

Power Finance & Risk



PFR Project Finance Midyear Review Roundtable 2021

Sponsored by:

CohnReznick
Capital 

 EASTWEST BANK
Your financial bridge®

Unauthorized reproduction, uploading or electronic distribution of this issue, or any part of its content is illegal without the Publisher's written permission. Contact us at (800) 437-9997.

● PFR PROJECT FINANCE MIDYEAR REVIEW ROUNDTABLE 2021

PARTICIPANTS:



Chris Simeone, Head of Eastern Region Project Finance, **East West Bank**



Conor McKenna, Senior Managing Director, **CohnReznick Capital**



Mike Roth, Managing Director, **Ares Management Corp**



Ellen Friedman, Co-Head, Energy & Infrastructure Projects Team, **Nixon Peabody**



Matt Hankey, President & CEO, **New Energy Equity**



Taryana Odayar, Editor, **Power Finance & Risk** (moderator)

Taryana Odayar, PFR: The market seems to have more or less recovered in terms of pricing and liquidity since the onset of the pandemic in the US last March. Chris, do you agree?

Chris Simeone, East West Bank: No doubt, the market has recovered. Just a couple of days ago, it was determined that the recession was only about a month-and-a-half or two months. The shortest recession in history. All asset classes, particularly in ESG, are pretty much back to where they were pre-COVID. If anything, things are a bit more aggressive.

What I'll say as it relates to East West Bank is that we tend to specialize in niche areas in the market where there is a little bit of a price pre-

mium relative to the straight utility-scale solar deal that's priced extremely aggressively by all parties. But there's no doubt there's liquidity out there. Call up your bankers, call up Ares. It's a good time to be a borrower right now.

Mike Roth, Ares Management Corp: I would agree with Chris. Project finance volumes are down, but there's strong liquidity for deals and competition is higher. In the renewables space, there continues to be downward pressure on pricing and we're seeing banks begin to get more active in the holdco debt space and proactively seeking to offer ancillary solutions to differentiate such as development capital.

On the term loan B side, that market is wide open. It's certainly able to price risk

very efficiently.

A key sub-set of the TLB market pre-COVID was the non-US investor base. That base paused post-COVID, but we are seeing it slowly come back, however, hindered by fewer site visits.

On the ABS side, that market is very strong. Yields are coming down which is benefitting the residential solar market.

On the equity side, there's strong appetite for renewable energy among both infrastructure and private equity funds.

In particular, many energy-focused private equity funds are launching energy transition strategies. Sometimes they're doing that with the existing team, and other times, they're hiring a new team.

PFR PROJECT FINANCE MIDYEAR REVIEW ROUNDTABLE 2021 ●

Conor McKenna, CohnReznick Capital: I agree a lot with what Mike was saying there. I think that we have seen fewer projects coming through, especially as the gestation cycle for a project takes time to get from mid-stage to late stage, to shovel-ready to NTP. When you have the hiccup that we had earlier in 2020, that has led to fewer projects being ready to go in the first half of 2021.

But in terms of the ability of the market to facilitate the commercialization of these assets, I would agree with both Chris and Mike's statements that the conventional market is ready to go.

More importantly, or more of a paradigm shifting adjustment that we're seeing, is the focus on the energy transition and larger infrastructure and newer players coming in to take advantage of greater growth opportunities broadly within sustainability and specifically in power.

That paradigm adjustment is being played out in a number of different ways, including the conventional debt side doing more of the holdco loans, and more business facilitation of larger platforms. Some of this money is looking to invest heavily into the space for the idea of greater growth into the future. That's been driving a lot of the focus of the market through the first half of the year.

Ellen Friedman, Nixon Peabody: The renewable space continues to keep us busy. As to what Conor was referring to, those are projects that are not going to be quite as familiar to lenders or equity investors, and not quite as homogenous. What's been nice about solar is that they have a relatively quick turnaround time from the point of NTP to COD. Banks have familiarity with and understanding of the risks in the wind space.

In contrast, there are many new technologies proposed in this so-called new energy space. Development periods will be much longer. There are unfamiliar risks and terms of art, such as FEED (front end engineering and design) studies and FID (final investment decision). This pivot will present challenges for some bankers and tax investors who seek to attain the same comfort level that they've had consistently with the solar and wind assets that they have presented to their credit committees in recent years.

There will be a steep learning curve for in-

vestors, presenting more complex structures involving multiple parties and new tax credit structures that will need to be developed around 45Q. I think that the real beneficiaries are going to be the consultants that everybody's going to have to hire.

Odayar, PFR: Matt, from a developer's perspective, how has business changed since the onset of the pandemic last March?

Matt Hankey, New Energy Equity: It's interesting to hear everyone talk about the overall trends in the market, which are absolutely true. We lived through it. Shoot back to January, February of last year, we were marketing a 30 MW portfolio of community solar assets in Illinois. Probably about the worst time to be marketing a set of projects as the floor fell out from under us. It ended up delaying the projects by 30-45 days.

We've seen tremendous liquidity flood into the market on the debt and equity side of any transactions that we're looking at. So, I think it's gone beyond recovering and I'm continuously blown away as to how fast the economy in general recovered. Probably the effect of a lot of money being pumped into the market.

As for the delays on projects, that's absolutely the case. Two years ago, I would be sitting here in July, saying, 'What projects can we get in this year in terms of COD?' Right now, we're talking about, 'Can we get a project in next year?'

These delays are driven by procurement, interconnection and permitting delays and timelines, which have just elongated tremendously in the DG community solar space. Permitting agencies had to shut down and go to some type of remote platform. In most locations, we lost three or four months there in the cycle. As expected, that's showing its face now, about a year later from the height of the pandemic. It's just an elongated development cycle, which has not typically been seen in community solar and DG.

