

## PROJECT FINANCE TRANSACTIONS BEFORE AND AFTER THE CRISIS BY THE MLA MARKET

Ágnes Csiszárík-Kocsir, János Varga and András Medve

*Óbuda University, Hungary*

Nowadays project financing is a major form for investment financing. Project financing was popular before the crisis because of the relative abundance of money, but after the crisis its importance decreased slightly. The strength of the form is, that it is able to finance large investments with a minimum of equity. The high – in some cases up to 90% - debt ratio, and the large amount of external funding the project financing is adversely affected by the global crisis. The aim of the study is to describe the project financing market before and after the crisis, from 2005 to 2014. The study focuses on the MLA market, as the most important actors in the PF transactions.

**Keywords:** Project financing, MLA market, Crisis, Secondary research.

### Introduction

#### The Theoretical Framework of Project Financing

Many of us associate the term project financing with financing projects. This is inappropriate since project financing is a special form of financing, a type of credit, which is different from traditional corporate financing in several ways. Project financing shows from what resources and in what form and proportion a certain project or investment is financed. This applies to corporate credit, for which there are several forms and constructions, by issuing bonds or simply from own resources, just to mention the two most important ones. Project financing can not be considered together with traditional corporate credit, as it is different from that in several factors. Before speaking about these factors, it is worth studying the definition of the concept of project financing. The economic crisis of 2008 has not been favourable for the spreading of this type of credit, since the abundance of money and later, the recession jeopardised several projects. The definitions in literature describe the essence of project financing as follows:

- Newitt – Fabozzi, 1997:  
“The financing of a given economic entity, which is considered by the creditor as its cash flow and revenue serves as the source to pay the credit back, its assets being the collateral.”
- Yescombe, 2008:  
“Project financing is the method of long-term crediting of larger projects where the granting of loans is carried out entirely based on the cashflow of the project.”
- Nádasy – Horváth – Koltai, 2011:  
“By the concept of project financing we mean the financing of such individual business investments in which the owners and external investors primarily consider the cashflow and

assets of the given investment as a basis when they examine the return of their invested capital and the opportunity of paying back the granted credit.”

### **Project Financing as Syndicated Loans**

Syndicated loans are such specific loans where the loan is provided by a group of two or more creditors within one loan contract. Syndicated loans are positioned between traditional and market based loans. The creditors are connected with each other on a market basis, and provide the requested sum as one creditor to the borrower. The lead arrangers (LA) <sup>1</sup> are usually larger commercial or development banks who raise the requested loan, divide it among themselves from the point of view of its allocation, agree about the details of the memorandum of information, and involve further partners in the financing process (Mora, 2010).

The process of syndicated loans carries considerable asymmetry from the information side, i.e. it embodies the problem of the principal-agent so well-known in corporate financing. LA banks possess a lot of information which is not or hardly known by the members of the syndicate.

The concept of syndicated crediting is not a novelty in the practice of banking. It appeared in the 1970s already, since a lot of banks were unable to meet the increased credit needs. This way, they could give credit to several promising projects, in the form of a consortium. Due to syndicated loans and venture capital investments banks were able to widen their range of products, thus increasing their profitability. Syndicated loans reduce the bank's exposure towards the client, and furthermore, they are able to involve other participants in the project. If there are multilateral and regional investment banks among the participants, it ensures a guarantee for the given project, therefore several commercial banks get involved in financing, reducing the political risk of the given country. Syndicated loans carry great importance all over the world, both in developed and developing countries (Eperjesi, 2013). Kopecky and Xiao signify three participants of syndicated loans, namely the company taking the loan, the bank giving it, and the local bank. Banks are divided into two further groups on the market of syndicated loans, those possessing high or low reputation. It is proven that the higher the reputation of a bank the larger its role on the market of syndicated loans (Kopecky – Xiao, 2013). LAs possessing higher reputation are able to reduce informational asymmetry as well. The reputation of LAs is, however, not static but very fragile, it can be seriously damaged if the members of the syndicate do not fulfil their responsibilities (Gopalan et al, 2011).

Syndicated loaning produced a huge increase before the outbreak of the global crisis in 2008, however, it fell back after it in an unprecedented degree. The upheaval before the crisis was due to the good monetary status of the financial enterprises, insurance companies, investment funds, and pension funds participating in syndicates, which gave a part of their assets as loans in this form in the hope of better profits. The losses of the financial and capital markets due to the crisis resulted in the loss of faith as well as financing eagerness of the participants, which affected the market of syndicated loans as well.

