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Project finance panorama all over the world and in Europe during the pandemic

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Abstract: Project finance as a special structured finance product is a product of modern banking finance. Covering a great area since the 2000s, it is a risky but high-yielding form of credit, and a key instrument for financing large projects. In recent decades, this form of financing, which was brought to life by the abundance of liquidity before the 2008 crisis, has given rise to a number of projects of major importance worldwide, not only in economic fields but also in social fields as well. It is a popular form of financing for energy projects, telecommunications, transport infrastructure and even social facilities. However, its high risk and high amounts make it very sensitive to any economic changes. If we look at the crisis of 2008 and the periods that followed, this kind of sensitivity is very evident when we look at the data. With the secondary research presented in our paper, we want to investigate to what extent the crown crisis, which escalated in 2020, affected this type of banking products, what changes the crisis caused in project finance, inferring the extent and impact of the crown crisis.

Keywords: structured finance, project finance, pandemic, global trends

1 Introduction

The 21st century has significantly enhanced the value of management techniques that increasingly help operators to deal with complexity, difficult tasks and new challenges in a rapidly changing business environment. A few centuries ago, it was this need that gave birth to the roots of project management and project finance, which have now grown into a very serious management field, even a science. After the Second World War, but especially after the 1980s, interest in both areas increased considerably. Both have developed in parallel and very rapidly, as project management and project financing are inseparable processes. Given that projects



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also have budgets, the financial aspects cannot be ignored. However, the success of a project depends to a large extent on the type and risk of resources available for its implementation. Project finance is about more than just associating financial resources to projects. It is a much more complex category, involving financial planning, estimating and monitoring cash flows, analysing risks and the ethical and moral responsibility of economic operators. It is not only the project itself that is complex, but also the specific financing technique that seeks to provide an appropriate financial solution to achieve project success. The importance of the subject, not only today but also for the future, makes it extremely important to study and understand it.

2 Project finance as a source of funding for projects

Project finance is a financial activity closely linked to project management. Given that it costs money to implement a project (given that it has a budget), we cannot ignore the question of what resources are available to ensure its implementation. As with project management, the origins of project finance go back a long way. First observed in mining activities in the 13th century, this specifically structured form of financing was really appreciated after the Second World War, similar to the rise of project management (Finnery, 2007; Szalay, 2011). While in project management the project itself is the object of study (Verzuh, 2006), in project finance it is the cash flows from the project that really make the analysis important. Also, projects became really important for organisations after the 1970s, when the economic complexity of both the global economy and organisational markets slowly reached untraceable proportions (Verzuh, 2006; Gareis, 2007). Project management can be seen as the management of complex and novel tasks that could no longer be satisfactorily solved by traditional processes.

The project itself is specific in that it is a unique task with a precise objective and expected outcome, a budget, a deadline and a defined resource requirement (Görög, 2001). Not only the uniqueness of the project, but also, over time, its financing started to show very specific characteristics. The form of financing associated with projects itself has evolved until it is now a specialised area of project financing. The role of project finance became increasingly important after the 1980s (Brealey et al, 1996). In the 1990s, project finance was mainly used for large-scale investment projects, such as offshore oil field development or remote mining operations (Gatti, 2013). Today, it is also increasingly found in medium-sized projects. At its core, it consists of financing a specific economic entity created by sponsors and in which the lenders share the risks. And the financial resources are provided exclusively to the project (Pinto, 2017). Lenders are paid almost entirely or exclusively from the cash flows generated by the new project. The borrowers create an SPE, or Special Purpose Entity, which has no other function than to develop, own and operate the



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project object. Elsewhere, the same is referred to as SPVs, or Special Purpose Vehicles. The repayment of the funds raised to finance the project is secured by the cash flow of the project and the assets of the project (Basel Committee on Banking Supervision, 2004). The same idea is shared by Finnerty (2007), who argues that the cash flows from the project are considered as the source of their services (Wibowo - Kochendörfer, 2015) and that this also provides the return and the return on investment (Finnerty, 2007). The specificity of project finance can be seen through the creation of SPVs. This implies the creation of special project vehicles (SPVs), which are legally independent. Investments in these SPVs are finite and last for a limited period of time (Walter, 2017).

