News+: Regulatory capital relief

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Unicredit and Mariner Investment Group last week inked a deal to transfer exposure of one of Unicredit's loan portfolios to funds managed by the newly formed Mariner Infrastructure Investment Management (MIIM). The aim of the deal was to reduce the banks regulatory capital requirements and stimulate new lending to infrastructure projects.

Unicredit sold the junior and mezzanine risk on €910 million (US$1.24bn) in Italian business loans to two funds managed by Mariner - the US$350 million International Infrastructure Finance Company Fund (IIFC) and the US$100 million Mariner Breakwater Fund. The credit control for the loans remains with the bank but Mariner will cover initial losses on the portfolio up to an agreed amount.

The strategy from the New York-based investment consultancy is the latest approach to inject liquidity into the infrastructure finance market. Mariner borrows from other sectors of the banking industry in its approach. Dr Andrew Hohns, who leads the MIIM team said, "This is not a novel idea. We are doing what banks do in other asset classes. Banks are always looking for capital market solutions for other books."

Post financial crisis the regulatory environment for banks has seen a seismic shift. The impending Basel III regulations have applied a greater impetus on the level of regulatory capital a bank is required to hold, particularly in regard to illiquid investments such as infrastructure.

Unicredit is just one of a number of lenders looking to shed loans from its balance sheet as a result. In 2012 German bank NordLB placed a portfolio of UK PPP/PFI loans with London listed infrastructure fund GCP Infrastructure. In doing so the bank was able to improve its capital ratio by reducing the risk rated assets held on its books.

The market has seen a marked reduction in long term lending and some banks have withdrawn from the market entirely. New financing models are now competing to fill the long term capital void. Insurers, pension funds and infrastructure debt funds have all become active players in the infrastructure debt market. Coupled with that is the emergence of bank replacement strategies and public solutions such as the EIB PBCE.

Rather than bringing institutional capital directly into the market, Mariner's strategy seeks to free up bank balance sheets in order to stimulate new bank lending. The Unicredit deal marks the inaugural investment from Mariner's new infrastructure business.

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The Mariner solution takes a portfolio of performing senior secured loans from a bank - these could be project finance loans or other credit facilities related to infrastructure transactions. The value of exposure in the portfolio is assessed on a loan-by-loan basis.

The Mariner funds will underwrite each of the underlying loans, taking capital from the fund and putting up a negotiated amount of credit enhancement against initial losses on the portfolio.

Mariner grants a security interest over the collateral in favour of the bank, while the bank keeps credit control on the loans.

This reduces the banks senior exposure on the portfolio of loans, which in turn reduces the regulatory capital the bank is required to hold. The reduction in regulatory capital allows the bank to extend new credit.

As new loans come onto a bank's balance sheet Mariner would look to offer the same solution, said Hohns, thus stimulating continuous new lending in the market and allowing banks to focus on origination and structuring.

Hohns predicts that more banks will move towards deleveraging in the future as more of these types of solutions become available to the banking market. Ultimately he believes this will help to create a more robust financing environment for infrastructure.

The investors

The MIIMs offering comprises two fund vehicles, each with a substantially similar investment mandate. Both funds will provide credit enhancement to infrastructure related loans in the energy, transport, social infrastructure, telecoms and utilities sectors.

The Breakwater Fund is an open ended single investor fund, while the IIFC is a pooled fund with a 10-year maturity, with an optional extension. The IIFC fund is made up of public and private pension funds, a large charitable foundation as well as capital from Mariner itself. The Breakwater Fund is a managed account for one corporate pension plan.

Investing in the first loss exposure on infrastructure loans is a relatively sound investment for institutional investors. Despite its illiquid nature infrastructure debt has a very low default ratio which makes it a more attractive investment option. According to research from Moody's, the 10-year loss rate for project finance loans is just 1.85 per cent. On a portfolio of US$1 billion loans the expected losses would be around just US$18 million.