COMMERCIAL BANKS, THE MAIN PROVIDERS OF PROJECT FINANCE IN CROATIA

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ABSTRACT

Croatian banks operate as universal banks and they are the only providers of project finance. In the Republic of Croatia debt markets for project finance, in particular commercial banks project finance activities are not on the level of European banks. This paper reports the results of a mail survey of project finance offered by Croatian banks. It is based on a questionnaire sent to 31 banks. The response rate was 90.32% (28 out of 31). The goal of the empirical survey was to determine the level of project finance offer and understanding project finance techniques in Croatian banks.

Introduction

Empirical survey has been undertaken in Croatian banks during the August and September 2012. Questionnaires were sent to 31 banks according to the rank list of banks in Croatia [1]. Project finance specialists and those who covers corporate segment were targeted persons. Questionnaire contains 10 questions about the project finance service offered by banks, number of realized/financed project in the last ten years, types of the realized/financed projects, and the need for special purpose vehicle (SPV). The survey had a response rate of 90.32%, 28 out of 31 banks responded to the survey.

According to the total assets, 5 of the sample banks have total assets of less than 1.000 billion kuna, 15 from 1.000 to 5.000 bill., 1 from 5.000 to 15.000 bill., 2 from 15.000 to 30.000, 2 from 35.000 to 45.000 bill., 2 from 55.000 to 70.000 bill., and 1 of the sample banks has total assets more than 100.000 billion kuna. Croatian banking market is strongly concentrated where two largest banks hold more than 42% of the market, while five largest banks have almost 76% of the total assets on the banking market (Table 1) [1].

Table 1: Five largest banks in Croatia with total assets and share in total assets

Name of the bank	***Total assets in 000 HRK***	***Share in total assets (%)***
Zagrebačka Bank d.d.	105.111.059	26.07%
Privredna Bank Zagreb d.d.	66.752.776	16.56%
Erste & Steiermärkische Bank d.d.	57.964.061	14.38%
Hypo Alpe-Adria Bank	40.091.136	9.95%
Raiffeisenbank Austria d.d.	36.099.919	8.96%

Croatian banks operate as universal banks. However they mainly operate as commercial banks. In that way, Croatian banks are the only providers of project finance. However, they can also bring together or include other financial institutions into the project finance structure.

Project Finance: Evidence from Croatia

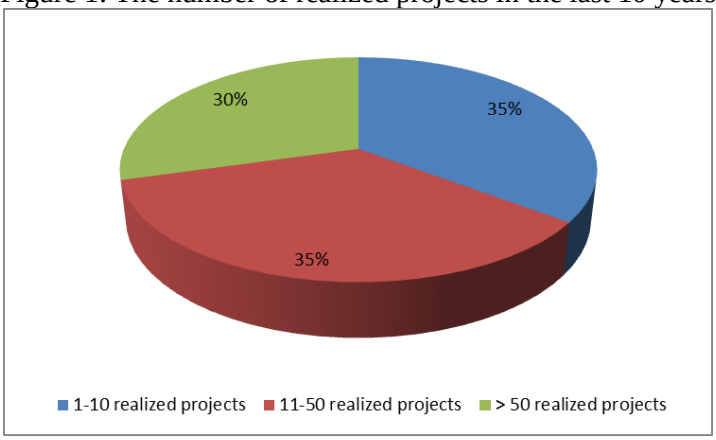
Project finance is generally used to refer to a non-resource or limited recourse financing structure in which debt, equity and credit enhancement are combined for the construction and operation, or refinancing, of a particular facility in a capital-intensive industry [2]. Project finance is the structured financing of a specific economic entity, also known as the project company – created by sponsors using equity or mezzanine debt and for which the lender considers cash flows as being the primary source of loan reimbursement, whereas assets represent only collateral [3].

Project finance can raise capital from a range of sources. This would include equipment suppliers with access to export financing; multilateral agencies; bilateral agencies, which may provide financing or guarantees; the International Finance Corporation or regional development banks that have the ability to mobilize commercial funds; specialized funds; institutional lenders and equity investors; and commercial banks, both domestic and international [2].

