



Pengurusan Air SPV Berhad Sustainability Sukuk Framework

April 2022

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1.0 INTRODUCTION - NATIONAL WATER SERVICES INDUSTRY RESTRUCTURING INITIATIVES

The restructuring in water services industry was initiated by the Federal Government to provide a holistic regulation of water services industry which covers both water supply and sewerage services. The objectives of the restructuring are clearly outlined in the National Policy Objectives for the Water Services Industry. In a nutshell, the reform aims to improve the efficiency in the water services sector for the benefit of the people as well as to maintain the sustainability of this important resource.

Background

The water services industry was under the purview of each State Government before the reform was initiated. In most cases, the State Governments own the water infrastructures and operate the water services. There are also some states, such as Selangor and Johor, where the water services operations are privatized and private concessionaires are responsible for the treating and supplying of water to consumers.

The industry was not centrally regulated, resulting in the varying degree of quality of water supply and services, and differing water charges from state to state. In the states where the water services are privatized, operations are fragmented with several private operators involved in providing water supply to the states which is highly inefficient.

The industry is also plagued by escalating costs of developing new water infrastructure, resulting in most States having to borrow from the Federal Government for capital expenditure (“**CAPEX**”). To compound the problem, some States are experiencing eroding mainstream revenue following rising operational expenses and high Non-Revenue Water (“**NRW**”). Many face difficulties covering their costs and, in some states, even operational expense (“**OPEX**”) is not met. Caught in this financial conundrum, it is not easy to continue to provide quality service to the consumers.

Instead of borrowing from the Federal Government, some states resorted to privatizing the water services. The plus side to privatization is that services often improve. However, it is not without a cost. These private operations are funded predominantly by debts raised at market rate and the expensive financial cost is passed on to consumers as higher water charges.

The water industry is; undeniably, facing many problems including poor management, but the main issue was financial. However, as the Government's resources are limited, proper financial planning need to be implemented to ensure the sustainability of water services industry. Without the financial means to properly maintain and upgrade the water infrastructure, the country is unnecessarily exhausting its precious resources.

Working Towards A New Water Services Industry Effecting Legislative Changes

In early 2003, the Federal Government stepped up efforts to reform the industry for the benefit of all stakeholders including the Federal Government, consumers and the State Government. It is an extensive process which included amendments to the Constitution and passing of new legislations to enable the Government to mobilize the reform.

In January 2005, Parliament approved the amendments to the Ninth and Tenth Schedules of the Federal Constitution. The amendment to the Ninth Schedule involves the transfer of water supplies and services from the State List to the Concurrent List. In other words, the water supplies and services are now a shared responsibility between the State and the Federal Government. It is a pertinent move which gives the Federal Government authority over the water services in the States. The Tenth Schedule was also amended and as a result, the revenue from water supplies & services (previously assigned to the States) is now assigned to the Federal Government.

Consequently, with effect from 21 March 2005:

The Federal Government will regulate the water supply & services industry but ownership and control of rivers, canals & water catchment remains with the State.

The State also retains power to declare & regulate water catchment areas, water sources and river basins.

In July 2006, further to the amendments to the Constitution, Parliament passed two new legislations namely the Suruhanjaya Perkhidmatan Air Negara Act 2006 and Water Services Industry Act 2006 (“**WSIA**”). The former provides for the establishment of Suruhanjaya Perkhidmatan Air Negara (“**SPAN**”) or National Water Services Commission as the technical and economic regulator and set out the function and powers of SPAN.

WSIA, on the other hand, provides the legal framework required for the regulation of the water and sewerage service industry. The Acts were enforced on February 1, 2007 and 1 January 2008 respectively.

The New Model - Separation of Responsibilities: Towards Better Efficiency

The legislative process was only the tip of the iceberg. Given that the current business model adopted by most State Water Operators (“**SWOs**”) does not promote sustainability of the water services industry, the Federal Government had to reinvent the wheel. A new model was developed, targeting to resolve the financial woes of the water services industry, promote financial sustainability in the SWOs, and alleviate the Federal Government/taxpayers’ financial burden. In the long run, the Federal Government wants the state operators to achieve full cost recovery and attain financial independence. These efforts will ultimately lead to improvement in the quality of water supply and the efficiency of the industry’s services.