Odayar, PFR: What are some of the changes that you've made in the ways you do business over the past year that you're going to stick with, even after offices re-open?

Simeone, East West: I'm going to be honest – pre-COVID, I rarely used video. Most of us would say most conferences were done over telephone. But a lot of bankers, like me, are in-person type people. And if I had a choice, we'd all be together in a room right now, chatting about these things. It's just an atmosphere that works. We want to be in front of our clients, and indeed, tomorrow, I'm going to be on a business trip, and we'll be doing that.

But I think this will all still be a part of the mix. Getting together over a video conference has worked well. It's surprised me that it tends to be efficient, it tends to be workable and likeable.

McKenna, CohnReznick: I'm going to continue to do what my clients want me to do, in terms of whether it's in-person, or over the phone, or over video. It's obviously easier to do more with video now being a greater part of the nexus. It's a little bit more personal than a phone call, but not quite as good as in-person. So, it's a nice hybrid. And I think everyone's still trying to figure out what the future's going to be like for meetings, and what's preferred, and what's most efficient, and what allows us all to do our job best. It's a work in progress, but we've learned and got a few more tools out of COVID.

Odayar, PFR: Have there been any hindrances in the way you do business because of the pandemic?

Hankey, NEE: Yes. From our perspective, we'll do a lot of early meetings via phone, Zoom and Teams which we would have done in person in the past. We have had to cut off Zoom for one day a week, so we have 'no Zoom meeting Tuesdays,' as we found ourselves with continuous 30-minute blocks of meetings throughout each day.

One hindrance that I've seen, is we've had two very large transactional processes that took on average 60 or 70 days longer than usual. There's usually that last meeting two weeks before close, when everybody flies to the same place and gets in the same room and just knocks out every piece of transactional activity, in terms of documents and diligence. We've tried to do that remotely and it just hasn't been effective for us. So, we're

● PFR PROJECT FINANCE MIDYEAR REVIEW ROUNDTABLE 2021

looking forward to getting back to finalizing transactions a bit more efficiently, so they don't drag on for that extra 60, 70 days.

Roth, Ares: I think about it in two ways – internally and externally.

Internally – we've expanded our team significantly. And if you think about our business, it is very dynamic in that we're doing a lot of different things including both debt and equity, in assets and corporates, and actively pursuing opportunities with a high degree of complexity – we really pride ourselves on offering many different types of solutions. And so, in order to execute that effectively, especially with new team members, it's really important that we give those new team members direct exposure to the various folks on our team that have specific and unique skill-sets so that they can accelerate their learning curve and drive collaboration. As a result, we currently expect to be going into the office more regularly in September.

But we certainly want to maintain some of the efficiencies of remote working and remote interaction, particularly externally.

Externally – at the end of the day, what we're doing is financing and investing in assets with useful lives of 40 years through illiquid debt and equity investments. And so, this is a relationship-driven business and it's important to get together in person with your partners and key stakeholders. Personally, I'm planning on going to my first renewables conference in September, so I'm looking forward to that. And I'm hearing that others are doing the same as well.

Odayar, PFR: Ellen, from an attorney's perspective, how has the pandemic affected the way that your work is conducted on a day-to-day basis?

Friedman, Nixon: A lot of what Mike said really rings true. At a law firm, there's a lot of training that is always being done. And I personally tend to work with people all over our footprint, so I'm not always working with the person in the next-door office. Remote training has always been something that we've had to do.

I miss the client contact. I've had two client meetings now and they've both been really great. I think it's a novelty at this point, but

I'm looking forward to having more opportunity to meet with people, both internally and with clients going forward.

But in terms of efficiencies, not having to commute and travel for meetings that take an hour is great. I've been quite productive, and I think the same has gone on generally for the whole law firm. So, I think we'll continue and I know we're going to make remote working available to whoever wants it.

McKenna, CohnReznick: I will say I have a huge backlog of closing dinners that keep on stacking up because we haven't done it for a year.

Friedman, Nixon: You see, this is good for your waistline.

McKenna, CohnReznick: There's a little bit more space here in the vest!

Simeone, East West: We've finally scheduled an in-person closing dinner next week, when I come back from my business trip. We're going to have clients coming to town for a big deal that we closed a couple of months ago. But up until then, the best that we could do was virtual closing dinners. I don't know, Mike, the common client that we closed on in Q4, I've been pushing them for a yacht party or something and it hasn't happened yet.

Hankey, NEE: I keep on thinking about Mike saying that it's a 40-year useful life, that's great!

Roth, Ares: I think it just turned 50! Conor, you've been closing too many tax equity deals!

Odayar, PFR: Apart from the pandemic, if you had to pick a couple of developments that have had a major impact on power and renewables project financings in the first half of 2021, what would they be?

Hankey, NEE: I have spent a significant amount of time on the phone over the last year, ever since the initial start of recovery from the pandemic. There's just so much money that wants to get into the market, and you're seeing folks who are willing to dip into a platform level or development capital level

in order to get some enhanced returns there.

However, I would caution folks who are in a similar position to us about some of those folks coming into the marketplace. We've built our business based on partnerships, learning each other's businesses, how we can each be successful. You can still get a competitive product while maintaining partnerships. Working with a very new entrant, who has not been through a process before on community solar or distributed generation assets is a pretty scary thing to do and it can elongate a transaction, and also, just create issues for you along the way.

There's a ton of capital out there willing to go into the riskier parts of what our business does in order to secure transactional value. It seems like there's a deal announcement every single week, if not multiple per week right now on the DG and community solar side.

Roth, Ares: There are two key developments.

My first observation is that there have been many new entrants into the market, and typically, when a new investor comes to the marketplace, they make one of two investments. The first prototype investment of a new entrant is to buy a passive equity stake in operating assets, and the second one is to acquire a partial or control stake in a platform. And the combination of those two is causing valuations to increase for both assets and platforms. It makes you wonder, well, what is motivating new entrants to do this?

