The Effects of the Financial Crisis on the Portuguese Project Finance Market
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Up until 2007/08, the financial markets were thriving and competition was one of the key points. Banks and investors were scavenging for profitable opportunities and only a few enlightened ones were unafraid of publicly saying this prosperity would not be as long-lasting as everyone seemed to be assuming.

So, and following up on a few early warnings, the credit crunch made its appearance and brought about a liquidity shortage for financial institutions worldwide. With the debt capital markets suddenly drying up, owing to several concomitant and concurrent causes, banks started to suffer tremendously and were finding it extremely hard to get funding. Especially damaging for the global project finance sector was the downgrading of the monoline insurers – responsible for "wrapping" the bonds issued under project finance regimes with AAA rating, rendering it a creditworthy investment for the capital markets. Since the banks were unable to fund their ordinary course of business using such debt capital markets, the interbank market soon followed the same path and banks were now fearful of lending to each other. Owing to such funding shortages, margins quickly increased, reaching 150/200 bps (or even more), where normally one would see margins ranging between 60 to 100bps in the pre-crunch period. The only way to raise finance and close the deals was now via the traditional credit facilities – be they syndicated or not – and it was nonetheless complicated.

Due to this setting, many deals in Portugal were put on ice and are now basically sitting in the pipeline, awaiting a better financial climate. Lenders are now extremely cautious, supporting their analysis on much stricter criteria, in particular when facing businesses relying on user charges and quite reasonably so, one might add, given the market conditions. All in all, they are presently much more risk averse. All eyes are set on the concept of "bankability", thus simpler structures and availability payments are well regarded by commercial banks. Efforts are being put together in order to tackle this ongoing risk aversion, hopefully forcing lenders to allocate their scarce liquidity. However, this is not to be construed as saying that the sector has completely disappeared. New solutions were found and new players were introduced, in order for new project finance deals to reach financial close. The infrastructure finance market is still there for the taking, albeit on a much reduced basis.

On a more general note, the Portuguese project finance market is facing the same problems as other sectors in relation to syndicated lending. First of all, some of the big lenders have retracted and it is now less usual to see foreign banks being part of the syndicates. Financial and credit institutions are now unwilling to lend for long terms as opposed to what they generally used to, and tenors have been reduced, sometimes only accommodating for the project's construction phase. Loans with a maturity of up to 25 years are now uncommon and are being replaced with 7-15 year loans. Today, such long tenors are generally seen coupled with soft mini-perms. Apparently, there is a growing consensus in the financial markets that lending for more than 15 years is an activity to be carried out by the capital markets and not for banks. There is obviously one downside to shorter loans, as they entail a new risk factor: there is now a refinancing risk for the Project Company. On the other hand, banks do not intend for loans to be that much shorter, as they will want to maintain the possibility of refinancing the said loan participations in the secondary markets.

Another ever-fading phenomenon is sole underwriting, as credit committees do not crave for large portions of undiversified debt to be held in their respective balance sheets. The market disruption clauses are not disregarded anymore and market flex provisions (allowing for lenders to, among other possibilities, change the pricing) are finding their way into the loan documentation once again, since banks now cherish and praise such a characteristic when deciding whether or not to participate in a syndicate loan. Club deals are becoming increasingly fashionable as they are considered to be useful tools for the borrower to avoid the market flex provisions. These changes entail that, albeit in lesser number and taking longer to reach such a stage, deals are getting done nonetheless. The fact that we are now seeing more club deals is no stranger to such delay. All in all, much more attention and effort are put into analysing clauses which were a part of the standard loan documentation. Such clauses tended to be overlooked and deemed "boilerplate" as they were rarely relied upon. The loan documentation is now (or, should we say, is once again) thoroughly scrutinised, making drafting more time-consuming. At this stage, preventive efforts are crucial.

Other noteworthy provisions which are obviously being carefully considered are the ones dealing with financial ratios. The debt service cover ratios seen in pre-credit squeeze times are nowadays hardly ever seen and the same may be said in relation to debt equity ratios. In the present economic circumstances, where revenues decreased and where real money shrunk, no lender will broker a deal based on the same ratios as before.

One of the mechanisms which forged its way into loan documentation, owing to demands by the lenders, is the cash sweep. This provides for the transfer at a given date of all or part of the funds in the project accounts to an account held by the lender (or the syndicate agent) therefore depriving the sponsors from such amounts. This provision is becoming more and more popular in financing arrangements in Portugal and it is a feature that is not limited to the project finance sector.

On a State level and in order to foster projects, the Portuguese Government has now committed to issue state "comfort". This is deemed as a way to fill in the void left by the monoline insurance model. Basically, the State will guarantee certain obligations, for instance, completion obligations by the borrowers. Sometimes it will only guarantee it partially but this suffices in sending out a message to lenders, making them more comfortable, leading them to grant the much sought after credit facilities.

Difficult times call for extraordinary measures. In other words, in times of need, different market players must step up. This is exactly the case for the European Investment Bank ("EIB") which has been particularly active in projects in Portugal in the last couple of years. The way in which EIB intervenes in the market is three-fold: (i) it can use its project-risk free counter-guarantee method; (ii) it can lend directly to the project therefore assuming the project risks along with the other commercial banks; or (iii) it may provide intermediate loans to commercial banks. The first possibility is basically one where the EIB lends to other (usually local) credit institutions and demands that for such lending to occur the said entity must guarantee the repayment of interest and principal under the facilities then granted. Structures described in (i) and (ii) above were used in the Portuguese project finance market quite recently. Commercial banks feel reassured when a multilateral institution like EIB steps in. There is another advantage in such a setting: EIB has access to better funding conditions and with the widening of the gap between funding costs for commercial banks and for multilateral institutional banks, such alternative becomes ever more appealing. Nevertheless, not all is great: EIB is known to be very stringent when it comes to due diligence requirements.

As a final remark, one should point out that the Portuguese project finance market, when compared to other markets, is a rather mature and robust market as well as a quite sophisticated one. In the aftermath of the financial turmoil, two major sectors stood out as still being able to put together project financings, e.g., motorway concessions and wind farms. It is predictable that these foregoing sectors remain the most active fields in the next few years notwithstanding the much debated commotion surrounding the visa's ("visto") refusal from the Accounts Court ("Tribunal de Contas") relating to road concession projects that might partially hamper such predictions. The consequence of such ruling is that any financial obligations (such as availability payments) of the grantor, EP - Estradas de Portugal, S.A. ("EP"; the former Portugal Road Agency) under the Sub-Concessions would not become effective. This stricter scrutiny on public expenses is yet another expression of financial bad weather. Although such news is unsettling market participants, an amendment to the sub-concession agreements and a compensation plan is being set up by EP and hopefully such measures will have the power to dissuade the Accounts Court from ruling a definitive visto refusal.