GETTING THE DEAL THROUGH

market intelligence

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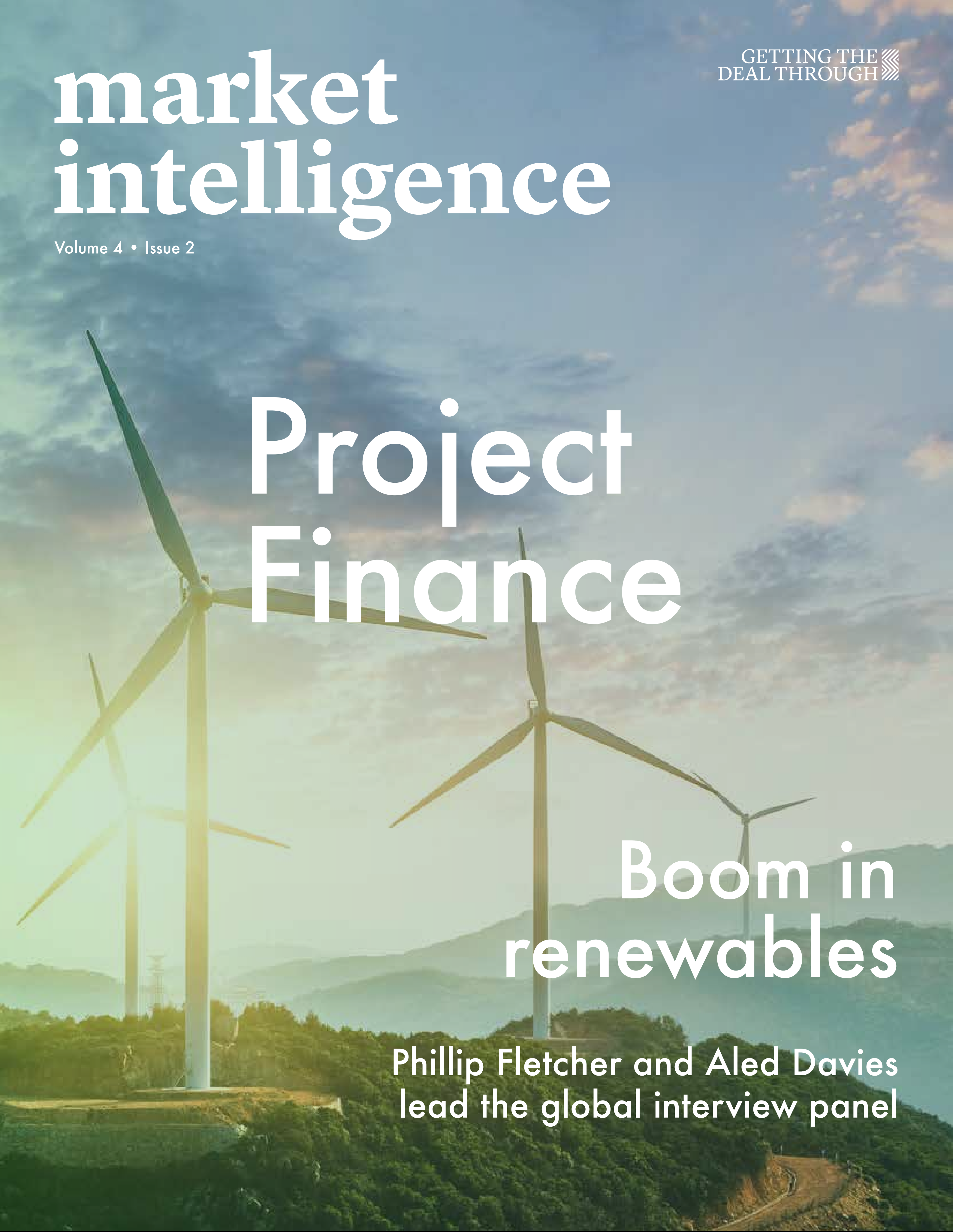

Project Finance

Boom in renewables

Phillip Fletcher and Aled Davies lead the global interview panel

The Americas • Asia-Pacific • Europe • Africa • Middle East
Activity levels • Keynote deals • Industry sectors • PPP • 2017 outlook

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GETTING THE DEAL THROUGH

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Welcome to *GTDT: Market Intelligence*.

This is the third annual issue focusing on global project finance markets.

