WHITE PAPER

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Selection Process on Track for Malaysia-Singapore High-Speed Rail Project

In what will be the first project of its kind in South East Asia, the governments of Malaysia and Singapore have agreed to collaborate on a high-speed rail project connecting the two nations' capital cities. The bidding process for the rail system's various contracts is expected to attract considerable international interest and is now commencing. This Jones Day *White Paper* describes the organizational decisions Malaysia and Singapore have made to carry out the project, the public-private procurement structure implemented to divide risks and share anticipated revenues, and the financing models that will capitalize the project.

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INTRODUCTION AND RECENT DEVELOPMENTS

In December 2016, Malaysia and Singapore signed a legally binding bilateral agreement, the HSR Bilateral Agreement, paving the way for the implementation of the Kuala Lumpur-Singapore High Speed Rail ("HSR"). This was quickly followed by the two countries' appointment of a Joint Development Partner to provide project management advice and support during the tender preparation and procurement phase of the HSR project.

These are two key milestones in the progress of the HSR project, and they set the stage for the international bidding process to select and appoint the entity ("AssetsCo") which will bring together key project and contracting players to execute South East Asia's first high-speed rail project. The AssetsCo tender is being launched at the present time.

COMMERCIAL FEATURES OF THE HSR PROJECT

With the official launch of the bidding documents, this Jones Day *White Paper* explores some of the key commercial features of the HSR project that are likely to come into play.

DIVISION OF TASKS

Rather than selecting a single integrated entity to carry out the HSR project, based on the contracting structure agreed under the HSR Bilateral Agreement (see Figure 1 below), Singapore and Malaysia have chosen to adopt a more complicated approach of dividing the tasks of implementing the HSR project between various parties. As such:

- Each government will separately assume responsibility for designing, building, and financing the HSR civil infrastructure (e.g., the tunnels, viaducts, bridges, depots, maintenance bases, etc.) and stations within their own countries. This will be undertaken by a separate Infrastructure Company ("InfraCo") in each country—"MyHSR" in Malaysia and "SG HSR" in Singapore, respectively. Each InfraCo will be that country's vehicle for planning, tendering, regulating, and implementing the project in its country. This will mean that separate contractors will be appointed to develop and, thereafter, operate and maintain, throughout the project life of the HSR, the HSR infrastructure within the territorial boundaries of each country.

- A single privately financed entity will be jointly appointed as the AssetsCo by the two InfraCos through an international public-private partnership ("PPP") tender to develop the HSR project, including to procure and maintain the rolling stock (i.e., the HSR trains) and associated systems (i.e., track work, power, signalling, and telecommunications systems), and to manage the network.

- Two train-operating companies ("OpCos") will be appointed to operate the HSR train services. An international OpCo will be jointly appointed by the InfraCos to operate the cross-border train services, while a domestic OpCo will be appointed by MyHSR to operate the domestic Malaysian services.

The demarcation of tasks between the various project partners reflects a risk-sharing approach that appears intended to allow both governments to retain control over the overall development and management of the HSR infrastructure within its own jurisdiction. This approach adopts what may be seen by both governments as a favorable risk allocation position in which:

- The respective governments retain ownership of the core HSR infrastructure;

