

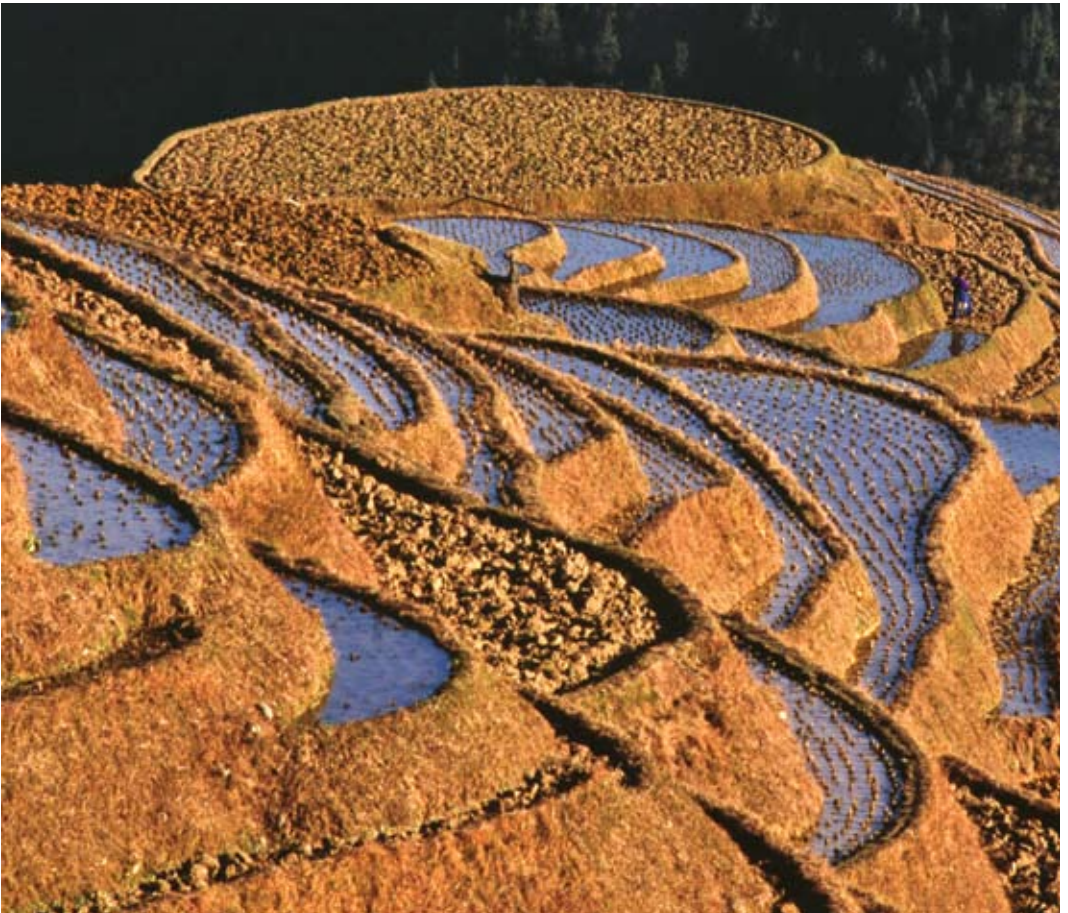
Innovation Series
GLOBAL CORPORATE TRUST

A World of Difference

In the world of project finance, trustees have moved from the back-office to front and center in every part of complex transactions involving a variety of jurisdictions and industries



THE BANK OF NEW YORK MELLON.



Globalization, industry expansion, new investor classes, deal complexity and emerging debt structures are interwoven trends changing project finance and the role of trustees.

Project Finance (PF) is currently enjoying a worldwide renaissance. Governments like it because it allows private money to fund development. Corporations like it for its off-balance-sheet financing of traditional and speculative or “risky” projects. Investors and bankers find it appealing because it allows them to diversify their portfolios while mitigating risk.

Since recovering from the dot-com meltdown, PF has reached record-breaking activity volumes, with US\$181.5 billion (545 projects) in 2006, a 30% increase from the US\$139.2 billion (513 projects) generated in 2005. Overall PF loan volume has been growing at a faster pace than the actual number of new projects, indicating growth in average PF loan size. (Thomson Financial, *Global Project Finance Review*, Fourth Quarter 2006.)

