Project finance in Indonesia: toll road financing

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Toll road (in some jurisdictions known as highways or expressways) projects are undertaken under a concession agreement signed by the Government of the Republic of Indonesia (government) and the toll road company established to develop, construct and operate the toll road project. This article focuses on toll road financing, including a discussion of debt to equity ratio requirements, due diligence issues, the structure of the financing, key challenges, quasi-equity for toll road projects and what the security package must cover.

As an introduction, the article also covers the overview on the latest development in infrastructure projects, especially toll roads, in Indonesia. To conclude it discusses recent government guarantees given for project financing.

Latest developments in infrastructure projects The government has issued a programme for the development of Indonesian welfare, called MP3EI. MP3EI provides steps for Indonesia to accelerate and expand economic development, to support its goal to become a developed country by 2025.

To achieve this goal, economic growth must be 7% to 8% a year. The private sector will have an important role in implementing the programme, investment, production and distribution. The government will position itself as the regulator and facilitator in co-ordinating the ministries and regional governments.

One of the MP3EI projects is the development of toll road infrastructure in Indonesia. Currently, there are 24 on-going toll road projects in Indonesia, which are still in the development stage as follows:

- **Trans Java Toll Road Projects.** These include (with details based on publicly available information):
  - Cikampek-Palimanan (116 km). The total investment cost is IDR12.6 trillion. Traffic volume/day is 27,501 vehicles;
  - Pejagan-Pemalang (57.5 km). The total investment cost is IDR5.52 trillion. Traffic volume/day is 15,773 vehicles;
  - Pemalang-Batang (39 km). The total investment cost is IDR3.82 trillion. Traffic volume/day is 15,566 vehicles;
  - Batang-Semarang (75 km). The total investment cost is IDR3.83 trillion. Traffic volume/day is 14,827 vehicles;
  - Semarang-Solo (75 km). The total investment cost is IDR6.21 trillion. Traffic volume/day is 27,190 vehicles;
  - Solo-Mantingan-Ngawi (90.1 km). The total investment cost is IDR5.14 trillion. Traffic volume/day is 9,842 vehicles;
  - Ngawi-Kertosono (87 km). The total investment cost is IDR3.83 trillion. Traffic volume/day is 5,325 vehicles;
  - Kertosono-Mojokerto (40.5 km). The total investment cost is IDR3.48 trillion. Traffic volume/day is 18,570 vehicles;
  - Surabaya-Mojokerto (36.27 km). The total investment cost is IDR3.21 trillion. Traffic volume/day is 22,002 vehicles.

- **Jakarta Outer Ring Road (JORR) II Toll Road Projects.** These include:
  - Cengkareng-Batu Ceper-Kunciran (15.22 km);
  - Kunciran-Serpong (11.19 km);
  - Serpong-Cinere (10.14 km);
  - Cinere-Cimanggis (14.7 km);
  - Cimanggis-Cibitung (25.39 km);
  - Cibitung-Cilincing (34.5 km).

- **Others.** These include:
  - JORR seksi W2 Utara (7 km);
  - Bekasi-Cawang-Kampung Melayu (21.04 km);
  - Depok-Antasari (21.55 km);
  - Bogor Ring Road (section II and III) (7.15 km);
  - Ciawi-Sukabumi (54 km);
  - Gempol-Pandaan (3.61 km);
  - Gempol-Pasuruan (33.73 km);
  - Waru (Aloha)-Wonokromo-Tanjung Perak (17.72 km);
  - Pasuruan-Probolinggo (45.32 km).

The above projects are based on the MP3EI. In addition, there are several proposed toll projects in Indonesia, including, among others:

- **DKI Jakarta New 6 Toll Road Projects.** These toll road projects were planned to be 70km in length with a total investment cost of about IDR40.1 trillion.
- **Medan–Binjai Toll Road (15.8 km).** This project is located in North Sumatera, Sumatera island, Indonesia. The total estimated project cost is IDR1.204 trillion.
- **Panimbang–Serang Toll Road.** This project is located in Banten, Java island, Indonesia, with a total estimated project cost of IDR12.5 trillion.
- **Probolinggo-Banyuwangi Toll Road (215 km).** This project is located in East Java, Java island, Indonesia with a total estimated project cost of IDR13.960 trillion.
Pandaan-Malang Toll Road. This project is located in East Java, Java island, Indonesia with total estimated project cost of IDR2.932 trillion.