Similar ideas are expressed by Young (2015), who argues that project finance is an alternative financing mechanism for structural development and that project financing depends on the project itself, rather than on sponsors and lenders. He also mentions that these financing techniques involve significantly more risk than traditional lending (Young, 2015). Project finance is an extremely risky activity (Yescombe, 2002) and even riskier in developing countries (Young, 2015), so the risk analysis and financial planning behind it is not entirely straightforward. Project finance can thus be considered essentially as asset finance, with the repayment resources being generated by the project (Kónya, 2009). Project finance has found applications in an increasing number of sectors of the economy. It has become popular for investments in the energy sector, transport, infrastructure development, telecommunications or real estate development (Madácsi, 2013). Similar findings were made by Szalay (2011), who argues that project finance can also be found in tourism, public services, health and, last but not least, agriculture.

Project finance can be considered as a form of credit and is a fairly new area among the types of lending (Csiszárík-Kocsir, 2016). In this paper, we also see references to authors such as Newitt and Fabozzi (1997) and Yescombe (2008), who have provided very well-known definitions of project finance. Newitt and Fabozzi's definition is very similar to the one defined by the Basel Committee on Banking Supervision, while Yescombe (2008) also highlights the need for financial planning behind project finance, and he also mentions the importance of project cash flows. The above-mentioned 2016 article also sets out the target areas for project finance, which include, in addition to those mentioned above, the construction of motorways, paper production, the chemical industry and airports. It is clear from these examples that project finance is covering an increasing range of investments in the economy and is indeed becoming a popular financing technique. Yescombe (2008), in his book *Fundamentals of Project Finance*, reiterates the importance of financial planning and the planning of cash flows from projects. In his view, the greater the risk to which future cash flows from a project are exposed and the more uncertain they are perceived to be, the greater the investor's fears about the certainty of return. The author sees project finance as a financial planning tool to support the longer-term financing of projects (Yescombe, 2008). The importance of financial



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planning, indicators and equity is also highlighted by Kónya (2009). He also mentions that the financial part of project financing is not the only part of the process that is planned and organised, but that the whole project financing process itself requires a defined sequence of steps. In his view, five distinct steps should be mentioned when describing the project finance process. A review of the literature confirms the notion that this is indeed a well structured and planned process. The techniques of structured finance that have been constantly being developed over the last decades are clearly visible. It can be seen as a financing solution that focuses on well-defined, long-term objectives while creating the partners needed to achieve success and a framework that makes it possible to manage and share the risks inherent in the project (Nádasdy et al, 2011). In addition to the financial aspect of project finance, other risk factors need to be carefully considered. Berlinger et al (2015) raise a very interesting aspect in their paper. In the authors' view, it is not enough to conduct a purely financial analysis to assess project risks, given that financial indicators cannot be sensitive enough to factors such as actor behaviour, morality or ethics.

There are basically two ways in which economic operators can behave and this can have a major impact on the success of the project and therefore on the effectiveness of the project financing itself, or the return on investment of the project. The actors involved in a project will either do their utmost to ensure the success of the project or they will prioritise the maximisation of their own benefits. The maximisation of private benefit is contrary to the interests of the financier, not to mention the fact that improving the quality of the project is not the first priority during implementation. In addition, successful projects and the efficiency of project financing itself strongly require the right project manager (Greek, 2013; Verzuh, 2006; Gareis, 2007). The quality of project management is essential in this process, but is not the subject of this study. Whatever the project management, the risks that arise during the project need to be constantly monitored. Investment risk, operational risk and revenue risk should be carefully assessed before financing a project. These risks should be shared between the project sponsors, the lenders and the other project participants, otherwise there is a risk of failure and loss (Jenei, 2017). In this way, project success can indeed be in everyone's interest, as there are profit strings attached. If well designed and structured, project finance can be a useful tool to help raise finance, make the project a success and achieve its objectives, as well as to help investors achieve their interests and objectives.

