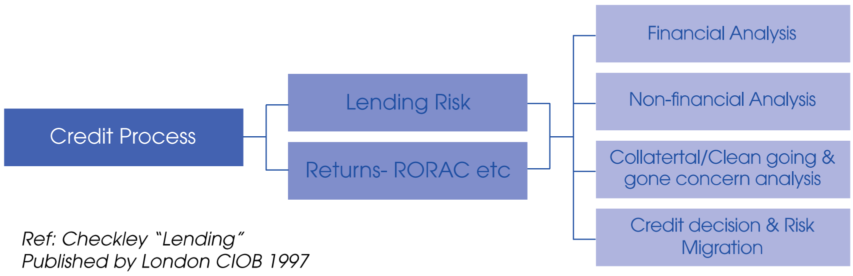
EXTRACTS FROM **UNIT 1** CREDIT RISK MANAGEMENT *continued*

Diagnostic Credit Evaluation Model



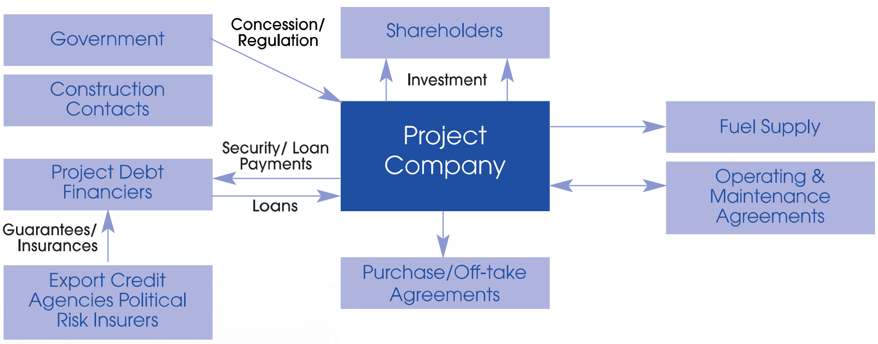
Ref: Checkley "Lending"
Published by London CIOB 1997

2. The level, distribution, severity and trend of problems, classified, non-accrual, restructured, delinquent and non-performing assets for both on and off-balance sheet transactions
3. The adequacy of the allowance for loan and lease losses and other asset valuation reserves
4. The credit risk arising from or reduced by off-balance sheet transactions, such as unfunded commitments, credit derivatives, commercial and standby letters of credit and lines of credit
5. The diversification and quality of the loan and investment portfolios
6. The extent of securities underwriting activities and exposure to counterparties in trading activities
7. Existence of asset concentrations
8. The adequacy of loan and investment policies, procedures and practices
9. The ability of management to properly administer its assets, including the timely identification and collection of problem assets
10. The adequacy of internal controls and management information systems
11. The volume and nature of credit documentation exceptions.

ADVANCED LEVEL CREDIT COURSE

EXTRACTS FROM **UNIT 7** SPECIALISED LENDING & PROJECT FINANCE

Example Power Plant Project Finance Structure



2. Project Finance Checklist Definition:

A financing of a particular economic unit in which a lender is satisfied to look initially to the cash flows and earnings of that economic unit as the source of funds from which a loan will be repaid and to the assets of the economic unit as collateral for the loan. Although the lender may be willing to look initially to the cash flows of a project for repayment as stated. The lender must feel comfortable that the loan will in fact be paid even on a worst-case basis. This may involve undertakings or direct or indirect guarantees by third parties.

2.1 Risks Inherent in Project Finance

- Initial Feasibility: The risks at this stage are borne by the equity sponsors.
- Construction Period: Still a high risk period. Project Finance lenders will endeavour to shift the completion risk to technically and financially reliable sponsors/contractors, as well as the responsibility for cost overruns.
- Operational Period: Project Finance lenders will have to rely on the underlying cashflows from the project and associated contractual arrangements during this stage.

LENDING & PROJECT FINANCE *continued*

2.2 Common Causes for Project Failures

- Delay in completion, with consequential increase in interest expense on construction financing and delay in the expected revenue flow
- Capital cost over-run
- Technical failure
- Financial failure of contractor
- Government Interference
- Uninsured casualty losses
- Increased price or shortages of raw materials
- Technical obsolescence of the plant
- Loss of competitive position in the market
- Poor management
- Overly optimistic appraisals of value of pledged security e.g. oil/gas reserves
- Financial insolvency of host government

2.3 Successful Project Financing Checklist

- Credit risk rather than equity risk involved
- Satisfactory feasibility study and financial plan prepared
- Cost of product/raw material to be used by the project has been assured
- Market exists for the product, commodity or service
- Transportation available at reasonable cost to move the product to the market.
- Adequate communications available
- Building materials available at cost contemplated
- Contractor, Operator, and Management Personnel are experienced and reliable.
- New technology not involved
- Contractual agreement among joint venture partners, if any, is satisfactory.
- Stable, friendly political environment exists; licences/permits available; contracts can be enforced; legal remedies exist.
- Country/Sovereign risk satisfactory
- Currency and foreign exchange risks addressed
- Key promotors have made an adequate equity contribution.
- Project has value as collateral
- Satisfactory appraisals of resources and assets have been obtained
- Adequate insurance coverage is contemplated
- Force majeure risk has been addressed
- Cost over-run has been addressed
- Delay risk has been considered
- Project will have an adequate ROE, ROI and ROA for the investor
- Inflation rate and interest rate projections are realistic.
- Environmental risks are manageable/Legal Compliances are met