ASIAN INFRASTRUCTURE
INVESTMENT BANK

PD000132-TUR
Aug. 31, 2018

Project Document
of the Asian Infrastructure Investment Bank

TSKB Sustainable Energy and Infrastructure
On-Lending Facility
Board Approval

Currency Equivalents

(As at Aug. 31, 2018)
Currency Unit – Turkish Lira (TRY)
TRY6.56 = USD1.00

Abbreviations

AIIB	Asian Infrastructure Investment Bank
AML	anti-money laundering
BBVA	Banco Bilbao Vizcaya Argentaria
BIST	Borsa Istanbul (Istanbul's Stock Exchange)
BRSA	Banking Regulation and Supervision Agency
CAR	Capital Adequacy Ratio
CBRT	Central Bank of the Republic of Turkey
CET	Common Equity Tier
CGF	Credit Guarantee Fund
CFT	Combating Financing of Terrorism
DA	Designated Account
DAC	Debt Assumption Commitments
EPİAŞ	Energy Exchange Istanbul
ERET	Environmental Risk Evaluation Tool
E&S	Environmental and Social
ESMS	Environmental and Social Management System
ESP	Environmental and Social Policy
EU	European Union
EUAS	State Electricity Generating Company
FI	financial intermediary
FX	foreign currency
GDP	gross domestic product
GHG	greenhouse gas
IFI	international financial institution
IFRS	International Financial Reporting Standards
IMF	The International Monetary Fund
LCR	Liquidity Coverage Ratio
Mteo	million tons of oil equivalent
MW	megawatt
NIM	Net Interest Margin
NPL	non-performing loan
OCP	Open Currency Positions
PIU	Project Implementation Unit
PPP	public-private partnership
ROE	return on equity
SA	Sub-loan account
SME	small and medium-sized enterprises
SOE	statement of expenditures
Treasury	Treasury and Finance Ministry

TSKB	Turkiye Sinai Kalkinma Bankasi
YEKA	Renewable Energy Resources Zone Areas
YEKDEM	Renewable Energy Support Mechanism

Contents

Project Summary Sheet

Republic of Turkey

TSKB Sustainable Energy and Infrastructure On-lending Facility

Project Number	000132
Guarantor Borrower	Republic of Turkey Turkiye Sinai Kalkinma Bankasi (TSKB), a privately-owned development and investment bank in Turkey
Sector / Subsector	FI (financial intermediary) / Banks
Project Objectives / Brief Project Description	The main objective of the Project is to advance Turkey's infrastructure – primarily in the field of renewable energy and energy efficiency, but also, in sectors of transport, power transmission, water management and treatment and telecommunications. The Borrower will use the loan from AIIB to finance the eligible subprojects in Turkey. At least 60 percent (and 75 percent on a best-effort basis) of AIIB's loan would be directed into renewable energy and energy efficiency Sub-projects. The rest of AIIB's loan would be directed into sectors such as transport, power transmission, telecommunications and water management and treatment, in accordance with the criteria and guidelines outlined in the Operational Manual.
Project Implementation Period (Start Date and End Date)	Start date: November 2018 End date: November 2021
Expected Loan Closing Date	April 1, 2022
Project Cost and Financing Plan	Project cost: C. USD235 million AIIB: USD200 million
AIIB Loan—Size and Terms	<u>Size</u>: USD200 million <u>Financing Terms</u>: Final maturity of 15 years, including a grace period of three years, with level repayments at AIIB's standard interest rate for sovereign-backed loans.

Co-financing – Size and Terms	None The Sub-borrowers will provide equity of at least 15-20 percent into the Sub-projects, to comply with criterion of Loan-To-Value of 80-85 percent, unless otherwise agreed with AIIB.
Environmental and Social Category	FI
Project Risk (Low/Medium/High)	Medium
Conditions for Effectiveness Conditions for Disbursement	Adoption of the Operational Manual Receipt of evidence, in form and substance satisfactory to AIIB, that at least 80 percent of the proceeds of the immediately preceding withdrawal by the Borrower have been utilized (except for the first withdrawal), and that 100 percent of the proceeds of all other earlier withdrawals by the Borrower have been disbursed to the eligible Sub-borrowers. Eligible expenditures under the Sub-loan, incurred in compliance with AIIB's procurement policies and guidelines and in respect of which the Sub-loan amounts were paid not more than six months prior to the date of the Loan Agreement, up to an amount of USD40 million may be financed retroactively.
Key Covenants	The Borrower is to: 1. Be in compliance with the applicable prudential regulations of the Guarantor and requirements of the Banking Regulation and Supervision Agency (BRSA). 2. Maintain a Project Implementation Unit (PIU), for implementation of the Project in accordance to the Operational Manual. 3. Ensure that the PIU is functioning at all times with sufficient resources and capacity to implement the Project in accordance with the Operational Manual. 4. Ensure that the Borrower and Sub-borrowers are in compliance with the Turkish legislation and standards,

	as well as AIIB's E&S Policy, the Policy on Prohibited Practices and Procurement Policy. 5. Monitor the Sub-projects and ensure adherence to the Sub-loan agreement, including carrying out of necessary E&S action plans, and establishment of appropriate Environmental and Social Management Systems (ESMS), where necessary. 6. Ensure that the selection of the Sub-projects comply with the Eligibility Criteria as set forth in the Operational Manual. 7. Ensure that at least 60 percent of AIIB's loan, and 75 percent on a best effort basis, are directed to renewable energy and energy efficiency Sub-projects, with the rest of loan directed into other infrastructure sectors set forth in the Operational Manual. 8. Ensure that the Sub-projects in the renewable energy sector have at least 15 percent sponsor equity, and the Sub-projects in all other sectors have at least 20 percent sponsor equity, unless otherwise agreed with AIIB. 9. Submit to AIIB the relevant Project level and Sub-project level documents including the Project Appraisal Forms, Borrower's Financial Statements, Project Financial Statements, and E&S Reports at the stipulated frequency in the Operational Manual.
Policy Assurance	The Vice President, Policy and Strategy, confirms an overall assurance that the Bank is in compliance with the policies applicable to the Project.

President	Jin Liqun
Vice President	D.J. Pandian
Director General	Yee Ean Pang
Manager	Gregory Liu
Project Team Leader IO 2 Supervisor	Seung Myun Lee, Senior Private Sector Operations Specialist Louis M. Vos, Lead Private Sector Operations Specialist
Project Team Members	Bao Jia Tan, Investment Officer Anthony E.C. Kuek, Senior Adviser

	Aleksandr Kanunnikov, Young Professional Nick Mant, Principal Credit Officer Giacomo Ottolini, Senior Procurement Specialist Henri Boullier de Branche, Senior Environnent Specialist Kishor Uprety, Senior Legal Counsel Lian Liu, Admin Assistant, IO Department

1 Strategic Context

A. Country Context

1. Turkey enjoys a strategic geographic location, an open and liberal trade and investment climate and a young and urbanized population. Since the early 2000s, it has achieved impressive economic and social development, rising to become the world's 18th largest economy. Much of these can be attributed to broad social and economic reforms, increased economic integration with the region and a transition of the economy away from agriculture into manufacturing and services. Its strong banking sector and macroeconomic management also allowed the economy to rebound quickly from the 2009 financial crisis and gross domestic product (GDP) growth averaged 7.4 percent from 2010 to 2015 (inclusive).

2. **Macroeconomy.** In 2017, Turkey enjoyed a sharp recovery to 7.4 percent growth, following slow growth of 3.2 percent in 2016. The recovery was supported by expansive fiscal policies, including a TRY250-billion Credit Guarantee Fund (CGF) program[1,2] that drove credit growth. External demand also picked up, partially spurred by the depreciating Lira, and net portfolio inflows quadrupled.

3. However, the economy today is faced with several macroeconomic challenges. In recent months, currency volatility had increased, with daily fluctuations of up to c.18 percent. On Aug. 13, 2018, the Lira hit its lowest since the Global Financial Crisis, at TRY7.24 against the dollar. Following measures[3] by the Central Bank (CBRT) the currency picked up and stabilized at TRY6.56 against the dollar. This translates to a drop in value of 40 percent for the Lira against the dollar, since the start of 2018.

4. Double-digit inflation—15.9 percent in July 2018—is also a core concern. In 2017, the 11.9-percent inflation (2016: 8.5 percent) was partially spurred on by the Lira's depreciation and received further impetus from upward inertia of price pressures and rising inflation expectations. In addition, the current account deficit rose from 3.8 percent of GDP in 2016 to 5.6 percent in 2017 (USD47.4 billion) on a 12-month rolling basis, largely due to high energy prices and gold imports. Gross external debt stood at 52.9 percent of GDP (USD466.7 billion) as at Q1 of 2018, with the private sector share (banks and non-bank corporates) being 69.7 percent. About USD182 billion (20 percent of GDP) is expected to mature within 12 months, with banks, trade entities and non-trade corporates making up 57 percent, 26 percent and 14 percent of

[1] The CGF was introduced in 1993, and then expanded about tenfold in 2017. The CGF provides state guarantees (for up to 100 percent of any export loan, 90 percent of SME loan, 85 percent of commercial loan) for loans, provided individual banks do not reach an NPL ratio of seven percent. This limits the maximum fiscal burden of the CGF to about USD4.5 billion over a three-year period. The maturity of the portfolio is about three years on average, and the average interest rate stands at 15 percent (vs. 17 percent for non-CGF backed corporate loans).

[2] In 2018, the CGF utilized the remaining TRY55 billion (which was part of the TRY250 billion CGF in 2016) to lend to large industrial companies (TRY25 billion) and export-focused companies (TRY15 billion). Continued efforts to ensure liquidity for small and medium-sized enterprises (SMEs) and improve financial markets effectiveness led to several changes being made to Law no. 7099, aimed at improving the investment climate. In March 2018, a series of measures were introduced to further improve ease of doing business, including streamlined bankruptcy and insolvency procedures.

[3] In response to the market volatility, the CBRT and BRSA undertook the following measures: one, the BRSA limited swap transactions to restrict speculative transactions on the TRY; two, reserve requirement ratios for the TRY were reduced by 250 basis points for all maturity brackets by CBRT; three, reserve requirement ratios for non-core FX liabilities were reduced by 400 basis points for one-, two- and three-year maturities by the CBRT.

this respectively. In terms of public debt, 2017 saw only a slight increase to a still-low 28.3 percent of GDP (38.9 percent dominated in FX), but contingent liabilities have increased due to public-private partnership (PPP) activity[4] and the expansion of state loan guarantees. Aside from the CGF, other explicit contingent liabilities of the government include guarantees[5] by the Treasury and Finance Ministry (Treasury) and other PPP-related commitments. The concerns surrounding Turkey's macroeconomy contributed to the downgrading of the country's sovereign debt rating by one notch, by all three rating agencies: Fitch, from BB+ to BB on July 14, 2018; S&P, from BB- to B+, on Aug. 17, 2018; Moody's, from Ba2 to Ba3, on Aug. 17, 2018 as well. In July 2018, the International Monetary Fund (IMF) said growth is likely to slow to around 4.2 percent in 2018.[6]

5. Most recently, the government has emphasized that one of the core priority in its "new economic model" is the reduction of inflation to single digits. On Aug. 9, 2018, it announced its intent to cut budget deficit to around 1.5 percent of GDP and bring the Treasury's domestic debt rollover ratio to below 100 percent. Hitherto, efforts include the hiking of rates[7] by the Turkish Central Bank (CBRT) (c.1097 basis points since the beginning of 2017), the introduction of instruments such as Non-Deliverable Forwards to allow for corporates and banks to hedge against exchange rate risks, and restrictions on FX borrowings.[8] The Treasury has announced that economic growth in 2019 is expected to be around 3-4 percent.

B. Sectoral and Institutional Context

6. **Financial Sector.** The Turkish financial sector is supervised by three main regulatory and supervisory authorities. The BRSA is the regulatory and supervisory authority for the banking industry as well as financial leasing, factoring, financial holding companies, electronic money institutions, consumer financing, some payment systems institutions and asset management companies. The Capital Markets Board of Turkey is the regulatory and supervisory authority for the securities markets. Finally, the General Directorate of Insurance and the Insurance Supervisory Board operating under the former Undersecretariat of Treasury, now Treasury and Finance Ministry, are responsible for the insurance sector.[9]

---

[4] Contingent liabilities arising from PPPs are mainly Debt Assumption Commitments (DACs). In DACs, senior loan payment guarantees could be extended by the Treasury, the special budget administrations or the state-owned enterprises for PPP projects. As of late 2017, a total of USD8.7 billion (c.1.0 percent of GDP) had been subjected to DACs.

