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The great infra coverage up

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A significant date in the project finance calendar – 31 March – slid past this week with little remark, but as we cringe our way through the financial Armageddon that is coronavirus, it's unlikely such popular interest payment and calculation dates will be treated in the future in quite so blasé a manner.

In Europe, at least, the end of March is a significant diary date for the majority of deals in this space as they have March-to-September calculation dates.

While everything's looking reasonably sound right now, September is the point at which – in the worst-case scenario – ratios are likely to start breaching with projects going into default.

From what we hear at *IJGlobal*, the focus of borrowers on project finance and infra debt is now turning towards debt service reserve accounts (DSRA) and debt service reserve facilities (DSRF) as belts tighten before they become garrottes.

Speaking to the infrastructure community this week – it's curious how many infra types live nearby (so much so that the threat, should they not reply, that I'll come around and breathe through their letter boxes carries weight) – and the mood is fairly sanguine, but nervous, about DSRAs and DSRFs.

To be clear, this is primarily demand-risk projects we're talking about here – everything from toll roads through to airports, ferries, light rail, trains, ferries… you name it… core infrastructure assets that are hugely impacted by lock-down scenarios.

March 31 passed without remark because we are too early into Covid-19 for it to have had too significant an impact on European and Americas demand-risk projects, but by September we will have reached the point on some assets that the ratios will breach, and they are technically in default.

Even if coronavirus blows over swiftly and we're all back to work in June/July – more to the point – back at work, but working slightly differently… that will be three months' revenue out the window and the financial model's starting to look like happy-pill optimism.

"They are going to have enough cover ratio for the here and now," says one senior infra source. "But in September they've had it. Their ratios will breach because the likes of toll roads will have had no revenues for the previous three months."

"Debt service reserve accounts will be tapped into by September," says another senior infra bod. "Debt service reserve facilities will be called and tested to see whether they can actually be called because the project may be in default… which would result in call stops."

Another top infra lender says that conversations with the wider corporate community has worrying ramifications.

"All the large corporates are drawing down on their liquidity to get cash in their accounts in preparation for the liquidity

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issues they are facing," says the source. "They can do that because their RCFs allow them to do so – their liquidity facilities don't really have conditions.

"However, taking money from your DSRA or calling on your DSRF, is very narrowly-defined. Projects can't just call these facilities and fill their accounts with cash – they have to wait until the problem is making itself felt.

"We have seen, historically, that DSRFs come under pressure because the banks may not actually allow them to be drawn."

That would be awkward.

Remember, remember – the 30th of September

Some, however, are a lot more sanguine and believe the sterling work they did putting the deals together in the first place should lend confidence to this not being a problem… unless, of course, you're a regional airport… in which case you're stuffed.

The DSRA is designed to deal with shock events that impact cash flow performance of a business – which is one of the benefits of infra and project finance… which underpins why people invest in core infra… they enjoy good liquidity in times of need.

"With core infra, you would typically take the view that once the virus is passed, you would expect the cash flows to return very quickly," says another senior infra type (one who lives close enough to fear letter-box breathing).

"The debt service reserve account really is there for a six-month – or a 12-month and sometimes an 18-month period – in which it can cover that debt service on transactions that are largely debt-funded and that's the major cost that needs to be covered.

"We are in a shock environment and – much like in 2008 – this is another test case for whether the liquidity facilities and all the structural enhancements we put into these transactions when we structured them, actually operate in the right way."

The DSRA serves as a cash reserve to save the equity cure and delaying lenders having to restructure debt. With a DSRF, however, lenders really don't want to be doling out cash in a distressed period to a struggling borrower… but they're contractually obligated to do so.

"If we are in a situation where the virus is still around in 12 moths' time, and you have exhausted all of your liquidity facilities," says the near-living infra type who fears letter-box breathing. "Then you have to start looking at all the various stakeholders as to how on earth you continue to get through this prolonged shock period… and there are various things you will look at."

First of all you turn to government support which – in the case of the rail and bus industries in the UK – you have seen. The government has stepped in to the franchises to take volume risk and give them management service contracts instead.

However, where there is no government support – as with airports – liquidity facilities are the first port of call, followed by equity curing.

Failing an equity cure, it comes back to debt holders and whether there is flexibility to waive covenant breaches.

Given that infrastructure is a sensible investor community, and that the Covid-19 shock event is nobody's fault – though not necessarily force majeure – lenders are being called on to support businesses and be flexible on covenants.

"We are not at a stage yet that we are talking about debt re-profiling or writing off any transactions," says another infra source. "We are looking at rating downgrades. That is definitely a feature we saw in the public markets – Gatwick and Heathrow downgraded last week, for example.

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"At the moment we are providing flexibility within infrastructure financing structures to get through the covid-19 situation."

Fast forward six months

Broadly speaking, the mood in the market is cautious positivity… but this is subject to change on an hourly basis. According to the Johns Hopkins website, we passed the 1 million mark for coronavirus cases this week.

The US shot up to a quarter-of-a-million in the blink of an eye; poor old Italy and Spain are being ravaged with about 120,000 cases each; Germany now has more cases than China ever admitted to (which rather makes you question the honesty of those stats); and the UK is approaching 40,000 (but we have no tests).

It's hard to believe this will be in the rear-view mirror by the end of September, especially judging by the number of flights going over south-west London (people who are stupid enough to leave their houses have actually started pointing at them, slack-jawed).

I look forward to learning just how flexible lenders are going to be in the coming months… especially when dealing with such valued infra clients.

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