### **Material and Method**

Project financing as a form of credit calculates with large sums of loans, either unable or not allowed to be provided by one bank due to the large risk involved. Project financing thus is not able to lack the technique of syndicated crediting. In this study we intend to present the development of project finance loans through the main leader arrangers' market (MLAs) according to the database of IJGlobal. The data appearing in the study include the data of the financially closed deals of the given year by the MLAs. The data are not filtered according to regions or sectors, i.e. they include all transactions closed by a given sponsor in a given area. The study analyses the market of the main leader arrangers horizontally and vertically, i.e. according to geographical regions and time periods. The primary data concerning project

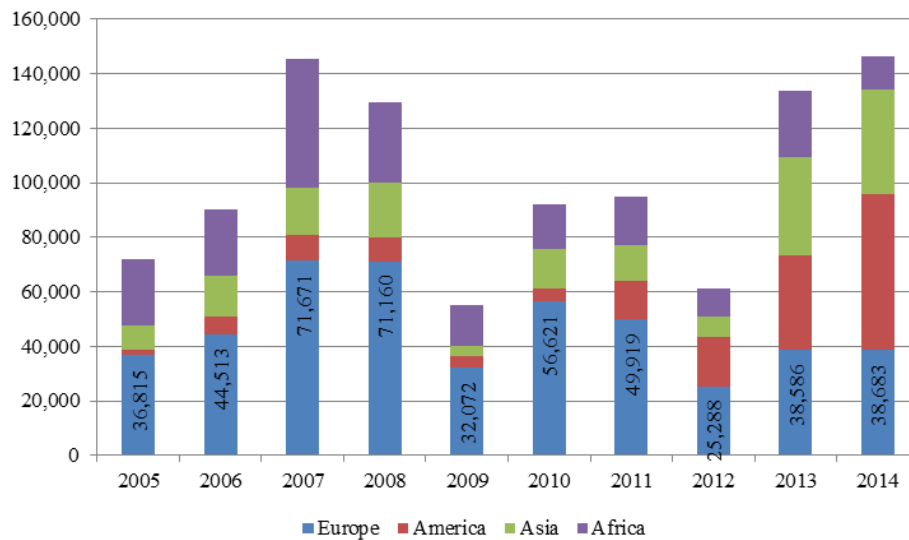
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<sup>1</sup> LA = Lead Arranger

financing come from the IJGlobal site maintained by Euromoney. These data have been accessible since 2005 so the study analyses a ten-year period. The data include the data of projects financially closed in the given period.

**Results**

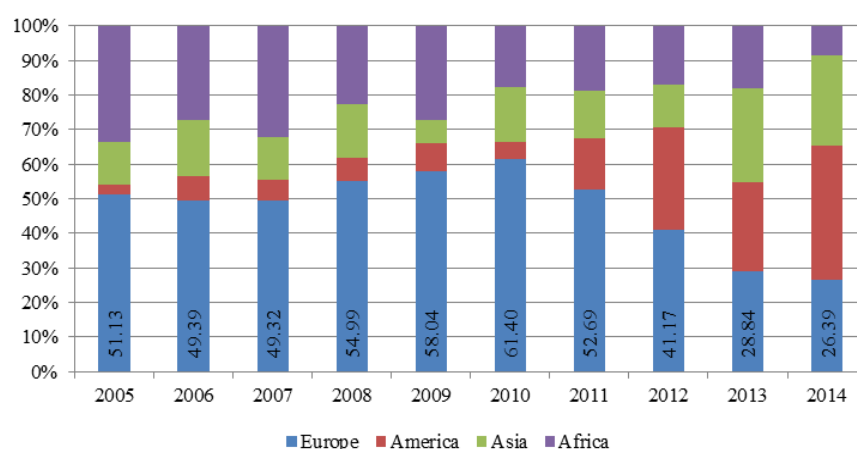
The market of project financing and therefore, the amounts invested by MLAs have considerably changed during the past years. The crisis deeply affected the financial world, and therefore the market of project financing as well. The growth theories prevailing these days put investments and, besides them, human capital in the centre (Farkas, 2012). Financing investments because of their volume, size and complexity is unimaginable without foreign capital today. Project financing being a structured financial product finances great projects with a considerable leverage, great risk and considerable return. The crisis, which began in 2008 and soon infected the entire financial market of the world, started from the market of structured products on interbank markets (Kiss, 2012), therefore, it is not surprising that the market of project financing has also been effected by its negative results.