To a certain extent, it is the low interest rate environment and investors seeking resilient investments post-COVID. It is also the general movement towards ESG. But most recently what I believe is causing this acceleration is what we are observing in the public markets. There's a lot of SPAC activity and the public markets are very enthusiastic about the energy transition trend. I believe many private investors are watching the public markets and that is influencing their private market investments in terms of strategy, entry point and valuation.

In addition, many market-leading private companies in the clean energy space are also watching the public markets and saying, 'OK, if I want to go public, I need a compelling growth plan and so how can I achieve that?' And that mindset is causing them to

PFR PROJECT FINANCE MIDYEAR REVIEW ROUNDTABLE 2021 ●

expand into new geographies and cross into new sub-sectors of clean energy where they believe they have a competitive advantage. As they augment their business plans and capital needs, private financing rounds are becoming larger. There is a perception that scale drives competitive advantages and synergies which, in turn, is driving projections for accelerated growth and higher valuations.

My second observation is the impact winter storm Uri in Texas had on market sentiment, and I think that humbled the market. I think it reminds market participants that success is not measured by raising capital and valuations – it is also measured by the long-term performance of these 40-year assets, and to achieve that successfully the commercial contracts must be well-structured vis-à-vis the local power market and potential black swan events.

Putting those two observations together, I think many market participants are trying to take a leadership role in the energy transition, but also trying to manage risk around new and innovative commercial structures. And so, I think many investors who are new to the space are seeking to rely on platforms and experienced management teams to help them navigate an evolving market, which again, is pushing up platform valuations.

McKenna, CohnReznick: Mike, from what you've just said, there's probably a half-hour of diatribe that I could do on either one of those points, whether it's how people are investing in the market, what the future's looking like, from both the public and the private side, as well as what you're thinking about for the adjustments that are necessary from what we saw in Texas in February.

We've been fairly active on the platform side. We closed four platform deals in the first half of the year but most of them closed in the second quarter. Some of it was minority, most of it was 100% takeout. And I think that this has been driven, partially, by what we're seeing in terms of the activity on the public side with the SPACs, IPOs and the growth. And if you take a look at how some of the public market renewables companies are trading, they're really, really robust.

Another thing is also just the fervor from investors. Not just public market investors, but private market investors. Everybody is

saying we need to have more sustainability and meet ESG goals. And that is also driving the money behind the money, in some cases. Meaning that the larger pension funds are saying, 'We have to meet these goals, so how are we going to do it? And who are we going to invest in that can do that?'

That is then driving some of the acquirers to be more aggressive in thinking about the growth opportunities in ways that you haven't seen historically for platforms. We saw that play out on a number of our transactions where we think it's going to lead to great synergies for those groups going forward, but in ways that maybe hadn't been there or the thesis hadn't been supported by the acquisition price, historically. And I think that's really interesting.

I really liked the activist momentum for **ExxonMobil** as that was somewhat of a canary in the coal mine in that even really well-run companies that have a proven thesis and track record of doing things a certain way are being told by their investors, by their money, that they have to change the way they're doing business. And if it can happen to a company like that, that's true for everybody. It's really leading to a shift in perspectives as to what growth in the future might mean inside of infrastructure and energy specifically.

Friedman, Nixon: From a legislative perspective, we've got the Biden administration pushing really, really hard to expand green and energy transition opportunities and incentives. The SEC is coming down on companies to provide more specific ESG disclosures. When it comes to the environment, I can't remember how many weird weather events we've seen in the last year. I don't think climate change is a hoax, unfortunately I think we're seeing it play out every day. As a result, it's driving increased investment and increased attention.

Another development we see is an increased focus on cybersecurity security in the energy space.

Another change on the horizon is the increased role of CFIUS (**Committee on Foreign Investment in the United States**). This organization has recently ramped up its staff and resources and is more actively examining proposed transactions, and in some instances closed transactions, with foreign

investment in critical infrastructure. This term is defined under the applicable regulations to include certain operating power generation facilities, oil and gas pipelines, LNG facilities and battery storage.

Recent legislative and regulatory changes to CFIUS have expanded the statute's reach. Under the updated regime, there are more situations which may require a mandatory filing. There is a heightened sensitivity to transactions which involve a foreign investor beneficially owned by a non-exempt foreign government. Proximity to certain military installations must now be considered in any CFIUS analysis. We see CFIUS becoming an important consideration in M&A transactions involving operating energy assets. Also, given the extensive rights afforded to tax equity under standard tax equity documentation, foreign-owned tax equity investors, should review whether CFIUS is applicable to their investments.

Simeone, East West: I feel like we could have a two-week conversation, Ellen. I can already tell that you're a professor on this topic, which I love.

McKenna, CohnReznick: And to build on what Ellen is saying, as it pertains to the administrative support, I think it's very helpful and constructive and it leads to greater thought and forward vision from investors. And that's really important. Not dealing with administrative headwinds and having tailwinds and support are constructive. I do think that it's coupled with the overall economic viability that has been proven in the renewable energy sector.

Simeone, East West: Certainly, what we've seen, to the points that Matt brought up, is international trade issues slowing down development especially in the solar sector and renewables in general. As for transactions that we've been living on, we've seen some lag in ultimately getting them done.

If we look at the first half of the year in general, we didn't see as many of the mega deals get done. I know that **Investec** led with **GenOn** on a big peaking power portfolio transaction. But there really weren't that many mega deals. There were still a handful of maybe somewhat smaller, but extremely interesting deals that did get done. And we

● PFR PROJECT FINANCE MIDYEAR REVIEW ROUNDTABLE 2021

expect the second half of the year to be pretty consistent with that.

