Project Finance

LNG to spearhead 2019?

Milbank LLP lead the global interview panel

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A snapshot of 2018

Project finance started with a whimper in 2018. In the first quarter, global project finance loans were down 30.8 per cent year-on-year; this downward trend can be broken down as follows:

- Americas project finance loans were down 28.8 per cent;
- Europe, the Middle East and Africa project finance loans were down 33.8 per cent; and
- Asia-Pacific and Japan project finance loans were down 28.6 per cent.

However, increasing confidence in the energy sector and higher (if not sustained) commodity prices, combined with strong activity in M&A and restructuring resulted in 2018 ending, if not with a bang, at least with a more healthy outlook for project finance. Offshore wind led the way in the power sector, branching out from its traditional base in northern Europe into Asia and North America, while waste-to-energy (WtE) projects spread out from the United States and Europe into Australia and the Gulf. Although financial closings of quasi-merchant, greenfield combined cycle gas turbine (CCGT) projects, gas-to-power projects and large-scale liquefied natural gas (LNG) export facilities were few and far between in 2018, confidence in the energy sector has resulted in a number of such projects shifting to the implementation stage with financial close expected in the next 12 to 24 months. Similarly, improving market sentiment and anticipated constraints in supply led to several greenfield and expansion projects in the minerals sector to begin moving forward after several years of slow growth.

What trends did we see in the project finance market over 2018?

Power

Renewable and clean energy projects dominated the power sector in 2018, with wind and solar being the most active and new technology in the form of battery storage also being an innovative feature in this sector. Offshore wind was especially prolific, with six projects in the United Kingdom (three greenfield and three refinancings) raising £11.7 billion of project finance in the last quarter of 2018 alone. By way of further example, the Netherlands’ 730MW Borssele III and IV offshore wind farm raised €1.034 billion of project finance debt, the largest project financing of a greenfield offshore wind project to have achieved financial close thus far. It has also paved the way for low-tariff offshore wind by demonstrating that such projects can be funded on a project finance basis, notwithstanding that the levelised cost of electricity from European offshore wind projects has fallen from above €150 per megawatt hour to approximately €35 per megawatt hour. Although offshore wind projects reaching financial close were still generally concentrated in northern Europe, we saw the emergence of offshore wind projects in new markets as diverse as North America, Taiwan, Japan and South Korea. The 128MW Formosa 1 project in Taiwan, for example, is the first offshore wind project financing in Asia; the project involved a limited recourse loan equivalent to US$627 million, with a 16-year door-to-door tenor, thereby setting a market precedent for long-term funding in Taiwanese dollars but with the backing of Denmark’s EKF. In North America, offshore wind projects are under way in Maryland, Massachusetts, Rhode Island, New York State and New Jersey, and are likely to reach financial close in 2019.

Project financing in the solar sector remained active. Notably, the first ever utility-sized solar project in oil-abundant Saudi Arabia, the 300MW Sakaka solar project, took place in 2018, being awarded at a record-low tariff at the time of bidding of US$0.02341 per kilowatt hour. Another noteworthy solar sector transaction in 2018 was Enel Green Power’s sale, on a build, sell and operate (BSO) basis, of a majority stake in its 1.1GW portfolio of three Mexican solar plants, including approximately US$605 million of project financing, to Canadian and Mexican long-term investors. Noticeable trends in the onshore renewables market included financing even being sought for merchant exposures and an increase in the number of commercial enterprises or industrial users acting as the power purchase agreement (PPA) counterparty and off-taking the electricity for their own purposes, rather than the PPA counterparty being a retailer or utility company. One such example is the University of New South Wales acting as off-taker under one of the two 15-year tenor PPAs for the US$260 million 255MW Sunraysia solar project in Australia (the more customary off-taker for the other PPA being ‘gentailer’ AGL). In terms of M&A, Global Infrastructure Partners’ purchase of Equis Energy, valued at approximately US$5 billion, was the largest renewable energy acquisition to date, and Actis’ acquisition of InterGen’s Mexico portfolio was noteworthy for including over 2,300MW of operating power assets (as well as three gas compression stations and a gas pipeline).

