INTERNATIONAL PROJECT FINANCE

Law and Practice

SECOND EDITION

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INTRODUCTION

The Definition of Project Finance

Whilst many attempts have been made to define project finance, the term has been used in many contexts over the years and its meaning has evolved as the techniques which it embodies have been adapted to macro-economic change. Like describing the 'elephant in the room', it is difficult to define, and perhaps not worth the exercise because inevitably you recognize it when you see it.

Accepted definitions focus on the financing of a specific asset in which lenders look principally to the revenues generated by the operation of that asset for the source of funds from which loans will be repaid. The primary security for the loans consists of the assets of the project, including, most notably, the cashflow the project generates and the contracts that assure the stability of both its costs and its revenues.

Project finance is deployed most commonly in the development of large infrastructure projects (e.g. power generation, toll roads, and telecommunications), social infrastructure (such as hospitals and schools), and the exploitation of energy and other natural resources, but it can be used to finance a broad range of assets and services.

Characteristics

Although each financing is specifically designed to meet the requirements of a particular project and the objectives of its sponsors, the following characteristics are common to most project financings:

(1) the project is developed through a separate, and usually single purpose, financial and legal entity;
(2) the debt of the project company is often completely separate (at least for balance sheet purposes) from the sponsors' direct obligations;
(3) the sponsors seek to maximize the debt-to-equity leverage of the project, and the amount of debt is linked directly to the cashflow potential of the business, and to a lesser extent the liquidation value, of the project and its assets;
(4) the sponsors' guarantees (if any) to lenders generally do not cover all the risks involved in the project;

(5) project assets (including contracts with third parties) and revenues are generally pledged as security for the lenders; and
(6) firm contractual commitments of various third parties (such as construction contractors, feedstock and other suppliers, purchasers of the project's output, and government authorities) represent significant components of the credit support for the project.