Interwoven trends altering trustee role

Much has changed in the past 15 years, when PF deals typically were “cookie-cutter” US power projects. In those days, the trustee largely played a back-office function, ensuring funds were collected and payments made on a regular and timely basis. There were well-established laws to guide trustees in almost every aspect of their roles and little need to provide further value-added services. Those days seem quaint from today’s vantage point.

While the power sector remains the most active issuer of PF activity, globalization, the expansion of industries using project finance, the rise of new investor classes, deal complexity, and emerging debt structures are all rapidly changing PF and the trustee role. These five interwoven trends are requiring trustees to take on ever-greater roles and responsibilities. As a result, the trustee has gone from being an afterthought on a PF deal to serving as a key partner in the overall plan, central to the success of the project.

Worldwide growth in project finance is rapidly changing the trustee’s role. Once considered back-office servicers, trustees have become vital intermediaries in complex transactions, exercising greater critical thinking across multiple jurisdictions and industries.

Globalization - The US is still a big PF market and power deals remain common. However, a growing number of extremely complex deals are taking place in the Middle East, Africa, and Latin America regions. These deals demand greater trustee expertise and critical thinking than in the past.

New PF uses - PF arrangements are evolving beyond power, oil and gas, bridges, tunnels, and airport facilities to include pollution-control facilities and alternative energy projects, such as solar and wind farms. This evolution requires trustees to be knowledgeable across different industries and project types, equally familiar with what might be required for a power project versus a toll road or wind farm.

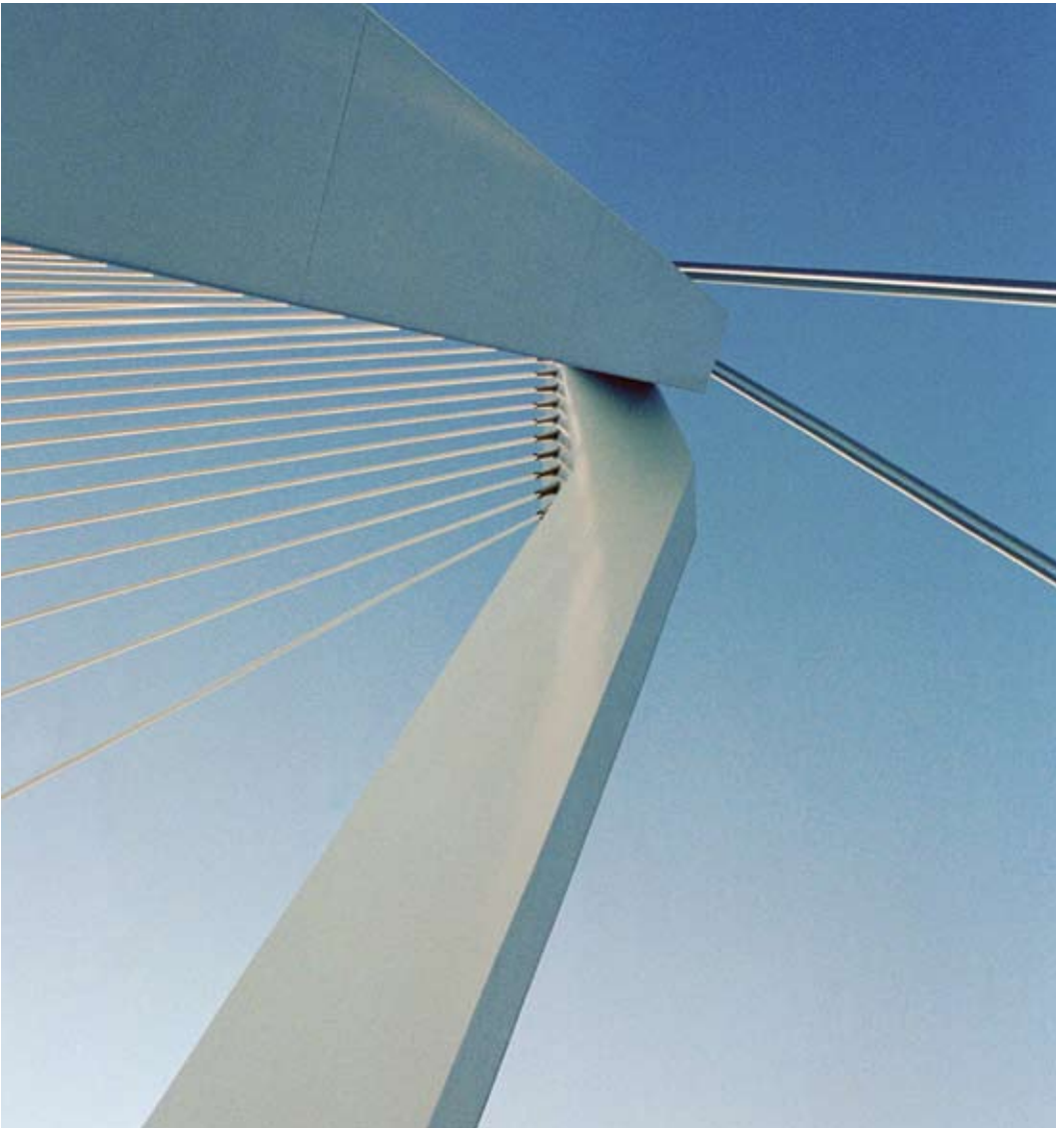
Changing investor classes and reporting needs - PF is being reshaped by the rise of new investor classes, including private equity funds, hedge funds, and institutional investors, such as insurance companies. Another player on this list is the Chinese government, which is buying up commodity rights all across the planet. These groups have lots of leverage, because they can raise lots of money. A typical PF deal, for example, might need to raise US\$1bn from at least 20 or more investors. But a private equity fund can put up the entire amount by itself.