Getting the Deal Through invites leading practitioners to reflect on evolving legal and regulatory landscapes. Through engaging and analytical interviews, featuring a uniform set of questions to aid in jurisdictional comparison, *Market Intelligence* offers readers a highly accessible take on the crucial issues of the day and an opportunity to discover more about the people behind the most interesting cases and deals.

Market Intelligence is available in print and online at www.gettingthedealthrough.com/intelligence

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In this issue

PROJECT FINANCE IN AUSTRALIA

Ben Farnsworth has extensive experience acting for Allens on Australian and offshore project financings across a wide range of industries. His recent work includes the financings of the US$20 billion Ichthys LNG Project, the A$8.5 billion Australia Pacific LNG project, the Runruno gold mine project and Otto Energy's Galoc oil field project in the Philippines, Fortescue Metals Group's ECA-backed Pilbara expansion and numerous PPP transactions.

Michael Ryan is the head of Allens' project finance group. Michael specialises in project finance transactions and acquisition finance transactions for both borrowers and financiers across the power and utilities, infrastructure, resources and oil and gas sectors in Australia and throughout Asia. He recently advised on the award-winning original project financing of the Hawaiki undersea telecommunications cable from New Zealand to Australia and the United States, AGL Energy Ltd on the establishment of its Powering Australian Renewables Fund and the project financing of the Fund's projects.

Tim Stewart is the head of Allens' infrastructure finance group. He acts for lenders, borrowers and sponsors in relation to all types of debt finance, including project, corporate, acquisition financing and restructuring. His recent experience includes advising on the acquisitions of the Iona Gas Storage Facility and the Canberra Data Centres business, the financing of numerous toll roads including Melbourne's East West Link, and various port-related bid financings, including for Port of Melbourne and the A$2.3 billion 99-year lease of the Port of Brisbane.

GTDT: What have been the trends over the past year or so in terms of deal activity in the project finance sector in your jurisdiction?

Ben Farnsworth, Michael Ryan & Tim Stewart: Project financing in Australia remained strong in 2016, despite the uncertainty in the global economy arising from the election result in the United States and the United Kingdom's decision to leave the EU.

Large economic infrastructure projects continued to be a focus, driven again by the sale of public assets by state governments encouraged by the federal government's asset-recycling programme, including the Victorian government's long-term lease of Port of Melbourne and the continuing privatisation of the New South Wales energy transmission and distribution businesses. Proceeds from the sale of public assets have been directed towards new infrastructure projects, including the $11 billion Melbourne Metro rail project in Victoria and the Sydney Metro rail project in NSW.

Following a trend that began to emerge in 2015, we have also seen a continued uptick in deal activity in the renewables sector, which we anticipated following the signing of the Paris Agreement on climate change by the Australian federal government in April. In 2016, we saw the sale of a number of renewable assets including the Pacific Hydro sale by IFM Investors to China's State Power Investment Corporation and the Cullerin Range wind farm, as well as a spate of new renewable projects. The establishment by AGL and QIC of the Powering Australian Renewables Fund targeting approximately 1,000MW of large-scale renewable generation, with a total investment of A$2–3 billion dollars captured market attention during 2016. Two operating solar plants (the Broken Hill solar farm and Nyngan solar farm, each in NSW) formed the seed assets of the fund with the 198MW Silverton wind farm recently joining the fund and other wind projects to be developed during 2017 and 2018.

Michael Ryan

While wind projects continue to dominate activity in the renewables sector, the development of large-scale solar projects in 2016 was boosted by the federal government's Australian Renewable Energy Agency (ARENA) awarding grants to 12 solar projects, a number of which Allens is working on, including the Manildra solar farm, Whitsunday solar farm, Hamilton solar farm and Gannawarra solar farm. It is inevitable that 2017 will see an increased level of activity in large-scale solar project development, but the jury remains out as to whether Australia will see a combined large-scale solar and battery storage project of any significant scale in the very near term. Conergy is currently developing the Lakeland combined solar and battery project in northern Queensland.

The success of that project, and others like it, will be closely watched by governments and industry players, particularly in states like South Australia, where the intermittency of renewables and the absence of reliable baseload generation in South Australia has been blamed for power outages experienced in that state during 2016.

In the resources sector, the stabilisation of low commodities prices in iron ore, coal and oil restricted financing activity for new developments in 2016, although record-high Australian gold prices (which have continued into the beginning of 2017) saw a busy year in the Australian gold sector, not only for funding new projects, but also for acquisitions such as Evolution Mining's acquisition of an economic interest in the Ernest Henry Mine in Queensland from Glencore.

