Frequently Asked Questions Series
Introduction to Capital Guarantees for Project Funding through In3

Here are some frequently asked questions to help demystify In3’s Capital Guarantee Program™ (CGP), to define industry jargon, build certainty and accelerate closings. Outline of process steps or request our video.

What is a project finance Loan/Capital Guarantee?
A capital guarantee or loan guarantee is a letter of commitment (when sent by a bank, a bank instrument) from a party or institution that serves as credit enhancement for the borrower. “Credit enhancement” is a method whereby a company attempts to improve its credit worthiness for one or more specific transactions.

- Bank Guarantees (BG), issued by the sender bank, block (set aside) an asset for the specific period to increase borrowing power. In the US, a BG is effectively the same as a Standby Letter of Credit (SBLC), a good option if a sovereign guarantee (defined next) is unavailable.
- Sovereign Guarantees are issued for public/private cooperation, and are usually the least expensive method of qualifying for project capital. They do require access to the right government officials (the country’s Minister of Finance), and thus subject to the quirks and sometimes politics of national governments.

Why is a guarantee needed?
Typically, new project companies (also called “greenfield” projects because nothing is yet built on the project site) do not have three years of audited financial statements, thus borrowing capacity is limited. Although many projects can be financed without such guarantees, BGs and SGs do help developers qualify for better terms (lower interest rates), faster closings, greater certainty and leverage (less equity co-investment decreases the amount of capital the developer must invest, while preserving rights to profits).

Such guarantees, whether from sovereign governments or banks, are instruments traditionally used to overcome the lack of lending in a country or sector. Guarantee instruments first emerged in Europe centuries ago, but today they are widely used in both the developed and developing worlds to improve infrastructure, the regional economy, create jobs, etc.

Another attractive feature of In3’s guaranteed project financing: instead of directly investing one’s own capital in the special purpose vehicle (with limited or no recourse to the project company owners), the guarantor frees up long-term capital, placed in operating assets, without encumbering those assets with a lien. Technically such guarantees are “contingent obligations”, not shown as debt on the guarantor’s balance sheet¹.

What is a project sponsor and why might you need one?
If an SG is unavailable, another method widely used by project developers, with little or no cost to them, is to involve a private sponsor as the guarantor. Sponsors can be stakeholders (with an equity interest), contractors (such as a well-established Engineering, Procurement & Construction firm), equipment providers, or other mission-aligned parties. Sponsors use their existing resources (cash on deposit, a corporate balance sheet, public equities, precious metals or other “fair market value” assets) to deliver the Bank Guarantee or SBLC.

Banks regularly use SWIFT codes and specialized equipment to transact with one another (send or receive messages and funds). Message Types (MT) are 3-digit numbers; here are the main SWIFT codes for CGP:
- Swift MT760 Guarantee – either Sovereign or Bank Guarantee / SBLC – issued by the sender bank, upon instructions of its account holder, in favor of a particular party or counter-party (“beneficiary”). Since banks do not generally put their own money on the line, the client’s asset is “blocked” by the bank, held as security (collateral) for the issuance of the guarantee. The type of asset is between the bank and their client. MT760, therefore, is more than just an inter-bank message: with the original hardcopy sent via courier, it becomes a full-blown, cash-backed, callable, operative instrument, similar to a bearer bond.

¹ The IMF uses footnotes in financial statements; corporate.findlaw.com/business-operations/sovereign-guarantees-in-project-finance.html
- **SWIFT MT-799 or 199** are purely advisory messages, specifically “pre-advice” messages, used to signal intended transactions. They are not used to transfer funds or even a promise to do so. We can also accept a bank-to-bank Email message in lieu of MT-799, which is sometimes preferable.

  It is important to avoid getting lost in a sea of jargon … **Swift MT-799 is purely inter-bank communication and nothing else.** A lot of fraudulent actors would have you believe MT-799 has transactional meaning, but it is not binding upon anyone to do anything.

- **Ready, Willing and Able (RWA) Letters** are issued by banks to explain their intent to proceed on behalf of a client for a specified transaction (such as BG/SBLC via MT760) when the time comes. The verbiage we prefer is available as a template. Note that it is not a form of payment or commitment to block funds. More at [in3capital.net/what-is-an-RWA-letter](http://in3capital.net/what-is-an-RWA-letter)

Of particular interest for In3 CGP is Swift MT760, which is what banks can use for both Sovereign Guarantees (SGs) and direct Bank Guarantees (BGs)/SBLCs. Sovereign Guarantees within the PPP structure may be preferable because they’re usually less “expensive” (or free) for developers, but for those developers or sponsors that have some liquid assets, funds can be used to directly purchase a BG or SBLC\(^3\), which works just as effectively, and faster and easier, to enhance the credit of the borrower for project financing.

