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INSIGHT

Project Finance Market Design and Origination

The Project Finance/Infrastructure senior debt market is categorized as "private debt" however, the structure of the market in terms of loan origination, sector expertise and relationships is fundamentally different from the broader corporate direct lending market. In our view, the Infrastructure Debt market is different in two primary respects; (i) concentration of debt issuance in a core group of project owner/developers, and (ii) the coverage of the sector by commercial banks, not investment banks.

by Richard Randall

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DEBT INVESTMENTS

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Project Owner/Developer Universe (US)

Infrastructure Projects are generally owned and financed through ring-fenced/bankruptcy-remote Special-Purpose Vehicle (SPV) structures that are owned by development companies that have the specialization and the long lead-time development risk appetite. When these companies are seeking financing for their capital intensive projects, they tend to turn to relationship financial institutions that also have the same bespoke expertise in infrastructure project finance. The developers of projects can range from; (i) large public companies, (ii) privately held corporations, (iii) infrastructure funds that specialize in projects, and (iv) larger diversified private equity (PE) funds.

The list below (Chart 01) breaks out the top 50 infrastructure project owners/developers in the US market that are responsible for the majority of senior debt transactions.

The large public investment grade companies generally have access to the public bond markets, however from time to time they have private debt transactions. At IFM Investors we have provided debt financings for projects owned by five of these seven companies.

Our largest source of deal flow tends to come from our relationships with the high yield (Sub-Investment Grade) corporate names, and most importantly the private companies and infrastructure funds. Our relationships at these firms are typically at the CEO and CFO levels, as well as with the treasury functions within the organizations. These relationships not only provide information on current investment opportunities, but also what is in their development pipelines. We have personal relationships with these firms that go back as far as 20 years.

> **post financial-crisis, asset managers like IFM Investors have developed a symbiotic relationship with these banks to provide the longer-term funded debt in consortiums with these specialty banks**

CHART 01

	Large Public/Strategies		Private Companies	Infrastructure Funds	Large PE Funds
	Investment Grade	Sub-Investment Grade			
1	Dominion	AES	Adv. Power	Arclight	Ares
2	Duke	Calpine	Caithness	Brookfield	Blackstone
3	Exelon	First Solar	Cheniere	Cap Dynamics	Carlyle
4	GE	NRG	Corvias	DESRI	KKR
5	NextEra (FPL)	SunPower	Fortistar	ECP	Warburg
6	Sempra		Freeport	EIF	
7	Siemens		Intergen	EIG	
8			Invenergy	GIP	
9			Long Road	*IFM Infra Equity*	
10			Panda	JPM Infra	
11			Pattern	LS Power	
12			Rockland	Macquarie	
13			Tenaska	Plenary	
14			Vivent	Riverstone	
15				Starwood	
16				Steel River	
17				Stonepeak	

***Source:** IFM proprietary data as of June 30 2018

CHART 02

Infra Owner Types	IFM Deal Count	%
Investment Grade Public	5	14%
Sub-Investment Grade Public	3	9%
Private Companies	**9**	**26%**
Infrastructure Funds	**13**	**37%**
Large PE Funds	5	14%

***Source:** IFM proprietary data as of June 30 2018

The chart above (Chart 02) shows the origination source of the 35 US deals that IFM Investors has closed over the past four years. Fifty-three percent of our transactions were sourced from privately-held infrastructure companies and specialty infrastructure funds.

Projects generally take two to three years to develop before they are ready for senior debt financing. As a result, we can expect to see between one to two transactions per year on average from each of these names. Therefore, in order to be positioned for the senior debt transaction, it is necessary to maintain dialogue with the project owner during the development phase. The project lead time and dialogue needed for success in infrastructure debt origination is a distinct characteristic, compared to the corporate/direct lending market, which is much more reactionary with shorter lead times.

The origination of deals in the infrastructure debt market tends to be direct in nature. We believe successful origination is dependent on long-term, deep relationships and frequent contact across this core group of infrastructure owners who are repeat debt issuers for their bespoke projects. This contrasts with the broader corporate private debt/direct lending market, which generally seeks out investment opportunities from thousands of small and mid-size companies that are usually 'one-off' transactions. A direct lending origination business tends to require a nationally-based footprint of industry generalists canvassing regions to resource opportunities. In contrast, infrastructure debt origination tends to require focused relationships with project developers which are founded on a deep technical knowledge base and cultivated over time.

