

KEYNOTE INTERVIEW

How to maintain a strong footing in a shifting market



*As direct investment becomes more common, agency services providers are more important than ever, says Wilmington Trust managing director **Will Marder***

Q How is lender appetite for US infrastructure evolving?

We see a lot of capital continuing to come into the US market, with a huge focus on energy and infrastructure assets. Infrastructure debt funds are aggressively moving into the space and, more recently, they have been joined by institutional investors that are looking to invest directly. Firms that have been passive in the past are taking a far more active role.

There is also a lot more capital coming from overseas, particularly targeting US energy assets. That is being driven by a number of factors. First, the US market offers superior yield to many other economies around the world. Then, there is a strong history of project finance in this market. Lenders and investors can get a superior yield along with

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the risk analysis and mitigation that comes from a solid project finance structure.

There is obviously a well-established commercial bank debt market offering term loans. Then there are these funds and institutional investors coming in with a competitive, fixed-rate, long-term product, offering a capital markets solution. They are providing a type of capital that is really desirable. It is something that borrowers are looking for and that is turning out to be a good fit. This availability of capital from new sources will continue to drive the infrastructure market in the US, and even across North and Latin America more broadly.

Q You mention international money flowing into the US. To what extent do you see capital flow in the opposite direction - from the US into Canada and South America?

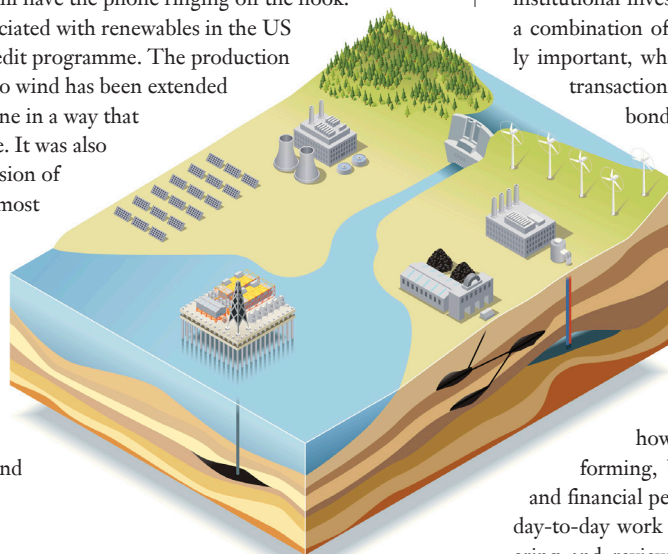
Just as we are seeing capital coming from overseas into the US, targeting US-domiciled energy and infrastructure assets, we are also seeing developers and finance companies looking across the border into Canada, and even more so into Latin America, in their hunt for yield.

There are a lot of excellent energy and infrastructure transactions taking place in Latin America, where there is a lot of oil and gas activity and there have been commodity-based metals and mining deals to be had. Again, it's looking for that combination of project quality and yield.

Q Could one challenge for lenders and investors in US infrastructure be that the energy space is a little too attractive for its own good?

The US project finance market has been dominated by the energy and natural resources sectors for many years. Conventional power generation, renewables and liquefied natural gas represent well over 60 percent of all deal activity. Off the record at least, a lot of lenders would say that the renewable energy market is very heavily banked and that it can be quite difficult for them to compete because the spreads over LIBOR are extremely low. Anyone developing a high-quality project, especially one with a good offtake contract, will have the phone ringing off the hook.

There are other challenges associated with renewables in the US that come in the form of the tax credit programme. The production tax credit that is primarily applied to wind has been extended for a year, but the extension was done in a way that gave developers very little lead time. It was also not accompanied by a similar extension of the investment tax credit, which is most commonly applied in the solar space. So, I think there was a bit of consternation there. Participants in these markets have not found a single-year extension to be particularly helpful. In fact, if anything, these short-term extensions just add an extra challenge, sending investors and lenders back to the drawing board.



Q How does the proliferation of the institutional market, and this cross-border trend, impact your role providing agency services?

For us, it is an interesting development because we look for transactions that require certain centralised agency roles that we can play. If you look back to before the credit crisis, this was typically a bank-led market and many transactions involved plain vanilla term-loan structures. A lot of the banks that were issuing that kind of debt had in-house agency capabilities and were happy to provide that service.