3 Material and method

Refinitiv's report for 2019 and 2020 was used for the study. From this report, we worked with the data that is aggregated from the project financing stock data for 2018, 2019 and 2020. We were interested in the extent to which the pandemic crisis

is affecting the project finance situation. What were the areas that were given higher priority in terms of amounts financed and number of projects financed as a result of the pandemic. The European situation is specifically addressed in the study, looking at the situation in the main target countries in both Western and Eastern Europe, with a particular focus on Hungary and its neighbouring countries. The paper presents the data in a descriptive manner, which is interpreted in a comparative way in the results section.

4 Results

Project finance, like all other forms of debt finance, is very sensitive to changes in the global market. Project finance reacts immediately to global market movements because of the large amounts and long maturities involved. In the event of a crisis, the amounts and number of deals are immediately reduced, thus holding back the development of large projects. Looking globally at the evolution of the amounts financed for projects, it can be seen that in 2019 there was a significant increase compared to 2018, as a 7.9% increase. In 2020, the amount financed compared to the previous year was only 89.5%, which is below the 2018 level. In the case of the Americas, a steady decline is visible, but in contrast, emerging countries, including Africa and Europe, have been able to grow significantly both compared to the previous year and compared to 2018. Asia and the Pacific jumped in 2019 but saw a huge drop in 2020 (70.5%), representing only 81.2% of the 2018 value. These figures show that investors see Europe and Africa as new potential destinations, while Asia is perceived as a risky place to invest. The decline in the US is visible because in previous years the US has highly outperformed other continents in terms of project finance and investors' risk assessment is also driving down the amounts invested there.

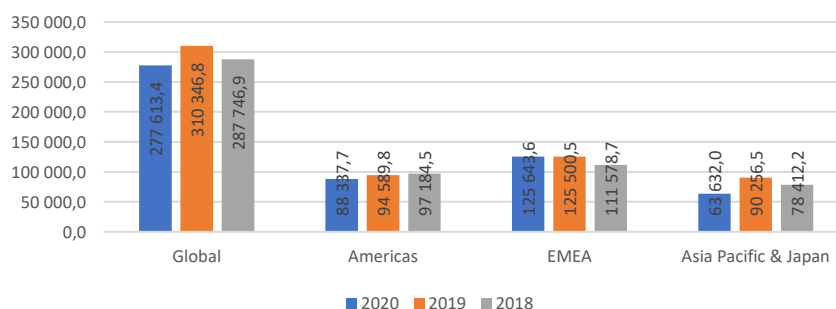


Figure 1: Value of project finance in each region of the world between 2018 and 2020 (USD million)
Source: own editing, based on Refinitiv 2019, 2020



It is also worth taking a look at the distribution of project funding between industries. In terms of amounts, it can be seen that the energy industry has slightly decreased by 2020, so that it is hovering around the 2018 value. It can also be seen that oil and gas investments have increased for all the years considered compared to 2018. Telecom project finance amounts have also increased in 2020, and industrial outsourcing has also changed significantly. In terms of telecom outsourcing, it can be seen that in 2020 the amount outsourced was double the amount in the previous year, which also represents a 60% increase compared to 2018. Industrial investments in 2020 were also double the amount of the previous year, which also shows an increase of 36% compared to 2018. In contrast, mining is steadily losing value, and the chemical industry is also showing a very hectic trend. There has also been a very marked increase in the amount of project funding for waste treatment and recycling. While 2019 saw a terrible drop, the amount for 2020 has already increased sevenfold. Similarly, the amount of project funding for water and sanitation shows a huge jump within a year. All this suggests that investors are increasingly supporting the financing of projects related to basic utilities, but the 2020 data clearly shows the advance of the oil and gas and telecoms sectors. This not only shows the impact of the pandemic, but also highlights the energy crisis that could escalate in 2021.

