

METHODOLOGY FOR CREDIT RATING OF PROJECTS

The methodology for credit rating of projects gives an answer to what risk factors should be assessed in order to establish the credit risk inherent for a given project. This methodology has yet another purpose: to give an answer to how such risk factors should be appraised, and which of their values/quantities should be deemed positive or negative from the rating viewpoint. BCRA subsequently reviews the financial strength of Sponsors and the risks under the Projects: financial risk, risk of non-completion, operating risk, market risk, counterparty risk, political and regulatory risk, force majeure risk, and the legal structure between the participants in the Project.

Analysis of the Project Sponsor

Definition of a Sponsor. Alternatives for the Sponsor's structure. Company with special investment purpose.

The firms create different organization structures with view to the implementation of projects. Such structures have distinctive functions, depending on who procures the financing and the management of the Project, on the contractual relations with counterparts, and other similar factors.

In general, the Sponsor is the company standing behind/supporting the Project. The implementation of the Project, as well as the exact and timely meeting of the liabilities thereunder, depend on the financial strength of the Sponsor and on its capability to take part in the Project management. The presence of several Sponsors under the same Project is also possible.

The alternative of a particular company taking part in a particular project, by establishing for this goal a daughter company with special investment purpose, is regarded by BCRA as the clearest alternative for a Sponsor's structure.

The assets and liabilities of the newly formed Company with special investment purpose would, to a large extent, be managed by the Sponsor or operator under the Project.

The main functions of the company with special investment purpose are to carry out the operating management of the implementation and operation of the Project, to maintain and collect the operation income from the newly constructed tangible assets, to monitor (jointly with the Sponsor) the execution of the investment plan and the serving of the liabilities under the Project.

Analysis of the financial strength of the Sponsor

The Sponsor may have considerable merit for the implementation of the Project and for the exact and timely redemption of the liabilities thereunder. In this context, the assessment of the financial strength of the Sponsor is of primary importance for the assessment of the creditability of the Project.

BCRA assesses the market risk of the Sponsor, its shareholding structure, its overall financial state, and elaborates a financial projection of its cash flows.

Assessment of the Project risks

Risk from non-completion

The risk from non-completion relates to the incapability of a given project to be implemented on time, as per its fixed budget and as per the scope of the applicable standards. Related to this, BCRA assesses the risks related to the fixed budget limit of the Project, to the possible delay in its execution terms, to the quality and complexity of the technology and the tangible assets of the Project, to the creditability of the Project contractors, etc.

Operating risk

BCRA reviews - as operating risk - all potential dangers, which may lead to the Project's inability to function at its forecasted levels of effectiveness. When assessing this risk, the following is being considered: the presence of contracts with, and of guarantees from the supplier of the equipment for the Project, as well as of contracts for maintenance of the equipment during the Project operation. BCRA also reviews the experience of the main contractors under the Project. The level of operating risk is also related to a number of factors of purely technological nature.

Market/System risk

BCRA assesses the market risk of a given project by elaborating a sector analysis of the market, where the products of the Project operation will be placed. Reviewed are, in turn, the risk from the state of the branch, the structural risks, and the overall system risk of the market, where the product/service of the Project will be placed.

Counterparts'/Partners' risk

Depending on the structure of the financing transaction of the Project, BCRA reviews the interrelationships of the Sponsor and/or of the company with special investment purpose with all counterparts taking part in the Project implementation. In this chapter of our Report, at BCRA we assess the reliability, and the contractual position of each counterpart, since this has direct relation to the Project vitality.

Political and Regulatory risk

The implementation of a Project carries an element of political and regulatory risk, because it is often associated with the building of specific infrastructure. Additionally, the end-product/service, which the Project shall (either directly or indirectly) 'produce', would generally be consumed by large social groups.

The political and regulatory risks are difficult to be assessed qualitatively. For this reason, when analyzing them, BCRA mostly focuses on how much the separate phases/stages of the Project are vulnerable to any possible changes in the macro-economic environment – be they of political or legal nature.

Risk from force majeure circumstances

The money generation under the Project depends to a large extent on the tangible assets built. Meaning that BCRA reviews the force majeure circumstances, which may damage or destroy such assets, or lead to a delay (or total default) of the opportunity to construct them. Force majeure circumstances are deemed all natural, political and other cataclysms (floods, earthquakes, civil commotion, riots, strikes, and the like), which are of unforeseen nature. Force majeure circumstances may also be errors and averages of the tangible assets, which are of mechanical nature, and are due to human or system error. The occurrence of such events may bring to failure of some of the parties under the contracts to meet their liabilities. BCRA assesses the risk from force majeure circumstances with each of the counterparts of the Project.

Financial risk/Funding risk

The analysis of financial risk has the purpose of reviewing the opportunities for securing of the funds necessary for the Project implementation, and of assessing the expected financial state of the Project. BCRA assesses the risk factors, which could endanger the raising of funds, and the factors, which – respectively - could endanger the creditors.

The main aspects, which are reviewed in the above relation, are the capital structure of the Project, the financial indicators of the company with special investment purpose, and the latter's capability to attract additional debt capital. BCRA also reviews the expected cashflows under the Project, and assesses these in the context of the redemption of the attracted resources.

Assessment of the contractual relations

BCRA reviews the legal structure of the Project. Meaning that we assess the adequacy of the contractual relations between the Project participants.

Main rating categories for awarding of credit rating of Projects:

PFR1	Very strong Project – the creditworthiness of the Project is high. The risk factors of the Project are low.
PFR2	Strong Project – the creditworthiness of the Project is high. The risk factors of the Project are relatively low.
PFR3	Project with moderate strength. The creditworthiness of the Project may be influenced (in moderate limits) by changes at the market and the economic environment. The risk factors of the Project are moderate.
PFR4	Project with unsatisfactory strength: the creditworthiness of the Project is not satisfactory. The financial liabilities undertaken under the Project can only be met in case favorable prerequisites do exist. The risk factors of the Project are relatively high.
PFR5	Project with very low strength: The creditworthiness of the Project is low, and the financial liabilities undertaken cannot be met on time. The risk factors of the Project are high.

Category „+” and „-“ may be added to each of the main rating categories, apart from P1 and P5. These categories reflect the existence of certain factors, serving as grounds to consider that the rating of the Project may become deviated from some of the main categories.