News+: PEBBLE

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The open format long term project financing tool

Last week saw the adoption of the PEBBLE product by the International Project Finance Association (IPFA) as a standardised format for funding greenfield project financings. PEBBLE, spearheaded by Dutch bank ING, is designed to improve liquidity for long term project finance debt by making it more accessible to institutional investors, thus solving the long term financing drought.

The product provides a standard and simplified process for project sponsors and procuring authorities looking to secure long term financing for their projects from non-conventional sources. It by no means eliminates the role of banks, instead creating a system where near "perfect liquidity" is achieved by enabling both banks and institutional investors to lend alongside one another.

Alistair Higgins, director at ING told IJ News: "The issue for the banking market is delivering sufficient long-term financing to meet the concession period of the project. If we can create a standard format and an agreed template for the market, then we can achieve the right conditions for institutional investors to invest more freely whilst also delivering sponsor and government long term financing needs. We are providing a standard, simplified process for sponsors to secure financing for their projects."

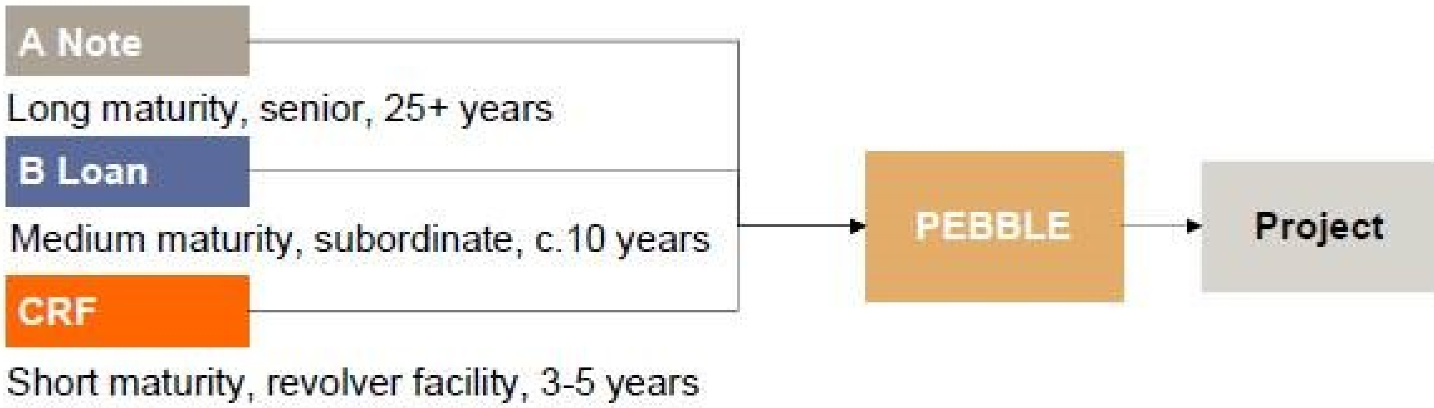
He added: "We have created a suite of documents that any bidder or institution can freely make use of. Institutional investors have been frustrated with numerous ways to access the market that don't necessarily address their concerns. As a result they end up not using any method at all."

One of the biggest factors affecting institutional investors' investment in infrastructure is the credit rating of infrastructure debt. Typically BBB rated infrastructure debt falls below the single A desired by most institutional investors. As a result, many in the market are looking for ways to enhance the credit rating of infrastructure debt.

How it works

PEBBLE structures the debt package with a senior "A Note" and credit enhancing "B Loan" tranche. The B Loan is a first loss, first pay instrument with a tenor of around eight to 10 years. Meanwhile the A Note tranche has a longer tenor matching the length of the concession. The A Note carries a fixed rate coupon and benefits from prepayment protection.

Both instruments amortise naturally without any cashsweep or refinancing risk introduced to the borrower. In addition there is a construction revolving facility that in certain circumstances provides contingency for cost overruns.



The B Loan helps to enhance the rating of the A Note, which makes it more favourable for institutional investors to fund. Ratings agencies often rate infrastructure projects at c. A/A2 around eight to 10 years after the project is launched. PEBBLE accelerates this process. And for the B Loan lender PEBBLE offers continued ability to support key infrastructure sponsors and procuring authorities, and optimal balance sheet utilisation.

The A Note is targeted at those wanting a lower risk profile. It provides the lender with a high quality long term asset backed investment, attractive risk adjusted return, and trusted co-origination, structuring and monitoring from a partner. Institutional investors are the obvious for the A Note piece but Higgins said appetite was also coming from some banks who valued the enhancement characteristic of the PEBBLE structure.

At financial close, most of the credit control lies with the B Loan lender, and this control passes to the A Note holder over the tenor of the B Loan. PEBBLE's intercreditor documents establish a standardised time frame for when the credit control passes over and how the relationship is managed throughout the project. IPFA recently announced adoption of these standardised documents as a "standard form", with market comment being sought over the next few months.

Not all PEBBLE structures have an explicit rating, but even where not explicitly rated the structure creates enhancement for the A Note investor analogous to a single A rating. It will be for project sponsors to decide if they want to opt for a rated or unrated PEBBLE, a choice likely to be influenced by whether there is liquidity in the market for that particular project. For example smaller projects may not need to opt for a rated PEBBLE as some financiers are happy to carry out due diligence without an official rating. Meanwhile those projects that need more liquidity are likely to seek an official rating.

A "mixer tap" for project finance

There is no restriction to which institutions acquire the two parts of PEBBLE. Those banks that are still in the business of lending long term may opt to take the A Note - with or without the B Loan, but for banks that are a little more constrained when it comes to long term lending the shorter B Loan provides an avenue for lending alongside an institutional investor that is looking for long dated debt by investing in the A Note. Taking this further, Higgins said, "there is no reason why an institutional investor won't in due course want to invest in the B Loan".

ING has created PEBBLE as a platform for various types of lenders to come together in one financing package. Tim Conduit, partner at Allen & Overy commented that: "PEBBLE is like a mixer tap for project finance, with institutions choosing the mix of A Note and B Loan to suit them."

PEBBLE is proving to be popular, with interest from both banks and institutional investors. A key advantage of PEBBLE is that it creates comfort in a form of standardisation for institutional investors, therefore opening the market to additional participants. A number of institutions have already achieved credit approval to fund using PEBBLE for live projects, with more currently reviewing documentation.

PEBBLE also benefits governments and sponsors by minimizing legal costs for bids, enhancing liquidity and creating an overall more competitive procurement process for government and sponsors.

For the procuring authority PEBBLE results in meaningful savings on unitary payments, greater funding liquidity, and improved competitive tension between alternate finance sources. Meanwhile for sponsors the benefits are funding from long term committed financial institutions, experienced long term agent provider, and no cash sweep requirement for term loan lending.