Yes, but *which* project financier?

by DOUG JONES

WHEN it comes to project financing, fashions come and go - often primarily at the behest of those marketing different types of financial products. And at present the use of capital markets for debt financing, as an alternative to relying on the banks, is a *highly* fashionable topic.

But whatever the whims of the marketers and the attractions and pitfalls of different financial products, there is one constant for everyone seeking project finance: the need for good advice and a careful, considered decision.

The idea of using capital markets to provide project finance is, of course, far from new, having been around since the late 1970s.

It is a relatively recent arrival in Australia however, where it has come into its own with the proliferation of significant debt-intensive acquisition and development projects.

The heightened Australian appetite for debt over the last few years has seen the institutional markets open up to project risk and provide an alternative funding source.

The reduction of government-sponsored note issues has been another important factor in the growth of the markets.

There are many reasons why a borrower might choose to raise project finance in the capital markets in preference to the banks.

The first is the pre-requisite of sufficient liquidity. The traditional bank markets are not always capable of satisfying the voracious appetites of major projects, and the Australian syndication market has suffered from the Asian financial crisis and the resultant withdrawal of several high-profile participants, particularly the large Japanese banks.

The second reason is equally fundamental: the cost of raising the funds. These costs are generally considered to be lower in the capital markets than in the bank debt market. In particular, interest rates on debt finance raised in the capital markets are usually lower and/or fixed.

The third factor in the attractiveness of the capital markets is the availability of longer-term debt.

Many projects need debt finance over at least 10-20 years, and it is uncommon for the banks to agree to extend commitments out so far. But longer-term finance over 15-25 years is not uncommon in foreign capital markets, particularly in the US, even though the local markets are still more used to medium and short-term debt.

A fourth factor is a more liberal and less restrictive contracting regime.

The capital markets generally take a more relaxed approach to documentation and require fewer representations, warranties, covenants and events of default than the banks. Further, the representations, warranties, covenants and events of default that are required are generally less "hair trigger" than the banks', usually being confined to the more fundamental issues.

This reflects the facts that:

❑ Investors in the capital markets have neither the resources nor the desire to continually monitor a borrower's performance against financial ratios and/or the progress of a project.

❑ It is cumbersome to hold bondholder meetings, so they are called only when strictly necessary. In marked contrast, the provisions in bank documents are generally designed to force borrowers to the negotiating table at a very early stage.

❑ It is not practicable for a borrower to continually obtain consents or waivers from the bondholders. To minimise the need for consents or waivers to be obtained, a lighter-handed approach to the documentation is required.

A final attraction is the perception that investors in capital markets are more passive than the banks if a project encounters difficulties, partly because of the logistical difficulties in calling bondholder meetings. There is certainly a history of relatively poor attendances at these meetings.

Despite the perceived advantages of raising project finance in the capital markets, there are numerous issues to be wary of before making the leap.

When it becomes a complex, costly, time-consuming process

Perhaps the greatest disadvantages of sourcing project finance from the capital markets are the cumbersome disclosure and registration requirements and potential liabilities for insufficient or misleading disclosure.

In bank financing, the banks take responsibility for their own due diligence and risk assessments. In capital markets issues, however, a full risk assessment must be disclosed in the offering documentation, and the issuer is liable for insufficient and/or misleading disclosure in this documentation.

Accordingly, extreme care has to be taken in the preparation of the offering documentation. This is generally a complex, expensive and time-consuming process.

In multi-jurisdictional offerings, for example, specialist lawyers need to be engaged in each of the jurisdictions to tailor the documentation to address all the local requirements.

Borrowers need to weigh up whether this additional layer of complexity and their own potential liability for inadequate or misleading disclosure are sufficiently offset by the advantages, such as better pricing, longer maturities and/or less restrictive covenants.

Other issues to be kept in mind include withholding tax, the roles of rating agencies and potential difficulties with restructuring the project if it runs into problems.

Withholding tax: In many cases, borrowers will want to tap into offshore capital markets, so as to reach the deepest market. The associated documentation will need to be carefully structured so as to minimise their liabilities to pay withholding tax.

