

EGYPT'S FEED-IN TARIFF PROGRAM

Briefing On Project Bankability And Finance Aspects



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INTRODUCTION

On 17 September 2014, the Cabinet of Ministers announced the inauguration of Egypt's feed-in tariff (FiT) program and invited investors to a pre-qualification submission. A few weeks later, the government released a shortlist of 110 qualified applicants for solar photovoltaic and wind FiT projects.

The off-taker under the FiT program will be either the Egyptian Electricity Transmission Company (EETC) – the country's bulk power purchaser and sole operator of the grid – or distribution companies (depending on project sizes) pursuant to power purchase agreements of 25 years' term for photovoltaic facilities and 20 years' term for wind facilities.

While investors are flocking to gain a foothold in the first FiT regulatory period, banks and financial institutions are carefully observing in anticipation for the final project documentation (including the power purchase agreement - PPA). The released draft of the PPA is based on Egypt's IPP precedents and the Suez wind farm BOO project. It is currently being reviewed by the qualified investors and the leading financial institutions to address its bankability.

The nature of renewable power projects – with their high upfront capital requirements and low operational costs – further emphasizes the bankability challenge. Hence, it is of paramount importance to highlight to the government the key bankability concerns for banks and financial institutions at these early stages of structuring and drafting in order to ensure that the draft PPA is issued in good shape for negotiation.

OBJECTIVES

The objective of this briefing is to identify the issues/concerns that banks and financial institutions regard as crucial for the bankability of renewable power projects under Egypt's FiT program, and what are the best mitigation strategies for banks and financial institutions to address those concerns. Feedback and discussion regarding this briefing will enable us to produce a list of recommendations and an action plan for the government in order to ensure smooth bankability and, hence, implementation of the FiT projects.

EXECUTIVE SUMMARY

PROJECT AGREEMENTS

Issues	Explanation	Recommendation/Solution
EGP/USD Convertibility	<p>The power purchase price is paid in EGP, but based on a USD denominated formula.</p> <p>The currency exchange rate exposure for investors is practically limited to the portion of the proceeds paid at the fixed rate (i.e. 15% for solar and 30% for wind).</p> <p>Nevertheless, given the current USD reserves shortage in Egypt, convertibility risk would substantially hurdle investors' ability with respect to debt service.</p>	<p>We understand that the Central Bank of Egypt (CBE) initially agreed to guarantee the convertibility of 50% of the project revenues. This may ensure the availability of USD for awarded investors at least to cover debt service requirements or a substantial part of it. However, this does not guarantee the availability of USD for dividends repatriation and investors will need to assess this risk.</p> <p>The CBE conversion guarantee mechanism used for securities investors (i.e. Foreign Investments Fund) is a precedent practice that can be followed with respect to FiT projects.</p>
Off-taker Payment Security	<p>It is crucial to ensure punctual and timely payment of the power purchase price.</p>	<p>Main concerns are addressed in the current FiT regime so that:</p> <ul style="list-style-type: none"> • off-taker payments are backed by a sovereign guarantee from the Ministry of Finance (MoF); • no public finance concerns arise as the burden of the tariffs will be ultimately shifted to private consumers; and • the off-taker is mandated to purchase all the power made available at the plant regardless of the grid capacity.
Borrower & Project Performance	<p>Banks must ensure the punctual performance by the Borrower of its obligations under the PPA.</p>	<p>A direct agreement is entered between the security agent representing the lenders and the projects concerned parties including: the Borrower, the off-taker (i.e. EETC) and MoF as guarantor for the off-taker's obligations (the "PPA Direct Deed"). This PPA Direct Deed mainly acknowledges the lenders' security interest in the project and provides some remedial rights in case of the Borrower's default.</p> <p>Although it is uncommon to have the government guarantee and the direct agreement in the same agreement, this approach has been used in the New Cairo Wastewater Treatment Plant PPP project.</p>
Financing Tenor	<p>Our understanding is that Term Facilities are usually available for terms between 8-12 years. Securing facilities for terms proportionate to the project term (i.e. 25 years for solar and 20 years for wind) may be a challenge.</p>	<p>Refinance may be considered by investors seeking longer-term facilities.</p> <p>The lenders' remedial rights and security interest acknowledgement under the PPA Direct Deed and the Usufruct Direct Agreement should extend to any refinancing for the project during the PPA term.</p>

EXECUTIVE SUMMARY

LENDERS' SECURITIES

SHARE PLEDGE

There are no restrictions on the pledge of shares. A pledge of shares may be granted in favour of a foreign bank. The pledge of shares can cover shares in the local project SPV or its direct offshore holding company.

