27th Training Program of Asian EXIM Banks Forum on Project Finance

Project Finance Documentation

Colin Gin June 2014
I. Overview of Project Finance
II. Structure
III. Factors to Consider Before Preparing Finance Documentation
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V. Specific EXIM Bank / IFI Institutional Issues
1. Overview of Project Finance

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Why Use Project Finance?

“A banker is a fellow who lends you his umbrella when the sun is shining, but wants it back the minute it begins to rain”

Mark Twain (1835 – 1910)
Why Use Project Finance? (cntd)

- **Off-balance sheet financing which:**
  - limits sponsors’ equity investments
  - maintains corporate credit rating

- **Optimal risk sharing:**
  - debt wholly/partially non-recourse to sponsors

- **Tax benefits:**
  - special incentives for core sector projects

- **Benefits to Sponsors**

- **Long tenors**

- **Risk diversification / Return maximization:**
  - sponsors can maximize their returns by participating in different projects
Disadvantages of Project Finance

- Cost of finance (interest, fees)
- Inflexibility (clearance from lenders)
- Timing to fruition
- Government and political risks
- Transactional costs
Target – “Mission Accomplished”

- Finance a good project
- Timely and within budget
- Financing is repaid
- Institutional goals met
- Documents to stand the test of time
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II. Structure
PF Deal
Project Documents Structure

Shareholders
- Subordinated Debt
- Shareholders Agreement + Equity Subscription Agreement

Implementation Agreement

Government

Off-taker

Fuel Supplier

Fuel Supply Agreement

Project Company
- Operation & Maintenance Agreement
- EPC Contract

Operator

Construction Contractor

Construction Contractor

Construction Contractor
PF Deal
Finance Documentation Structure

- Lenders and Agents & Security Trustee
- Individual Lenders
- Accounts Bank
- Project Company - SPV
- Shareholders
- Government
- EPC Contract
- Power Purchases
- Fuel Supplies
- Security Trustee
- Common Terms Agreement
- Loan Agreements
- Accounts Agreement
- Sponsor Support Agreement
- Direct Agreement
Know Your Product (KYP)

- **Loans**
  - Direct loan: market-based pricing with major international and/or local currencies
  - B-loan: ADB as Lender of Record (funded by eligible third-party financing)
  - **Unfunded risk participations**: fronting arrangement with IFIs and/or commercial banks

- **Guarantees**
  - Political Risk Guarantee: FX restrictions, expropriation, political violence and contract dispute
  - Partial Credit Guarantee: non-payment by the borrower of the principal and interest due

- **Equity Investment**
  - Investment into enterprises: common shares, preferred stock, and/or convertibles

- **Technical Assistance**
  - Grants to assist the project preparation or capacity building
III. Factors to Consider When Preparing Finance Documentation

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Don’t start drafting documentation until you know:

- Project is viable (technical, economic, political, legal, E&S)
  - Experienced management team
  - Proven technology
  - Strong economic demand
  - Social and political support
  - Excellent partners
- Other risks must be manageable
- Timetable must be defined
- Project must serve a real need!!
- Term Sheet?
The Importance of Due Diligence

- Due diligence findings translated into term sheet requirements (contingency sponsor support, additional E&S reports and safeguarding)

- Sometimes walk away from the transaction – integrity due diligence findings, allegations of corruption, major unresolveable E&S issues

- Sometimes amend underlying documents to allocate risk properly (unfair risk allocation), eg change of law / political FM risk

- Sometimes restructure the financials of the deal (introduce higher DSCRs, cash sweep mechanisms, re-leverage D:E ratio)
Key Issues in Structuring

- Many exist, but to name a few:
  - D:E ratio – back ended equity
  - Development costs/ (fee?)
  - Sponsor contingent equity
  - Sponsor support release date
  - Cash sweeps
  - Dividend blocking DSCRs
  - EODs and cure periods
  - EPC contingency
  - LD and liability limits for contractors
Documenting the Transaction

• Form of loan agreements and finance documentation
  • AP-LMA based form
  • Traditionally not wedded to templates
  • Leaning that way now as the team grows, younger lawyers in place
  • Provides consistency in approach

“Consistency is Key”
IV. Finance Documentation Issues

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- What is it and why do we use it?
  - Consistency across all loans (definitions, disbursement procedures, reps & warranties, EoDs, boiler-plate, governing law)
  - Single point of contact - administrative ease
Common Terms Agreement

- Issues arising in the CTA
  - Disbursements – pro rata vs EXIM Banks tied financing issues
  - Mandatory Prepayments - policy issues
  - Use of proceeds – differing requirements
  - Environmental & Social Safeguards
  - Anticorruption provisions
  - Preferred Creditor Status (repatriation issues)
  - Events of Default – differing requirements
  - Governing Law
Loan Agreements

- Main terms (loan amount, interest rate, repayment schedule, fees and anything “bank” specific)
- For IFIs, includes “institutional specific” provisions (E&S, anticorruption, EoDs)
- Governing law and jurisdiction
Sponsor Support Agreement

- What this is?
- What types of sponsor support there are
  - Full completion guarantee
  - Limited cost overrun support
- Other obligations
  - Retention of shareholding
  - Ensure debt service reserve account is full
Sponsor Support Agreement (continued)

- When it falls away
  - Performance tests under EPC
  - Lender reliability tests
  - Permits and approvals
  - Ratio tests
  - All financing, project and security documents
  - No “Material Adverse Effect”
  - Absence of defaults
Accounts Agreement

- What is it? Where does it fit in?
- Account Bank (onshore and offshore)
- “Cash flow waterfall”
  - Sets out the “order” of how project moneys are “spent” and “reserved for” in order to meet all project expenses, debt service and reserve requirements
  - Dividend tests prohibit shareholder distributions unless conditions are met
Security

- Security - understanding the different types of security available for a typical project finance deal.
  - Land mortgages
  - Equity pledge
  - Security over Accounts and receivables
  - Moveables (equipment and assets)
  - Project documents
  - Insurances
  - Quasi-security
    - Completion guarantee
    - Direct Agreements
  - Governing law
Direct Agreements

- Direct Agreements (tri-partite) with counterparties to the project documents (Concession Agreement, PPA, EPC, O&M, etc)

- What are the objectives?
  - Consent to assign by way of security to lenders
  - Consent to assign the contract to 3rd party in case of default by the Project Company
  - Additional grace periods before terminating project document
  - Step-in rights for lenders
  - Clarifications and additional negotiated items for lenders

- Governing law
Inter-Creditor Agreement

- Voting rights based on proportion of loan size
- Voting thresholds for different decisions (waivers & amendments, acceleration, enforcement) – unanimous/supermajority/simple majority/unilateral
- Security sharing and turnover
- ADB and other IFI requirements (unilateral rights), exception to sharing - preferred creditor status
IV. EXIM Bank / IFI Institutional Issues

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Institutional Specific Requirements

- Procurement – “tied” financing
- Suspended or ceases to be a member of ADB, leads to cancellation/prepayment
- Safeguards
- Prohibited list
- Anticorruption, anti-money laundering, financing of terrorism
- Sanctions list
- GAP
- Development Monitoring Framework
- Social Protection Requirements
- Privileges and immunities
  - What are they?
    - No taxes or duties imposed
    - Access to hard currency
    - Freedom to repatriate
  - Where from?
    - Charter
    - Statutes in each member country
    - Private Sector Framework Agreement / Host Country Agreements
Thank you.