

Industrial Project Finance.

Top Ten Things Lenders Look For When
Considering Greenfield Industrial Project
Finance.



Top Ten Things Lenders Look For When Considering Greenfield Industrial Project Finance

By Jeff Lupoff, Senior Managing Director, Structured Finance Group, GE Capital, Corporate Finance

In today's economy, it may seem counterintuitive to be thinking about financing for greenfield industrial projects. However, today's production cuts may lead to tomorrow's supply shortages. Smart businesses are looking around the corner for opportunities amidst the recovery. Since greenfield projects can take anywhere from six months to a year or more to develop, now could be just the right time to begin lining up financing.

Industrial project finance (IPF) is usually based on a non-recourse or limited recourse financial structure. This means the debt and equity used to finance the project are paid back from the cash flow generated by the project. The project's assets, rights and interests are typically held as collateral as a second "way out" for the lenders.

From environmental to economic to operational challenges--project finance is complex and involves various forms of risk. As such, sponsors and advisors should be prepared to address these risks. While each project is unique, lenders will typically consider these ten factors when assessing how creditworthy the project is.

1) Strategic Equity. There is perhaps no greater validation for a lender that a prospective greenfield IPF might be viable, than when the equity backing the project is strategic. A greenfield steel facility backed by an equity investment from a company in the steel sector, for example, is strategic equity.

While financial or private equity investors can also play an important role in the capital structure of a greenfield project financing, it is the substantial investment from strategic equity that gives lenders comfort.

Lenders consider strategic equity investors to be more likely to defend and support their equity if an unforeseen negative event occurs. In addition to a financial fix, strategic investors could possibly offer an operational remedy--such as engineering. Lenders like to see most if not all of the equity funded before any debt is drawn. In today's volatile markets, lenders will want to see a minimum of 40-50% junior capital and mostly Strategic Equity in the overall IPF construction budget. Unexpected things often happen during construction and ramp-up, so a de-levered capital structure is the prudent path.

2) Experienced Management Team. As a greenfield project is a start-up business, a management team with a history of success with similar projects is very important.

3) Proven Technology. IPF is not viewed as venture capital by project finance lenders. Therefore, the underlying technology needs to be current, and at the same time proven.

4) Does/Will Demand Exceed Supply? To help validate the need for the construction of any greenfield project, lenders will likely require an independent market analysis as part of the due diligence process. Lenders will want comfort that demand is expected to exceed supply.

5) Lower-Cost Producer. Once convinced that demand will exceed supply and there is a need for the greenfield project, lenders will also want independent validation that the project will be a lower-cost producer. In the event demand declines, lenders will want to know that the industrial project they financed is not likely to shut down.

6) Merchant vs. Contract. “Off-take” contracts where buyers of the output of the greenfield project are lined up ahead of time can be a real positive compared to a “merchant approach,” which is more speculative. Contracts can base load production at a project and provide a known source of revenue to help service the project finance debt. On the other hand, contracts are not always iron clad. The credit quality of the off-taker can deteriorate, and contracts can be subject to litigation. As a low cost producer, the project should remain competitive and generate attractive cash flow even if the contract relationships disappear.

7) Equipment, Procurement, Construction (EPC). Think of the EPC as the contractor. Who will build the project? If a prospective greenfield industrial project clears the above hurdles, IPF lenders will want to know who the EPC will be. Has this firm built similar projects on time and on budget? Is the construction contract fixed price? Is the EPC a creditworthy entity and do they stand behind their work? Larger industrial project financings might have big name EPC firms while mid-size greenfield IPFs generally do not. Without a reputable EPC, lenders will generally look to an independent engineer and will likely require some contingent equity when structuring the IPF. An independent engineer is usually selected and engaged by lenders to monitor the construction process and budget. Depending on the construction and ramp-up risks involved, contingent equity in the form of cash and/or letters of credit and a completion guaranty will likely be required. Lenders and strategic equity providers will typically negotiate milestones to permit contingent equity amounts to be released over time. Depending on the construction and ramp-up risks involved, Contingent Equity in the form of cash and/or Letters of Credit and a Completion Guaranty will likely be required. Lenders and Strategic Equity providers will typically negotiate milestones to permit Contingent Equity amounts to be released over time.

8) Pledge of Shares. IPF lenders generally like to see the project operating company owned by a holding company where the holding company pledges the shares of the operating company to the IPF lenders and guaranties the obligations of the operating company.

9) Debt Service Reserve. Lenders will generally look for a minimum six months of principal and interest in a funded debt service reserve.

10) Hedges for Significant Cost Items. Lenders might want the project to enter into hedging agreements for components of the project cost structure that are the most significant. This might include energy costs, interest rate, and other inputs.

IPF was used recently for a greenfield project financing in the packaging sector. The project was backed by a substantial strategic equity investment, had an experienced management team, using proven technology, and executed off-take contracts prior to financial closing. With no EPC, IPF lenders gained comfort from the role of the independent engineer, coupled with independent analysis supporting favorable supply/demand dynamics and a lower-cost position.

Other structural enhancements to the financing helped mitigate construction and ramp-up risks, as well as production inputs with significant cost. The bottom line is that even in volatile capital markets, smart IPFs can get done as long as they possess the right characteristics.



Jeff Lupoff (jeffrey.lupoff@ge.com) leads GE Capital's Structured Finance Group that focuses on meeting the specialty finance needs of mid-size and large U.S. companies. www.gelending.com. GE Capital does not provide legal, accounting or tax advice and potential customers should seek such advice from their own professionals.