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EBA Assessment criteria for project finance exposures (EBA/RTS/2016/02 13 June 2016)

Toepassingsveld

Verzekerings- of herverzekeringsondernemingen naar Belgisch recht.
Verzekerings- of herverzekeringsgroepen naar Belgisch recht.

	Category 1	Category 2	Category 3	Category 4	Category of the infrastructure investment	Comments
Factor: financial strength						
(a) Sub-factor: market conditions	Few competing suppliers or substantial and durable advantage in location, cost, or technology. Demand is strong and growing.	Few competing suppliers or better than average location, cost, or technology but this situation may not last. Demand is strong and stable.	Project has no advantage in location, cost, or technology. Demand is adequate and stable.	Project has worse than average location, cost, or technology. Demand is weak and declining.		
(b) Sub-factor: financial ratios (e.g. debt service coverage ratio (DSCR[1]), Interest Coverage Ratio (ICR[2]), loan life coverage ratio (LLCR[3])and debt-to-equity ratio)	Strong financial ratios considering the level of project risk; very robust economic assumptions.	Strong to acceptable financial ratios considering the level of project risk; robust project economic assumptions.	Standard financial ratios considering the level of project risk.	Aggressive financial ratios considering the level of project risk.		

1 The Debt Service Coverage ratio ('DSCR') refers to the ratio of the cashflow available for debt service which can be generated from the asset to the required repayment of the principal and the interest payments during the life of the loan, where the cashflow available for debt service is calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project. Ideally, this ratio should be well above 1.

2 The Interest Coverage Ratio ('ICR') refers to the ratio of the cashflow available for debt service which can be generated from the asset to the required repayment of the interest payments during the life of the loan, where the cashflow available for debt service is calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project. Ideally, this ratio should be well above 2,5.

3 The Loan Life Coverage Ratio ('LLCR') refers to the ratio of the net present value of the cashflow available for debt service to the outstanding debt balance, and refers to the number of times the cashflow available for debt service which can be generated from the asset can repay the outstanding debt balance over the scheduled life of the loan, where the cashflow available for debt service calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project. Ideally, this ratio should be well above 1.

(c) Sub-factor: stress analysis on the basis of the income being generated during the tenor of the loan[4]	The project can meet its financial obligations under sustained, severely stressed economic or sectoral conditions.	The project can meet its financial obligations under normal stressed economic or sectoral conditions. The project is only likely to default under severe economic conditions.	The project is vulnerable to stresses that are not uncommon through an economic cycle, and may default in a normal downturn.	The project is likely to default unless conditions improve soon.
(d) Sub-factor: financial Structure				
• Amortisation schedule (sub-factor component)	Amortising debt without bullet repayment.	Amortising debt with no or insignificant bullet repayment.	Amortising debt repayments with limited bullet payment.	Bullet repayment or amortising debt repayments with high bullet repayment.
• Market/cycle and refinancing risk (sub-factor component)	There is no or very limited exposure to market or cycle risk since the expected cashflows cover all future loan repayments during the tenor of the loan and there are no significant delays between the cashflows and the loan repayments. There is no or very low refinancing risk.	The exposure to market or cycle risk is limited since the expected cashflows cover the majority of future loan repayments during the tenor of the loan and there are no significant delays between the cashflows and the loan repayments. There is low refinancing risk.	There is moderate exposure to market or cycle risk since the expected cashflows cover only a part of future loan repayments during the tenor of the loan or there are some significant delays between the cashflows and the loan repayments. Average refinancing risk.	There is significant exposure to market or cycle risk since the expected cashflows cover only a small part of future loan repayments during the tenor of the loan or there are some significant delays between the cashflows and the loan repayments. High refinancing risk.

[4] The tenor of a loan refers to the amount of time left for the repayment of a loan.

