Rating Project Financing

Overview of the methodological rating assignment
to project financings

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Introduction

Project financing is a fundamentally risky undertaking. Similar to venture capital financing for a start-up, financing projects that are only at the planning stage is subject to numerous uncertainties. From a creditor perspective, however, there is a need for a sound assessment of the risk profile of one project compared to other projects.

From a methodological point of view, a project rating is fundamentally different from an issuer rating. Since business models and financial planning of projects are naturally based on planning data and experience values, a quantitative credit rating is only possible to a limited extent. The assessment of the risk profile is ultimately based on the systematic evaluation of mainly qualitative features with regard to project-typical risk and success factors. Thus, when assigning a project rating, a credit rating agency cannot provide a statistically estimated probability of default, but only a sound assessment of the risk profile of a project financing.

Investment grade project ratings are the exception in the private sector. In the sphere of influence of the public sector, on the other hand, project finance often benefits from guarantees or specific subsidies and, at best, from implicit support from the owners. As a result, project financing in Switzerland often occurs within the sphere of influence of the public sector. As an alternative to project financing, financing within the framework of a public-private partnership (PPP) is increasingly being considered.

It is not uncommon for the public sector to enter the market indirectly via its state-owned companies in search of debt capital for project financing. Typical project financing is then also found in the energy production, health care, transport infrastructure, or wastewater treatment sectors.

Rating Concept and Rating Criteria

Risk factors for project financing are systematically identified and assessed by the rating team and subsequently discussed by the Rating Committee. Within the scope of the credit rating process, credit-relevant issues from the following four areas (without being exhaustive) are generally relevant (see also Fig. 1):

- **Project specific risk profile**
- **Structural risk profile**
- **Institutional risk profile**
- **Guarantees and support from public authorities**

The starting point for assigning a credit rating to a project financing is the so-called anchor rating, i.e. the creditworthiness of central owners and/or guarantors of the project financing. Deviations from the anchor rating are then objectively justified due to the different risk profiles of a project financing.

Project specific risk profile

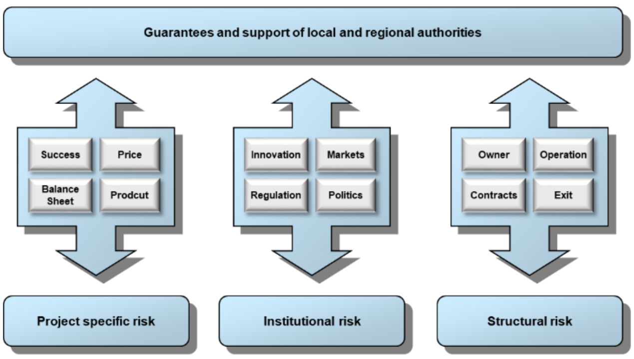
In a first step, the project documents are critically examined with regard to the competitiveness of a business model (project case). The various assumptions and expectations in the planning data are subjected to conservative stress scenarios with regard to the profitability and balance sheet resistance of project financing. The following is a selection of the characteristics tested:

- Competitiveness of technologies and products
- Purchase contracts with price guarantees (cost-covering prices, market prices, fixed prices, etc.)
- Substitutability of suppliers and customers
- Stability and profitability of cash flows
- Earning power and reserve cushion for interest and debt service (scenarios for price and interest rate development)
- Financing horizon, amortization period, and capital structure (ranking)

Structural risk profile

In a second step, the project documents are critically analyzed for the suitability of the planned corporate structure (project structure). In this process, potential sources of risk and threat are subjected to a critical review with regard to the longer-term sustainability of a project's operations. The following is a selection of the examined characteristics:

- Creditworthiness of the owners and ownership structure
- Specific technical experience and operational resources of promoters
- Statutes (competences and duties)
- Risk buffer in the event of a negative scenario (shareholder agreement with dividend lock-in, additional funding obligations, etc.)
- Alternative strategies for the period after capital repayment or deficient business performance (exit)



1 *Assessment of the risk profile of project financing with systematic project-specific risk and success factors*

Institutional risk profile

In a third step, the project documents are critically examined for possible negative developments in the environment of project financing (project framework). This takes into account possible sources of risk that could jeopardize long-term and technologically complex project financing in particular:

- Project-specific market structures and developments (liberalization, internationalization, and barriers to competition)
- Project-specific technological change (length of innovation cycles)
- Regulatory stability and reliability (reform cycle and legal security)
- Political risk for stability of essential project prerequisites (national and international)

With the final assessment of the risk profile of a project financing by the Rating Committee, down-notching from the anchor rating is performed. ■

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