Many banks that are active today continue to function in that centralised role, whether it's holding collateral or serving as an administrative agent. But the funds that we see coming in, and the institutional investors looking to invest directly into these kinds of assets, typically don't have those types of in-house capabilities. That allows us to leverage our capabilities, and pivot with the market to adapt our products and services to suit the needs of those moving

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into this space.

Q Just how have you adapted your products and services?

We really focus on the long-term administration of the projects themselves. We sit in the middle, between a project company and its various lenders. Sometimes that will just be a bank group. Sometimes it will be an infrastructure debt fund or a group of institutional investors. Sometimes it will be a combination of all three. It is particularly important, when you have those hybrid transactions involving bank loans and bonds, that you have someone in the middle to act as a traffic cop, making sure all parties get the information they need and that they get it on time.

A lot of what we do, for example, focuses on covenant compliance. Lenders want to know how the projects are performing, both from an operational and financial perspective. So, much of the day-to-day work that we do involves gathering and reviewing the required reports, interacting with independent engineers, and then distributing that material to all the lenders. We warehouse all those documents, keep a running record of everything that has been delivered and track anything that's outstanding. And then, of course, we hold the collateral that has been pledged to support the funds that have been borrowed and hold reserve accounts.

Q Given this wide lens that you have on the market, have you noticed changes in the way that deals are being structured? Are covenants weakening in the same way we have seen in the LBO market?

As you say, historically speaking, a high availability of capital often comes with a softening in covenant packages. In terms of infrastructure, it depends, to a large extent, on where in the structure that debt is coming in. For debt coming in at the operating company level, we continue to see standard structures and strong covenant packages, because there you have all the risks around the project company itself. We see traditional non-recourse project finance borrowing and I think that is true whether

you are talking about a bank loan or a capital markets solution.

However, as we move up the structure to the holding company level, and even above that, we do see fewer covenants. That is just the nature of where that debt exists. There are fewer assets for those lenders to put a claim on. They are typically relying on the upstream cashflows coming from the project itself to its owners. It's a different structure.

Q Are you seeing any other innovations in terms of structuring?

There are a lot of large transactions where the owners are seeking to optimise the financing structure. They may utilise fairly standard project finance debt at the operating company level. And then, at the holding company level, they are adding on leverage, sometimes coming from the infrastructure debt funds which are prepared to take a bit more risk in search of that higher yield. So, the larger, savvy borrowers are able to reach out to different pockets of capital to obtain medium-term, low-priced, commercial bank term-loan debt at the project company level and then put in an additional long-term financing layer with, perhaps, a private placement or other capital markets structure above that.

Q How is intense competition for assets impacting pricing and returns?

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Q Which sectors are beginning to catch the interest of lenders and investors?

I think battery storage and offshore wind are both interesting areas of innovation and development. There have been multiple very large battery storage deals announced recently, and I am sure people will be tracking those markets very closely. I think that LNG will continue to attract a lot of capital. We've seen major private equity players entering the LNG space aggressively. There is undoubtedly huge appetite for those assets.

We are also seeing fits and starts in the public-private partnership space, particularly around airport financing, which seems to be attracting some attention. That said, there have been issues with those assets coming online. A number of deals, including transactions in Denver and St Louis, have been shelved.



A high degree of competition in the market inevitably tends to drive up prices. Certainly, over the past year or two, we are hearing that it is becoming harder and harder for equity investors to secure assets, and that prices are going higher and higher. Obviously, that lowers returns.

It also makes it more challenging for these investors to get in there and make the necessary improvements to these companies – to do what it is that they need to do to generate their returns. I think this is a trend that is likely to continue. However, it is also somewhat offset by the ready availability of inexpensive debt.

Q As you say, the infrastructure debt market has been transformed by the arrival of funds and institutional investors. How do you expect the make-up of the industry to evolve?

I don't expect to see any consolidation. If anything, it seems to me that some of the players that exited the market for a while are now coming back and are increasing-

ly active. If you look at some of the traditional Dutch commercial banks, they have long histories of being active in the energy and infrastructure sectors. They have made strong comebacks in the US market over the past several years. Then you also have some traditional names in the capital markets sector who are resurrecting themselves to take advantage of the strength in these sectors. It certainly seems that from both a lender and institutional investor perspective, there are more new names coming in than are going out. The space is demonstrably growing. ■

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