REAL ESTATE MORTGAGE

The project land is provided under a usufruct. In practice, registration of usufruct rights is not customary and is expected to raise many difficulties. Lenders usually secure the project land by the step-in and novation rights under a direct agreement, which extends to the project land. According to the draft Usufruct Agreement circulated during April 2015, this direct agreement will be a separate agreement from the direct agreement that provides for the MoF guarantee and will cater for the lenders' remedial rights and security interest over the project land (the "Usufruct Direct Agreement").

COMMERCIAL MORTGAGE

Commercial Mortgage covers tangible assets (such as machinery and equipment) and intangible assets (such as the trade name and trademark); however, it does not cover inventory or receivables.

The commercial mortgage must be registered at the Notary Public and annotated in the commercial registry of the borrower. This will be an important

and effective security for this type of projects.

ASSIGNMENT OF RECEIVABLES

Assignment is used in the context of finance in Egypt subject to a condition precedent, which is the occurrence of an event of default. The reason is that Egyptian law does not recognize the concept of assignment by way of security. The assignment can cover receivables under the PPA, EPC contractor guarantees, and indemnities under the O&M contract.

ASSIGNMENT OF INSURANCE

Covers the proceeds from the project insurance policies. Can be achieved through either a formal assignment perfected by a court bailiff notice to the insurer or by way of endorsing the relevant insurance policies naming the Security Agent as the first loss payee.

PLEDGE OF BANK ACCOUNTS:

This covers the Borrower's revenue accounts. Doubts exist as to the enforceability of pledges over banks accounts in Egypt, yet it is common practice for banks to obtain such pledge.

CORPORATE GUARANTEE

This guarantee is usually provided by the creditworthy parent of the project SPV. If the guarantee is given by an Egyptian company, corporate benefit for the guarantor must be demonstrated.



PROJECT AGREEMENTS

The Power Purchase Agreement (PPA) is the most important document of the project and the main umbrella for the other project ancillary agreements (such as, the usufruct agreement for the project land, the PPA Direct Deed for lenders' security interest which include the guarantee of the Ministry of Finance (MoF)...etc).

In this section, we address issues relating to the PPA.

1 CURRENCY & CONVERSION RISK

Tariffs for solar projects above 500kW and wind projects are denominated in USD and shall be payable in EGP according to exchange rate formula that includes a fixed and floating forex components:

SOLAR POWER

15% fixed rate (at EGP 7.15 per USD 1)

85% floating rate (subject to prevailing market rates)

WIND POWER

30% fixed rate (at EGP 7.15 per USD 1)

70% floating rate (subject to prevailing market rates)

This means that the currency exchange rate exposure for investors is practically limited to the portion of the proceeds paid at the fixed rate (i.e. 15% for solar and 30% for wind). Nevertheless, another substantial exposure arises with respect to convertibility of the EGP proceeds given the current USD reserves shortage in Egypt.

Convertibility risk would substantially hurdle investor's business, particularly with respect to Debt Service. The larger tranche of project financing will be denominated in USD (this would typically cover 80% of project financing). The investor will have to convert the EGP proceeds into USD in

order to be able to serve its debt.

MITIGATION STRATEGY

We understand that the Central Bank of Egypt (CBE) initially agreed to guarantee the convertibility of 50% of the project revenues. This portion is based on the following estimated project financial model:

- 50% of project revenues allocated to debt service;
- 11% of project revenues allocated to tax payments (which are payable in EGP); and
- Remainder of the revenues allocated to operation and maintenance costs and dividend distributions.

This may ensure the availability of USD for awarded investors at least to cover debt service requirements or a substantial part it. However, this does not guarantee the availability of USD for dividends repatriation and investors will need to assess this risk.

We suggest that the Central Bank of Egypt (CBE) provides written regulations/mechanism similar to the EGX Foreign Investments Fund where it commits to ensure the availability of USD for awarded investors at least to cover debt service requirements. The CBE has adopted a similar mechanism for currency conversion for foreign investments with respect to securities listed on the Egyptian Stock Exchange, which is known as the

Foreign Investments Fund. This system provides the foreign investors a two-way conversion mechanism through Egyptian custodian banks in connection with Egyptian listed shares and treasury bills (i.e. the investor may convert foreign currency into EGP for the purposes of purchasing Egyptian securities and reversibly may convert EGP proceeds realized from the sale of Egyptian securities into foreign currency). The CBE sponsors the funds necessary for such conversions, only provided that the investor proves that its initial investment in the securities was injected in Egypt in foreign hard currency and was converted into EGP through one of the licensed banks.

