THE OPPORTUNITY FOR LENDING IN LATIN AMERICA

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INFRASTRUCTURE PROJECTS AND INDUSTRY EXPANSION IS DRIVING THE DEMAND FOR BILATERAL AND SYNDICATED LOANS IN LATIN AMERICA.

While the U.S., Europe and other parts of the world have been beleaguered by an economic downturn since 2008, Latin America has gone from strength to strength. To this end, global banks thirsty to lend are seeking opportunities in the region. But to execute a successful strategy, they need to partner with a seasoned administrator that has expertise in navigating the markets as well as advanced technology to execute and support the process.

Rich in natural resources, human capital and land mass, Latin America's economy has sustained an upward trajectory in growth. According to the CIA's *World Factbook*, Brazil is the world's eighth largest economy and Mexico ranks #12. Meanwhile, Argentina, Colombia, Peru and Chile rank in the top 50. Importantly, the sovereign debt of seven Latin American countries now has investment grade ratings from S&P and Moody's.

The World Bank estimates that in 2013 GDP in Latin America and the Caribbean will grow by 3.8% to 4%, largely driven by infrastructure development. To illustrate, Peru is expected to award $10 billion in infrastructure projects in 2014, and Chile is planning to award $14 billion.

In the last 25 years, much of the responsibility for these projects has shifted from the public sector to domestic and foreign private providers. Today, the planning, construction and operation of transportation systems, power and telecommunications utilities as well as water sources and sanitation facilities is fueling the Latin America's economy. Developments in the mining, agriculture, oil and gas, trade and services and other industries also have contributed significantly to the recent expansion.

Moreover, certain countries have developed renewable energy plans. The Mexican government entered into a contract with Iberdrola, a Spanish engineering company, to construct a wind-energy plant in Oaxaca State. In addition, Iberdrola has installed a wind farm in the state of Rio Grande do Norte, Brazil, and it has partnered with Neoenergia to construct nine other wind farms in the country.

GLOBAL EXPERTISE IS REQUIRED TO BRING THESE PLANS TO FRUITION AND CREATE VALUE FOR LATIN AMERICA.

Trends in the loan cycle indicate that Asian banks are the key lenders supporting this activity. For example, Chinese lenders have committed about $75 billion to Latin American development since 2005. But nowadays their European counterparts are also investing in key industrial growth opportunities.

These major financial institutions work with the development banks, including the Inter-American Development Bank (IADB), China Development Bank, the Brazilian Development Bank (BNDES) and the Export Development Bank of Canada (EDC) to finance an array of projects. The EDC in particular brings Canadian corporate oil and gas expertise to the region with 500 Canadian companies active in Brazil and trade totaling $6.5 billion between both countries. Bloomberg data show 37 syndicated loans totaling about $11.6 billion were transacted in the first half of 2013, with an average deal size of $313 million. The energy and financial industries borrowed the largest amount of funds.

BRAZIL AND COLOMBIA AMONG CANADA'S MAJOR TRADING PARTNERS

Colombia is also an attractive market for Canadian companies. Two-way merchandise trade in 2012 reached nearly $1.5 billion, making Colombia the fifth-largest trading partner in Latin America and the Caribbean (excluding Mexico). Canadian exports increased more than 11% in the two-year period (August 2011 to July 2013) after the Canada-Colombia Free Trade Agreement came into force.

LOAN PRODUCTS IN LATIN AMERICA

The Latin American loan market consists primarily of bilateral loans with some syndicated lending on large project finance opportunities.

For example, the U.S. drought in 2012 combined with other factors has increased the demand for agricultural exports from Brazil. Some local producers in Brazil are taking advantage of this trend and are financing expansion through bilateral loans with financial institutions that are backed by U.S. receivables. These trades may be attractive to lenders since it insulates against foreign exchange risk. The servicing of these transactions requires a party to track the receivables and manage the associated cash flows. These transactions require an independent intermediary to collect the receivables and monitor the level of collateral in the accounts so that it is sufficient to meet the terms of the loan.

