PROJECT FINANCE

Project financing in an evolving world

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One of my senior colleagues once said: "Whenever steel hits the ground, projects lawyers will be involved." This is true not only for the lawyers at my firm, but equally for all of the projects lawyers named in this guide. Fortunately for us all, steel is once again being erected across the globe.

Project finance funds investment across a broad spectrum of industries, including natural resources, telecommunications, transportation, social services and power generation and transmission. Massive levels of investment are needed in each of these sectors to meet the demands of growing populations and economies. Whilst perhaps not alchemy, the magic of project finance is that it turns a collection of permits, contracts and other promises – what some might uncharitably call a pile of paper – into vibrant economic undertakings that help meet those demands. Transformations of this nature are very much the purview of lawyers, and thus our contribution to the success of a project can be significant.

Project financing has evolved significantly since I began to practice in the early 1980s. Then, it was a tool used principally by commercial banks to finance the construction of natural gas projects and power plants, largely in North America and Europe. When (more rarely) projects were financed in the southern hemisphere, lenders and sponsors were generally based near London, New York or Tokyo. In recent years, this north-south divide has disappeared, in large part because the evaporation of credit in those financial centres has allowed lenders from across Asia, the Middle East and Latin America (coupled with an increased involvement of export credit agencies, multilateral development organisations and, for stronger projects, the capital markets) to fill the resultant liquidity gap. Likewise, a wide range of sponsors from those regions are now driving the development of projects across the globe, in part to assure their home markets with access to natural resources and in part because they are able to supply equipment and skilled labour at competitive prices.

Economic growth has been particularly rapid in what the investment banks refer to as the four "BRIC" emerging market countries. For the past few years, the domestic project finance markets of three of those countries, Brazil, India and China, have been liquid enough that they have not required funding from international sources. Consequently, for now, project financings in those countries are being documented under domestic law, often by leading local lawyers rather than international firms. Should the capacity of domestic financial institutions in those countries become stretched (as may already be the case in India), we can expect the involvement of international lenders, and lawyers, to increase.

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Significant investment is also taking place in Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa (commonly referred to as the "CIVETS" group) and a number of other similarly situated countries. By some accounts, in the Middle East and North Africa alone, infrastructure projects worth more than $500 billion have been announced in recent years, in many cases with the host government making legislative and regulatory changes designed to promote the involvement of the private sector. To meet rising demands for power, a variety of countries, from Abu Dhabi and Turkey to Malaysia and Vietnam, are contemplating ambitious nuclear ventures involving private sector investment, each of which will require massive levels of funding and complex regulatory reform.

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Infrastructure investment is also occurring in the developed world. In his 2011 State of the Union address, President Obama set out a range of challenging energy and infrastructure investment targets. While the tangible impact of statements like this are hard to identify, they point to a trend of continued investment, a large portion of which will be project financed. Similarly, there are major European nuclear and offshore wind initiatives in the pipeline. However, the continuing contraction of public sector budgets across Europe and the United States will certainly have some adverse impact on these plans.

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Activity is occurring across sectors as well as across regions. Concerns over climate change are leading to investment both in low carbon power and in energy efficiency, while urbanisation is driving investment in utilities as well as roads and rail. Steadily rising oil and other commodity prices have been an important contributor to the number and scale of natural resource projects. As exploration for new resource discoveries is driven to ever more remote locations, the cost of extracting those resources (often in excess of $5 billion per project) rises, resulting in ever larger financings and a corresponding need for lawyers capable of structuring transactions that mobilise diverse sources of capital. Although the short term prospects for commodity values look promising, the cyclical downturn that will almost inevitably follow will see prices drop, putting pressure both on existing projects and on those in the planning stages.

The world not only demands more, it demands that more be accomplished better. Most major financial and industrial businesses today accept that their investment activities carry with them a responsibility to meet high social and environmental standards, and so look to their lawyers to help them meet these objectives. In most instances, this simply involves applying common sense and a long-term view, but compliance with these standards may in some cases require difficult economic compromises to be made.

Fortunately, there appears to be no limit on the types and locations of projects under development. The diversity of sponsors is growing, and the issues that they face are ever more complex. Steel will indeed be hitting the ground over the coming years, and as the attraction of project financing techniques to sponsors and lenders appears to be undiminished, the lawyers in this guide will remain involved.