We would expect that the CBE may require the following eligibility criteria to guarantee the availability of USD for 50% of the project's revenues:

1. Project investment funds must be injected by

investors in Egypt in foreign hard currency;

2. Any conversions to EGP must be done through one of the licensed banks under the supervision of the CBE;
3. Conversion will be guaranteed to the extent necessary to cover debt service costs provided that:
 - USD funds are not available in Egyptian licensed banks or available at rates that exceed certain threshold above the exchange rates announced by the CBE (we understand that such threshold will be set at 3%);
 - Facilities are made for the project in foreign hard currency; and
 - The said facilities are either disbursed into accounts opened in Egypt or covers credit lines provided to the investor with respect to project equipment imported to Egypt



2 OFF-TAKER PAYMENT SECURITY

Power projects' finance is heavily dependent on the project's proceeds and cash flow. Hence, financial health and creditworthiness of the off-taker is crucial for banks to ensure punctual and timely payment of the power purchase price.

MITIGATION STRATEGY

Risks and concerns with respect to off-taker payments are addressed through the following:

1. Payments of the off-taker under the PPA will be backed by a sovereign guarantee from the Ministry of Finance. Lenders must ensure that the government has followed the

required legal formalities in relation to the MoF guarantee.

2. Payment of the lucrative tariffs will not impose an additional burden on the already soaring public budget, but will be rather passed ultimately to the private sector through renewable purchase obligations on certain bulk consumers (as determined annually by the Cabinet of Ministers).
3. The Renewables Law mandates the power off-taker to purchase the power made available by the relevant plant, even in cases where the grid was not upgraded to accommodate the produced capacity.

3 BORROWER & PROJECT PERFORMANCE

Banks must ensure the punctual performance by the Borrower of its obligations under the PPA. In project finance, banks would seek some remedial rights in case of Borrower's default.

MITIGATION STRATEGY

PPA Direct Deed is entered between the security agent representing the lenders and the projects concerned parties including: the Borrower, the off-taker (i.e. EETC), MoF as guarantor for the off-taker's obligations. The PPA Direct Deed covers the following aspects:

- **Security Interest**

- **Acknowledgement:**

Acknowledgement of the lenders' security interest over the project documents – please refer to Lenders' Securities below for more details on the available securities.

- **Sovereign Guarantee:**

Guarantee by MoF of the off-taker's obligations under the PPA.

- **Remedial Rights:**

The financiers receive some remedial rights such as cure period and step-in rights in case of the Borrower's default under the project agreements. Step-in entitles the lenders, in certain

cases, to nominate an interim replacement of the Borrower who will undertake its obligations under the project documents.

- **Transfer and Novation:**

The lenders will be entitled in certain cases and subject to certain conditions to transfer and novate the project documents to a substitute developer/ operator to be approved by the off-taker and NREA. The Usufruct Direct Agreement is also between the security agent representing the lenders, the Borrower and NREA and caters for the lenders' security interest acknowledgement, remedial rights

and novation rights over the project land allocated by NREA. It is worth noting that although it is mentioned in the released draft Usufruct Agreement, the draft Usufruct Direct Agreement has not been released yet.

In other words, the ability of the banks to enforce over the project as an ongoing business will be through the contractual mechanism set out in the PPA Direct Deed and the Usufruct Direct Agreement. A similar structure was used under the New Cairo Wastewater Treatment Plant PPP project (the only PPP that reached financial close in Egypt).



4 FINANCING TENOR

Our understanding is that Term Facilities are usually available for terms between 8-12 years. Although the PPA term is 25 years for solar power and 20 for wind power, securing facilities for longer term may be a challenge. Refinance may be considered by investors seeking longer term facilities.

Also we understand that the larger tranche of the USD lending will be likely made by offshore banks and international financial institutions, as local banks

would likely face challenges in long term USD lending. Accordingly, it would be critical for refinancing that the guarantees accommodated in the PPA Direct Deed and the Usufruct Direct Agreement (including MoF guarantee, lenders' security interest acknowledgement, remedial rights and novation rights) are extended to any project refinancing during the term of the PPA.

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LENDERS' SECURITIES

In addition to the lenders' protections in the Project Documents (as explained above) financing power projects is expected to be made against fairly typical security package, subject to the following Egyptian law principles:

- Security in Egypt may only be granted over existing and specified assets. Granting a security over future assets is null and void (in practice assignment of receivables is an exception as it is not perceived as a security under Egyptian law).
- In addition, Egyptian law does not recognize the concept of floating charge.

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CENTRAL BANK OF EGYPT

1 PLEDGE OF SHARES

There are no restrictions on the pledge of shares. A pledge of shares may be granted in favor of a foreign bank.

The pledge of shares can cover shares in the local project SPV or its direct offshore holding company. Perfection of share pledges depends on the type of shares:

pledge over materialized shares is not registerable, but is rather possessive where the share certificates are kept with the pledgor.

pledge over immaterialized shares, must be registered with Misr for Central Depository and Registry (MCDR).

