

# Will ECAs disrupt GCC power's mini-perm moment?

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The retreat of big European lenders from project finance has created an opportunity for regional banks in the Middle East. International banks and ECAs often crowded out local lenders such as Arab National Bank (ANB), Samba and Riyad Bank during the pre-2008 financing boom. In the aftermath of the 2008 crisis, however, the pool of willing lenders has shrunk dramatically and local banks are now often a vital component of Gulf Cooperation Council deals.

Local lenders had the liquidity to back projects in the early 2000s, but the expertise of international competitors meant they often missed out on lead arranger mandates and were relegated to the role of syndicate bank. With international lenders now operating with less liquidity, GCC banks, now more experienced, have become more active. Foreign banks in contrast have retreated from lending but used their deep market knowledge to swallow up advisories across the region.

This trend is apparent in all sectors in each of the Middle East states. Regional banks provided almost half of the \$7.25 billion facility for Qatar Petroleum and ExxonMobil's Barzan gas project, which closed last year, and ANB, National Commercial Bank, and HSBC-owned SABB were the only lenders on the Medina Airport PPP in Saudi Arabia that signed this summer. In contrast to their European rivals, local banks are highly liquid and are often at least part state-owned, making them ideally placed to finance a burgeoning list of power and infrastructure developments in the region.

## Booming but not bottomless

A population boom has prompted the need for significant infrastructure development, and most states in the region are looking to diversify their economies. QNB estimates that the total population of the GCC reached 46.8 million in 2011, up from 33.2 million in 2004, and will grow to 49.8 million in the next year. The Arab Spring has prompted grand infrastructure plans in states such as Saudi Arabia, Kuwait and Abu Dhabi, and all the large oil & gas producers are looking to develop other sources of revenue.

Although the region as a whole is flush with petrodollars, local lenders will be unable to cover all of the debt needed to finance these essential projects. Capital markets provide a small or non-existent component of many local banks' funding mix, leading to a reliance on deposits and limited access to sources of US dollars. These lenders are unlikely to escape the impact of new global banking regulations, either. The local banks can't do this forever, says Jonathan Robinson, head of project finance MENA at HSBC. They have stepped up in a very big way but it is not a limitless pool of liquidity. We are already starting to see in Saudi Arabia local banks curtail their long-term lending.

Deals with multiple funding sources help spread the lending burden, and multi-tranche deals have become the standard in recent years. Asian ECAs, in particular, have taken an ever-increasing share of project financings. JBIC, Kexim and K-Sure have stepped up to support the move of their equipment exporters, natural resources importers, and equity investors away from their quiet domestic markets. Japan's decommissioning of its nuclear plants following the Fukushima disaster is driving demand for gas from a variety of sources, including the Gulf, and leading its utilities to head overseas in search of earnings growth.

Although Japanese, Chinese and Korean official agencies have been the most active in this respect, the older agencies

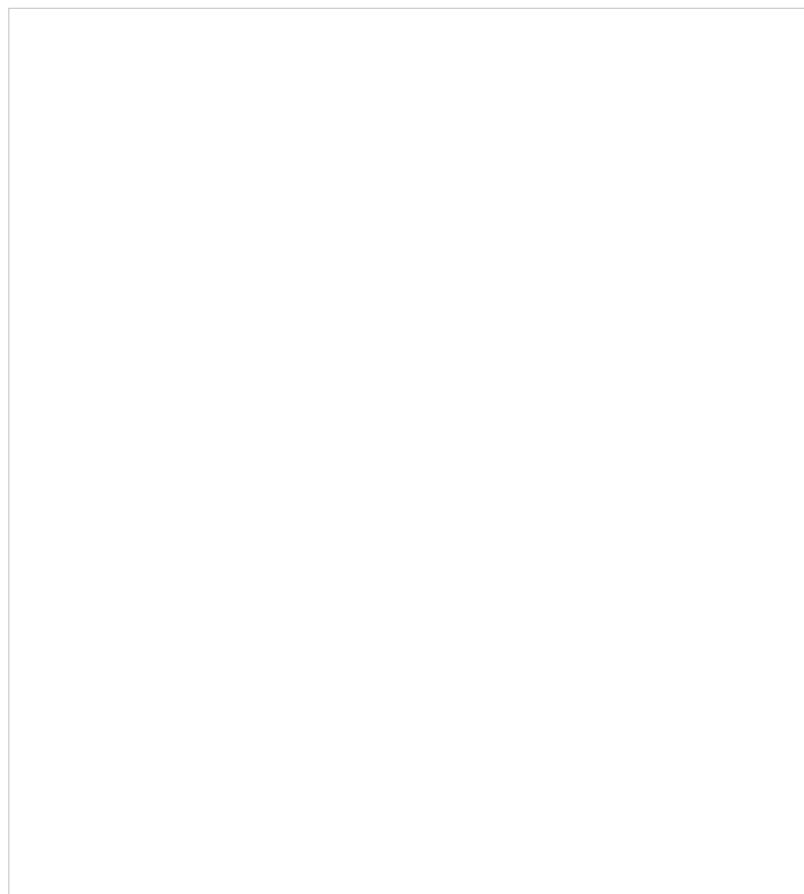
such as US Ex-Im have also become more aggressive. Ex-Im's \$4.9 billion loan to Saudi Aramco & Dows Sadara project is the biggest in its history. Once considered the lender of last resort, US Ex-Im, say bankers active in the region, is looking to imitate the Asian agencies success and become more proactive.

