PROJECT FINANCE

Recent Developments in Japanese Project Finance Markets

Alexander K Borisoff (left) and John Inglis
Milbank Tweed Hadley & McCloy LLP
Tokyo

Japanese banks and investors continue to play a critical role in global project finance markets. This dynamic is evident in the activity levels of the key Japanese financing institutions: in 2014, the top three Japanese banks—the so-called Japanese megabanks—were reported to have had a combined market share of 15% of the US$260 billion global project finance loan market. Japanese corporations have also played a key role as sponsors in the development of some of the most ambitious projects worldwide. This is particularly the case recently in the LNG sector, where Japanese sponsors have taken a prominent role, together with the support of Japanese governmental entities, such as the Japan Bank for International Cooperation (JBIC) and Nippon Export and Investment Insurance (NEXI), in the largest LNG deals in Asia-Pacific and North America in order to satisfy Japan's strategic energy needs. Japan, a famously resource-limited country, has also been active in the development of other natural resources from international sources and in environmental-related projects, such as carbon capture and storage projects.

Due to continuing limited growth in the Japanese domestic market and increasing energy and other natural resource needs, it is expected that Japanese banks and sponsors will continue to look abroad for growth and strategic overseas opportunities for the foreseeable future. In addition to traditionally stable markets in North America, Europe and Australia, Japanese banks and sponsors are trying to encourage growth by tapping into new markets in regions such as Africa, Latin America and less developed and developing markets in Asia, in order to seek new opportunities, diversify their project portfolios and minimize risk from potential economic downturn in any one region. This has not been without its challenges. In addition to ordinary course risks that are always present when developing complex projects in less tested markets, Japanese market participants are facing the additional challenge of increased competition from market participants from other countries that are similarly seeking overseas investment opportunities or access to natural resources. In particular, both developed and emerging markets in Asia are continuing their efforts to expand their reach overseas. While the key competition over the past few years has been from Korean and Chinese market participants, increasingly, activity from Southeast Asian countries has led to a more crowded field in sourcing new investment opportunities. The challenge therefore has been not only for Japanese sponsors to offer high quality products or services when investing overseas, but to do so in a way that delivers timely and cost-effective development and financing solutions that are able to compete with other market options.

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These efforts have taken numerous forms as Japanese institutions have sought new and more diverse ways to deploy capital. One example of this is the efforts by Japanese banks and other finance providers to expand their access to local currency financing options. While Japanese banks have access to deep reserves of yen deposits, local currencies are less available and entail risks, such as exchange, inflation and repatriation of investment capital risk, which Japanese banks and investors seek to minimize. Japanese banks have been trying to solve this issue through a number of different initiatives, including partnering with local banks to secure sources of local currency funding (which, in some cases, has led to the acquisition of overseas banks) and establishing long-term relationships with them. In another example of taking steps to adapt to local funding requirements, a major Japanese financial institution recently established an Islamic fund and began offering Islamic financial services in order to strengthen its operations and ability to finance projects in Muslim states in the Asia-Pacific region, particularly in Malaysia.

Another recent trend involves the methods by which the Japanese ECAs have been supporting projects overseas. In the years following the global financial crisis, Japanese businesses were strongly supported by JBIC and NEXI as they invested heavily in projects around the world. While the global financial outlook today is much better than it was just a few years ago, in order to expand Japan's global project finance presence while minimizing the risk such expansion entails, it is expected that Japanese financial institutions will continue to rely on JBIC and NEXI in their traditional roles as providers of political and financial support. For its part, JBIC sees a continued need for new infrastructure development all over the world and expansion opportunities for Japan to promote Japanese businesses and technology globally, and as such, it is willing to support Japanese investors and sponsors as they try to meet that need, including, in recent developments, by way of non-traditional methods, such as equity and fund investments. Additionally, part of JBIC's ongoing role in supporting Japanese global project finance initiatives, besides providing credit and other financial support, will continue to be to liaise with local host governments and ensure they are fully committed to the project being developed in their territory.

A relatively new source of additional funding for Japanese global project finance has come from a well-known, but up until now, underutilized source: the Japanese regional banks. Traditionally regional banks limited their lending activity to domestic projects, but increasingly the megabanks are partnering with them in club deals to access their vast capital resources from domestic deposits. As the market for Japanese domestic projects is currently limited in scope (largely focusing on the development of solar and other renewables), regional banks are turning their attention overseas in order to expand their presence and provide a better return on their capital resources. While it is helpful for sponsors to have them along for larger projects because of the additional financial support they provide, regional banks are also currently limited in their willingness to take on certain types of risk (e.g. operational vs. construction risk) and lack the experience and resources to independently participate in global project finance deals. While the regional banks may continue to require additional "hand-holding" from the likes of JBIC or the megabanks for the foreseeable future, their presence in overseas deals is undoubtedly a benefit for Japanese sponsors since it allows them to be more competitive when bidding for global projects by providing access to larger, more inexpensive pools of capital.

As Japanese investors continue to expand and invest in overseas projects they are also expanding the range of external financing options available to them. In addition to partnering with other banks and ECAs, both domestically and overseas to obtain access to local currency funding and expertise, it may require in some cases non-traditional sources of funding, such as the deployment of infrastructure funds focusing on Asia and greenfield projects, and alternative markets outside of Japan, such as the U.S. 144A bond market, to support the continued growth of Japan's ambitious project finance plans. And while increasing competition from other foreign financial institutions is putting downward pressure on pricing and financing terms, with the support of their partners and recent project finance innovations, Japanese investors expect there to be significant activity and room for expansion in the project finance sector going forward, and remain generally upbeat about the future prospects for the role of Japanese banks and sponsors in the global project finance market.