Project Finance 2020

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Milbank LLP

Lexology Getting The Deal Through is delighted to publish the thirteenth edition of *Project Finance*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on China, Cyprus and Turkey.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

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Mining sector: the shift back to project financing

Alec Borisoff and Katherine Hannah

Milbank LLP

The last 18 months have seen substantial activity in the mining sector as commodity prices have risen from historical lows and project sponsors have advanced financing programmes to fund their projects around the world. Despite concerns that traditional project finance lenders had become too conservative to efficiently support such projects, much of the recently closed finance activity in the mining sector has been provided by export credit agencies, multilateral agencies and commercial banks, demonstrating the continuing attractiveness of project finance as a principal funding source for mine developers.

For several decades, when project sponsors thought of funding sources for mining projects, the range of options was generally considered to be quite small. Mining activities typically took place in challenging jurisdictions, involved substantial capital costs, and offered a unique potpourri of resource risk and price risk that all but the bravest of financing institutions were willing to absorb. This complex mix of risks presented by mining projects did, however, lend itself well to the emerging market of project finance lenders, and as export credit agencies, multilaterals and commercial banks stepped forward to provide funding to these projects over the course of several commodity cycles, it became taken for granted that when rising prices and declining supply demanded that it was time to finance the construction of new mines or the expansion of existing ones, project finance lenders would be approached to meet developers' funding needs.

The historical attractiveness of project finance debt for mining transactions is apparent for several reasons. Lenders typically include export credit agencies or multilateral lenders, or both, who can provide soft (if not hard) political cover in the traditionally challenging jurisdictions where these projects tend to be developed; project sponsors can benefit from tenors that are usually longer and with pricing that remains generally competitive across cycles; funds can be drawn as and when needed to help minimise negative carry costs; project lenders and agencies in particular have typically been able to absorb price risk; and in the event of distress, these lenders have traditionally been willing to work with sponsors to identify solutions to help the project achieve long-term success. These benefits, as well as the general lack of alternative viable financing options in the sector, made the project financing of large-scale mining assets an obvious path forward for project sponsors.

Despite these apparent benefits, project financing developed a reputation for being a time-consuming and expensive process, as lenders to these mining projects needed to undertake substantial technical, market, legal, environmental and other diligence to close. Moreover, although many of these financings allocated completion risk to the project sponsors through the issuance of completion guarantees by project sponsors, a perception developed that many of the financing terms and conditions required by project finance lenders created operational constraints that some sponsors found to be too burdensome, including as they related to desired changes to operating budgets, mine plans and expansion plans. Furthermore, as government and civil society increasingly focused on the environmental and social impact of these projects, enhanced compliance regimes became another important component of the cost-benefit analysis being undertaken by sponsors as they considered the available alternatives for their funding plans.

The view that the cost of implementing a project financing outweighed its benefits was played out as companies emerged over the past few years from the recent extended cycle of depressed commodity prices. For several mining majors, these perceived 'costs' were enough to encourage them to shy away from approaching project finance lenders for their greenfield or expansion projects, and leading them to opt instead for alternative funding options, including from their own balance sheets. For junior miners, the issue was not so much a decision to move away from project finance lending so much as it was the confluence of not thinking they would be able to attract such debt together with the availability of other emerging funding options offered by streamers, royalty providers, capital market options and other alternative financing sources. As prices started rising during this most recent upswing in the commodities cycle, many industry participants and observers questioned whether the traditional reliance on project finance debt for the development of mining assets was the right option or whether the availability of other options – many of which could claim to be faster and cheaper to execute with looser covenant compliance requirements for sponsors – would permanently alter the industry's reliance on the traditional project finance funding source. This view was reinforced in early 2018 with FQM's election to issue a US$1.8 billion bond to fund its Cobre Panama copper project despite having successfully syndicated an export credit agency-supported project financing for US$2.5 billion – for many industry observers, this decision supported the view that project finance debt required too many conditions to be satisfied for a successful closing or imposed ongoing covenant compliance requirements that was too burdensome or restrictive, or both.

Notwithstanding the outcome on Cobre Panama, during the course of 2018, several sponsors proceeded with their plans to raise (or explore the raising of) project finance debt. Many of these sponsors were encouraged by the apparent debt appetite from commercial banks as well as the strong interest from a growing list of export credit agency lenders that were willing to provide attractive terms for well-structured projects to support their national offtakers and exporters amid increasing competition in the sector. As the first of these project financings began to achieve signing during the course of 2018, the industry recognised that many of these agency lenders were able and willing to take a constructive approach both to ensure that timelines could be met and to address new developments in the market; this included a willingness

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to negotiate intercreditor arrangements with streamers and other alternative finance providers that had become a fixture in the market since the last round of financings during the prior commodity cycle.

Of particular interest is that this change in perception over the past 18 months has happened across all segments of the mining market, with mining majors, mid-tiers and junior miners all taking advantage of project finance markets to both meet funding needs and to take advantage of the long tenors, competitive pricing and other supporting features of project finance debt. Since November 2018, at least four project financings involving a range of junior to major sponsors have successfully signed or funded, or both – including financings for Fruta del Norte in Ecuador, Mina Justa in Peru, Quebrada Blanca 2 in Chile, and Nevada Copper in the United States – several of which involved intercreditor arrangements with alternative finance providers (a new structural feature for many agency lenders) and all of which involved the participation of multiple export credit agencies.

This trend is continuing – there are currently several other mining projects seeking agency-backed project finance debt, and if commodity prices hold (always the big risk in this market), it is likely that several additional upcoming projects involving all types of mining sponsors will take this path in the coming years. What is now clear is that sponsors are increasingly taking the view – particularly following the recent successful financing of several projects in the past eight months – that project finance lenders are keen to work constructively to make multi-sourced financings work and to escape the negative perceptions of the past. As additional mining projects achieve financial close over the next several months on multi-source financing packages involving agency lenders and commercial banks, it is fair to expect that project financing will remain a viable – if not a preferred – option for mining sponsors as they design their funding plans for the rest of this commodity cycle and beyond.

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