Bad timing

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Liberalisation of Turkey's energy sector has gathered pace over the summer, with the first power grid privatization tenders following hot on the heels of Sabanci/Verbund's Eu1 billion Enerjisa portfolio financing and the announcement of substantial end user tariff increases, which should help lubricate the privatisation process.

But the tenders for the Baskent and Sakarya power grids – respectively won by the joint venture of Sabanci and Austria's Verbund, and the Akcez consortium – received fewer bids than anticipated, particularly from foreign companies, of which there were only two. There was also disappointment on the generation side, with only two companies bidding for two thermal power plant tenders in Afsin-Elbistan region with a combined investment of $5 billion. No foreign companies bid for these projects

Progress on the tendering front, while welcome, has come at a time of huge uncertainty with unresolved financing issues and the broader credit crunch being overshadowed, temporarily at least, by a political crisis that threatens the future of Turkey's ruling party and risks plunging the country into chaos. Investors are understandably jittery.

Constitutional court

Prime minister Recep Tayyip Erdogan's Justice and Development Party (AKP) has been a massive hit with Turkish voters, getting re-elected last year with an increased share of the vote. But after six years of the AKP in power, a section of the secular elite still mistrusts it for its Islamist roots. In March the country's chief prosecutor filed petition with Turkey's constitutional court to ban the AKP on the grounds that it is leading the country towards an Islamic theocracy. The petition also calls for barring Edrogan from politics as well as a further 70 AKP officials, including Abdullah Gul, Turkey's president.

Adding to the sense of turmoil, on July 14 charges were brought against 86 people for allegedly plotting a coup against the government, including several retired generals.

Against this backdrop it is unsurprising if some foreign investors feel hesitant about venturing into the Turkish market. Yet the country's energy sector nevertheless holds huge attractions for investors due to the confluence of long-standing supply constraints and demand that is soaring as the country has delivered GDP growth rates consistently around 6% to 7% over the past five years.

Energy demand is growing even faster at an annual rate of 8% and is set to double by 2016. Liberalisation is the only way for Turkey to attract the $130 billion investment in the sector that is seeking. Moreover, Turkey urgently needs to attract foreign investment in order to counteract a current account deficit that is escalating because of fuel price inflation and is expected to reach $50 billion this year. Privatisation revenues will also help to ease the government's worsening budget deficit, and the government has promised the International Monetary Fund that it will reduce its 80% stake in the country's electricity generation and transmission markets.

Responding to the disappointing response for the Afsin-Elbistan tenders, the chairman of Turkey's Energy Market Regulatory Authority (EMRA), Hasan Koktas, said the hesitation on the part of foreign companies was only a temporary response to current uncertainty, and that ultimately the economies of scale offered by Turkey's power projects would entice them back. And despite the bad news on the tendering front, there was positive news in June when Suez-Tractebel announced it had entered a joint venture partnership with Mimag-Samko to build an 800MW to 1,300MW thermal power plant with a total investment in excess of $1.5 billion.

Distribution network

The shape that future power project financings will take in Turkey is highly dependent on the privatization of the electricity distribution companies; a major impediment at present to securing power purchase agreements is the transitional state of the network's ownership.

The state-owned electricity distribution company TEDAS, which in 2007 had a 98% market share across Turkey, has been broken up into 21 companies, each corresponding to different regions, with the intention of auctioning them off on 40-year Transfer of Operating Rights concessions. A previous round of liberalisation in 1993 broke Turkey's state-owned energy utility into two companies – TEDAS and TEAS, the latter being responsible for generation and transmission. In 2003 TEAS was broken up further into three companies. One of these companies, TEIAS, will retain ownership of the transmission network. The tenders require the winning bidders to invest large sums at the beginning of the concessions to upgrade the existing system to increase capacity.

On July 1, auctions were held for the first two distribution companies, Baskent in the centre west and Sakarya in the northwest of Anatolia. Sabanci/Verbund's winning bid on Baskent was $1.225 billion and the Akcez consortium, which comprises the Turkish company Akkok and the Czech company CEZ, won the Sakarya concession with a $600 million bid. Although both winning consortia included foreign investors, there was disappointment that they were the only foreign companies bidding. Eight had pre-qualified for privatization in 2006 (the sales were initially planned for 2007 but were delayed by the elections), including the energy giants AES, E.ON, Enel, Iberdrola and Suez-Tractebel.

It is widely thought the cause of this reticence is Turkey's political uncertainty, though it has also been suggested that the caution partly stemmed from unease over the tariff regime during the transitory period lasting until 2010 when liberalisation kicks in. End user tariffs have been heavily subsidised in Turkey, but in the last week of June EMRA approved large tariff increases of 21% for consumers and 22% for industry. If the price hike came too late for the first round of tenders, the transition period tariffs shouldn't be such an obstacle for the next round.

