Making mining projects bankable

by Thomas Wexler

The word “bankable” is often used in mining project financings. For example, definitive feasibility studies and material project contracts are sometimes referred to as bankable. Structures that allow projects to be funded by bank debt are also called bankable. Yet use of the word is neither defined nor constant. A working description of the term might be: “in a form, and having content that banks would agree is suitable and conforms to market practice.” Bankability is obviously a fluid, subjective concept.

Banks are last to commit their funds to a project but often cover as much as 70 to 80 per cent of the overall project costs. As a result, they take a quasi-equity view of their investment. First-time borrowers protest that the heavy documentation and intrusive consent requirements and reporting covenants amount to micro-management, but for banks this degree of protection is non-negotiable. For sponsors contemplating project finance, much time, expense and misery can be saved by anticipating banks’ needs and structuring their project to meet those requirements.


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One key feature of bankability is that the financed asset should be owned by a single-purpose entity solely dedicated to the development of the subject asset. If a financing runs into difficulties, creditors want to exercise remedies, or more likely, restructure the original financing, without being forced to negotiate with equally ranked creditors. A project sponsor should ensure that the relevant borrowing entity owns only that asset. Otherwise, the sponsor will need lenders’ consent to release non-core assets from their security structure. Lenders are reluctant to grant such a release prior to completion or where the project is not performing well. If possible, a sponsor with multiple potential projects, especially those at different stages of their economic lives or in different jurisdictions, should keep them in separate vehicles, each owned by distinct intermediate holding companies.

Lenders require an effective lien over every asset that a borrower owns or may own in the future. This includes rights over real property, deposits, mine output, contracts and intangibles. This may not always be practical, efficient or effective, especially in civil law jurisdictions that do not have the common law concept of a floating lien or debenture (which extends a security interest over all of a borrower’s assets regardless of type, location or time of creation or acquisition).

There are several areas where the lenders’ need for a full security package may not be realized. First, the civil codes of certain jurisdictions, which were drafted before mining project finance was invented, do not necessarily provide for an effective security interest over every type of asset. Fortunately, many jurisdictions are revising their legal systems to facilitate the security-taking process.

Second, certain countries’ foreign investment legislation may prevent strategic assets — mineral deposits or land overlying those deposits — from being mortgaged in favour of foreign lenders, or owned by them following foreclosure. Project funders attempt to allay this problem by having an onshore entity hold the “restricted” assets in trust for offshore creditors.

Third, and sometimes the most time consuming, is the issue of contractual rights and permits. In most cases, a borrower may assign, by way of security, its rights in contracts, permits and other third-party claims. Note that this affects only the assignment of the borrower's contractual rights. It does nothing to ensure performance by the counterparty to that contract. Without a direct contractual link with the counterparty, lenders can face difficult situations. For example, a borrower might default prior to completion with the construction contractor still on site and refusing to continue work without all payments being made current. Or, a buyer could default for operational reasons and the lenders may wish to sell the mine or the mining company, yet find that the authority responsible for the mining concession refuses to allow a new owner to operate the asset.

To avoid these scenarios, lenders insist on direct contractual relationships with counterparties to key contracts and permits. Generally known as direct agreements, collateral warranties or consents, these documents should, at minimum, provide for the counterparty to recognize the lenders' right to cure the project company's default and for the counterparty to continue performing its obligations with a successor to the borrower. While direct agreements are negotiated between the counterparty and the financiers, the completion of these documents to the lenders' satisfaction is a condition precedent for drawdown.

Contractors operating on international projects are used to negotiating direct agreements with lenders; less sophisticated counterparties often balk at this requirement. Lenders also need to take a realistic view as to what can be obtained, and over what time frame. For example, it is not reasonable for lenders to insist on direct agreements with all contractual counterparties, especially for non-material contracts or where the counterparty's services are offered to any paying customer. In certain countries, concessions or licences granted to a mining company are considered a unique privilege for the original borrower and are not transferable even to a credit-worthy successor nominated by the lenders in a restructuring. At best, lenders may have to settle for comfort from the relevant authority agreeing to consider granting the mining rights to an acceptable successor.

This article describes only some of the features of a bankable transaction. Potential borrowers will ultimately save time and expense by understanding the extent of and reasons for banks' requirements and anticipating those requirements as far in advance as possible. CIM

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