Pasir Koja–Soreang Toll Road (10.57 km). This project is located in Bandung, East Java, Java island, Indonesia with a total estimated project cost of IDR1.430 trillion.

Manado-Minut-Bitung (49 km). This project is located in North Sulawesi, Sulawesi island, Indonesia with a total estimated project cost of IDR1.732 trillion.

**Toll road financing Debt to equity requirement**

The toll road concession agreement adopted by the Government requires concessionaires to comply with a debt to equity ratio of 70:30. The debt to equity ratio is calculated from the total project cost as agreed under the toll road concession agreement. For example, if the total project cost is estimated at USD1 billion, the concessionaire can only obtain loan financing up to USD700 million. The remaining portion of the financing must come from equity, which must be contributed by the sponsors or funded by a quasi-equity instrument.

This requirement has had a huge impact on how a toll road concessionaire structures its financing:

- The debt portion is financed by a project financing scheme. Although the loan is structured as project finance, banks usually still require a guarantee and undertaking from the sponsors.
- The equity portion is financed by capital injected by the shareholders as paid-up capital. However, for certain toll road projects, it is not economically efficient for the sponsors to inject the full 30% equity portion as paid-up capital. For example, the 116km Cikampek to Palimanan toll road in West Java, which requires a total project cost of IDR12.6 trillion. For these kinds of projects, quasi-equity instruments can be used.

**Legal due diligence: why needed?**

Toll road projects are undertaken under a concession agreement signed by the government and the Toll Road Company (a single purpose vehicle (SPV) established to develop, construct and operate the toll road project).

Given the large scale of investment required and the fact that the Toll Road Company is an SPV, financing a toll road project is a high risk transaction. Therefore, before lenders decide to finance a toll road project, they should undertake a proper legal due diligence.

Legal due diligence is important to lenders to identify the following key information:

- The validity, terms and conditions of the concession agreement. The lenders must be fully aware of the terms and conditions of the concession agreement, particularly the economic aspects governed by the agreement, such as the concession period, toll tariff, regular tariff adjustment and compensations. These aspects are fundamental for the assessment of the feasibility and viability of the toll road project.
- The establishment of the Toll Road Company, that will be the borrower under the project financing scheme and mainly responsible for the repayment of the loan to the lenders.
- The rights and obligations of the Toll Road Company with respect to the development, financing, construction and operating of the toll road project. The lenders must be fully informed of any additional investment to be made during the operation of the constructed toll road. The concession agreement may impose an obligation on the Toll Road Company, in certain circumstances, to widen the road or to construct additional lanes, access roads or toll gates.
- The assets and liabilities of the Toll Road Company. This informs the lenders as to what assets can be encumbered as security for the financing. The main asset of a Toll Road Company is the concession right itself. Therefore, precise identification of the liabilities attached to the concession right will help the lenders in structuring the financing scheme and security package.
- The project sponsors and the Toll Road Company's shareholding structure. This enables the lenders to properly assess the financial and corporate strength of the sponsors behind the Toll Road Company, so that the lenders can accurately identify what kind of support or guarantee the sponsors should give to the lenders. In the Indonesian market, all project financings require the support and certain guarantees from the sponsors.

Lenders need this information when structuring the project financing scheme and the security package, including the sponsors' support or guarantee. Lawyers need this information to properly draft the transaction documents, including all covenants and undertakings to be inserted into the transaction documents.

**Structure of project financing**

Toll road project financing is commonly structured as a syndicated loan, due to the huge size of the loan. Once the loan syndication is formed, the following are appointed:

- **A facility agent.** The facility agent's role is to administer the loan to co-ordinate the relationship between the syndicated lenders and toll road concessionaire.
- **A security agent.** The security agent's role is to be a proxy for the syndicated lenders in managing the security package and executing the security documents.

A toll collection is in IDR, the loan is usually structured as an IDR loan.

The normal concession period of a toll road project is between 25 to 35 years. However, the longest tenue available for a loan is 15 years. Before 2012, the longest tenue was 12 years, including a grace period during the construction.

All toll road project financing requires support and a guarantee from the sponsors. In most toll road financing, the sponsors must give a corporate guarantee or undertaking to secure the full repayment of the loan by the concessionaire to the lenders (who are not willing to take on the project's risks).

