Scope's Project Finance Ratings Q&A
How We Are Different

Scope's project finance ratings focus on the expected loss for an investor exposed to project finance credit risk. This innovative analytical approach is a valuable alternative to existing credit opinions in infrastructure and project finance.

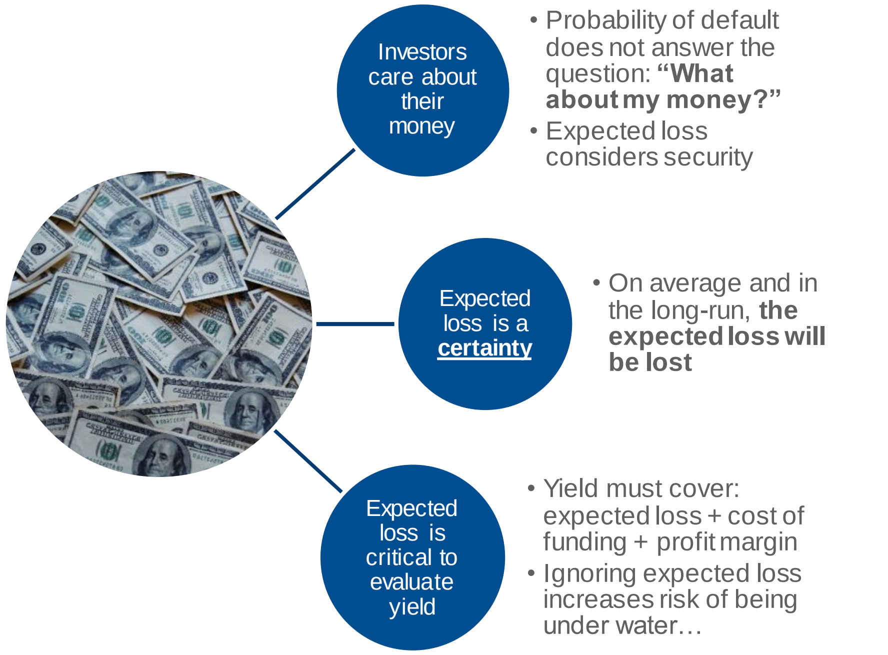
Is there a need for new infrastructure and project finance ratings?

Scope offers credit analysis which addresses the ultimate risk for investors: the risk of a loss, rather than the probability of default-events which will often only result in some form of restructuring, frequently with limited or no severity to senior creditors. Rating approaches which focus solely on assessing a probability of default leave investors wondering what will happen to their investment after a default.

What do Scope's infrastructure and project finance ratings reflect?

A rating reflects the expected loss associated with payments contractually promised, by the legal maturity, and accounting for the time value of money at the rate promised to the investor.

Figure 1. Why expected loss ratings?



Source: Scope.

What are the three pillars of Scope's infra and project finance approach?

Scope built the analytical approach on three pillars well understood by project finance experts: 1) A project is not a corporate; 2) Project finance is about security; and 3) Black swans exist in project finance (i.e. unlikely events with very severe consequences). See Figure 2, Figure 3 and Figure 4 for details of the three pillars.

What key aspects make Scope's project finance rating approach different?

Scope pays equal attention to the likelihood and the severity of the credit impairment events which may result in losses for an investor, offering an analysis of recovery rates. We are thus able to reflect in our rating: events with potentially catastrophic severity, yet with remote likelihood; as well as more likely events with mild severity. The expected loss to the investor results from combining contributions from all possible project outcomes weighted by their likelihood.

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Related Research

General Project Finance Rating Methodology
November 2019

General Project Finance Analytical Considerations
September 2017

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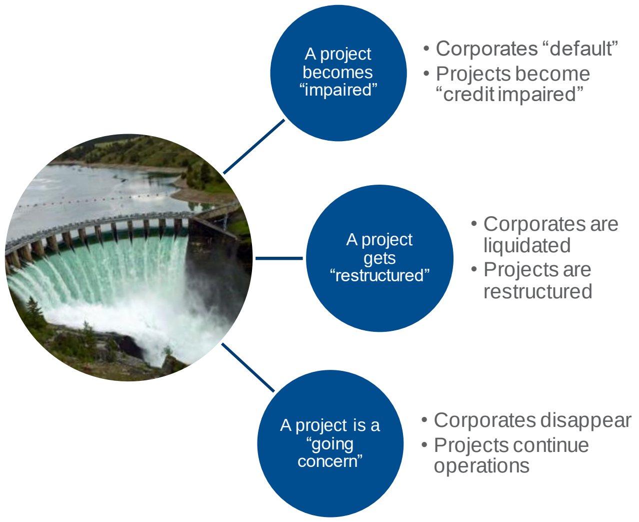
Can Scope analyse greenfield projects and merchant risk?

Scope's value approach to project finance ratings analysis enables us to capture construction risk and see through to the operating life of the asset. Likewise, the fundamental analysis of value also allows to reflect merchant risk. This is makes Scope's analytical approach one of the best-suited to reflect current trends in project finance.

Can Scope capture the specifics of different markets?

