



KARACHI THATTA DUAL CARRIAGEWAY

Project Report



MAY 30, 2018

PUBLIC PRIVATE PARTNERSHIP UNIT
FINANCE DEPARTMENT
GOVERNMENT OF SINDH



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Project Background

Realizing the importance of developing better road network and to provide boost to economic development of the Sindh Province, the Pakistan Peoples Party led Government of Sindh launched the Karachi Thatta Dual Carriageway (KTDC) Project. The main objective of this project is to dualize the existing road network, provide safe commuting experience, reduce travelling time and connect agricultural produce to the markets in urban centers.

The scope of this project is limited to developing a 49.5 km dualized road from Ghaghar Phattak to Makli bypass. The project includes 15 bridges, 3 pedestrian bridges in urban centers, 12 bus stops and crossings for access roads to connect the towns and villages along the route. Moreover the project company shall also provide ambulance service, fire fighting vehicles, heavy and light cranes, special recovery vehicles, mechanical broomers, water bowsers and patrolling vehicles.

This new corridor will open up new avenues of progress and prosperity in the area. The construction of this high standard road (which is in accordance with the internationally acceptable AASHTO Standards) will give easier and cheaper access to market, health and educational institutions for the people of the region.

The Karachi Thatta Dual Carriageway Project is based on DBFOT mode i.e. Design, Built, Finance, Operate, Maintain, and Transfer basis and the Concession period include 25 years of operate and maintain after the Substantial Construction Completion.

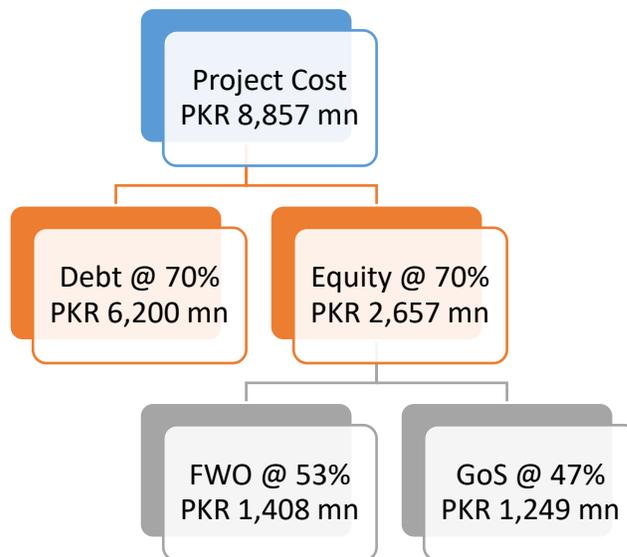
Sponsoring Agency/Department

- Frontier Works Organization (“FWO”)
 - 53% of Equity (Class A Shares - Voting Shares)
- Government of Sindh (“GoS”)
 - 47% of Equity (Class B Shares - Non-Voting Shares)

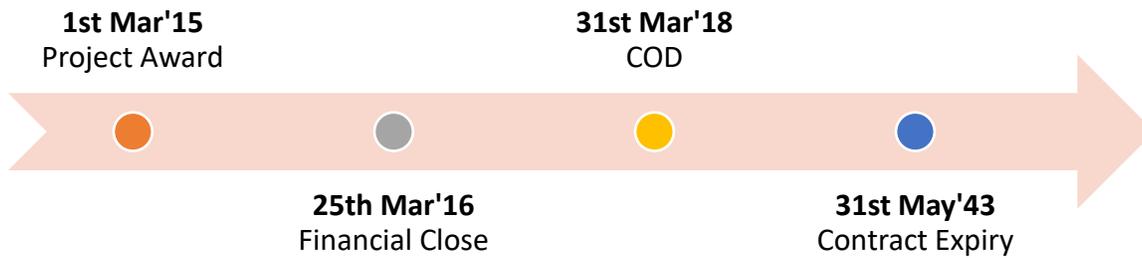
Technical Description of the Physical Infrastructure

- GoS “DBFOT” the Project through public-private partnership.
- The project is construction & development of 49.5 Km long section of National Highway (N-5) between Gaghar Phatak and start of Thatta bypass
- Dual carriageway with design life specification of 50 years for bridges and structures, and a maximum speed of 100 km/h on the Project site.
- Concession agreement between GoS and Karachi Thatta Construction & Management Pvt. Ltd (KATCAM), a SPV formed by FWO and GoS, as the Concessionaire.

