DOWN THE FLEXIBLE ROAD

THE SALIK FINANCING COULD BE A TEMPLATE. BY CHRISTOPHER HALL, CRAIG NETHERCOTT, PARTNERS, AND AARON BIELENBERG, CHIRAG SANGHRAJKA AND ARJUN AHLUWALIA, ASSOCIATES, LATHAM & WATKINS.

This past July, the Government of Dubai's Department of Finance together with the Road Transport Authority of Dubai (together, the Government) successfully closed one of the most innovative infrastructure financings in MENA that can serve as a template for flexible structured infrastructure and real estate financings within and outside of the region.

Infrastructure monetisations are often unappealing to government entities because of the resulting loss of ownership, control and revenue stream attendant to more traditional models, as well as the usual implications of issuing on the capital markets, if relevant.

However, the Salik financing, which was structured as a dual-tranched (conventional and Islamic) secured syndicated bank financing, addressed typical sovereign concerns as it provided for limited recourse to the Government and no transfer of ownership or operations of the toll road asset. It additionally satisfied investor requirements and was consequently oversubscribed as it provided investors with a sound security package with recourse to the asset's revenue stream.

The toll road

The Salik toll road system (Salik) is the first free-flow electronic tolling system in the Gulf region and is operated by the Government. Salik applies at four gates along the E11, or Sheikh Zayed Road, the principal highway that runs through Dubai to Abu Dhabi and the Northern Emirates and along which the emirate's main commercial and residential districts, including the port of Jebel Ali and the Dubai International Airport, are located.

Since becoming fully operational in September 2008, Salik has enjoyed consistent traffic volumes in excess of 800,000 trips per day and produced consistent revenues for the Government in excess of US$230m in both 2009 and 2010, despite volatility in the global economy.

The financing structure

The Salik financing monetised tolls and other revenues associated with Salik, including revenues collected from users relating to the purchase of Salik tags, the recharging of Salik cards and the payment of fines relating to failure to comply with Salik rules and regulations.

Under the Salik financing arrangements, the Government agrees to turn over gross Salik revenues on a weekly basis to a special purpose vehicle (SPV) in exchange for (a) an upfront payment by the SPV to the Government of approximately US$800m and (b) a series of monthly deferred payments comprised of the surplus Salik revenues after payment by the SPV of its financing expenses, principal and interest/profit repayments and the top-up of a liquidity reserve account.

The SPV is initially funded by the upfront payment by the investors under the following tranches of senior debt facilities incurred by the SPV:

- Dirham-denominated conventional tranche of US$200m equivalent;
- US dollar-denominated conventional tranche of US$400m; and
- Dirham-denominated Sharia-compliant tranche of US$200m equivalent.

Citigroup, Commercial Bank of Dubai, Dubai Islamic Bank and Emirates NBD were appointed by the Government as mandated lead arrangers and bookrunners for the senior facilities debt. The financing structure is further described in Figure 1.

The Salik financing is the first toll road financing in the MENA region and the first toll road financing globally to include a Sharia-compliant tranche. It was also the first use of a Dubai International Financial Centre Special Purpose Company SPV.

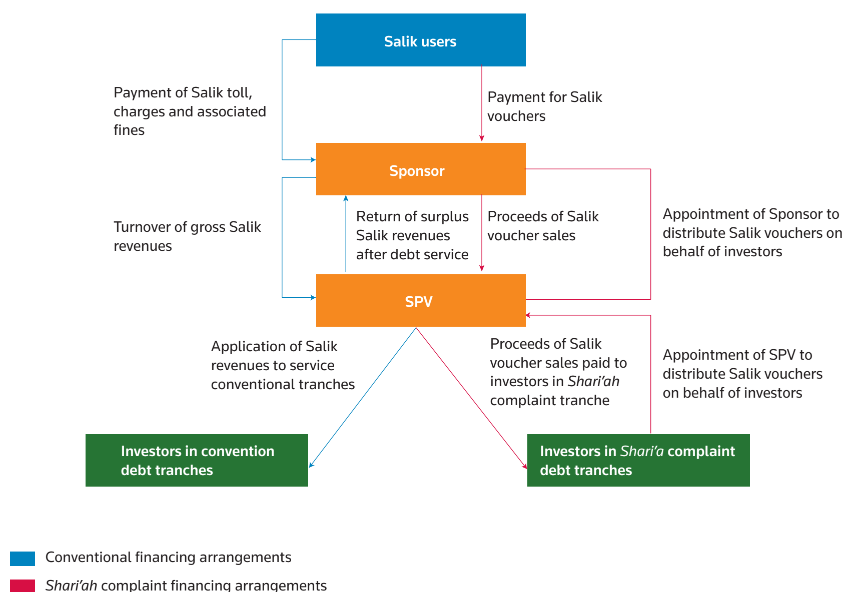
The clear and positive response of the market to the Salik financing is indicative of the market's appetite (at the level of both local UAE banks and international financial institutions) for projects with strong underlying economics and the flexibility that the market is willing to offer to such projects. This article seeks to identify a number of those areas of flexibility, which may in turn be helpful to other sponsors considering the feasibility of similar monetisation arrangements.