The general reluctance of banks and export credit agencies (ECAs) to finance ‘dirty’ coal-fired power projects has led, in addition to wind and solar, to new forms of clean energy projects. Examples are the A$700 million, 400,000 tonnes per year 363MW Kwinana WtE project, which was the first utility-scale WtE project to reach financial close in Australia, and the 300,000 tonnes per year 277MW WtE project in Sharjah, which was the first WtE scheme to be financed in the Gulf region. In addition to offshore wind in Taiwan, we are now witnessing a trend for renewable power (both solar and wind) in South East Asia generally; this in part is driven by governmental policies to promote clean energy and by the increasing reluctance of banks to finance coal-fired power projects. Indeed, many project developers have
also changed corporate policy by moving away from or even disposing of interests in coal-fired plants. The advent of new investors, who may have, up until now, focused on the United States and western Europe, seeking to venture into new markets is also stimulating activity in the sector. Although most of these renewables projects tend to be small scale, investors are looking to build up portfolios which they can then monetise through secondary market sales. Geothermal energy also saw activity such as Indonesia’s 98.4MW Rantau Dedap geothermal power project, raising a US$539 million limited recourse facility, and in the hydro sector the Nam Theun 1 hydropower plant in Laos was able to close financing on US$934 million of project debt.

In terms of non-renewable power projects in 2018, Asia-Pacific saw its fair share of landmark power projects reaching financial close after many years of negotiation with power authorities, including the 1,200MW Nghi Son 2 coal-fired independent power producer (IPP) project in Vietnam (being the first IPP project in Vietnam involving international investors since 2003) and the US$1.7 billion Jawa 1 1,760MW integrated LNG-to-power project in Indonesia (being the first such project in the Asia-Pacific region). Despite the initial optimism, there are still few LNG-to-power projects that have reached financial close; a number of announced projects are progressing slower than forecast (in part due to political risk). Latin America was one bright spot for the sector, where the US$1.5 billion non-recourse project financing (comprising project bonds and term loans) for the 1.5GW Porto de Sergipe LNG-to-power project in Brazil reached financial close and a number of similar projects are now in the implementation stage as developers look for opportunities to counter hydroelectrical generation capacity shortfalls and LNG producers look for new markets for LNG.

The conventional power sector also saw the refinancings of two independent water and power projects (IWPPs) in Bahrain, namely US$1.3 billion for the 1,234MW and 48 million gallons per day Al Dur I IWPP and US$243 million for the Al Ezzel IWPP.

PPPs
Although political support for PPPs waned in certain jurisdictions, 2018 nevertheless saw the closing of some significant PPP projects, including the €2.3 billion debt funding of Turkey’s Canakkale 1915 bridge, which was noteworthy for being one of the few internationally funded and developed infrastructure PPPs in Turkey since the Eurasia Tunnel and Bosphorus Bridge. Two large motorway PPP projects were also financed in the Netherlands, one being the €1 billion Blankenburg Connection near Rotterdam. Further afield in Cameroon, the €1.2 billion Nachtigal 420MW hydroelectric project was one of the few hydropower PPPs in sub-Saharan Africa in 2018, and several projects under Colombia’s US$25 billion 4G road infrastructure programme continued to progress. The spate of restructurings in 2018 also included PPPs, with the refinancing of the Paris Sud University PPP in France being one example.

Oil and gas
Although oil prices began to recover in 2018, oil and gas projects still saw their fair share of restructuring, especially in the offshore sector. This did not, however, put a stop to the implementation of some noteworthy projects, including the Gulf Cooperation Council’s Duqm refinery and Malaysia’s ongoing RAPID refinery and petrochemical project. The US$4.6 billion project financing of the Duqm refinery is especially noteworthy as being the first major cross-border refinery project in the Middle East,
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comprised of a joint venture between government-owned oil companies Oman Oil Company and Kuwait Petroleum International. Another significant cross-border project financing was the €3.7 billion Trans Adriatic Pipeline (TAP), being the final link of the project to transport gas from Azerbaijan’s Shah Deniz 2 gas field to Italy.

