Sulaibiya

01/02/2003

Middle East Water Deal of the Year 2002

Kuwait witnessed its first use of the build-operate-transfer (BOT) model in 2002. The KD114 million ($377 million) Sulaibiya wastewater and reclamation financing set a precedent in the region, not only for its innovative financing, done solely in regional currency, but also for its size. It is the largest project of its kind in the world. Sponsors Al Kharafi and Ionics achieved a robust 25-year financing package and a long concession from the Ministry of Public Works of 27 years.

National Bank of Kuwait, Bank of Kuwait and Middle East and Middle East Bank will provide each debt of KD38 million with a margin of 200bp over kibor. They are also underwriting the project. The debt to equity ratio is 85/15. Al Kharafi (75%) is a family-owned multi-million dollar Kuwaiti group. Ionics (25%) is a US publicly-traded company. Financing has not been syndicated and the current loan will be kept in place instead of refinanced. Sulaibiya dealt with many innovative and challenging issues. It benefits from a new kind of technology called ultra filtration reverse osmosis (UF-RO), pioneered recently by Ionics. UF-RO uses a new process so thorough that brackish water can be converted into drinking water ? although it will not be used for this purpose. This was a groundbreaking development for a region of limited natural resources. It is also the largest of UF-RO technology in the world. Three 25km pipelines will carry wastewater from the city to the plant. Project company Utilities Development Company (UDC), led by George Labib, has been set up to manage and execute the project, while Al Kharafi and Ionics have negotiated a fixed price turnkey EPC contract with the SPC. Construction began on the plant late last year and is expected to be complete within 2.5 years. Once operational, Kuwaitis will be supplied with an additional 375,000 cubic metres of brackish water per day. Of this amount, payment for 300,000 cubic metres (or 80%) of incoming water is guaranteed by the state. Lenders found significant comfort with this arrangement, seeing it as a security package on variable water inflow. Production volume will also be subsidised by the government in cash. The most significant risk to the project are during the construction period, when, as George Labib of UDC explains: ?Banks are unsure as to whether plants will operate as planned ? whether they will have the capacity to cope with large production. We signed agreements early on to secure our supply contract.? The complication of particularly large pipes, three each stretching to 25km in length, adds to the risk. Well-established German contractor Philipp Holzmann is undertaking construction with Al Kharafi and ILF designed the plant. It should come into operation in 2005. The supply contract was secured by the shareholders not the project company at first, and then transferred to UDC. Labib of UDC continues: ?Another consideration was the security package. This was resolved with a security agent bank. You cannot have security on facilities without owning the land ? normally the security is on the asset. The Sulaibiya pipelines were under the jurisdiction of public property, so banks resolved this in the best way possible ? the security down on the commercial name of Utilities Development Company. The mortgage is on the special purpose vehicle (or SPV) as an entity, not as physical assets. This was the best way forward under Kuwaiti law.?The contract is similar to a UK PPP contract, with terms and conditions such as availability and performance included, and the concessionary has a 27-year term. UK's United Utilities group came on board during the concession period to operate and maintain the plant with Utilities Development Company. Graham Parker at NBK explains the issues lenders had to consider. He says: ?From a bank's point of view the main challenges were the length of the facility ? a 25 year financing. We were able to provide this in local currency, which was a major factor. It would have been impossible to hedge otherwise. Also it was important that local banks were able to fund it themselves. This is a breakthrough for lenders. We have proven that the regional market is changing, and that local banks are more mature and competent.? The regional currency, the Kuwaiti Dinar, has been kept instead of being swapped into US Dollars. As there is no long term forward hedging for domestic currency, matching projected revenues to an international currency would have been near impossible. Labib adds: ?UDC is the first SPV that got real project financing in the sense of project finance, not corporate finance. Having a BOT model was a challenge ? normally the project company would sourcs resources from the shareholders. But Al Kharafi and Ionics have great experience of the BOT model outside of Kuwait, and it is the strength of these two companies that has given lenders comfort.?Revenues on the Sulaibiya plant have been predicted at about $2 billion.

Utilities Development Company

Status: closed 24 June 2002

Size: $433 million

Location: Sulaibya, Kuwait

Description: BOT financing of a wastewater and reclamation plant in Kuwait.

Sponsors: Al Kharafi and Ionics

Debt: KD114

Arrangers: National Bank of Kuwait, Bank of Kuwait and Middle East, and Middle East Bank

Tenor: 25 years

Margin: 250bp over Kibor

Lawyers to the lenders: International ? Shearman & Sterling. Local ? Al Bader and Al Essa

Lawyers to the sponsors: Allen & Overy

Technical advisor to the lenders: Halcrow

Technical advisor/construction managers to UDC: CDM, KEO International

Insurance advisor to UDC: Arab Commercial Enterprises

Insurance advisor to lenders: Willis

Auditor: PKF

Construction: United Utilities/UDC and Philipp Holzmann

Plant design: ILF

Financial advisor: ABN Amro