In this rapidly evolving market, trustees are often selected by borrowers and arrangers to administer and support financing arrangements in a variety of new ways. This is leading to increased trustee responsibilities.

Growth of complex 3Ps - Public-private partnerships are growing bigger and more complex. These intricate projects offer great economies of scale, but they also require reaching out to a substantial number of investors for funding. With more investors, the trustee's role becomes more complicated, especially if the project does not perform as planned and remediation becomes necessary. In addition, as these transactions become more complex, so does the role of the trustee, requiring more sophisticated modeling and reporting.

Hybrid project, structured finance - Trustees are often selected to administer emerging-market debt structures in new ways. These deals require a hybrid approach, with structured finance, credit enhancement, real estate financing, and project finance rolled up into a seamless package. That level of planning and execution requires trustee involvement in every part of the transaction, which is well beyond the trustee's normal PF role.

The private market has proven to be better able to finance and manage 3P funding for projects like hospitals and airports, creating opportunities for trustees to take on expanding roles such as cash management.



Key regions

The best way to understand PF trends and how trustees are adapting is to examine some of the latest trends occurring in key regions of the globe.

EMEA was the most active region for 2006, with 272 PF loans worth US\$97.4bn (49.7% of the transactions). Asia-Pacific was the second most active region, with 158 deals (US\$40.4bn), followed by the Americas with 116 deals (US\$44bn). While EMEA has been the most active PF market over the past three years, the Americas had the highest increase in activity for 2006 (103% increase). (Thomson Financial, *Global Project Finance Review*, Fourth Quarter 2006.)

EMEA—Middle East/Africa

The most significant PF trend today is the growing dominance of transactions in the Middle East and Africa. Oil and gas, mining and minerals, and the power sector account for 83% of deals in these regions. Growth areas include Saudi Arabia, Oman, Dubai, Bahrain, Nigeria, Mozambique, Botswana, Ghana, and South Africa. The Chinese government is helping to fuel these projects by lending and investing throughout Africa.

Rising investment plus booming commodity and oil prices are giving these countries the cash to invest in long-term infrastructure projects and to diversify into other products and services, such as leisure, hotels, and financial services.

One example of this trend and how it affects the trustee can be seen in The Bank of New York Mellon's efforts on behalf of Blue City, a massive, master-planned, development project slated to be built on the northern coastline of Oman. I offer this example because of its multifaceted, multi-jurisdictional, and multicurrency aspects. In fact, Blue City was recently awarded Euromoney's Project Finance magazine's Middle East Leisure Deal of the Year.

On this landmark tourism development project, The Bank of New York Mellon was selected by Blue City Investments 1 Limited to provide multiple

The EMEA has been the most active project finance market over the past three years, while the Americas had the highest escalation in activity for 2006 with a 103% increase.



corporate trust services, including acting as trustee, registrar, agent, cash manager, account bank, look-back calculation agent, and Irish paying agent. The trustee is involved in every part of the transaction, well beyond the trustee's normal PF role. The ownership structure, securitisation, and international cash flows also make this project different.