Similarly, there were a number of divestment processes conducted in the coal sector, although complicated by a spike in the coal price in November. Rio Tinto recently announced its agreement to sell its stake in the Hunter Valley Operations mining complex in New South Wales, as well as its interests in the Mt Thorley Warkworth mine to Yancoal. This is the latest in a number of sales processes conducted by Rio for its Australian coal assets.

The financing of privatisations and new projects in Australia have been supported by our well-tested and sophisticated project financing market. There has been strong global and


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> **"Impending asset sales will bring fresh funding to state budgets to encourage the development of new infrastructure projects."**

domestic interest from banks looking to invest in Australian infrastructure assets. Domestic pension and superannuation funds have emerged as sources of alternative debt financing for infrastructure projects on a primary basis.

The trend of spending on Australian infrastructure projects and renewable assets is set to continue in 2017. There is already a strong pipeline of infrastructure projects, including the privatisation of the NSW Land and Property Information business, the second Sydney Harbour tunnel, the third stage of WestConnex and a number of smaller social infrastructure PPPs.

In terms of project finance transactions, which industry sectors have been the most active and what have been the most significant deals to close in your jurisdiction?

BF, MR & TS: Renewable projects and the Australian infrastructure sector dominated project financing deals in 2016, as optimism from the signing of the Paris Agreement fuelled an increase in demand to finance or own renewable assets and the reinvestment of funds raised from privatisation of public assets continued to drive spending on new infrastructure.

There were a number of significant deals in the past year. IFM Investors and Australian Super paid A$16.8 billion for the Ausgrid distribution network after making an unsolicited proposal for the asset under the NSW unsolicited-proposal framework. The sale of Endeavour Energy, the third and final piece of the energy transmission and distribution network to be privatised in NSW, is now under way.

On the renewables side, AGL and QIC established Australia's first unlisted renewable energy fund, called the Powering Australian Renewables Fund, to support the investment and development of large-scale renewable energy projects. The A$450 million Silverton wind farm project, which closed earlier this year became the first greenfield project to be developed by the fund and complements the two solar power plants (Broken Hill and Nyngan) transferred into the fund by AGL in November 2016. The development of large-scale solar projects has gathered pace in 2016 and ARENA has awarded grants totalling A$1 billion for the development of these projects.

Transactions such as Wirsol and Edify Energy's portfolio project financing of three solar farms with a combined output of almost 200MW (Whitsunday, Hamilton and Gannawarra), which reached financial close a short time ago, will provide a likely blueprint for future solar development in Australia.

Tim Stewart

The need for greater data capacity in Australia led to increased investment in telecommunications and information technology infrastructure in 2016. While most activity centred on building greater capacity in data centres (with Canberra Data Centres and AirTrunk being the most notable of those), the Hawaiki submarine cable project between New Zealand, Australia and the US captured attention as only the second subsea cable across the Pacific connecting Australia and the United States.

Which project sponsors have been most active in driving activity? Which banks have been most active in providing debt finance?

BF, MR & TS: There has been great diversity in project sponsors and banks in the infrastructure sector. Domestic and international infrastructure investors and specialists have been active in pursuing both infrastructure assets subject to public sales and new infrastructure projects. Chinese state-owned entities were once again active in the past year, acquiring Pacific Hydro and being involved in bids for Ausgrid and the acquisition of Duet Group. Despite the setback arising from the Australian federal government's intervention in the sale of Ausgrid's electricity transmission and distribution assets , Chinese bidders are expected to be active again in the coming year.

In relation to debt finance, strong liquidity of bank debt remains. While the big four Australian banks remain a strong presence in the Australian project finance market, European and Asian banks have emerged as strong competitors and we are increasingly encountering deals with very diverse banking groups. The Clean Energy Finance Corporation, a government corporation with access to $10 billion of Commonwealth funding to finance the clean energy sector, has become active again in renewables after a period of hibernation.

While debt financing for construction of new infrastructure projects has been dominated by bank debt, diversification of funding sources continues to improve for operating projects. US private placements in particular were popular, with examples including bank debt for TransGrid being partially refinanced with a US$775 million US private placement issue and Sydney Airport turning to the US private bond market for a US$900 million financing. Transurban Queensland again tapped the US private placement market while also issuing in the European medium-term note market and Swiss markets. The Australian corporate bond market was less active but WestLink M7 (a toll road in western Sydney owned by Transurban, QIC and Intoll) was able to raise A$500 million in July.