At East West Bank, we closed the largest biomass power portfolio financing done in quite a long time. We got that done in May and that was a \$40 million transaction. So, smaller than the megadeals, but certainly, big for biomass power. Last month, we were very enthusiastic that we were part of a club deal for **LS Power**, providing \$108 million for a battery storage deal. I think all of this fits into the big ESG scheme.

Hydrogen is the next big thing and renewable fuels will be something that is white hot in the second half of 2021, so wait and see for that. And at East West Bank, I expect us to make pretty much the largest tax investment in an alternative energy project ever.

Friedman, Nixon: Chris, is that 45Q tax credits or 48 or 45?

Simeone, East West: It would be legacy ITC transactions. All of our tax investments in the first half of the year and prospectively for the rest of the year are purely legacy commitments that we made for transactions that ran into this year. Just like all banks, 2021 has been a tougher year. Maybe not quite as hard as 2020 when stuff got out of whack, but 2021 has still had some tightness in tax equity markets. But we are going to make a big investment pretty soon.

Odayar, PFR: The Biden administration is proposing a number of changes related to the extension and the phasedown of the ITC and the PTC, as well as the introduction of a direct pay option. How would direct pay work in practice? And until there's more certainty around these proposals, will project financing activity be affected?

Friedman, Nixon: Good question. The Senate **Energy and Natural Resources Committee** voted on July 14th on the Energy Infrastructure Act. This bipartisan package was voted out of the committee with a 13-7 vote after adding 48 amendments to the bill.

There are two tracks in Congress right now. Many assume that both the bipartisan Energy Infrastructure Act and a more aggressive platform advanced by Democrats using the reconciliation process will continue to proceed on parallel paths. It's hard to predict the results of this process including direct pay provisions for the various tax credit regimes. Hopefully we'll see resolution in the near-term.

Tax equity transactions monetize both the tax credit depreciation. No proposals currently allow for a direct pay of depreciation.

There will still be an opportunity for bridge loans to provide liquidity during the period between when the project starts construc-



A Shared Vision

Project financing for a sustainable future.

What makes **East West Bank** a fast-emerging player in the power, energy, and infrastructure space? We genuinely share your belief in clean energy, and we take great pride in supporting innovations that open the door for future projects. When you team up with us, you can count on our seasoned professionals and agile organizational structure for a swift execution in *structuring, leading, and arranging complex project financing*.

Together, we will *Reach Further*.

eastwestbank.com/projectfinance



Equal Housing Lender
Member FDIC

PFR PROJECT FINANCE MIDYEAR REVIEW ROUNDTABLE 2021 ●

tion and needs capital, to when they might otherwise receive direct pay or cash grants. Given the uncertainty, some developers may be waiting to see what legislation is passed near-term. This may be keeping some deals, especially long lead time 45Q CCS projects, from signing up tax investors.

Odayar, PFR: Matt, from a developer's perspective, what are your thoughts around the proposed tax changes and the direct pay option?

Hankey, NEE: I think I might be in Conor's camp. I'd be interested to hear his perspective on this, given that he has great business around raising tax equity for his customers and partners. It would be a tremendous injection of profitability for New Energy Equity, but overall, I worry that it would end up being a bad thing for the industry. We have an industry that, unfortunately, has some companies which don't know how to effectively develop projects, and I worry that removing the tax equity process could impact the quality and longevity of these projects which is bad for the industry.

I actually do think that the tax equity market and the complexity of it is a decent barrier to entry, which makes projects tougher to get done and also corrects a lot of project issues along the way. If you know what you're doing, it's not a big deal, and if you don't know what you're doing, it's probably a significant deal. So, I think it would be a short-term gain, but long-term, I would like to see some type of tax equity component on things.

I do think it's best for the industry, just because it will bring a higher quality of asset into the market. It just creates a higher bar for folks to jump over, to develop projects and get them on the ground.

McKenna, CohnReznick: I want to choose my words very carefully, because my general thesis, and I mean this sincerely, is that I just want what's best for the industry. I want overall growth. I want us to be successful as a group, long-term. I've been around long enough to see and be a part of the 603 cash grant world and see the positives and challenges that were borne out of that.

Now that we're exponentially larger, I think, to Matt's point, there are some con-

siderations here. I agree that it would lead to substantial growth in the market. Now, whether that would actually lead to better projects being done, I question that.

And I think there's a tougher point, because what you have now is a subsection of the market that is really good at owning and operating assets and getting things over the finish line, because they've worked through the challenges of highly complex financing. It's almost like the training ground for being a good operator of an asset is partially through the financing process.

If you take out that aspect of tax equity, it's like taking away part of the training that you need to become really fit at doing this job, especially in distributed generation, because it's such a complicated business to manage. And so, while there are always challenges in tax equity, having it as a steward to really prudently underwrite is extremely helpful.

And you do have guys, like Chris, who have been around for a long time. They know the business. They understand how to underwrite properly on the debt side. But you'll see newer participants who may not have the same experience and may not know to ask all the right questions when they're deploying capital. So, with a significantly larger base within debt of potential capital versus what you see in tax equity, and the level of sophistication differential, I think there's an important aspect to the market and a specific benefit that tax equity does provide.

That said, it is a mitigating factor, too, to what could potentially be good growth. There are good projects that are harder to get done because there just isn't enough tax equity out there. Good utility-scale gets done in general – if it isn't with the original sponsor, it will be with somebody who will buy the asset. With DG, it's sometimes harder.

Again, there are so many different complexities there. And you can see that being dominated by a handful of names. I think that the question is, if you get rid of the barrier that is tax equity, are we in a position to self-govern effectively as a group? In general, a lot of people who have been successful have been aggressive and developing and trying to push the envelope. I don't know if they're necessarily the same people you'd want as your long-term owners though.

