WHAT ROLE CAN BANK DEBT PLAY IN FINANCING INFRASTRUCTURE PROJECTS?

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2. Detailed Feasibility, Design and Structuring

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LIFECYCLE OF AN INFRASTRUCTURE PROJECT: SUITABILITY FOR BANK LOANS

1. Project Concept and Pre-Feasibility

- Very risky early stage activity
- Uncertainty about project feasibility, so technically there is "**not yet a project to lend to**"
- Largely unsuited to bank loan financing

2. Detailed Feasibility, Design and Structuring

- Risky early stage activity
- No "**clear line of sight**" to project cash flows
- Relatively unsuited to bank loan financing
- Possible in limited cases, based on the strength of project sponsors and security package

3. Procurement and Construction

- Banks play a significant role in this phase
- If project is well structured, project cash flows can be ascertained and risks appropriately allocated to various parties
- Duration matches short term liabilities of banks

4. Operation and Maintenance

- Where possible, banks can provide long term loans to the end of project /concession life
- Banks can also support project companies with **working capital loans** as required

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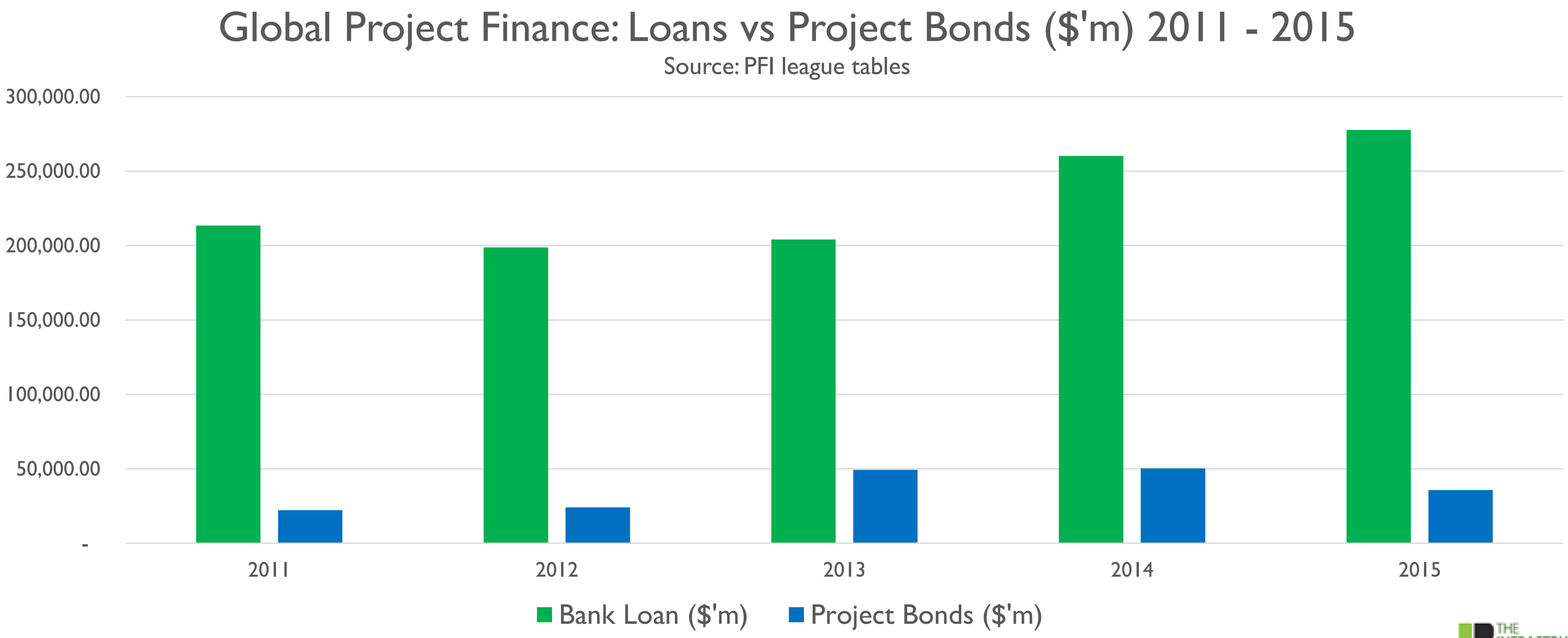
BANK LOANS IN INFRASTRUCTURE: FEATURES

- Based on the Project Finance methodology, these loans are typically applied subsequent to financial close, to support Procurement and Construction as well as Operation and Maintenance
- Typically Project Finance loans are syndicated amongst banks/lenders to help in the diversification of single obligor risks
- Loans are priced based on market driven considerations (bank cost of funds, risk profile of the project etc.)
- The tenor of the loans will typically be short to medium term (up to 7 years), and would leave the project with some refinancing risk
- Due to the relatively short term nature of banks' liabilities, longer term loans are quite difficult to achieve
- Loans are secured against the project company's assets and structured to include safeguards such as cash flow controls, reserve accounts, performance bonds, project completion insurance and support from International Financial Institutions