In a recent toll road project, the lenders came to an agreement with the sponsors on the sharing of the project's risks. Under this agreement, the sponsor's support and undertakings are limited to the completion of the construction of the project and the first few years of commercial operation. Following this period, the lenders take on the full risk of the project.

See box, **Common structure of toll road project financing**.

It is a normal requirement that all revenues generated by the toll road concessionaire must be managed and controlled by the lenders through an escrow agent in accordance with a cash waterfall and account management agreement. Under this agreement, all revenues must be deposited into an escrow account controlled by the escrow agent. After this, the funds in the escrow account must regularly be transferred out by the escrow agent to the:
**Common Structure of Toll Road Project Financing**

1. The lenders give the financing to the toll road concessionaire (1).
2. The toll road concessionaire provides security to the lenders (2).
3. The sponsors and/or the shareholders provide a guarantee and support to the lenders (3).
4. The toll road concessionaire repays the loan to the lenders using the proceeds from the toll collected and other revenues generated during the concession period (4).

**Key Challenges for Toll Road Financing**

**Bankability of the toll road concession agreement.** Before the amendments introduced in 2010, many banks and financiers considered that the toll road concession agreement was not bankable as:

- There was uncertainty relating to the termination compensation to be received by the concessionaire and the lenders if the government terminated the concession. There was no clear provision on how much and when the termination compensation is to be paid.
- The step-in right that allows the lenders to take over the project in the case of default was not exercisable by the lenders without the government’s involvement.
- The toll road and the land on which it lies belonged to the government. Encumbrance on the concession right is permitted but lenders could not enforce the right without the government’s consent.

- There is no government guarantee and the lenders’ rights were not well protected by the government under the concession agreement.

In 2010, a few major banks entered into discussion and negotiation with the government on this issue. The objective was to make the concession agreement bankable and acceptable to the banks, so that banks can finance toll road projects being developed. Some major changes were agreed on by the stakeholders in this negotiation. Under the amended concession agreement, although there is still no government guarantee, the termination compensation and the step-in right are well-defined.

**No guarantee from the government.** Another problem faced by lenders in structuring toll road project financing is that the government will not issue guarantees, letters of undertaking or letters of comfort in lenders' interest.

**Full guarantee from the sponsors.** Almost all toll road project financing requires a full guarantee from the sponsors/shareholders of the concessionaire.

In some projects, the sponsors cannot give a full corporate guarantee due to an existing covenant in another agreement prohibiting this. In those cases, the banks require the sponsors to issue a letter of undertaking to the effect that if the concessionaire experiences a cash shortfall then the sponsors undertake to provide additional funds to the concessionaire. This is so that the concessionaire can service all its obligations to the lenders and fund operational costs.
In a recent toll road project financing, the banks agreed to limit the scope of the undertaking to be given by the sponsors to the completion of the construction of the project and for the cash shortfall for the first few years of commercial operation. This is a significant landmark for toll road project financing.

**Long tenure of the loan.** Another challenge faced by the parties is the mismatch of the concession period and the tenure of loan. The concession period for a toll road project is between 25 to 35 years, the longest tenure available for a loan is 15 years. This reduces the bankability of the toll road project, as a toll road project is by nature a long term investment. If the concessionaire must repay the loan within 15 years, it will be a challenge for the concessionaire to manage the cash flow for the loan repayment.

**Financing in IDR.** Almost all toll road project financing is in IDR by local banks, because toll revenues are all in IDR. Therefore, financing in other hard currencies, such as US dollars or euros, requires a hedging instrument both for the currency fluctuation and the interest rate.

In a recent toll road financing, an offshore export import bank agreed to fund up to USD100 million. However, local banks do not allow the concessionaire to buy hedging facilities. The parties eventually successfully structured the financing without the hedging facilities, with the:

- Financing by the offshore export import bank in US dollars.
- Loan received by the concessionaire in IDR.
- Payment in IDR.

The scheme requires all of the following:

- A local fronting bank to fund in IDR.
- An international prime bank to issue stand-by letter of credit (SBLC).
- The export import bank to place the US dollar deposit.