[5] According to Law no. 4749, there are four types of Treasury Guarantees, namely Treasury repayment guarantees, Treasury counter-guarantees, Treasury country guarantees and Treasury investment guarantees. The Treasury counter-guarantees and Treasury country guarantees have never been used. The Treasury repayment guarantee is one of the most commonly used guarantee type used today, to support the external financing of the public investment projects realized by public banks, state owned enterprises, municipalities and their affiliates. Treasury guaranteed external debt stock increased by USD1,552 million to USD13.9 billion (c.1.4 percent of GDP) by the end of 2017.

[6] IMF. World Economic Outlook Update. July 16, 2018.

[7] It should be noted that rates were held constant in the latest meeting of the Monetary Policy Committee (MPC), as it was assessed that "signs of deceleration in domestic demand (has) become more visible."

[8] The restrictions were effected in May 2018 and are set out in the Council of Ministers Decree No. 9. Please refer to Annex 2 Additional Industry Background for more details.

[9] The other authorities that have a role in the regulation and supervision of the banking system are the Central Bank of the Republic of Turkey (CBRT) as the monetary authority, the Financial Crimes Investigation Board (MASAK) as the authority for AML and CFT; and the Savings Deposit Insurance Fund (SDIF) as the deposit insurance and bank resolution authority.

7. Turkey's financial sector exhibited 18 percent compound annual growth rate in asset size between 2008 and 2016, higher than the average rate of GDP growth of the country. Central to the system is the banking sector, that as at end-2016, made up about 81 percent of the financial sector by assets, 80 percent of the foreign direct investments into the sector, and 105 percent of Turkey's GDP. In the wake of Turkey's financial meltdown in February 2001, extensive regulatory reforms were made, and proved effective in helping the sector show resilience and maintain investor confidence during the global financial turmoil in 2009. That said, the open investment environment makes the Turkish financial markets volatile and sensitive to changes in international investor sentiment—Turkey was one of the countries most affected by the asset sell-off in November 2016; and there were also sharp falls in domestic and external government bond yields when there was a global return to emerging markets in the following April 2017.

8. **Banking Industry**. As of December 2017, a total of 51 banks operate in Turkey, including 33 deposit banks, 13 development and investment banks, and five participation banks.[10] Concentration of the banking sector by asset size is moderate—the five largest banks amount to about 60 percent of total assets, and comprise two state-owned banks and three private banks. In terms of ownership, the private domestic, foreign-owned and state-owned banks are comparable to each other in market share. The banking sector remains well managed and prudently regulated by the BRSA and is governed under the Banking Law No. 5411. By 2016, the Turkish banking laws were found to be fully compliant with Basel III, with the Basel Committee's Regulatory Consistency Assessment Program's reports stating that "the Turkish rules go beyond the minimum Basel standards."[11] The majority of banks are also in compliance with International Financial Reporting Standards (IFRS) 9 reporting requirements.

9. The Basel Framework requires minimum capital ratios of 4.5 percent for Common Equity Tier 1 (CET1), 6.0 percent for Tier 1, and 8.0 percent for Total Capital (Tier 1 and Tier 2) to risk-weighted assets. In addition to implementing the Basel minimum capital ratios, the BRSA has required of Turkish banks to establish a higher total target capital ratio of 12 percent. Banks that fail to meet the 12-percent target ratio are subject to various supervisory actions, including restrictions on growth, dividend payments, and branch openings. In addition, all banks are to implement the capital conservation and countercyclical buffers set at 2.5 percent of CET1 capital and between 0-2.5 percent of CET1 capital for the capital countercyclical buffer. This effectively establishes a minimum CET1 ratio of 7 percent and Tier 1 of 8.5 percent. Banks in Turkey are also required to implement an Internal Capital Adequacy Assessment Process which is used to internally calculate the capital adequate to cover current and future risks by banks. In line with Basel III, the BRSA uses two types of liquidity adequacy ratios that banks must comply with: liquidity coverage ratio (LCR) of 100 percent and FX LCR of 80 percent.

10. Key ratios for the Turkish banking sector remained healthy in Q1 of 2018, and liquidity position was good, with total LCR at about 120 percent and FX LCR at about 180 percent,

[10] According to the Banking Law No 5411: Deposit banks operate primarily for the purposes of accepting deposit and granting loan in their own names and for their own accounts; Development and investment banks operate primarily for the purposes of economic development in Turkey; Participation banks operate primarily for Islamic financing.
[11] Basel Committee on Banking Supervision. Regulatory Consistency Assessment Program reports: (i) The Assessment of Risk-Based Capital Regulations, and (ii) The Assessment of Basel III Liquidity Coverage Ratio Regulations.

well above the minimum BRSA regulations (however, loan-to-deposit ratio was a high 143.7 percent reflecting banks' reliance on wholesale funding). These would provide the sector with buffers in times of economic slowdown or shocks. Asset quality was also good, with non-performing loan (NPL) at 2.9 percent, return on assets at 1.7 percent, and return on equity (ROE) at 16.1 percent. Provisioning for NPL was strong with specific provisions at 75.1 percent, CAR at a robust 16.6 percent and low leverage of 7.8 percent. Nevertheless, in the event of a significant tightening of global liquidity and persistent lira depreciation, while banks are not allowed to hold net open currency positions, corporate sector balance sheets could be strained, and defaults in the corporate sector could impact on the banking sector.

11. **Infrastructure Industry**. More than USD100 billion have been spent since 2010 in capital projects and infrastructure, and up to USD325 billion of further investments is expected from 2017 up to the centennial celebrations of the nation in 2023.[12] Turkey's strategic geographical location as well as growing population, urbanization and economy is expected to support robust demand for infrastructure projects across all sectors.

12. Hitherto, the government's efforts to support infrastructure growth have ranged from promoting multiple PPP opportunities, to offering guarantees to lower the risk threshold for private investors into the sector. As government guarantees are expected to decline, it would be crucial for the infrastructure industry to continue to crowd in capital from the private sector and multi-lateral development banks.

13. Power Sector. Turkey has had the highest growth rate of energy demand among OECD countries over the last 15 years. Primary energy consumption grew by an average of 4 percent for 2003-2013. Today, only 26 percent of its total energy demand is met by local resources. In a bid to reform the sector and provide a sufficient and cost-effective supply of power, it is working toward a competitive market with private sector participation. While about 23.4 percent[13] of the country's electricity generation is still controlled by the State Electricity Generation Company (EUAS), the remainder is now generated by the private sector. In addition, the new Electricity Market Law also introduced a new market operator, the Energy Exchange Istanbul (EPİAŞ), to manage the operation of organized wholesale markets so that electricity prices can be more predictable and the investor confidence in the sector can be increased.

14. Renewable Energy Sector. The energy sector, including renewable energy, will continue to grow significantly as Turkey seeks to reduce its energy deficit and generate up to 30 percent of total energy from renewable sources by 2023. In 2013, the Government introduced the Renewable Energy Support Mechanism (YEKDEM) for renewable energy plants to enjoy Dollar-based feed-in tariffs for the first 10 years of operation. Plants that make use of locally-produced equipment also enjoy additional subsidies. The existing YEKDEM would end in 2020, and the government announced a transition to the Renewable Energy Resources Zone Areas (YEKA) scheme for the wind and solar sectors since 2017. As part of YEKA, competitive winner-takes-all (in the designated-area) auctions would be held to decide the feed-in tariff, that would last for 15 years beginning from construction of plant. This is intended to spur cost

[12] PwC, 2016. Capital Projects and Infrastructure Spending in Turkey: Outlook to 2023.
[13] Ministry of Energy and Natural Resources. Please see: http://www.enerji.gov.tr/en-US/Pages/Electricity

efficiency and effectiveness and was successfully illustrated in a first 1GW solar auction in 2017.[14] More YEKA tenders are expected to take place in the near future.[15] It remains uncertain whether YEKDEM or YEKA would be implemented for the biomass, geothermal and hydroelectric power plant sectors after 2020.

15. Energy efficiency is also a focus for the Government. In 2018, the National Energy Efficiency Action Plan was introduced and aimed for Turkey to reduce 14 percent of primary energy consumption by 2023. This would be achieved partially through government investments of almost USD11 billion in energy efficiency measures. In addition, the country is also looking to establish itself as a supply hub for renewable plant component manufacturing, especially in the wind sector. Additional industry background can be found in Annex 2.

16. Transport Sector. Transport infrastructure has also been a key area of investment as Turkey looks to boost its logistics capacity as a key trading link between Asia and the Western countries. Its first PPP projects, namely the Istanbul Third Airport PPP Project and Izmir Bay Crossing and Izmir-Istanbul Highway PPP, have taken off in the sector and more flagship projects in the pipeline are expected to move forward.

17. Turkey's ambitious 2023 Master Plan involves more than doubling its current railway network over the next decade and is expected to cost up to about USD45 billion. About USD11 billion of rail network expansion and upgrading (electrification and signaling upgrades) have been announced and at least 1,500 miles of high-speed rail line are expected to be built in the next five years. To manage traffic across the whole national rail network, the government recently reformed the State Railways of the Republic of Turkey (TCDD). In the port sector, upcoming megaprojects include the Kanal Istanbul Project, and the government has committed to laying the foundations in 2018. In the airport sector, multiple projects have been tendered and are in the process of construction, in hopes of having Turkey challenge the Gulf states as a regional hub. The government had set a target to have at least 60 airports in the country by 2023, including Hakkari-Yüksekova Airport and at least three airports in Antalya region.

2 The Project

18. The Project will provide long-term financing (Sub-loans) through TSKB (Borrower) to privately owned companies (Sub-borrowers) in Turkey to invest in projects (Sub-projects) primarily in the renewable energy and energy efficiency sectors. These include Sub-projects in the wind, solar, geothermal, hydro (up to 30 megawatts [MW] and only run-of-river type plants), and biomass industries. Beyond the renewable energy and energy efficiency sectors, the Borrower can also extend AIIB's loan to the Sub-projects in the transport, power transmission, water management and treatment, and telecommunications sectors.

[14] The bids registered in the first 1 GW solar auction for the Karapinar Solar Farm in 2017 illustrated the significant cost reductions that the solar sector will register under a competitive system: the winning consortium submitted a bid totaling USD69.9/MWh for a duration of 15 years; in comparison, the equivalent Feed-in Tariffs originally was USD133/MWh.

[15] In June 2018, the Ministry of Energy and Natural Resources announced the launch of a tender for a 1.2 GW offshore wind power plant, with a ceiling price set at USD80/MWh.

19. Extending at least 60 percent (75 percent on best effort basis) of the loan to renewable energy and energy efficiency projects ensures that funds are directed to an underserved sector crucial for sustainable economic growth of the country. Contributing to energy production within Turkey would also reduce its reliance on energy imports, in turn reduce the current account deficit confronting the country.

A. Rationale

20. **Alignment with AIIB's Mandate, Thematic Priorities and Energy Strategy.** The Project is well aligned with AIIB's mandate to (i) foster sustainable economic development, create wealth and improve infrastructure connectivity in Asia (Turkey) and (ii) promote regional cooperation and partnership in addressing development challenges.

21. The Project also promotes AIIB's thematic priorities to (i) advance green and sustainable infrastructure and (ii) mobilize private capital into sustainable infrastructure. The Operational Manual shall guide the Borrower to ensure that AIIB's loan would primarily be directed into renewable energy and energy efficiency sectors. The latter would have to satisfy an energy saving ratio or CO_2 reduction of 20 percent or more annually, or at least 50 percent in cost savings due to reduced energy consumption. These are consistent with AIIB's Energy Strategy as well. To mobilize private capital into the Sub-projects, all Sub-projects would require the Sub-borrowers to inject a minimum of 15 percent equity into renewable energy Sub-projects and 20 percent equity into the Sub-projects in other sectors, unless otherwise agreed with AIIB.

