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JOINT CONCESSIONING OF KENYA RAILWAYS AND UGANDA RAILWAYS

The present document is a case example tabled by Anthony Muriithi of M.A. Consulting, Nairobi.

JOINT CONCESSIONING OF KENYA RAILWAYS AND UGANDA RAILWAYS

Introduction/Background of the project

The joint concession of Kenya and Uganda railways is a decision by the Governments of Kenya and Uganda decision to concession their two railways jointly to single concessionaire who will establish operation subsidiaries in each country. The joint concession will be awarded through a bidding process governed by the laws of Kenya and Uganda. The concession covers more than 3000km of rail network across Kenya and Uganda, and will run for 25 years for freight services, and 7 year for the long distance and commuter services in Kenya (Uganda has no passengers services).

The Pre-qualified Lead Investors for the concession have already been selected, and the final contract documents have been issued to pre-qualified bidders. The bid submission and opening of the proposals is scheduled for June 15, 2005. The Lead Investors have 3.5 months period for due diligence, starting from March 15-June 15. Previously, the bidding was scheduled to take place on April 15, 2005, but since modification has been made to accommodate the bidders request for more time on due diligences, and consequently an extension of the bidding date and date for signing the concession agreement. Initial concessioning delays were due to long time taken in negotiations for joint agreements and signing of MOU between the Governments of Kenya and Uganda.

A good lesson to learn from public-private partnership is the wide range of involvement of drivers of the concession at various levels. The main drivers of the concession process are the Governments of Kenya and Uganda through the ministries responsible for transport, finance, and the Kenya and Uganda railways corporations. The Governments have engaged the IFC of World Bank (for Kenya) and CANARAIL of Canada (for Uganda) as their lead project advisors. The public and private sectors have been involved directly and indirectly through the stakeholders' workshops and investors' conferences held in Kenya and Uganda.

Critical government agencies involved from public sector includes the ministry of trade and industry, the Attorney General, local governments, investment promotion centres, and public enterprise reform units. The private sector involvement includes members of parliament, trade unions, transport operators and freight forwarders, oil pipeline and oil companies, port authority, Magadi Soda Company (operates private railway line), banks, insurance, manufacturers, social security and pension funds, revenue authorities, business consultants, donors (e.g. EU, World Bank and JICA), and regional organization involved in development of transport (e.g. TTCA, PMAESA, and USAID ECA HUB). At the international levels, a pre-marketing consultation with international investors in USA, Canada, U.K and South Africa was carried in June 2004.

The proposed concession legal structure entails 2 national concession companies that will be registered in each country (for revenue and expenditure accounting), and owned 100% by a Holding Company (HC). In December 2003, a harmonization work was concluded and joint restructuring agreed by the Joint Steering Committee in an MOU between Governments of Kenya and Uganda. Further, there are plans for establishment of a joint railway commission for harmonization of regulations. An interface agreement for cross-border issues and inter-governmental agreement to further harmonize regulations and operations will be signed.

Challenges:

A major and immediate challenge currently facing the concessionairing process is the passing of the Privatization Bill by Kenyan parliament, and the amendment of Kenya Railways Act (needed to empower the concessioning of the Kenya Railways). Uganda enacted the Public Enterprise Reform Divestiture (PERD) Act in 1993, which enables the concession, while new Railway Act is being enacted.

Given the poor state of the railway infrastructures in Kenya and Uganda, Governments are faced with immediate challenge to spend large sums of money on modernization and renewal of railway infrastructures and their expansion immediately after takeover of the concession. Meeting this responsibility will be a major challenge to the Governments, which have strong expectations of shedding away heavy expenditures on railways. Other immediate challenge for the Governments for the success of the concession is the takeover of the railways commercial debts owed to the suppliers, creditors, local authorities, utility service providers and clients. A liquidating environment liability of 2 to 3 million USD is required for Kenya railways. Meeting the retirement, terminal and other benefits for the downsized and retired railway employee is another task that alone requires Kshs 22 billion for Kenya Government. It is anticipated that the commercial liabilities and employee debts will be paid in due course through the concession fees and income generated from commercial management of non-core assets.

Encroachment on land alongside the railway networks is a major problem on safety of operations that will need to be tackled. A minimum distance of 5.2 meters on either side of the track centre line is required to ensure operational safety. The concession process anticipates a Relocation Action Plan (RAP) that will be implemented in the first 2-3 years of the concession. A proposal is made on the table to widen safety zone to 30 metres.

Financing

The value of the infrastructure assets of Kenya and Uganda railways jointly is estimated at USD184 million. The value of the rolling stock able to provide services is estimated at USD120 million (almost 50% of registered rolling stock items is regarded as scrap). Approximately USD120 million will be required in form of deferred maintenance to get all rolling stock assets running again. The total value of equipment assets is estimated at USD53 million (including USD25 million for he marine vessels in Uganda). The total value of the real estate assets is estimated at USD 166 million (this include value of operational buildings estimated at USD38 million and value of land at USD128 million).

