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Earlier this year, a consortium led by Infinity Energy and Masdar acquired onshore wind platform Lekela Power from emerging markets private equity powerhouse Actis and the international renewables developer Mainstream Renewable Power in one of the largest M&A transactions in the energy and infrastructure space on the African continent in years.

Alongside the equity provided by the consortium's sponsors, the acquisition was funded using holdco finance for the bidco, while leaving the project finance debt at the project(s) level in place.

This transaction is an augur of several macro themes playing out in the African E&I sector, including:

- *Changing of the guard* – The rising star of regional and African headquartered owners – alongside Infinity and Masdar, the Africa Finance Corporation holds significant equity in the acquisition vehicle – taking over from a retreating cadre of international developers now increasingly looking to more nascent emerging markets in their hunt for returns;
- *Old trading partners* – The historic trading relationship between the Arabian gulf and Africa that has long brought riches through the Indian ocean trading routes are now bringing comparatively cheap Middle Eastern equity into the sector, reducing the delta between the cost of equity and debt financing as global inflation pushes rates higher;
- *Sophistication of financing structures* – The innovation in accessing additional sources and pools of liquidity through the increasing use of holdco financing structures for portfolios of assets more commonly established in the developed markets; and
- *New frontiers for traditional PF* – The structuring of transactions to reduce their exposure to sovereign credit risk at a time when the Covid-19 pandemic

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and the existing model of IPPs have put a tremendous strain on African government balance sheets.

While all of these trends would merit exploration, this article will focus on the last two. And in particular, it will offer some suggestions for how the African E&I market could embrace more of the flexibility and efficiencies offered from holdco financing structures, by encompassing the optional debt platform structures available with holdco financing, and with it, continue to reduce the traditional concentration of risk on sovereign balance sheets.

Evolution of portfolio holdcos

The holdco finance structures for portfolios of power assets originated from the debt platforms and structured financings for European infrastructure including airports, shipping lines and rolling stock with regulated and often inflation-linked returns. These structures were designed to maximize the sources of liquidity and optimize the cost of capital, with “bank and bond” debt platform structures to accommodate their funding base of traditional commercial banks as well as pension funds and other institutional investors in the private placement markets.

As quantitative easing swelled the coffers of the asset managers and infrastructure funds, they started seeking to deploy capital into the power sector. The power sector was going through its own evolution as a result of the quickening energy generation, with smaller individual assets to be financed – say a 15MW solar PV as against a 1.2GW CCGT, for example – and with it, in the subsidized world of renewable obligation certificates, contracts for difference and feed in tariffs, a revenue stream that resembled infrastructure assets.

The small scale of the renewables posed an issue for the large international investors and financiers from a human resource perspective as the amount of work involved in a 15MW solar project might still be the same as in a 1.2GW CCGT, but without the same amount of capital deployed. The solution was the aggregation of large numbers of projects into portfolios of a magnitude that could put significant capital to work in a single transactional structure.

Additionally, the use of the debt platform structure to provide a permitted acquisition and permitted additional debt regime, within the financing terms and conditions, allowed sponsors to buy and sell individual assets within the portfolio and raise new debt against the asset base without the need for time-consuming consent processes or costly refinancings.

This offered a neat solution to both equity and debt providers that wanted to see larger amounts of MWs being developed at greater speed and scale, without the lag of having to consider each individual project. And it is these debt platform structures that are as yet, still to arrive in the African market.

Holdco financing structural features

While there are a number of permutations of a portfolio financing structure, there are a number of key structural features typical to most portfolio financings that distinguish it from traditional PF:

- *Holdco financing* – The borrower is a holdco SPV that sits above the individual project SPVs in the structure such that the borrower is the owner of and recipient of revenues in the form of distributions from multiple project SPVs. With the borrower being a holdco with its only assets being the shares in the underlying project SPVs, the nature of the covenant package is typically targeted at and only applicable to the borrower holdco, and would not look down to individual projects: with the holdco lenders being asked to rely primarily on the financial covenants being tested on the financials of the holdco SPV only.
- *Senior secured vs structurally subordinated* – Portfolio financings can be done as a senior secured financing with the project SPVs granting upstream guarantees and security. These financings are more common for portfolios of smaller assets where the cost of getting project finance is not economic given the size of the individual assets.

