EXPERT COMMENTARY

Wilmington Trust's managing director, project finance, Will Marder, looks forward to continued growth in 2021 as the market emerges from a challenging year with strong foundations

Project finance proves resilient

Last year was an unusual and unprecedented one in many ways, both professionally and personally. Indeed, 2020 started off in rather a quiet fashion. At Wilmington Trust, we had just wrapped up a very busy 2019, a year characterised by considerable year-end activity with clients pushing hard to close transactions before the new year. It seemed that some of our clients had 'deal fatigue' and were regrouping as we entered the first quarter of 2020. Of course, it was only a short while into the year that the global pandemic impacted all of us.

Some of the covid-19 impacts were short-lived, while others have continued, but it is fair to say that many of us are happy to bid adieu to 2020 and usher in 2021.

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2020 reflections

Thinking back to the early days of the pandemic, industry conferences were being cancelled, often at the last minute, and we all wrapped our arms around what it meant to be working from home. From our perch at Wilmington Trust, the transition was quite smooth – it was an amazing large-scale experiment that many banks had never wanted to attempt in the past – and it succeeded. However, the project finance market experienced some initial speed bumps, as lenders took a pause to consider the impact of the pandemic. As governments around the globe pushed benchmark interest rates down repeatedly, some small- and medium-sized lenders grappled with cost of capital issues. Several lenders regrouped to focus on their domestic markets.

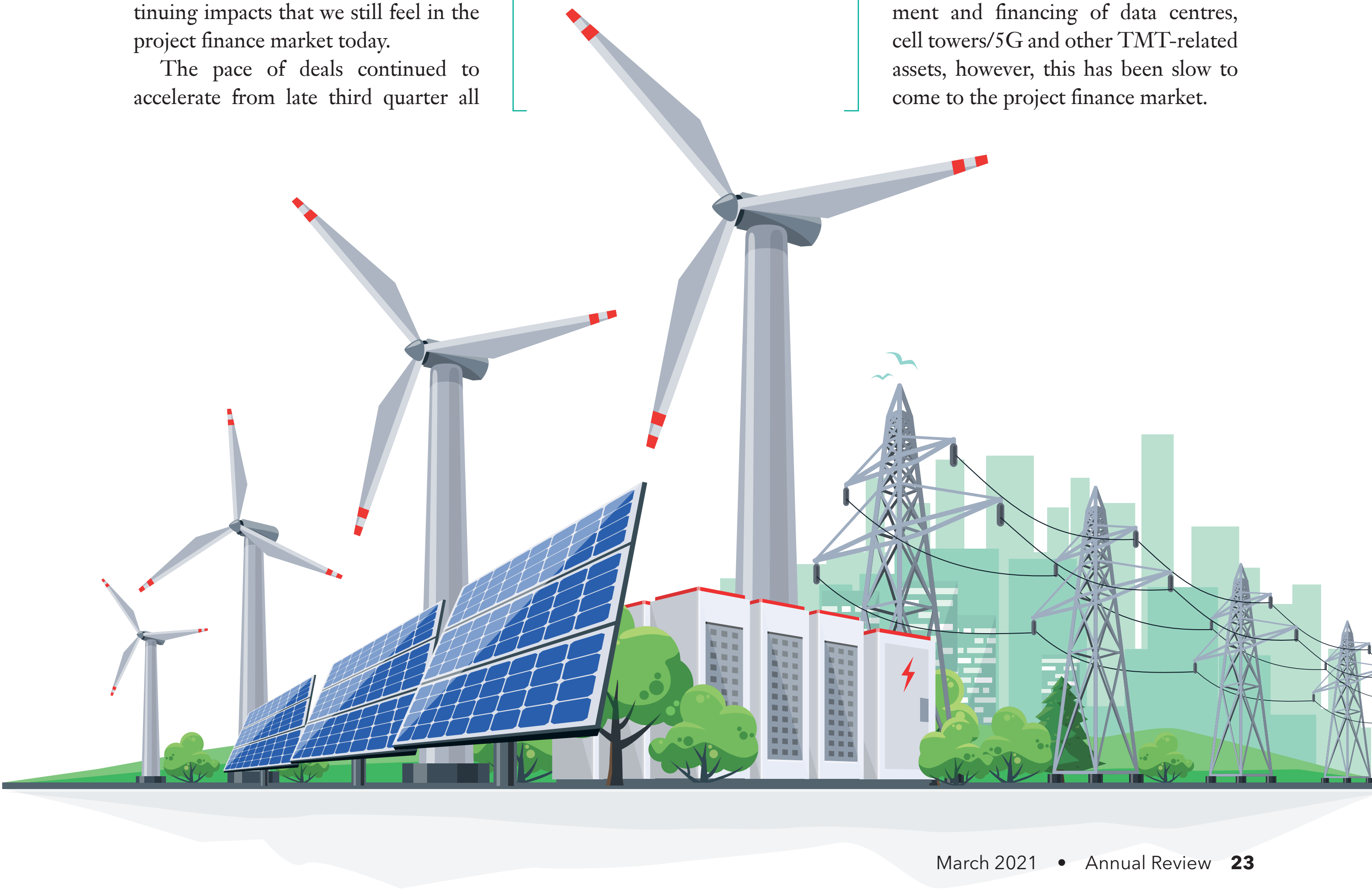
However, by early summer green shoots started to appear and dealflow began to come back. Signs were positive that our project finance marketplace had considerable resilience, driven by the long-term nature of the assets themselves, as well as the blood, sweat and tears invested by developers in getting projects to the stage where they are ready to bring to market for financing. The low interest rate environment made it all the more appealing for borrowers to tap the market. The supply of capital was reasonably strong, having been bolstered in previous years with money from new entrants, like infrastructure debt funds.