**Environmental and social issues.** Multi-national agencies like the International Finance Corporation (IFC) and the Asian Development Bank (ADB) are interested in financing toll road development. However, to allow them to fund toll road projects, the concessionaire and the projects must comply with certain environmental and social standards and requirements adopted by those multi-national agencies.

The challenge for toll road projects is that, under the concession agreement, the land acquisition is undertaken by the government under prevailing laws and regulations. The land acquisition process may not meet the requirements set by those multi-national agencies. Additional works must be done and there are additional costs involved to meet the environmental and social standards and requirements set by the multi-national agencies.

**Quasi-equity for toll road project**

A quasi-equity financing is rarely used in a toll road project financing. This kind of financing may assist the sponsors in fulfilling the equity portion, especially for toll road projects that require a huge amount of equity portion.

Under Indonesian generally accepted accounting principles (GAAP), in order to be treated as equity, this quasi-equity financing must meet the following criteria:

- The principal of the quasi-equity facility cannot be repaid by cash. Instead, it will be repaid using new shares to be issued by the toll road concessionaire. The terms, conditions and the formula for the conversion of quasi-equity financing into new shares in a toll road concessionaire is governed in the financing agreement between the quasi-equity financier and the toll road concessionaire.
  
  - The quasi-equity facility must be unsecured.
  - Any payment to the quasi-equity financiers must be subordinated or ranked junior to the payment obligations under the debt portion.
  - There must be no mandatory requirement to pay the interest. The payment of interest accrued on the quasi-equity facility is dependent on the availability of excess cash. If there is no excess cash, the concessionaire is not obliged to pay the interest and the failure to pay the interest is not an event of default.

The biggest challenge in getting the quasi-equity facility to finance toll road projects is the tenure of the quasi-equity facility, which must be longer than the debt portion.

Security package for toll road project financing

Being a project financing, all assets of the concessionaire and the project itself must serve as main security for the financing by the lenders.

Under the toll road concession agreement, the main assets (that is, the toll road and the land) cannot be encumbered as security for the financing. Therefore, the security package must cover the:

- Assignment of the concession right and construction contract.
- Encumbrance of all movable assets, bank accounts, receivables and insurance proceeds.
- Pledge of shares in the concessionaire by the shareholders.
- Sponsors’ support and guarantee

**Assignment of concession agreement and construction contract**

The concession agreement provides for a step-in right by the lenders so that the lenders can take over the project if the concessionaire defaults.

As part of the security documents, the concessionaire must sign a conditional assignment agreement so that on the occurrence of an event of default, all the concessionaire’s rights under the concession agreement must be assigned or transferred to the lenders.

Another key project document is the construction contract. Therefore, the lenders also require the concessionaire to assign all its rights under the construction contract to the lenders as part of the security package.

An assignment agreement does not create a perfect first ranking security interest granting a priority right to its holder. The assignment agreement only creates a contractual obligation on the assignor (in this case, the toll road concessionaire) to assign all its rights and benefit arising from the concession agreement and the construction contract to the lenders.

The toll road concessionaire must deliver a written notice to the government (as the counterparty under the concession agreement) and the contractor (as the counterparty under the construction contract) regarding the assignment of its rights to the lenders. It must also obtain an acknowledgement of the assignment.

**Fiduciary security**

Indonesian law does not recognise the concept of a floating charge covering all assets of the charger. The encumbrance of movable assets must be either in the form of a pledge or fiduciary security.
Movable assets (other than shares and bank account) are commonly put under a fiduciary security arrangement. This allows the encumbered movable assets to be put under the chargor's control before the occurrence of an event of default. Under the pledge arrangement, the pledged assets must be put under the control of the pledgee (that is, the security agent on behalf of the lenders), which means that the pledgor cannot further use the pledged assets.

All fiduciary security agreements must be printed in Indonesian, drawn up as a notarial deed and signed before a public notary in Indonesia (Indonesian Fiduciary Security Law). To be perfected, the fiduciary security must be registered with the fiduciary security registration office. Once it is registered, the fiduciary security registration office will issue a certificate of fiduciary security.

Pledge of bank accounts
Bank accounts are pledged to the lenders as security for the loan repayment. The concessionaire, as owner of the bank accounts, must sign a pledge agreement with the security agent acting on behalf of all lenders.

To perfect the pledge, the toll road concessionaire must deliver a notice of pledge to the bank with whom the bank accounts are opened and obtain an acknowledgement of the notice.