Often, the construction of these small assets has to be financed initially with equity from the sponsor, with a plan to do a portfolio financing when these assets become operational, and are generating cashflows with part of the proceeds being returned as special dividends.

For portfolios that contain larger individual assets within them, holdco financings are done on a structurally subordinated basis with the project SPVs still retaining their own individual asset level project financings, which could include PF level mezz or junior debt with no interaction, for example through an intercreditor agreement, between the two sets of lenders and there is no asset level security granted in favor of the holdco lenders.

In these circumstances the debt service is entirely reliant on distributions from the individual project SPVs and so the lock-up tests and distribution policies at the project level are critical to the sensitivity analysis for the holdco debt.

- *Debt platforms and operational flexibility* – Typically one of the key advantages to sponsors of portfolio financings is the debt platform structure, with its ability to provide for individual projects and assets to be acquired and

sold, and with additional debt to be raised on a pari passu basis without any existing lender consent(s) being required.

This is negotiated through a pre-baked “permitted acquisitions” and “permitted additional debt” regime, often augmented by some fixed parameters to determine what is and is not allowed to be part of the portfolio.

In this case the portfolio test will typically stipulate eligible technologies, jurisdictions, construction vs operational and fixed vs merchant offtake, expressed as a percentage of the total NPV of the cashflows from all the projects in the portfolio.

Key credit features

There will inevitably be different sensitivities and credit features in any particular deal. However, compared with traditional project finance, there are a number of distinguishing features in a portfolio financing, notably:

- *Diversification of revenue risk* – Possibly the most important differentiating credit feature is the portfolio effect. By having revenue generated from multiple projects, the risk of default at the holdco level from any one single project is reduced. How significant the portfolio effect is depends on a number of factors, including: the number of projects in the portfolio; the weighted average asset life of the different assets; what proportion of the total revenue any individual asset accounts for; the number of offtakers, and their respective contribution to the total cashflow of the portfolio; how diverse the currencies are in which the offtake agreements/revenue streams are in; the number of jurisdictions the portfolio encompasses; what stage of the life-cycle the assets are in – i.e. construction, in operation with little or no track record, in operation with long track record, etc.; and the proportion of the platform’s cashflow being generated in jurisdictions that are considered lender friendly.

By way of example, having a large portfolio of operational projects in South Africa’s REIPPP will greatly reduce the operational risks of any single project causing a default under the financing but ultimately the entire portfolio still has a concentration of revenue risk in a single offtaker, being Eskom in this case.

- *Distributions and lock-up tests* – Where the portfolio financing is structurally subordinated with asset level project finance in place below it, a key sensitivity analysis for the debt sizing and setting the financial ratios is the ability of the underlying projects to be able to make distributions up to the holdco in order to meet debt service at the holdco level.

Given the potential for multiple levels of holding company vehicles between the asset-owning SPVs and the holdco borrower, anti-layering and leakage provisions need to be appropriately enforced to protect the dividends moving up through the structure to provide the holdco lenders debt service.

This will be a key diligence feature at the outset, requiring analysis of the sensitivity on the lock-up tests under the project finance documentation, as well as detailed diligence of any shareholders' agreements and distributions policies within the articles of the project vehicles where the holdco does not own 100% of all the individual projects, which is often the case in Africa – where a minimum percentage of local ownership may be required.

Where the relevant holdco is a minority interest in the underlying projects then even greater focus is placed on the terms of the shareholder arrangements and the minority rights that the holdco borrower has (and on which holdco lenders may look to exercise reserved discretions).

