CHECKING THE RIGHT BOXES TO SECURE FINANCING

Watson Farley & Williams' **Lindsey Keeble, Christina Howard,** and **Florian Kutzbach** deliver key financing advice

The ownership, acquisition and development of ports and terminals require significant financial investment and therefore an owner or investor is inevitably going to require external financing in order to secure the funding needed for the relevant acquisition or development.

In the current climate in which ports are competing for customer volume, continued investment (and the funding of such investment) in the infrastructure, superstructures and equipment for a terminal is increasingly important; an operator therefore needs to ensure that it has the correct structure to be able to attract financing to ensure a bankable transaction.

While there are other sources of funding available in relation to ports and terminal projects, including equity investment from local or international partners, it is common for funding to be sought by way of external financing through a commercial loan from a bank or development fund or subscription for bonds.

CONCESSION AGREEMENT

Any lender assessing potential port financing will firstly want to ensure that the key contracts, permits and licences granting the borrower the rights to develop and use the port are, and will remain, valid during the life of the loan.

The main contract in any port project will be the concession agreement (and any local general or special terms and conditions under which the concession has been granted). A concession agreement will usually have been entered into by a national port authority (usually part of the local government) and will typically be governed by the local law in which the port/terminal is located and granted in accordance with local law/regulations/procedures.

Early due diligence is therefore key to ensuring that the relevant local law requirements have been fully complied with in granting the concession and that there is no risk that the concession could be terminated or revoked prior to the repayment of the loan or that the port authority cannot comply with its obligations under the concession agreement as a result of any breach of local process/tendering requirements. This is particularly relevant where the lenders seek to enter into a direct agreement with the granting authority to clarify or interpret the concession agreement to address bankability concerns unearthed during the due diligence phase.

Key bankability concerns that will guide the lenders in this respect include a clear risk allocation and protection in terms of, for example, permissions, change in law, force majeure, liquidated damages (for delay or operational failures), exclusivity, termination and termination compensation as well as step-in and enforcement.

A lender will also wish to confirm whether the concession agreement contains any right in favour of the port authority to withdraw or add conditions to any permits or licences needed for the exploitation of the concession or contains any other contractual rights of termination or revocation in favour of the local port authority. Lenders will also look for relief, at least in respect of time, from any permitting delays.

Any onerous financial provisions under the terms of the concession which may impact the borrower's ability to service the loan will also need to be considered to ensure that the borrower is not potentially subject to significant compensation requirements or penalties in the event of non-performance or breach.

If the relevant transaction being financed will result in a direct or indirect change of ownership of the concession holder, a lender will also need to confirm whether such change will trigger a change of control under the concession agreement (or under any other key documents for the concession or the port project). Breach of change of control provisions may result in a right for the port authority to terminate or revoke the concession and any other contracts which are required for the development/exploitation of the port project or trigger a lengthy consent process.

■ Certain jurisdictions, including Portugal, charge stamp duty if swaps are entered into after the signing of the original loan agreement

■ From left to right: WFW's Lindsey Keeble, Christina Howard and Florian Kutzbach

Any lender financing a port project will wish to include detailed consent rights in relation to any proposed amendments to the terms of or exercise of renewal or other rights by the borrower under the concession agreement.

INCOME STREAM

A key focus for any lender will be the ability of the borrower to satisfy its payment obligations and repay the loan over its term. As with any project financing, this will mean an assessment of the project income stream which, in the case of a port or terminal project, will mean an assessment of the traffic volumes and key customer agreements.

The lender will also need to check how the port is used – is there one main user of the port or are there multiple users? What contractual arrangements are in place with each user; do they have a minimum usage fee or provide a regular income? Can the rights of the borrower under these agreements be assigned in favour of the lender as security for the loan?

If the relevant financing relates to the development of a port or terminal project then there may not yet be an established income stream for the project and the lender will therefore look to take security in relation to the development contracts and will consider direct agreements to enable the lender to have step in rights in respect of the relevant project, including the construction and operational contracts as well as the concession agreement itself (where possible).

