Qatar: Ras Abu Fontas Desalination Plant

17/04/2008

Qatar has closed the project financing of its latest desalination plant, in line with the Gulf state's pledge to invest more than US$140 billion in infrastructure before 2015.

The financial close of the Ras Abu Fontas (RAF) A1 desal plant on 13 March 2008 [Projects Database] follows a spate of recent Qatari project-financings:

- Mesaieed Power Plant [Projects Database]
- the expansion of QAFCO's ammonia and urea production facility [Projects Database]
- Qatalum aluminium plant [Projects Database]
- Qatargas4 [Projects Database]

The RAF A1 transaction stands out from these deals as the first project in Qatar's power and water sector to be co-financed by conventional and Islamic lenders.

The 45 million gallon per day water desal facility is being constructed as an extension to the existing Ras Abu Fontas power plants, around 10km south of the country's capital, Doha.

RAF A1 will be built by Italian construction firm Impregilo and - upon completion in 2009 - will be owned and operated by the Qatar Electric & Water Company (QEWC). Qatar General Electricity and Water Corporation (Kahramaa) is the off-taker.

The financing

The US$640 million project closed with a 70:30 debt-equity ratio; securing US$300 million in conventional commercial loans and US$150 million through a fully Sharia'a compliant Istisna-Ijara facility.

QEWC - advised by the Bank of Tokyo-Mitsubishi and Shearman & Sterling - provided US$190 million towards the project costs.

A total of five banks provided the commercial loans:

- Bank of Tokyo-Mitsubishi
- Royal Bank of Scotland (RBS)
- Doha Bank
- Gulf International Bank (GIB)
- Standard Chartered

Bank of Tokyo-Mitsubishi and RBS acted as book runners on the deal.

The US$150 million 20-year Istisna-Ijara loan was sourced from Qatar Islamic Bank (QIB).

QIB has successfully syndicated the loan in collaboration with Islamic banks from Malaysia through its subsidiary the

Asian Finance Bank; from the UK through its new unit, the European Finance House; and from Saudi Arabia.

Jean-Marc Riegel, QIB general manager investment banking and development group, said: "The Islamic financing tranche has been funded exclusively by full fledge Islamic banks, demonstrating that the Sharia'a compliant banking industry is maturing quickly, and that it is ready for bigger projects and longer term maturities."

Simmons & Simmons acted as legal adviser for both the banking team and Islamic financiers.

Julian Nichol, who co-led the Simmons & Simmons team with Adam Cooper, says: "On the commercial side, there are several interesting points about this deal: firstly, there is the use of the Islamic finance tranche which is the first time QEWC has turned to Islamic financing. Also, the project company, QEWC, is not an SPV; the state-owned company was really able to flex its financial muscle to raise the debt on good commercial terms.

"Plus the Water Purchase Agreement contains a put-option; if QEWC defaults on either of the loan agreements, Kahramaa can be forced to buy the desalination facility for a pre-determined price. This strong structural feature makes it a highly bankable project."

Islamic tranche

The Istisna-Ijara combination is commonly used in Islamic project financing: Islamic investors will often finance specific tangible assets in the deal as part of a larger project financing involving non-Islamic debt tranches, as in the case of the RAF A1 plant.

As Cooper explained: "This about the seventh or eighth project in a series of similar co-financings, stretching back to the Shuweihat power and water project in Abu Dhabi in 2001; it was this deal that set the precedent."

An Istisna is a form of procurement contract; under an Istisna a financier provides funds to a supplier who agrees to construct and deliver a specific asset by a certain date. The financier acquires title to the asset and immediately sells or leases it back to the supplier.

The use of an ijara - or lease - is a way for the financiers to generate a return in the post-construction phase of a project; the bank purchases an asset and leases it back to the project company.

QIB financed the construction of the RAF's three desalination units, each with a 15 million gallons per day capacity, through the 20-year Istisna-Ijara scheme.

Salah Al Jaidah, the chief executive of QIB, explained: "Istisna-Ijara is the equivalent of 'lease-to-own' schemes in conventional banking. Impregilo will build the desalination units on order from QIB over a period of 16 months, and these will be rented out to QEWC by QIB for the remaining period of 18 and a half years of the 20 year contract period."

In line with the growth of the Islamic finance sector over the last seven years, the structuring of co-financed deals has steadily improved; the RAF A1 deal is highlighted for its smooth inter-creditor process, when compared to previous deals.

As Cooper said: "Unlike its predecessors, this contract had a fully integrated common terms of agreement - a much purer way of bringing the different types of financing together."

The future

The RAF A1 facility follows the burgeoning trend for conventional and Islamic co-financed projects in the Gulf States, and also the understanding and acceptance in the traditional banking community of Islamic finance structures.

The current credit squeeze - mirroring previous times of low market liquidity - has bolstered demand for this type of financing.

Cooper recalls: "The Shuweihat deal was in syndication just after September 11; with traditional banks reluctant to lend, the project's financing had to be restructured - it was the Islamic financiers who stepped in to fill the hole left by nervous western banks.

"After 2003 there was enough liquidity in the market to reduce the need for Islamic banks, but co-financed deals still pushed through, including the UAE's Dolphin Energy, Qatargas 2 and Saudi Arabia's Rabigh Petrochemicals complex.

"Since the credit crunch there has again been a tightening in the market, a real stiffening of terms. In this climate, the role of the Islamic banks is reinforced: they represent a terrific source of available liquidity and can step in to fill the gaps created."

The financing of RAF A1, as the first project in which QEWC has used an Islamic debt tranche, is an indication of the current strength of the Islamic market and the increasing desire among Arab institutions to use this model.

As Simmons & Simmons' Nichol says: "The attraction of Islamic financing is that it not only plugs a funding gap, but puts an Islamic stamp on the project. It is becoming a feature in energy and infrastructure projects in Qatar, Saudi Arabia, UAE, Bahrain and Pakistan."

The project at a glance

Project Name	Ras Abu Fontas A1 Desalination Plant
Location	Qatar
Description	Ras Abu Fontas A1 is to be a 45 million gallon per day desal add-on facility to the existing Ras Abu Fontas power plants. Completion is slated for 2009.
Sponsors	Qatar Electricity and Water Company
Operator	Qatar Electricity and Water Company
EPC Contractor	Impregilo
Off-taker	Qatar General Electricity and Water Corporation (Kahramaa)
Total Project Value	US$640m
Total equity	US$190m
Total senior debt	US$450m
Debt:equity ratio	70:30
Participant banks	Bank of Tokyo-Mitsubishi Royal Bank of Scotland Doha Bank Gulf International Bank Standard Chartered
Book Runner	Bank of Tokyo-Mitsubishi Royal Bank of Scotland
Legal Adviser to sponsor	Shearman & Sterling
Financial Adviser to sponsor	Bank of Tokyo-Mitsubishi
Legal adviser to banks	Simmons & Simmons
Date of financial close	13 March 2008