**What banks can be used for a Bank Guarantee/SBLC or Sovereign Guarantee verification?**

A guarantee of commercial value must be issued from or verified by a **Rated Bank** and delivered via SWIFT or Euroclear. Not every guarantee that we might receive is necessarily valid and usable, which is why we recommend sending the proposed BG or SG language to us before going to the trouble of obtaining the instrument. A smaller rated bank can be used when there is an additional, larger confirming bank involved.

In3 works with our partners to ensure that each guarantee provided is legitimate, and we follow our lender’s underwriting process and protocol. Full “inception to completion” procedure shown [here](#).

All SGs are discounted, but developers with SGs from countries with low credit-ratings or even no credit ratings (unrated countries) can still use the SG, once verified by a rated bank. Our investment partners will often make up the difference for the project at hand. Note that we cannot work in countries with sanctions against them – Russia, N. Korea and Venezuela – nor accept guarantees from banks in those countries.

**What is the difference between a Letter of Credit and Standby Letter of Credit?**

A Standby or Synthetic Letter of Credit (SBLC) is a type of Letter of Credit (LC) that can be used to secure the bank guarantee. Neither type of letter is needed to back up a Sovereign Guarantee, as the sponsoring sovereign nation’s treasury serves that purpose. (Technically, an LC is a credit document that is used to make payment to the beneficiary on the fulfillment of contractual obligations, while a Standby Letter of Credit is a contingent payment used by the beneficiary only if the borrower fails to make the loan payment due to any reason.)

Further, SBLCs are a payment guarantee generally issued by a bank (the “issuing” or “sender” bank) on behalf of a client, securing payment to a third party (“beneficiary”) in the event of default. In3’s partner would be the beneficiary when funds are loaned from the In3 capital partner’s accounts to the client (project developer’s SPV) … with typical loan terms of 3% APR for up to 20 years under the SG or BG.

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\(^3\) Note that top banks tend to charge much more than if an SBLC asset were held as collateral.

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In the event the client fails to fulfill a contractual commitment, the issuing bank would be obligated to release payment to the lender. That’s the guarantee part. This has never happened in our history, and must be avoided at all costs. There is a “cure period” written into the financing agreements, and the parties would come together to address whatever caused the failure, to get the project development or construction back on track.

In practice, such “recourse” rarely comes to that, as the obligation to the bank serves as a form of accountability, so in the event of a problem there is impetus to resolve the situation in an amicable manner. That is the purpose.

How do Sovereign and Bank Guarantees differ in practice?

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<tr>
<th>Sovereign Guarantee</th>
<th>Bank Guarantee / SBLC</th>
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<tr>
<td>SGs are effectively free to developers, with rare exception. Governments sometimes own equity.</td>
<td>Costs vary depending the bank used and the asset used as collateral; fees usually range from 0.5-15%.</td>
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<td>Issued (signed) by the country’s Ministry of Finance, authenticity verified by a rated bank using RWA letter</td>
<td>Issued by a rated bank, preceded by RWA letter. Low-rated banks are asked to use a Confirming bank.</td>
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<td>Issued for 100% of the project’s budget (they are typically discounted in terms of effective value as credit enhancement)</td>
<td>100% loan-to-value (LTV) is preferred, but can be leveraged 1.2-2x... recommend at least 50% BG LTV coverage (for example, $50M BG/SBLC for $100M budget) for the best terms. 75%- is even better.</td>
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<td>Stays in effect for the life of the project or at least the life of the loan, typically ~10-20 years</td>
<td>Stays live as an “operative instrument” only during construction, until commercial operation date (COD)</td>
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<td>Offer of equity % in SPV based on country’s credit rating and verifying bank’s rating and capacity. Both SGs and BG/SBLCs are ultimately sent via SWIFT MT760, with verbiage to comply with international rules (URDG 758 from ICC), not politics or the IMF.</td>
<td>BG coverage (LTV) is one of the main factors in determining the equity kicker. Both SG &amp; BG use an RWA letter to initiate due diligence, the results of which will put an offer for % of equity carried interest (AKA rights to profits or cashflows) on the table.</td>
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<td>Requires a letter from the developer acknowledging the type of public-private cooperation (e.g., PPP).</td>
<td>No PPP/letter required. When using leverage, initial Monthly Draw Schedule become sensitive.</td>
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Is a Guarantee needed if there’s a Completion Bond or Insurance Wrap?