Ownership and operational flexibility

Given the importance of the Sheikh Zayed Road (and, by association, Salik) as one of Dubai's key infrastructure assets, two of the Government's key concerns with regards to the Salik financing were that:

- The Government should retain full ownership rights in respect of Salik assets and the (legal and beneficial) right to receive Salik revenues; and

FIGURE 1 - ONGOING PAYMENT FLOWS DURING THE LIFE OF THE SALIK FINANCING UNDER THE CONVENTIONAL AND *SHARI'AH* COMPLIANT FINANCING ARRANGEMENTS



• The Government should retain full operational control over Salik assets and its relationships with Salik customers, including the right to set the toll rate and the right to maintain and amend policies relating to toll charging and its enforcement.

These requirements can be difficult to reconcile with traditional securitisation-based monetisation arrangements, which would usually require a sale of receivables (or at the very least a grant of security over such receivables) in favour of the SPV, together with customary control rights over how the receivable-generating assets are managed and operated and how the receivables are collected.

As a result, the securitisation model is often inappropriate in circumstances where ownership and control over the receivables to be monetised are to remain with the originator of the receivable, particularly where the receivables come from a wide customer pool and are not subject to fixed contracts. The flexible Salik financing structure also was more appealing to the Government than a typical PPP or concession based infrastructure financing, which usually involves a transfer of ownership and/or operating rights for a defined term.

The Salik financing accommodates these requirements, while also providing investors with the requisite degree of comfort on how Salik revenues would be collected, through use of a turnover obligation and a finely balanced series of termination events (the events).

Turnover obligation

Under the Salik financing arrangements, the Government retains ownership of Salik assets and Salik receivables, together with all rights to manage and operate the assets and collect the receivables, but has an obligation to turn over the gross receipts of Salik receivables to the SPV. The SPV applies the amounts received from the Government subject to a defined cash waterfall to service its financing costs under the senior debt facilities and to maintain a liquidity reserve, with the surplus being returned to the Government for its own use.

The risk to the investors that the Government may fail to collect sufficient revenue from Salik receivables to service the senior debt facilities is mitigated by the fact that the turnover obligation applies to gross revenues; that is to say, revenues before any deduction, including in relation to any operational or maintenance costs of Salik. The investors do, however, take traffic risk in this financing.

As a result of this, the Government will only receive funds to the extent that Salik revenues collected exceed the amounts required to meet the financing obligations owed to the investors under the senior debt facilities. In other words, and in contrast to most infrastructure or corporate financings, the financing obligations owed to the investors under the senior debt facilities are effectively senior to the operating and maintenance costs of the Government, and the “first loss” is effectively for the account of the Government. Operation and management costs are outside of the transaction and continue to be paid for by the Government funded from its own internal revenues and through the Government's budgeting processes.

Events

In structuring the financing, certain events were defined to create a risk allocation structure that principally exposes investors to traffic risk only, with other risks mitigated through tiered degrees of recourse to the Government. There are six categories of event:

• Notification events arise on the occurrence of certain risk events that fall outside of typical traffic risk, including a material change to the

basis for toll charging, a repeated reduction in the number of available lanes on the Sheikh Zayed Road or failure to enforce Salik toll charging. The occurrence of a notification event may impose additional information obligations.

