Sunset as seen from Jebel Hafeet mountain, UAE @ Leonid - Dreamstime.com

HAFEET – GCC'S FIRST CROSS-BORDER RAIL FINANCING

The Hafeet Rail project, a landmark initiative by Etihad Rail, Oman Rail and Mubadala Investment, marks a significant milestone as the GCC's first cross-border rail network. This ambitious project is the first of its kind, a government-government collaboration in the region's rail sector and aims to enhance connectivity between the UAE and Oman, fostering economic growth and sustainability. Among several firsts, it is the region's first ever greenfield rail project to be financed on a limited recourse project finance basis and should serve as a benchmark for several other rail projects in the future given its cross-border complexities, regulatory framework besides lenders taking on demand/operating risk. By **STEPHEN KNIGHT***, partner,* **DENTONS** *and* **SAURABH KUMAR***, executive director project finance,* **STANDARD CHARTERED BANK**.

Under the leadership of the United Arab Emirates and the Sultanate of Oman, the Hafeet Rail project is set to transform regional transportation. Spanning 238km, the network will connect five major ports and various industrial zones, facilitating the efficient movement of people and goods and includes 60 bridges, some soaring up to 34m high, and tunnels extending up to 2.5km.

The railway will reduce travel time between Abu Dhabi and Sohar to just 100 minutes, with freight trains transporting over 15,000 tonnes of cargo per journey, equivalent to approximately 270 standard containers, reaching speeds of 120km/h; and passenger trains reaching speeds of 200km/h with each train able to accommodate up to 400 travellers and connecting these key cities across the two countries.

The Hafeet Rail project is poised to transform regional transportation by enhancing the mobility of people and goods between the UAE and Oman using state-of-the-art infrastructure. It aims to strengthen historical ties between the two nations, boost tourism while also contributing to their sustainability goals. The project is a new milestone in the development of the rail sector in the UAE, Oman and the broader Middle East and will help uptier the region's positioning and competitiveness in the global infrastructure space

ECONOMIC IMPACT

By connecting Sohar to the UAE's national rail network as Phase I of the project, this unified transport and logistics chain will span the region, delivering mutually beneficial socioeconomic and competitive advantages.

The improved connectivity provided by the joint rail network will benefit local producers and manufacturers in both countries by giving them better access to larger markets, both domestically and internationally. The joint rail network is a vital addition to the regional logistics sector. It will play a role in stimulating various industrial sectors and economic activities by providing increased

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commercial and investment opportunities, supporting the integration of port activities and connecting them to regional and international markets. Additionally, it will contribute to attract national and foreign investment.

Sectors set to benefit from this new capacity range from mining to iron and steel, agriculture and food, retail, ecommerce, and petrochemicals. The project will provide key benefits that will help to reduce costs, improve efficiency and effectiveness of transportation and ensure logistics services meet the needs of end-users.

Overall, the network will also provide trade, investment, and job opportunities for the private sector, training national human resources, enriching tourism activities, and improving global competitiveness by further establishing the two cities as key logistics hubs serving as gateways to regional markets.

The project was also developed with sustainability at its core, enabling an environmentally cleaner method of freight transportation between the two countries, moving away from the traditional truck transportation model. This project is also integral to Etihad Rail's commitment towards supporting the UAE's strategy of achieving net-zero emissions by 2050. Etihad Rail's network is set to play a pivotal role in reducing carbon emissions from road transport by 21% annually by 2050, which is equivalent to removing 8.2m tonnes of CO_2[1].

FINANCING OVERVIEW

The US$2.5bn Hafeet Rail project secured US$1.5bn in project finance debt from a diverse consortium of 17 banks comprising local, regional, and international financiers, with significant support from Emirati and Omani banks reflecting the project's strategic importance to both nations. The project was very well received in the bank market and was significantly oversubscribed. This high level of interest reflects strong confidence in the project's viability, strategic significance and alignment with the region's sustainability goals.

The facilities were split into conventional facilities and Islamic Istisna'a-Ijara facilities, with each facility split between dirham and rial, with initial tenors of eight and 12 years.

One of the most important objectives for the sponsors was to maintain the project development timeline. As a result, the project financing structure and liquidity pools were driven by the tight project development timeline. As a result, while there was strong interest from export credit agencies and development finance institutions for the project, the sponsors ultimately decided to proceed with a liquidity pool comprising project finance commercial banks given the timelines.

While the project could have been levered up further given the strong oversubscription, the sponsors chose to stick to the original leverage of 60:40 along with bankable coverage ratios, further demonstrating their strong commitment to this strategic project.

Standard Chartered in their capacity as lead financial adviser with FAB as co-financial adviser provided sponsors with financial advice on the financing while Dentons advised the sponsors on the legal aspects of the financing.

CONSTRUCTION RISK

The main feature of the financing from the financiers' perspective was ensuring the project was constructed on time across its four-year scheduled construction period and on budget, while the sponsors wanted flexibility to manage the construction risk in an appropriate and commercial manner given multiple design and build packages, multiple supply contracts and the first-of-its-kind cross-border nature of the project.

As a result, in addition to appointing reputed EPC contractors, the sponsors provided limited support to the financiers during the construction phase of the project until such time as the project becomes operational. Significant due diligence was undertaken with Atkins, as the financiers' technical adviser, in order to construct a completion date definition that reflected the requirements of financiers and sponsors alike.