Similar to insurance, guarantees are indeed used to allocate risk, including commercial, credit, political, or in the case of In3’s CGP, the risk of failure (default) during construction, or non-completion of the project asset due to developer or contractor non-performance. **No insurance product constitutes a bank guarantee,** offering the same depth. Developers might still want to obtain completion or performance bonds from hired contractors (EPC or GC firms), just as they would want to use vendors that warrant their work or products.

Why is a Loan Guarantee needed if there is a PPA, PPP, or Bank Confirmation Letter (BCL)?

With energy generation projects, **Power Purchase Agreements** (PPAs) from creditworthy offtakers do mitigate most of the commercial risks, but they are not a form of loan guarantee that serves to enhance the credit of the borrower. Such credit enhancement is key to obtaining financing at the most beneficial terms.

**Public-Private Partnerships** (PPPs) are helpful in gaining the full cooperation of the public-sector sponsor, and to obtaining investment, but again, they do nothing to enhance the developer’s credit qualifications.

**Bank Confirmation Letters** (BCL) simply do not qualify. BCLs contrast with what is acceptable for project financing under a loan guarantee because they are used only if

1. You want to confirm account numbers and balances of accounts with a financial institution.
2. You want to determine if the party actually owns any accounts with the financial institution.
3. You want to ensure all of the party’s accounts are included in an estate settlement, etc.

It is a verification of assets and nothing more.

**What other tools, products or instruments do not qualify?** As stated above, insurance products, even if government-issued, performance guarantees, completion bonds, etc. None of these are loan guarantees.
CONCLUSIONS: Why is all this necessary? What’s the bottom line? Why bother?

The main advantage of securing a guarantee, whether Sovereign or Bank, is that it speeds up the financing process, and greatly reduces costs, while increasing the odds of securing the necessary capital to develop, build and operate projects.

The best options are either

A. Work in a country that can offer a Sovereign Guarantee (SG) under a verifiable set of conditions from the Ministry of Finance. Most countries will not provide SGs, for varying reasons, so …Plan B:

B. Obtain a Bank Guarantee (BG/SBLC) from sources like
   - A private party “sponsor” with a financial interest in the project, such as a well-established general contractor or EPC firm responsible for project construction
   - An existing bank relationship with cash deposit accounts (net worth holdings) or a liquid asset such as shares of public stock, developed real estate (appraisal may be required), gold, silver or other forms
   - A development finance institution like US IDFC or regional development bank
   - An NGO / not-for-profit (philanthropic) impact investor or Family Office that is mission-aligned
   - If some cash is available, and can be leveraged, with the above options not viable, consider directly procuring an annual Standby Letter of Credit for a fee that typically ranges from 4% up to 12% or more, depending on the bank’s rating. 12% is for top-tier banks like Barclays or Lloyds.

Keep in mind that there are usually bank fees for issuance of SWIFT MT760 that are not insubstantial for larger projects, ranging from 0.5% up to 2% of the investment/loan amount, depending on the bank used. This fee is charged annually, and the instrument stays in place during the project’s construction period only, until reaching Commercial Operation Date (COD), so typically 1-3 years (subsequent years can be paid from invested proceeds, if necessary), then released. It can be left in place longer, depending on the desired effect.

Thus, with some countries, and for some developers, Sovereign Guarantees may be preferable. SGs use the treasury of the country to backstop the financing, without cost to the developer.

In both cases, whether SG or BG, these tools enable up to 100% financing, at any reasonable stage of development (does not need to be shovel-ready), and preserving a substantial ownership stake in the project SPV’s assets. Direct bank guarantees (whether private or institutional) are most reliable, though the cost can be quite variable. Ask your bank.

**Next steps:** request any of the following: Visit In3capital.net for these tools:

- Project information summary questionnaire
- SG template and RWA verification template
- “How to” online library including BG/SG verification and 1-page “roadmap” Tools & Resources

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Impact Project Finance & Strategic Advisory

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