And therefore, I like the groups that are like

Matt's group or groups that Mike invests in, or Chris, the guys that you finance. They're sophisticated investors who can understand that we're all in this for the long run. That's part of the aspect that I think about when looking at the potential for adjustments and the way in which we look at financing for the tax equity piece of the transaction.

Roth, Ares: I'll add a few thoughts and I'm going to take it by each sub-sector of solar.

In utility-scale, I agree with Conor. In the absence of tax equity, I think what we would see is more projects with shorter contracts and hedges, particularly in liquid power markets.

In the residential space, there are two different dynamics I'd follow in a no-tax equity market environment. The first one is the market share of new installations between third-party ownership, which is leases and PPAs versus loans. Most people would be surprised to know that the loan volumes make up about two-thirds of annual volumes. It would be interesting to see if that changes in the absence of tax equity. The other dynamic is minimum FICO and average FICO scores of a customer pool – would that change? For example, we believe one of our portfolio companies, **PosiGen**, is a pioneer in the residential solar space because of how they underwrite customers. Their primary focus is monthly savings as opposed to FICO scores, and they've been helping new tax equity investors understand new methodologies in underwriting and risk management which have proven to be highly effective.

And the last one is community solar and the C&I space. It is a highly fragmented sub-sector and I believe there are about 300-plus individual companies out there, whereby most companies are hyper-local and focus on just 1-2 states. Most of these companies and developers can either be categorized as what I'll call 'develop and flip,' where they develop assets and sell it to third parties, versus 'asset aggregators' which we also refer to as IPPs. Without tax equity, I think you would see more companies pursue the latter to own the asset base. Right now, for the 'develop and flip' participants, tax equity is very challenging as a first-time issuer and it is a hindrance to owning assets. Ares has actively pursued opportunities in the behind-the-meter and

● PFR PROJECT FINANCE MIDYEAR REVIEW ROUNDTABLE 2021

distributed generation space to help operators raise tax equity and transition their strategy from the former to the latter. In the absence of tax equity, I think you would see less asset-level M&A as developers build on balance sheet.

Simeone, East West: Great observations. It's further edifying things that I see every day. East West Bank is one of the most active, if actually not the most active over the past couple of years, in providing DG solar financing. The first deal in the market that closed through COVID in March 2020 – we did that deal ourselves. It was a \$40 million DG solar portfolio in Southern California.

And we're one of the most active providers of capital for residential solar and we've done a lot of community solar. I'm trying to think of why we haven't provided tax equity to DG. And I think it's related to all the things that you're saying here in terms of how things

shape up. Obviously, it's related to tax capacity too.

But there actually is another component that we're not talking about, maybe somewhat related to what you were getting at, Conor. East West Bank is a regulated bank, a commercial bank. We don't have a separate infrastructure arm that's aiming to, I guess, quarantine our investments from the rest of our assets. And so, when we provide tax investments, we are regulated by the OCC and Fed. And they provided us guidance that we're not able to provide tax equity against merchant-type stuff. But invariably what I see these days in community solar and DG in general has merchant-type components. The framework that we see in New York for community solar, according to our guidance from the OCC, is too merchant for what they would allow us to do.

So, that's another challenge that we've had on our side. I don't see many developers like

you, Matt, understanding that. And so, when I talk to sponsors, they're usually surprised when I give that feedback. And I don't think it's very well understood by the market yet.

Friedman, Nixon: Earlier this year, the OCC codified rules governing national banks' lending power to make tax equity investments. The OCC discussion issued together with these rules may address some of the concerns that you're raising.

Simeone, East West: A couple of months ago, we were looking at New York State community solar. And they said, 'Pass.' I'm like, 'Alright, but tough feedback.'

Friedman, Nixon: Interesting. And on the switch to direct pay, I think it makes good sense when you're talking about the 45Q credit. All of the arguments for and against which everyone's talked about are with re-

RENEWABLE ENERGY EXPERTISE

Exceptional advisory services for leading investors, smart energy innovators and global clean energy corporations.

Project Finance | M&A Advisory | Capital Raising | Restructuring

200⁺

Transactions
Closed

40⁺ GW

Financed
to Date

\$26⁺ Billion



Total Transaction
Value

Every transaction a catalyst for change, every closing a step towards a cleaner future.



To learn more, contact:

Info@cohnreznickcapital.com | 917-472-1286

cohnreznickcapital.com | Connect with us  

Securities offered through CohnReznick Capital Markets Securities LLC, a Maryland limited liability company. The firm is a member of FINRA and SIPC and is registered as a broker dealer with the SEC.

**CohnReznick
Capital** 

PFR PROJECT FINANCE MIDYEAR REVIEW ROUNDTABLE 2021 ●

spect to solar, wind or even battery storage. But in terms of the 45Q tax credit and CCUS, this sector will require enormous tax equity checks, push investors to embrace new technology, require long commitment and construction periods and invest over a 12-year credit term. The universe of tax investors, which is already comparatively small, may be reluctant to shift to CCS transactions. As a result, perhaps Congress will bifurcate its approach to direct pay for wind, solar and carbon capture. We will see.

Odayar, PFR: Have there been any new entrants to the tax equity market this year? And have there been any changes in the way existing investors have been doing business, or preparing for potential tax law changes?

McKenna, CohnReznick: New entrants, yes. We're seeing that in a number of different ways, typically as co-investors coming in behind either an aggregator or a syndicator. So, we've seen greater penetration of new investment, which is helpful.

In terms of change in tax law, we've kind of learned our lessons back in 2017 as to the adjustments that might be necessary. And that's part of the language that's currently in most of the documentation. That said, I don't know if tax equity is necessarily pushing this quite as much, because if there are going to be adjustments it's going to be to their benefit. We're seeing a little bit less fervor or focus from the buyers of tax equity on this point than I saw back in late 2017.

