BEST PRACTICES AND STRATEGIES FOR PROJECT FINANCE

Thinking Beyond Traditional Solutions

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BEST PRACTICES AND STRATEGIES FOR PROJECT FINANCE

As project finance continues to grow and adjust to the ever growing diverse needs of project sponsors, their lenders and investors, the analysis of the attendant risks also continues to grow in complexity. This presentation will address best practices in understanding and mitigating project risks and will offer strategies in readying renewable projects for financing.

Quote of the date and the reason why we are all here:

“A bank is a place that will lend you money if you can prove that you don’t need it.” (Leslie Townes Hope, a/k/a, Bob Hope, 1903-2003, English born American Comedian, Vaudevillian, Actor, Singer, Dancer and Author)

“Project Finance involves one or more corporate sponsors investing in and owning a single purpose, industrial asset through a legally independent project company financed with limited or non-recourse debt.”
RATIONALE FOR USING PROJECT FINANCE STRUCTURE:

- **Economically and legally independent** project entity

- **Highly leveraged project entity** with concentrated equity ownership

- Allows for project sponsors to develop **outside of their respective balance sheets**

- **No recourse** to owners of project entity; recourse is **only to project assets**

The risk profile of a particular project, when properly structured, may allow for an attractive net cost of financing.
DRAWBACKS OF USING PROJECT FINANCE STRUCTURE:

- **Takes longer** to structure and execute than equivalent size corporate finance

- **Higher transaction costs** due to creation of an independent entity and complex contractual structure

- **Non-recourse project debt** is more expensive due to greater risk and high leverage

- High leverage and extensive contracting restricts managerial flexibility

- Project finance requires greater disclosure of proprietary information to lenders

Still, the combination of organizational, financial, and contractual features may offer an opportunity to reduce net cost of financing and improve performance.
RENWABLE ENERGY PROJECT RATINGS

Project Finance Renewable Portfolio Rating Distribution

Note: Includes Public, Private Ratings and Credit Assessments
TYPICAL PROJECT FINANCE SCHEMATIC

Project Company (Borrower)

- Strategic Equity Investors
  - Sponsor/Holdco
  - Project Level Equity Investors
  - Debt Providers

- Feedstock Agreements
- Technology License Agreements
- EPC Contract
- O&M Agreement
- Offtake Agreements
PROJECT STRUCTURE MUST ADDRESS A NUMBER OF RISKS TO ACHIEVE OPTIMAL FINANCING

**Sponsors**
Experienced & financially strong strategic investors with demonstrated track record of investing & operating similar projects. Ability to provide financial support to Project.

**Construction Risks**
Fixed price, date certain, turnkey EPC contract with liquidated damages. Completion guarantee by Sponsors.

**Economic Performance**
Generates good debt service coverage under stress scenarios. Stable Project returns, with potential for additional upside. Adequate Debt Service Reserve Account.

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**Management**
Strong managerial, financial, operational, & technical capabilities with demonstrated track record of implementing similar projects. Continuity of senior management.

**Technology Risks / Feasibility**
Perpetual technology licenses & performance warranties. Technology reviewed by an independent engineer.

**Operations Risks**
O&M contract with experienced contractor. Adequate Maintenance Reserve Account.

**Offtake**
Long-term quantity offtake agreement. Long-term fixed price offtake agreement (or at least a price floor). Adequate storage & transportation infrastructure.

**Feedstock Supply**
Adequacy of available feedstock. Long-term quantity supply agreement. Long-term fixed price supply agreement (or at least a price ceiling). Independent feedstock assessment.
PROJECT CAPITALIZATION

### Sources of Funds
- **Equity Investors** – Sponsor(s) provide initial cash investment → Receive net profits generated by the project
  - Equity = 20 to 50% of project costs, depending on debt service coverage
- **Senior Project Debt Providers** – Commercial Banks(??) / Institutional Investors (QIBs) → Expect timely payment of interest and principal
- **Other Sources** – Government Grants and/or Loans