**Figure 1.** The development of amounts invested by MLAs in project financing by region, between 2005 and 2014 (million USD)  
 Source: Own editing according to IJGlobal

Examining the MLA market it is not only the invested amounts that are interesting but also their share according to continents. It can be seen in the figure above that before the crisis, and even after it (until 2011) Europe possessed a larger amount alone than the three other regions together (with the exception of 2006 and 2007, when the proportion of Europe is slightly smaller than 50%). The proportion of Europe comprised 51.21% of the whole MLA market between 2005 and 2008, then this proportion grew to 57.38% in the following three years, the average amount becoming only 32.13% between 2012 and 2014. Therefore, after the beginning of the crisis the drawback of Europe is apparent, in the last two years the continent did not even reach 30% of the complete MLA amount. It is interesting that while Europe carries the effects of the crisis America began soaring after it. Before the crisis, between 2005 and 2008 America possessed a value of 5.77%, which is the smallest proportion considering the examined four continents. Immediately after the outbreak of the crisis this proportion nearly doubled, and became 9.3% between 2009 and 2011, then the average of the following three years (31.49%) almost reached the

European average. Looking at America, the highest proportion, 38.97%, can be seen in the last year, which means the largest amount of all the four continents. Asia, like America, also started an increase after the crisis, showing an average value of 14.08%, then dropped slightly to 12.12%, and between 2012 and 2014, became 14.08%. The last examined year, 2014, is also determining for Asia, since the proportion of the continent within the entire MLA value is 26.24%, only 0.15% points behind the European data. Africa is the region which was not able to return to the starting point either in its value or proportions. Before the crisis the projects realised there by MLAs comprised a proportion of 28.94%, which became 21.2% after the crisis, only having a proportion of 14.48% in the last examined period. The reason is that the most important investments in order to exploit social, irrigation, oil, gas and renewable energy sources had already been carried out before the crisis, therefore the investment potential of the area has also decreased.



**Figure 2.** The development of the proportion of amounts invested in project financing by MLAs by region, between 2005 and 2014 (%)

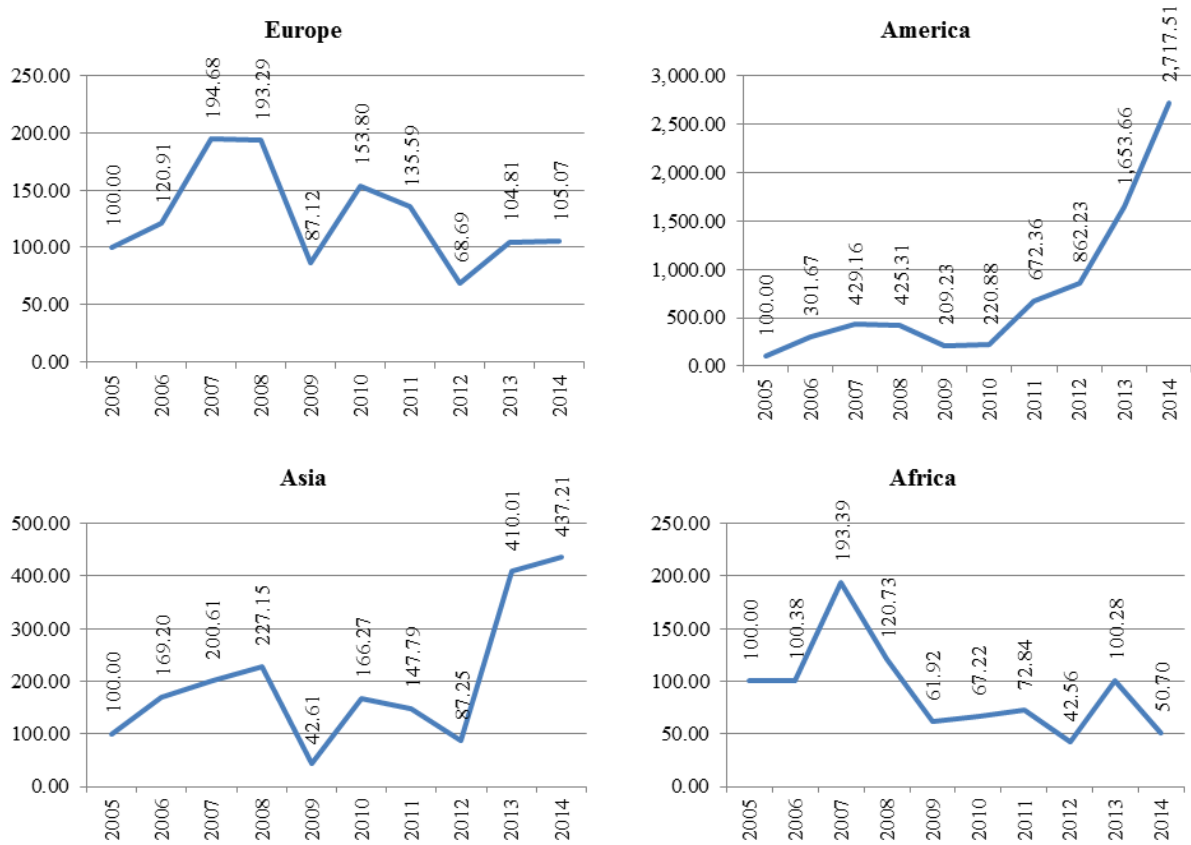
Source: own editing according to IJGlobal

