Managing Project Risks -- Business Partnerships and Financing

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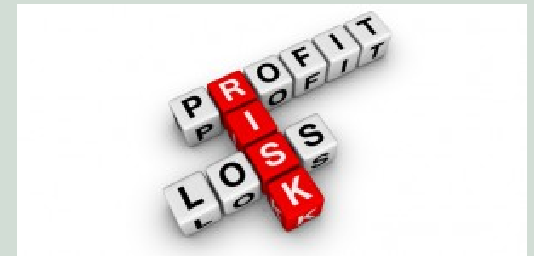
Managing Project *Risks – Discussion Topics*

There are a number of risks which will affect project feasibility, project financing and operational success:

- Strength of the partnership;
- Percentage of initial equity investment;
- Source of revenues and extent to which the revenue stream can be guaranteed over the life of the project;
- Strength of Operator experience;
- Supply of skilled labour;
- Hidden costs -- Taxes, insurance, interest rates, etc.
- Schedule (permitting, community opposition, construction, etc.)



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1) Strength of the partnership and equity participation

Determining the best type of partnership will in large part depend on the financial relationship:

- Do the partners share common goals and vision
- What level of financial risk is each business partner prepared to take?
- What financial capital does each business partner have available for initial investment?
- What potential do the business partners have to raise additional equity (investment capital) and/or debt financing from other sources
- What capability does each partner have to assume and carry risk
- Separate politics from business

Challenge* -- *often Aboriginal organizations do not have the ability to assume risk or assist with initial capital/financing.

Food for thought* – *is equity participation the best option for the community? To what extent?

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Business Relationship/Partnership/Participation Models

There are a number of business partnership/participation models available. Some of the most common are:

- Impacts and benefits agreement -- *usually includes cash*
- Participation Agreement – *sometimes excludes cash*
- Memorandum of Understanding – *not commercially binding*
- Joint venture agreement (JV)/Limited Partnership (LP)/special purpose vehicle (SPV)
- Private-public partnership (P3) – *minimized Owner risk*
- Revenue Sharing – no ownership; no bottom line risk

Each is different; different purposes; different stages of business development. Each nets advantages/disadvantages and carries varying levels of "risk"

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In addition to ownership, there are other potential opportunities for financial benefits:

- Procurement (contracting strategy that maximizes involvement of local businesses);
- Training and capacity building;
- Employment (employment strategy that maximizes hiring of eligible/interested local people from construction through to operations);
- Resource revenue sharing (share of top-line revenues without the risk of ownership) – requires alignment with Ontario and Canada. ***Political Option***

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2) Source of revenues and extent to which the revenue stream can be guaranteed over the life of the project

- Important for financing to have a guaranteed revenue stream (eg. Power Purchase Agreement)
- Term of the revenue guarantee will be an important factor (has to be equal to or longer than period of debt retirement); *challenging for replacement cost model of financing*
- Typically challenging to finance a project based on private sector customers alone (eg. mining projects)
- Calculating ROI/IRR requires certainty in cost structure – often the biggest risk once a guaranteed source of revenue is identified

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3) Strength of Operator experience

- Financiers want a reliable Operator with strong track record of success
- Why? Poor operation can lead to uncertain cost management which can jeapordize ROI/IRR
- Operator does not have to be an equity partner
- However, some "skin in the game" can enhance accountability and performance (tricky balance between control and incentive)
- More challenging to be tough on Operator if equity partner
- Terms and conditions of Operator contract are very important – performance based, strong liability clauses and exit clause

Source: Mark Simchock; Sylvia Duckworth

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4) Supply of skilled labour

- There are some important aspects to skilled labour:
  - Having a reliable and experienced workforce – schedule/productivity
  - Aboriginal inclusion – maximizing the potential for aboriginal skilled/unskilled labour is often and important factor for “social license to operate”; may be negotiated in the IBA/Participation Agreement
  - Get the trades unions on board; often aboriginal labourers are not “union hall”; to maximize aboriginal inclusion it is important the unions buy-in to community/Project goals/objectives
- A skilled labour force takes time to train; plan ahead and communicate potential employment opportunities with youth well in advance of project start-up; start early!
- Manage attrition – ensure the workforce is sensitive to aboriginal culture; encourage mentoring and elder participation
- Aboriginal inclusion can be enhanced with aboriginal set-asides in procurement

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5) Hidden costs -- Taxes, insurance, interest rates, etc.

- There are costs that need to be well understood that are not directly construction or operations related
- "On-reserve" spending is defined/controlled very tightly; to get the tax credit it is important to understand the rules and be conservative with cost estimating
- Bid bonding; the ability to cover the bid bond may be a factor in structuring the partnership and project ownership
- Insurance requirements are similar; can be very costly and typically requires a strong balance sheet and experience; can also shape partnering and ownership structures; some large companies self-insure which can be a big cost savings
- Interest rates are currently very low and attractive; Rates go up much quicker than they come down; Be conservative

Remember that contingencies (operational and construction) add to capital, operating and financing costs

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Schedule (permitting, community opposition, construction, etc.)

- The timeline for permitting and approvals can be uncertain and longer than anticipated; major projects can take 10 years from initial concept to commissioning
- Managing the schedule in the early stages requires strong community and leadership support; opposition can add delays and financing uncertainty
- Project financing never includes the cost to get through EA and feasibility; this is very difficult money to source and can reach up as high as 4-5% of capital cost
- Construction delays can result from many sources -- low productivity; badly managed procurement; poor project management/supervision; labour challenges (disputes and supply); material delivery shortages/delays; weather
- Construction delays directly impact IRR/ROI; delays in getting to production/revenue can be extremely costly

Source: PLANACADEMY

- *Choose your Constructor/operator carefully*
- *Build-in contingencies*
- *Have iron-clad contracts*
- *Avoid liability*

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SUMMARY

There are many factors that can affect the feasibility, financing and long term financial success of a project:

- Feasible project with a high chance of success (revenue and cost certainty)
- Appropriate business partners and adopting the right business partnership model
- “Social License to Operate”
- Labour supply and training
- Schedule certainty and management
- Cost uncertainty and mitigation
- Financing terms and conditions
- Performance.

Not having the building blocks for success will increase “uncertainty” and “risk”, which will in turn threaten project feasibility, financing and profitability

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