Project Value



Contract Timeline





Financial Information

Caps on Equity Transfer

Contracts provide for caps on equity transfer in different stages of the contract, especially during the construction stage and for a few years thereafter.

- FWO can sell 24% of Class A shares (i.e. holding 76% of Class A shares) without the consent of financiers.
- FWO can sell further 25% of Class A shares (i.e. holding 51% of Class A shares) with the consent of the financiers.
- FWO to retain 51% of Class A shares throughout the facility
- Class B equity, which is not voting and not liable for non-performance.

Loan Details

Total Debt of PKR 6,200 Million for 10 years.

- Floating rate (KIBOR + 0.45%)
- Debt Service Coverage Ratio and Interest Coverage Ratio - 1.10x
- Forecast IRR – 20.9%
- Leading Banks
 - Dubai Islamic Bank Pakistan Limited (Mandated Lead Arranger)
 - Meezan Bank Limited (Mandated Lead Arranger)
 - MCB Bank Limited (Mandated Lead Arranger)

Sponsor Support Obligation:

Sponsors (FWO and GOS) to meet the following:

1. Funding at least:
 - a. 30% of the Base Project Costs (approx. PKR 2,657 Million);
 - b. Expenses and capital costs necessary to achieve completion of the Project, (as required under the Concession Agreement) over and above the Project Costs.
2. Provision of Irrevocable, unconditional first demand bank guarantee and/or Standby Letter of Credit (“SBLC”) by GoS in favour of the Financiers in form and substance acceptable to the Financiers required to secure all obligations under Project Fund Agreements and/or EF&U Agreement. Similarly, FWO shall provide a contractual commitment regarding its obligation to fund 30% of the Base Project Costs and Cost Overruns in the Project Funds Agreement and/or EF&U Agreement.
3. Upon first demand, make any cash injections required to satisfy Project cost overruns, operating cost overruns and compliance of financial covenants.



Security and step in arrangements

Security Structure includes:

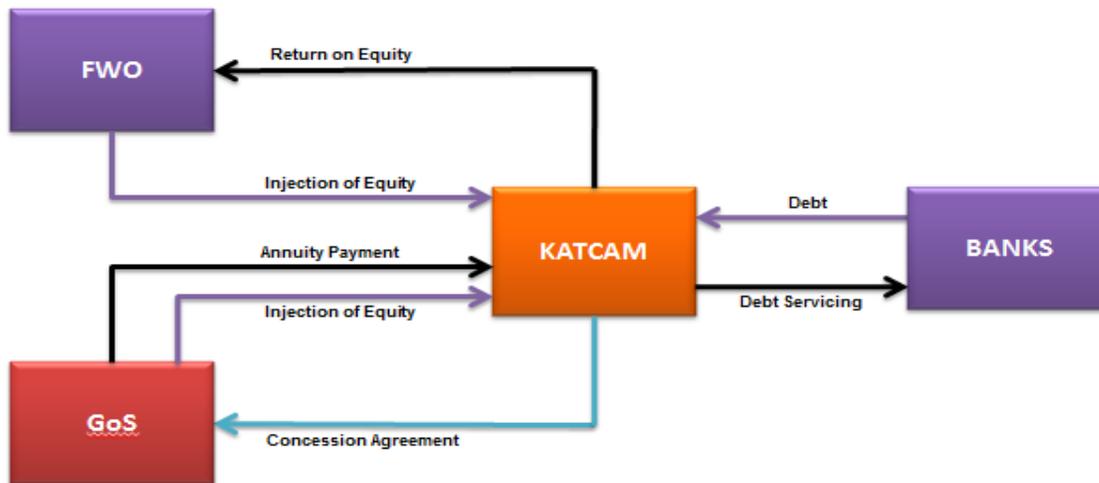
1. SBLC amounting to PKR 5,000 Million provided by GoS before financial close.
2. Lien over cash deposit amounting to up to PKR 1,200 Million to be deposited by GoS with the Agent Bank one month prior to COD. Alternatively, GoS may provide a SBLC amounting to PKR 1,200 Million.
3. Exclusive hypothecation (collateral pledge) on all present and future **current assets** (all rights, benefits and claims including clear right of way with respect to the Concession Area) of Company along with margin of 25%;
4. Exclusive assignment/mortgage over the Company's rights and benefits under all **Project Documents**, including but not limited to the Concession Agreement, O&M Contract, EPC Contract and any performance guarantees warranties issued there under and any amendments thereto.
 - Assignments/mortgage will be through Direct Agreements between the Financiers and counterparties to the Project Documents;
5. Assignment/mortgage over all rights and benefits of the **Customer** under any and all Project insurances and cut-through agreements (if available) / clauses for reinsurance;
6. Pledge of 100% **shares** of Project Company