The bids were not underwritten and the process of getting the deals banked now begins. This is where the political turmoil distracts from some of the deeper underlying uncertainty surrounding the deal. With the lack of clarity over what tariffs would prevail during the transitional period, and also grumbling from some quarters that the concession terms are not sufficiently appealing for investors, not to mention the credit crunch, it may be that some companies have been holding off to see whether the sales are bankable before committing themselves to future tenders.

Although Turkish officials have publicly expressed confidence that more foreign companies will be involved in future auctions, the disappointment that there weren't more bidders in the first two will likely run deep as the concessions were among the more attractive ones on offer. Baskent has 2.08 million customers and supplies 8,041 GWh in the region that includes the nation's capital Ankara. Sakarya, which has 1.3 million customers and supplies 4,134 GWh is smaller but has the added attraction that it is supplying Turkey's most important and fastest growing industrial area.

Next up in the process are Meram, located in central Anatolia, and Aras, in the east, which have a final bid date of September 15. The initial indication is that the tariff increase may have succeeded in luring back foreign investors as 23 companies have pre-qualified for the two tenders, including Suez-Tractebel, which bid for the Meram grid, and a bid for Aras from Russia's Inter RAO, which was reported to be interested in one of the Afsin-Elbistan plants but failed to make an offer. Also pre-qualified is Sabanci/Verbund, which is bidding on both tenders.

However, the proof of whether the market has got over its jitters will come when final bids are made in September, by which time the situation should be clearer on the political front.

Announcements haven't been made for when the remaining companies will be tendered, and it is likely that some might end up remaining under public ownership. Before the privatization was postponed at the beginning of 2007, Istanbul was also to be included in the first slew of tenders. However, since then it has become a buyer's market and Istanbul is now being held back in the hope of getting a better price in the future. The government had hoped to raise $10 billion out of the Istanbul distribution network sale, though that is now looking optimistic now.

Aras Electricity Distribution, by contrast, was not one of the companies slated for the first slew of privatizations in 2007, and is the least attractive of the first companies on offer, being situated in an undeveloped part of the country.

Coal and hydro

Turkey's energy sector privatizations are not restricted to the distribution networks, however. When TEAS was broken up in 2003, another company formed was EUAS, the generating arm of the utility, which owns 103 hydroelectric power stations and 19 thermal power stations. The government also intends to sell off some of these plants, though media reports say it intends to keep the larger stations in public ownership as a means keeping electricity prices down.

Around 50% of the country's generating capacity is currently in the form of gas-fired plants, something that is becoming increasingly problematic given inflation in the sector. Consequently, the emphasis in Turkey's new generation capability is for renewable sources and fuel sources that can be obtained domestically. The government hopes to develop a wind turbine construction industry so that it can develop 15,000MW of wind capacity, but for the moment the main focus is on coal and hydroelectric power.

The Afsin-Elbistan region is where 40% of Turkey's lignite reserves are located, and lignite will be used to fuel the two thermal power plants that have been tendered in the region, which will each generate 200MW. Park Teknik and Akfen have bid for power plant C, while only Akfen bid for plant D.

Again, getting the projects banked is likely to represent a challenge, especially given the amount of financing that has to be raised – $2.5 billion for each project. While the regulator may have put the lack of bids down to the political crisis, it should be noted the projects were first tendered in 2007 but received not bids at all so had to be retendered. The small number of bidders could equally be down to the market not rating the projects as strong enough.

However, unlike independent power projects in Turkey, power plants tendered by the government, like the ones in Afsin-Elbistan, plus those that will be sold off as part of the privatisation programme, have the advantage that they will have power purchase agreements put into place with TETAS, the state-owned power wholesaler, and third companies formed after the TEAS.

A further lignite-fuelled thermal power plant based in the eastern Bingol-Karliova provinces is to be tendered in October. By contrast, the Suez/Mimag venture will source high-grade coal from abroad for its thermal power plant. Several possible locations have been identified, and the SPV set up for the venture – owned 90% by Suez, 10% by Mimag – will start applying for permits in the coming months. The project is scheduled to be operational by 2013.

But the most significant recent development in power generation, however, has been the closing of Sabanci/Verbund's Eu1 billion financing for the 1.9GW Enerjisa portfolio comprising 10 hydroelectric and one gas-fired thermal power plant (see Deal Analysis in this issue for details). Sabanci/ Verbund plan to have 5GW of installed capacity by 2010.

Given how active Sabanci/Verbund have been in the early tenders for the distribution networks, the partnership gives an early indication of how the power sector may shape up after full liberalisation takes effect in 2010. At present, the uncertainty surrounding the distribution networks means that it is difficult for power projects to secure power purchase agreements, and although the booming demand for energy means that sponsors are willing to take on merchant risk, it makes acceptable term and pricing much harder to secure. But beyond 2010, if the privatization proceeds smoothly, it is likely that vertically integrated energy companies will be able to negate some of the merchant risk by sourcing output from their generation facilities to their distribution networks.