Domestic pension funds, institutional investors and offshore funds continue to circle the Australian market for debt funding opportunities in operating projects but remain selective. Transurban was able to refinance its Lane Cove Tunnel project in June with a combination of bank funding and long-term debt placements from IFM managed funds, REST Super and Prudential. We expect to see such funds play a greater role in debt funding operating projects in 2017.

What are the biggest challenges that your clients face when implementing projects in your jurisdiction?

BF, MR & TS: Australia's complex political landscape continues to be the biggest challenge that our clients face in the infrastructure sector. The uncertainty of the federal government's position on national security has caused Chinese state-owned entities difficulties, highlighted by the federal government's unexpected intervention to prevent China's State Grid and Cheung Kong Infrastructure from acquiring the Ausgrid network on national-interest grounds. As an attempt to give investors more certainty around the rules that would apply to future asset sales, the Foreign Investment Review Board clarified the foreign investment rules late last year. The Australian Taxation Office's recent alert flagging a crackdown on tax-effective stapled structures has also given rise to structuring issues and tax risks for new

THE INSIDE TRACK

What three things should a client consider when choosing counsel for a complex project financing?

- Track record is important.
- Commercial understanding – our teams have a 'deal mentality' to get things done with a minimum of fuss.
- Depth of talent and full-service capability is important in Australia. Clients need to know that the firm can deliver, from senior partner to junior associate, and can bring the best insights into Australia's complex regulatory framework.

What are the most important factors for a client to consider and address to successfully implement a project in your country?

A good understanding of the various project financing structures which have been successful in the Australian market while bringing a global perspective. Risk allocation between sponsors, financiers and government is constantly shifting. Understanding what the Australian bank market will accept will be crucial.

What was the most noteworthy deal that you have worked on recently and what features were of key interest?

Allens advised AGL Energy Ltd on the development of the Powering Australian Renewables Fund targeting approximately 1,000MW of large-scale renewable generation, with a total investment of A$2–3 billion. QIC, on behalf of certain of its managed funds and the Future Fund have joined AGL as an equity investor in the fund. The fund was established with the Broken Hill solar farm and Nyngan solar farm which AGL sold into the fund and was project financed on a non-recourse basis in November 2016.

The 198MW Silverton wind farm development was recently brought into the fund and non-recourse project finance debt was put in place in January this year. Further large-scale renewable projects will be developed and brought into the fund during the course of 2017 and 2018.

The fund represents the first aggregated fund for renewables investment in Australia and represents a market changing platform for the development of large-scale renewables by allowing financial investors (including domestic and offshore funds) to participate in greenfield renewables development alongside experience developers and vertically integrated power retailers such as AGL.

Others are now trying to emulate the model in the Australian market.

Ben Farnsworth, Michael Ryan & Tim Stewart
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infrastructure projects, which could particularly impact the renewables sector.

Similarly, proposed federal and state government intervention in the energy sector such as the recent announcements by the Australian federal government of a A$2 billion expansion of the Snowy Mountains Hydro Scheme to expand its 4,000 MW capacity by 50 per cent and the South Australian government's proposal to build a new gas-fired power station and mandate a large-scale battery project as a response to blackouts in South Australia during the past year may cause some uncertainty for the private sector about the east coast merchant power markets. Similarly, the Western Australian energy market regulations remain under review.

Other challenges that our clients face include access to longer tenor debt on account of tighter capital management rules for banks in Australia and the refinancing risk that shorter tenor debt introduces, although European banks have been busy differentiating their offering by providing longer tenors on certain projects (the Gold Coast Rapid Transit Stage 1 Refinancing and Stage 2 Funding, Webb Dock Terminal project financing and Wirsol solar portfolio development financing present as examples) and we often encounter clients looking to capital markets, such as US private placements, to refinance as a means of accessing longer tenors.

In the resources sector, funding for new coal projects remains difficult for Australian and international commercial banks, many of whom have policies restricting support for coal projects and those same policy concerns are also causing concern around the long-term funding for the coal-fired power generators.

Are there any proposed legal or regulatory changes that may give rise to new opportunities in project development and finance? Do you believe these changes will open the market up to a broader range of participants?