22. **Alignment with Country and State Priorities.** The Project would support the government's plans for infrastructure investments by contributing to long-term capital needed for vital infrastructure building in Turkey. It is aligned with Turkey's goals to decrease energy intensity by at least 20 percent compared to 2008 and generate at least 30 percent of total electricity output from renewable energy by 2023. It is also aligned with the macroeconomic priority of the government to reduce its current account deficit while ensuring sufficiency energy for economic growth.

B. AIIB's Value Addition to the Project

23. **Provision of Long Term Capital**. The Project will contribute to the limited long term foreign exchange lending in Turkey for investment into the infrastructure sector. Banks are the main source of financing but there is significant scarcity for long-term financing. Less than half of bank loans are shorter than one year, 40 percent are between one to five years, and only 12 percent are above five years. This is largely because the banking system is funded mostly (c.53 percent) by relatively stable customer deposits, and 88 percent of these have maturities below three months. The need to limit the maturity mismatch to ensure liquidity is thus a constraint for banks to provide long-term loans.

24. However, much of the infrastructure sector requires long-term finance due to the long-term nature of construction, expansion or ongoing operating costs. Long-term finance can also reduce the firms' exposure to rollover and interest rate risks so that longer term fixed investment decisions can be made. The Project will play a vital role in closing this financing gap.

25. The Project will also help the Borrower enhance and diversify its sources of long-term funding required for lending to the infrastructure sector.

C. Project's Value Addition to AIIB

26. This is AIIB's first engagement with banks as financial intermediary (FI) and would be an opportunity to learn and develop a new business line in FI on-lending. The Borrower will also provide AIIB with the opportunity to understand its deal pipeline, its lending processes, its local organizational network, and the infrastructure and financial markets. This would be a good opportunity for AIIB to learn about Turkey's financial and infrastructure sectors.

27. The Borrower is well positioned to be AIIB's FI in Turkey due to its:

a) Long and successful history of cooperation with various international financial institutions (IFIs), including the World Bank, Islamic Development Bank, Kreditanstalt für Wiederaufbau, European Investment Bank, the European Bank for Reconstruction and Development, Japan Bank for International Cooperation, Agence Française de Développement, Council of Europe Development Bank and others, particularly in the infrastructure area.

b) Strong financials outperforming both the industry average and the local development and investment banks average profitability and operational efficiency.

c) Adoption of best market practices, as recognized by Istanbul Stock Exchange i.e., Borsa Istanbul (BIST) with high score of 9.54 of 10 as at Q2 of 2018, in its Corporate Governance Index. Since 2009, BIST has deemed the Borrower to be among the companies with the highest corporate governance rating in Turkey. With a competent management team, the Borrower was also the first bank in Turkey to issue green and sustainable infrastructure Eurobonds.

d) Strategic focus on infrastructure (including renewable energy) and energy efficiency investments which make up 42 percent of the loan book.

e) Established and validated Environmental and Social (E&S) Risk Management System.

D. Objectives

28. The main objective of the Project is to advance Turkey's infrastructure – primarily in the field of renewable energy and energy efficiency, but also in the sectors of transport, power transmission, water management and treatment and telecommunications. In the long run, this would allow the country to reduce its reliance on imported energy and in turn, reduce its current account deficit.

29. The Project objectives would be measured through the following:

a) Total share of renewable energy, energy efficiency in the Sub-loan portfolio generated by AIIB's loan.

b) Total installed capacity of renewable energy financed by the Sub-loan

c) Total reduction in CO_2 emissions due to Sub-projects.

For more details, please refer to Annex 1: Results Framework and Monitoring.

E. Description of the Borrower

30. Established in 1950, the Borrower was the first investment and development bank founded in Turkey. It was set up with the support of the World Bank, the Government of the Republic of Turkey, the Central Bank of Turkey and leading Turkish commercial banks. Today, it is Turkey's only private development bank, and its major shareholders are İş Bankası (50.7 percent), Turkey's largest private bank by assets, and Vakıfbank (8.4 percent), fifth largest bank in Turkey by assets. 39.3 percent of the shares are traded publicly on BIST, and market capitalization was TRY2.4 billion as at July 31, 2018.

31. The ownership of İş Bankası, in turn, is split between the Atatürk Shares (28.09 percent), the employees' pension fund (39.95 percent) and the remaining 31.96 percent is traded on BIST. At the end of 2017, İş Bankası had USD96 billion in total assets (c.11 percent market share) and USD10 billion in equity. İş Bankası is rated B2 by Moody's.

32. As at Q2 of 2018, the Borrower had TRY35 billion in assets, making it the second largest development and investment bank, and fourteenth within the whole banking sector. It has a 3.4 percent market share in long-term FX corporate loans and was rated B2 by Moody's.[16] It has two branches (one in Ankara and one in Izmir) and employs 371 people. As a development and investment bank, the Borrower is not authorized to take deposits. Around 87 percent of its funding is long-term, of which c.64 percent is long-term financing (average 11 years maturity) provided by IFIs. Around 82 percent of IFI funding is guaranteed by the Turkish treasury.

33. The Borrower provides medium-term and long-term funding to Turkish companies, primarily through loans denominated in foreign currency. In Q2 of 2018, 10 percent of the loan book was denominated in TRY; 47 percent was in USD, with the balance of 43 percent in EUR. The Borrower also on-lends to SMEs as part of a scheme called APEX, where it extends credit to commercial banks and leasing companies which on-lend to SMEs. On top of these, it also provides short-term working capital loans (19 percent of the portfolio), as well as treasury, investment banking and advisory solutions to its clients.

34. The Borrower maintains strong corporate governance and is recognized by BIST as one of the companies with the highest Corporate Governance Index. As at Q2 of 2018, the Borrower had a corporate governance rating of 9.54/10 by SAHA.[17] The Borrower has eight Executive Vice President Offices and 27 departments as of 2017. Of these departments, 24 departments report to the General Management Office while the Internal Audit, Internal Con-

[16] On Aug. 28, 2018.

[17] Corporate Governance and Credit Rating Services Inc. SAHA Ratings was established in December 2005. It was certified by the Capital Markets Board to conduct Corporate Governance Compliance Rating in 2006 and was the first domestic rating agency authorized to conduct corporate governance compliance ratings.

trol and Risk Management Departments report directly to the Board of Directors via the Executive Vice President reporting to the Audit Committee. The most recent organizational chart is shown in Annex 3.

35. Through its lending, the Borrower supports various development themes, such as "Renewable Energy," "Energy Efficiency," "Resource Efficiency," "Research and Development," "Industrial Development," "Occupational Health and Safety," "Climate Change," "Innovation," "Women's Employment and Equal Opportunity," "SME Support," "Midcap Capacity Building" and the biggest proportion of its loans (Q2 2018: 33 percent) is in the electricity production sector. Its outstanding renewable energy portfolio is USD1.9 billion and consists of 283 renewable projects (6,074 MW), of which 223 (5,049 MW) are in operation.

36. **Loan Approval and Monitoring.** The Project Team reviewed the Borrower's loan evaluation process, credit risk assessment process and final approval process of the Evaluation Committee and the Board. The Borrower was assessed to have robust lending practices in place, with strong internal capacity to conduct financial, technical and operational analysis, implementation and monitoring of its Sub-loans.

37. Disbursements are made upon fulfilment of conditions that the Sub-borrower addresses E&S concerns, and that it has sufficiently hedged its foreign currency position. Once disbursements are completed, the Loans Monitoring Department takes over the monitoring of the loan and prepares monitoring reports at least once a year. Internal and external ratings of the Sub-borrowers are also monitored, along with their shareholding structure, collateral package and appraisal reports of the collateral prepared by independent appraisal companies.

F. Implementation of AIIB's On-lending Facility

38. The Borrower will be responsible for the implementation of the Project. It shall establish a PIU, with the terms of reference acceptable to AIIB and with adequate budgetary and human resource allocation, for the purposes of overseeing the Borrower's lending to the Sub-borrowers. This will include the selection, appraisal, monitoring, records keeping and information management of the Sub-project, as indicated in the Operational Manual. The information will then be reported to AIIB periodically at the stipulated frequency. The PIU shall also ensure compliance of the Borrower and Sub-borrower with the Turkish legislation and standards and AIIB's fiduciary and safeguard requirements as stated in its E&S Policy, the Policy on Prohibited Practices and the Procurement Policy.

39. All Sub-loans shall also be made in accordance with the Council of Ministers Decree no. 32 which regulates the foreign exchange lending provisions. Although AIIB's loan will be provided in FX, the Borrower will be able to make the Sub-loans in local currency, if required, by making use of country's well-developed currency swap market.

40. **Pipeline.** A preliminary pipeline has been presented to AIIB but may be modified by the Borrower during the Project Implementation Stage. All Sub-projects in the pipeline should be aligned with the Eligibility Criteria set out as per Annex 5, which would be included in the Operational Manual.

41. **Operational Manual.** Some of the key guidelines set out in the Operational Manual

include the following:

(a) Fund flow: The Borrower shall open and maintain a segregated Designated Account (DA) in US Dollars for the purpose of making withdrawals from AIIB for further on-lending to Sub-borrowers. The Borrower shall operate operating accounts in applicable loan / commitment currencies for managing and disbursing eligible Sub-loans. Exchange gains or losses arising from the transfer of loan proceeds from the DA to the operating accounts are not considered eligible and will not be absorbed under the AIIB loan. The withdrawal applications that will be submitted by the Borrower to AIIB will have two signatures indicated in their list of authorized signatures. Disbursement arrangements from AIIB to the Borrower will be communicated in a Disbursement Letter, and will follow the Advance Method. From AIIB to the Borrower, the amount of the proposed disbursement must be (i) in a minimum amount of USD2 million and (ii) in a maximum amount of USD50 million.

The Borrower shall open and maintain a separate Sub-loan account (SA) for each Sub-loan in accordance with policies and procedures satisfactory to AIIB for the purpose of receiving each payment of interest or other charges and repayment of principal from the Sub-borrowers.

The Borrower shall separately report the utilization of principal repayments made by Sub-borrowers under the Sub-loans (to the extent payments are not required to meet the Borrower's payment and repayment obligations to AIIB under the Loan Agreement) to finance additional Sub-loans in accordance to the terms stipulated in the Operational Manual. The DA and SA will be recorded in a Statement of Expenditure (SOE) Form, and supporting documents will be retained by the Borrower and made available to AIIB upon request.

(b) Right to conduct prior review: The Sub-borrowers and the Sub-projects can be selected directly by the Borrower based on the Eligibility Criteria agreed with AIIB, set out in the Operational Manual. However, AIIB retains the right to conduct prior review of the Environmental and Social due diligence (ESDD) of the Sub-projects.

(c) Reporting and supervision requirements: To facilitate the monitoring of AIIB's loan, the Borrower shall provide AIIB with the following regular reports:

No.	Requested Report	Frequency	Due Date
1	Project Appraisal Form	N/A	Prior to Borrower's proposal to allocate the Sub-loan from AIIB's loan.
2	Borrower's audited financial statements covering the period of one financial year of the Borrower, prepared in accordance with IFRS; and the corresponding Management Letter.	Annual	No later than 30 days after approval by the Borrower's Board of Directors.

3	Borrower's audited financial statements covering the period of one financial year of the Borrower, prepared in accordance with the requirements of the BRSA.	Annual	Together with No. 2.
4	Certificate of compliance with the applicable prudential regulations of the Republic of Turkey and requirements of the BRSA.	Annual	Together with No. 2.
5	Unaudited Mid-Year Project Financial Statement, comprising the SOE and activities of the DA, and SA covering the period of the first six months of the Borrower's financial year.	Annual	No later than 45 days after June 30 of each year
6	Audited End-Year Project Financial Statement, comprising the SOE and activities of the DA, and SA covering the period of the first six months of the Borrower's financial year.	Annual	No later than 180 days after Dec. 31 of each year
7	E&S Monitoring Report, comprising: ESDD conducted on the Higher Risk[18] Sub-projects, the portfolio breakdown by industry sectors and product lines, portfolio monitoring including the installed capacity and CO_2 reduction of the Sub-projects, and changes to the Borrower's ESMS (where applicable). It will also highlight details on the Higher Risk Sub-projects undergoing monitoring, and all issues arising from non-compliance and explain how the issues have been or are being addressed during the implementation of the Sub-project(s)	Semi-Annual	No later than 60 days after June 30 and Dec. 31 of each year

In addition, AIIB shall retain the right to conduct supervision visits (including on-site visits to the Sub-borrowers and the Sub-projects) at its discretion.