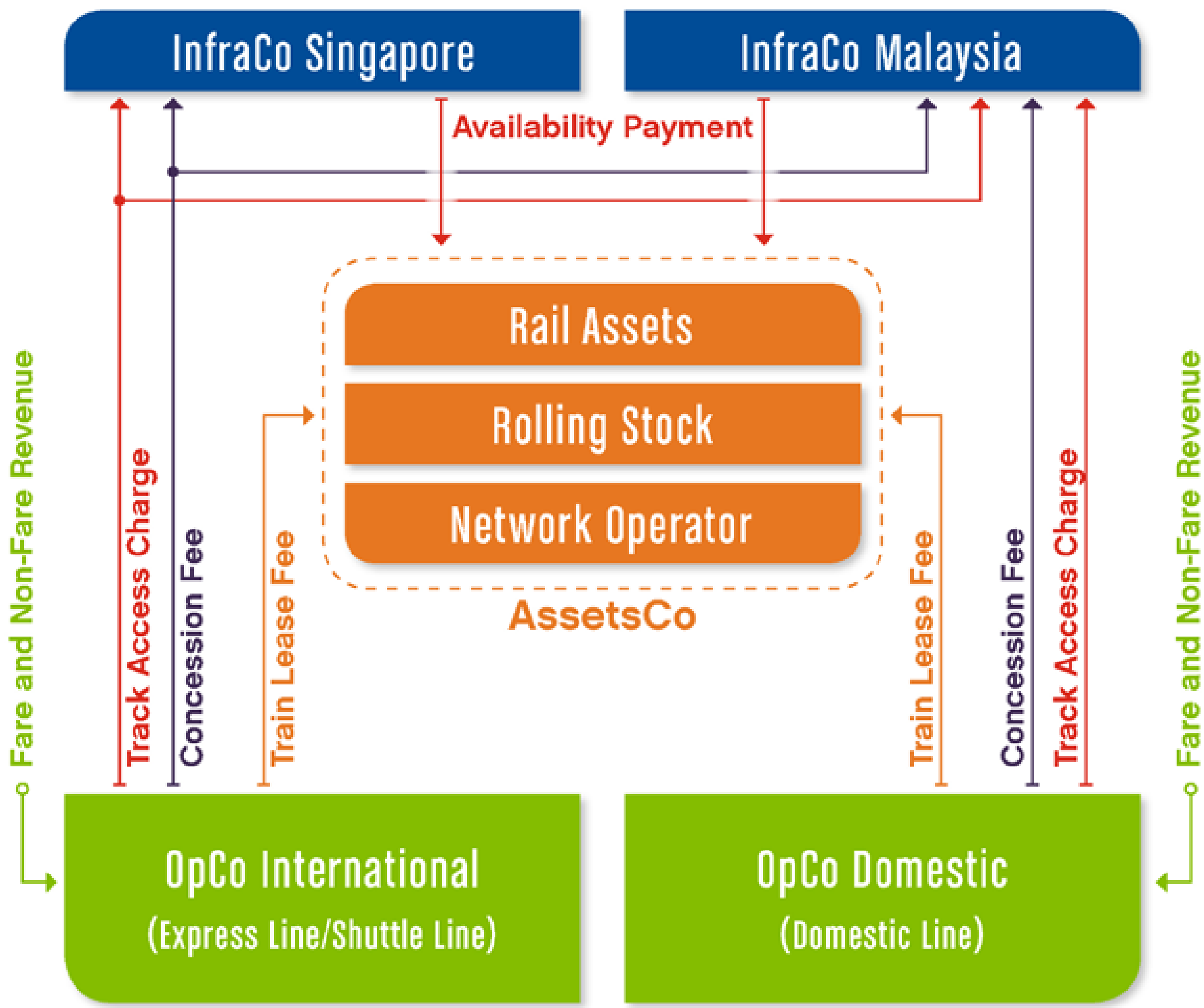
- Tasks that are better performed by the public sector (such as land acquisition, planning, design, civil infrastructure works, and project supervision) can still be assumed by the respective governments for purposes of core HSR infrastructure; and

- Risks around delivery, operation, and management of the rolling stock, rail assets, network operation, and train services can be largely transferred to the private sector players.

However, without the involvement of a single integrated entity to undertake the whole of the project, coordination issues between the various parties will be more evident. The various parties will also be concerned if, as a result of such coordination issues, the performance of its contract is dependent upon the performance of the other different and inter-related parties and contractual regimes. Potential bidders would need to closely scrutinize the interface arrangements for each of the roles of the HSR project and ensure that each contractor's risks and responsibilities are clearly documented within the relevant interface documentation.

High-Speed Rail Bilateral Agreement

(Figure 1)



CONCESSIONS: TRAFFIC-BASED AND AVAILABILITY PAYMENTS

Based on the contracting structure adopted by both governments, part of the HSR project will be undertaken using a PPP procurement model under which the public and private sectors will share the risks, responsibilities, and rewards of the development and management of the rolling stock and rail assets, as well as the operation of the train services for the overall project. Separate tenders will be made for selection of the AssetsCo, under a PPP model, and for selection of each of the OpCos. The use of separate contract packages involving the AssetsCo and OpCos is likely to enable SG HSR and MyHSR to benefit from adopting:

- A traffic-based concession arrangement with the OpCos where it is expected that some element of the revenue and demand risk will be assumed by private-sector players. Under this model, in exchange for the concession granted by the governments to operate the train service, the OpCos will pay concession fees, received from ridership payments. These funds are intended to offset the capital costs for the HSR infrastructure; and

- An availability-payments-based PPP concession agreement with AssetsCo in which the two governments will pay AssetsCo a monthly availability payment over the operation phase of the project. It is intended that the InfraCos will fund the availability payments to the AssetsCo from ring-fenced track access charges that SG HSR and MyHSR receive from the OpCos. The availability payment regime will be subject to payment deductions for performance shortfalls caused by the AssetsCo (for example, resulting in service delays).

Additionally, the AssetsCo will receive payments of the train lease fees from the OpCos. Such train lease fees are intended to help finance and cover the AssetsCo's costs of acquiring and maintaining the HSR rolling stock and HSR systems.

FINANCING SOURCES

High-speed rail projects are often multibillion-dollar undertakings, and the HSR project, with recent estimates as high as MYR 77 billion (US$18.8 billion), is no different in this regard. Such capital-intensive projects require funding from different sources, and the reality of such projects is that most modern high-speed rail projects are dependent on public investment. Perhaps as a reflection of this fact, at the outset, both governments have recognized that in order to implement the HSR project, both public funds and private capital will have to be utilized. The unique structure of the HSR project will require complex and innovative financing solutions.