Under the new model, there will be a separation of responsibilities between water asset owners and operators. SWOs will no longer be responsible for developing water infrastructure and its funding so that they can concentrate solely on providing water services to consumer and improving their operational efficiency. The responsibilities of developing water infrastructure and sourcing for its funding will be transferred to Pengurusan Aset Air Berhad (“**PAAB**” or the “**Company**”).

Well Managed Environmental, Social, and Governance (“ESG”) Risk

PAAB has initiated certain measures to reduce its environmental footprint, as evident from the Langat 2 WTP project. For example, the Group has installed 1.2 kilometres of soft rock along the river as a fauna habitat, which will also help to prevent soil erosion. The project also fulfils the Department of Environment’s requirement for a ‘zero discharge project’ by recycling the wastewater produced from the Treatment Plant. There is also a provision of using the treatment plant wastewater for landscaping purposes. The staff quarters were installed with rainwater harvesting as an independent water supply. To prevent the loss of treated water, monitoring of NRW has been part of the scope under Langat 2. Aside from encouraging SWOs to install solar panels for efficient energy preservation, PAAB is also substituting traditional cement with Mascrete Eco Cement which emits less carbon dioxide during production.

2.0 BACKGROUND OF ISSUER

2.1 About Us

PAAB is a wholly owned company of the Minister of Finance Inc., incorporated on 5 May 2006 with the objective of being the holding custodian of the National Water Assets.

PAAB forms part of the Government’s efforts to restructure the water services industry in the country to achieve better efficiency and quality, as well as to ensure sustainability of the industry.

Our main responsibility is to develop the nation’s water infrastructure in Peninsular Malaysia and the Federal Territory of Labuan, using competitive financing sourced and obtained from private financial market. The Water Assets are then leased to water operators licensed by the industry regulator, SPAN for operations and maintenance.

Pengurusan Air SPV Berhad (“**PASB**” or the “**Issuer**”), 100% owned by PAAB is a special-purpose vehicle established to undertake the proposed issuance of Islamic medium-term notes and Islamic commercial papers in connection with PAAB under the national water services industry restructuring initiatives.

2.2 Our Vision and Mission Statements



With the Vision to become a Centre of Excellence, PAAB has four (4) mission statements to support the vision of company. The mission statements consist of the following:

- i) Provide creative solutions and nurture cost recovery in national water services industry;
- ii) Revitalise the national water services industry through efficient deliverables;
- iii) Cultivate talent and expertise to meet future industry demand; and
- iv) Value creation for stakeholders through optimum operation.

These mission statements were subsequently translated to the four (4) Key Result Areas (“KRAs”) which are Sustainable Financial Position, Efficient Deliverables, Competent Human Capital, and Optimum Business Processes. The KRAs are illustrated in the following:



2.3 Our Sustainability Initiative

PAAB is currently working on its Sustainability Framework to deliver its sustainable futures. The enabler of value creation is the sustainability strategy where PAAB will focus on the three (3) sustainability's pillars namely; environmental, social and governance. This initiative also to support national agenda and the United Nations' Sustainable Development Goals mainly on:



3.0 PASB SUSTAINABILITY SUKUK FRAMEWORK

PASB's Sustainable and Responsible Investment Sukuk Framework ("**PASB Sustainability Sukuk Framework**" or "**Framework**") is presented in line with any one or more of the following frameworks, standards, principles or guidelines (as may be amended and/or substituted from time to time):

- i) the Sustainable and Responsible Investment (SRI) Sukuk Framework as set out in the Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework issued by the Securities Commission ("**SC**") on 9 March 2015 and effective on 15 June 2015 which was revised on 22 November 2021 (as amended and/or substituted from time to time) ("**LOLA Guidelines**");
- ii) the ASEAN Green Bond Standards issued by the ASEAN Capital Markets Forum ("**ACMF**");
- iii) the ASEAN Social Bond Standards issued by the ACMF;
- iv) the ASEAN Sustainability Bond Standards issued by the ACMF;
- v) the Green Bond Principles issued by the International Capital Market Association ("**ICMA**");
- vi) the Social Bond Principles issued by the ICMA;
- vii) the Sustainability Bond Guidelines issued by the ICMA; and
- viii) such other frameworks, standards, principles or guidelines in relation to green bonds, social bonds or sustainability bonds as may be incorporated by the SC into the LOLA Guidelines from time to time or such other frameworks, standards, principles or guidelines, whether or not having the force of law, in relation to green bonds, social bonds or sustainability bonds as may be issued from time to time.