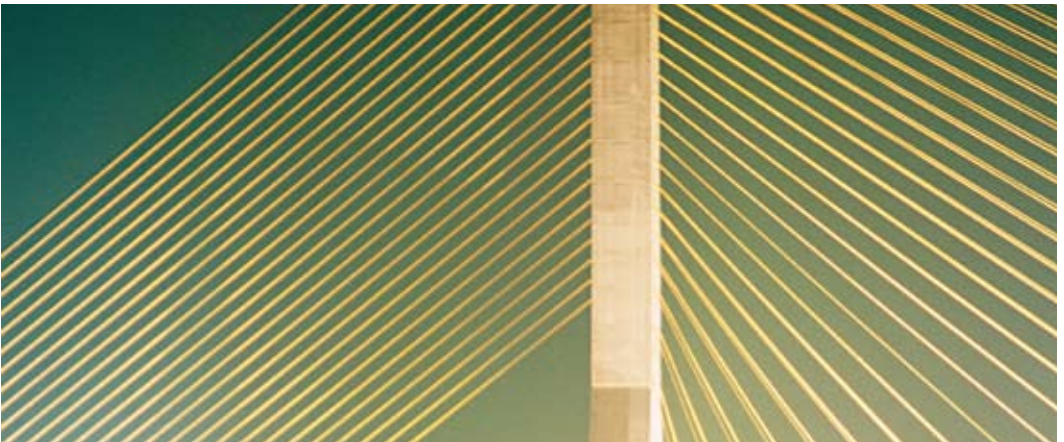
EMEA—Europe

Infrastructure is the main focus in Europe. The transportation sector has taken the lead in lending activity, ahead of the power sectors. The Central and Eastern European countries have substantial investment needs; the question is whether funding will be provided by the EU, by each national government, or through some 3P framework. For PF to succeed in this region, changes in the legal and regulatory framework would be necessary.

North America—Canada

Free-market efforts have brought a breath of fresh air to this market. In July 2005, repeal of the 30% foreign investment limit for registered pension and retirement plans opened the Canadian market to foreign issuers. At the same time, Canada's sliding dollar relative to the euro and low interest rates relative to the U.S. began to cut costs for foreign companies, making Canada a leading choice for raising capital.

As a result, issuances of Maple bonds grew from C\$21.6bn in 2005 to C\$28.7bn in 2006, a 33% increase. In the first quarter of 2007, a total of C\$14.4bn in debt was issued, putting the market on pace to double last year's issuance. European borrowers are now the biggest Maple bond issuers, accounting for about half the sales.



Market liberalization also has led to greater 3P funding for highways, hospitals, universities, and airport projects. It is a growing trend as the private market is proving better able to finance and manage these projects.

These changes are having a direct influence on the trustee. Trustees are continuing to serve traditional structured roles in Canada, such as providing paying agent, transfer agent, issuer and indenture trustee services. But the new foreign issuers—in addition to 3P arrangers—are asking for an expanded role, especially day-to-day administration and cash management. That role had traditionally been played by Canadian banks.

One example of this trend occurred when Babcock & Brown Public Partnerships Limited acquired Access Durham Justice in March 2007, the company developing the Durham Courthouse project in the City of Oshawa, Ontario (outside of Toronto). The 3P contract, commissioned by the Province of Ontario through the Ontario Infrastructure Project Corporation, is to design, build, operate, and maintain a 33-courtroom public courthouse for a period of 30 years. The Bank of New York Mellon was chosen to fulfill its traditional bond trustee role as well as serve as bond manager and insurance trustee.

United States

For a nation that refused to sign the Kyoto Protocol on Climate Change, the most surprising trend is the number of alternative energy projects underway or in development. Investors are lining up to fund ethanol plants, wind farms, liquefied natural gas, biofuels, solar projects, and anything else that might offer a new energy source.

Increasing demands in the transportation, infrastructure and alternative energy sectors are fueling the growth of project finance markets around the globe.

Rising oil prices continue to drive the market. On January 9, 2007, The US Department of Energy's Energy Information Administration projected average prices would remain above US\$64 per barrel for 2007 and 2008. These ongoing higher prices are bringing previously uneconomical production back on line (oil sands, coal liquefaction, etc.) and spurring investor interest in funding development of alternative fuels.