3 Project Assessment

42. An assessment of the Borrower's corporate governance, credit approval and monitoring process, policies and written procedures on management of financial and operational risks, financial and risk profile, as well as internal audits and information management systems was conducted by the Project Team at the pre-appraisal stage. An Independent Financial Consult-

[18] Higher Risk transactions are the provision of project finance or long-term (over 36 months) corporate finance or equity finance into activities that involve (a) involuntary physical or economic resettlement, (b) risk of adverse impacts on Vulnerable Peoples, (c) significant risks to or impacts on the environment, community health and safety, biodiversity, cultural heritage or (d) significant occupational health and safety risks.

ant was also engaged to ascertain the financial and operational risks of the project. A confidential appraisal report based on due diligence of the Project Team was filed, and all above-mentioned areas were found to be satisfactory and aligned with AIIB's policies and requirements. The following is a summary of relevant assessment:

A. Technical Assessment

43. The Borrower would be responsible for the implementation of the Project, including the selection, analysis and monitoring of all Sub-projects. It has hitherto demonstrated strong capacity to implement financial intermediation loans funded by various IFIs, and its extensive experience in the Sub-loans to renewable energy and energy efficiency projects makes it a strategic partner for AIIB. Previously, the Borrower implemented the World Bank Renewable Energy and Energy Efficiency Facility and Geothermal Lending Facility, which were rated Satisfactory and Highly Satisfactory, respectively, by the Independent Evaluation Group of the World Bank. The focus on renewable energy and energy efficiency is also in line with Turkey's need to reduce energy imports and improve self-sufficiency of energy. Extensive research was conducted and ascertained that there would be sufficiency demand for energy to ensure continued economic growth of the country.

B. Financial Assessment

44. The Sub-projects to be funded are not confirmed, thus a traditional economic and financial analysis of the project cannot be conducted. The Borrower is expected to conduct the necessary financial evaluation of each Sub-project and Sub-borrower to ensure viability of the Sub-loan. The Sub-loan pricing and maturity will be determined by the Borrower with the proviso that the interest rate shall be (i) consistent with market conditions or (ii) if there is no market-determined benchmark rate, adequate to cover all costs and risks associated with the Sub-borrower and the Sub-project, ensuring an adequate profit margin of the Borrower.

45. The financial evaluation of the Borrower itself was deemed as highly satisfactory. The Borrower was deemed to have sound financial practices, which have led to its strong liquidity, capital adequacy, asset quality, and profitability. The following table summarizes its historical performance and Q2 of 2018 performance vis-à-vis the overall banking industry. A more detailed breakdown of its financial performance can be found in Annex 4.

Table 1: Financial metrics (2016-2017 reported based on IFRS, Q2 2018 based on BRSA)

	2016	**2017**	**Q2 2018**	**Q2 2018 Banking Sector-wide**
CAR	14.6%	17.0%	15.2%	16.3%
Loan/Asset	72.2%	77.1%	77.5%	66.2%
NPL	0.3%	0.2%	1.9%	2.9%
C/I	15.0%	12.5%	13.3%	36.4%
NIM	3.5%	3.9%	3.9%	3.7%
ROE	17.6%	18.4%	17.7%	14.4%

46. The Borrower's balance sheet is highly dollarized but with well-managed open currency positions (OCP) as it lends predominantly in hard currency and uses FX derivatives to hedge the remaining position. It enjoys a stable and diversified funding base, including long-term credit lines from different IFIs, subordinated debt with 10-year maturity and several issuances of five-year Eurobonds.

47. As at Q2 of 2018, the NPL ratio (PAR90+) was 1.9 percent, below the industry average of 2.9 percent. This reflects the Borrower's robust underwriting policies, cautious lending approach and long-term type of lending with longer tenors and installment repayment profiles. The Borrower has a policy of making 100 percent impairment provisions against NPLs.

C. Fiduciary and Governance

48. **Bank Domicile**. The Borrower is established in Turkey, which is not considered a "high-risk and non-cooperative jurisdiction" according to the Financial Action Task Force for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.

49. **AML & CFT (Anti-Money Laundering and Combating of Terrorism).** The Borrower regularly reports to the Financial Crimes Investigation Board of Turkey. As it does not accept time or on demand deposits and does not open accounts for individuals or legal entities, its risk profile on the AML & CFT side is limited. The quantity of suspicious transactions identified by the bank was below five in 2017.

50. **Integrity.** Due diligence was undertaken by AIIB on the Borrower, its shareholders and top management to ensure that internal integrity was sound. The review concluded that there were no integrity issues, and that the Project does not pose unacceptable reputational risk to AIIB.

51. **Financial Management.** The Borrower's financial management systems are satisfactory, with adequate systems and procedures in place to manage IFI-financed projects. AIIB will ensure the continued compliance of the Borrower with domestic prudential regulations through the annual audit reports, to be prepared in accordance to IFRS, and subjected to independent audit. All Sub-loans would also be appropriately document and accounted for in the mid-year unaudited financial reports and annual end-year audited financial statements denoting the activities of the DA and the SA. The annual end-year audited financial statements would be made publicly available.

52. **Procurement.** AIIB is providing financing to an FI to finance eligible infrastructure projects through the Sub-borrowers in accordance to the Operational Manual. Thus, procurement of goods, works and services financed under these investments is to be conducted in accordance with the provisions of AIIB's Procurement Policy and method applicable to Private Sector Entities. The Borrower shall ensure that the procurement provisions are complied with by demonstrating that established commercial practices and appropriate procurement methods are followed and market price are achieved. Financing to public-sector entities are not eligible as defined in the Operational Manual.

53. **Anti-corruption.** The Borrower is committed to preventing fraud and corruption. It shall ensure that its operations and that of the Sub-projects' are in strict compliance with AIIB's Policy on Prohibited Practices. Implementation of the Sub-projects shall be monitored regularly by the Borrower, and AIIB should be notified within two business days at the latest of any suspected Prohibited Practices and any investigations on Prohibited Practices involving the Borrower or a Sub-borrower.

D. Environmental and Social

54. AIIB's Environmental and Social Policy (ESP) is applicable to this on-lending facility. The Project has been placed in Category FI, because the financing structure involves the implementation of Project by the FI, in so far as conditions in the Operational Manual—including alignment of the Sub-borrower and the Sub-project with AIIB's ESP—are met.

55. The Project Team has assessed[19] that the Borrower's ESMS is materially consistent with the provisions of AIIB's ESP and relevant Environmental and Social Standards as embedded in the Operational Manual. The Borrower's ESMS includes E&S policies, manuals and procedures applicable to its lending operations and to its own activities such as: the establishment of an internal Sustainability Committee; accounting of the greenhouse gas (GHG) emissions due to its own energy consumption; disclosure of its internal E&S performance in the annual Sustainability Report. Since 2012, the Borrower's E&S policies, processes and tools have been integrated into a Sustainability Management System. The System has been found to be suitable, and of equivalence to the E&S policy requirements of the various IFIs. The Borrower also maintains sufficient in-house E&S personnel and capacities with experience in selected sectors (renewable energy, energy efficiency, etc.).

56. The Borrower's Sustainability Committee has established five working groups, including one on Gender Equality and one on Dialogue with Stakeholders. The former defines and implements initiatives to support gender equality within the Borrower and reaches out to its Sub-borrowers on related issues. The latter engages with a broad stakeholder base on sustainability issues, including media, industry working groups, etc. On top of these, the Borrower has also established an external communication mechanism to address third-party views, enquiries or concerns regarding their own E&S processes and outcomes, as well as E&S impacts and performances of their portfolio investments.

57. The Borrower's E&S policies and standards guide its screening, categorization, preparation of E&S instruments, disclosure and consultation with stakeholders, including Project Affected People, at the Sub-project level. First, screening and categorization are carried out systematically using the proprietary Environmental Risk Evaluation Tool (ERET) Model, and the Sub-projects would be categorized within a four-tier system comprising A, B+, B- and C. The outcome of the ERET Model determines the level of ESDD to be conducted for the Sub-

[19] The assessment was made through review of available E&S documentation by the Borrower, interviews with the Borrower's E&S specialists, and review of E&S appraisal and monitoring documentation of selected Sub-projects, during the course of the Bank's E&S due diligence. The assessment is in line with that of other IFIs such as Agence Française de Développement, the European Bank for Reconstruction and Development, European Investment Bank, International Bank for Reconstruction and Development, International Finance Corporation, Japan Bank for International Cooperation, Kreditanstalt für Wiederaufbau, etc.

project and is then presented to the Borrower’s Credit Committee. For all Higher Risk transactions, specific higher risk aspects of the Sub-projects will need to be assessed and mitigated in a manner aligned with AIIB’s Environmental and Social Standards. The Borrower will also obtain the authorization of the Sub-borrowers of the Higher Risk Sub-projects to publish the brief Sub-project description, E&S instruments, a summary of E&S impacts and mitigation measures, to be published on its website.

58. In all Sub-loan Agreements, the Borrower shall ensure inclusion of standard E&S covenants, E&S monitoring and reporting requirements, and where necessary, the Sub-project specific Environmental and Social Action Plan. AIIB’s E&S requirements will also be annexed to the Sub-loan Agreements. The Borrower will provide support to the Sub-borrowers for the establishment of a Sub-project level ESMS, which will outline the processes to disclose E&S information of the Sub-project, conduct stakeholder engagement activities, and establish the required grievance redress mechanism.

59. For all Sub-projects, the Borrower would require the Sub-borrowers to provide an Environmental Impact Assessment, environmental, health and safety clearance certificates, an Environmental and Social Management Plan, and specialist studies where applicable. Additionally, for all Higher Risk Sub-projects, the Sub-borrowers would also be required to submit further E&S instruments such as a “bankable” Environment and Social Impact Assessment or specialized studies, and where applicable, a Resettlement Action Plan (RAP) prepared by an independent specialized E&S consultant.

60. The Borrower will conduct regular monitoring and supervision of the E&S performance of the Sub-projects against the commitments and requirements indicated in the Environmental and Social Management Plans and Environmental and Social Action Plans. Frequency of monitoring shall reflect the level of E&S risks and impacts of the Sub-projects throughout the Sub-loan cycle. The following requirements shall also apply:

a) For all Category A Sub-projects, the Sub-borrowers will be required to appoint independent third-party monitoring consultants.

b) For all Category A and B+ Sub-projects, the Borrower will be required to conduct regular on-site monitoring throughout the construction phase and at least once after the commissioning of the financed activities. Subsequently, during the operation phase of the Sub-project, Sub-borrowers will submit an annual E&S report to the Borrower, throughout the Sub-loan cycle.

c) For Category B- and selected Category C Sub-projects, the Sub-borrowers would need to submit regular monitoring reports to the Borrower throughout the construction phase and the first year of operations of the financed activities.

61. As per 41.(b), AIIB retains the right to conduct an E&S prior review of all Sub-projects to be financed from AIIB’s proceeds. This is likely to be exercised on initial Sub-projects in each sector (i.e., renewable energy, energy efficiency, transport, power transmission, water management and treatment, and telecommunications) and Higher Risk Sub-projects. The exercise of the right can be triggered after AIIB will receives the Project Appraisal Form, as set forth in the Operational Manual, in the course of the Borrower’s Sub-loan evaluation process.

The prior review entails the review by AIIB of the ESDD and other E&S appraisal material to engage with the Borrower, where necessary, on specific E&S risks of Sub-projects, to strengthen alignment with AIIB's ESP.