Brazilian states recently have refinanced their funding needs by using a repack structure via a remote Special Purpose Vehicle (SPV) backed by a U.S. dollar loan from a large financial institution. These repack structures allow the states to take advantage of interest rate differentials and a stable U.S. dollar. This is a deviation from past practices where loans came directly from the Brazilian government.

In some cases, financing a project involves a syndicated loan during the construction phase, which is then refinanced through a bond issue on completion. Banks are better able to manage the construction phase risks so they partake in the syndicated loan. They also favor the shorter tenor of the construction loan due to regulatory changes that have increased capital charges for longer dated commitments. Once completed, the bonds tend to be for a much longer tenor and the cash flows are more certain, which attracts alternative investors such as pension funds and insurance companies. This is evidenced in the Mexican wind farm project (Oaxaca) which issued project bonds once the construction phase was completed.

FUTURE TRENDS

As Latin America continues to grow, the demand for bilateral and syndicated loans, as well as the need to issue project bonds, will likely increase. Of course, the appetite will vary across the region. For example, it may be higher in countries such as Chile, where there is a mature debt capital market. Brazil is poised for an increase in project financing considering it is hosting the World Cup in 2014 and the Olympics in 2016, and the total cost for the two events is expected to exceed $50 billion. In addition, a major train line is being built from Sao Paulo to Rio de Janeiro at an estimated cost of $19 billion.

On the supply side, global financial institutions are keen to lend especially because good quality loans in Europe and the U.S. are not abundant at this time. Still, some lenders need to be more comfortable with their balance sheet position under the rules of Basel III before they increase their activity in the Latin American loan market. In Europe and the U.S., insurance companies and other non-bank investors have filled the gap in lending left by the global banks. These players are unlikely to play a significant role in Latin America until the market evolves to a stage where a secondary market can support securitization.

PARTNERING WITH A LOAN SERVICING EXPERT

Loans differ from bonds and equities in that they are not dematerialized. This means that there is more work involved in administering them. Many lenders do not have the technology infrastructure to support loan administration. Since the financial crisis, there has been a move away from the historical models where one of the syndication banks took on the administrative agent functions to keep the deal in-house. They recognize specialized, independent third party agent banks have a role to play.

In the case of Latin America, lending can take different forms, such as a project bond, bilateral loan or syndicated loan, and there is no one size fits all solution. Being able to track activity, monitor performance, account for all the changes on the loans, as well as understand regulations, regional nuances and other specifics is critical.

Financial institutions with a strong balance sheet and reputation can support their lending program by partnering with an independent global bank with multiple offerings and expertise in bilateral and syndicated loans as well as hybrid solutions. The servicing bank can provide specialized investment management and administrative expertise within Corporate Trust to help clients invest in and service the administration of their loan investments. It can serve as a local collateral agent and account bank and as a collection agent for exporters.

In addition, it will have sufficient scale to invest in loan processing technology that meets the needs of the Latin American market. For example, the systems will incorporate local market conventions and be available in Spanish and Portuguese.

BRAZIL: A POPULAR GLOBAL DESTINATION FOR FOREIGN INVESTORS

According to *Ernst & Young's* 2012 *Brazil Attractiveness Survey* of 250 foreign direct investors (FDIs):

- Brazil is the second most popular global destination in terms of FDI value and fifth in terms of FDI projects
- The number of FDI projects in Brazil increased by 39% in 2011, to a record 507
- These projects created an estimated 161,166 jobs

Citing *Business Week*, the report says between 2011 and 2014, BNDES forecasts that Brazil's industrial and infrastructure sectors will receive a total investment amounting to $906 billion (BRL1.6 trillion). The manufacturing industry is expected to receive $422 billion (BRL741 billion), and infrastructure and construction projects are projected to receive $484 billion (BRL848 billion) during the same period.

CONCLUSION

Latin America is a large, growing market with significant opportunity driven by the need to build out the infrastructure and the desire to expand business in an array of industries. New entrants can get a foothold in the market by partnering with an independent service provider that understands the market practices across the region and has the technology to support the complexities of loan administration and project finance through the entire life of the project. Doing so will allow them to concentrate on their core competencies and benefit from the Latin American market as it matures.

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