This framework consists of four (4) key pillars:

- i) Utilisation of Proceeds;
- ii) Process for Project Evaluation and Selection;
- iii) Management of Proceeds; and
- iv) Reporting Commitments.

3.1 Utilisation of Proceeds

Proceeds from PASB Sustainability Sukuk will be utilised by Issuer and PAAB for:

- (i) to refinance the principal amount of any existing financings of PASB and/or PAAB obtained for the purposes of item (ii) and/or item (iii) below;
- (ii) to finance PAAB's acquisition of existing Water Assets, rights, liabilities and land from privatised water concessionaires or other operators or State Governments in Malaysia ("**Acquisitions**");

- (iii) to finance PAAB's capital expenditure in relation to the Water Assets;
- (iv) to fund the fees, costs, expenses and all other amounts payable under or in relation to the Sukuk programmes;
- (v) for the refinancing part, the Sukuk proceeds could be used for Water Assets Projects prior to the SRI Sukuk issuance year; and/or
- (vi) working capital and general corporate purposes.

The Water Assets shall be network of pipes, reservoir, plant and machinery, dam, lands, buildings and structures.

Example of Eligible Projects for Water Assets (“Eligible Projects”):

Eligible Categories	Use of Proceeds	Example Projects
Water-related assets as defined below (“Water-related Assets”)		
Affordable Water Infrastructure	1. Improvement in water supply infrastructure in order to increase efficiency and accessibility of water delivery system 2. Water treatment	<ul style="list-style-type: none"> • Upgrading of existing water treatment plant • Rehabilitation of existing water treatment plant • Extension of existing water treatment plant • Develop new water treatment plant
Sustainable Water Management	1. Improvement in water management for local waterworks (water supply)	<ul style="list-style-type: none"> • Pipe rehabilitation works • Pipe Replacement Programme • Sludge treatment works for water treatment plant & distribution improvement work

Exclusion Criteria

Assets that do not fall into the Eligible Projects as listed above will not be eligible under this Framework. Explicitly, PASB commits to not knowingly allocating the proceeds from PASB Sustainability Sukuk to the following sectors and activities:

- Sectors which are prohibited by laws and regulation in Malaysia
- Activities which are in relation to hazardous chemicals or waste
- Fossil fuel related projects

3.2 Process for Project Selection and Evaluation

PAAB will ensure the process for project selection and evaluation of the Eligible Projects complied with SC's SRI Sukuk Framework and recognised the best practices relating to the Eligible Projects. The Eligible Projects must meet the criteria set out in the Utilisation of Proceeds of this framework.

The following process for project selection and evaluation are being adopted by the PAAB to ensure any material environmental or social risks associated with the Eligible Projects are properly addressed.

3.2.1 Project Evaluation for CAPEX Approval

Project evaluation is performed to assess the feasibility of proposed CAPEX to be funded by PAAB and shall be initiated by Facility & Planning Division. The project must be approved by SPAN.

Respective teams within PAAB, mainly from the Project Management Division and/or Special Projects Division are responsible to identify the environmental and social risks associated with the projects and provide an analysis to the Project Evaluation Committee ("**PEC**"), according to internal environmental and social risk policies/initiatives.

The evaluation shall be performed by a committee within PAAB's organization namely PEC either through meeting or circulation based on types of application. The PEC Members will determine the way forward and outcome of the evaluation process i.e. to approve / put on hold / disapprove etc.

The process for project evaluation will involve the following teams within PAAB:

- PEC Secretariats (Staff from Project Planning Department)
- PEC Members (Chief Operating Officer, Head of Divisions from Project Management, Facility & Planning, Commercial, Finance & Treasury, and Head of Revenue Management Department)
- PEC Chairman (Chief Operating Officer. In the absence of COO, Head of Corporate & Secretarial Division or Head of Project Management Division/Facility & Planning Division shall act on his/her behalf in accordance to project value)

3.2.2 Process for Tender

In PAAB, the company is implementing tendering system for approach project related to Water Assets and it depends on the project/ tender value. The company has adopted the green procurement where more weightage are given to those tenderers which their products and/or services are certified with MyHIJAU (an official green recognition led by Malaysian Green Technology and Climate Change Centre). The advantages of having tendering system are:

- i) Tenders are open to all interested contractors/ suppliers. Tenders are floated by large private and public listed organizations for major projects and procurements. Any interested parties can choose to participate in the tendering process, based on the eligibility's requirements published.
- ii) Tenders are inherently fair. Under the tendering system, contracts are awarded on the basis of predetermined criteria such as price, capability and quality.