62. As per 41.(c), the Borrower will also submit a semi-annual E&S report to AIIB, detailing the environmental and social risk management measures implemented for all new and on-going Sub-projects during the reporting period, the ESDD conducted on the Higher Risk Sub-projects, the portfolio breakdown by industry sectors and product lines, portfolio monitoring including installed capacity and CO_2 emissions reduced thus far, and changes to the Borrower's ESMS (where applicable). It will also highlight details on status and findings of the Higher Risk transactions monitoring, and all issues arising from non-compliance and explain how the issues have been or are being addressed during the implementation of the Sub-project(s). AIIB will maintain regular supervision of the Borrower's activities and conduct visits to selected Sub-projects where necessary.

E. Risks and Mitigation Measures

63. As this is the first engagement with banks as financial intermediaries, AIIB has assigned an overall **"Medium"** risk rating to the Project. The possible risks and mitigation measures are listed below:

Risk	**Assessment**	**Mitigation**
Macroeconomic Risk	Medium	Financial criteria for the Sub-borrowers are set in the *Operational Manual* to ensure stringent financial assessment of the Sub-projects for on-lending. These criteria would include a minimum debt service coverage of the sub-borrower, and analysis of its sensitivity to FX risk.
FX Risk	Medium	The Borrower has a well-managed OCP as it lends predominantly in hard currency and uses FX derivatives to hedge the remaining position. The Borrower also has a strong CAR which could sustain potential further devaluation. For the Sub-projects, (i) a significant portion of the loan will be utilized in the renewable energy project where the tariff will be adjusted to reflect foreign exchange rate and (ii) stringent financial criteria are set out in the Operational Manual. The Borrower is also well experienced in conducting financial evaluation of the Sub-borrowers to ensure repayment of the Sub-loans. The recent amendments to the Council of Ministers Decree no. 32 which regulates the foreign exchange lending provisions, also introduced restrictions on FX borrowing to ensure the corporate sector FX debt remains manageable.

Deterioration of Asset Quality	Medium	The Borrower has good CAR and a proven track record of managing the loan portfolio with low NPL levels even in times of crisis (i.e., during the banking crisis in 2001-2002 and the 2008-2009 global financial crisis). This is in large part due to its good corporate governance, accounting (already implemented IFRS 9) and risk management systems in place.
Environmental, Social and Reputational Risk	Medium	The Borrower has internal E&S resources and a proven track record in implementing their ESMS across a wide range of Sub-projects in Turkey, including Higher Risk Sub-projects. AIIB will also continue to supervise the Borrower's implementation and monitoring of the Sub-projects through the regular reports provided by the Borrower.
Implementation Risk	Low	The Borrower has a positive track record in implementing similar facilities of other institutions. It also reports under the green bond compliance framework. All Sub-project shall to be in compliance with AIIB's policies. AIIB is committed to continue to supervise the Borrower's implementation and monitoring of the Sub-project.

64. The Project is guaranteed by the Republic of Turkey through a Sovereign Guarantee and will have an economic capital consumption of 17.5 percent of the average outstanding balance.

Annex 1: Results Framework and Monitoring

Monitoring Indicator	Details	Units	Target[20]				Data Collection and Reporting	
			Y1	Y2	Y3	Y4 and onward	Frequency and reports	Responsibility for data collection
Share of renewable energy and energy efficiency projects	Share of renewable energy, energy efficiency in the Sub-loan portfolio generated by AIIB's loan	%	N/A	N/A	N/A	≥ 60%	Annual	The Borrower
Installed capacity	Installed capacity of renewable energy Sub-projects	MW	N/A	N/A	N/A	> 70	Annual	The Borrower
Reduced CO_2	Amount of reduced CO_2 per unit energy produced due to the Sub-projects	$MtCO_2$	N/A	N/A	N/A	N/A	Annual	The Borrower

[20] The first, second and third anniversary of signing.

Annex 2: Additional Industry Background

A. Renewable Energy Sector

1. Today, the development of renewable energy sources and promotion of energy efficiency measures are two of the priorities of Turkish energy policy. In early 2015, the Turkish government announced the National Renewable Energy Plan, which sets out the roadmap plan for development of renewable energy until year 2023. The plan for promotion of energy efficiency is captured in the National Energy Efficiency Action Plan.

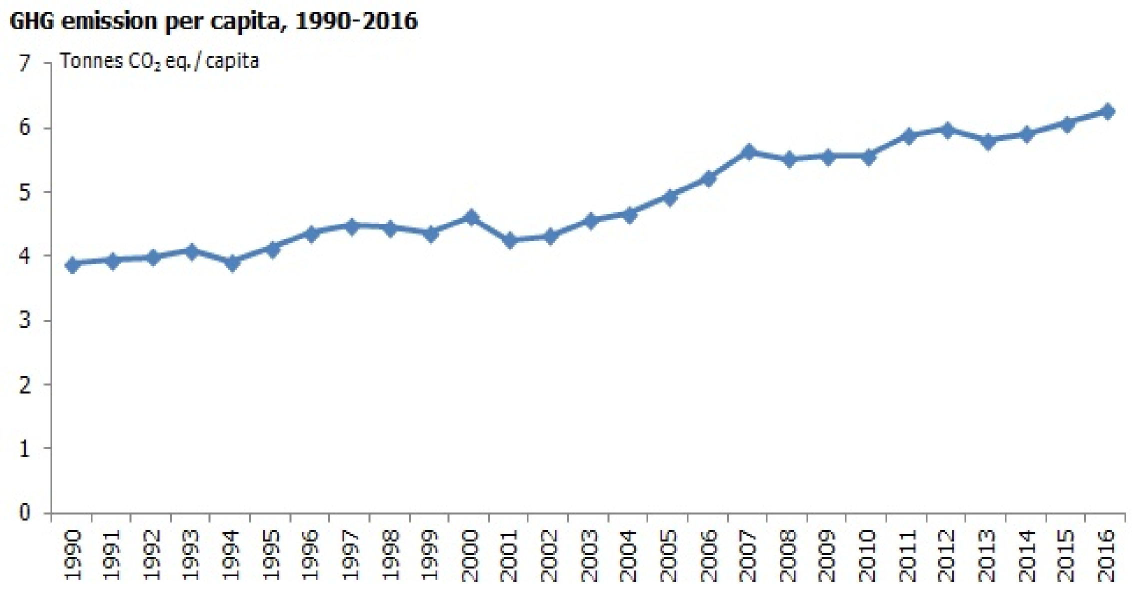
2. The vision of the Turkish government is to have an electricity generation mix in which the share of renewable energy accounts for 30 percent of the overall need as well as 10 percent of the transportation need. There is also a commitment to reduce by at least 20 percent (with reference to 2008 figures) the amount of energy consumed per unit of GDP in 2023 (in terms of energy intensity). According to the Ministry of Energy and Natural Recourses, the total amount of investments required to meet the energy demand in Turkey by 2023 is estimated to be around USD110 billion, more than double the total amount invested in the last decade. The ambitious target serves to achieve the following by 2023:

- Hydropower: Installed capacity of 34,000 MW.
- Geothermal: Minimum 1,000 MW.
- Solar: Minimum 5,000 MW (including unlicensed generation facilities).
- Wind: Installed capacity of 20,000 MW.
- Biomass: Installed capacity of 1,000 MW.

3. The emphasis on renewable energy and energy efficiency serves to address (i) Turkey's growing energy needs; (iii) Turkey's reliance on energy imports; and (iii) growing CO_2 emissions. According to current estimates, an increase of around 90 percent in primary energy demand will take place during the period of 2011-2023. In 2012, primary energy consumption reached 118 million tons of oil equivalent, of which 84 percent was from imports. In this respect, improved energy efficiency and the further diversification of energy sources will be important to help reduce the country's external energy dependence.

4. Overall GHG emissions as CO_2 equivalent for the year 2016 were 496.1 million tons (Mt). The biggest share with 86.1 percent of total CO_2 emissions was the energy sector, with 33.5 percent of total CO_2 emissions due to electricity generation and heat production.

Figure 1: GHG Emissions Per Capita, 1990-2016



Source: Turkstat.

5. In September 2015, Turkey submitted its Intended National Determined Contribution with a greenhouse gas reduction target of up to 21 percent below business-as-usual in 2030. One of the biggest contributors to GHG emissions are expected to be the coal-fired units that the government continues to build, to ensure sufficient energy supply in the future. In addition to the 67 coal-fired power units (capacity of 16.3 GW) in use today, and six units with a capacity of 2.6 GW under construction, more than 63 units of coal-fired power plants with a total installed capacity of 44.7 GW are currently under development (either pre-permitted or permitted). Combined, their estimated annual emissions would amount to 205 Mt CO_2, roughly two-fifths of Turkey's national emissions today.

Renewable Energy Sources

6. Hydropower: Turkey has a theoretical hydroelectricity potential of 1 percent of the world one, while its economic potential is 16 percent of that of Europe. The hydraulic resources of Turkey hold a significant position with potential of 433 billion kWh, while the technically usable potential is 216 kWh, and the economic hydroelectricity potential is 140 billion kWh/year. Hydropower assets would be financially sustainable given their low operating cost once built, longer asset life, and the additional non-energy benefits they have in the Turkish electricity market.

7. Wind: As of the end of 2017, there were 207 wind energy plants, with a total installed capacity of 6,516 MW, equivalent of 7.6 percent of the total potential.[21] Turkey's wind energy sector attracted USD12.3 billion in investments over the past 11 years, according to the Turkish Wind Energy Association. Installed capacity was 146MW in 2007 and by end of 2017 reached c. 6,500MW.

[21] Ministry of Energy and Natural Resources. Please see: http://www.enerji.gov.tr/en-US/Pages/Wind

8. Solar: As of the end of 2017, there was a total installed capacity of 3,421 MW for solar powered plants. This is the equivalent of 4 percent of the total potential. In 2017, electricity production based on solar energy reached 2,684 GWh, or 0.91 percent of electricity production. With the rapidly growing unlicensed market, both PV (Photo-emissive Solar Technologies) and Concentrated Solar Power capacities are expected to reach to a competitive level in a very short period in Turkey. Currently, equipment production capacity of Turkey is rapidly increasing and some of the manufacturing facilities are under construction.

9. Geothermal: The geothermal capacity of Turkey is predicted as 31.5 MWt, with 78 percent of geothermal fields situated in Western Anatolia, nine percent in Central Anatolia, seven percent in the Marmara Region, five percent in Eastern Anatolia and one percent in the other regions. As of the end of 2017, there were 40 geothermal power plants with a total installed capacity of 1,064 MW. This is the equivalent of 1.2 percent of the total potential.

10. Biomass: It is estimated that the biomass potential in Turkey is about 8.6 tons of equivalent petrol (Mtep), and biogas quantities that can be produced from biomass is expected to be 1.5-2 Mtep. As of the end of 2017, there were 122 renewable waste power plants with a total installed capacity of 634.2 MW, equivalent to 0.7 percent of the total potential.

Regulatory Framework

11. Turkey's current national energy regulation is articulated in the following laws:

- New Electricity Market Law (Law No. 6446): This law governs the electricity market system. For instance, it states that the maximum installed capacity for a renewable energy plant to operate without a license is 1 MW, with the ease of increasing up to five times (5 MW) by a decree of the Council of Ministers without a change in the Law.

- Law on the Utilization of Renewable Energy Resources for the Purpose of Generating Electrical Energy (Law No: 5346): This law regulates the renewable energy sources for electricity and defines renewable energy resources as non-fossil energy resources such as wind, solar, geothermal, biomass, biogas including landfill gas, wave, drift, tide hydroelectric power plant which are channel-type or river-type or whose reservoir area is less than 15 km^2.

- Law Amending the Law on the Utilization of Renewable Energy Resources in Electricity Generation (Law No: 6094): This law introduces significant amendments to improve the incentive mechanism under the Renewable Energy Law and encourage renewable energy investment opportunities in Turkey. Importantly, some of the regulations state:

    - Each supplier who sells electricity to consumers has an obligation to pay a renewable energy fee proportional to the amount of electricity that the supplier has sold to its consumers divided by the total electric energy that all suppliers have sold to all consumers in the country. In other words, they are indirectly obliged to purchase electricity that is generated from renewable resources.

- A feed-in tariff, i.e., a guarantee on the purchasing of electricity generated from renewable energy at a defined price for both licensed and unlicensed facilities generating electricity from renewable energy which are operational currently and which will become operational before Dec. 31, 2020.