Roth, Ares: I would add that from our perspective over the past maybe 18 months or so, we've been in the market for tax equity issuances in a variety of sub-sectors – wind, utility solar, C&I solar, community solar, residential solar and also a virtual power plant opportunity! And some of those were launched pre-COVID, some a few months into COVID, and some very recently. We're fortunate enough to be in a position where those deals either have closed or are expected to close in the near future.

In the wind space, you have a few large investors that are active, no new investors to my knowledge, and the constraint for them is more due to their teams' bandwidth.

In resi, I don't believe there have been new investors. There are only a few issuers and they do very large deals. If you are a new entrant, you are typically not relevant vis-à-vis a large deal for a public company.

In C&I and community solar, that's been the most dynamic given the high fragmentation, small deal sizes and new issuers who are enthusiastic about speaking to a new investor about their first deal together. But it is an opaque market with many syndicators who may not reveal their investor base, so it is difficult to know if there are new investors.

As a related point, there was a point in time where a few months into COVID it felt like many investors who had been actively investing were proactively stating to the market, 'I am not active in C&I.' But in the past few months, that's changed significantly. If you look at bank profits for the largest US banks, they're higher year-to-date 2021 than they were pre-COVID. And so, many investors have come back and there's a lot of optimism. I feel good about well-structured projects and companies being able to raise tax equity, assuming they are not a first-time issuer or have institutional sponsorship.

Odayar, PFR: Some really good points raised here on tax equity. Let's turn for a moment to the bank loan market, particularly Term Loan As and Term Loan Bs. What are some of the strategies that different lenders are pursuing in order to stand out and win business?

Simeone, East West: Having to talk about strategies that we or banks generally are using, what's interesting about the way that you pose the question is on competition. But at East West Bank we don't really have competition in project finance.

Let me explain that in a couple of ways. I can borrow an idea from our Chairman, **Dominic Ng**. If I aspire to be in the Olympics, what am I going to do? I love basketball, but am I really going to drive myself to be a basketball player? Well, I'm an American, it turns out that Team USA happens to be the dream team. Maybe that's not the easiest and quickest path for me to become an Olympian. Maybe I should focus more on a niche sport like the luge or something like that.

I don't know how many of us have tried the luge – maybe I should have done that when I was younger. And that's really what our general strategy is at East West Bank. We find the niche aspects of the project finance market. Matt, you guys work in DG solar. We've done a lot of DG solar. We love DG solar. But not every bank is waking up and thinking about, 'Oh, I'm going to provide financing for DG solar.'

A couple of months ago, we closed that \$40 million biomass power portfolio financing with **Denham Capital** and **Greenleaf Power**. Biomass is part of the ESG sector, but it's not getting the same type of everyday headlines as traditional solar and even battery storage these days. We love working on that stuff.

And on battery storage, we closed a \$108 million club financing with LS Power last month. So, each day we come into office, I'm never thinking about competition. I'm thinking about where we fit in in providing our clients the best solutions.

Mike and I, we both teamed up on that LS Power deal. And he looked at a subordinated piece for a development facility for a large solar developer in Q4. East West Bank was a part of a club that provided the senior piece. When we talk about providing financing, it's always in a symbiotic context.

If Investec is leading a big deal, we have very similar clients. They'll be administrative agent, we'll provide the depository services, the swaps, the LCs and all that stuff. Our strategy is to give our clients exactly what they need every single day, regardless of any of the context. We don't have any red tape in terms of boxes to check. We don't ever use the terms, 'This financing uses market standards.'

And we're a lean structure. I report to the most senior person in the East Coast region. He reports directly to the CEO. We're lean, we move quickly, we provide Matt and other sponsors in the business exactly what they need. So, it's providing a different product than the core international bank-dominated project finance market.

Hankey, NEE: I'm going to respond to Chris, because I'm on the other side of the transaction. When we head out into the debt markets for any process, we're looking for somebody

● PFR PROJECT FINANCE MIDYEAR REVIEW ROUNDTABLE 2021

who's going to provide ease and simplicity to our transaction. The cost of capital is already pretty competitive across the board no matter where you look and you're typically always going to be able to achieve an aggressive cost of capital.

Our focus ends up being on ease of transaction, surety of financial close, former customer references and other related points. In a recent process that we ran, we did choose a debt provider based on the fact that they were willing to provide or syndicate tax equity, which allowed for a ton of shared due diligence across the portfolio, so that we didn't have some of the normal complexities in terms of trying to accommodate two very large syndicated parties within one transaction.

So, anything that you can do to increase ease and flexibility and lower transactional costs for us is key. Our transactions are already hard enough in terms of just grouping them up in the larger portfolios. We don't need additional hurdles or complexity making it harder than it already is.

Roth, Ares: Here's how I think about it from both the private equity seat, as well as the flexible capital seat.

If you're a participant in a Term Loan A market such as a bank, I think there are two steps. First, to get the call, it's mostly about where the market views your terms to be, most notably fees and spread. And generally, your ability to execute and your reputation for being a good and fair partner, both leading up to a closing and more importantly, post-closing.

Second, to win the mandate among others, a lot of consideration goes into understanding friction costs and transaction expenses, including your advisers and law firms and third parties, how many of them do you need, and what does that total budget look like. It is very helpful if you have closed a deal together before because you can use precedent docs to save time and money.

To hit on what Matt said, if you can provide tax equity on top of a debt solution, that's obviously a differentiator and likely allows you to jump the line and win a mandate through a bilateral discussion with limited competition.

