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Recent developments and current trends in energy and infrastructure project finance

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Introduction

2016 was a challenging year in the project finance market. Sluggish growth, low commodity prices, and the ongoing impact on commercial banks of the Basel reforms all worked to create a reluctant global market where global project finance volumes fell by over ten per cent compared to 2015. Lending fell by a comparable fifteen per cent.

Nation-specific tensions exacerbated these global trends. In the West, political uncertainty following the UK's referendum decision to leave the European Union, and the outcome of the US presidential elections, stifled investment in energy and infrastructure projects; whereas in Africa, there were more restructurings than normal, and the drop in crude oil prices caused a number of companies to divest their assets and substantially reduce exploration activities – a particularly stark change compared to the previously booming African oil & gas sector, epitomised by Vitol's US$4.7 billion Offshore Cape Three Project in Ghana.

In fact, oil & gas projects were the biggest losers in 2016: by the end of January 2016, energy groups had announced the postponement or cancellation of the closing of approximately US$400 billion of investments in oil and gas projects since the price of oil began its precipitous decline. From June 2016, the amount of unspent capital, set aside for capital investment, doubled from $200 billion to $380 billion and an estimated 2.9 million barrels of oil a day are now not expected to come on stream until early in the 2020s.

2017 was, and 2018 looks set to be somewhat different however. Investor confidence strengthened, commentators are more optimistic, and new opportunities abound – particularly in Asia-Pacific, where project finance volumes increased by 55.9 per cent in 2017 compared to 2016, and demand for infrastructure projects is robust. In fact, the Asian Development Bank (ADB) has estimated that the region should invest $1.7 trillion a year in infrastructure until 2030 to maintain its current growth rate, eliminate poverty and tackle climate change. Additionally, the price of crude oil is forecast to stabilise and perhaps rise over 2018 as global economic growth returns. With this optimism in mind, this article considers three key trends that are emerging in 2018.

The rise of renewable energy

Perhaps the most notable trend is the global renaissance in renewable energy projects (primarily solar or wind, but also biomass and geothermal). In 2017, power generation from renewable sources rose by nine per cent, four times its 2000 levels. In 2016 (despite the overall negative conditions for project financings) and 2017, over half of new energy capacity added year on year was made up of renewable sources. In the third quarter of 2017, US$66.9 billion was invested in renewable projects worldwide, up forty per cent on the corresponding period in 2016. Solar generation itself rose by thirty per cent, outstripping net growth in coal generated power (previously the greatest source of energy in the world). In Japan, solar projects in particular contributed to the total of fifty new renewable deals in the Japanese power sector, valued at US$8 billion altogether.

National policies have been key drivers of the increased renewable activity. In Mexico, since the Energy Reform initiated by Enrique Peña Nieto's government, the country has sought and secured a regular succession of renewables deals through their auction system, such as the 377MW solar PV project in the Aguascalientes region, recently won by French renewable energy developer Neoen (November 2017).

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The MENA region in particular, however, has buoyed the renewable energy sector through its immense investment in solar and wind power projects. Prompted by the Pan-Arab Renewable Energy Strategy (motivated by the region's particular vulnerability to climate change, its natural climatic advantages and a governmental desire to divert domestic oil consumption to the export market), Middle Eastern governments have pledged themselves to ambitious targets to achieve a sustainable energy future, and thereby stimulated much activity. Dubai, for example, aims to generate twenty-five per cent of its energy from clean sources by 2030, and seventy-five per cent by 2050. And in January 2017, the UAE promised a US$163 billion investment in clean energy in order that half of the country's power demand is met by renewable sources by 2050. In Egypt, the government aims to have an installed renewable capacity share of twenty per cent by 2022.

Renewable energy technology has also become cheaper: solar panels are now sixty-two per cent cheaper than they were in 2009, and a recent consortium of JinkoSolar and Marubeni submitted an Abu Dhabi tender at the record low price of 2.42 US cents per kWh for the Sweihan Solar Plant. Such conditions have stimulated a wave of renewable projects that look set to continue well into 2018 and beyond. Saudi Arabia, for example, plans to add approximately 4 GW of renewable projects in 2018 alone, and estimates that eight projects will begin construction over the next year. Further notable project financings in the sector include the Gabal El Zeit Wind Project in Suez, Egypt (which closed in December 2017) and was the first major power sector financing in Egypt since the Arab Spring, and the first renewable energy Independent Power Producer project of its size and kind. The Scatec Solar Project, Egypt (October 2017), was also notable in its financing of some of the first utility scale solar plants in Egypt.