The process for Tender will involve the following teams within PAAB:

- Tender Opening Committee
- Tender Evaluation (for Technical and Commercial) Committee

- Commercial Division (Tender Evaluation Department, Tender Secretariat Department, Contract Department, Procurement Department)
- Approving Authorities (Ministry of Finance ("**MOF**")/ Board of Directors ("**BOD**")/ Procurement Board A ("**PBA**")/ Procurement Committee B ("**PCB**")/ Procurement Committee C ("**PCC**")/ Quotation Committee ("**QC**"))

Finance & Treasury Division of PAAB will analyse if the required project is in line with this Sustainability Sukuk Framework and to confirm the compliance with the Framework, based on the analysis/input provided by the PEC and/or respective teams/departments/divisions. Once this analysis has been performed and approval has been granted by Chief Executive Officer ("**CEO**"), the project will be financed through the Sukuk proceeds.

3.3 Management of Proceeds

In the event of PAAB finances water-related assets as defined in the Use of Proceeds section, the bond will be labelled as "Sustainability Sukuk". The net proceeds of the Sustainability Sukuk shall be allocated for the financing and / or refinancing of existing or new Water Assets, working capital and general corporate purposes as well as to defray the Sukuk issuance expenses. PAAB's Finance & Treasury Division will track internally the proceeds raised from the Sustainability Sukuk to be allocated to Eligible Projects.

For the refinancing part, the Sukuk proceeds could be used for Water Assets Projects prior to the Sustainability Sukuk issuance year.

Pending the full allocation of the proceeds, the balance of unallocated proceeds shall be earmarked and held in the form of temporary sustainable cash or cash equivalent investment instruments in line with PAAB's Treasury Department standard operating procedure/manual.

3.4 Reporting Commitments

The reporting will include Allocation Reporting and Impact Reporting. The report will be publicly available on PAAB website (<http://www.paab.my/>).

3.4.1 Allocation Report

The allocation reporting will be available to investors within approximately one year from the date of the bond issuance, and yearly thereafter until the bond proceeds have been fully allocated. It will be available on PAAB website.

- Allocation per Water Assets Categories;
- Example of projects financed by the proceeds, including their description (date, location, category) and the corresponding allocated amount (in MYR);
- Allocated amount vs. total amount (in %);
- Portion of financing and refinancing; and

- Weighted average cost of the project being financed or refinanced by the Sustainability Sukuk issuances.

3.4.2 Impact Report

On an annual basis, until full allocation, PAAB will provide an impact reporting, whereby, for Water Assets s, and where feasible, PAAB will report on relevant impact metrics.

Examples of relevant metrics could include:

Eligible Categories	Use of Proceeds	Reporting Indicators
Water-related Assets		
Affordable Water Infrastructure	1. Improvement in water supply infrastructure in order to increase efficiency and accessibility of water delivery system 2. Water treatment	<ul style="list-style-type: none"> ▪ Value of new water assets developed (RM) ▪ Increment of reserve margin (%) ▪ Number of households benefited from the projects
Sustainable Water Management	1. Improvement in water management for local waterworks (water supply)	<ul style="list-style-type: none"> ▪ Value of upgraded infrastructures for existing water assets (RM) ▪ NRW reduction (%)

4.0 EXTERNAL REVIEW – SECOND OPINION

RAM Sustainability Sdn Bhd (“**RAM Sustainability**”) was appointed as an independent third party to provide second opinion report on PASB Sustainability Sukuk Framework and its alignment with the SC’s SRI Sukuk Framework, ICMA’s Green Bond Principles, ICMA’s Social Bond Principles, ICMA’s Sustainability Bond Guidelines, ACMF’s ASEAN Green Bond Standards, ACMF’s ASEAN Social Bond Standards and ACMF’s ASEAN Sustainability Bond Standards. The opinion from RAM Sustainability will be made available on PAAB’s website.