Linked to the sheer size of the project and in order to streamline decision-making to achieve successful construction completion, it was agreed that while Atkins would provide the financiers with technical advice prior to financial close, Systra SA would perform the role of PMC with a dual duty of care to both financiers and Hafeet Rail until the end of the construction period. This unique feature for a project financing in the region was based on the concept of an independent tester in UK PFI/PPP where the completion tests are signed off by a single consultant owing its duty of care to financiers, the public authority and the project company.

REVENUE RISK

While the sponsors provided some support on the construction risks, one of the main goals of the financing from the sponsors' perspective was ensuring that once the project is operational, it should stack up on its own merits based on the robust business case.

As a result, revenue risk is passed to the project company and consequently the financiers. Atkins was also appointed as the lenders' market consultant to review the business case prepared by McKinsey in conjunction with the sponsors.

While this is a greenfield rail project, the traffic risk is mitigated by the fact that there is already robust volume of traffic between Sohar and Abu Dhabi via roads and given the significant cost and time savings associated with moving to the rail network, this is simply a substitution of the existing traffic volumes from road to rail. The strong support of the governments of the UAE and Oman for the long-term success of the project and the beneficial impact the project will have on the socioeconomic and competitive environment in both countries meant the financiers were willing to assume revenue risk.

TENORS AND REFINANCING RISK

Another of the key features of the financing was the refinancing risk. The sponsors chose to have multi-tenor facilities along with a healthy balance between both tenors to reduce the risk of refinancing the facilities in the future when liquidity, pricing or the revenue risk borne by financiers was unfavourable. Both the eight-year and 12-year tranches were structured on a hard mini-perm basis with lenders essentially taking refinancing risk.

Lenders derived comfort from the construction and operating track record of Etihad Rail in previous projects, its strong business case as well as the overall strategic importance of the project. Given the multi-tenor nature of the facility, the financing was structured in a way that security can remain preserved for the financiers participating in other tenors without having to release and retake the security, as well as reducing the associated refinancing costs.

CONVENTIONAL AND ISLAMIC FACILITIES

The conventional facilities were financed by Abu Dhabi Commercial Bank PJSC, Ahli Bank SAOG, Arab Bank PLC, Bank Dhofar S.A.O.G., Bank Muscat SAOG, Commercial Bank of Dubai PSC, First Abu Dhabi Bank PJSC, National Bank of Kuwait S.A.K.P. UAE, National Bank of Oman SAOG, Oman Arab Bank SAOG and Standard Chartered, with Abu Dhabi Commercial Bank PJSC acting as conventional AED & US$ facility agent and Bank Muscat SAOG acting as conventional OMR facility agent.

The Islamic facilities were financed by Abu Dhabi Islamic Bank PJSC, Ahli Islamic, Ajman Bank PJSC, Alizz Islamic Bank SAOC, Bank Nizwa SAOG and Meethaq Islamic Banking, with Abu Dhabi Islamic Bank PJSC acting as the investment agent.

Alongside the now typical challenges faced when putting together dual-tranche conventional and Islamic facilities, the presence of the mixture of UAE banks (which are now required to follow Accounting and Auditing Organization for Islamic Financial Institutions (AAOFI) standards as interpreted by the UAE Central Bank) and Omani banks (which do not) created additional complexities.

While it is increasingly common to have AAOFI and non-AAOFI tranches in Islamic murabaha facilities, it is not market practice to do so in Istisna'a-Ijara facilities and so the documentation needed to cater for the requirements of both UAE and Oman regulations, supported by Abu Dhabi Islamic Bank PJSC as the investment agent.

The remaining administrative roles applicable to all facilities involved First Abu Dhabi Bank PJSC as global agent and UAE account bank, Abu Dhabi Commercial Bank PJSC as UAE security agent, offshore security agent and offshore account bank, Bank Dhofar S.A.O.G. as Oman security agent and Bank Muscat SAOG as Oman account bank.

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OPERATING MODEL

Given that operating a cross-border rail project has not been done in the GCC previously, significant attention was given to ensuring the project pursued an appropriate operating model. Sponsors landed on having Hafeet Rail, a UAE incorporated company, as the principal obligor under the financing and owning the various rolling stock, which was able to give effective security over the future pool of the project's rolling stock to the financiers under the UAE movables assets security legislation. Hafeet Rail's wholly owned subsidiary, Hafeet Rail SPC incorporated in Oman, will operate the railway on the Oman side of the border, granting a commercial mortgage over its assets in Oman.

FUTURE-PROOFING THE FINANCING

As one might imagine, the construction of the new railway from Sohar to connect with the UAE's national rail network will only achieve its full potential if the network is allowed to grow. With that in mind, the financing provides Hafeet Rail with the flexibility to expand its project through the incurrence of additional capex, additional debt that is non-recourse to the initial project's revenues and assets, while allowing the revenues generated from any such expansion to be ringfenced from the initial project's financiers' control.

Significant time was spent structuring this aspect of the financing to ensure that it provided Hafeet Rail with the flexibility to carry out the mandate given to it by the sponsors and the governments of the UAE and Oman.

EXPEDITIOUS TIMELINE

One of the most successful features of the project financing was the sheer speed at which a first-of-its-kind cross-border project came to fruition. The sponsors appointed Standard Chartered as their lead financial adviser, FAB as co-financial adviser in March 2023 and Dentons as sponsors' legal counsel in September 2023, with commitment letters being signed by 17 banks in March 2024 and finance documents were signed on September 26 2024. In just over a year, the sponsors had put pen to paper and documented the entire transaction, demonstrating the commitment of the financiers, the sponsors and the respective governments. ■

FOOTNOTE

1 - Source – ER website