The Strategy of International Project Financing
Syllabus

This course is intended for future finance professionals seeking a 'practitioner's' grasp of Project Financing (PF) and for future executives who wish to understand how PF can help in the execution of business strategy. As such, the course focuses on the reasons why borrowers employ PF and critically examines whether such uses create or destroy value.

The course is largely taught from the borrower's perspective. This viewpoint is fundamental because it is the borrower who must decide whether PF has a role to play in the execution of business strategy. Students interested in a Lender's perspective will benefit however from a deeper understanding of borrower motives, their ideas on how PF creates value, and from insight into how borrowers compute PF economics.

Course content consists of lecture material, readings and most importantly recent PF case studies. Most of the case studies are written by the Professor and reflect transactions with which he is personally knowledgeable. The case studies are designed to display the dilemmas that arise when attempting to employ PF to achieve business objectives. In this way, the nexus between PF and success or failure in business strategy will be illustrated. Students will form teams and present at least one case study to the class during the semester. By course's end, the student should have gained a basic understanding of Project Finance fundamentals, an appreciation of situations where PF can be helpful, and of the challenges to be overcome if PF is to contribute value.

The first part of the course will cover PF fundamentals and economics. Topics will include the theory of project financing, the creditworthiness of project loans, sources of PF funding, how to compute 'leveraged economics', and the impact of PF on project economics. Part 2 of the course will focus on the specific strategies that employ PF, and will examine cases which illustrate the factors which lead to either successful deployment of PF or value destruction.

The Strategy of International Project Financing is intended to be taken in conjunction with "*Negotiating and Implementing Project Financing*". This second course will focus on how to design a Project loan, negotiate its terms, and place the financing in the debt markets. While the two course sequence is recommended for those who seek a mastery of PF, each course is designed to stand on its own. Students who decide to take only one course will achieve a fundamental knowledge of project financing along with an emphasis on strategy or tactics, depending upon the course selected.

Course readings will consist of selections from **Project Financing, Asset-Based Financial Engineering** (PF Abfe) by John D. Finnerty, John Wiley & Sons, Inc, 1996, and materials/articles provided by the Professor. In addition, students will be expected to read the assigned Case Studies. Two of the case studies, "The Chad-Cameroon Petroleum Development and Pipeline Project", and "Petrolera Zuata, Petrozuata C.A." will be available in the bookstore; the instructor will provide the remaining cases via WebCt. Lecture notes will also be placed on WebCt at least one week in advance, so that students can read the material and concentrate in class on the discussion.

Students will be assigned and graded on at least one case study, which will count for 25% of the course grade. A mid-term (25%), final exam (40%) and class participation (10%) will compose the remainder of the student's grade. It is likely that the final exam will be a take-home case study.

Questions or messages may be sent to me via e-mail at sarbogast@houston.rr.com or svarbogast@uh.edu. In time critical situations, the home e-mail address is probably a better bet. Alternatively, I can be reached at 713 898-2636. I will also be available in my office, Bauer 250C at 5pm on Mondays and Thursdays .

The course topics, readings and case studies are outlined below. **Class will begin at 6pm on Monday, August 22.**

Good Luck!

The Strategy of Project Financing
Course Outline

1. Course Objectives:

- Define 'What Is Project Financing' (PF)
- Contrast Project Financing with Centralized Corporate Financing (CCF)
- Outline the Reasons/Conditions which justify choosing Project Financing over CCF
- Examine the Credit Problem at the core of Project Financing
- Map the Allocation of Risk under Different Project Financing Structures
- Understand the distinction between 'Non-Recourse' and ' Limited Recourse' PF
- Understand the conditions and terms which enable PF to insulate/extend Corporate Borrowing Capacity
- Understand the terms and conditions that enable a borrower to achieve and benefit from 'leveraged economics'
- Understand the terms/conditions that enable PF to minimize or eliminate stronger Partner's need to "carry' financially weaker partners
- Understand how the use of PF enables strong partners to work more successfully with financial weak partners in Joint Ventures
- Understand the terms/conditions that enable PF to mitigate project political risk
- Examine cases that illustrate the success and failure of project sponsors to use PF to achieve business strategic objectives
    - Was the success/failure the result of PF being an appropriate means to achieve the business strategic objective?
    - Was the success/failure the result of the PF financing strategy being appropriately crafted?

