Turkey – unclogging the fan

Angus Leslie Melville

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The Turkish currency crisis is causing ripples around the international infrastructure finance community with all parties active in the nation reaching for project documentation to ensure they are not about to take a severe haircut.

And – as it turns out – that's quite a few of you.

According to the *IJGlobal* database, a total of 36 PPP transactions – deals that meet our criteria and methodology – have made it to financial close in the social infrastructure and transport sector in the last 13 years.

Since 2005, Turkey has seen financial close achieved on infra deals valued at a shade more than $44 billion, financed by debt in the order of $33.5 billion.

While the early deals were dominated by national banks, more recent transactions have brought in a swathe of DFIs, international lenders and equity partners – though the sponsors are all home-grown.

This year alone, we have seen five deals make it over the line:

- Ankara-Nigde Highway
- Dardanelles Strait Bridge
- Bilkent Laboratory
- North Marmara Motorway – Kinali-Odayeri Section
- North Marmara Motorway – Kurtkoy-Akyazi Section

While 2017 was even busier with closes on:

- Istanbul Ikitelli Integrated Health Campus
- Bursa Integrated Health Campus
- Izmir Bayrakli Integrated Health Campus
- Manisa City Education and Research Hospital
- Gaziantep Integrated Health Campus
- Kocaeli Integrated Health Campus
- North Marmara Motorway

These projects were financed in USD or Euro and Yen, with Turkish Lira revenues indexed to the relevant currency – which was perfectly fine before the currency crisis kicked in and the Lira went from $3.73 at the start of 2018 (2 January) to $5.99 at the time of writing. It hit the high point on 13 August when it reached $7.03.

Sources close to these PPP transactions say that this has resulted in the availability payments almost doubling next year, hugely impacting the long-term viability of these projects.

Furthermore, thanks to some crafty wording in the documentation, an availability payment cannot be less than the previous one, so the government is now stuck with a situation it cannot resolve.

As one financial adviser who was heavily involved with drafting a number of PPP deals in Turkey says: “Once the exchange rate drops, there is no way down for the government.”

President Tayyip Erdogan did take action on 13 September to minimise the impact of foreign currency-denominated contracts by banning them. Under this new regulation, companies with such contracts have one month to renegotiate them in Turkish Lira.

However, in the event that an agreement cannot be reached on new terms, the contract price will automatically convert at the 2 January (2018) exchange rate, adjusted for consumer price index (CPI) inflation (around 12.3%).

Fortunately, PPP transactions seem to fall into the exempted category which impacts all agreements made by contractors of state-owned institutions, provided they are centred on a tender, agreement or international agreement awarded by the state based on a foreign currency, or indexed to a foreign currency.

Lenders are of the view – for now – that their projects have grandfathered through, but they are keeping a weather eye on the market, likely with lawyers primed and on retainer.

However, most believe that PPPs will be exempt. In truth, they are more worried about the ability of the sponsors (all of them Turkish) and (possibly more of a danger area) the sub-contractors to finish construction as the market continues to contract.

For operational assets, there is no word of Turkey failing to honour availability payments – which mostly impacts hospitals with the toll roads looking after themselves and the government topping up where necessary. The motorways will, however, be impacted by reduced traffic as the economy continues to struggle.

It should also be noted that in the 2017 financial year, the top-up payment from government to the toll roads amounted to around 3 billion Lira ($500 million). On the hospital front – once they are all finished – the government will pay 5-6 billion Lira over gilt each year, but that is set to double.

There is word of cost over-runs on a couple of projects in Turkey, but this is put down to the government having brought in variations to the contracts above the cap. We hear that the relevant ministry has upped availability payments to cover these additions.

Word on the street

While we have painted a fairly dark picture of the Turkish market, and indeed, it is pretty damn grim on the ground with GDP plummeting and interest rates soaring – those involved in the PPP sectors remain cautiously optimistic.

Some people are drawing a comparison between Turkey and Argentina, but as one source says: “This is not fair at all. Argentina has a track record of not paying, while Turkey has a great track record of paying.”

For those with fears that the government will wheedle its way out of paying its dues, they take solace from Turkey having based its PPP documentation on the UK’s PFI model… and then added more twists and turns than was entirely necessary.

One lender says: “The payment mechanism for the hospitals is really confusing, so it’s hard for the government to come in and start picking it apart and find deductions to force the company into issues and save money. It’s just too difficult.”

As for a market exodus, well that’s just not happening says one source: “I don’t see any lenders trying to get out of these projects. They can’t get out in any case! They are in the same situation as a major shareholder, so they have to make it work.”

And you have the support of the multilateral community. For all everyone likes to take a pop at them, they do make a massive difference when the fan starts to clog up.

One lender says: “This is where you do take the umbrella effect of having all these multilaterals involved. They are the ones that they [the Turkish government] will call on first… and they’re the ones they will come calling on again first for bail-out money. That’s a pretty difficult circle.”

For all the concerns over the future of the PPP projects in Turkey, the primary sense from the market is that everything will be fine in the end and that “there are a lot of levers the government will pull before this happens”.

However, as one lender to PPP in Turkey puts it nicely: “You’d be an idiot not to be nervous.”

Further, you would also – according to sources on the ground – fall comfortably in the idiot category if you expected to see another Turkish PPP brought to market in the medium term.