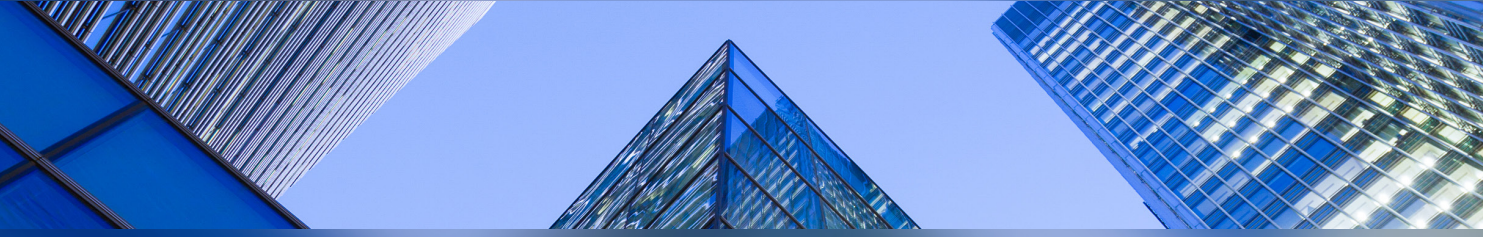


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**DRAFT LAW TO DIVERSIFY FUNDING  
OPTIONS FOR TURKISH PROJECTS**

## DRAFT LAW TO DIVERSIFY FUNDING OPTIONS FOR TURKISH PROJECTS

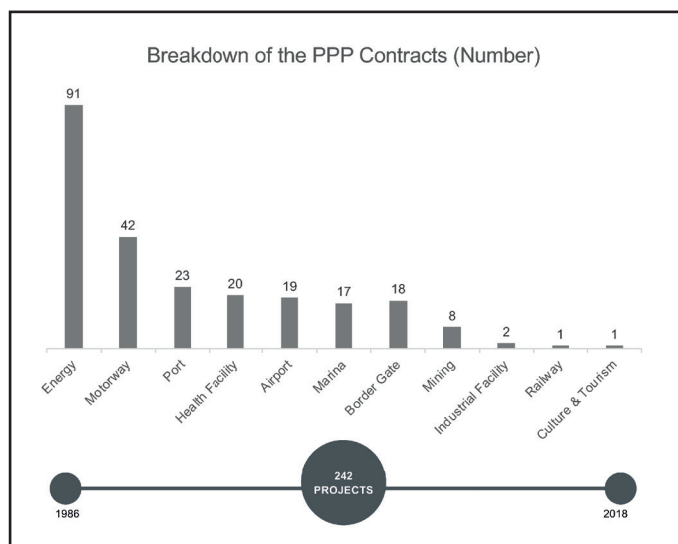
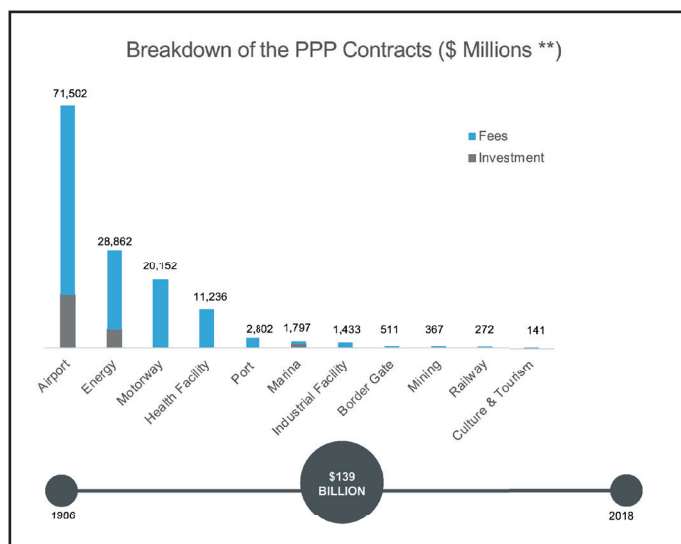
On 6 February 2020, a bill that introduces significant structural changes to the Banking Law (Law No. 5411) (the “**Banking Law**”) and Capital Markets Law (Law No. 6362) (the “**Capital Markets Law**”) of Turkey was submitted to the Turkish Parliament (the “**Draft Law**”). The Draft Law proposes significant improvements to the legal framework applicable to project bond issuances in Turkish capital markets and Turkish securitisation and debt funds, such as the introduction of security trustees, and adopts new rules that will enable a wider investor base to provide financing directly to Turkish projects.