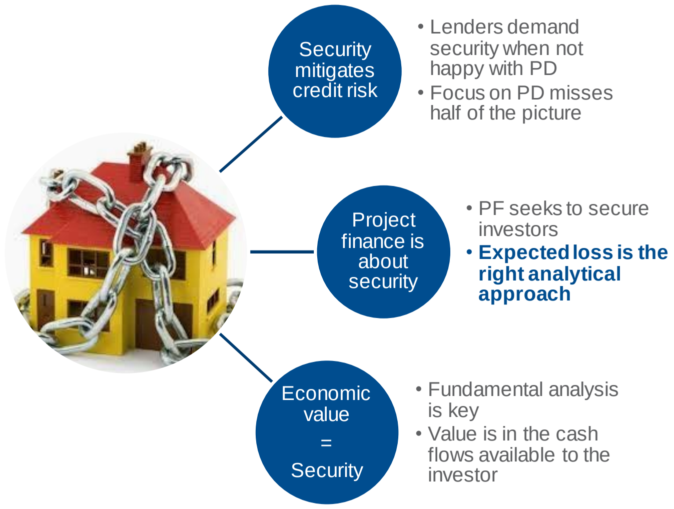
Scope's methodology captures the key differences that exist between countries and markets, like local market characteristics and governance structures which influence PPP frameworks. For example, our analysis is sensitive to supportive elements such as termination provisions that would reduce the severity of credit impairment events. This is one advantage of our focus on expected loss, which enables investors to compare credit risks between diverse locations and markets in a systematic and consistent manner.

Figure 2. Pillar 1: A project is not a corporate



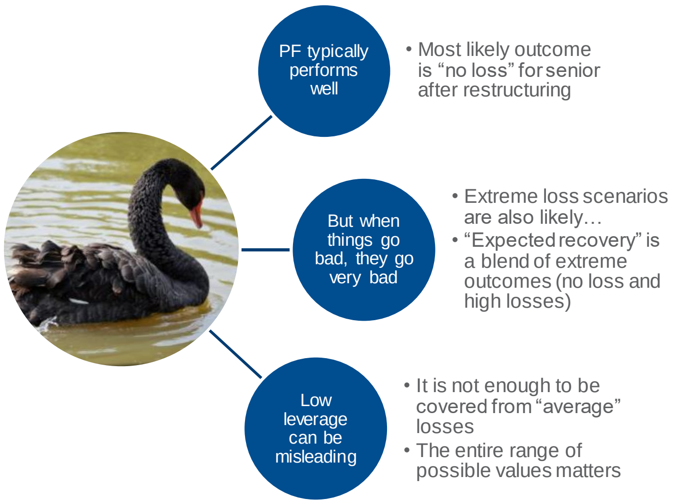
Source: Scope.

Figure 3. Pillar 2: Security is important



Source: Scope.

Figure 4. Pillar3: Black swans exist in project finance



Source: Scope.

What is the most important element of your analysis?

Scope analyses the project's economic fundamentals and the competitiveness of its output in its specific political, regulatory and market context. They influence the framework of incentives of the stakeholders and are key drivers of the credit performance of a project, together with the strength of the financial structure. This is the foundation of our credit analysis, and we put effort in understanding the rationale for the project and its strategic positioning in the market.

Is this methodology transparent?

Scope's methodology provides an unprecedented level of transparency in rating methodology, through a detailed and clear presentation of our analytical approach and the assumptions we make during the rating process. This glass-box approach is for the benefit of investors, and helps sponsors understand our credit view of relevant risk areas in project finance.

Our methodology details thorough guidelines for the assessment of a project's risk factors and recovery risk factors. This makes it possible for projects to be rated consistently and reduce the impact of subjectivity in the qualitative assessments of risk.

How does Scope provide insight into a project's risk characteristics?

Scope splits the risk of a project into areas of risk which could trigger credit impairment events. This framework enables us to identify and analyse the specific risk factors that drive each risk area. Furthermore, we are also able to reflect on the different risks of the stages of a project (i.e. construction and operation), and our analysis goes beyond the moment of default when we analyse the severity of credit impairment events. Our analysis empowers investors by identifying the risk elements contributing the most to total expected loss.

Is Scope sensitive to the structural characteristics of a project?

Scope's methodology is sensitive to the structural elements designed to protect investors. For example, Scope's analysts capture the effects of subordination, amortisation speed, refinancing risk, promised rate, distribution lock-up, etc. when they analyse the severity of the most relevant credit impairment scenarios using the project's cash flow model. This rigorous approach incorporates a project's unique characteristics and structure and makes our ratings sensitive to changes in the project or its environment.

What can Scope rate under its project finance methodology?

Scope applies this rating methodology to the analysis of cash-flow-secured debt issued by projects and structured corporates. Our analysis will credit the security package and the project finance characteristics present in the rated debt (e.g. ring-fencing, strong covenants, finite risk horizon, step-in rights), even if the issuer does not strictly qualify as *project finance*. This flexible approach is well-suited to accommodating the broad range of structures and legal forms used for infrastructure and project financing.

Does Scope apply mechanistic sovereign or counterparty caps to project finance ratings?

Scope does not mechanistically limit the maximum rating achievable by project finance credit exposures based on the credit quality of the host country or counterparties (e.g. an offtaker). Instead, our analysis focuses on the specific role of a given counterparty and related risk factors influencing a given risk area, which we assess and factor into our analysis. Scope's credit ratings reflect the credit risks of a project, including risks arising from an exposure to a country or counterparty with weak credit quality or economic fundamentals in cases where it is justified.

What additional value does Scope offer through these ratings?

Scope analyses the relationships and incentives of the stakeholders in a project to build a view on the 'soft' components of the contractual framework. Scope analyses how and to what extent the interests of the sponsor and other stakeholders of the project are aligned with those of the investor. Sponsor's interest in the project is an important driver of the sponsor's expected performance.

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