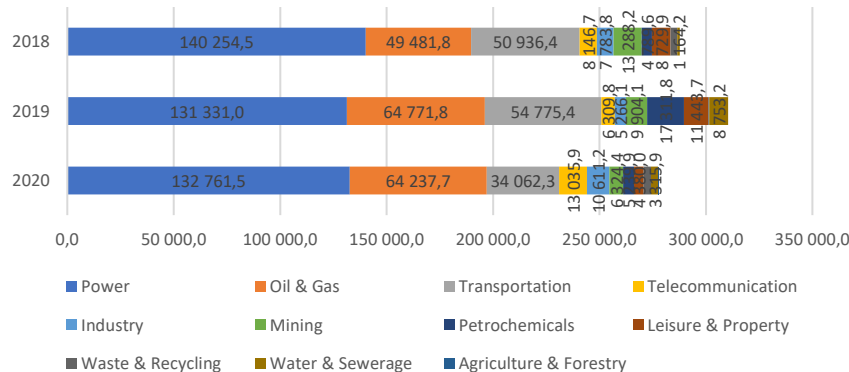


Figure 2: Value of project finance by industry between 2018 and 2020 (USD million)

Source: own editing, based on Refinitiv 2019, 2020

The value of the amounts financed per transaction is also very telling. It is clear to see what could be concluded from the amounts. America has the lowest value per transaction, which is also below the global value per transaction. Europe and Africa show a steady increase in values. Asia shows the most hectic jumps. While it had the highest value in 2019, by 2020 it had fallen back, falling behind Europe. The data clearly demonstrate the trend just described. The investment destinations that currently dominate the project finance market are clearly visible.

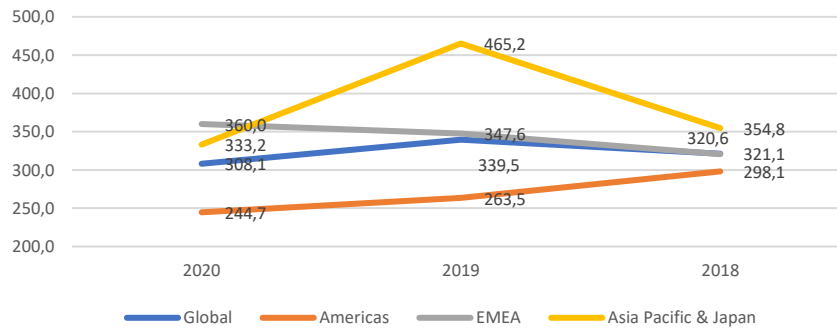


Figure 3: Average transaction value of project finance in each region between 2018 and 2020 (USD million)

Source: own editing, based on Refinitiv 2019, 2020

It is also worth looking at industry values in terms of values per transaction. It can be seen that there is a huge variation between sectors. The largest values per transaction are in the oil and gas, telecommunications and chemicals sectors. In addition, waste management and recycling have high values. In 2020, the oil and gas industry has the highest value per transaction,

In 2019, the chemical sector was clearly the highest. It is interesting to note that telecoms only had the highest value per transaction in 2018, due to the high cost of investment.