- Lock-up events include compensation events and certain other defaults. The occurrence of a lock-up event results in a block on the return of surplus Salik revenues by the SPV to the Government. That surplus is instead retained in a separate lock-up account pending satisfaction of certain release conditions.
- Compensation events are notification events that are accompanied by a reduction in certain funding coverage ratios below specified thresholds. These are designed to catch notification events that have a material and adverse effect on Salik revenues. The occurrence of a compensation event may trigger an obligation on the Government to make a payment to the SPV to "top up" Salik revenues and restore the relevant funding coverage ratios to a specified level, in a manner broadly analogous to an equity cure to Ebitda in the context of a leverage covenant.
- Monitoring events arise if compensation events occur for a specified number of consecutive periods and may result in the appointment of an independent expert to prepare a revised traffic report. Such report may form the basis of the calculation of the amount required to be prepaid if a prepayment event subsequently occurs.
- Prepayment events arise if compensation events occur for a further specified number of consecutive periods. Upon the occurrence of a prepayment event, the Government may be required to make a payment to the SPV (which shall be applied in prepayment of the senior debt facilities) in an amount sufficient to restore the relevant funding coverage ratios to a specified level, in a manner broadly analogous to a straightforward equity cure against net debt in the context of a leverage covenant.
- Termination events include traditional events of default such as non-payment by the Government, misrepresentation, insolvency or cross-default. Upon the occurrence of a termination event, the Government may be required to make a payment to the SPV in an amount sufficient to prepay the outstanding senior debt facilities in full.

This complex series of events is also of benefit to the Government because, in contrast to fully sponsor-guaranteed debt, there are only limited circumstances in which there may be full recourse to the Government for the amounts due under the senior debt facilities. The Salik financing demonstrates that, through this structure, a strong sponsor may be able to take the benefit of limited recourse while also achieving pricing levels that would be consistent with fully sponsor-guaranteed debt.

Leverage flexibility

The Salik financing also incorporates provisions that allow for additional indebtedness to be incurred on the basis of Salik revenues and the security package granted by and in respect of the SPV, subject to a cap and compliance with certain funding coverage tests.

While such "accordion" facilities or mechanics were not at one time unusual in the context of leveraged finance transactions for strong sponsors, they have become increasingly rare and are almost unheard of in the context of a project financing absent an anticipated change in a project's economics (such as would result from a significant increase in a project's capacity).

The inclusion of this feature in the Salik financing is indicative of the market's positive response to Salik assets and financing structure, but also is another bespoke feature of the financing that is applicable to many other infrastructure assets, particularly new assets in emerging growth economies, where there is limited traffic history but robust growth prospects.

Sharia compliance

A further important element of the Salik financing was the inclusion of a Sharia-compliant tranche. The Government required that investors in the Sharia-compliant tranche be put on an equal footing with investors in the conventional tranches and that all material business terms of the conventional tranches applied equally to the Sharia-compliant tranche.

This was ultimately achieved by applying concepts developed for mobile telecommunications provider Mobily in Saudi Arabia (and later applied by Etisalat in the UAE), in which airtime was recognised as a intangible asset with economic value that could form the basis of a Sharia-compliant financing structure.

In the case of the Salik financing, the financing documentation provides for the sale of Salik "vouchers", representing intangible rights to use the road network, to investors in the Sharia-compliant tranche who (acting through their investment agent) in turn appoint the SPV and (indirectly, through a sub-distribution agreement) the Government to sell Salik vouchers to the ultimate road users. The proceeds of such sales are distributed through the SPV to the investment agent for onward distribution to the investors in the Sharia-compliant tranche.

An intercreditor agreement ensures that investors in the conventional and Sharia-compliant tranches rank *pari passu* and each class benefits equally from the security structure.

A roadmap for flexible financings

The market's positive response to the Salik financing, which was more than twice oversubscribed in the conventional tranches, is indicative of its demand for projects with strong underlying economics and of the high degree of structural flexibility that the market is willing to offer to such projects. The lessons learnt on the Salik financing may provide a useful roadmap to such areas of flexibility that may be applied more widely to monetisations for infrastructure and other assets. ■