NEWS ANALYSIS: Tenor times

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Power project sponsors and lenders are pessimistic about the state of the project financing market in North America in 2012. US pricing is expected to stay in its current range of between 250bp and 275bp over Libor for strong projects with strong sponsors, most tenors will remain at 10 years or less, and mini-perm structures will continue their renaissance, said speakers at *Project Finances US Power and Renewable Finance conference in New York* in mid-February.

Capital is available to power sponsors. The expansion of Japanese banks in the sector has been widely documented but the shorter tenors have also allowed Canadian banks, which typically cannot lend beyond 10 years, to participate in deals for which they would not previously get credit approval. In addition, smaller US banks, including CoBank, KeyBank and US Bank, are using the departure of some European institutions to expand their project finance activities.

Larger projects are tenor constrained, rather than capital constrained, says Geraint Breeze, executive director of power and infrastructure project finance at CIBC, who adds that this scenario is not expected to change this year.

Certainty would bring back bank underwriting, says Brett Challenger, senior vice-president in the energy and water services banking division at CoBank, referring to the stability of other lenders. This would be a key component to pushing tenors out and bringing in pricing. He would not comment on when and expects that it will depend on a resolution to the on- going European credit issues.

Lenders in the US renewables sector say wind plant production confidence levels are the main issue they face. Referring to recently operational facilities, Nick Bellamy, managing director of natural resources, infrastructure and power at Credit Agricole, said, P90 is the new P50. This has resulted in higher debt service coverage ratio requirements for deals and tougher due diligence, he added.

Brian Goldstein, managing director and head of project finance Americas at BNP Paribas, notes that the bank uses a one-year P99 to mitigate the downside production risks. Ric Abel, managing director at Prudential, says that his institution assumes a P75 confidence for all wind deals internally.

Wind plant performance is not a new issue. Clifford Kim, an analyst at Moodys, found that wind plant production was on average 9% lower than expectations, in a September 2010 report. Lenders have been complaining about disappointing wind farm production for more than a year.

Steve Ryder, vice-president, finance, at Invenergy, says that the firm is not experiencing the same performance pressure as lenders on its operational wind plants. It looks at them as a portfolio that is performing at very near 100%.

Canadian power project developers are already looking at entirely new sources of capital, turning to private placements, pension fund debt and mezzanine financing to take up the slack as European project finance banks rein in lending. Private placements continue to offer fixed- rate debt with tenors of 20 years or more to renewables projects, says William Sutherland, senior managing director at Manulife, at Project Finances 3rd annual Canadian Power Finance Conference in Toronto on 25 January. Pricing on this debt tends to be higher than on bank loans.

Canadian pension funds have participated in at least one deal with Manulife, and are looking at participating in other placements, according to both Sutherland and a number of developers. More participation from these funds would add additional capacity to the market and address some developers questions about whether the private placement market has the depth to take up all of the slack left by European banks. Developers are also considering mezzanine financing for some projects. John Carson, chief executive of Alterra Power, says that his firm has discussed using this type of debt, which would come at a higher cost than project level loans.

Bank financing is still available. Paul Bradley, chief financial officer of Northland Power, says mini-perms with tenors of seven or eight years are popular for projects in Canada. Pricing is up about 25bp to between 250bp and 300bp over CDOR compared to a year ago. Speakers describe Japanese banks as aggressive, note that US banks, for example Union Bank, are beginning to offer longer tenors in the market, and add that Canadian banks are active but cannot match their competitors on tenor.

The impending expiration of tax equity incentives for wind projects in the US could be a positive for projects in Canada. Mike Crawley, president of International Power Canada, says this could make more capital available for deals north of the border. The current incentive regime will expire at the end of 2012. Creativity around capital financing for projects is required, says Carson.