### Uses of Funds
- **Construction Fund** – Used to pay construction costs
- **Capitalized Interest** – Used to pay interest during construction
- **Debt Service Reserve Fund** – Used to pay debt service if project revenues are insufficient to pay interest and principal
- **Other Reserves** – Maintenance, operating
- **Project ‘Soft’ Costs** – Used to pay for land, engineering, environmental studies, feedstock study, independent engineer’s report, other development costs
- **Legal and Financial Costs**

### Working Capital
- Working capital line to fund operations – In place or funded by sponsor at financial close
PRIVATE PLACEMENT MEMORANDUM OUTLINE

- Summary of Certain Terms of the Private Placement
- Introduction
  - Description of the Issuer
  - Plan of Finance
  - The Project
  - The Technology
  - The Bonds
  - Security and Sources of Payment for the Bonds
  - Independent Consultant Engineers Report
  - Market Consultant’s Report
  - Feedstock Supply Arrangements
  - Offtake Arrangements
- Sources and Uses of Funds
- The Issuer
PRIVATE PLACEMENT MEMORANDUM (cont’d)

- Security and Sources of Payment for the Bonds
  - Indenture
  - Loan Agreement
  - Accounts Agreement
  - Pre-Conversion Date Waterfall
  - Post-Conversion Date Waterfall
  - Intercreditor Agreement
  - Collateral Securing the Bonds
  - Collateral Securing the Working Capital Facility Additional Debt
  - Additional Debt

- Description of the Bonds
  - General
  - Registration
  - Redemption of the Bonds Prior to Maturity
  - Selection of the Bonds for Redemption
  - Notice of Redemption
  - Book-Entry-Only Form of Ownership
PRIVATE PLACEMENT MEMORANDUM (cont’d)

- Bondholders’ Risks
- Litigation
- Enforceability of Obligations
- Legal Matters
- Placement of the Bonds
- Annual Information Disclosure
- Disclosure of Special Relationships
- Miscellaneous
- Appendices
  - Appendix A – Description of the Issuer and the Project
  - Appendix B – Project Operating Model
  - Appendix C – Independent Engineer’s Report
  - Appendix D – Feedstock Study
  - Appendix E – Market Study
  - Appendix F – Document Summaries (Bonds, Feedstock, Off-take, EPC, O&M, etc.)
  - Appendix G – Book-Entry-Only
  - Appendix H – Form of Legal Opinions
  - Appendix I – Form of Investment Letter
PROJECT FINANCE WATERFALL

Cash Flow Waterfall – Administered by the Trustee

- Cash flows into Revenue Account (cash transfer from Construction Account at COD + all project cash flow)
  - 1) Cash transferred to the Operating Account (pays operating expenses)
  - 2) Cash transferred to Trustee, Servicing Agent, Collateral Agent, Accounts Bank to pay servicing fees
  - 3) Cash transferred to pay Debt Service (Interest and Principal) on Senior Debt
  - 4) Cash transferred to fill Working Capital Reserve Account , if needed
  - 5) Cash transferred to fill Debt Service Reserve Account, if needed
  - 6) Cash transferred to pay Debt Service (Interest and Principal) on Subordinated Debt
  - 7) Cash transferred to pay Permitted Tax Distributions
  - 8) Cash held in Covenant Compliance Holding Account (If certain coverage ratios are not met)
  - 9) Cash to be distributed to Project Sponsors
RATING AGENT CRITERIA FOR PROJECT FINANCE

- Standard & Poor’s – www.standardandpoors.com
RATING AGENT CRITERIA FOR PROJECT FINANCE

- Moody’s Investors Service – www.moodys.com

- Fitch Ratings – www.fitchratings.com
Thinking Beyond Traditional Solutions

Alternative Energy and Clean Tech Services

- Project and Strategic Equity
- Project Finance
- Tax Structuring and Consulting
- Transactional Guidance
- Water and Wastewater Regulation Assistance
- Energy Efficiency and Demand Response Assistance
- Sustainable Energy and Climate Change Guidance and Representation
- Environmental Compliance
- Energy Regulation, Compliance, and Guidance
- Energy Purchase and Sale Contract Guidance
- Policy Advocacy
- Clean Energy Contract and Regulatory Representation
- Real Estate
- Feedstock and Offtake Contracts

Proud Partners - Richard G. Lugar Center for Renewable Energy

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