(e) Sub-factor : foreign exchange risk	There is no foreign exchange risk because there is no difference in the currency of the loan and the income of the project or because the foreign exchange risk is fully hedged.	There is no foreign exchange risk because there is no difference in the currency of the loan and the income of the project or because the foreign exchange risk is fully hedged.	There is a difference in the currency of the loan and the income of the project, but the foreign exchange risk is considered low because the exchange rate is stable or because the foreign exchange risk is hedged to a large extent.	There is a difference in the currency of the loan and the income of the project, and the foreign exchange risk is considered high because the exchange rate is volatile and the foreign exchange risk is not hedged to a large extent.
Factor: political and legal environment				
(a) Sub-factor: political risk, including transfer risk, considering project type and mitigants	Very low exposure; strong mitigation instruments, if needed.	Low exposure; satisfactory mitigation instruments, if needed.	Moderate exposure; fair mitigation instruments.	High exposure; no or weak mitigation instruments.
(b) Sub-factor: force majeure risk (war, civil unrest, etc)	No or very low exposure to force majeure risk'.	Limited exposure to force majeure risk.	Significant exposure to force majeure risk which is not sufficiently mitigated.	Significant exposure to force majeure risk which is not mitigated.
(c) Sub-factor: government support and project's importance for the country over the long term	Project of strategic importance for the country (preferably export-oriented). Strong support from Government.	Project considered important for the country. Good level of support from Government.	Project may not be strategic but brings unquestionable benefits for the country. Support from Government may not be explicit.	Project not key to the country. No or weak support from Government.

(d) Sub-factor: stability of legal and regulatory environment (risk of change in the law)	Favourable and stable regulatory environment over the long term	Favourable and stable regulatory environment over the medium term	Regulatory changes can be predicted with a fair level of certainty	Current or future regulatory issues may affect the project
(e) Sub-factor: acquisition of all necessary supports and approvals for such relief from local content laws	Strong	Satisfactory	Fair	Weak
(f) Sub-factor: enforceability of contracts, collateral and security	Contracts, collateral and security are enforceable	Contracts, collateral and security are enforceable	Contracts, collateral and security are considered enforceable even if certain non-key issues may exist	There are unresolved key issues in respect if actual enforcement of contracts, collateral and security
Factor: transaction characteristics				
(a) Sub-factor: design and technology risk	Fully proven technology and design	Fully proven technology and design	Proven technology and design — start-up issues are mitigated by a strong completion package	Unproven technology and design; technology issues exist and/or complex design.
(b) Sub-factor: construction risk				
• Permitting and siting (sub-factor component)	All permits have been obtained	Some permits are still outstanding but their receipt is considered very likely	Some permits are still outstanding but the permitting process is well defined and they	Key permits still need to be obtained and are not considered routine. Significant

			are considered routine.	conditions may be attached.
• Type of construction contract (sub-factor component)	Fixed-price date-certain turnkey construction EPC[5] (engineering and procurement contract)	Fixed-price date-certain turnkey construction EPC	Fixed-price date-certain turnkey construction contract with one or several contractors	No or partial fixed-price turnkey contract and/or interfacing issues with multiple contractors
• Likelihood to finish the project at the agreed time and cost (sub-factor component)	It is almost certain that the project will be finished within the agreed time horizon and at the agreed cost.	It is very likely that the project will be finished within the agreed time horizon and at the agreed cost.	It is uncertain whether the project will be finished within the agreed time horizon and at the agreed cost.	There are indications that the project will not be finished within the agreed time horizon and at the agreed cost.
• Completion guarantees[6] or liquidated damages[7] (sub-factor component)	Substantial liquidated damages supported by financial substance and/or strong completion guarantee from sponsors with excellent financial standing	Significant liquidated damages supported by financial substance and/or completion guarantee from sponsors with good financial standing	Adequate liquidated damages supported by financial substance and/or completion guarantee from sponsors with good financial standing	Inadequate liquidated damages or not supported by financial substance or weak completion guarantees
• Track record and financial strength of contractor in	Strong	Good	Satisfactory	Weak

5 An Engineering and Procurement Contract ('EPC') or 'turnkey contract' refers to an agreement between the engineering and procurement contractor ('EPC contractor) and the developer, whereby the EPC contractor agrees to develop the detailed engineering design of the project, procure all the equipment and materials necessary, construct and deliver a functioning facility or asset to the developer, usually within an agreed time and budget.

6 A completion guarantee refers to a guarantee provided by the contractor to the project's lenders to undertake to deliver the project within the specified timeframe, and to pay for the cost overruns, if any.