One area of weakness was, and continues to be, the availability of tax equity for renewable energy projects. Many active providers, such as the big domestic banks, have been impacted by loan loss provisions and tax credit carry forwards. They have to carefully consider what their tax appetites will look like after the expected economic impact of the pandemic. Indeed, many small- and medium-sized investors took a pause in 2020 to evaluate market conditions, and this is one of the continuing impacts that we still feel in the project finance market today.

The pace of deals continued to accelerate from late third quarter all the way to New Year's Eve. We had proven that the market was strong, that we could originate, negotiate and close deals in the new virtual environment, and that project finance structures and mechanisms continued to work well. We all did this while sharing space with our significant others, kids engaged in remote learning and pets unused to seeing us at home during the day.

"Renewables can be expected to drive the project finance market again in 2021, especially with tax credits now extended"

One interesting aspect to the past year is the huge uptick in home internet usage – often by multiple users at the same time for many hours a day. Mum or dad, used to having all the bandwidth to themselves when working from home on a random day, suddenly had to contend with kids live-streaming into class and sapping connectivity. There was some expectation that recent personal experiences would drive the development and financing of data centres, cell towers/5G and other TMT-related assets, however, this has been slow to come to the project finance market.



Other expectations did not come to pass. A highly divisive US presidential election did little to dampen the broader financial markets, nor did it serve to slow down the pace of dealflow in the project finance space. In fact, details of a range of tax credit extensions came out in late December, providing another year for onshore windfarms and two years for solar projects. The US Congress did not correct a reduction in the tax credit rate for projects that started construction in 2019. The tax credit rate dipped to 40 percent of the full rate for 2019 projects compared to 60 percent for 2018 and 2020 (now extended to 2021) projects. Offshore wind also received a significant extension. Looking ahead to 2021 with the incoming Biden administration and Democrat-controlled House and Senate, there appears to be very strong support for renewables.

The road ahead

As we enter 2021, questions swirl around when we will be able to get back to 'business as usual'. When will we return to commuting, to a normal office environment, to client meetings and conferences? An informal poll of clients indicates that most, if not all, are waiting for the wide distribution of vaccines. Until that point, it is unlikely that we will be reconvening in the halls of convention centres and hotels. However, as noted before, the market has adjusted very well to working remotely, and there is a strong pipeline of transactions in various stages of development.

Renewables can be expected to drive the project finance market again in 2021, especially with tax credits now extended. Offshore wind could prove to be a bright spot, poised for strong growth up and down the east coast of the US. This market segment is ripe for development as the US shockingly still has only a single operating offshore windfarm with a nameplate capacity of just 30 megawatts – and the financing on that project closed nearly six years ago.

Some expect the Biden White House to push the Bureau of Ocean Energy Management to start issuing construction permits again, which have been on hold since mid-2019. Providing some additional support to offshore wind is the ruling by the Internal Revenue Service, which came out in late December 2020 and said that federal tax credits can be claimed on offshore wind projects and renewable energy projects on federal land that are completed within 10 years after the year construction starts. This provides much more runway for complex offshore projects than the standard four years and should provide more comfort for lenders and tax equity investors looking to put capital to work on those deals.

There remains a strong interest in investing that encompasses environmental, social and governance principles. Many investors wish to return to a new normal, one in which there is a greater amount of clean energy developed, and a continued diminishing of fossil fuel-fired generation. Also driving this movement are corporate power purchasers, which will likely continue to focus on renewables, propping up a power purchase agreement market characterised by soft pricing.

Interestingly, the largest buyers behind corporate PPAs are the same entities that are large consumers of power via data centres: Apple, Amazon, eBay, Equinix, Facebook, Google, Iron Mountain and SalesForce, to name a few. Data centres have grown in number, but they have also become more efficient. In order to provide reliable data service in more diverse locations, we can expect to see data centres built in a wider variety of states across the country and indeed, overseas, as well.

Overall, we remain hopeful for a year of sustained deal activity, a year in which we can eventually return to normal. Last year was indeed challenging, but it pushed our industry to look at how and where we work. It tested our operations, our processes and procedures, but we will emerge from the other side with a well-proven foundation from which we can continue to grow. n

Lessons learned from 2020

Overall, our corner of the financial market is quite resilient to external impacts. Well-developed projects will continue to find buyers and well-structured deals will continue to find financing

From the perspective of Wilmington Trust, an independent provider of trust and agency services (not directly tied to any source of financing on the deals in which we are involved), we saw many more private placements than in previous years. This is a trend that had been slowly growing in 2018 and 2019, but really took off in 2020.

Traditional commercial bank lenders focused on key areas of strength – providing short-term construction financing, flexible equipment supply loans and other revolving credit facilities, in addition to medium-term financing.

Borrowers sought long-term financing in the form of private placements from life insurance companies and pension funds, which were very active in 2020. For smaller transactions, such as rooftop solar in the commercial and industrial sector, leasing was a popular way to raise capital and deal with the tax credit attributes.

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