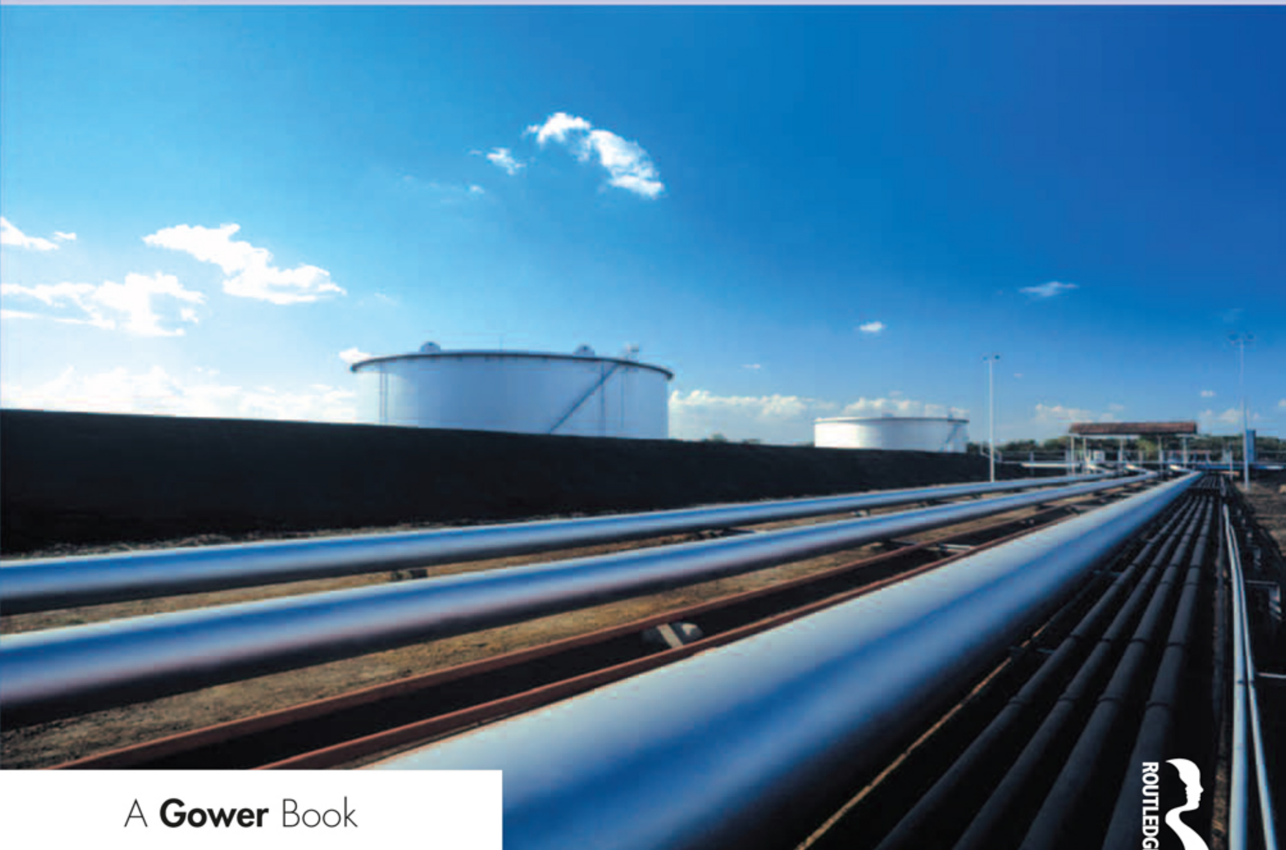
The Principles of Project Finance



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Introduction

Welcome to *The Principles of Project Finance*. This book has been put together to explain and illustrate the ideas behind an important concept in the global capital markets – project finance. This technique is used to fund large capital expenditure projects, usually in the energy or infrastructure arenas.

Project finance is positioned at a key point between the global capital markets and the energy and infrastructure industries. Unlike some other now notorious parts of the capital markets, it is used to fund real assets with long economic shelf lives.

To explain and illustrate the ideas behind project finance, the book is made of chapters written by a range of leading players in the market from around the world.

The book is split into four sections.

The first section reviews various themes and issues key to the project finance market – views from bankers, lawyers and advisers plus chapters on bank, bond and multilateral finance and a look at environmental, insurance and construction market issues.

The second sector looks at how project finance is used in various sectors of the energy and infrastructure market – renewable energy, oil and gas, mining, PPPs and roads and transportation.

The third section then takes an in-depth look at various projects finance markets from around the world – Australia, Vietnam, Indonesia, India, Turkey, Russia, Africa, France, USA and Brazil.

Finally, the fourth section presents a series of Top 10 deal case studies from the pages of Thomson Reuters Project Finance International (PFI), the leading source of global project finance information.

I started at PFI some time ago, more years than I care to remember, and was struck by the importance of the project finance technique on a global basis. Project finance is a highly specialised niche market, certainly, but in 2010 it topped the US$200bn mark according to PFI's tables.

The technique involves funding a large capital expenditure project via non or limited recourse financing. This means a project company is established to build and run the project which raises both debt and equity to fund the project. This project company solely depends on the performance of its asset to provide a return to its equity and debt investors.

The project sponsors behind the project company can, and do, provide various guarantees on the performance of the project and its project company. The level of support provided will determine just how non or limited recourse the project financing is. However to be a project financing, the equity and debt holders need to share in important aspects of the risk inherent in the project – construction risk, operationing risk, political risk and revenue risk.

Project finance has been around for some time. Some say it started when independent power projects (IPPs) were first financed in the USA in the late 1970s, others that it dates back to the development of the North Sea oil fields in the 1970s while others say it dates back to the reserve based lending (RBL) sector backing US oil independents after the Second World War.

Others take the concept much further back. In one article in PFI, Plutarch, ancient biographer of notables such as Alexander the Great and Cato, was revealed as no fan of project finance. In describing an early non-recourse ship-financing deal entered into by Cato, he damned the technique as “condemnable.” Not sure what he would have made of subprime mortgage securitisations.

In the modern age, however, the concept really motored in the 1990s alongside the Asia markets boom, followed by the US power market boom and then the take-off of the public private partnership (PPP) concept to fund governmental infrastructure. All the while the oil and gas and mining industries were well served by the technique.

Looking into the future, large scale oil and gas projects and a host of renewable energy financings appear to offer the best deal prospects. But the project finance market has been adapting to the needs of its clients whatever they required, all the way back to Cato.

Rod Morrison
Editor
Thomson Reuters Project Finance International.