GLOBAL SIGNIFICANCE OF BANK LOANS IN INFRASTRUCTURE FINANCING

- The debt component of infrastructure financed using the project finance methodology accounts for between 60% and 90% of the total project cost
- Of this debt funding, bank loans account for a significant majority
- The following slides highlight the importance role that bank debt plays in the funding of infrastructure globally

GLOBAL SIGNIFICANCE OF BANK LOANS IN INFRASTRUCTURE FINANCING



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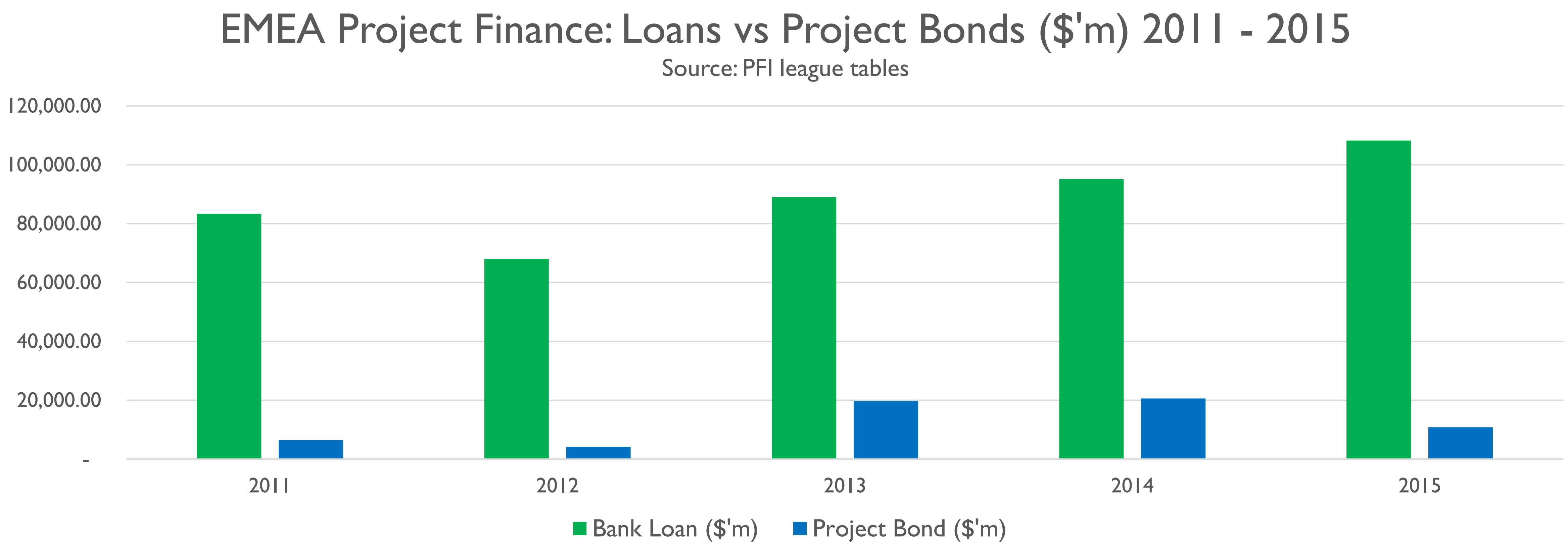

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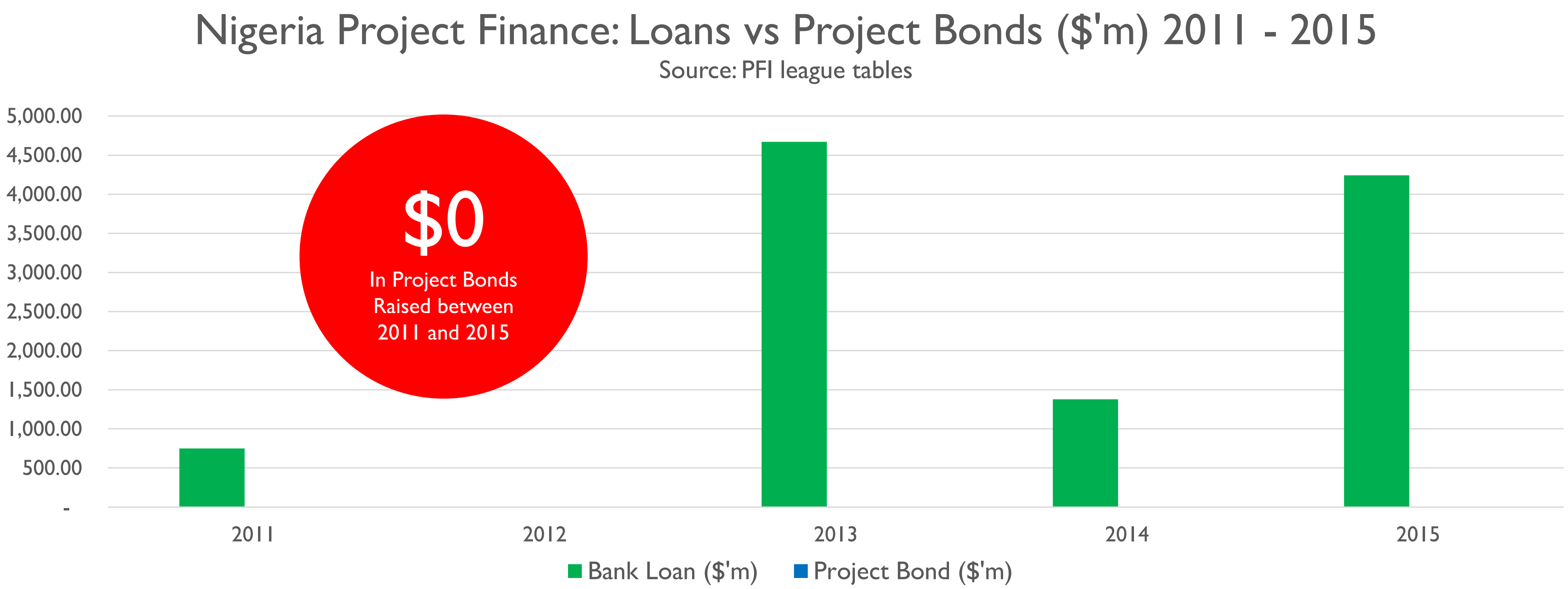

