These factors are particularly important if the project developer is operating in a country for the first time. Lenders must have confidence that the developer will complete the project on time and on budget and that they will operate the project efficiently. All three elements are essential if cash flow is to meet debt service requirements as well as provide a satisfactory return to shareholders.

Economic Feasibility Risk

Lenders need to be satisfied that the project is economically feasible. They will usually expect to see a feasibility study completed by the project developer. They need assurance that sufficient cash will be generated from project operations to cover operating expenses and service the debt, as well as provide a return on the equity invested. They also want to see that the project is sufficiently robust to withstand adverse developments such as demand fluctuations, price changes and contingencies such as rising interest rates or falling exchange rates.

A key question is: who will accept the foreign exchange risk? The ensuing analysis should test cash flow projections using base case, best case and worst case scenarios. The sensitivity of profitability to changes in each variable should be tested, with probability estimates applied to each case.

Risk of Non-completion

The essence of limited-recourse or project financing is that loans are repaid only from the cash flow of the completed project and not from the cash reserves of the owners themselves. The risk is that non-completion means no cash flow and, therefore, no ability to repay the owners from the revenues generated by the project. For this reason, many lenders require project developers to guarantee all debt prior to completion of the construction and start-up of the operation.

Other lenders are prepared to accept the completion risks, provided that the project developers are well-established and that the underlying project is inherently robust and relatively uncomplicated. Certain elements in the build-operate-transfer (BOT) arrangement can also help to offset the lender's reluctance to accept completion risks. They include the following:

- fixed price turnkey contracts for construction and equipment;
- developer undertakings to meet cost overruns;
- clear commitments to achieve completion;
- performance bonds and liquidated damage undertakings;
- penalties for late performance;
- insurance protection against *force majeure* during construction; and
- assignment of contract benefits to lenders.