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Where the risks are only partial

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With economic turmoil still influencing the progress of many infrastructure deals, banks are still trying to reschedule or restructure debt on projects that have gone sour. This increased level of caution dictates that only projects with a high enough credit rating will be considered. For small rapidly developing countries such as the Dominican Republic this level of caution presents a serious hurdle to developing a viable and functioning infrastructure.

To address this issue the Inter-American Development Bank (IADB) has been pioneering a new structure known as partial risk guarantees. The Bank tested the structure for the first time in Colombia in 1997 for a $100 million water project in which the IADB guaranteed $30 million of the financing. The debt is split into two tranches with the IADB tranche having a guarantee enhancement, therefore making it more attractive to certain investors who were uncomfortable with the Colombia risk.

And in the next few months a second project ? a 300MW independent power producer plant close to the city of San Pedro de Macoris in the Dominican Republic ? will close financing using this technique. The oil-fired combined cycle plant is expected to cost $280 million and will be developed by the US's Congentrix. There is also a 20-year purchase agreement for the electricity on fixed priced formula. Industry sources reckon say this could be the last Dominican independent power project with this type of purchase agreement. In future, as the power market is deregulated there, offtake prices are likely to be left to the free market as is the case in Chile and Argentina.

Meanwhile, the IADB is guaranteeing against payment defaults on the offtake side of the contract for the new power plant and assuming the currency risk. The project is also receiving a guarantee from the Dominican government, which played a key role in securing the finance, but this wasn't enough.

Says Andrew Aldridge of the Commonwealth Development Corporation (CDC) in London which is taking a 35% equity share in the project: "In these situations a government guarantee isn't high enough for investors to be satisfied." The Republic's credit rating, which is below single-A simply is not high enough to make the project interesting for a large enough pool of investors.

Says Roberto Crabera of the IADB in Washington: "The IADB guarantee enables the project to pierce the sovereign ceiling." He says that the partial risk guarantee initiative is still a relatively new product and to a certain extent is still being developed. The IADB is studying and evaluating projects in Argentina, Brazil and others in the Dominican Republic for partial loan guarantees. However, "I think it will be particularly useful for helping to get projects financed in the smaller Central and South American countries," says Crabera.

Says Aldridge: "Basically it is a case of the IADB using its triple-A rating to enhance the credit quality of the project. It enables you to then sell the debt into the US market and do a Rule 144A bond issue or a private placement." However, partial risk guarantees are not cheap and cost around 2% to 2.5% of the sum guaranteed.

Crabera does not see partial risk guarantees competing head on with the traditional A-B loan structures advocated by the

World Bank. "A-B loan structures are still in use and have a role to play," says Crabera. "Partial risk guarantees work with well-structured projects, with a good power-purchase agreement, strong government guarantees, but where the market won't take on the country risk as in the case of the Dominican Republic." He says that the mechanism was particularly suited to big projects in smaller countries.

Initially the scheme was created for infrastructure type projects such as water and power, but is increasingly seen as attractive for transport and telecoms projects as well. Says Crabera: "After the Asian crisis a lot of projects in Mexico and Brazil couldn't get financing so many will need help from the likes of the IADB."

Private sector financiers acknowledge that multilaterals do have an important role to play in emerging market countries. This is especially so given the fall-out from the Asian crisis, which has rocked confidence. In the Côte d'Ivoire the $223 million Azito project, multilateral backing was the key to securing financing. The International Development Association (IDA) provided a loan guarantee, which was enough to get other private-sector banks involved. Meanwhile, the International Finance Corp (IFC) entered into interest swap deal with Azito company for $32 million worth of debt.

Imaginative financial schemes such as those applied to Azito and the Dominican Republic independent power projects show how multilateral funds can be leveraged to maximum benefit for recipient countries. The various types of guarantee options available allow a significant involvement of private sector finance, which means multilateral funds can be spread further.

Without these schemes many emerging market countries would struggle to find the necessary resources to develop the basic infrastructure that their economies need in order to take off.