Risk and reward

• Under the right circumstances, international project finance can be very lucrative.

• But it is also comes with risks – some of them significant – not present in domestic projects.

• Risks should be anticipated, considered and managed.
Topics to be reviewed

- Participating in overseas procurements
- Dealing with foreign lenders and foreign investors
- Dealing with general cross-border project financing risks
  - Construction risk, taxation risk, currency risk, interest rate risk and commodity risk
Topics to be reviewed (cont’d)

• Considering key funding sources

• Addressing social and political roadblocks, including national partner risk

• Managing project political risk

• Dealing with infrastructure supply risk
Participating in overseas procurements

Things to consider:

- Host (procuring) country governments may take formal or informal measures to favour local bidders.
  - These measures may be subject to international trade agreements (e.g., NAFTA, WTO).

- The host country’s business culture may differ greatly from Canada’s.
  - Bribery and other corrupt practices may be common or expected.
  - Compliance issues with respect to Canadian and foreign laws.
Participating in overseas procurements

Things to consider:

• Expertise and resources may not be as plentiful in the host country as they are domestically, and technology may be vastly different.

• Language and cultural barriers may have to be overcome.

• It might be wise to consider assembling teams of advisors and partners in the host country.
  • e.g., retaining legal counsel in the host country.
Dealing with foreign lenders

• Project lenders have become more risk-averse since the financial crisis, and this may be especially true for foreign lenders.

• Host country lenders may be unable or unwilling to provide sufficient financing.
  • It may be necessary to assemble a local or international syndicate.

• Language and cultural barriers may cause problems.

• Relevant local laws (e.g., collateral, dispute resolution) should be canvassed.
Dealing with foreign investors

- Consider the nature of the capital markets and the securities laws of the host country.

- Cultivate relationships in the host country.

- Consider whether you may not wish certain host country residents to invest in your project.
  - e.g., prospective investors may be current or future competitors.

- Again, language and cultural barriers may be challenging.
Dealing with cross-border financing risks

• Construction risk
  • Delays can occur for many reasons (e.g., force majeure events).
  • Construction capacity may be constrained
  • Labour legislation may be different

• Taxation risk
  • Examples of taxes possibly payable: income tax, withholding tax, stamp tax, consumption/value-added tax and branch profits tax.
  • Double taxation treaties may be in effect.
  • It is essential to obtain competent advice on the domestic and foreign tax implications of a project.
Currency risk

• The main areas of foreign currency risk:
  1. Unavailability of foreign currency
  2. Inability to transfer currency abroad
  3. Currency devaluation due to foreign exchange rate fluctuations

• Some currency risk may be due to political action or instability in the host country.

• Consider methods of minimizing this risk.
  • e.g., require consistency of currency when contracting; enter into hedges and other derivatives; obtain political risk insurance.
**Interest rate risk**

- Floating interest rates are common in international project finance, but fixed rates are generally desirable to lock in project returns.

- Consider the possible effects of interest rate fluctuations and the project’s capacity to handle them.

- Consider methods of minimizing this risk.
  - e.g., enter into interest rate swaps and other hedges; seek fixed-rate loans from export credit agencies or multilaterals.
Commodity risk

• Prices of project inputs and outputs can fluctuate dramatically.

• It is important to perform a detailed analysis of the project’s commodity risk exposure.

• Consider methods of minimizing this risk.
  • e.g., enter into commodity swaps or other hedges; enter into long-term supply contracts with ability to renegotiate terms.
Key funding sources

• Consider the traditional sources of international project finance:
  • Commercial lenders
  • Bond markets
  • Equity investors
  • Lease financing

• Consider alternative financing structures
  • Export Credit Agencies
  • Multilateral Credit Agencies
Key funding sources

- **Export Credit Agencies:**
  - Organized and funded by a single country’s government.
  - Concentrate on providing coverage for political risks abroad.
  - Examples: Export Development Canada (EDC); US Export-Import Bank (USExim).

- **Multilateral Agencies:**
  - Funded by multiple governments and organizations.
  - Also tend to concentrate on providing coverage for political risks abroad.
  - Examples: International Finance Corporation (IFC); Multilateral Investment Guarantee Agency (MIGA); both are associated with World Bank Group.
Addressing social and political roadblocks

• Legal system risk and national partner risk
  • The host country laws and economy may be unfamiliar and unpredictable.
  • The host country’s legal system and government may be difficult to maneuver.
  • Analyze host country laws and consider retaining counsel in the host country.
  • Consider the stability of the host country’s economy.
  • Consider risk of prolonged procurements and possibility for protracted litigation in respect of project issues.

• Environmental risk
  • Environmental regulations, standards and activism may heavily impact project development and operation.
  • Determine how best to allocate risk, consider retaining counsel.
Managing project political risk

• Political risks are risks grounded in decisions made or actions taken by the host country’s government, or in force majeure events with political undertones.

• Examples of political risks:
  • Restrictions on foreign currency
  • Civil unrest
  • War and terrorist attack
  • Expropriation
  • Governmental contract repudiation and frustration
Managing project political risk

• It is essential to consider the likelihood of political risk in a host country impacting your specific project.

• Examples of methods of dealing with political risk:
  • Public or private insurance
  • Seeking host country legislative approval or seeking other governmental protections
  • Forging strong relationships with government officials and other important figures (without resorting to corruption)
  • Involving host country lenders, investors, suppliers and others
  • Consider the protective capacity of bilateral investment treaties (BITs)
Dealing with infrastructure supply risk

Things to consider:

• A competing project could emerge.
  • Government becoming a competitor may be especially problematic.

• Nationalization or expropriation may occur.

• Consider how best to allocate these risks, including by obtaining insurance coverage, where appropriate.
Conclusion

• There are risks unique to engaging in international project finance.

• Think through these risks, obtain competent professional advice and plan ahead.
Questions?