PROJECT FINANCE

Leveraging GICs to Drive Superior Project-Finance Economics

Using GICs to Improve Pro-Forma Debt Service Coverage

The GIC structure can be especially useful in a “closed system” financing, where bonds are supported solely by income generated by a particular asset. Examples include housing revenue bonds, state water revolving funds, project financings, and securitizations. In these transactions, a GIC can affect the financing model by providing a stable income source on invested bond proceeds, including Project Fund, Reserves and Debt Service Funds, alongside that of the asset being financed.

The shortcomings of traditional investments.

- **Money Market Funds:** Yields fluctuate based on short-term interest rate cycles. Because rating agencies demand conservative modeling, cash flows derived from money market funds often have to be projected at stressed or “worst-case” low rates, offering little structural boost to pro forma coverage.
- **Treasury Portfolios:** While safe from default, Treasuries are subject to market price volatility. If bond proceeds must be liquidated prematurely or during an unfavorable interest rate environment to fund project draws, the issuer faces potential capital losses, making liquidation values inherently uncertain.

How GICs solve the risk profile.

A Guaranteed Investment Contract (GIC)—typically issued by highly rated financial institutions or insurance companies—mitigates these risks through two vital features:

- **Fixed Rate of Return:** Locks in a predictable yield over a specified term, eliminating reinvestment and interest rate risk.
- **At-Par Withdrawals:** Allows the issuer to draw down funds to match project construction schedules or debt service requirements without suffering market value adjustments or penalties for early liquidation.

Financial and credit impact supports the treatment of investment income.

Because rating agencies recognize the stability and principal protection of a qualifying GIC, they allow issuers to treat the investment earnings more favorably in financial models:

- **Revenue Recognition:** GIC earnings can be integrated directly alongside primary operational revenues rather than heavily discounted.
- **Enhanced Metrics:** Predictable, higher-certainty investment income strengthens projected Debt Service Coverage Ratios (DSCR).
- **Leverage Capacity:** Stronger pro forma coverage metrics can enable an issuer to safely size a larger bond issue or secure more favorable credit ratings.
- **Yield Curve Alignment:** Because GIC pricing generally respects prevailing yield curve dynamics, extending the investment term to match the project horizon allows issuers to capture higher yields on idle capital.

BOTTOM LINE

A qualifying GIC can affect both the return on invested proceeds and, by providing a fixed contractual revenue source, the financing model itself.