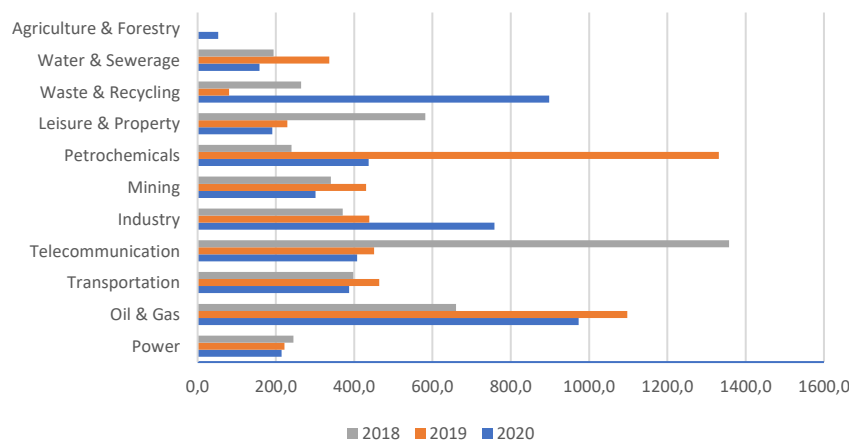


Figure 4: Average transaction value of project finance by industry between 2018 and 2020 (USD million)

Source: own editing, based on Refinitiv 2019, 2020

We now turn to the European picture. It is clear that Western Europe continues to be a prime target for project finance compared to Eastern Europe. The top two countries were clearly the best performers in 2019 and 2020, but Spain came third in terms of the amount of project funding.

In these countries, energy investments were the main beneficiaries of project finance. The largest investments were in renewable energy, with a high proportion of wind farms financed from this source of finance. In France, another telecoms investment stands out in 2020, with a high value in terms of project financed amounts. In Eastern Europe, Turkey, Russia and Serbia topped the ranking in 2018. In 2019, Russia and Turkey continue to lead, but interestingly, Hungary has also been ranked in the top spot. In 2020, Russia was followed by Poland and Croatia with a mixed bag of energy investments.

Table 1: Project funding values for European countries between 2018 and 2020 (USD million)

	2018	2019	2020		2018	2019	2020
Western-Europe	79 824,2	75 959,6	75 359,4	Eastern-Europe	12 411,6	24 471,2	6 865,4
United Kingdom	22 843,1	26 249,8	21 672,7	Russia	1 927,2	16 789,8	2 023,3
France	8 454,7	11 910,5	15 591,8	Turkey	8 001,1	4 918,3	1 027,1
Spain	4 973,5	11 727,1	15 555,2	Hungary	246,3	989,9	230,4
Italy	16 598,4	5 636,9	2 232,6	Ukraine	98,9	0,0	0,0
Netherlands	7 358,5	5 136,2	2 782,1	Poland	658,4	385,2	1 856,6
Germany	6 763,2	3 426,8	7 584,0	Serbia	750,9	317,0	126,6
Norway	1 074,4	2 672,0	1 078,6	Croatia	282,0	222,6	1 095,8
Belgium	3 173,4	2 639,1	1 907,6	Bulgaria	0,0	175,0	150,0
Sweden	1 982,0	1 702,3	3 253,9	Slovak Republic	26,4	0,0	0,0
Portugal	3 514,2	1 642,6	1 994,6	Romania	0,0	0,0	216,6
Ireland	597,0	1 236,9	495,6	Lithuania	0,0	0,0	76,9
Finland	661,7	649,8	909,3	Czech Republic	0,0	0,0	62,2
Switzerland	96,5	0,0	0,0				
Greece	728,9	129,6	126,0				
Austria	0,0	0,0	163,8				

Source: own editing, based on Refinitiv 2019, 2020

5 Summary

As described above, project finance remains a significant source of financing worldwide. However, investors' assessment of risk is highly variable. They prefer



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regions where they can safely rotate funds invested for the long term. We certainly benefit from the fact that Europe ranks high in terms of funding sources, both in terms of the amount financed and the value per transaction. However, it is also important to see that there is huge competition between continents. The projects that receive this form of funding for our major projects are those that can offer the right advantages and guarantees to their investors. For our country, it is good news that we are in a leading position in the Eastern European field. Although we do not have huge oil and gas resources, we are a popular destination, which means that we have been able to raise funds every year. From renewable energy sources to leisure infrastructure, Hungary is also keen to finance leisure activities. In terms of project finance, our risk rating is good, so if the global economy does not show any further signs of the coronavirus epidemic, Hungary can expect to continue to receive adequate and sufficient resources in the future.

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