As part of any lender's due diligence exercise, risks will be identified as well as potential sources of additional cash flow, which lenders may want to ensure are applied in prepayment of the financing. Care needs to be given to such additional borrower cash events as often such payments are designed to compensate the borrower for losses incurred; for example, if there are indemnity payments due to a borrower under a concession agreement. To ask for these to be applied in repayment of the loan could leave the borrower with financial exposure and put strain on its cash flows, ultimately risking the financing.

As lenders may find that corporate guarantees in relation to the obligations of the borrower are often not available due to the corporate/joint venture structure of a port project and the desire for the sponsors to ringfence their local operations, a key issue will be what other security is available for the loan. Linked to this will be what security is permitted under the terms of the concession agreement and other contracts. In addition to assignments of the income stream, the lender may consider taking security in the form of a pledge over the shares of the borrower or a charge over its business or property/equipment. Any shares pledge will, however, need to be considered in light of the change of control issues highlighted above.

As the borrower is likely to be established in the local jurisdiction, the lender will need to take local law advice in relation to taking security over the relevant entity and local assets as well as the ability to enforce any such security.

ENVIRONMENTAL ISSUES

Depending on the location and nature of the relevant port development project, a lender may require an analysis of the local environmental laws and regulations (and whether the port has 'green port' credentials) and potential liabilities for the owner of the development and whether this could adversely impact the ability of the borrower to service the loan. Compliance with the Equator Principles applicable to project finance banks will be of relevance here.

Additionally, local law advice will be needed in relation to any port financing. In addition to confirming compliance with all local law requirements when the concession was granted, if security for the loan will be created in an overseas jurisdiction, then any relevant local law issues and costs in relation to taking such security should be considered. Relevant costs may include local taxes as well as notarial fees and registration fees in relation to security created in that jurisdiction. Stamp duty/private stamp taxes in particular can be a significant cost if applicable to the loan (particularly if they are a fixed percentage of any loan amount).

Any such costs should be identified at an early stage in order to ensure they are factored into the overall pricing of the loan and structuring of any security. Certain jurisdictions, for example Portugal, also charge a further stamp duty if swaps are entered into after the signing of the original loan agreement which can be mitigated if considered up-front.

Given the scale of a port financing, there may be multiple lenders and facilities covering different aspects of the project, including local development banks. Multiple facilities at different levels (senior, junior, mezzanine etc.) can give rise to complex intercreditor issues. Negotiations with any existing lenders in relation to these issues, such as subordination and cure rights, will need to be considered at an early stage to ensure that in the event of any breach or default, each lender's rights are protected.

In conclusion, when assessing any port/terminal financing proposal, a lender will undertake a detailed risk and bankability analysis, based on thorough local due diligence, in order to identify the key risks. With advice at an early stage from experienced advisors any such risks can usually be addressed or mitigated, allowing the financing to go ahead.

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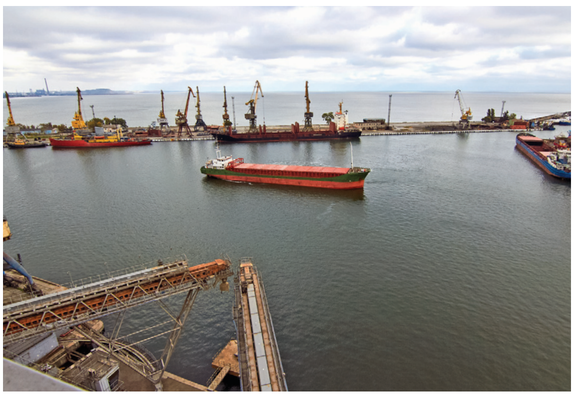
■ **There needs to be a clear risk allocation in concessions**



■ **A lender will check how the port is used and whether there is one main user or multiple users**