

MAR 14 2013  
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**MEMORANDUM**

March 12, 2013

**TO:** Mark Davis  
Deputy Director – Infrastructure Development, AIDEA

**CC:** Ted Leonard, Executive Director, AIDEA  
Pat Clancy, WFG

**RE:** Project Financing

Mark,

You have asked that WFG provide information in response to two related topics:

- 1) Why providing AIDEA the ability to use project financing without ownership is useful?
- 2) Provide examples of projects for which this new financing tool might be used / types of projects for which AIDEA would use project financing as opposed to what it can already accomplish with Development Finance.

**SUMMARY RESPONSES**

- 1) Why providing AIDEA the ability to use project financing without ownership is useful?
  - It more closely matches AIDEA's financing tools with the nature of the projects being financed, and is more consistent with public policy supporting economic development finance programs.
  - It reduces complexity, cost and time involved in structuring financings.
  - It provides AIDEA (and the state) more protection from possible risk and liabilities associated with projects being financed.
  - It can improve overall economics of financings by more closely aligning ownership with potential tax benefits.
- 2) Provide examples of projects for which this new financing tool might be used / types of projects for which AIDEA would use project financing as opposed to what it can already accomplish with Development Finance.
  - Industrial development as opposed to commercial real estate (which can and should be funded with loan participations)
    - Oil and gas
    - Minerals / mining

- Infrastructure development (ports, roads, etc.) for programs “sponsored” by other entities, and therefore not “owned” by AIDEA.

## DISCUSSION & EXPLANATION

AIDEA’s core mission is summarized in the two paragraphs below (from AIDEA’s website):

*AIDEA is a public corporation of the State of Alaska, created in 1967 by the Alaska Legislature "in the interests of promoting the health, security, and general welfare of all the people of the state, and a public purpose, to increase job opportunities and otherwise to encourage the economic growth of the state, including the development of its natural resources, through the establishment and expansion of manufacturing, industrial, energy, export, small business, and business enterprises..."*

*We are proud to serve the Governor and the State of Alaska as the state's development financing authority. AIDEA's mission is to provide various means of financing to promote economic growth and diversity. We do that by acting as a funding resource in partnership with other financial institutions, economic development groups and guarantee agencies.*

For several decades, AIDEA accomplished this mission by using two primary tools:

- 1) loan participations with banks to fund, principally, commercial real estate development, and;
- 2) development financing for large industrial or infrastructure projects owned (at least in part) by AIDEA.

AIDEA’s ownership in large “enabling infrastructure” projects including the DeLong Mountain Transportation System and the ports of Ketchikan and Skagway have achieved significant economic development results for Alaskan regions, while providing modest financial returns to AIDEA. The ownership model, with AIDEA maintaining an active, ongoing ownership role, will continue to be an appropriate approach to infrastructure projects supporting private economic activities – in situations where AIDEA’s long term ownership meets state public policy objectives.

For infrastructure programs sponsored by other entities, where AIDEA may be playing a more facilitating financing role – and there are public policy or business reasons for the sponsoring entity to maintain ownership – project financing (without AIDEA ownership) would be more appropriate.

Similarly, for non-infrastructure projects, the “develop and own” model is not ideal. These are typically industrial resource development projects that involve direct financing and operations of private businesses (as opposed to infrastructure), and engender risk profiles not common to commercial real estate. These projects often



meet the profile for industrial “project financing” – defined by the International Project Finance Association as:

*The financing of long-term infrastructure, industrial projects and public services based upon a non-recourse or limited recourse financial structure where project debt and equity used to finance the project are paid back from the cashflow generated by the project.*

In order to enable priority economic development, AIDEA has recently structured financings with features very similar to project finance lending, but with the complication of statutorily-required AIDEA ownership (either directly or through an LLC). While this approach has allowed AIDEA to engage in targeted industrial resource development (e.g. oil drilling in Cook Inlet), the legal complexity of the ownership structure adds to cost and AIDEA has a less “arms’-length” standoff from potential project risks and liabilities.

There is usually no public-purpose rationale for AIDEA to hold an ownership position in these industrial facilities. To the contrary, there are very good public policy and business arguments for AIDEA NOT having an ownership position, including: risk mitigation, cost of complex ownership structures, potential competition with other private investments, and tax issues.

Direct project financing authority will enable AIDEA to participate in financing for industrial development projects (and “other-sponsor” infrastructure programs) as a “project lender” – with more flexibility (and higher return potential) than commercial finance, but with a more effective firewall against environmental and liability risks and lower transactions costs. Additionally, the overall project economics may be enhanced as the 100% private owners have access to tax benefits that are not likely to accrue to AIDEA.

Please feel free to call or email Pat or me if you need any clarification.

Regards,

A handwritten signature in blue ink, appearing to read 'Mark Gardiner'.

Mark Gardiner  
Western Financial Group

Attachment: The next page includes, for reference, a longer definition of project finance – courtesy of Wikipedia.



*Project finance is the long-term financing of infrastructure and industrial projects based upon the projected cash flows of the project rather than the balance sheets of its sponsors. Usually, a project financing structure involves a number of equity investors, known as 'sponsors', as well as a 'syndicate' of banks or other lending institutions that provide loans to the operation. They are most commonly non-recourse loans, which are secured by the project assets and paid entirely from project cash flow, rather than from the general assets or creditworthiness of the project sponsors, a decision in part supported by financial modeling.[1] The financing is typically secured by all of the project assets, including the revenue-producing contracts. Project lenders are given a lien on all of these assets and are able to assume control of a project if the project company has difficulties complying with the loan terms.*

*Generally, a special purpose entity is created for each project, thereby shielding other assets owned by a project sponsor from the detrimental effects of a project failure. As a special purpose entity, the project company has no assets other than the project. Capital contribution commitments by the owners of the project company are sometimes necessary to ensure that the project is financially sound or to assure the lenders or the sponsors' commitment. Project finance is often more complicated than alternative financing methods. Traditionally, project financing has been most commonly used in the extractive (mining), transportation, telecommunications and energy industries. More recently, particularly in Europe, project financing principles have been applied to other types of public infrastructure under public-private partnerships (PPP) or, in the UK, private finance initiative (PFI) transactions (e.g., school facilities) as well as sports and entertainment venues.*

*Risk identification and allocation is a key component of project finance. A project may be subject to a number of technical, environmental, economic and political risks, particularly in developing countries and emerging markets. Financial institutions and project sponsors may conclude that the risks inherent in project development and operation are unacceptable (unfinanceable). To cope with these risks, project sponsors in these industries (such as power plants or railway lines) are generally completed by a number of specialist companies operating in a contractual network with each other that allocates risk in a way that allows financing to take place. "Several long-term contracts such as construction, supply, off-take and concession agreements, along with a variety of joint-ownership structures are used to align incentives and deter opportunistic behaviour by any party involved in the project." [2] The patterns of implementation are sometimes referred to as "project delivery methods." The financing of these projects must be distributed among multiple parties, so as to distribute the risk associated with the project while simultaneously ensuring profits for each party involved.*

*A riskier or more expensive project may require limited recourse financing secured by a surety from sponsors. A complex project finance structure may incorporate corporate finance, securitization, options (derivatives), insurance provisions or other types of collateral enhancement to mitigate unallocated risk.[2]*