BF, MR & TS: State government asset-recycling programmes continue to give rise to new opportunities in the infrastructure sector. For example, the privatisation of NSW Land and Property Information is under way, with proceeds from that transaction due to be channelled towards new infrastructure projects.

Following the federal election in July, the federal government has endorsed the continued operation of the Australian Renewable Energy Agency and the Clean Energy Finance Corporation to encourage investment in renewable and clean energy. Grants from the Australian Renewable Energy Agency have resulted in new entrants in the market for developing solar projects, while access to funding from the Clean Energy Finance Corporation has further encouraged the development of projects involving clean energy during 2016.

What trends have you been seeing in terms of range of project participants? What factors have influenced negotiations on commercial terms and risk-allocation? Are there any particularly innovative features?

BF, MR & TS: The range of project participants has become increasingly diverse in Australia.

Equity investors comprise infrastructure investment specialists, sovereign wealth funds, Chinese-owned entities and domestic and offshore pension funds as global demand for Australian infrastructure continues to be strong. We saw in 2016 keen interest from European power developers looking to participate in the Australian renewables sector as activities in their home markets cool.

With respect to debt, bank debt liquidity in the project finance market remains strong. The Australian domestic banks now face stiff competition from European and Asian banks, with Chinese and European banks continuing their strong return to the Australian market.

Given the strong liquidity in the project finance debt market and alternative debt markets (including capital markets and domestic and offshore pension funds) for operating projects and the lack of any large commodity-driven resources or oil and gas development projects, export

> *"The recent volatility in power supply in South Australia has prompted questions around Australia's baseload generation capacity and the integration of renewables into the network."*

credit agenices have had limited involvement in Australian projects in 2016 but appear to remain keenly on the sidelines.

Domestic pension and superannuation funds are also emerging as alternative debt providers, although this appears to be limited to operating projects at this stage. Access to capital markets for greenfield infrastructure projects remains limited or non-existent but does represent a funding market for investment-grade operating projects.

For PPPs in Australia, risk-allocation continues to be driven largely by precedent; however, on new PPPs, we may see state governments modify risk allocation in direct response to recent events such as the issues currently surrounding the new Royal Adelaide Hospital, much like the Ararat prison did a few years ago. The fallout response may take another year or two to manifest itself in future risk allocation.

In the renewables sector, given the limited market for long-term investment-grade off-take contracts, equity investors and project financiers have shown a greater willingness to take greater market price exposure. We expect that to continue further in 2017.

What are the major changes in activity levels or new trends you anticipate over the next year or so?

BF, MR & TS: Renewables and government asset sales will continue to be the focus of the Australian project finance market in the coming year. Impending asset sales will bring fresh funding to state budgets to encourage the development of new infrastructure projects, particularly in the metropolitan areas of Australia, where the impact of decades of underinvestment in road and rail infrastructure is bearing on productivity levels.

The renewables sector will continue to be boosted by the Australian government's funding support through the Australian Renewable Energy Agency and the Clean Energy Financing Corporation, as well as private sector funds to promote the development of renewable assets. It is inevitable that fund aggregation vehicles such as the Powering Australia Renewables Fund will play some role in future renewables development.

As we enter the new year, renewables are not the only story in Australia's energy sector. The recent volatility in power supply in South Australia has prompted questions around Australia's baseload generation capacity and the integration of renewables into the network. The federal government's announcement regarding the A$2 billion expansion of the Snowy Mountains Hydro Scheme to expand its 4,000MW capacity by 50 per cent represents part of the response. How state governments and the private sector responds will be interesting. New investment into gas-fired power generators and large-scale battery solutions (whether co-located with solar or wind plants or not) are likely to feature as a response and provide potential projects for 2017 and beyond.

Further, concerns around domestic gas supply in eastern Australia and talk of domestic reservation policies may also spark activity in gas infrastructure while simultaneously putting a stymie on further export LNG projects, which kept our market busy just a few short years ago.

In mining, commodity prices have recovered, but new project activity remains generally subdued. There will be exceptions such as the Australian gold sector generally, and some commentators suggest that new greenfield project growth will return over the next two years. The market is watching with interest the progress of Adani's Carmichael coal project and BBI's Balla Balla Infrastructure iron ore project. In the shorter term, we expect that M&A activity will continue with certain of the sales process commenced in 2016 yet to close, such as Barrick's sale process for its interest in the Kalgoorlie Super Pit, Australia's second-largest open cut gold mine.

It will be another busy year for project financing in Australia.

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