Ajman - the Middle East's first wrapped refinancing

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The Arab emirates have a growing reputation as an investment hotspot - and the tiny city-state of Ajman is no exception. But business conditions are not quite yet optimal - it took a hastily concluded refinancing to save Ajman's wastewater project from antagonism and arbitration

Ajman was from the outset a groundbreaking enterprise - for the first time in the Middle East, a public service would be provided through government partnership with the private sector.

A first glance, PPP seemed an odd model for a cash-rich oil producing nation. But rentier states built on commodity surplus are more often than not home to fairly nebulous financial systems - nepotism, commission payments, kickbacks and all the vagaries of *wasta* (patronage) capitalism do not always make for efficient project management.

Unlike the neighbouring emirate of Sharjah, which has opted for the more traditional approach of financing projects from its own balance sheet, the Ajmani government was quick to identify the value for money PPP could bring.

Nor is it coincidence that wastewater was the object of the region's first public private enterprise - it was the perceived knock-on effect of a reliable wastewater system, rather than any inherent virtue in the project itself, that was the main reason for choosing PPP.

The government realised that good infrastructure would result in higher property prices and - just as important - cleaner beaches to pull in the tourists.

The first deal

The most salient feature of the initial Ajman financing was its reliance on the consumer. It was to be the latter - rather than the government - who would foot the bill. The appeal to policy makers of such an arrangement is clear; the pitfalls, however, were not. It was this meretricious aspect of the deal that was to cause its near collapse.

The first Ajman contract, signed on 19 December 2001, was an agreement between the government and a consortium of Black & Veatch and Thames Water to build a centralised piped wastewater collection and treatment system to provide services to the city's resident's.

Black & Veatch would lead construction, with Thames Water holding a 25-year post-construction maintenance contract, from which it was projected to gain US$450 million.

Total project value was US$140 million, including an initial equity stake of US$38 million. A further US$77.5 million was privately financed, with the remaining US$24.5 million to be recovered in connection fees. A 14 year deal Hypovereinsbank, Bayerische Landesbank, United Arab Bank and Mashreq Bank (the local currency agent) was signed in January 2003 at 2 per cent above LIBOR.

Where it all went wrong

The project had not advanced far before the lenders began to have misgivings. Their main gripe was the sporadic flow of revenue - property owners, whose upfront fees for connection to the system were to finance construction, were not paying up.

The root of the problem was twofold. First, the government was showing reluctance to enforce payment. Second, the financing agreement did not provide adequately for the problems caused by unreliable revenue.

'Previous financing was very prescriptive, making no allowance for timing of revenues received,' says Jason Zibarras, of new funder ING's infrastructure finance and advisory team. 'The project was in real difficulties. There was a danger it was heading toward arbitration.'

But while financing seems to have been far from perfect, other inside sources have laid the blame firmly on the Ajmani administration. One source told *IJ News*: 'The government was not making property owners pay up. It had influence over revenue collection but failed to wield it,' .

Refinancing

With lenders making ever louder noises of dissatisfaction and arbitration looming, it was clear that if any new deal was to be reached, the first task was to abandon the policy of relying on connection fees for revenue. ING was appointed to arrange refinancing in the third quarter of 2005.

This time, the consumer was taken out of the loop, with revenue guaranteed by the government.

But with the old deal near breaking point, a straightforward refinancing was out of the question. 'The situation with the existing banks had continued for too long. Financing had to be put in place expeditiously and an innovative approach was required,' says Zibarras

'It was clear that tenor and rates were the key. We needed an improved funding structure that would have regard for the quality of the sponsors involved.'

A credit wrap was the fastest way to a new financing agreement.

The new deal was financed by an unsyndicated US$100 million credit facility from ING, guaranteed by monoline credit insurer Ambac through Ambac Assurance UK. The original lenders were repaid in full upon the first drawdown under the new facility.