Tariff, Pricing & Contract Structure

GoS to pay semi-annual Annuity payments, which covers for

- Debt Servicing for that period,
- Operations expense, and
- ROE component provided that project facility remains available and in case of non-availability there will be deduction from the annuity payments.

Contract Structure



Activities leading to commercial close and financial close

- National Highway Authority issues NOC on Karachi Thatta Road to GoS to develop it under PPP mode for a period of 25 years along with traffic and technical data on the facility.
- Works & Services Department, GoS in partnership with PPP Unit, GoS develops the project structure and procurement pack with HaidermotaBNR as legal advisor.
- RFP is issued for the project leading to numerous pre-bid meetings and a bidding time of almost 8 months.
- Two (2) bids are received by the GoS.
- FWO is declared the preferred bidder for the project.
- GoS starts negotiation with FWO team leading to signing of concession agreement in first half of 2015.
- Financial close is achieved on the deal in 2016 and is the first road project with a Shariah compliant structure.
- Full-fledged construction works are started on the facility in June 2016.



- A Shariah Structure was approved by the Product development and Shariah Compliance (PDSC) team by Dubai Islamic Bank Limited. The facility documents/Financing Agreements were vetted in light of Shariah Structure and Shariah guidelines to make the transaction Shariah compliant.

1. Investment Agency Agreement

Musharaka Financiers will appoint DIBPL as their Investment Agent to act as agent on behalf of co-owners (Musharaka Financiers) and enter into transaction documents on behalf of the Musharaka Financiers for the proposed Diminishing Musharaka facility.

2. Musharaka Agreement

- Investment Agent and KATCAM (as Managing Co-owner) will enter into a **“Musharaka Agreement”** to build and jointly own the Musharaka Assets in their respective pre-agreed ratio of joint ownership in the Musharaka Assets, based on each co-owner Musharaka contribution in the total expected cost.
- The co-owners (Musharaka Financiers) will agree that legal title of the Musharaka Assets will be retained in the name of managing co-owner (KATCAM) which will hold the title of the Musharaka Assets on behalf of all the joint owners of Musharaka Assets including co-owners (Musharaka Financiers)
- Each of the co-owners (Musharaka Financiers) will contribute its respective Musharaka investment in cash in multiple payments as and when demanded by managing co-owner (KATCAM) through a Contribution Request whereas KATCAM will also contribute its Musharaka investment in cash.
- In this connection, to legitimate the Qabd (possession) over the Musharaka Assets by co-owners (Musharaka Financiers) there will be exclusive charge over the Musharaka Assets in favor of co-owners (Musharaka Financiers).
- The KATCAM will look after the construction of the Musharaka Assets and shall ensure that the construction of the Musharaka Assets is done as per the agreed design. Managing Co-owner (KATCAM) will intimate the completion of the Musharaka Assets to co-owners (Musharaka Financiers) through “Asset Completion Notice” as and when the entire/part of the Musharaka Assets are completed.
- The Managing Co-owner (KATCAM) will be entitled to claim reimbursement (upon submission of relevant evidences /invoices) of the ownership related costs, if any, actually incurred and to become proportionate part of each joint owner’s share in Musharaka Assets.
- Managing Co-owner will arrange Takaful of the Musharaka Assets under Islamic concept of Takaful or otherwise provide written justification for procuring conventional insurance.