- *Pricing pressure* – A rough rule of thumb for subordinated debt on single asset projects is that the margin should be around double that of the project finance debt. However, with hard currencies already facing steep interest rate increases, the economic benefits of portfolio financing structures to sponsors have to be managed. With the elevated level of the benchmark rates, e.g. term SOFR, there is downward pressure on interest margins in order to offer an acceptable “all-in rate” to sponsors for the new debt.

A portfolio financing structure provides for the diversification of credit risk through the portfolio effect. By utilizing the portfolio effect, the margin requirements for portfolio debt can be kept lower than the equivalent subordinated debt on a single project, such as a junior or mezzanine tranche within a project financing that is a party to the relevant intercreditor agreement, because the risk of a default at the holdco level is lower than at any one single project for a mezzanine lender.

Innovation in Africa

As is often the case, different markets have their own unique challenges and benefits. A flavor of some of the additional nuances to holdco financings of portfolios in the African context include:

- *Capital repatriation considerations* – African portfolio financings often include an “offshore” holdco jurisdiction such as the Netherlands or Mauritius. When

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running the sensitivity analysis on the distributions and dividend streams from the underlying projects to the holdco, it is often necessary to consider how difficult it might be to get those dividends out of the country in a reserve currency such as US dollars.

Coupled with this is provision for adequate mechanisms to protect the project revenues against depreciation of the local currency and inflation. Nigeria is a recent example of the difficulties of getting hard currency to pay distributions offshore.

- *Participation of multilateral and development finance institutions* – The participation of DFIs or multilaterals in the project level PF debt can often be treated as accretive to the credit risk by reducing the likelihood of certain risks at the project level from materializing.

Other stakeholders in the project such as the sponsor and commercial lenders (if any) can benefit from the “halo-effect” of the DFIs/ multilaterals. This positive feature should be considered alongside the desired security structure and lock-in provisions required under the PF debt.

- *Adequate termination payout* – The debt service of a holdco portfolio financing is reliant on the cashflow up-streamed from the project level SPVs as distributions. At the project level, any capital injected into the project SPV from the holding companies above will be treated as equity for the purposes of the project documentation (regardless of whether it is true equity or the proceeds of the holdco financing pushed down).

A key point for diligence of the underlying project documents is therefore to what extent payouts under the various termination scenarios (other than under a project sponsor default) in any government or offtaker support arrangements also cover repayment of the “equity” injected into the project. This provides additional comfort that the value of the security interest (i.e., shares in the holdco) is preserved in the event of an early termination of a project’s PPA.

- *Credit enhancements and PRI* – Noting the reliance on distributions from the projects that the holdco lenders are taking, one possible credit enhancement for the holdco lenders is security over any equity risk mitigation products in place. These include the MIGA equity PRI cover policies.

Post Covid-19, many African economies have seen their currencies depreciating, and have experienced a shortage (sometimes acute) of US dollars in their currency market. In addition to the obvious political risk such as expropriation, PRI cover is also especially useful for currency risks (convertibility and transferability) and, where possible, breach of contract.

A PRI policy for currency risks has now become more important for sponsors and holdco lenders to mitigate against currency convertibility and transferability, especially when a debt sizing is being performed on a set of projected cashflows running beyond the loan tenor, which is typically much shorter than the assumed amortization profile introducing refinancing risk.

Conclusion

The reason these structures are timely is because they provide greater flexibility in capital structuring for portfolios that contain multiple smaller individual assets, particularly in the renewables sector as the energy transition continues apace.

With the retreat of state utilities as the sole suppliers of power in their countries, and the increased focus on the private sector to deliver more of the capital to fund a just energy transition, these holdco structures are ideal for the new types of projects being pursued, including the often equity-driven C&I space and the larger pan-African portfolios.

In balancing the credit risk of subordinated debt against diversification of risk, the structure unlocks additional pools of liquidity to be tapped, thereby increasing the development funding for critical infrastructure in Africa.

In many cases, allowing the release of equity through portfolio financing, capital can be redeployed to other projects more quickly, and with it increasing the speed of much-needed development on the continent.

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