REPRINT | FINANCIER WORLDWIDE MAGAZINE

FINANCIER WORLDWIDE corporatefinanceintelligence

REPRINTED FROM:
SEPTEMBER ISSUE 2012

Weighing the opportunities and risks of project financing in Iraq

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New project financing opportunities are opening up throughout Iraq. As the country's economy recovers from decades of war, demand is growing for new infrastructure. Because internal public funds are limited, the Iraqi government has taken a number of steps in recent years to attract international capital in sectors like housing, hospitals, power plants, transportation, telecommunications and manufacturing. As a result, construction projects are underway in Baghdad and other urban centers and rural communities.

But should a prudent foreign investor consider financing such projects? Certainly, an investor needs to weigh the risks, as well as the opportunities. From a security standpoint, many areas of Iraq, particularly in the northern region of Kurdistan, offer a relatively safe environment with reduced political risk.

Attracting foreign capital

To stimulate investment and development of infrastructure projects, Iraq enacted several investment laws in 2006 at the federal and regional level. These laws are aimed at encouraging foreign investment that creates job opportunities for Iraqis as well as strengthening the nation's economy. To take advantage of these incentive programs, it's important for international investors to understand the requirements of these laws.

Iraq's Investment Law No. 13 of 2006 established the National Investment Commission (NIC), which has the authority to grant investment licences for projects of national and strategic importance. The NIC is designed to serve as a single point of contact for investors considering projects that typically are greater than US$250,000.

There are many benefits of an investment licence, including exemptions from project taxation for 10 years, the right to repatriate capital and assets and a guarantee that the project will not be nationalised, except by a court ruling.

However, a licence does impose a few burdensome requirements, such as employing a certain number of Iraqi citizens, providing feasibility studies, and submitting certified and audited financial records. However, this is the official Iraqi platform for obtaining key investment incentives.

In many ways, the Kurdistan Investment Law No. 4 of 2006 provides a more appealing legal framework for projects in that region, including a more comprehensive set of tax exemptions. As a result, a growing number of international investors have been considering projects in that semi-autonomous area. In fact, Kurdistan's autonomy and ability to serve as a secure gateway to the region are important considerations when making investment decisions.

In general, the Iraqi and Kurdistan laws provide investors with important guarantees to reduce legal risks and explicitly permit arbitration as a means to resolve investment-related disputes.

A risk mitigation checklist

Before entering into a long-term project financing arrangement in Iraq or Kurdistan, it's essential to mitigate as many risks as possible. Therefore, investors should consider the following steps:

Conduct a thorough due diligence process. Foreign investors need to look closely at local contractors and make sure that they have the right people and systems in place, along with a genuine commitment to completing the project.

Understand the applicable laws and regulations. Investors must be sure they know the legal provisions and governmental requirements and be certain they can comply with those rules in order to minimise the risk of a potential challenge down the road.

Engage local professionals. It's vital for foreign investors to engage local professionals with deep knowledge of the issues associated with doing business in Iraq and Kurdistan. This is one of the most effective ways to gain firsthand understanding of the business and legal climate, as well as identifying local participants for a major project.

Get assurances in writing. Foreign investors should obtain guarantees and assurances from the government on tax and financial incentives, ownership of assets, documents for international workers and other key points. Putting these key points in writing can reduce the risk of misunderstandings and also puts the government on notice regarding the terms and conditions of the project.

Share the risk. Bringing in a multilateral agency such as the World Bank or the European Bank for Reconstruction and Development can help mitigate the political risks for large-scale infrastructure projects. After all, the regional or national government will want to maintain a positive relationship with these international financial entities.

Purchase political insurance. Political risk insurance is one of the

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key mitigation tools for investors and lenders. In Iraq, obtaining political risk coverage should be high on the list of any investor's priorities. However, no policy can protect against all risks, and investors need to weigh the trade-offs between coverage and premium rates, and understand that insurance alone will not make a bad agreement any better.

Choose the appropriate financial structure. Foreign investors should examine their options for financing a project, including the benefits and disadvantages of each structure. For example, a public-private partnership may offer a foreign investor some protection against market risks.

Secure ownership of assets. Whenever possible, an international investor should strive to secure ownership of the asset (or land) being developed in Iraq. Since Iraq's investment laws place restrictions on some forms of land ownership, a leasing arrangement may be necessary. But in any case, agreements should be made to give investors as much control as possible over project assets.

Prepare a contract that protects your interests. When negotiating and drafting financial agreements, foreign investors must be sure to protect their interests. That means avoiding boilerplate language and provisions, such as resolving disputes 'in local courts'. An international arbitration requirement is one of the essentials in any Iraqi contract.

Consider the opportunities

As one of the world's emerging markets, Iraq offers a wide range of opportunities for foreign investors. As the legal framework for project financing is more fully developed, both private and public entities will better understand the processes and procedures for mitigating risks and achieving mutually beneficial results.

At the same time it's important to weigh a multitude of factors before making an investment decision. In addition to mitigating risks, investors should understand that some legal procedures for the incorporation of companies and for the entry of international executives can be onerous and time-consuming.

Certainly, going into Iraq requires a willingness to tackle unforeseen challenges and a long-term time horizon for obtaining a return on that investment. But establishing a presence at an early stage of the market – ahead of the competition – has historically been one of the best strategies for generating above-average returns. ■

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