Substantial tax incentives are available as well. At the federal level, the Energy Policy Act of 2005 authorized subsidies for wind and other alternative energy sources, and included a provision for clean renewable energy bonds to be issued by electrical cooperatives and municipalities. The tax code also offers production tax credits, accelerated depreciation schedules for renewable energy equipment, an ethanol production mandate, and tradable "green" energy credits.

These projects require greater trustee attention to detail and a willingness to take on more risk. Overall there is more daily activity, more investment of monies and distributions of money, and more documentation to obtain and review, all of which require a greater level of care. The trustee typically is brought in at the post-planning phase to ensure the documents being created will work mechanically. Increasingly, these projects require trustees who have worked on renewable energy projects before and have expertise in working on projects such as a wind farm.

A second trend is growing privatization within the transportation sector, especially for toll roads. More of these projects are being financed through bonds, rather than loans, which increases the responsibilities of the trustee.

Latin/South America

PF is growing throughout Latin America, fueled by rising oil prices, growing demand for commodities, and the lack of infrastructure to support extracting these resources. Both the Chinese and Japanese are investing throughout South America. The biggest push is in Brazil, particularly for power and infrastructure-type projects. Local companies are obtaining funding directly in the local capital markets. In the past, most funding came from big banks and corporates.

The focus in Mexico is on toll-road projects, with a greater proportion of

transactions being securitized locally in pesos. We had been accustomed to seeing Mexico issue into the US or Europe to obtain capital, which required us to follow New York or UK law. Some of the New York investment banks have recently opened local offices or have beefed up staffing in Mexico.

Asia-Pacific

Strong regional economic growth, increased interest by foreign investors, and market deregulation resulted in a record year for Asian PF (+83% versus 2005). (Thomson Financial, *Global Project Finance Review*, Fourth Quarter 2006.) As in Europe, the top three sectors were transportation, power, and oil and gas. In India, total deals year to date are approximately US\$22.6bn. Inside China, the government still controls infrastructure development, so PF development is slow to take root.

The main APAC project finance instrument is loans. As such, the common PF intermediary is the facility agent, which tends also to act as the security agent and account bank. It has been a highly specialized area dominated by a few banks, but that situation is changing as deal size grows, with extensive mixing of corporate and project debt financing packages. Infrastructure needs should drive PF in India and China over the coming years.

The increased role of trustees not only requires global settlement and cash management capabilities, but also cultural, transactional, legal and regulatory understanding of each local market.

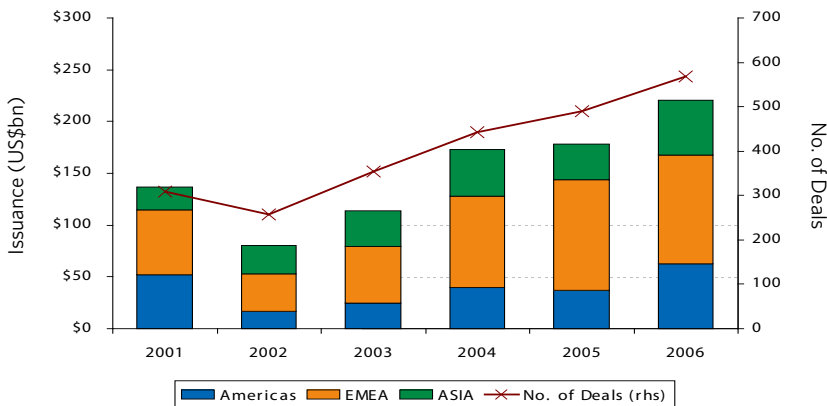
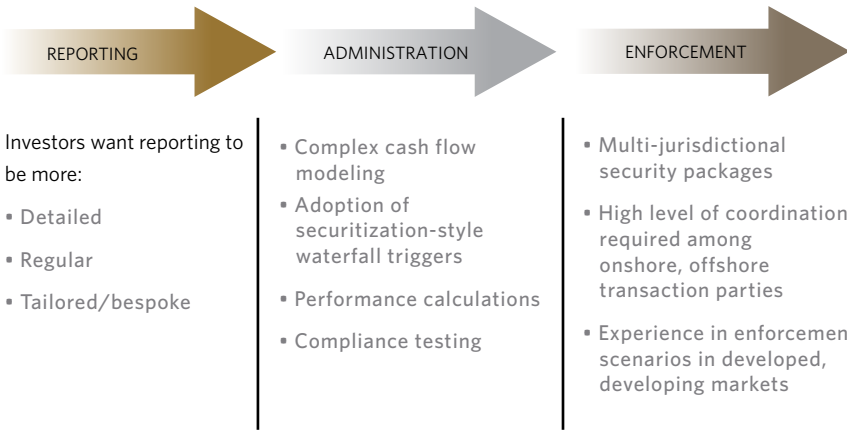
Trustee role expanding worldwide

While each region and nation presents unique situations and challenges, globalization, the expansion of industries using project finance, the rise of new investor classes, deal complexity, and emerging debt structures are all rapidly changing PF and the trustee role.

