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2013 Energy Finance Saw Rise Of Yieldcos, Term B Loans

By **Keith Goldberg**

Law360, New York (December 11, 2013, 6:47 PM ET) -- For energy developers in both the conventional and renewable sectors, 2013 was about finding new ways or rediscovering existing avenues to raise cash for their projects. Here, attorneys reveal five trends they have observed in energy project finance over the past year.

Yieldcos: A Possible Lifeline for Renewables

When electricity giant NRG Energy Inc. spun off several of its conventional and renewable energy assets into a wholly owned subsidiary earlier this year, it raised eyebrows in the renewables industry.

NRG Yield Inc. is a yieldco, a publicly traded company that's formed to hold operating assets that produce a consistent cash flow, which then pays out a significant percentage of its earnings to investors. It's a way for an owner — in this case, NRG Energy — to monetize assets without giving up control of them.

Given the difficulties renewable developers face in securing outside financing projects, forming a yieldco could help them generate the cash needed to jumpstart new projects, attorneys say.

"This is a very attractive way to raise additional funds and remain in control of projects once they're built and operating," said Martin Klepper, the co-head of Skadden Arps Slate Meagher & Flom LLP's energy and infrastructure projects group.

With master limited partnerships still off-limits to renewables and real estate investment trusts only recently gaining traction within the industry, yieldcos could provide another vehicle for renewable developers to gain broader access to capital in the equity markets, according to Rob Freedman, the co-head of Shearman & Sterling LLP'sglobal sustainable development group.

"It looks very similar in that you're building a portfolio of energy assets, particularly in the renewable space, and issuing an IPO off of that," Freedman said. "Given that NRG has pulled that off, you're going to see some folks next year really trying to replicate that."

But there is one catch: Yieldcos don't offer the same tax benefits as MLPs and REITs, Freedman said.

Powering Up with Term B Loans

There was a flurry of refinancings of existing power projects over the past year, and attorneys attribute much of that to the renewed interest in the so-called Term B loan market, a process that began in 2012.

"To me, the big story was the resurgence of the Term B market for project financings," Freedman said. "You've seen some projects become oversubscribed in the Term B market for significant amounts of capital, including for assets that have merchant components."

Essentially, Term B loans are high-yield, longer-maturity, syndicated loans that are offered to a wider group of potential investors than just commercial banks, such as institutional investors. The wider the investor net, the wider pool of potential capital, attorneys say.

"Lower costs and less restrictive terms are what drives that market," Bracewell & Giuliani LLP partner Robin Miles said. "There's a lot of institutional money that's out there looking for deals and one of the places they can put their money is in these large power projects. They're contracted, so they have adequate cash flows to furnish the debt."

Asian Financing of LNG Export Projects

Cheap, abundant supplies of U.S. natural gas have fueled a push to develop projects to export the more lucrative liquefied version. With their multibillion-dollar price tags, LNG export projects require plenty of outside financing, and attorneys say that funding is increasingly coming from energy-hungry Asia, the likely destination for all these LNG exports.

One example is the state-owned Japan Bank for International Cooperation. In September, the bank signed a memorandum of understanding with Alaska to explore ways to develop gas from the state's North Slope region and export it to Japan. Earlier this year, the JBIC began shopping loans to secure financing for Sempra Energy's $6 billion Cameron LNG project in Louisiana.

That project is being built and financed largely by the three companies that will buy its gas, Japan's Mitsubishi Corp. and Mitsui & Co. and a subsidiary of France's GDF Suez SA.

"Because the LNG will be exported to Japan, the government of Japan is happy to fund the [export] projects," said Morgan Lewis & Bockius LLP partner Brian Bradshaw, who specializes in oil and gas project finance. "It is the union of very capital-intensive LNG export projects and Japanese-backed financing, which is some of the cheapest out there."

The Comeback of Merchant Power Financing

Securing financing for the development of a large-scale merchant power project — a project that doesn't have a contracted off-taker or power purchase agreement — has been virtually impossible in recent years, but several projects have been financed on a merchant basis during the past year.

Examples include private equity firm Panda Power Funds picking up an 829-megawatt gas-fired power plant project in Pennsylvania in August and lining up financing for its development. That same month, the firm said it would build a blockbuster 859-megawatt natural gas-fired power plant in Maryland that will power nearly 1 million homes in the Washington metropolitan area.

The biggest reason for the increase in merchant project financings might be the fact that it's so difficult to secure a long-term PPA, according to Morgan Lewis partner Richard Filosa, who specializes in power project finance.

"That competition has put tremendous pressure on pricing," Filosa said. "Project sponsors and lenders are forced to find other creative ways to finance their projects in certain markets where it makes sense."

Panda Power's activity also highlights the fact that when it comes to large-scale power project development, it's no longer just the traditional utilities and energy companies that are paying the freight.

"We're seeing an increase in participation in the sector with private equity funds, pension funds and institutional funds who weren't necessarily direct investors in the past," Filosa said. "There are a large number of pension funds who are now directly investing in the power market."

A Late Wind-Financing Rush

For wind developers, securing financing for their projects in 2013 was a rollercoaster ride, courtesy of the federal renewable energy production tax credit, which has expired five times, only to be brought back from the dead and temporarily extended. The latest resurrection came in January, when it was extended for one year as part of a broader congressional deal to avoid the "fiscal cliff."

The latest expiration lasted only two days, but it was enough to send wind project financing into a tailspin — only 1.6 megawatts of wind power was commissioned in the first half of 2013 before the industry rebounded, according to the American Wind Energy Association.

Now that it's looking increasingly likely that the PTC won't be renewed by year's end, there's been a late flurry of financing activity so projects and their investors can still qualify for the credit, according to Hunton & Wiliams LLP project finance partner Eric Pogue.

"It took a few months to get a few projects back together and then it's been a ramp-up throughout the year — I think it was really over the summer before we saw an across-the-board pickup," Pogue said. "People want to get the financing and equity investors lined up in order to have the confidence to begin construction so that they can take advantage of the production tax credit before it expires."

--Additional reporting by Jake Simpson and Karlee Weinmann. Editing by Elizabeth Bowen and Chris Yates.