In the Republic of Croatia the first example of project finance can be found in the mid-1990. It was the first form of project finance through the partnership of private and public sector in the construction of Jadranska highway in Istria. After that, we can find the similar examples in construction of highways in other part of Croatia. In the last ten years there are just a few projects where we can find project finance techniques. Croatian market is still in the learning and preparation phase for the future, even though the results of the survey show that from 28 of the banks that participated in the survey, 17 of them or 61% of them offer the service of project finance.

From 17 of the banks that offer the service of project finance, 6 of them realized/financed 1-10 projects, 6 of them 11-50 projects, and 5 of them realized/financed more than 51 projects in the last ten years (Figure 1).

Figure 1: The number of realized projects in the last 10 years



Project finance, as an appropriate method of long-term financing for capital-intensive industries can be identified in different sectors: finance for natural resources projects, finance for independent power projects, finance for public infrastructure and finance for telephone networks [4] [2]. According to the results of the survey, 17 of the Croatian banks participated with project finance in various industries, like tourism, real estate, infrastructure, energy, telecommunication and ecology. Although in the last 20 years, the majority of project finance in Croatia, in real sense, can be found in construction of highways,

Croatian banks did not participate in finance for public roads (highways). Responses are summarized in Table 2.

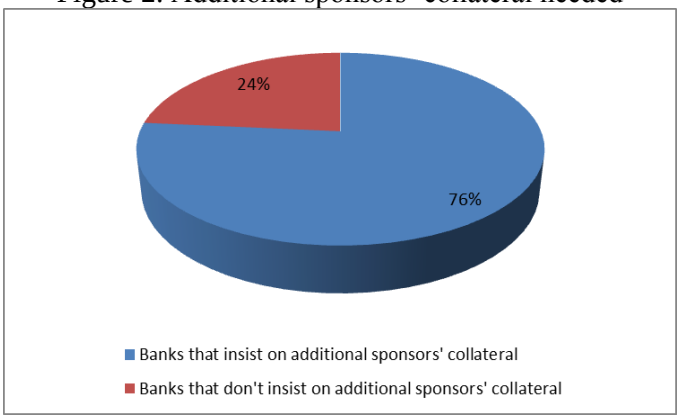
Table 2. Project finance in different sectors

	Responses (%)	Responses (numbers)
Tourism	64.71%	11
Real estate	100.00%	17
Infrastructure	17.65%	3
Energy	29.41%	5
Telecommunications	5.88%	1
Public roads	0.00%	0
Ecology	5.88%	1

Many lenders deal with project finance as part of their "structured finance" operations, covering any kind of finance where a special-purpose vehicle (SPV) like a Project Company has to be put in place as the borrower to raise the funding, with an equity and debt structure to fit the cash flow, unlike corporate loans, which are made to a borrower already in existence [4, p. 12]. Results of the survey shows on the scale from 1 to 5, that from 17 of the banks, 3 of them or 17.65% think that special-purpose vehicle is not necessary for project finance structure, and on the other hand, 6 of them or 35.29% think that it is more than necessary to set up a special-purpose vehicle for project finance structure. The rest of the banks are in between with their answers.

According to the results of the survey, all of the 17 banks that offer project finance will not finance any project without appropriate Sponsors. Sponsors' financial credibility is very important. Furthermore, when decide about financing a project, 13 banks or 76.47% of them insist on additional sponsors' collateral and 4 banks or 23.53% of them do not insist (Figure 2).

Figure 2: Additional sponsors' collateral needed



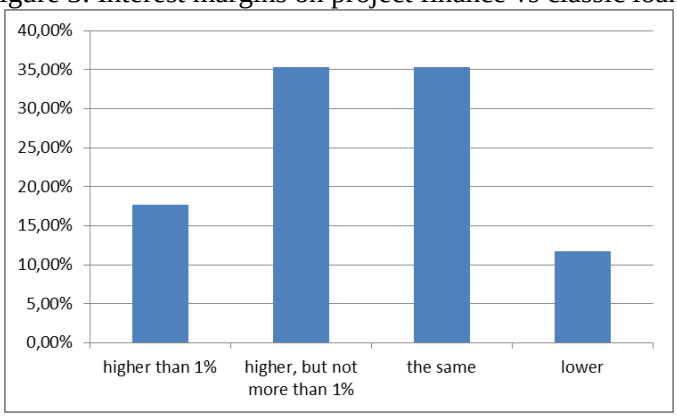
Another area of interest in our survey was to determine the size of the interest margin on project finance, compared to classic forms of financing. In general, interest rates on project financings may be higher than on direct loans made to the project sponsor since the transaction structure is complex and the loan documentation lengthy. Project finance is generally more expensive than classic lending because of [2, p. 6]:

- the time spent by lenders, technical experts and lawyers to evaluate the project and draft complex loan documentation;
- the increased insurance cover, particularly political risk cover;

- the costs of hiring technical experts to monitor the progress of the project and compliance with loan covenant; and
- the charges made by the lenders and other parties for assuming additional risk.