If we examine the change of volume of amounts invested by MLAs according to 2005 it can be stated that they changed very hectically during the examined years. In Europe the years following the base period showed a significant increase, therefore the MLA value before the crisis was nearly double of the value of 2005. The crisis affected the European MLA market so deeply that the value hardly exceeded the value of the base period by 5%. After the outbreak of the crisis (in 2009) the value decreased by 12.88%, compared to the base period. The second great fall back from the base period can be seen in 2012 when the volume of the MLA market fell back from the data of the base period by 31.31%. In the background of the drop back we can observe the economic difficulties resulting from the Greek crisis influencing the whole world, and furthermore, the decrease of state investments. Since the investments carried out by project financing are long term the cause of the decrease in 2012 might be the low number of projects started in 2007 and 2008.

In Asia the MLA market gained an even larger impetus after the base period. The value of volume more than doubled compared to the base period (227.15%), and after that fell back to 42.61%, compared to year 2009. It is curious that soon the Asian market recovered, but plummeted again in 2012, due to similar causes as in Europe, even if in a smaller degree (12.75%). About Asia it has to be highlighted that following the low point of 2012, in 2013 and 2014 it quadrupled, compared to the base period.

The African MLA market fell considerably after the crisis, just like the previously examined two continents, decreasing in 2009 by 38.08%, according to the data of the base period. Interestingly, the African MLA market was unable to achieve the level of 2005 until 2013 when, hardly exceeding 100%, it had a significant further decrease of 49.3%

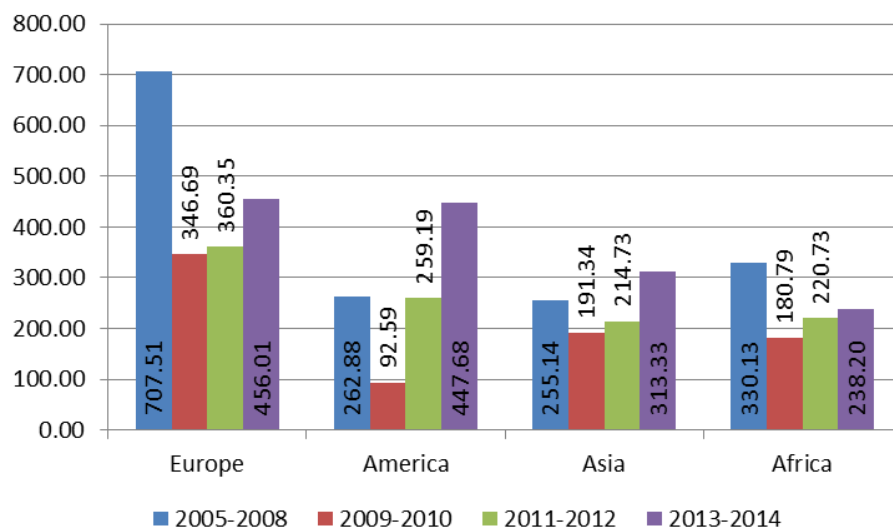
America is the only examined region where there was no decrease in the average of the 10 years. This is due to the very low starting value of 2005. The data are not so outstanding if we take the year 2006 as base period. However, taking the same base year of 2005 as with the previous three continents it can be observed that following 2010 the data show a significant increase never seen before. While in 2012 every other region fell back the American data became eight times that of the base period, which increased even faster in the following years (being 16 times in 2013, 27 times in 2014 that of the base period)!