- In case of total loss/ destruction of the Musharaka Asset, the Takaful/insurance claims received will be shared among all joint owners i.e. (Musharaka Financiers) and managing co-owner (KATCAM) in the ratio of their respective investment in Musharaka Assets considering the ration of that time.

3. Payment Agreement

- Investment Agent will enter into a “Payment Agreement” with managing co-owner (KATCAM) whereby Investment Agent will agree to give on Ijarah (lease under Shariah principles) the usufructs of Investment Agent`s undivided share in the completed component of Musharaka Assets against semiannual Rentals Payments.
- Rentals Payments for each semi-annual period will comprise of Rentals to be calculated at the start of each semiannual Rentals Period on the basis of Rental Rate.
- As the first relevant Musharaka Asset is delivered /constructed and becomes available for use (i.e. utility can be derived from the asset), an “Asset Completion Notice” will be submitted by managing co-owner (KATCAM) to Investment Agent.
- Subsequently, Investment Agent (acting on behalf of co-owners/Musharaka Financiers) will issue First Rental Payment Notice to the managing co-owners (KATCAM), to commence the Ijarah of co-owners (Musharaka Financiers) undivided joint ownership in Musharaka Assets. The Commencement Date would occur on the date of delivery of the constructed assets to the Investment Agent.
- The Rentals will be classified as Advance against Rentals, from the date of first Musharaka Contribution till the Commencement Date. The First Rental Payment Notice will also include an “Additional Rent” to cover profit during the construction period that is equivalent to cumulative Advance against Rentals and will be paid by KATCAM through setting-off the Advance against Rentals already paid.
- As per the principles of Shariah the amount of Advance against Rentals received before the completion of asset and Commencement Date cannot be recorded as income by the Musharaka Financiers. The amount of Advance against Rental would be taken on account basis and may be recorded as income upon the commencement of lease on the Commencement Date either in full or as accrued over the respective period.
- As and when any additional Musharaka asset is completed/constructed, a subsequent Asset Completion Notice will be issued by managing co-owner (KATCAM) and subsequently, Investment Agent and KATCAM will enter into a revised Rentals Notice to Ijarah the further Musharaka assets (along with the existing Ijarah assets).
- For the avoidance of doubt, please note that the execution of revised Rental Notice on delivery of additional Musharaka assets will not change the Rental amount, set at the beginning of each semiannual Rental Period.



Rental Payment for each period will comprise of:

- i. Variable Rental Amount: Rent to be calculated at the start of each quarterly Rental Period on the basis of Rental Benchmark;
- ii. Supplementary Rent which will be equal to the Asset Service Charge Amount i.e. major maintenance expense (reimbursable to KATCAM) for the preceding Rental Period

Note: Musharaka Assets will be delivered gradually in stages. The rent will be charged on semi-annual basis for the completed/constructed portion of the Musharaka Assets. Rental amount recovered from the customer shall be considered as earned/ Advance against Rentals.

4. Undertaking to Purchase Musharaka Units

Managing co-owner (KATCAM) will undertake to purchase Musharaka Units of the Musharaka Assets from co-owners (Musharaka Financiers) in the following manner:

a) On Event of Default and Termination after Rental Commencement Date:

Managing co-owner (KATCAM) will purchase all Musharaka Units of Musharaka Assets from the co-owners (Musharaka Financiers) at sum of:

- i. the outstanding Musharaka share of co-owners (Musharaka Financiers), being base amount ; and
- ii. the accrued and unpaid Variable Rentals amount (if any) until the date of execution of Undertaking to Purchase.

b) On Event of Default and Termination before Rental Commencement Date,

Managing co-owner (KATCAM) will purchase all Musharaka Units of Musharaka Assets of co-owners (Musharaka Financiers) if the Musharaka Assets have come under the joint ownership of co-owner at sum of:

- i. the aggregate of all Musharaka Contribution Payments made up to the enforcement date; and
- ii. the Advance against Rentals Payments paid and payable by the managing co-owner (KATCAM) up to the end of the prevailing calendar month in which the enforcement date occurred;

c) Periodic Purchase of Musharakah Units on Buy Out Payment Dates

Managing co-owner (KATCAM) will purchase Musharaka Units of Musharakah Assets from the co-owners (Musharaka Financiers) from time to time by paying Outstanding Buy-Out Price on the Buy-Out Payment Date, as specified in the Undertaking to Purchase, to be executed by



Managing co-owner (KATCAM). In all above mentioned cases, proper offer and acceptance between parties must be ensured. Further, the record of all dealings must be maintained.