### Turkish project finance market at a glance

#### Impressive Track Record

Turkey has been pursuing an ambitious PPP programme and carried out impressive project financing deals with increasing investment volumes since the early 2000s. The Turkish government continues to be a leader in the emerging markets with landmark infrastructure PPP projects like the Istanbul Grand Airport and the Third Bosphorus Bridge, and continues to attract new foreign and local investors’ attention with mega PPP projects on the pipeline like Canal Istanbul, Grand Istanbul Tunnel and the Izmir Bay Crossing Bridge.

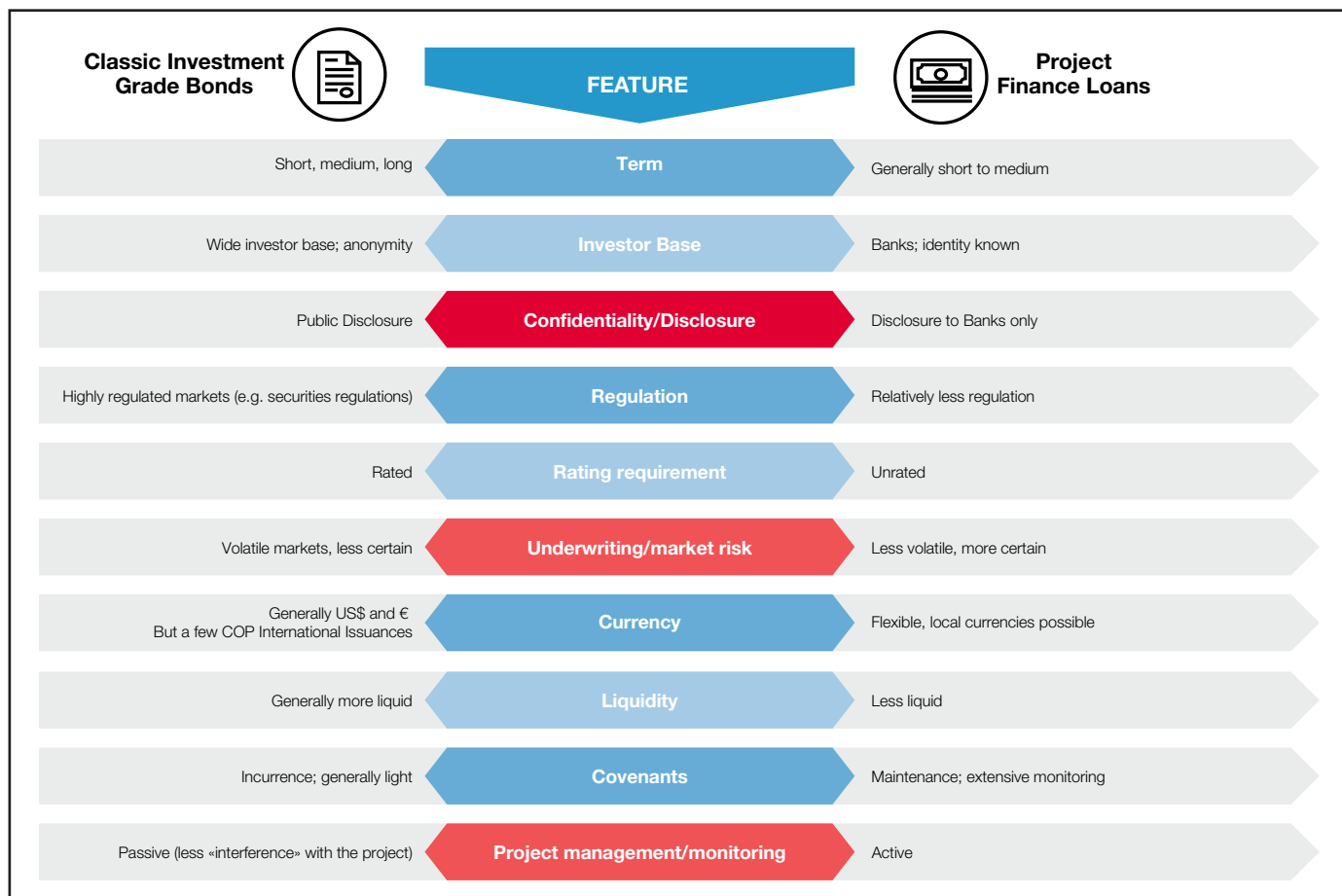
Despite Turkey’s robust PPP programme, debt financing of infrastructure projects through capital markets has been relatively limited compared to its peers. In the aftermath of a number of adverse economic shocks, the Turkish government is now taking numerous measures to support growth, including increasing the sovereign support where government is best able to absorb risk in PPP projects and proposing alternative solutions to meet the financing needs of the Turkish project developers.



