal, as was the New Schools project to build and manage 300 new school facilities.

The schools deal was actually the first to be tendered, but it ran into problems and the tendering process will need to be re-activated in 2010. "It was a little bit ambitious to start the PPP market with a transaction involving 300 schools scattered all over country," is one banker's verdict. But like other market participants, he now feels that Egyptian PPP has good forward momentum going into 2010.

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