ECAs are unlikely to ever want to take on all of the risk attached to a greenfield development, however. While ECAs have become more proactive and user-friendly, their support is still tied to equipment purchases and/or equity components. Stefano Terranova, executive vice-president at GDF Suez/International Power, explains: The likes of the Japanese or Korean ECAs will not run out of liquidity or firepower, especially because their involvement is very much a question of macro level economic policy for their countries.

However this model is not really sustainable for the non-Korean or non-Japanese sponsors, like us, who wonder whether we can continue to predominately work with Asian partners and access their financing.

Project bonds do not look like a viable alternative for sponsors, although the strong interest from investors in the upcoming Shuweihat 2 and Emal 2 bonds is encouraging. Debt capital markets in the GCC region are still in their infancy, and investors remain wary of the risks in the region. The unrest in the Arab world in early 2011 did affect GCC governments, though to a lesser degree than in North Africa, and tensions with Iran could affect the regions hydrocarbons producers. Bonds are likely to become more prevalent for expansions or refinancings, where there are existing cashflows, but few lenders in the region expect them to represent a large proportion of debt financing any time soon.

### Tenors down, pricing up in Middle Eastern power



Source: [BenchBase](#)

### Is the mini-perm the answer?

Sponsors are keen to widen the lending pool and keep those banks nervous about the impact of Basel III active in the market. As a result, tenors have shortened significantly in recent years, and some developers are now looking at using mini-perm structures to tempt retreating banks back into deals. Only a few projects in the GCC have ever used mini-perms, and these were usually hard mini-perms with guaranteed takeouts. Notable deals included GDF Suez's Al-Dur

independent power project, which used a \$1.6 billion 8-year loan, and the \$1 billion 10-year Zayed University PPP financing. Both of these projects closed in 2009, in the immediate aftermath of the financial crisis.

Now it appears that developers are thinking again about refinancing risk. ADWEA issued a request for proposals on its Mirfa independent water and power project in October, which permits lenders to structure their bids using either 23-year or 7-year tenors. The short tenor option would be structured as a mini-perm with the intention of using a bond to meet the balloon payment at maturity.

Power and water projects in the region should be a good fit for a mini-perm. Tenors have been dropping for IWPP and IPP deals over the last decade, corresponding with a significant increase in the margin on loans (see table above). In August 2008 the Ras Girtas Power Company closed the \$3.25 billion Ras Laffan C IWPP financing with a 25-year tenor and a margin starting at 105bp over Libor. A typical power deal in 2012 was ACWA Powers \$170 million Barka IWPP refinancing, which closed with local banks, and partly in local currency, for a 12-year tenor and pricing of as much as 500bp over Libor.

The biggest power deals in the market this year are refinancings. The Dubai Electricity and Water Authority decided in April to shelve its Hassyan project in the United Arab Emirates, and lenders suggest that debt market conditions are a factor in the limited number of greenfield power projects coming to market. Introducing mini-perms, in theory, will not only increase the lending pool but, by extension, also increase the number of bidders on deals. The refinancing risk inherent in mini-perm deals is offset by the regulated nature of the Middle East power market, with state-backed projects benefiting from predictable revenue.

Mirfa will have a debt service coverage ratio of just 1.2x, a small cushion for lenders, but banks will be comfortable enough because the revenue should be predictable. If there is no market available to take out the debt when it matures, there will not be large amounts of surplus cash to sweep, meaning the project company will simply have to pay down its debt over a longer period following a restructuring. Several bankers active in the market told Project Finance that in time all power deals in the Middle East will be structured with shorter tenors and with a bond take-out in mind.

### **ECAs as blessing and curse**

ECA support will probably prove to be a stumbling block to the wider adoption of this model. Although US Ex-Im and its Asian counterparts are increasing their commitments to project financings, they show no signs of wanting to assume refinancing risk. This makes hybrid deals with short-term bank debt and longer-term ECA loans unlikely.

The Mirfa mini-perm may never materialise in any case. Sources familiar with the bidding say that many of the groups are structuring their bids around 23-year tenors and avoiding the short tenor option. They blame this on distaste for the mini-perm option at export credit agencies, notably JBIC, which is particularly wary of refinancing risk, and is involved in a number of the bids.

Saudi Arabia, Oman and Qatar still have plenty of liquidity in their local banking markets to fund their ambitious programmes, for now at least, and there is no desperate necessity for a new funding structure. If Mirfa does use a mini-perm and executes a convincing take-out strategy, however, it may pave the way for similar water and power deals in the region. I think Mirfa is rightly looking at whether a new structure is the way to go, Robinson says. I do not think the market is there yet, but people will watch this deal with keen interest.

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