7 A liquidated damage refers to a monetary compensation for a loss, detriment or injury to a person's rights or property, awarded by a court judgment or by a contract stipulation regarding breach of contract.

constructing similar projects (sub-factor component)				
(c) Sub-factor: operating risk				
• Scope , nature and complexity of operations and maintenance (O & M) contracts (sub-factor component)	Strong long-term O&M contract[8], preferably with contractual performance incentives[9], and/or O&M reserve accounts[10], although an O&M contract is not strictly necessary to perform the required maintenance because the O&M activities are straightforward and transparent.	The O&M activities are relatively straightforward and transparent, and there is a long-term O&M contract, and/or O&M reserve account.	The O&M activities are complex and an O&M contract is necessary. There is a limited long-term O&M contract and/or reserve account.	The O&M activities are complex and an O&M contract is strictly necessary. There is no O&M contract. There is therefore the risk of high operational cost overruns beyond mitigants.
• Operator's expertise, track record, and financial strength (sub-factor component)	Very strong, or committed technical assistance of the sponsors	Strong	Acceptable	Limited/weak, or local operator dependent on local authorities

8 An Operation and Maintenance ('O&M') contract refers to a contract between the developer and the operator. The developer delegates the operation, maintenance and often performance management of the project to an operator with expertise in the industry under the terms of the O&M contract (i.e. scope, term, operator responsibility, fees, and liquidated damages).

9 Performance incentives or performance based contracting refer to strategic performance metrics which directly relate contracting payment to these performance metrics. Performance metrics may measure availability, reliability, maintainability, supportability.

10 An O&M reserve account refers to a fund into which money is deposited to be used for the purpose of meeting the costs of operation and maintenance of the project.

(d) Sub-factor: revenue assessment, including off –take risk[11]				
• What is the robustness of the revenue contracts (e.g. off-take contracts[12], concession agreements, public private partnership income stream, and other revenue contracts)? What is the quality of the termination clauses[13]? (sub-factor component)	Excellent robustness of the revenues	Good robustness of the revenues	Acceptable robustness of the revenues	The revenues of the project are not certain and there are indications that some of the revenues may not be obtained.
• If there is a take-or-pay[14] or fixed-price off-take contract (sub-factor component)	Excellent creditworthiness of off-taker; strong termination clauses; tenor of contract comfortably	Good creditworthiness of off-taker; strong termination clauses; tenor of contract exceeds the maturity of the debt.	Acceptable financial standing of off-taker; normal termination clauses; tenor of contract generally matches the maturity of the debt.	Weak off-taker; weak termination clauses; tenor of contract does not exceed the maturity of the debt.

[11] Off-take risk refers to the risk that the demand for the output or service does not exist at the price at which it is provided or the off-taker is unable or refuses to honour his commitment to purchase the output or service.

[12] An off-take contract refers to a contract between a producer of a resource/product/service and a buyer (‘off-taker’) of a resource to purchase/sell portions of the producer's future production. An off-take contract is normally negotiated prior to the construction of a facility in order to secure a market for the future output of the facility. The purpose is to provide the producer with stable and sufficient revenue to pay its debt obligation, cover the operating costs and provide certain required return.

[13] A termination clause refers to a provision in a contract which allows for its termination under specified circumstances.

[14] A take-or-pay contract refers to a contract in which it is agreed that a client buys the output or service from the supplier or the client pays the supplier a penalty. Both the price and the penalty are fixed in the contract.

	exceeds the maturity of the debt.			
• If there is no take-or-pay or fixed-price off-take contract (sub-factor component)	Project produces essential services or a commodity sold widely on a world market; output can readily be absorbed at projected prices even at lower than historic market growth rates.	Project produces essential services or a commodity sold widely on a regional market that will absorb it at projected prices at historical growth rates.	Commodity is sold on a limited market that may absorb it only at lower than projected prices.	Project output is demanded by only one or a few buyers or is not generally sold on an organised market.
(e) Sub-factor: supply risk				
• Price, volume and transportation risk of feed-stocks; supplier's track record and financial strength (sub-factor component)	Long-term supply contract with supplier of excellent financial standing.	Long-term supply contract with supplier of good financial standing.	Long-term supply contract with supplier of good financial standing — a degree of price risk may remain.	Short-term supply contract or long-term supply contract with financially weak supplier — a degree of price risk definitely remains.
• Reserve risks[15] (e.g. natural resource development) (sub-factor component)	Independently audited, proven and developed reserves well in excess of requirements over lifetime of the project.	Independently audited, proven and developed reserves in excess of requirements over lifetime of the project.	Proven reserves can supply the project adequately through the maturity of the debt.	Project relies to some extent on potential and undeveloped reserves.
Factor: strength of sponsor (including any public private partnership)				

[15] Reserve risk refers to the risk that the accessible reserves are smaller than estimated.