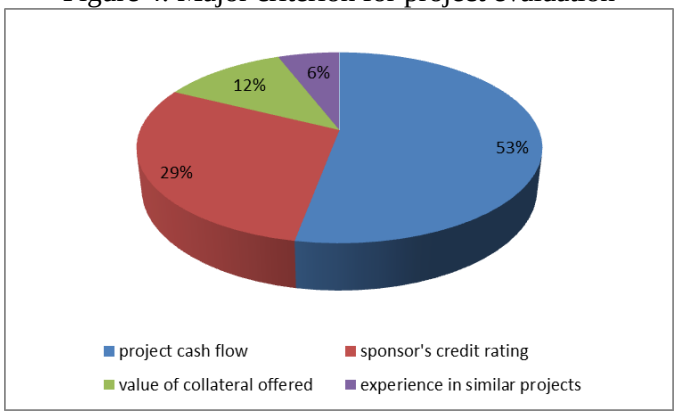
According to the results of the survey 3 (17.65%) of the sample banks have higher interest margins on project finance for more than 1% compared to those on classic loans, 6 (35.29%) of them have higher interest margins on project finance but not for more than 1%, 6 (35.29%) of them have the same interest margins on project finance and classic loans, and 2 (11.76%) of the sample banks have even lower interest margins on project finance than those on classic loans (Figure 3).

Figure 3: Interest margins on project finance vs classic loans



Finally, we wanted to find out what is the major criterion for positive decision when a bank evaluate individual project and approve project finance. According to the results of the survey, for 9 of the sample banks or 52.94% of them the major criterion for positive decision is a project cash flow, for 5 banks or 29.41% of them it is a sponsor's credit rating, for 2 banks or 11.76% of them it is a value of collateral offered, and for 1 sample bank or 5.88% of them it is the experience in similar projects (Figure 4).

Figure 4: Major criterion for project evaluation



Conclusions

This paper has presented the findings of a mail survey of the project finance sent to a selected sample of 31 banks in Croatia. The response rate was 90.32%. The purpose of this study was to determine the bank's project finance activity, especially number of realized/financed project in the last ten years, types

of the realized/financed projects, the need for special purpose vehicle (SPV), the size of the interest margin on project finance and major criterion for project evaluation. The results of the survey show that 17 of the responding Croatian banks offer the service of project finance, or we could say that 17 banks have project finance activity. Croatian banks participated with project finance in various industries. However, in the last 20 years, the majority of project finance in Croatia, in real sense, can be found in construction of highways, Croatian banks did not participate in finance for public roads (highways).

Results also show that for 3 of the sample banks special-purpose vehicle is not necessary for project finance structure, and 6 of them think that it is more than necessary to set up a special-purpose vehicle for project finance structure. According to the results of the survey 3 of the sample banks have higher interest margins on project finance for more than 1% compared to those on classic loans, 6 of them have higher interest margins on project finance but not for more than 1%, 6 of them have the same interest margins on project finance and classic loans, and 2 of the sample banks have even lower interest margins on project finance than those on classic loans. Finally, we find that for 9 of the sample banks the major criterion for project evaluation and positive decision is a project cash flow, for 5 of them it is a sponsor's credit rating, for 2 banks it is a value of collateral and for 1 sample bank it is the experience in similar projects.

In conclusion, Croatian banks operate as universal banks and they are the only providers of project finance. Commercial banks project finance activities in Croatia are not on the level of European banks. Because of the financial crises in the last few years Croatia faces a lack of investments. However, there are some bank's project finance activities. The largest Croatian banks have special departments for project finance and they can offer a full project finance service. We hope that project finance activities will improve in the future.

Literature

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