This consideration is not confined to direct fundraising from the capital markets. As an illustration, structures have recently been developed to facilitate the offshore refinancing of bank debt, essentially by cloaking syndication sell-downs as capital markets issues in order to take advantage of the withholding tax exemptions granted to bond issues.

Rating of instruments: It is common practice in a project finance capital markets issue for ratings to be obtained from at least two different rating agencies. In contrast, when funds are sourced from the banks, the banks themselves evaluate the credit risk, so there is no need for rating agencies to become involved.

So as borrowers negotiate the contractual relationships in any capital markets issue they need to be very much aware of the criteria and commentaries of the rating agencies.

The timetabling of the issue also needs to allow sufficient time for the rating agencies to undertake and complete their reviews.

Reconstruction problems: It is widely recognised that it is difficult enough to even identify bond holders - let alone get them to make collective decisions on the restructuring of a project in distress. When a project runs into serious problems, it is inherently much easier for the problems to be worked out in a bank structure than with a capital markets issue.

Even if the relevant documentation grants a bond trustee a fairly broad discretion to make decisions, many bond trustees are reluctant to exercise this discretion, because it carries with it an exposure for making the wrong choice.

This means decisions need to be made, in documenting the capital markets issue, about the degree of flexibility required and the manner in which consents will be obtained. To put it kindly, these are not always easy issues to resolve.

In summary, despite the perceived advantages of raising project finance in the capital markets, and despite some of the hype, there are myriad issues to be considered before by-passing the bank syndication market in favour of the capital markets - no matter how good or poor your financial fashion sense. ■

Ed.: Doug Jones is a construction partner in national law firm Clayton Utz.

❑ NS Komatsu has appointed **Malcolm Barnes** as chief information officer, responsible for business transformation, e-commerce and IT/MIS. Barnes, who was the company's e-commerce manager, joined NS Komatsu in January. CIO is a new position.


CIO Barnes.

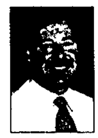
❑ Vermeer Manufacturing Company has appointed Brian Metcalf vp sales and marketing. He will be responsible for strategic and operational sales and marketing worldwide. "His selection was the result of a worldwide search process that included reviewing several external candidates," says chairman and ceo Robert

moved from Bickford Feehely to join the property services team at Phillips Fox, one of them being new partner **Jim Feehely**. **Alistair Savage**, a specialist in construction and engineering law, joins as a solicitor, as does the third new arrival **Petra Faas**, a specialist in construction and commercial law.

❑ *America's Specialised Carriers & Rigging Association has appointed **Joel M. Dandrea** as vp transportation matters. He was formerly director driver training and development at the American Trucking Association.*

❑ Ancon CCL has appointed **Barry Metham** to lead the Halfen division, which specialises in facade support, lifting anchors, framing systems and anchor channels. An

❑ Ingersoll-Rand Company has appointed Matthew T. Farrell as vp investor relations and communication. Farrell, who moved from Honeywell International, is filling a new post and will report to Ingersoll-Rand chairman, president and ceo Herbert L. Henkel.


Engineer Methem.

❑ *Lyle Crutchett has retired from Pioneer Road Services in SA. He'd been with PRS for more than 20 years, latterly as project engineer and estimator.*

❑ Schenck Australia md **Bob Shelston** announced three appointment to form the nucleus of the new Loading Systems Divi-

have been involved in over 40 train loading installations from the east to the Pilbara.

❑ Barry Munce has joined Sinclair Knight Merz as national technical manager, aviation, and chief pavement engineer, based at SKM's ACT office. He's had nearly 40 years experience in highway and airport pavement design, construction, maintenance and evaluation.

❑ *After 20 years with Hardcastle & Richards, latterly as gm, **Richard Cugley** has joined Maunsell McIntyre as industry director, mining and industrial. His appointment broadens the firm's expertise in the mining and industrial sectors in the southern states.*

Ed.: Contributions to People are welcome.