- Feed-in tariffs are to be based on the USD and not subject to any escalation.

- The local equipment bonus is to also be added to the feed-in tariff plan, for a term of five years from starting date of operation for a particular generation facility.

- Land Usage Fee Incentives: Until 2020, a discount of 85 percent for permission, lease, easement rights and servitude right fees for generation facilities based on renewable energy resources will be applicable for the first 10 years, including the period of investment and operation.

- Energy Efficiency Law (Law No: 5627): The purpose of this Law is to increase efficiency in using energy sources by avoiding waste, easing the burden of energy costs on the economy and protecting the environment. This law covers principles and procedures applicable to increasing and promoting energy efficiency in the energy generation, transmission, distribution and consumption phases at industrial establishments, buildings, power generation plants, transmission and distribution networks and transport. It also raises energy awareness in the general public.

- Environmental Law (Law No: 2872): Amended in 2006, this law states that industrial plants receive a reduction of up to 50 percent of their electricity bills if they set up their own waste treatment facilities.

B. Banking Sector

The analysis of financial information is based on the latest audited 2017 Financial Statement and unaudited Q1 2018 Financial Statements of Turkish banks prepared in accordance to BRSA requirements.

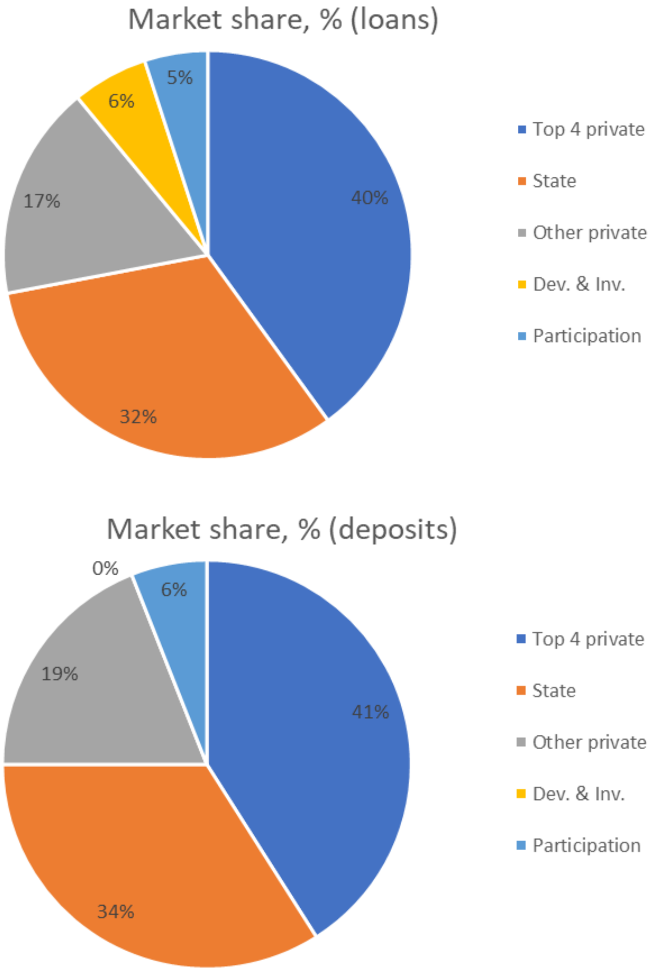
History

12. The February 2001 banking crisis saw losses in the two largest state banks amounting to USD2.5 billion as a result of overnight interbank borrowing at stratospheric interest rates as banks sought to avoid default in the daily clearing. Leading up to the crisis, bad loans were building up in the state banks, but no reserves were needed to provide for them, and supervision was extremely lax. As such, the government focused on radical financial and operational restructuring of the state-owned and failed private banks, with capital infusions from the private sector into weak private banks and a further tightening of bank supervision. This was coupled with ambitious budgetary targets supported by new fiscal measures and a revitalized privatization program covering the telecommunications, electricity, natural gas, sugar, and tobacco sectors. The CBRT was given statuary independence, and its depleted reserves were built up through restoration of credit lines from international banks with augmented official financing, notably from the IMF (which increased its USD11 billion credit line by USD8 billion).

Market Structure

13. As of March 2018, a total of 51 banks operated in Turkey, including 33 deposit banks, 13 development and investment banks, and five participation banks.22 Concentration of the banking sector by asset and deposit size was reasonably high with the seven biggest banks controlling c. 70 percent of the sector (each bank had 8-13 percent market share with no clear market leader).

Figure 2: Average market shares in terms of loans and deposits



Source: The Banks Association of Turkey.

22 According to the Banking Law No 5411: Deposit banks operate primarily for the purposes of accepting deposit and granting loan in their own names and for their own accounts; Development and investment banks operate primarily for the purposes of economic development in Turkey; Participation banks operate primarily for Islamic financing.

Table 2: Top 10 Banks in Turkey

	Share in Assets	Foreign Shareholder	Actual Free Float
Ziraat Bankası	13.3%	-	-
Türkiye İş Bankası	11.1%	-	31.1%
Garanti BBVA Group	10.0%	BBVA (49.85%)	50.1%
AKBANK	9.7%	-	49.5%
HALKBANK	9.4%	-	48.8%
YapıKredi	9.1%	UniCredit Group (40.9%)	17.8%
VakıfBank	8.3%	-	25.2%
QNB Finansbank	3.9%	QNB S.A.Q. (99.88%)	0.1%
DenizBank	3.7%	Sberbank (99.85%)	0.1%
TEB	2.6%	BNP Paribas (72.5%)	-

Source: The Banks Association of Turkey

14. The top seven banks comprise three state-owned banks, including Ziraat, Halkbank and Vakifbank, and four private banks, including Isbank, Garanti bank (majority owned by BBVA), Akbank, and Yapi Kredi (majority owned by Unicredit). All top seven banks, apart from Ziraat bank, are traded on BIST. The eighth, nineth and tenth are represented by smaller banks mainly focused on the consumer and SME segments (QNB, Denizbank and TEB). Five out of the top ten banks have foreign banking groups as strategic shareholders. In 1H2018, it was announced that NDB Emirates will buy out the majority stake of Denizbank from Sberbank Russia.

Banking Sector Financial Performance

Table 3: Financial Performance of the Banking Sector

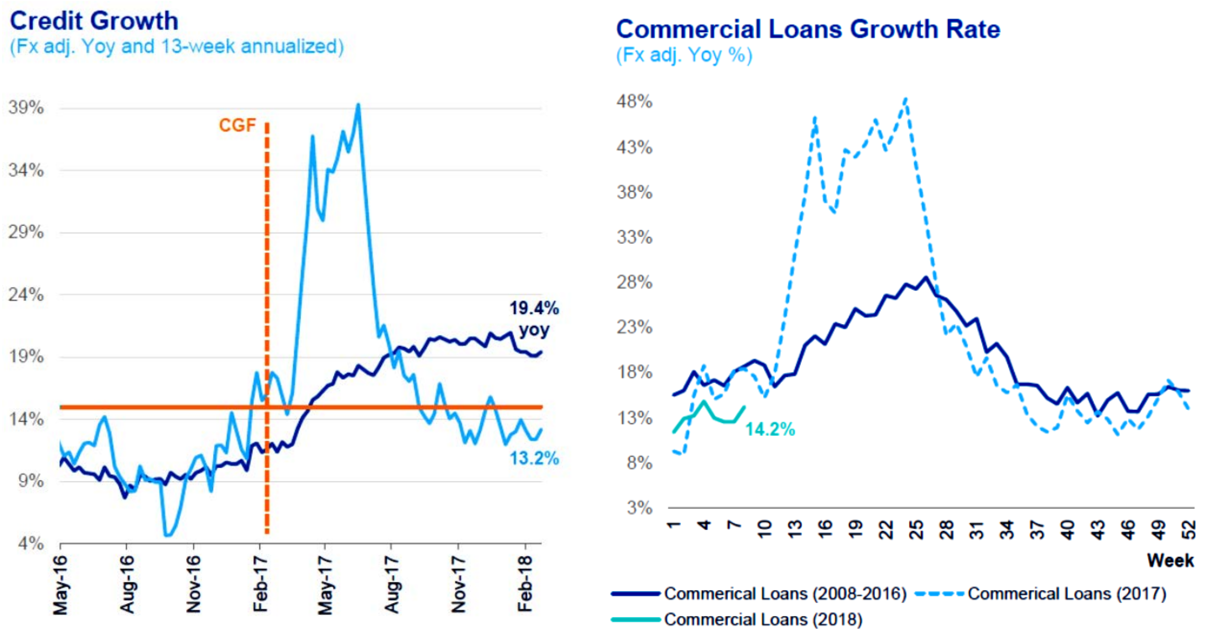
	2012	2013	2014	2015	2016	2017	1Q18
Banks #	45	49	51	52	52	51	51
Branches #	10,234	11,023	11,223	11,193	10,781	10,550	10,510
Loan Growth (ytd)	15%	33%	18%	21%	17%	14%	5%
Deposit Growth (ytd)	11%	24%	10%	19%	17%	11%	4%
Loans/GDP[1]	48%	55%	58%	61%	64%	68%	71%
Deposits/GDP[1]	49%	53%	51%	53%	56%	57%	60%
Loans/Assets	58%	61%	62%	64%	64%	65%	66%
Deposits/Assets	59%	58%	56%	56%	56%	55%	55%
NIM	4.1%	3.8%	3.6%	3.6%	3.7%	3.9%	3.9%
NPL Ratio	2.8%	2.6%	2.8%	2.9%	3.2%	2.9%	2.8%
Specific Coverage	75%	77%	75%	76%	78%	80%	76%
CAR[2]	17.3%	14.6%	15.7%	15.0%	15.1%	16.5%	16.1%
Tier 1 Ratio	14.2%	12.2%	13.1%	12.5%	12.6%	13.6%	13.5%

Source: BRSA.

15. Profitability: Net profit of banking sector reached almost TRY50 billion (12 month cumulative) in December 2017 indicating 60 percent y-o-y growth compared to the previous year. In 2017, the sector posted the highest ROE over the last 6 years, at 16 percent. Increasing profitability was mainly driven by NIM expansion on the back of (i) increasing share of loans in total assists, (ii) surging yield on state securities and TRY loans, and (iii) currency depreciation effect. The growth of NIM was supported by operating efficiency improvements done by Turkish banks (opex-to-assets ratio went down from 2.2 percent in 2013 to 1.8 percent in 2017) driven by digitalization in the retail segment and decreasing number of branches.

16. Loans: Supportive fiscal and macroprudential policies assisted credit growth in the corporate segment through both supply and demand channels in 2017. However, with the waning impact of these incentives (particularly the CGF mechanism), loan growth is set to slow and converge to its historical average of 13-14 percent per annum in 2018.

Figure 3: Loan Growth



Sources: BRSA, BBVA research

17. At end-Q1 of 2018, the total share of FX-denominated and FX-linked loans reached 36.7 percent. FX share of lending differed across segments with a high 56 percent of corporate loans denominated in FX, 17 percent in the SME segment, and close to zero in the retail segment23, respectively. In May 2018, a new regulation was put in place within the Council of Minister's Decree no. 32, aimed at limiting FX borrowing of the corporates with the following restrictions:

a) Companies with FX debt exposure under USD15 million:

   i. No Mismatch (FX Revenues): foreign exchange income of the previous three years will be the total available limit.
   ii. Mismatch (No FX Revenues): cannot roll-over, redeem the debt at the maturity of the liability.

b) Companies with FX debt exposure above USD15 million: No restriction even if the company has no FX revenues.

c) FX-linked loans (where the principal is denominated in TRY but linked to TRY/FX exchange rate) are prohibited.

