Take cover

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Finding comprehensive insurance policies for project finance deals post September 11 has become far more difficult and expensive, but lenders have not shied away from investing in deals in the Middle East, where pricing remains competitive and interest in oil, gas and liquefied natural gas deals is high. However, questions are being raised over what the effect of threat of an Iraqi war would have on deals in the region and whether deals, whose policies are coming up for renewal, would be able to find cover at all.

At the end of November, Moody's Investors Service placed the project debt for Oman LNG and Ras Laffan LNG, two of the most high profile project finance deals in the Middle East, under review for a possible downgrade. In each case the ratings agency said the two key causes for concern were the possibility of war in the region, as well as recent increased terrorism activity. But what the agency queries in both cases is the level of protection provided by their insurance policies.

In the case of the Oman LNG, a project which earlier this year closed another portion of financing, attracting a large group of international and regional banks during syndication, the deal has insurance policies that provide some terrorism cover - according to one source of between $250 million and $400 million - and, as is customary, no cover for war. However, Moody's notes that: "While the rating has always taken into account the risks arising from the geographical location of the project, Moody's believes that the overall risk profile of the project has now increased." The rating agency says it will review Oman LNG again when the project company renews its policies on January 2 2003. It will then assess the extent to which the new policies provide for terrorism cover in relation to the potential exposure of the project under various scenarios..

Set in the context of a looming war between Iraq, this represents at the moment a slight readjustment to a highly rated project debt - Oman LNG carries an A3 rating from Moody's. Were an attack on Iraq to take place, the situation could change.

Meanwhile, as *Project Finance* went to press, Ras Laffan, the Qatari liquefied natural gas project that first set a project financing benchmark for the region in the mid 1990s, was also under review. Moody's has put the Baa2 debt rating on Ras Laffan Liquefied Natural Gas Company under review for downgrade.

The project company's insurance policy was due for renewal on 15 December 2002 and Moody's says it expects that "reflecting the changes in the insurance market since September 11 2001, the new policies will not provide for significant terrorism cover for onshore assets in relation to the potential exposures of the project under various scenarios".

Once again the agency says that while it had always factored in the location of the project and its proximity to more unstable countries, it believes the overall risk profile of the project has increased. "The action is due to the increased possibility of war in the region, as well as the recent increase in global terrorism activity, combined with a likely reduction in the scope of insurance policies to be held by the project," according to Moody's.

The rating reviews throws up a few questions: Has the risk of terrorism on those projects really increased, even given the possibility of an Iraqi war? If deals signed after September 11 - after which the ability to find insurers willing to provide cover for terrorism or war at a reasonable cost, if at all - now carry policies with lower level of cover, is this a problem?

And how much of a target are two Islamic countries for hard-line Islamic fundamentalists anyway? Lastly what would be the effect on the insurance market in the event of war?

Bankers in the market have clearly felt the impact of tightened insurance policies post September 11 and not just in the Middle East, but so far they say that this is having very little impact on the pricing of deals in the region. According to one London-based banker, in a number of the Middle Eastern deals in which the government has taken a significant stake or is acting as offtaker, the government has agreed to reprice the offtake in the event of some level of damage taking place at the project. But he adds you also "get everything you can lay your hands on in the insurance market in terms of sabotage or terrorism risk".

Says Jan Willem Plantagie, director at Standard & Poor's in London: "If you assume the worst and that your project is attacked or destroyed, in these cases [Oman LNG and Ras Laffan] the government is a major shareholder. The project is important for the country and it provides hard dollars. You can't rely on the government stepping in but you do know that they would feel the pain too."

Finding policies that cover terrorism risk has become much harder post September 11 and not just in the Middle East. Leading up to a war in Iraq it could become much harder. In some cases very large sponsors have turned to their captive insurer to deliver a policy at a better rate than if they had gone to the market.

Private insurers, meanwhile, are keen to point out that they are still offering cover. AIG says it does provide insurance for political risk, including war, political violence and terrorism. However, each project is considered on its own merits. Ray Antes, vice president in political risk at AIG Europe in London, says of Qatar and Oman: "We would be comfortable with those locations but obviously we consider each project on a case-by-case basis. If you suggested a location closer to a specific hot spot then we would need to consider the situation carefully."

Says Antes: "AIG's policies are non-cancellable. So we take a view on a project at the start. If we lock into a multi-year policy then we are on the hook. If a situation heats up we monitor and prepare for the worst case scenario." This contrasts with insurers in the Lloyds market who generally only provide one-year contracts.