The project bond market

A second key emerging trend is the re-development of the project finance bond market, and the re-introduction of project bonds into mainstream financings in numbers comparable now to pre-financial crisis and the millennium (when project bonds were more commonly used in financings). Usually, the popularity of project bonds rises and falls according to the cost of other sources of financing. Over 2017, project bond and institutional investor activity in the sector increased by forty-six per cent to US$63.7 billion, whereas loan volumes remained static year-on-year. In light of investor reluctance and perceived investor vulnerability in 2016, such a development has been regarded positively: the bonds enabled project financings to continue without a capital funding shortfall, in otherwise challenging conditions.

Bonds have been used with increased engagement in Asia: the ADB has launched a programme to support project bonds in forty-eight Asian nations. Their programme successfully supported the green project bond debt in the Philippines' US$252 million Tiwi-MakBan geothermal power plant. Commentators have interpreted the programme as successfully setting a precedent for future green bond issuances in the region. In Europe, too, the European Investment Bank has created a 'Europe 2020 Project Bond Initiative', which aims at increasing the use of project bonds in European infrastructure financings in transport, energy and information and communication technology. The €504 million bond issuance for the Port of Calais in France is just one example of the projects the initiative has supported. In Abu Dhabi, the Fujairah F1 Water and Power Plant followed a precedent set by the Shuweihat S2 IWPP, and was refinanced with US$400 million amortising bonds, issued by Emirates Sembcorp Water & Power Company (the SPV that operates the plant) in December 2017.

The ACWA Power Bond further highlights the increased significance of bonds in project financings. In this issuance, Saudi Arabian developer ACWA Power accessed US$814 million in capital, secured against seven power generating assets. Project-level debt is serviced before dividends are paid to bond holders, thus making it 'truly unique'. There was much popular demand for the bond – it was nearly 250 per cent oversubscribed, encouraging ACWA to reportedly consider returning to the bond market in 2018 with another project-backed issuance.

Liquefied Natural Gas

The Liquefied Natural Gas (LNG) market has also seen considerable recent change. Over the year, the price of LNG declined (especially in the Asian spot market), which forced prices on long-term LNG sale and purchase agreements to fall. The effect of this, particularly when taken with the global stagnation in energy demand during 2016, was to cancel or suspend LNG to power projects in the US, Canada and Australia.

Nevertheless, in 2017, the market grew in strength – in part due to the changes that the sector has undergone. For example, about 30 per cent of LNG contracts are now short term, at less than two years, enabling prices to be lower and commitments to shrink, which suits project sponsors. In fact, global demand for LNG is predicted to rise by two per cent a year to 2030, and from then, to increase at four to five per cent per year. In Saudi Arabia, it has been announced that the nation plans to increase LNG's share of the power mix to seventy per cent (from fifty per cent) by the end of the 2020s.

In practice, these statistics translate into an estimated twenty or more gas to power projects coming on stream globally from now to 2023. The decline in gas prices that has accompanied the rise in demand, and changes to typical LNG contracts has successfully increased the competitiveness of LNG to power projects compared to coal or other energy sources. This has contributed to a boom in LNG to power projects in South America, the Middle East and South America.

Conclusion and thoughts for 2018

Of these trends, in 2018 we expect the rise of renewable energy projects in particular to continue and strengthen. India is a country of particular interest in this sector: it has been reported to boast the greatest potential solar and wind capacity in the Asia-Pacific region, and its government has set a target of reaching 175GW of renewable energy in their mix by 2022. Investor appetite for project bonds also looks set to continue: as mentioned above, it is rumoured that ACWA power will issue another project-backed bond. If the size of their first issuance set the tone, it is likely that this issuance will also be high-value and bolster the market further. As for LNG, the Asian market is certainly one to watch, with current estimates predicting that Asian LNG demand will make up seventy per cent of total global demand until 2030. And, of these three markets, it is thought that up to 2040, the LNG to power market will see the strongest growth.

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