### Credit Crunch

To date, almost all of the large-scale infrastructure projects in Turkey were financed by banks through conventional loan facilities. However, as a result of the burdensome regulations on treatment of banks and the lending standards introduced in the aftermath of the financial crisis, conventional lenders were no longer able to extend long-term loans with suitable terms and were more inclined to downsize their exposure in Turkey. In addition, the fluctuations in the value of Turkish currency along with the rise in costs of borrowing has made it increasingly challenging to fund infrastructure projects solely by bank loans.

Consequently, in order to tackle the immediate need for funding necessary to meet the country's enormous infrastructure and energy needs and support project developers, the Turkish government is seeking to explore and implement alternative financing methods. The project developers, in particular those that are highly leveraged and particularly sensitive to depreciation of the Turkish Lira, are likewise looking into innovative opportunities to diversify their funding base by tapping into the capital available from institutional and other capital markets investors.



### Conventional Loans vs. Project Bonds

Project bonds are bonds issued to the capital markets in order to fund the whole or part of a project financing. The issuance documentation typically follows that of a standard corporate bond issuance, save that, additionally, the bondholders (and any other funders to the project) will benefit from standard project financing terms such as an extensive covenant package and security over the assets of the project company. Where other forms of debt are provided alongside the bonds, intercreditor arrangements will govern decision-making and enforcement rights.

Historically, in a project bond financing, an issuer would receive the proceeds of the issuance entirely upfront – as opposed to a gradual release of funds on different project phases based on the financing needs of the project (as bank finance typically does). Whilst this approach is still used, particularly for refinancing in the global markets, many institutional investors now offer phased drawdowns, whereby they purchase bonds over the construction period, minimising the negative carry which may otherwise apply if project companies hold funds until required. This development has made project bonds increasingly competitive against bank finance.

While Turkey has set out ambitious targets for short-term public infrastructure projects, it currently still lacks a legal framework suitable for long-term domestic capital market financing of infrastructure projects. While similar structures have been used in global markets by Turkish issuers to procure funding to their projects, the size of the domestic institutional investor base as well as the country's domestic issuance regulations currently in place, which do not differentiate much between a greenfield project bond or a regular corporate bond issuance, appear to be key concerns for potential issuers and investors in the local market. With the Draft Law, Turkey aims to facilitate issuance of project bonds in a bid to provide funding to Turkish projects with attractive terms.



### Proposed alternative financing structures under the draft law

Considering the increasing costs of funding and current lending market conditions in Turkey, project sponsors are now looking into alternative (re)financing structures that could be viable for Turkish PPP and energy projects. The Draft Law sets out the legal framework for less-tested structures in the local market, including project bonds and security trusts, which could be used to tap liquidity into the Turkish projects from capital markets, with more favourable terms.

Currently most infrastructure financing in Turkey is provided by domestic and international banks, including multilateral development banks. Against the backdrop of the credit crunch, local banks are no longer willing to provide financing for public concessions and PPP projects at low costs, increasing the country's dependency on offshore liquidity and financing sources.

The novelties introduced under the Draft Law could be used in order to lessen Turkey's dependence on foreign financing by allowing efficient and widespread funding from Turkish and foreign corporate investors. Further, the Draft Law aims to support the country's ambitious PPP programme to develop public infrastructure, which is expected to create greater demand for long-term capital market debt and lead to further enhancements in its PPP framework.