LNG contract prices also began to rise in 2018, along with oil prices, with China remaining the key driver of demand in the LNG market. The forecasted shortfall in LNG supply from around 2022 to 2024 onwards leading to the expectation of increased demand at that time has resulted in a greater sense of urgency among LNG players that they need to make final investment decisions on the huge LNG schemes sooner rather than later. The LNG Canada scheme finally went ahead, albeit on an equity basis. The LNG space also saw some refinancings, including the US$930 million Peru LNG bond refinancing.

Mining
The past year witnessed an upturn in the low commodity prices of previous years, bringing with it a degree of relief to the depressed mining industry, especially in mining project finance in Latin America. Examples of closed deals include the US$900 million project financing of the US$1.8 billion Mina Justa copper project in Peru, which was the largest mining project in the region and involved ECA lenders from North America, Europe and Asia, as well as the project financing of the US$1 billion Fruta del Norte gold project in Ecuador, which also involved ECA support and represented the largest foreign investment in the country in recent years. Several other major projects in the sector in the Americas and Africa started financing processes during the year and are slated to close in 2019, reflecting a higher degree of optimism as production forecasts across a variety of minerals and metals point towards continuing supply deficiencies in coming years.

What can we expect in 2019?
With gas prices on the rise, there is strong expectation that LNG will spearhead the global project finance market in 2019, especially the US LNG market, which has potentially four or five huge export facilities with volumes in excess of US$30 billion. The impact of the tariffs being applied on US LNG by China is, however, uncertain. There are also new LNG projects and refinancings under way in Australia and Papua New Guinea worth in excess of US$50 billion; the refinancings in Australia include Australia Pacific LNG and potentially Ichthys LNG, while the new projects in Papua New Guinea comprise two new trains in the Total-led Papua New Guinea LNG project and one additional train in the ExxonMobil-led existing Papua New Guinea LNG project. In Mozambique, the Anadarko-led Area 1 LNG scheme and the ExxonMobil-led Area 4 Rovuma LNG scheme are seeking to raise financing totalling US$30 billion. The size of the impact on LNG of China’s blue skies policy and resulting move away from coal to the more environmentally friendly gas waits to be seen. It will also be interesting to see whether the bank market can absorb the huge amount of financing required for the anticipated LNG windfall or whether new players may come to the fore.

It is expected that quasi-merchant, greenfield CCGTs will also contribute to a strong pipeline of projects in the United States in 2019. Although the offshore wind market in northern Europe may slow somewhat in 2019, there are high hopes for offshore wind in the United States at long last, while the offshore wind prospects for Taiwan, South Korea and Japan are exciting. The phasing out of tax credits for renewables projects in the United States, however, is likely to be one of the

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critical issues for the success of the renewables sector in 2019. Although the technology is still very much in its infancy, battery storage projects may also gain some traction in 2019, including in the Middle East and North Africa region, such as in Egypt.

In the metals sector, despite some price retractions towards the end of the year, continuing projections for strong demand will drive several long-dormant projects to seek financing in the coming year, and the availability of a broadened menu of funding options from agencies, commercial banks, streaming companies and capital markets will give sponsors options when designing their funding plans. Similarly, technological developments such as increased use of electric vehicles will continue to drive demand for particular metals such as lithium and cobalt which are critical for car batteries, while several major projects in Latin America and Africa involving base metals such as copper will likely come to the market as off-takers in Asia and Europe continue to compete for access to limited production. The impact of trade wars and political instability, one of the big question marks for 2019, will have the potential of disrupting markets, which could influence the speed with which projects move forward.

In terms of the project bond market, although investors’ continuing aversion to construction risk will likely put a brake on any increase in the issuance of bonds for greenfield projects, there is optimism that bond refinancings will increase. It will also be interesting to see whether equity funds, which are increasingly investing in infrastructure assets, will become less risk-averse and move away from their conservative portfolio strategies focusing on investment-grade brownfield assets in developed countries. At the same time, commercial banks and agency lenders will continue to assess these developments as competition from other funding sources shakes up sectors that had traditionally looked to bank debt to meet financing needs, and it will be interesting to see how this optionality drives these traditional debt providers to focus on flexibility and efficiencies to ensure they remain an attractive source of funding for project sponsors. All in all, there are hopeful signs that 2019 will start with more of a bang than did 2018.