5. Security and other Documents

- Security and all other documents e.g. Common Terms Agreement etc., shall be drafted/reviewed by transaction legal counsels, Mohsin Tayebaly & Co, acting as Legal Counsel on behalf of co-owners (Musharaka Financers) and by the Shariah Boards of all co-owners (Musharaka Financers).
- The inter creditor agreement (between financiers), security agreements and other financing documents have been structured to bring all financiers pari passu in terms of security and defines thresholds for voting rights to trigger EOD for different sets of events of defaults.
- For sale and lease transaction, return structure and how profits were structured rather than interest please refer to Shariah structure defined.

Risks

| RISKS | DESCRIPTION | ALLOCATION | MITIGATION |
|---------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Pre-Financial Close: All risks up to financial close | It is the risk that the company will not be able to achieve financial close and arrange funding required for Financial Close. | Project Sponsors and Mandated lead advisors and arrangers (“MLAAs”). | Appointment of strong Project Implementation team by the sponsors and MLAAs to manage requirements of Financial Close. |
| Design Risk | It is the risk associated with the impact on project cash flows, reputation, or other aspect of an organization from deficiencies in design or engineering errors. | - EPC contractor up to a certain threshold -Sponsors and Islamic Financiers to the extent of their share in Musharaka (Partnership assets) | Risk transferred through liquidated damages available for performance shortfall up to a certain threshold. Furthermore, the technology would have an Independent Engineer certification providing a comfort on technical aspects of the project. |
| Construction /Completion Risk | The risk that a project may not be completed and/or produce revenue, either because the financing was cut off before completion, loss from cost overruns or the project's construction was done poorly and it fails to pass the completion test. | - EPC contractor up to a certain threshold. -Sponsors and Islamic Financiers to the extent of their share in Musharaka (Partnership assets). | - Risk transferred through liquidated damages available for up to a certain threshold. - Turnkey Contracts with EPC. - Insurance |
| Cost Risk | It is the risk that the project costs more than budgeted. It can lead to performance risk if cost overruns lead to reductions in scope or quality. Cost risk can also lead to schedule risk if the schedule is extended because not enough funds are available to complete the project on time. | - EPC contractor up to a certain threshold - Sponsors to bear all risks over and above the EPC threshold. | - Contractor has offered fixed-price turnkey contracts, thereby accepting much of the capital cost overrun risk. - Capped Sponsor support is provided through completion cost guarantees. |
| Refinancing Risk | It is the possibility that a borrower cannot refinance by borrowing to repay existing debt. It increases in periods of rising interest rates, when the borrower may not have sufficient income to afford the interest rate on a new loan. | N/A | N/A |

| | | | |
|-----------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Risk related to change in law, taxes, scope, technical standards, regulatory framework | It is the risk that a change in laws and regulations will materially impact a security, business, sector or market. A change in laws or regulations made by the government or a regulatory body can increase the costs of operating a business, reduce the attractiveness of investment and/or change the competitive landscape. | Government of Sindh | |
| Exchange Rate Risk | It is the financial risk of an investment's value changing due to the changes in currency exchange rates. | Concessionaire | None of the construction items are imported or debt raised is foreign while inflation has been hedged by Government of Sindh so the project resources cover for this risk. |
| Operating Risk | It is the risk of a change in value caused by the fact that actual losses, incurred for inadequate or failed internal processes, people and systems, or from external events (including legal risk), differ from the expected losses. | Sponsors and Islamic Financiers in the ratio of their share in Musharaka (Partnership assets). | Appointment of reputable O & M contractor. |
| Commercial Risk Market Risk Demand Risk | It is the possibility for an investor to experience losses due to factors that affect the overall performance of the financial markets in which it is involved. | Government of Sindh | |
| Procurement Risk Performance Risk | This includes risk associated with the reliability of supplier, compromise on quality of procured goods or the contracts being biased towards the suppliers. | Sponsors and Islamic Financiers in the ratio of their share in Musharaka (Partnership assets). | -Risk transferred through liquidated damages for performance shortfall up to a certain threshold -Insurance |
| Financial Risk | It is associated with financing, which includes financial transactions that include company loans in risk of default, the uncertainty of a return and the potential for financial loss. | Government of Sindh | Government has taken the interest rate volatility risk as interest rates on commercial debt are floating and private parties cannot cater for that risk. |