Role of Banks in the US Project Finance Debt Market

Infrastructure financing is a business serviced primarily by non-US commercial banks who are willing to commit their balance sheets and provide long term capital. US bulge bracket investment banks are generally absent from this sector; the main reason being the long lead times required to structure and close the transactions, and the significant requirement for lead banks to provide and hold a material portion of the loans. In contrast, bulge bracket investment bank generally prefer to place capital and risk, collect a fee, and move on to the next deal with no ongoing capital at risk.

Infrastructure projects tend to require debt capital facilities averaging $500 million but can range up to several billions of dollars. The owners of these projects need debt investors who have the expertise to analyze and structure the complex credit facilities, and who also have the capability and flexibility to work with the borrowers during the life of a loan where change orders, amendments, and waivers are a fact of life. Large cap non-US commercial banks have dominated the space for the past 30 years, with insurance companies coming in a distant second. (Chart 03)

Following the financial crisis, regulators imposed tighter capital rules on banks and insurance companies which greatly reduce the types and term (years) of infrastructure

CHART 03

	Banks			Insurance Companies	Institutional/Asset Manager
	U.S./Canadian	European	Asian		
1	Citi (US)	ABN (Dutch)	CBA (Aus)	Allianz	Barings
2	KeyBank (US)	BNP (FR)	Mizuho (JP)	Hartford	Blackrock
3	Morgan Stanley (US)	CreditAg (Fr)	MUFJ (JP)	John Hancock	Hastings
4	RBC (CAN)	ING (Dutch)	NAB (AUS)	Mass Mutual	IFM
5	SunTrust (US)	Investec (UK)	SMBC (JP)	Metlife	Hastings
6		Natixis (FR)		Nationwide	Siemens
7		NordLB (GER)		NY Life	
8				PacLife	

***Source:** Dealogic as of December 31 2017

CHART 04 RECENT LEAGUE TABLE DATA FOR NORTH AMERICAN INFRASTRUCTURE DEBT MARKET

North American Project Finance Loans Volume by MLA – Full-year 2017				
Rank	Mandated Lead Arranger	Vol.$m	Deals	% Share
1	Mitsubishi UFJ Financial Group	3,657	42	10.1
2	Royal Bank of Canada	1,1854	11	5.1
3	Morgan Stanley	1,780	10	4.9
4	Sumitomo Mitsui Financial Group	1,740	27	4.8
5	Canadian Imperial Bank of Commerce	1,621	11	4.5
6	Santander	1,541	18	4.2
7	Bank of Nova Scotia	1,266	4	3.5
8	ING	1,206	16	3.3
9	Credit Agricole CIB	1,155	17	3.2
10	TD Securities	1,142	3	3.1

***Source:** Dealogic as of December 31 2017

» projects to which these institutions could lend. This has created an opening for non-financial institutions to play a greater role as debt capital providers in the industry. Unlike direct lending (i.e., commercial finance), where banks completely exited the industry, project finance banks still play a critical role (i.e., agency, unfunded credit, interest rate swaps) and use their balance sheets, although in a much reduced capacity. Post financial-crisis, asset managers like IFM Investors have developed a symbiotic relationship with these banks (where many members of the Debt Investments team had started their careers) to provide the longer-term funded debt in consortiums with these specialty banks.

The most recent league table on this page (Chart 04) for the infrastructure debt space demonstrates the "non-household" names that lend to the sector. Except for Morgan Stanley, which is unique among investment banks in committing its balance sheet, the lead arranging banks tend to be a mixture of Japanese, European and Canadian institutions who arrange these loans in "club" structures alongside other banks, insurance companies, and institutional fund managers like IFM Investors. At IFM Investors, we maintain close long-term relationships with these banks, and predominantly source loans both in primary origination clubs and secondary trades. Many of the individuals at these banks are former colleagues and business partners with relationships which go back over 20 years.

Conclusion

The Project Finance market is one that has evolved since the financial crisis to include institutional investors. The transactions are quite large and highly structured, and hence require the market to work in a coordinated fashion in order to provide debt and share risk on an equal basis. There are fewer deals compared to the corporate private debt markets, however, deals and necessary expertise are much more concentrated and focused. A dedicated expertise and focus is also required in origination. Given the borrowers are much more concentrated and the lender universe is highly bespoke, in our view the market requires deep and long term relationships in order to be successful. ■

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