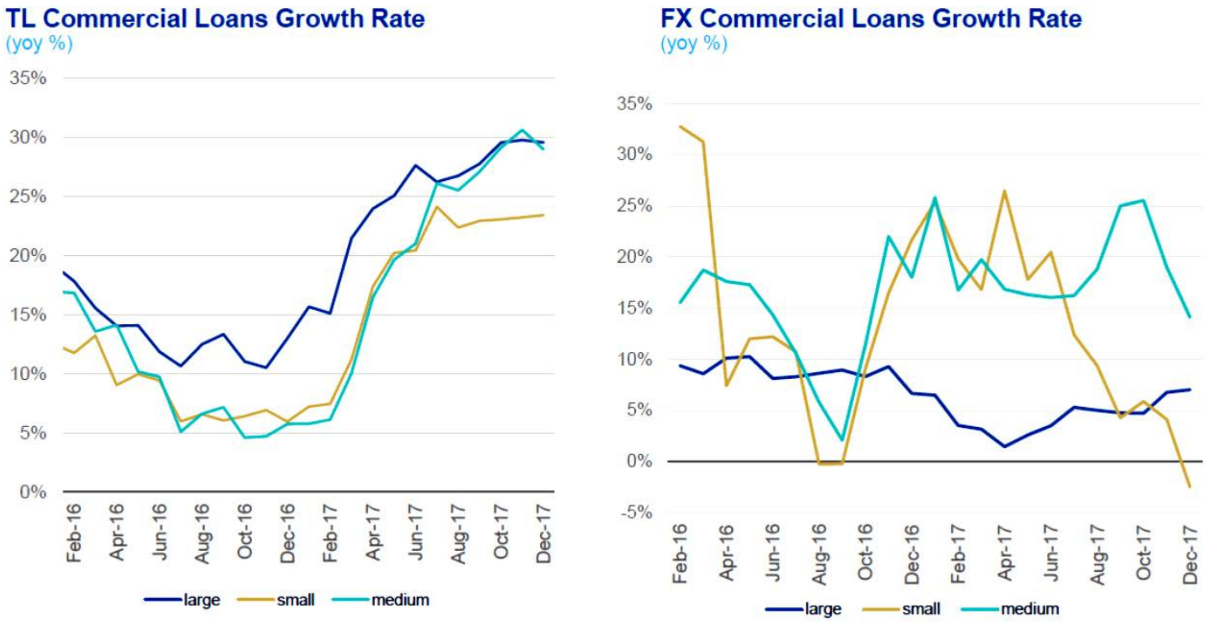
d) Exceptions: Public institutions, banks, leasing companies, factoring and financing companies, lenders under investment incentive, investors in machinery, PPP firms.

The restrictions are expected to affect 23,000 companies, which hold 16 percent of foreign-

23 After the 2001 crisis Turkey prohibited FX lending to retail customers

currency-denominated private debt. As a result of these measures, SMEs started to decrease their FX exposure switching to TRY lending which grew considerable across all segments.

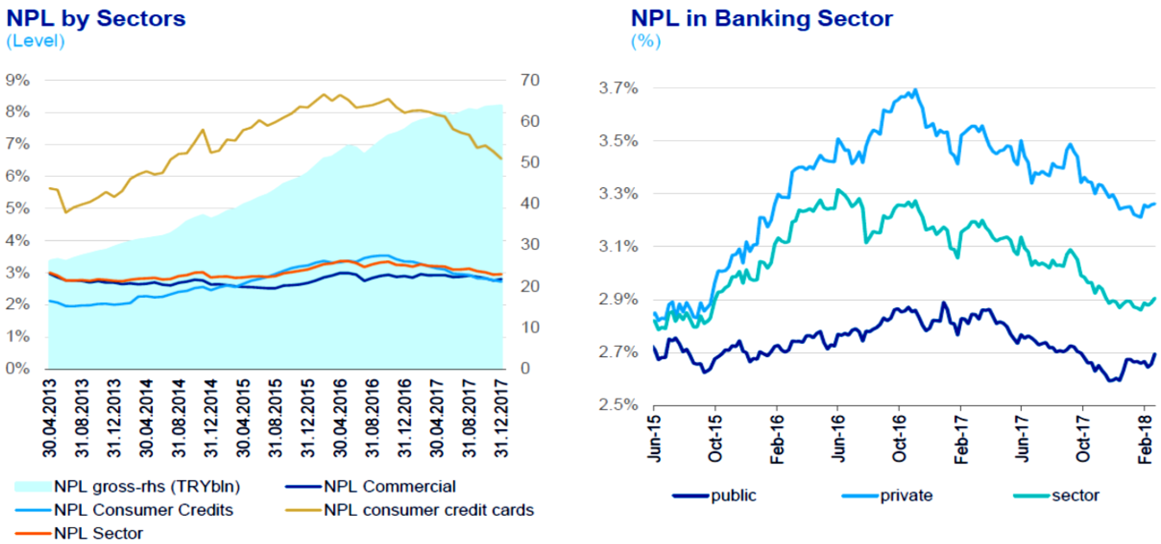
Figure 4: Loan Growth in TRY and FX



Source: BRSA, BBVA research

18. Asset quality: The asset quality of the banking sector remains strong. With the push of the credit channel and the pick-up in economic activity, the banking sector faced decreasing amount of additions to NPLs and write-offs. Starting from Q4 of 2016, the NPL ratio went down from 3.3 percent to 2.9 percent across the banking sector.

Figure 5: Non-Performing Loans



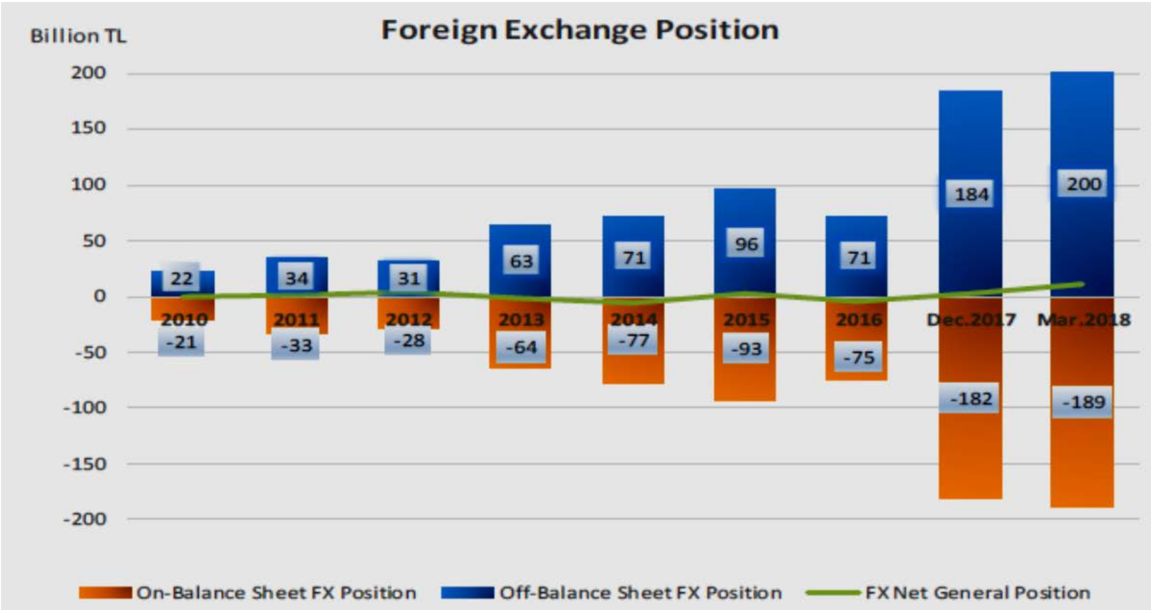
Source: BRSA, BBVA research.

19. While NPL figures remain low, the increase in number of restructured loans and Group

2 loans[24] (Q1 2018: 4.0 percent) remain a concern. keep increasing and stood at 4.0 percent in March 2018.

20. FX position: Nearly all Turkish banks have tightly managed OCP via extensive usage of FX derivatives. However, the OCP of the non-financial corporate sector remains quite sizable at about USD210 billion in Q1 of 2018 and needs to be managed.

Figure 6: Foreign Exchange Position of Banking Sector

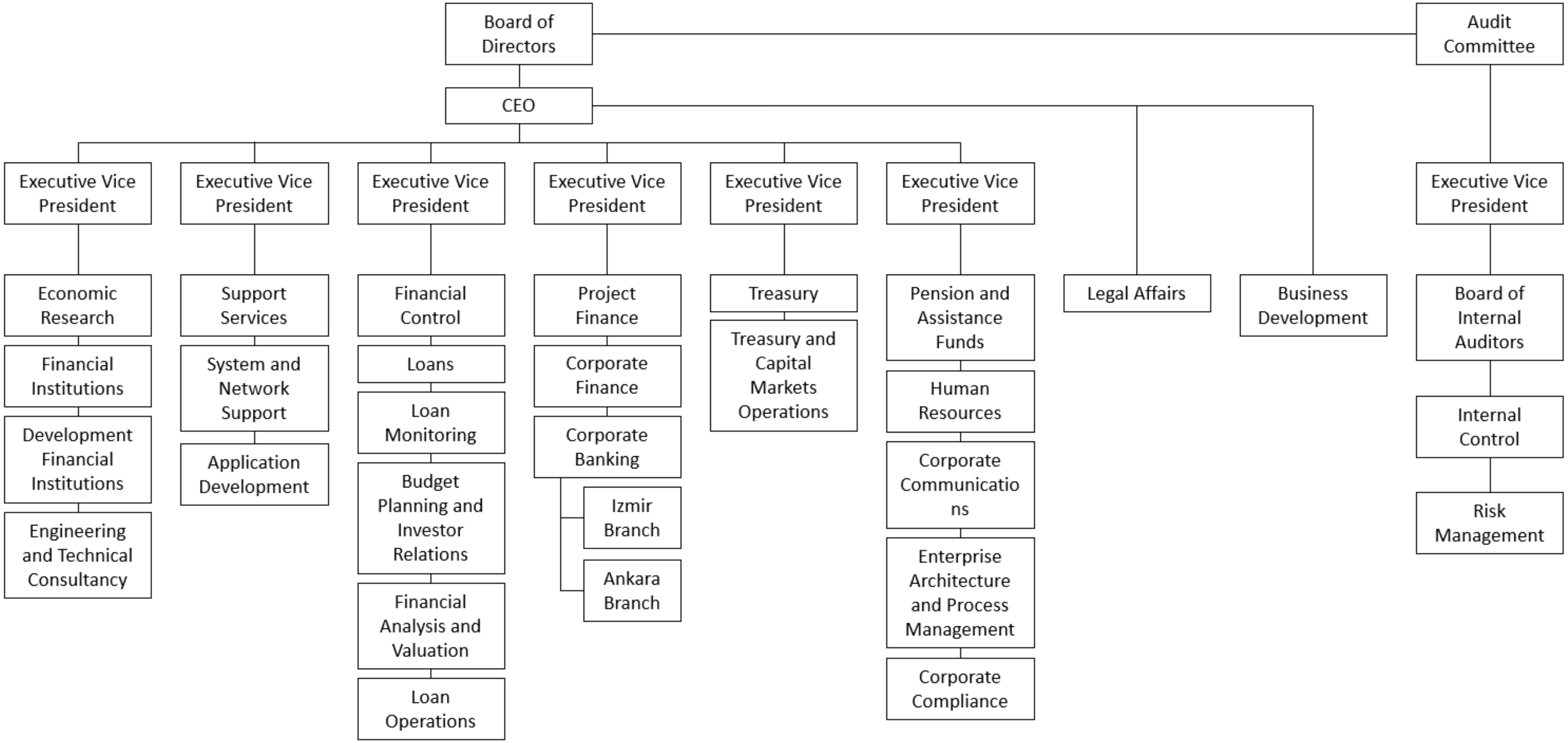


Source: BRSA.

21. Funding: Despite strong loan growth in the banking sector, especially in the SME segment, structural challenges on the liabilities side persist, particularly the availability of long-term financing. Although deposits constitute the main funding source for banks, corresponding to 53 percent of the liabilities, 88 percent (according to date of final maturity) of the bank deposits have a maturity of less than three months. Against this backdrop, long-term financing from IFIs become crucial for the banks.