The two InfraCos, backed by their respective governments, will fund directly the capital-intensive civil works component of the HSR project. Civil works will comprise most of the costs of the HSR project. However, significant financing will also be required at the AssetsCo level. The AssetsCo will be primarily responsible for arranging financing for the rolling stock, systems, and operations components.

Funding for the AssetsCo will include equity and likely project financing loans on a limited or nonrecourse basis. Given the scale of the financing requirements, much of the financing for AssetsCo is likely to be provided as debt, and the cost of such financing will be a key issue in providing a competitive bid for aspiring AssetsCo bidders. Any such financing would likely involve multiple sources (e.g., export credit agencies, national policy and development banks, multilateral lenders, commercial banks, etc.) and likely different currency tranches/lenders.

Revenue for the AssetsCo will primarily come from two separate revenue streams: the availability payments from the InfraCos, and train lease fees from the OpCos.

Focusing first on the availability payments, these will be paid separately by MyHSR (in Ringgit) and SG HSR (in Singapore Dollars). In theory, the availability payments should be funded by payments to the InfraCos from track access charges paid to them by the respective OpCos (subject to deductions based on AssetsCo KPIs, for example, due to network failures or service delays caused by AssetsCo), but it has been said the InfraCos will be responsible for the payments even if the OpCos fail to make their payments. This should help to insulate the AssetsCo from risk of nonpayment of the track access charges by the OpCos.

Recent announcements suggest that each InfraCo will be severally (and not jointly and severally) responsible for payment of its portion of the availability payment. MyHSR will be responsible for 100 percent of the availability payments for the domestic Malaysian service and 50 percent of the payments for the international (express and shuttle) service, while SG HSR will be responsible for 50 percent of the payments for the international service only. As such, careful analysis will be required by AssetsCo bidders and their funders to ensure the bankability of the HSR project as a whole and of each of the two separate sub-projects (i.e., domestic Malaysian and cross-border projects). Each will need to be evaluated separately in terms of payment risks, currency convertibility/risks, commercial risks, etc. The cross-border sub-project, with payments in two currencies from severally liable InfraCos, and with currently unclear currency denomination from the relevant OpCo, will present particular challenges.

Separate financings may be considered for each of these sub-projects, in particular given the separate revenue streams and currencies for payments from the respective InfraCos. Separate financings will also facilitate different financing structures that may be appropriate for each of the sub-projects, such as local currency financings or Sharia-compliant financing in Malaysia. However, project participants will need to carefully consider the extent to which issues affecting one of the sub-projects will affect the performance or operations of the other sub-project. If such risks are significant, it may be necessary to utilize a single integrated financing structure. In either case, such risks will potentially cause inefficiencies in the financing that will require mitigation or increased risk by potential lenders, which will increase financing costs.

The rolling stock arrangements and train leases with the separate OpCos will also likely introduce similar currency and other bankability issues. Again, the OpCos for each of the sub-projects will engage severally with the AssetsCo, and each must be creditworthy and responsible for payment of its train lease fees. The rolling stock may be separately financed from the other assets and, if so, will be separately secured by the rolling stock and relevant lease fees. The OpCos will be separately selected by the InfraCos, and the contract terms for the OpCos will be shorter (so successive OpCos will be selected/required). While the creditworthiness and commercial acceptability of the OpCos is important to the AssetsCo, it will not be entitled to select the OpCos. Careful consideration will be required by bidders and funders alike as to the extent of security that will be required from the OpCos and the terms for appointment of the OpCos by the InfraCos. Potential lenders in particular may seek to protect themselves in the event they are not comfortable with the OpCos.

CONCLUSION

The HSR project is indeed an exciting project for both Malaysia and Singapore, with its promise of connecting both capital cities at a significantly reduced travelling time. Internationally, this project has also attracted the interest of major players from Europe as well as bidding consortiums from China, Japan, and South Korea hoping to participate in one of the distinct packages to be procured for the project. 2018 will definitely be the year to watch in this space, particularly following the official launch by both governments of the PPP tender for the AssetsCo.

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ENDNOTES

1 Different project and risk allocation structures are possible. For instance, the Taiwan High Speed Rail Project is an example of a high speed rail line which was developed by a single entity under a Build-Operate-Transfer model. The relatively complex structure adopted for the KL – Singapore HSR project reflects the cross-border nature of the project, as well as the inclusion of two distinct HSR projects, one of which is purely domestic within Malaysia.

2 Both the Singapore and Malaysian Governments have commenced their respective HSR infrastructure development process. In February 2017, Singapore appointed a technical advisory firm to conduct the Advanced Engineering Study for the design of the HSR infrastructure in Singapore. MyHSR has also appointed its Reference Design Consultants (RDC) to provide consultancy services to MyHSR for the reference design of the HSR infrastructure in Malaysia.

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