Refinancing also saw a reshuffle of the consortium. Thames Water relinquished its 60 per cent holding in project company Ajman Sewerage, 40 per cent to Besix and 20 per cent to Veolia water. The remaining shares are held by Government of Ajman (20 per cent), the UAE's Six Construction (10 per cent) and Black & Veatch (10 per cent).

Operation and maintenance of the project, originally contracted to Thames Water Middle East (Germany), would now be undertaken by the newly created Moalajah company, owned 67 per cent by Veolia and 33 per cent by Besix .

Following the wrap, the project is rated A3 Stable Outlook by Moodys and BBB Stable by Standard and Poors.

Sticking points

The most pressing constraint was time, given the deterioration in relations between the parties. Wrapped refinancing is a quicker process overall; but the intricate nature of the deal meant extra work was necessary.

'You've not just got the lender but the monoline guarantee in play, which makes things more complicated,' says Allen & Overy's Shezaad Sacranie, who advised ING. 'Also, The fact that we were taking out the connection fee meant that we had to fill gaps - a lot of documentation was required, as was a lot of financial engineering.'

Speed was not all, however. Both lenders and agencies had to overcome a certain degree of reluctance before signing.

'Ambac was new to the region and needed a lot of reassuring,' says Sacranie, who sees the extra energy expended on putting a detailed case to all the risk takers as the main factor behind the success of refinancing.

Conclusion

With the PPP model wholly new to Ajman, it might have been expected that difficulties result from lack of experience and precedent. This was not really the case, says Sacranie, who explains that while there arose no legal obstacles peculiar to the case, all the usual constraints to business in the UAE still apply.

'Technically, courts in the UAE will uphold contracts signed under foreign law. In reality, they have a habit of retrying cases on their own merit under UAE law.'

In the event, it was the initial contract, which attempted to pass upfront costs directly to the consumer, that was at fault - given customers' understandable reluctance to pay for services not yet in place, this failure is perhaps unsurprising.

The specious appeal of relying on property owners for revenue blinded the initial contractors to the absence of sufficient authority - and sufficient will - to enforce payment.

The project was salvaged when new government guarantees removed the consumer risk from the equation, at a stroke providing the security that lenders require. With revenue secure, bankers could have faith in greater adherence to the construction timetable and a return on the investment, allowing credit wrapping to be pushed through rapidly.

The deal at a glance

Project Name	Ajman Wastewater
Location	Ajman, United Arab Emirates
The project	Project company Ajman Sewerage will finance, build, operate and manage the new collection network, comprising over 22 pumping stations, 225 kms of gravity pipeline and 30 kms of pumping mains. The system also includes a new 49,000 m3/d wastewater treatment plant.
The deal	US$100 unsyndicted refinancing package with A3 rated credit wrap
Initial sponsors	Thames Water, Black & Veatch, Veolia, Government of Ajman, Six Construct
New sponsors	Besix, Black & Veatch , Government of Ajman, Veolia, Six Construct
Initial operator	Thames Water
New operator	Moalajah (67 per cent Veolia; 33 per cent Besix)
EPC contractor	Black & Veatch
Project duration (Including construction)	2003 -2009 + 25 year operating agreement
Construction Stage	Under construction - scheduled for completion in September 2008
Total Project Value	US$140 million
Total equity	US$38 million (US$24.5 million to be recovered in customer connection fees)
Initial debt	US$77.5 million
Refinanced debt	US$100 million
Debt breakdown	Unsyndicated loan
Initial debt pricing	LIBOR + 200bp
New debt pricing	LIBOR + 100-150bp
Credit Insurer	Ambac
Credit Rating	Moody's A3 stable outlook; Standard & Poor's BBB stable
Debt:equity ratio	71:29
Initial Lead Arrangers	Hypovereinsbank, Bayerische Landesbank, United Arab Bank, Mashreq Bank

New sole arranger	ING
Legal adviser to sponsor	Denton Wilde Sapte
Financial adviser to sponsor	ING
Legal adviser to the government	Abbas el Neel (legal adviser to HH the Ruler of Ajman)
Legal adviser to lender	Allen & Overy
Date of financial close	20 March 2006