[24] Group 2 loans under BRSA definition include loan on the watch list (broadly in line with the newly adopted IFRS 9 and Stage 2 definition there). IFRS 9 came into force starting from Jan. 1, 2018

Annex 3: Organizational Chart



Annex 4: Financial Performance of the Borrower

Financial year ending Dec 31	***2015***	***2016***	***2017***	***1Q2018***
Type of Financial Statements	*Audited IFRS*	*Audited IFRS*	*Audited IFRS*	*Audited TFRS*
Currency	*USD million*	*USD million*	*USD million*	*USD million*
SUMMARY BALANCE SHEETS				
Liquid Assets and Securities	2,014	1,430	1,269	1,364
Net Customer Loan Portfolio	4,716	4,969	5,929	6,031
Fixed and Other Assets	653	724	722	742
Total Assets	**7,383**	**7,124**	**7,919**	**8,137**
Customer Deposits	0	0	0	0
Borrowings	5,397	5,620	6,351	6,711
Other Liabilities and Provisions	951	530	520	481
Total Liabilities	**6,348**	**6,151**	**6,871**	**7,193**
Total Shareholder Funds	**1,034**	**974**	**1,048**	**944**
SUMMARY PROFIT AND LOSS				
Operating Income	244	223	286	105
Operating Expenses	(49)	(48)	(45)	(13)
Provisions	(6)	(3)	(47)	(25)
Tax	(36)	(35)	(39)	(26)
Profit After Tax	**153**	**137**	**155**	**41**
KEY RATIOS				
Total Assets Growth	31.9%	16.3%	19.8%	7.8%
Net Customer Loans Growth	25.8%	27.0%	28.6%	6.8%
CAR Ratio - National Regulations	16.0%	14.6%	17.0%	15.8%
Tier 1 Ratio - National Regulations	15.3%	13.8%	12.7%	11.4%
Net Interest Margin	3.5%	3.6%	4.0%	4.3%
Gross Cost of Risk	0.1%	0.1%	0.9%	1.6%
Operating Costs / avg. Assets	0.8%	0.7%	0.6%	0.7%
Operating Cost / Operating Income	20.0%	21.6%	15.8%	12.8%
Return on Average Assets	2.4%	2.1%	2.1%	2.0%
Return on Average Equity	15.9%	15.0%	15.9%	15.5%
Loan Loss Reserve / Gross Loan Portfolio	0.3%	0.3%	0.7%	1.2%

Portfolio at Risk 90 days / Gross Loan Portfolio	0.4%	0.3%	0.2%	0.2%
Provisions / Portfolio at Risk 90 days	69.5%	93.2%	278.5%	525.2%

Annex 5: Key Eligibility Criteria

Eligible Sub-borrowers

An entity may be eligible to receive a Sub-loan if it meets the following requirements:

1. It is a private entity (i) which is carrying out or is established for a business purpose, and is operating on a commercial basis; (ii) which has more than 50 percent of shares owned privately (i.e., not any governments nor government-owned entities); (iii) which is financially and managerially autonomous from the government; and (iv) whose day-to-day management is not controlled by the government.

2. It is registered and operating primarily in Turkey, or has a fixed place of business in Turkey.

3. It has obtained all necessary approvals, certifications and permits, and is in compliance with all applicable national environmental, social, health and safety legislations, and employment regulations and standards in effect in Turkey.

4. It meets the Borrower's requirements in, inter alia: credit-worthiness, foreign exchange position, E&S risk profile, and procurement practices.

5. It meets the Borrower's requirements in capacities to, inter alia: ensure adequate and proper financial accounting of all incomes and expenditures, prepare audited financial statements relating to all its activities and the Sub-project to be financed through the Facility, manage its financial position in a prudent and effective manner, ensure adequate and satisfactory E&S monitoring, reporting and where necessary, rectification of the Sub-project to be financed through the Facility, and ensure proper procurement procedures.

6. Exclusions: It is not included in AIIB's published Debarment List, or that seeks to engage in activities as listed in AIIB's Environmental and Social Exclusion List using AIIB's loan.

Eligible Sub-projects

A Sub-project may be eligible for a Sub-loan if it meets the following requirements:

7. It is undertaken in Turkey.

8. It has obtained all necessary approvals, certifications and permits, and is in compliance with all applicable national environmental, social and health and safety legislations, and employment regulations and standards in effect in Turkey, as well as any relevant public consultation obligations in effect in Turkey.

9. It is in compliance with AIIB's policies including the Policy on Prohibited Practices, the Procurement Policy and Interim Operational Directive on Procurement Instructions for Recipients, the Environmental and Social Policy (ESP), Environmental and Social Exclusion List, and where applicable, the Environmental and Social Standards 1 and 2.

10. It meets the Borrower's requirements in, inter alia: technical and engineering feasibility and

viability, financial viability and business model feasibility, provision of security package commensurate of the risk profile of the Sub-project, and thematic and sector priorities.

11. It is undertaken in one of the following sectors:

    a. Renewable energy, including (i) wind, (ii) solar, (iii) geothermal, (iv) biomass and (v) run-of-the river hydroelectric power plant (up to 30MW installed capacity).

    b. Energy efficiency, as defined in the Operational Manual.

    c. Other infrastructure sectors, limited to (i) transport; (ii) power transmission; (iii) water management and treatment; and (iv) telecommunications.

12. It has at least (i) 15 percent sponsor equity financing for renewable energy projects and (ii) 20 percent sponsor equity financing for all other projects, unless otherwise agreed with AIIB.

13. It has a minimum debt coverage ratio of (i) 1.1 for renewable energy projects and (ii) 1.2 for all other projects, calculated on a yearly basis after completion of the investment and throughout the life of the Sub-loan, unless otherwise agreed with AIIB.

Eligible Sub-loans

A Sub-loan may be eligible for the Facility if it meets the following requirements:

14. It has a minimum tenor of 48 months and no longer maturity than the final maturity of AIIB's loan, unless otherwise agreed with AIIB.

15. It has a maximum aggregate principal amount of USD30 million from this credit line, unless otherwise agreed with AIIB.

16. It is made on terms whereby the Borrower shall obtain, from the Sub-borrowers, through appropriate legal means (a Sub-loan Agreement), rights that are adequate to protect the interests of the Borrower, the Treasury and Finance Ministry, and AIIB, including the rights to:

    a. require the Sub-borrower to build, operate, maintain and monitor with accurate and adequate records, the Sub-project, with robust due diligence, integrity and efficiency, and in accordance with sound technical, financial, environmental and social management processes, and high managerial standards.

    b. require that the Sub-borrower provides all information reasonably required by AIIB and relating to the foregoing and to the administration, operations and financial condition of the Sub-borrower and to the benefits to be derived from the Sub-project

    c. require the Sub-borrower to prepare financial statements in acordance to recognized accounting standards in a manner to reflect the operations, incomes and expenditures related to the Sub-project;

d. require the Sub-borrower to prepare E&S reports, in substance and form as per agreed with AIIB, in accordance with the Operational Manual.

e. require the Sub-borrowers to procure all goods, civil works and consultant services to be financed through the Sub-loan in accordance with the *Operational Manual*; and to ensure that the procured goods, civil works and consultant services are deployed exclusively for the approved Sub-projects.

f. require (i) the Sub-borrowers take out and maintain with responsible insurers, sufficient insurance against relevant risks in a manner consistent with sound business practices; and (ii) without any limitation upon the foregoing, that such insurance shall cover hazardous incidents that occur (ii.a) during the acquisition, transportation and delivery of the goods and civil works to the place of use or installation of the Sub-project to be financed as part of the Facility, and (ii.b) during operations and maintenance of the Sub-project; (iii) and the insurance shall provide indemnity to be made payable in a currency freely usable by the Sub-borrower to replace or repair such goods and civil works.

g. inspect, by itself or jointly with representatives of AIIB, if the bank shall so request, the Sub-project sites, civil works, plants and construction, operations and mainteinance, and any relevant records and documents.

h. suspend or terminate the right of the Sub-borrower to use the proceeds of the Sub-loan upon failure to perform its obligations under its Sub-loan Agreement.

17. The purchase of land or used equipments s are not eligible for AIIB's financing; but it may be included during the calculation of the aggregate cost of implementing and completing the Sub-project, including any working capital and any tax (excluding income tax) necessary, subject to the Borrower's assessment.

18. **Retroactive financing.** Eligible expenditures under the Sub-loan, incurred in compliance with AIIB's procurement policies and guidelines and in respect of which the Sub-loan amounts were paid not more than six months prior to the date of the Loan Agreement, up to an amount of USD40 million (20 percent of the amount of AIIB's loan), may be financed retroactively.

Annex 6: Sovereign Credit Fact Sheet

A. Recent Economic Development

Turkey's economy grew strongly from 2001 to 2014, with GDP quadrupling in nominal US dollar terms, underpinned by a comprehensive macroeconomic and structural reform program. As a result, Turkey's per capita income of USD10,883 in 2016 puts it in the group of upper-middle-income countries.

Following a strong performance in 2015, growth slowed to 3.2 percent in 2016, reflecting weak investment due to a failed coup attempt in July 2016. However, growth rebounded sharply to 7.4 percent in 2017 due to a strong policy stimulus and favorable external conditions.

Nevertheless, the strong fiscal stimulus also resulted in higher risk for the economy. The current account deficit reached 5.6 percent of GDP in 2017, which led to downward pressure on the currency. Inflation was, on average, 11.1 percent in 2017, partly due to the large Lira depreciation and higher domestic demand.

Further, Turkey has been affected by financial and economic shocks since the beginning of 2018. The inflation rate was at a 15-year high of 15.9 percent in July 2018 and the Lira has depreciated sharply against US dollar since January 2018. There has also been announcement of tariffs on Turkish steel and aluminum and sanctions against some Turkish government officials by the US. There are continuing uncertainties affecting the economy, and these are likely to affect growth negatively in 2018.

B. Economic Indicators

Table 4: Selected Macroeconomic Economic indicators (2015-2020)

Economic Indicators	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
National income and prices (change %)						
Real GDP growth*	6.1	3.2	7.4	4.7	4.4	4.0
CPI Inflation (period average, %)*	7.7	7.8	11.1	10.4	9.0	8.2
Central government operations (% of GDP)						
Overall balance	-1.5	-2.0	-2.2	-3.1	-3.3	-2.9
External debt (% of GDP, end period)	46.1	46.9	53.2	54.1	54.6	54.3
Gross external financing need (% of GDP)	23.7	22.9	24.9	25.1	26.3	26.5
Nominal gross public debt (% of GDP)	27.6	28.3	28.5	27.8	27.9	27.9
Public gross financing needs (% of GDP)	4.7	5.3	5.1	5.6	5.1	5.7
Money and credit						
Broad money (M2, % of GDP)	17.1	18.3	15.7	-	-	
Gross foreign reserves (USD billions)	110.5	106.3	107.7	107.7	107.7	107.7
Current account balance (% of GDP) *	-3.7	-3.8	-5.6	-5.7	-5.6	-5.5

Exchange rate (TRY/USD, EOP, TR data)	2.92	3.53	3.77			

Note: All figures in the table are retrieved from IMF Country Report No. 18/110, WEO July 2018.
*Data retrieved from World Bank Report—Turkey Economic Monitor, published on May 31, 2018, with projected figures from 2018 to 2020.

C. Economic Outlook and Risks

Looking ahead, Turkey's medium-term growth is projected to fall to about 3.5-4.0 percent annually. Growth in 2018 is expected to decline to 4.2 percent, from 7.4 percent in 2017, due to weaker policy stimulus and tightening financial conditions. Inflation is forecast to reach double digits in 2018, before declining.

There are several risk factors to Turkey. Policy imbalance may lead to downside risks, with a large gross external financing requirement, low reserves and dependence on short-term capital inflows. In addition, a possible further deterioration in geopolitical tensions in the region could also undermine investor and consumer confidence.

Its public debt ratio was about 28.4 percent of GDP in 2017, well below its historical ten-year average. Gross public sector financing needs have declined significantly and should remain low over the medium term. Turkey's government debt is sustainable under different shock scenarios. However, the key risk is with external debts. Turkey's external debt, while sustainable, is high and vulnerable to currency shocks. The debt is forecast to stabilize at around 52 percent of GDP in the medium term. It continues to be susceptible to Lira depreciations, and the annual rollover needs of more than 20 percent of GDP expose the economy to high liquidity risks.[25]

[25] IMF, 2018, Country Report No. 18/110– 2018 Article IV consultation—Press release; Staff report; and Statement by the Executive Board for Turkey, April 2018.