Class I – Introduction & Overview

Course Overview: 1) PF Fundamentals, 2) PF Strategy and Economics, 3) PF Strategies 'In action'
Definition of Project Financing and Historical Development
Overview of Reasons Sponsors Consider PF
Lenders Objectives
PF Issues Borrowers and Lenders negotiate

Read: PF Abfe: pp. 1-13
Case Study***: "Didn't You Used to Be Project Financing/"***

Class II – The Project Finance Credit Problem

How to attract financing for a Project that doesn't exist?
Types of Projects that are suitable

Completion credit risk and support
Operating period credit risk & support
Typical Lender Credit Benchmarks
Non-Recourse vs. Limited Recourse Financing

Read: PF 7th: pp. 1-27 (posted by Professor)
Case Studies: ***H.K. Genco Ltd. (A***)

Class III – Sources of Project Finance Funding

Commercial Bank Market
Private Placement Market
Rule 144A Bond Market
Export Credit Agencies
Multilateral Agencies
Comparison of Terms and Conditions
Implications for Borrowers

Read: PF Abfe pp. 157-186
Case Study: ***Petrolera Zuata, Petrozuata C.A.***

Class IV - Framing the Economics of PF

Actual PF Objectives of Sponsors
Investment Economics & Financing Economics
How to do 'Leveraged Economics'
When to do financing economics vs. when to adjust Project Economics
Defining the Opportunity Cost of PF: Cost of Capital vs. Cost of Debt
Centralized Financing - the usual alternative; "Non-economic" costs of PF
Capturing PF costs in Project Economics (I) - the High Cost Financing Debit
PF economics as a Financing Strategy

Read Teaching Note I on PF & project economics and problems assigned by Professor

Class V – When Does Project Financing Make Economic Sense?

Sponsor Economics when You Don't Have Money
Competing using 'Leveraged Economics' - Non-recourse and recourse financing
Economics of using PF to 'Stretch the Corporate Balance Sheet'
Economics when Political Risk discourages investment or interferes with operations
Economics when your Partner Doesn't Have Money
Capturing PF costs in Project Economics (II) - the 'Cost of Carry'
Bank Economics of PF Lending

Read: Teaching Note II on PF Economics and do problems provided by Professor

Class VI – Business Strategy & Project Financing

Introduction to Corporate Strategy
Investment Strategies that Often Employ PF

- Growth in Capital Intensive industries
- Accessing scarce resources
- High ROE in Regulated Industries
- High ROE in Low Risk Assets
- Speculative Acquisition
- Growth in High Risk businesses or locations

Contribution of PF to each Strategy

- Map of actual PF rationales vs. contributions to Strategy

PF's critical success factors & economics

- Potential Pitfalls & Misuse of PF

Read: PF Abfe, pp.14-33
Case Study: ***Mission Petroleum Considers Investment Policy and Project Financing***

Class VI – Project Financing to Expand Debt Capacity

The theory of 'Off-Balance Sheet Financing'
Security packages – then and now
Accounting Treatment of Project Financing – then and now
Rating Agency Treatment of Project Financing
Does "Off-Balance Sheet" PF exist?

Read: PF Abfe, 53-69, Figure 5.1 (pp. 72-76)
Case Study: ***Terrasia Aromatics Project (A)***

Class VII – Project Financing to maximize use of available capital, distribute risk and fund Growth

Can high growth strategies based upon PF succeed?
The critical roles of the Business model and risk allocation
Case study: A look at Indiantown Cogen Project vs.Calpine
Recognizing the limits of PF-based high growth
Mapping of risk among project, sponsors, suppliers, customers and lenders
Allocation of Credit Support among project, sponsors, suppliers, customers and lenders

Read: PF Abfe, 204-235

Case Study: ***The Euro Disneyland Project (**in PF Abfe, pp. 256-287)*

Class VIII – PF and the Problems of Partners

Partners without Money or unwilling to make it available
Forms of 'Imposition', Over-financing & 'Carrying' a Partner
The Risks of Carrying a Partner
How Project Financing Can Minimize 'Carry'
Credit Leakage to Weaker Partner
When Partners are not strategically aligned - PF terms as proxy for Partner disputes
How PF can reconcile or overcome Partner non-alignment

Read: Article provided by Professor
Case Study: ***Ban Diego LNG***

Class IX – The Nature of Project Political Risk

The Usual Suspects: Expropriation, Nationalization, Convertibility, and Civil Strife
Historical Perspective: Expropriation of the Middle East Oil Concessions, 1971-75
Change in Terms and Creeping Expropriation
National Partner Risk; Infrastructure & Supply Risk
Predicting & Quantifying Political Risk
Classical Use of PF to Hedge Political Risk

Read: PF Abfe, 188-203
Case Study: ***Soro Dondar (A)***

Class X – Using Project Financing to Hedge Today's Political Risk

New Forms of Political Risk - Project in Very Poor Countries; Potentially Failed States
New Options for Hedging Political Risk: ECA's, MLA's, Political Risk Insurance
PF and: 1) Stake Reduction; 2) Deterrence; & 3) Deal Term Definition/Clarification
PF and Structural Constraints on Host Government options
Integrated Strategy for Hedging Political Risk via PF

PF 7^{th}, pp. 43-46, 341-346 (posted by Professor)
Case Study: ***Chad-Cameroon Pipeline*** (A)

Class XI – The Strategy of Project Financing: Conclusion

Determining whether PF is a Financing Enabler of Business Strategy
Pitfalls of PF – High cost CCF and the empty Political Risk structure
Setting Financing Strategy to Obtain Effective PF

Conclusions re: where PF adds value to Strategy and where it destroys value
Final Exam Preview