The concession long-term investment in Kenya (25 years) is estimated at USD250-300 million (with USD30-40 million in the first 5 years). The long-term investment for the concession in Uganda is estimated at US$54 million, and USD18 million for the short-term investment for the first 5 years. Already the EU is financing the repairs of the Nile Bridge, new culverts and construction of 30 km of new track along the main Kampala-Malaba railway line in Uganda.

The proposed joint concession shareholding structure (transaction configuration) entails the formation of a Holding Company (that will comprise 2 national companies, one registered in each country). The Lead Investor is required to take at least 35% of the Holding Company. Specific targets are set for least 20% Kenyan ownership and at least 20% Ugandan ownership of the Holding Company. It is worth noting that the 40% shareholding reserved for local ownership is open to both public and private ownership with equal opportunity.

The concession fee structure entails:

1. Upfront fee of USD3 million in Kenya and USD2 million in Uganda

2. Variable annual fee for each Concession for 25 years: 5% of annual gross revenues for the first five years; 7% of annual gross revenues thereafter

3. Fixed annual fee for each Concession for each of the 25 years: amounts may vary from one year to the other

4. Fixed annual concession fee for each of the 7 years for the Kenya passenger services (the amounts may vary each year)

A performance bond by each concession company will be prepared to cover penalties for non-performance of obligations and cap liquidated damages for concessionaire default. Core infrastructure and existing assets (and their rehabilitation) will remain owned by the Governments of Kenya and Uganda. New investment on infrastructure will remain the responsibility of the Governments.

Evaluation:

Evaluation with regard to knowing whether the project could be considered a success story or be replicated in other parts of the continent is difficult at this stage of the concession process, but an easy evaluation could be provided after the takeover and running of the project by the concessionaire. In absence of this, evaluation could only be limited to the current concessioning process with regard to issues on keeping of the timeframe, coordination and handling method of the concessioning, reactions of the interested private sector, and quality of the feasibility studies.

Though started in 2002, the current concession process has been tedious but fair in time taken. The process has involved

- Parallel due diligence Phase of KRC and URC proceeded individually, with IFC advisor to GOK and CANARAIL advisor to GOU (2002-03)

- Strategic decision by both Presidents to a joint concession (June 03)

- Harmonization work concluded and joint structuring agreed by the Joint Steering Committee in an MOU between GOK and GOU (Dec 03)

- Start of Implementation Phase (work on draft Bidding docs) (Jan 04)

- Pre-marketing consultations with international investors in USA, Canada, U.K. and South Africa (June 04)

- Railway Stakeholders Conference, and Regional Railway Investors Conference, Nairobi (July 04)

- Conference Wrap-up on Main Investors Issues: Nairobi Bidders Conference (March 05)

- Bid submission date and opening of proposals (April 05)

Next steps of the concession process will involve:

- Evaluation of technical proposals (started in April to May 05)
- Opening of financial proposals (May 05)
- Evaluation of financial proposals (May-June 05)
- Notification of successful bidder (award) (July 05)
- Satisfaction of conditions precedent to signing (Aug 05)
- Signature of the contract documents (signing) (Aug 05)
- Financial closing and commencement (Dec 05)

A wide range of stakeholders and investors have been involved, there is a serious limitation on the quantity and quality of information available for analyses and critical `evaluation of the concessioning processes. Reports on the feasibility study on the joint concessioning of Kenya and Uganda railways and study on the joint valuation of assets, which carry a lot of information on concessioning are yet to be made public. The studies are however available to the pre-qualified lead investors. Though the IFC and CANARAIL have wide experience as project advisors on concessioning, more is required for involvement of local experts and other expertise from other regions. Previously, the Governments of Kenya and Uganda had pursued concession of their railways separately, engaging two separate advisors. The two advisors were maintained for the joint concession.

Lessons learned:

Main lessons for policy makers and regulators are many and include the need to provide adequately for legislative and regulatory framework at national, across the country and regional levels to enable concessioning to avoid delays. The legislative framework should also provide for efficient and safe operation of the concession. Harmonization of regulation across the countries and creation of a joint commission for regulation is important. Signing of an interface agreement and inter-government MOU on joint concessioning is important.

Because of its magnitude and operation across the countries, the join concession requires a strong commitment by the governments and strong political will in its every stage of the project starting from the conception, planning, preparation, design, negotiation and implementation. It is important to involve workers/labour in critical stages of the project and provide for their safety net through retrenchment scheme and selection of required labour by the concessionaire.