| | | | |
|----------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------|-------------------|
| <p>Force Majeure Risk</p> | <p>-It is the risk caused by natural and unavoidable catastrophes that interrupt the expected course of events and restrict participants from fulfilling obligations.</p> <p>-Under law, it refers to an irresistible force or unforeseen event beyond the control of an entity making it materially impossible to fulfill an obligation.</p> | <p>- Force Majeure Risk according to events defined in the IA will be borne by Government.</p> | <p>-Insurance</p> |
|----------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------|-------------------|



Contract Termination

| PARTY | EVENTS OF DEFAULT | TERMINATION PAYMENTS |
|------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Authority</p> | <ul style="list-style-type: none"> - GoS Event of Default, the Concessionaire shall by a notice in writing inform the GoS of its intention to issue the Termination Notice (the Concessionaire Preliminary Notice). -In the event the underlying GoS Event of Default is not cured by the GoS within the Cure Period and the same is subsisting at the expiry of the Cure Period, the Concessionaire shall be entitled to terminate this Agreement by issuing the Termination Notice upon expiry of the Cure Period. -In the event of Termination due to a GoS Event of Default, GoS shall pay to the Concessionaire, by way of Termination Payment, an amount equal to the GoS Default Termination Amounts. -Upon occurrence of a Termination Event directly resulting from the failure by the GoS to fund the GoS Annuity Amount Payment Account, the Investment Agent may serve a notice in writing to KATCAM (the “Default Notice”), with a copy to other Financiers, requiring KATCAM to rectify the Termination Event within sixty (60) days of the notice. | <ul style="list-style-type: none"> -Upon the occurrence of an Event of Default & Termination, the breaching party is liable for any excess cost/fee arising as a result of termination before the completion date of the contract. -The Termination Payment shall be payable to the Concessionaire by the GoS on or prior to the Termination Payment Date in accordance with a demand being made by the Concessionaire in writing, subject to the same being duly certified by the Independent Engineer and Independent Auditor. |
| <p>Concessionaire</p> | <ul style="list-style-type: none"> -Any Material Breach by the Concessionaire or the Sponsors of any GoS Agreement having a Material Adverse Effect on the Concessionaire’s ability to perform its obligations under this Agreement and/or on the Project or having a Material Adverse Effect on the rights and/or obligations of the GoS hereunder or under the GoS Agreements; -Concessionaire fails to commence the Site Construction Works within 30 from the Commencement Date; -Concessionaire fails to achieve Substantial Completion by the date falling 90 days following the Scheduled Substantial Completion Date. | <ul style="list-style-type: none"> -Upon the occurrence of an Event of Default & Termination, the breaching party is liable for any excess cost/fee arising as a result of termination before the completion date of the contract. -The Termination Payment shall be payable to the GoS by the Concessionaire on or prior to the Termination Payment Date in accordance with a demand being made by GoS in writing, subject to the same being duly certified by the Independent Engineer and Independent Auditor. |



Lessons from the Case

- **Can this project be considered a success?**
Yes
- **What appears to be the key contributing factors?**
 - Strong Financial standing of Sponsors
 - Reputable and experienced Management
 - Guaranteed Annuity Payments
 - Part Stand By Letter of Credit backed security structure
 - History of successful highway PPP transactions under Government of Sindh
- **Any other lessons learned?**
 - Strong sponsors will require less Government support.
 - Competition over a period of time will open up both debt and equity markets for PPPs.
 - Islamic finance is slowly entering the infrastructure finance market.

Project Pictures