Pledge of shares
The shareholders of the concessionaire must pledge all their shares in the concessionaire to the lenders.

In addition, shareholders must grant a power of attorney to cast votes and sell the pledged shares. The power of attorney is exercisable by the lenders on the occurrence of an event of default.

The pledge of shares must be recorded in the shareholders' registry maintained by the concessionaire.

It is a mandatory requirement under Indonesian laws that the pledged share certificates must be delivered to and kept under the custody of the pledgee (in this case, the security agent acting on behalf of the lenders).

Sponsors’ support and guarantee
Lenders commonly require the sponsors or shareholders of the concessionaire to give a full corporate guarantee covering all payment obligations of the concessionaire under the financing documents.

If the sponsors or shareholders are not allowed to give the corporate guarantee, they will be requested to issue a letter of undertaking. This letter requires the sponsors or shareholders to provide additional funds/capital to the concessionaire in case the concessionaire has a cash shortfall.
Other undertakings usually required from the sponsors are a:

- **Project completion and cost overrun undertaking.** The sponsors undertake to the lenders that the construction of the toll road will be completed in accordance with the concession agreement. In addition, the sponsors undertake that they will provide additional capital to the concessionaire if there is any cost overrun during the construction of the project.

- **Cash deficiency undertaking.** The sponsors undertake that if the toll road concessionaire is short of cash, the sponsors will provide additional capital to the toll road concessionaire so that it can service all its payment obligations.

Government guarantees for project financing Toll road projects are undertaken through a public private partnership (PPP) scheme. The government does not give guarantees in relation to the financing of existing toll road projects.

Government guarantees may be necessary for the development of certain infrastructure projects. Therefore, the government has established the Indonesia Infrastructure Guarantee Fund (*PT Penjaminan Infrastruktur Indonesia (Persero)*) (IIGF). The IIGF’s main objectives are to:

- Provide guarantees to investors of PPP projects in Indonesia.
- Enhance creditworthiness, including the bankability of PPP projects.
- Improve governance and transparent process in providing guarantees.

See box, *Risks guaranteed by the IIGF.*

**Importance of project financing in Indonesia**

Due to the development programme being pursued by the government (see above, *Latest developments in infrastructure projects*), there are many infrastructure projects being developed to support and facilitate the economy growth targeted. All of these infrastructure projects will need project financing.

The nature and structure of project financing in Indonesia is slightly different from that applied in mature markets. Having in-depth knowledge of the legal aspects of project financing in the Indonesia market benefits stakeholders, particularly investors and bankers, in deciding what to invest in and in structuring a proper project financing scheme.

**Risks guaranteed by the IIGF**

From the official website of IIGF at iigf.co.id, these are the risks guaranteed by IIGF:

* In preparing this paper, Wiyono Sari was assisted by Rizaldy Tauhid, a senior associate at Wiyono Partnership, who specialises in banking law, project financing, infrastructure projects and construction law.

*(Official website of the IIGF, iigf.co.id.)*

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*(Official website of the IIGF, iigf.co.id.)*
Professional qualifications. Indonesia, Advocate

Areas of practice. Corporate restructuring and acquisitions; infrastructure projects, particularly toll road projects, water projects and power projects; project financing; debt restructuring (including debt-to-equity conversions); capital markets.

Non-professional qualifications. Law, University of Indonesia; LL.M (cum laude), Leiden University, Netherlands.

Recent transactions
- Acting for the concessionaire of 116 kilometre Cikampek to Palimanan Toll Road in getting project financing of around USD925 million and quasi-equity of around USD265 million.
- Represented a consortium of contractors in getting bank guarantee facilities of around USD122 million.
- Represented toll road companies in negotiating amendments of concession agreements with the government.
- Acting for China Development Bank in providing financing to a palm oil plantation company in Indonesia.
- Acting for a private equity fund in financing water projects in Indonesia.

Languages. English, Indonesian, Hokkian

Professional associations/memberships. Indonesian Advocate Association (PERADI); Indonesian Capital Market Lawyers Association (HKHPM).

Publications:
- PublicationsToll Road Projects In Indonesia: Regulatory Framework.
- Project Finance for Toll Road Construction: An Overview.
- Corporate Acquisition Through Conversion of Debt into Equity: The Fourth Form of Corporate Acquisition.