Take Project and Political Risk in Dironda?

A Case Study in Project Financing Infrastructure in an Emerging Market Country

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Abstract

Project Finance is often employed for the purpose of shifting specific risks from Sponsors to Lenders. Indeed the allure of financing that becomes „non-recourse‟ to Sponsors at some point is that all risks that could produce a cash flow insufficiency are shifted to the Lenders. This allure becomes especially powerful when the project location involves multiple operating, commercial and political risks.

Commercial lenders have learned over time that this can be an expensive proposition for them. They have reacted to periodic waves of loan defaults (e.g. oil/gas post-1986, Independent Power post-2000) by devising various strategies that limit their assumption of „non-recourse‟ loan risk. Principal among these are: 1) include ECAs/MLAs in the lending group to benefit from the supposed insulation, or „halo effect,‟ they provide; and 2) the requirement that the project purchase Political Risk Insurance (PPI).

This case study provides a recent example of the costs/benefits to Sponsors and Lenders of adopting these strategies. Dironda, located on the Horn of Africa, is surrounded by countries that are not strangers to civil wars. A world-class port management company selects Dironda as the site for a new container port – a facility intended to handle all in/out marine trade for Ethiopia and to provide a competitive transshipping option for vessels unable to transit the Suez Canal. Clearly the Sponsor likes the project and is forging ahead. However, its project financing plan demonstrates a intent to limit the owners‟ exposure to risk – and the risks are many, including the future course of Ethiopia's economy, whether the port will attract material transshipping volumes away from existing ports, and whether Dironda's own economic straits might produce labor and other difficulties.

Commercial lenders are interested but are considering a demand for more comfort. The lead arranger is not clear that it can attract sufficient loan capacity via syndication to complete the deal. Do they need to press the Sponsors to provide PRI? Do they need to add an MLA to the lending group? How will the Sponsors react to such demands at this late date in the financing schedule? Students will have to quantify the cost of adding PRI, make judgments about its efficacy, and see if they can construct a value proposition that Sponsors may also see in their interests? This case is historically grounded in a Port project

financing concluded in the region in 2008.