Now putting on my flexible capital hat, we pride ourselves on offering bespoke solutions to solve problems. We find that many times, borrowers do not understand the inefficiencies being offered by traditional products and so there is an education period where we spend the time sharing our perspectives. And then we try to offer a solution and walk them through the cost-benefit analysis both today and over the next five years or so across multiple scenarios. I do believe our clients appreciate being educated on the pros and cons in a candid way, even if that means our solution is not what's best for the company.

As Chris mentioned before, we collaborated on a development loan facility last year, which is a really nice solution where we paired a bank-led first lien LC solution with a subordinated investment where Ares invested. We believe that this type of a combined solution optimizes for maximizing total proceeds while minimizing the blended cost of capital, and gives the company multi-draw flexibility through a borrowing base construct.

McKenna, CohnReznick: I think there's two parts. Number one is relationships, meaning your existing relationship either with the client, or with the other parties that are involved. They know you, they know that you're going to be a good party in the deal and that the execution's going to be fairly efficient that way.

And the second is constructive problem solving. So, it's not like you're just doing the same cookie-cutter deal that everyone else is offering. If you can go a little bit outside the box to make it easier for the client, then that's really what we've seen as a differentiator.

Cost of capital is always a fight. But it's really just about constructive problem solving and trust that you're going to be a good operator in the transaction.

Odayar, PFR: Have there been any innovative financing structures used recently? And any inflection points for developers?

Hankey, NEE: I actually think one of the big problems that we see at times is lack of innovation and flexibility in tax equity as it relates to the DG and community solar market. Take a market like Minnesota. You have a utility

tariff rate for 25 years. At a fixed rate, you're selling a guaranteed savings contract to either a commercial, municipal or a residential customer. We have seen banks and tax equity providers really struggle to get their heads around this as a significant protectant to default. I think this is because they're coming in from different perspectives and different markets, whether it be residential or whether it be utility-scale. As a community solar developer, if we lose a customer or they default on their contract, we could replace them within 30 days. From a customer's standpoint, they get a guaranteed savings contract that you get.

I actually think we need a year of a little bit more out-of-the-box thinking in terms of community solar and distributed generation so that folks could see the real benefits of what that industry segment brings.

We have started to see storage get incorporated into more and more projects. For a while, it had been talked about, but we hadn't seen it very much in actual installations. We're seeing it pop up quite a bit now. We've completed our first few storage projects this year and expect to grow that portion of our business significantly. I am also just really interested, as we push innovation on that side, how that's going to affect the customer, and how the utilities are going to react to that, and what that will mean for the customer over time.

Roth, Ares: We started off this discussion by talking about how liquidity remains very strong. And I think it's true for what I'll call plain vanilla solutions. That being said, we do see inefficiencies. To name a few – and this is true for all renewable energy projects – access to development capital for the early-, mid- and late stage, and I would say access to tax equity, particularly for first-time issuers or for situations where the commercialization structure is a bit newer.

To Matt's point, maybe it's a new community solar market, or an unrated counterparty that the bank community has not underwritten before, or in the utility solar space – a new hedge structure that's never been used there but has worked well in the gas-fired space. At Ares, we seek to work with companies and developers seeking innovative solutions with execution certainty and a trusted

PFR PROJECT FINANCE MIDYEAR REVIEW ROUNDTABLE 2021 ●

partner – it can be an equity-like security or a debt-like security or a hybrid of something in between.

Friedman, Nixon: Some of the deals that I've worked on have borrowing base structures to address more variable cash flows. This concept is popular in asset securitizations, but somewhat innovative for the project finance market and builds upon the target debt balance concept present in certain power project financings.

Odayar, PFR: One of the major events this year was the highly anticipated PJM capacity auction, which was two years in the making. A lot of folks were disappointed with the results, and now PJM is planning to scale back the Minimum Offer Price Rule (MOPR) ahead of the next auction which is penciled in for December. Thoughts around this?

Simeone, East West: I'll admit I'm somewhat confused with nuking the MOPR or the intention to nuke the MOPR. Because that sounds like a price floor. That sounds like it ought to bolster the realized result of the capacity auction. So, what's going on there?

It doesn't help the possibility for a higher price in the next auction. But the hope is that the actual value of capacity will be realized in the December auction. And therefore, leading to the retirement or the early retirement of assets that ought not to be in PJM anymore. And thereby on a future basis, leading to better results in future auctions. I think that's the intention with MOPR.

In terms of what I believe for the next auction, I don't think anyone's expecting prices to go blockbuster. If they do, fantastic. But I would say, from what I'm hearing, I think most are expecting it to be a little bit better than the last result.

Odayar, PFR: Anyone else feeling optimistic?

McKenna, CohnReznick: No – hope is not a strategy. I like to think that in general, the market tells you where you're clearing at. And unfortunately, it told us this is where the value is right now. It's an open market and

I can see all of the rationale and the fundamentals to support future optimism. Until that's borne out – and I think we've seen a decent amount of this across other ISOs as well – you kind of have to prove it out in order to say, 'Oh, it's going to be better in the future.'

We'd have to see those retirements. We'd have to see if there couldn't be enough additional capacity brought online to more than supplant what is happening. Whether there will be a retirement is based on a couple of other things, like exogenous events that none of us can really guess. It's always hard. And so, I like to try and focus on what I do know now and work from there. And I think that it behooves market participants to think accordingly as well.

Simeone, East West: There are no knowns, there are no unknowns. But are there unknown unknowns?

McKenna, CohnReznick: Yes. And for what it's worth, my general thesis is the merchant curve is never going to be right. The merchant curve is a proxy for your optimism or your belief in the future. It's a catch all because you can't get all the unknown unknowns. They're going to be happening in 10, 15, 20 years from now. These capacity curves or the thesis around this, is a proxy for the unknown unknowns that may be impacting future values.