## Project Bonds

### • *Investment Institutions: Greenlight for Project Finance*

Investment institutions are joint stock companies licensed by the Capital Markets Board of Turkey (the “**CMB**”) to operate a portfolio consisting of capital markets instruments, real estate, private equity investments and other assets and rights in accordance with the Capital Markets Law.

The Draft Law provides new rules for project financing, outlining for the first time the ability of Turkish investment institutions to engage in lending and provide direct financing to Turkish projects.

### • *PF Funds*

The Draft Law allows investment institutions to establish special purpose project financing funds (“**PF Funds**”) to provide long-term financing to projects that entail high capital costs in sectors such as infrastructure, public services, energy, industrials or high tech. In order to act as founder and/or manager of PF Funds, the investment institutions would first need to obtain a licence from the CMB.

Similar to the real estate investment funds introduced back in 2014 in a bid to support the then blooming Turkish real estate market, Turkish PF Funds will also be contractually formed unincorporated funds that have no legal personality. The PF Funds will be established to manage the portfolio of bonds or other capital markets instruments issued in respect of a specific project and managed by a licensed investment institution in accordance with the Capital Markets Law. The assets forming a PF Fund would be considered separate from the assets of such PF Fund’s manager or founder, which will have a fiduciary relationship with the investors.

PF Funds introduced under the Draft Law could be the much-needed novelty in the Turkish project finance market, allowing Turkish project developers to explore alternative financing techniques with more suitable terms. In addition, these PF Funds may potentially also be used for refinancing, securitisation or repackaging of the existing conventional bank loans in the Turkish PPP market, and could potentially boost investments in relatively underutilised schemes, such as municipal bond issuances.

The Draft Law also announces that further guidelines and detailed rules applicable to establishment and operations of the PF Funds will be published by the CMB under a separate communiqué at a later stage.

### • *Recent amendments to the Turkish PPP Legislation*

In tandem with the recent amendments to the Turkish PPP laws increasing the sovereign support for the PPP projects in anticipation of the tender for Turkish mega PPP projects on the pipeline, the Draft Law mainly authorises the CMB to regulate the capital markets to provide alternative ways of funding to project developers in Turkey. These developments appear to be in line with the economic programmes and plans of the Turkish government announced in the past years, which focused on carrying out mega infra PPP projects with a fresh, unified and efficient legal framework. Considering the need in the market for urgent and efficient refinancing, we believe the Draft Law



may finally lead to alternative financing methods (e.g. project bonds or other capital markets instruments) being introduced to either finance or refinance the PPP deals while aiding the Turkish government to get a hold of its contingent liabilities and ballooning costs.

In addition to the legislation process of the Draft Law, the secondary legislation to be issued by the CMB would also be key to understand the main rules for issuances by project developers, including with respect to issuance limits or any exemption to be introduced regarding specific types of projects.

### Security Available to the Investors

Due to the likelihood that the holders of a project bond will change over time via trades on the secondary market, for any public listed issuance it is key for a party to act as a fiduciary representing the interests of the entire group of bond investors, and manage the security on their behalf.

Although the security agency concept is widely used in the Turkish market under different structures, Turkish legislation currently still lacks an investor-friendly legal framework suitable for the use of concepts similar to security agencies or trusts. The Draft Law introduces for the first time the concept of a security trustee, a CMB-licensed security holder acting on behalf of the investors, that will oversee the collateralised assets which are segregated and bankruptcy remote. In a bid to increase the value of security held by investors in the Turkish Capital Markets, the Draft Law also grants significant exemptions and authorities to the security trustees such as the right to liquidate the secured assets without going through the Turkish enforcement offices.

- **Security Trustee**

The Draft Law provides that Turkish investment institutions may act as security trustees (*teminat yöneticisi*) in relation to certain Turkish capital markets instruments provided that they obtain a licence from the CMB allowing the offering of custodian and depository services.

- **Security Trust Agreement**

The security trustees would be entitled to hold securities on behalf of investors and assist note holders with related matters ranging from preservation of security to enforcement. For these purposes, the security trustees would be required to enter into a written security trust agreement with the relevant investors setting out the terms applicable to, amongst other things, actions to be taken in the event of a default, methods of liquidation and sharing of enforcement proceeds amongst the investors.