OTHER IMPORTANT ATTRIBUTES OF BANK LOANS

- As earlier noted, bank loan financing accounts for the significant majority of the project costs
- Aside this, bank loan financing also offers a great degree of flexibility to projects especially in the procurement and construction phases, where it is very important to project success.
  - The phased drawdown approach to bank loans makes it more appropriate to construction financing, as interest is paid based on funds drawn down. With project bonds, interest (coupon) payment on the full financing requirement is due immediately after the floatation of the bond
  - Bank loans can factor in appropriate moratoriums based on the features of the project
  - Where required bank loans can be restructured relatively easier than project bonds, and with less negative impact on the project.
  - Bank loans can also be pre-paid relatively easier and with less cost implications than would be the case with project bonds
  - Bank loans are usually quicker to access and can therefore support the **working capital** needs of infrastructure projects

RECENT LANDMARK INFRASTRUCTURE PROJECTS SUPPORTED BY BANK LENDING

Lagos – Ibadan Expressway (2014)

- N167 billion road financing via a Private Finance Initiative
- N50 billion First Tranche
- Financed by N25bn Federal Government allocation
- N25bn (50%) by a consortium of local commercial banks

Smile Telecommunications (2015)

- US$ 315 million syndicated multi-tranche term expansion facility
- Syndicate included DFIs, Export Credit Agencies, International lenders as well as local (Nigerian) commercial banks

Azura IPP (2016)

- US$876 million project financed greenfield IPP
- US$190 million in Equity Financing
- US$686 million (78%) in debt financing
- Bank loans totalling US$354 million were deployed
- Local (Nigerian) bank tranche amounted to $120m

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CURRENT TRENDS: INFRASTRUCTURE BANK LOANS

- Bank loan financing has faced some headwinds in recent years, stemming largely from regulatory requirements
- Basel III prescribes higher capital and liquidity requirements for banks undertaking specialised lending such as project finance and this is expected to shift banks' appetite for deploying loans to projects
- In Nigeria, the implementation of Basel II and the increased risk weightings for project finance loans could also have a dampening effect on bank loans to infrastructure projects
- Furthermore, banks' sector exposure limits, especially in the power sector creates some challenges with extending loans to infrastructure projects
- Nevertheless, dwindling government revenues and the reduced ability for the Nigerian government to unilaterally fund infrastructure projects means that there is the need to create incentives that channel bank funding into infrastructure projects

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DEVELOPMENT FINANCE INSTITUTIONS – A CRITICAL ENABLER

DFIs have played a notable role in the channelling of bank loans into infrastructure, by providing structures and instruments that increase access to funding, reduce costs and reduce risks

- Providing access to concessionary loans at relatively low rates and long tenors for on-lending to banks
- The use of A/B Loan structures as a risk reduction mechanism for the commercial and investment banks
- Participating in project lending exercises via first loss/ subordinated tranches
- Provision of outright credit guarantees
- Provision of Political Risk Insurance
- The presence of DFIs is also a strong signalling tool and could provide some collective safety/political protection for project financiers

HOW DO WE SUSTAIN THE MOMENTUM?

- To ensure that bank loans remain an integral medium of financing infrastructure, it is important to:
  - Ensure a robust pipeline of well-structured projects
  - Undertake industry capacity building initiatives to support a stronger project finance/PPP ecosystem
  - Engender a clearer PPP regulatory environment, and with the presence of the ICRC, this is ever improving
  - Create appropriate take-out mechanisms for bank loans, which could be in the form of capital market instruments (infrastructure project bonds, infrastructure debt funds) and longer tenured debt (e.g. from DFIs);
  - The above requires the development of strong, well functioning capital markets.

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THANK YOU