As these projects become more complex, trustees are taking on greater responsibilities and exercising more critical thinking.

Trustees today are able to provide more services than in the past. However, to undertake multifaceted, multi-jurisdictional, and multicurrency PF projects, clients need a dedicated independent trustee who has global settlement and global cash management capabilities. The right trustee also understands each local market from a cultural, transactional, legal, and regulatory standpoint, which can help to reduce risk for international investors.

Demands Growing on Trustees in PF Transactions



Source: Dealogic Projectwear

Samir Pandiri joined the Bank in 2005 and is responsible for managing the international services business, which includes the EMEA, Asia and Americas regions, and the Investment Management Group for the Bank's Global Corporate Trust Division. Prior to joining The Bank of New York, Samir spent nearly 15 years at other financial services organizations, with expatriate business management assignments in Hong Kong, London, and New York. The global trust services team within the corporate trust division comprises more than 800 professionals who are experts in innovative types of financings and have in-depth understanding of both their local markets and their respective client needs.

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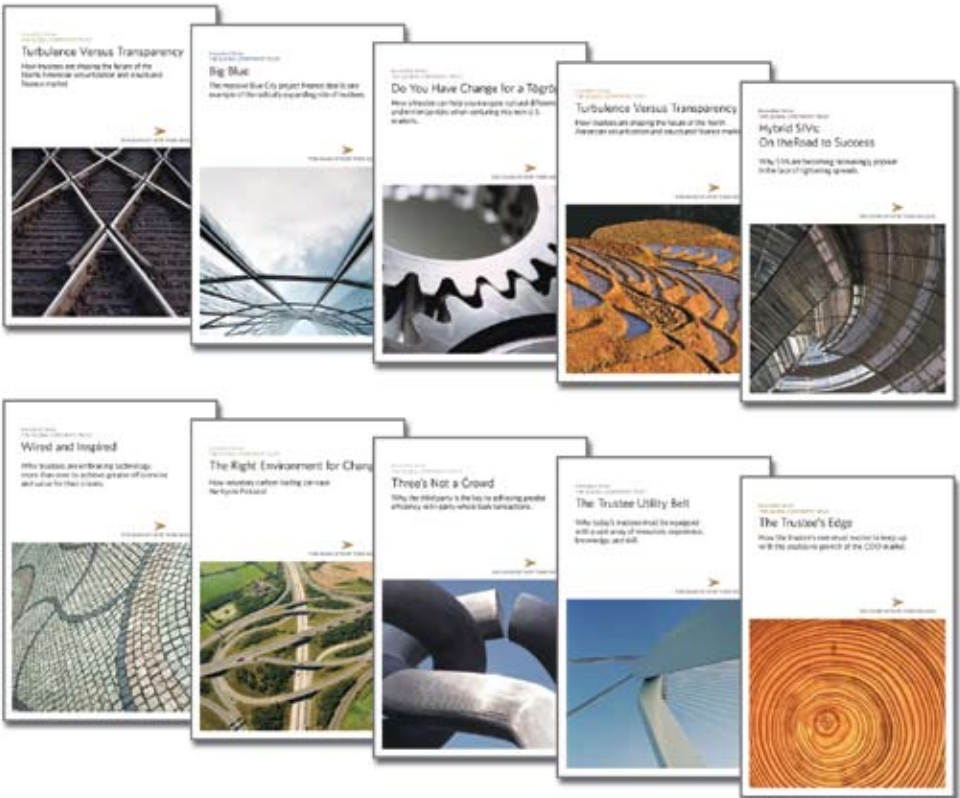
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Who's Helping You?



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Project finance is growing due to globalization, industry expansion, new investor classes, deal complexity and emerging debt structures. Learn how these interwoven trends are strengthening the role of trustees in this edition of the Global Corporate Trust Innovation Series.

Who's Helping You?



By Samir Pandiri



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