The great American infra debt squeeze

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In the land of the blind, the one-eyed man may indeed be king… but in the land of the free, it's balance sheet that a monarch doth make. With limited greenfield activity, the US is gainfully employed doing what so many markets have been doing for a good long while – not an awful lot, and turning a buck where they can.

Having spent much of last week in New York wearing out shoe leather and hosting the first of our panel sessions for *IJGlobal's* 20th anniversary special edition (out December, order your copy now to avoid disappointment), the mood on the street swings worryingly from one extreme to the other.

While nobody is holding their breath for good news out of Washington DC, there is a general sense that something's coming – but then it's hard to recall a time when that sentiment did not prevail. There must be something in NY water that breeds positivity in stark contrast to reality.

But while something may be coming – winter for sure – nobody is holding out for the $494 billion annual spend to 2040 that GIH says the US needs to deploy to keep it on track for economic and demographic growth.

Lenders in the city that never sleeps bemoan their position at the sharp end of the stick… while the infra debt funds and private placement people fill their boots, simultaneously laughing up their sleeves (a sure-fire recipe for wardrobe malfunction).

Woebegone bankers

Infrastructure debt has always been a difficult beast to grapple. Depending on market conditions, the whip hand falls to either borrower or lender and – as cruel experience has shown – neither has held back on the liberal application of this implement of encouragement / brutality.

Back when liquidity was limited, lenders sucked their teeth, furrowed brows and expounded that pricing was heading north and it was being joined on the journey by a host of covenants… because that's what it takes to get a lender comfortable with deals in a tough market, convince the ever-nervous credit committee and drive them on to financial close. Happy times in the lending community.

Nowadays the market is awash with liquidity and the tooth sucking has switched sides of the table. It now falls to the borrower to knit brows, airily pointing to the hoard of lenders kicking down doors to "support" bids. And so the price of debt heads south, followed by covenants… shed like rose-leaves fallen and left to wither and go brown (read a poem, you savage).

This environment drives "bold" behaviour within the lending community as pressure is brought to bear on teams to shift money out the door, stay in until the project is operational, scoop up some delightful fees and head back out to originate with fuller pockets and a renewed love of doing deals.

Bold behaviour

Much like all other markets, the US pays little heed to construction risk when pricing debt, making refinance during the implementation phase a near certainty. To be fair, with many deals falling in less challenging sectors – renewable energy, transmission lines, etc. – construction risk is largely ignored by all parties.

Bottom line is that with so much demand for assets, people are willing to take a favourable view on the risk.

But there's more… and for this, some sources point the finger firmly at Japanese banks – not for the first time. After all, there's an old saying that the willing horse gets the work, well not only are Japanese banks willing, they're willing and able!

"The Japanese banks are running around offering seven-year tenor structures – or longer – but our perception is that they are trying to move a lot of this paper to institutional buyers," says one Big Apple banker. "This goes particularly for deals in USD. They are doing so many deals that there is no way they can hold all of that on their balance sheet."

Appetite for paper is pushing everyone up the risk and timing curve, and it's causing a problem for you more traditional lending houses.

On long-tenor project finance deals most lenders look to exit after construction and structure the deal to force refi with step ups… but that's not happening these days.

Asset famine is forcing private placement investors and infra debt funds to enter the fray earlier than primary lenders anticipated, resulting in bank assets falling and the net interest income is less – which leaves people looking to fees to see how much money is being made.

What's the end result?

Origination intensity is on the rise and people are taking a view on primary financing based on their ability to recycle capital and how quickly that can be done.

Pricing as a function will be influenced more by the ability to recycle than an objective view of construction risk – and that's a global phenomenon.

There's a lot activity in the US on the solar and wind fronts and there are no signs of that slowing down, which is just as well given continued decommissioning of power plants around the country.

In spite of the US president's insistence that coal is still a player, research group Resources for the Future has identified since 2000 some 3,300 coal-fired units alone have been decommissioned (a loss of 115MW of generating capacity). Of all the decommissioned power plants across the US, coal-fired plants accounted for 40% against losses for gas-fired at 29% and petroleum liquids on 13%.

That's a lot of power generation that has to be replaced and renewables seems to be leading the charge – let's hope energy storage can keep up. One thing for sure, there is not a lender on IJ's radar that would touch coal-fired electricity generation with a barge pole.

Meanwhile, deals can't come quick enough for traditional lenders and the paper ravenous private placement people / infra funds who will have it off their books in the blink of an eye.

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