And I think back to some of the assets that were done in 2012 or 2013. If you look at the merchant curves that were assumed there when some of these people were building and financing these assets, they said, 'Oh, we're going to have this great value from the merchant in the back end.' Merchant curves have come down, yet the returns on those assets have been fantastic. In other words, they sold for a lot more than what they'd originally been underwritten for. So, while the merchant curve came down, the value was actualized. Chris, to your point about unknown unknowns, that's really what some of these assumptions are meant to capture.

Friedman, Nixon: Going forward, it's going to be interesting to see how the potential cost of carbon emissions is factored into financial projections of fossil generators. I don't think

that that is currently routinely done, but it might be something that folks will do in the future.

Odayar, PFR: In terms of outlook for the rest of the year, of course there's President Biden's proposed infrastructure bill that's in the works, but that aside, what might be some of the other key drivers of project finance activity, for both thermal and renewable assets?

Roth, Ares: I would say there are three key drivers we are watching.

The first would be inflationary pressures, labor shortages and supply chain constraints. The impact that those are having is that some projects may become uneconomic and get delayed to next year.

The second one is renewables platform activity. In 2021, we've seen more than a dozen deals close or which are actively in the market, and what that's doing is it's bringing new investors into the mix. And that's sometimes causing companies to change their business model, expand, diversify, pivot from 'develop and flip' to 'asset aggregation.'

And then the last one that we've been seeing a little bit of is generalist investors, private equity, venture capital, strategics and family offices, coming into the space. They typically have a strategy which they label as "energy transition," or "sustainability," or "clean-tech" and they tend not to focus on assets, but on the services segment of the value chain, and tech-enabled opportunities at the intersection of disruptive innovation and infrastructure assets.

At Ares, more and more we find ourselves both actively competing and collaborating with this newer investor base and have made a few investments in companies alongside them where the company is involved in the commercialization and optimization of assets and tend to be focused innovative commercial structures using proven technology that is being used by market leaders. The reason we are spending time in this area is that we find our value-add expertise and flexible capital is very helpful to all stakeholders and there is a shared belief that we can create value by working together because we all bring diverse skillsets and experiences to the table which are comple-

● PFR PROJECT FINANCE MIDYEAR REVIEW ROUNDTABLE 2021

mentary. There was one particular instance last year, where we were simply looking to offer flexible capital at the asset-level, but a week before closing we were asked to join the board to provide strategic guidance and oversight.

Hankey, NEE: I'm a developer, so I'm paid to be an optimist, but I do maintain a healthy skeptical view. I think the thing to keep your eye on as we head into the latter part of the year are the project delays, which is not good for any sector of project finance. Procurement delays in terms of product not getting shipped, increased prices, interconnection delays and permitting delays. We didn't touch on it specifically, but the Forced Labor Prevention Act currently seems to be a pretty significant unknown. It's a significant announcement that we are supportive of, but there seems to be some details missing as to how it's going to be implemented and enforced and how that's going to delay module shipments coming into the country for the rest of the year. What does that do in terms of pushing projects from this year into next year?

Friedman, Nixon: Renewable fuels – of all sorts – will be in the headlines going forward.

I also think that we will see more carbon capture, transportation and sequestration projects announced, similar to the Navigator project that was recently announced – it's a proposed Midwest hub-and-spoke carbon capture network. The tax benefits for direct air capture may be increased substantially which may lead to more DAC projects announced.

The cost for carbon transportation infrastructure may be supported by low cost flexible federal loans under the SCALE Act, a proposal included in the Energy Infrastructure Act recently voted on by the Senate Energy and Natural Resources Committee, which has broad bipartisan support. This new loan program, to be called "CIFIA," is anticipated to be similar to the existing TIFIA for transportation infrastructure and WIFIA for water infrastructure programs.

There are many proposed complex carbon capture projects incorporating new manufacturing technology leading to production of various low carbon fuels including "green" or "blue" hydrogen using feedstock such as petcoke and municipal solid waste. Capturing carbon from some emitters is easier than from others. We will see carbon capture deals involving the "low hanging fruit" such as

ethanol plants, fertilizer facilities or steam methane reformers used in refining processes, which have relatively pure carbon dioxide flue gas streams move forward more quickly than other emission sources such as fossil power generators.

CCUS activity is currently being incentivized by a very generous 45Q credit, which Congress may increase and/or as discussed above, allow for a direct pay option. All this makes this new sector very exciting.

Simeone, East West: I'll give a slightly different take. I do see a lot of that stuff in the second half, but I think the key driver is mostly within our control. When I say our control, I mean everyone in this roundtable discussion right now – all sponsors, all bankers, all advisers, all attorneys, all of us. We should just keep our feet on the gas pedal.

We're also going to see gas-fired financings in the second half of 2021. Not the traditional, conventional type probably, but we're going to see renewable natural gas-fired financings.

We're going to see biomass power financings. We're going to see fuel cell project financings. We're certainly going to see a lot of battery storage. Let's reach further, let's be productive, let's make it happen. ■



Power Finance & Risk

Executive Roundtables

The *PFR* Editorial Team hosts monthly deep-dive discussions on hot-button issues & challenges in energy infrastructure development and project finance.

Roundtable discussions take place virtually and at *PFR*'s offices in midtown Manhattan; they are recorded, transcribed, and published online, in front of the pay wall, as well as in a special supplement to the *PFR* WEEKLY.

Roundtable reports are 8-12 pages in length, co-branded with the roundtable sponsors and aggressively promoted to the *PFR* audience.

For more information on *PFR* Roundtables, please contact:

Alexander Siegel Global Head of Sales • +1 212.224.3465 • alexander.siegel@euromoneyplc.com

Taryana Odayar Editor - Power Finance & Risk • +1 212.224.3258 • taryana.odayar@PowerFinanceRisk.com