The details of mandatory minimum content and formal requirements in relation to such security trust agreements are expected to be published by the CMB under a separate communiqué.

- **Noteholders' meetings**

The Draft Law allows holders of a specific note to take joint action through noteholders' meetings. Pursuant to the Draft Law, noteholders would be able to take decisions with affirmative votes from investors holding the notes representing more



than 50% of the nominal value of the relevant outstanding bonds, unless such matter is specifically made subject to a higher threshold under the offering documents or the secondary legislation to be issued by the CMB.

The Draft Law also provides that the offering documents would be required to set out in detail under which circumstances an issuer or a noteholder may convene a noteholders' meeting or take a specific action in relation to the relevant capital markets instruments.

- **Segregation of Collateral**

The Draft Law provides that the collateral held by the security trustees would be segregated and ring-fenced from their own assets, allowing for bankruptcy remoteness of the collateral held on behalf of the investors.

- **Enforcement**

The Draft Law also aims to promote the use of this concept novel to the Turkish capital markets by allowing the security trustees to directly sell the secured assets, without going through a public tender run by Turkish enforcement offices or obtaining any other judicial or regulatory approvals. If implemented, these features in the Draft Law could allow project developers to seek financing in the Turkish capital markets more frequently and with attractive terms, given the investors would be offered an enhanced and "more liquid" security package.

These expedited enforcement options proposed under the Draft Law could, if implemented, significantly increase the value of security granted by the issuers, since under current market rules, there is fairly limited availability of easily enforceable security interests, and the requirement to go through the ordinary debt collection process before Turkish courts is generally considered to be time consuming by the investor base.

## Outlook

With its impressive track record and strong sovereign support, Turkish infrastructure and PPP projects continue to be an attractive opportunity for all types of investors across the globe. With the Draft Law, Turkey appears to be following in the footsteps of Argentina and other Latin American countries which have implemented integrated landmark infrastructure PPP projects with blended financing structures in their regions. The developments to be introduced under the Draft Law could lead to the much anticipated relief to the credit crunch experienced by Turkish project developers in the aftermath of adverse economic shocks that occurred since mid-2018s and offer an opportunity for sponsors to diversify their funding base by tapping into the capital available from both local and foreign investors. If implemented, the Draft Law could also allow greater participation from institutional investors, bring in new sources of capital and help local banks to better manage exposures under a fresh legal framework.

While the targeted revisions to the underlying regulatory framework could potentially expand the use of capital markets instruments to finance infrastructure, it would ultimately be up to the Turkish regulatory authorities to put in place secondary legislation to set out the detailed rules applicable to issuances. Therefore, in addition to



the legislation process of the Draft Law, the approach to be taken by the Turkish regulatory authorities in areas such as potential exemptions which may be granted to specific projects, or the interplay between the Draft Law and the existing dollarisation restrictions in the Turkish capital markets, will be key to analyse and understand the upcoming opportunities for investors.

Market players would likewise need to adapt to a different set of rules and standards in parallel with the implementation of the Draft Law. While the issuers would have a wider range of options to fund their projects through multi-sourced financing structures, they would also require familiarisation with increased financial reporting, rating and the mandatory public disclosure requirements to be introduced under secondary legislation by the CMB in the historically bank loan dominated Turkish project financing market that is used to operating on a confidential basis. Furthermore, the level of sovereign support for these new financing structures would also play a vital role in the early stage development of the local markets. In particular, it would be interesting to see whether the Turkish government will extend the scope of sovereign support that is currently only available to external financing resources (such as debt assumption by the Turkish Treasury) or establish a centralised fund in a bid to achieve off-balance sheet financing of capital project costs (such as guaranteed revenues) in relation to the upcoming projects.

With the right mix of investors, a well-structured project and robust risk mitigants, the Turkish project bond market could be an appealing alternative to other, more conventional methods of financing. Following legislation of the Draft Law, we would expect both project sponsors and sovereign actors to explore alternative markets and take advantage of the cost benefits to be had from a bond issuance in blended greenfield financing structures as well as potential refinancings.

## CONTACTS



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