2 REAL ESTATE MORTGAGE

The project land is provided under a usufruct which is registerable, hence, in theory, it can be subject to a real estate mortgage.

In practice, however, in order to register the usufruct right with the notary, the original registered title deed must be submitted to the notary at the time of registering the usufruct right. Since the land was allocated to NREA by virtue of a presidential decree, then this allocation decree (representing the original title deed) is most likely not registered, and thus it will be impossible to register the usufruct right.

Even in case the original title deed is registered, registration of usufruct rights is not customary and is expected to raise many difficulties with respect to registering mortgage for foreign banks and registration fees. Moreover, registration of a real-estate mortgage in general is a very slow and bureaucratic process before the government notaries and takes from one to two years to be registered.

The project land is covered by the step-in and novation rights under the Usufruct Direct Agreement, which usually comforts the lenders with respect to securing the project land. In other words, the ability of the lenders to enforce over the project as an ongoing business, including the project land, will be through the contractual mechanism set out in the PPA Direct Deed and the Usufruct Direct Agreement. It is

worth noting, however, that the draft Usufruct Direct Agreement has not been released yet.

3 COMMERCIAL MORTGAGE (FONDS DE COMMERCE)

Egyptian law does not recognize the concept of floating charge. The closest Egyptian law concept is the “commercial mortgage” which covers all the tangible assets (such as machinery, equipment) and intangible assets (such as trade name, trademark). Unlike the floating charge, the commercial mortgage only covers existing assets, which have to be clearly identified in the relevant commercial mortgage agreement, and does not cover inventory or receivables.

The commercial mortgage must be registered at the Notary Public (banks’ notary public office is the competent office) and annotated in the commercial registry of the borrower.

It must be noted that the bank holding the commercial mortgage must be licensed by the Minister of Economy to obtain commercial mortgages. All local banks and some of the international financial institutions (for example, IFC)

4 ASSIGNMENT OF RECEIVABLES

Egyptian law does not recognize assignment of contracts by way of security. However, assignments is used in the context of finance in Egypt and market practice is to grant an assignment subject to a condition precedent, which is the occurrence of an event of default.

The assignment can cover receivables under the PPA, EPC contractor guarantees, indemnities under the O&M contract.

The assignment of rights under an agreement does not need to be registered. The only formality required is that the relevant obligor must send a court bailiff notice to the contract counter party notifying such counter party of the assignment of the obligor’s rights

under the relevant agreement. An assignment of rights under a relevant contract is perfected through the service of a notice on the relevant contract counter party through court bailiff notifying such counter party that the relevant obligor has assigned its rights under the relevant contract to the assignee.

5 ASSIGNMENT OF INSURANCE PLEDGE OF SHARES

Assignment of insurance policies covering the project can be achieved through either:

Assignment of Proceeds:

The Borrower formally assigns all the proceeds of the relevant insurance policies to the Security Agent (on behalf of the lenders). This will be an absolute assignment that will be perfected by a court bailiff notice to the insurer the same way as for the assignment of receivables explained above.

Policy Endorsement:

The Borrower executes an endorsement of the relevant insurance policies with the insurer naming the Security Agent (on behalf of the lenders) as first loss payee of the policies.

In both cases should the insured events occur during the term of the facility, all proceeds will be paid to the Security Agent. The Security Agent will be responsible for allocating such proceeds for replacement/repair of the damaged assets or towards mandatory pre-payment as per the terms of the Facility Agreement.

6 PLEDGE OF BANK ACCOUNTS

Pledge of bank account is possible in Egypt and does not require any registration.

However, doubts exist on the perfection of a pledge over an Egyptian bank account, where the pledgor continues to operate the account. This is because the transfer of possession of a movable to the pledgee or to a third party on its behalf is essential to the creation of a valid pledge under Egyptian law. Moreover, the pledge of future assets is null and void under the Egyptian Civil Code. Therefore, there is a risk that any interested party can claim that any increase in the amounts of the pledged bank account after the pledge is perfected is a mortgage of a future asset.

Notwithstanding the above issues, it is normal market practice in Egypt to take such a pledge relying on the banks right of set-off under the law.

7 CORPORATE GUARANTEE

This guarantee is usually provided by the credit worthy parent of the project SPV.

As a general rule, any guarantee given by an Egyptian corporation must achieve a corporate benefit for the guarantor, otherwise it may be voidable. A downstream guarantee ordinarily satisfies this test of corporate benefit, but an upstream or horizontal guarantee will only do so if there is a corporate benefit to the guarantor and not merely to the group as a whole.

WHO WE ARE

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