## What is Project Financing?

Project Financing is a long-term, zero or limited recourse financing solution that is available to a borrower against the rights, assets, and interests related to the concerned project.

If you are planning to start an industrial, infrastructure, or public services project and need funds for the same, Project Financing might be the answer that you are looking for.

The repayment of this loan can be done using the cash flow generated once the project is complete instead of the balance sheets of the sponsors. In case the borrower fails to comply with the terms of the loan, the lender is entitled to take control of the project. Additionally, financial companies can earn better margins if a company avails this scheme while partially shifting the associated project risks. Therefore, this type loan scheme is highly favoured by sponsors, companies, and lenders alike.

## What Is Special Purpose Vehicle and Why Is It Necessary?

During Project Financing, a Special Purpose Vehicle (SPV) is appointed to ensure that the project financials are managed properly to avoid non-performance of assets due to project failure. Since this entity is established especially for the project, the only asset it has is the project. The appointment of SPV guarantees the lenders of the sponsors’ commitment by ensuring that the project is financially stable.

FeaturesFeatures of Project Financing

Since a project deals with huge amount funds, it is important that you learn about this structured financial scheme. Below mentioned are the key features of Project Financing:

* **Capital Intensive Financing Scheme:** Project Financing is ideal for ventures requiring huge amount of equity and debt, and is usually implemented in developing countries as it leads to economic growth of the country. Being more expensive than [corporate loans](https://www.bankbazaar.com/personal-loan/corporate-loan.html), this financing scheme drives costs higher while reducing liquidity. Additionally, the projects under this plan commonly carry Emerging Market Risk and Political Risk. To insure the project against these risks, the project also has to pay expensive premiums.
* **Risk Allocation**: Under this financial plan, some of the risks associated with the project is shifted towards the lender. Therefore, sponsors prefer to avail this financing scheme since it helps them mitigate some of the risk. On the other hand, lenders can receive better credit margin with Project Financing.
* **Multiple Participants Applicable**: As Project Financing often concerns a large-scale project, it is possible to allocate numerous parties in the project to take care of its various aspects. This helps in the seamless operation of the entire process.
* **Asset Ownership is Decided at the Completion of Project:**The Special Purpose Vehicle is responsible to overview the proceedings of the project while monitoring the assets related to the project. Once the project is completed, the project ownership goes to the concerned entity as determined by the terms of the loan.
* **Zero or Limited Recourse Financing Solution**: Since the borrower does not have ownership of the project until its completion, the lenders do not have to waste time or resources evaluating the assets and credibility of the borrower. Instead, the lender can focus on the feasibility of the project. The financial services company can opt for limited recourse from the sponsors if it deduces that the project might not be able to generate enough cash flow to repay the loan after completion.
* **Loan Repayment With Project Cash Flow**: According to the terms of the loan in Project Financing, the excess cash flow received by the project should be used to pay off the outstanding debt received by the borrower. As the debt is gradually paid off, this will reduce the risk exposure of financial services company.
* **Better Tax Treatment**: If Project Financing is implemented, the project and/or the sponsors can receive the benefit of better tax treatment. Therefore, this structured financing solution is preferred by sponsors to receive funds for long-term projects.
* **Sponsor Credit Has No Impact on Project:**While this long-term financing plan maximises the leverage of a project, it also ensures that the credit standings of the sponsor has no negative impact on the project. Due to this reason, the credit risk of the project is often better than the credit standings of the sponsor.

## What Are the Various Stages of Project Financing?

#### Pre-Financing Stage

* + **Identification of the Project Plan** - This process includes identifying the strategic plan of the project and analysing whether its plausible or not. In order to ensure that the project plan is in line with the goals of the financial services company, it is crucial for the lender to perform this step.
  + **Recognising and Minimising the Risk**- Risk management is one of the key steps that should be focused on before the project financing venture begins. Before investing, the lender has every right to check if the project has enough available resources to avoid any future risks.
  + **Checking Project Feasibility** - Before a lender decides to invest on a project, it is important to check if the concerned project is financially and technically feasible by analysing all the associated factors.

#### Financing Stage

Being the most crucial part of Project Financing, this step is further sub-categorised into the following:

* + **Arrangement of Finances** - In order to take care of the finances related to the project, the sponsor needs to acquire equity or loan from a financial services organisation whose goals are aligned to that of the project
  + **Loan or Equity Negotiation** - During this step, the borrower and lender negotiate the loan amount and come to a unanimous decision regarding the same.
  + **Documentation and Verification -**In this step, the terms of the loan are mutually decided and documented keeping the policies of the project in mind.
  + **Payment** - Once the loan documentation is done, the borrower receives the funds as agreed previously to carry out the operations of the project.

#### Post-Financing Stage

* + **Timely Project Monitoring** - As the project commences, it is the job of the project manager to monitor the project at regular intervals.
  + **Project Closure** - This step signifies the end of the project.
  + **Loan Repayment** - After the project has ended, it is imperative to keep track of the cash flow from its operations as these funds will be, then, utilised to repay the loan taken to finance the project.

## Types of Sponsors in Project Financing

In order to determine the objective of the project and the risks related to it, it is important to know the type of sponsor associated with the project. Broadly categorised, there are four types of project sponsors involved in a Project Financing venture:

* **Industrial sponsor** - These type of sponsors are usually aligned to an upstream or downstream business in some way.
* **Public sponsor** - The main motive of these sponsors is public service and are usually associated with the government or a municipal corporation.
* **Contractual sponsor** - The sponsors who are a key player in the development and running of plants are Contractual sponsors.
* **Financial sponsor** - These type of sponsors often partake in project finance initiatives and invest in deals with a sizeable amount of return