But while insurers are still willing to provide cover, it is done at a cost. And those deals that have emerged post September 11 have done so with reduced cover. Says the London-based banker: "Unfortunately in recent projects, lenders have had to be satisfied with sabotage and terrorism cover not reaching the full amount of the project cost. At best you are looking at between 50-70% of the debt."

However Plantagie, points out that: "Terrorism cover in the Middle East has always been difficult and expensive to achieve. Equally property damage insurance has become very expensive, with premiums on these policies almost doubling in some cases. The concern on property damage insurance is that the proceeds under the policy would not cover the outstanding debt.?

And in reality, the difficulty of providing full cover for war or terrorism risk, on project finance deals only poses one risk in an otherwise complex deal. Says one banker: ?What you realise is that the maximum probability of loss from a terrorist attack would in many cases not equal the full amount of your assets. And in most cases the cover would provide for 50% of the assets or 75% of the debt, anyway."

Moody's notes in the cases of Ras Laffan and Oman LNG that while the projects do have a high concentration of assets on one site, both have comprehensive security arrangements, which are coordinated with the government, the major shareholder in each case.

Those close to the market say that in many ways the situation regarding terrorism cover for some of the biggest projects in the region has not really materially changed. Plantagie says covering for terrorism was always a problem, particularly in the Middle East: "Worldwide, finding terrorism cover is difficult but we have not downgraded any project because of this and are for the moment unlikely to do so."

Lenders say that they continue to do deals in the region because of the quality of the projects and the overall structure of transactions. Ras Laffan is 66.5% owned by the Government of Qatar, 26.5% by ExxonMobil, 4% by Itochu and 3% by Japan LNG.

In the case of Oman LNG LLC, which closed a $1.364bn syndicated loan earlier this year, the deal has impressive credentials. The project is 51% sponsored by the Government of Oman, with Shell taking 30%, Korean LNG 5%, Mitsubishi Corp 2.77%, Mitsui & Co 2.77%, Partex of Oman 2% and Itochu Corporation taking 0.92%.

While the deal followed the recent trend of having large arranging bank groups spreading the risk, it still showed the lure for bankers for LNG deals in countries such as Oman. Banks arranging the deal include ABC, Apicorp, ANZ, Bank of Tokyo Mitsubishi, Credit Agricole Indosuez, Credit Lyonnais, Gulf International Bank, HSBC, Mizuho, RBS and SMBC.

About 20 banks joined the syndication, which closed in March this year, and at the time they felt that the strong sponsor group and the way the deal was structured was pushing it towards a corporate credit rather than a pure project finance transaction. With this in mind the deal achieved the highest rating for an unwrapped project credit in the Middle East, initially gaining A3 and A- ratings from Moody's and S&P respectively.

The 16.5-year deal is split between a $1.3 billion term loan and a $64million revolving letter of credit facility. Pricing starts at 90 basis points over Libor for years one to five, rising to 110bp for years six to 10; and 140bp thereafter.

Says Plantagie: ?Clearly war risk is something that you have to take into consideration but if you look at the region over the past 10 years you see that lenders have not been that affected. The Pricing on projects in the Middle East is still extremely competitive. It may go up as fewer banks participate in project finance but then there are now more local banks involved. This means there is still plenty of liquidity.?

Initial financing for both deals was funded in the late 1990s and since then Ras Laffan and Oman LNG have continued to attract considerable attention from lenders to finance or refinance subsequent trains. Ras Laffan continues to perform well with strong cash flows and in 2001 had revenues of $1.48bn. Oman LNG, meanwhile, has also benefited from the high oil price and high volumes shipped, giving it revenues of $1.18 billion in 2001.

Says one source: "The question is, if there were a war would the market for insurance shut? At the moment it is not a concern but it could be if the market did close."

Another banker says: "Oman LNG refinanced post September 11 and the deal was able to satisfy the lenders. We were very comfortable with the deal." He says that so far insurance has not been a sticking point for project finance deals in the region, nor has it had an effect on the pricing of deals. "It really depends on the whole package on offer. Pricing on Oman LNG didn't really move. So far projects have been able to obtain cover in the pure brokerage market, or as captive reinsurance. And up to now it really hasn't stopped any deals." What it has meant, however, is that bankers have had to become more adept, post September 11 at looking at the insurance on such deals.

He says that a reduction in the number of insurers providing cover for terrorism or sabotage is a concern but "not a major obstacle" for LNG or oil and gas deals at the moment. "It has not stopped deals of this type so far in the region.? But he adds: "So perhaps the question should be what would lenders do if there were no insurance at all?"