**Figure 3.** The change of volume of amounts invested in project financing on a basis of 2005  
 Source: own editing according to IJGlobal

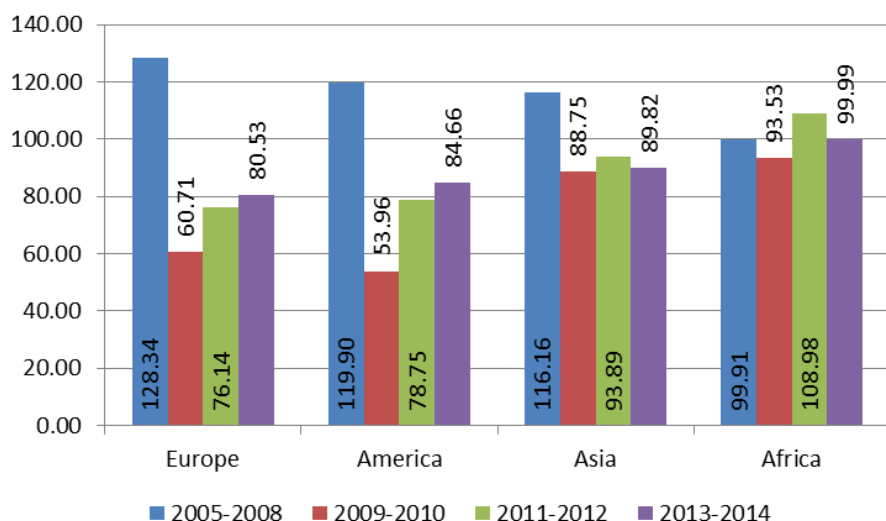
It is worth examining the development of deal values by individual MLAs after the previously shown data. As the following figure shows it is obvious that no continent could compete with the value of Europe before the crisis. While a European MLA had an average of 707.51 million USD in deal value, in Africa only half of that was observed, slightly higher than the remaining two regions. After the crisis, between 2009 and 2010 the European data halved (346.69 million USD), America fell back to its third, Asia and Africa also decreased, although not in such extent. In the following two years an increasing average deal value is typical of each region, which increased further in the last two examined years. The largest increase was produced by America between 2013 and 2014, which is not surprising, considering the above mentioned facts.

It is interesting that, if we look at the average deal value of the four continents, a typical ‘U’ shape can be seen, with its low at the breakout of the crisis and its indirect effects. After that all regions started to grow. In the case of America an irregular ‘U’ shape can be observed, as it is higher than in the other three cases. This shape can be connected to the scenarios of the crisis (‘V’, ‘L’, and ‘U’ shapes).



**Figure 4.** Average deal value by individual leader arrangers (million USD)  
 Source: own calculation according to IJGlobal

After examining the average deal values it is worth looking at average transactional values as well. While it can be stated that deal values which started from a peak before the crisis and after a short period of low returned to higher values, transactions show different values. In Europe and America, after initially high values (128.34 and 119.9 million USD), they fell considerably between 2008 and 2009. During this period both continents’ transactional values halved, and it can be seen that in the following years they were only able to proceed upwards slowly and gradually. Meanwhile Asian and African transactional values were jumping up and down. The crisis decreased their values but not so drastically as in the case of the previous two regions. It is also interesting that, apart from the considerably high average values of 2011-2012, between 2013 and 2014 both fell back, although only in a small extent. In the case of Africa it has to be highlighted that it was the only continent where the average transactional value exceeded the level before the crisis by 2011-2012, being the highest in the four regions, which was not typical in the other three regions.



**Figure 5.** Average value by individual transaction (million USD)  
 Source: own calculation according to IJGlobal

Another interesting fact related to the last two figures is that the fall back of 2012 cannot be seen in either. This is due to the small correction of the data in 2011, but it is not enough to show growth. The number of projects compensates for the low MLA values of 2012, which decreased in par with the values in the examined period.

## Conclusion

As the article shows project financing is very significant for investments. Project financing loans represent a huge burden for banks, due to their amounts and loan periods, therefore the form of the credit can only be a syndicated credit. The leader arrangers who collect the necessary sources for syndicated loans, allocate them, manage the deals, moving bigger sums than the sponsors of the projects. The activity of leader arrangers can be well seen in every examined continent. It is apparent from the aggregated data that every crisis affects the MLA market to a certain degree. It can be observed that the average values are not as hectic as the aggregated data, and in each case a certain pattern is visible. Since project financing is an important field of investment loans, if we look at the data above, we can be optimistic that the values financed by MLAs will increase in the future, allowing strategic investments, which are important domestically and internationally as well.

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