(a) Sub-factor: financial strenght of the sponsor	Strong sponsor with high financial standing	Good sponsor with good financial standing	Sponsor with adequate financial standing	Weak sponsor with clear financial weakness
(b) Sub-factor: track record of the sponsor and its country/sector experience	Sponsor with excellent track record and country/sector experience	Sponsor with satisfactory track record and country/sector experience	Sponsor with adequate track record and country/sector experience	Sponsor with no or questionable track record or country/sector experience
(c) Sub-factor: sponsor support, as evidenced by equity, ownership clause[16] and incentive to inject additional cash if necessary	Strong. Project is highly strategic for the sponsor (core business — long term strategy)	Good. Project is strategic for the sponsor (core business — long term strategy)	Acceptable. Project is considered important for the sponsor (core business)	Limited. Project is not key to sponsor's long term strategy or core business
Factor: security package				
(a) Sub-factor: assignment of contracts and accounts	Fully comprehensive	Comprehensive	Acceptable	Weak
(b) Sub-factor: pledge of assets, taking into account quality, value and liquidity of assets	First perfected security interest[17] in all project assets, contracts, permits and accounts necessary to run the project	Perfected security interest in all project assets, contracts, permits and accounts necessary to run the project	Acceptable security interest in all project assets, contracts, permits and accounts necessary to run the project	Little security or collateral for lenders; weak negative pledge clause[18]

[16] An ownership clause refers to a provision that states that a project cannot be owned by a different entity than the actual owner (sponsor).

[17] First perfected security interest refers to a security interest in an asset (mortgaged as a collateral) protected from claims by other parties. A lien is perfected by registering it with appropriate statutory authority so that it is made legally enforceable and any subsequent claim on that asset is given a junior status.

[18] A negative pledge clause refers to a provision that indicates that the institution will not pledge any of its assets if doing so gives the lenders less security.

(c) Sub-factor: lender's control over cash flow (e.g. cash sweeps[19], independent escrow accounts[20])	Strong	Satisfactory	Fair	Weak
(d) Sub-factor: strength of the covenant package (mandatory prepayments[21], payment deferrals[22], payment cascade[23], dividend restrictions[24] …)	Covenant package is strong for this type of project. Project may issue no additional debt.	Covenant package is satisfactory for this type of project. Project may issue extremely limited additional debt.	Covenant package is fair for this type of project. Project may issue limited additional debt.	Covenant package is Insufficient for this type of project. Project may issue unlimited additional debt.
(e) Sub-factor: reserve funds (debt service, O&M, renewal and replacement, unforeseen events, etc)	Longer than average coverage period, all reserve funds fully funded in cash or letters of credit from highly rated bank	Average coverage period, all reserve funds fully funded	Average coverage period, all reserve funds fully funded	Shorter than average coverage period, reserve funds funded from operating cash flows.

[19] A cash sweep refers to the mandatory use of excess free cash flows to pay down outstanding debt rather than distribute it to shareholders.

[20] An independent escrow account refers to an account held in the sponsor's name by a bank under the support of an escrow account agreement between the lender and borrower providing for irrevocable instructions from the borrower to the effect that all operational revenue or proceeds from sale of assets of the project will be paid into this account, and where the bank is authorised to make payments from available funds only as agreed in the project financing documents.

[21] A mandatory prepayment refers to a provision that requires the borrower to prepay a portion of the debt with certain proceeds if and when received before the maturity date.

[22] A payment deferral refers to a provision that indicates that the borrower is allowed to start making payments at some specified time in the future.

[23] A payment cascade refers to a provision whereby the project's cash flows are summarised using a cash flow waterfall, which shows the priority of each cash inflow and outflow.

[24] Adividend restriction refers to a provision that defines the circumstances in which the lender is able to prevent equity distributions.