

CORONAVIRUS: INFRASTRUCTURE FINANCE – IMMEDIATE FINANCING CONSIDERATIONS FOR INFRASTRUCTURE INVESTORS AND FUNDERS

The global escalation of the Coronavirus (Covid-19) pandemic has come at a critical time in the financial reporting cycle for many infrastructure investor-owned businesses. In this briefing, we consider some of the key financing issues, looking at liquidity, yield and capital management tools, such as debt buy-backs, as well as touching on issues for businesses further down the stress/distress curve.

For those businesses with a 31 December financial year-end, their annual audited financial statements and projected financial performance for the 2020 calendar year will be due within the next few weeks. For those with a 31 March financial year-end their expected financial year-end results may already be showing signs of deterioration. And, for those with other reporting timetables, similar issues will inevitably arise in the near-term.

The impact on businesses in the transport sector is particularly visible, but the impact on other sectors as a result of supply chain and workforce issues is no less acute.

The prevailing hope is that the current disruption is temporary, but in the meantime the situation requires immediate attention.

Key Consideration 1: Maintaining Liquidity

In such an uncertain environment, the first priority from a financing perspective is to ensure the financing group has robust sources of liquidity sufficient to enable it to cope with any market disruption.

1. **Drawing Undrawn Facilities:** for some financing groups it may make sense to draw down any undrawn facilities to the extent possible to maximise flexibility, notwithstanding the additional interest cost of doing so. This is particularly the case where general “material adverse effect” or similar events of default may make it difficult to satisfy the standard “no default” and repeating representation drawdown conditions if the Coronavirus situation deteriorates further.

2. **Working Capital Facility “Clean-Down”:** often there is a requirement to reduce the cash drawings (net of cash on balance sheet) under a financing group’s revolving working capital facility to zero for a period of up to five business days at least once in any financial year (with not less than three months between clean-downs). A financing group would ideally satisfy its clean-down obligation as early as possible, to get it out of the way, and maximise the time period until its next clean-down obligation arises.
3. **Bridge Funding for Future Capex:** historically, infrastructure financings were structured so that, alongside the term debt and working capital revolving facility, a committed capex facility was sized according to the expected development capex needs of the business for the tenor of the financing. However, more recent financings have generally reduced the size of the capex facility in favour of increased day one term debt and/or lower funding costs, and relied instead on the financing group’s ability to tap the market as and when the funding need arises. It may now be time to consider putting in place additional committed funding lines (even if subject to ratio-based drawdown conditions), particularly where development capex and/or capex related acquisitions are critical to delivering the business plan.
4. **Accessing Blocked Account Cash:** some infrastructure financings, particularly those at a holdco or midco level, contain debt service reserve requirements under which the financing group must make sure it has reserved cash (or has liquidity facilities available) to service scheduled debt service payments over the next six months. In an environment in which interest rates fall (and if a portion of the financing group’s debt is floating rate and unhedged), the reduction in projected debt service costs may enable a portion of the debt service reserve to be released, providing valuable liquidity. In addition, many of the more recent financings allow any cash swept into the lock-up account as a result of a breach of the lock-up ratios to be withdrawn to fund debt service, working capital requirements and capital expenditure where other sources of funding are not available. This flexibility can prove invaluable in preventing a lock-up test failure from deteriorating into a default.
5. **Equity Cure vs. Pre-Default Equity Injection:** most infrastructure financings will contain a limited number of equity cure rights, allowing for the injection of equity following a financial covenant breach and the pro forma recalculation of the financial default ratios to remedy the breach. The pro forma recalculation may be either by way of addition to EBITDA or by way of debt reduction and recalculation of interest. However, generally, the equity cure proceeds must be applied to prepay the financing, which means that the financing group does not actually receive a meaningful liquidity benefit from the equity injection. Depending on the circumstances and the treatment of equity injections in the financing documents, it may be preferable to inject equity in advance of an expected financial covenant breach.

Key Consideration 2: Preserving Yield

Many infrastructure investors are yield investors and their investments are structured to ensure the ability to pay an ongoing yield from the outset without a requirement to de-leverage first.

1. **Timing:** infrastructure financings typically test financial covenant and lock-up ratios semi-annually. The lock-up ratios, which determine whether distributions can be paid, are usually tested on a backward-looking (last 12 months) and forward-looking (next 12 months) basis. There may also be a prescribed window within which distributions can be made following delivery of the semi-annual compliance certificate. Financing groups will need to consider the timing carefully to ensure that distributions are made to the extent available and appropriate, particularly where there is holdco debt to service which relies on a distribution stream.
2. **Lock-Up Tests:** the forward-looking lock-up ratio tests are necessarily based on projections. Such projections, while subject to reasonableness requirements, will be based on assumptions as to future course of events, including the severity and length of the impact of Coronavirus. The extent to which financing groups are comfortable to take a reasonably optimistic view may well evolve over time, and this should be factored into any decision to make, or delay making, distributions at any given point.
3. **“Warehousing” Distributions:** where a financing group is able to comply with its distribution requirements, but favours a cautious approach given the market uncertainty, it may be possible for it to make a distribution from the financing ring-fence, but “warehouse” the cash by retaining it at a holding company level in order to provide the equity investors with flexibility in determining how and when those funds are used.
4. **Governance:** as always, good governance will require the directors and shareholders to take full account of the needs of the operating business and the duties of the directors in deciding whether or not to make any distribution.

Key Consideration 3: Optimising the Capital Structure

Many financing groups already had plans to refinance/ re-leverage and they will continue to look to take advantage of the low interest rate environment and/or extend maturities when the position stabilises. In addition, the market volatility will present some borrowers and issuers with an attractive liability management opportunity.

1. **Capital Markets Issuance:** many infrastructure businesses anticipate refinancing existing term debt using the bond markets to access long-term fixed rate funding at historically low yields. At present, however, the markets are volatile, and pricing is difficult to predict. Although yields are attractive, issuers may be nervous of relying on the availability of the debt capital markets to provide refinancing debt until markets become more reliable. As well as investor sentiment, ratings are central to the ability of issuers to access the market, so issuers considering accessing the debt capital markets should allow themselves plenty of time to engage with rating agencies and prepare disclosure so that they are “oven ready” as and when a window of opportunity appears.

2. **Speed/Ease of Execution:** for transactions not yet committed, the logistical challenges arising from office closures and remote working arrangements are likely to reduce speed of execution. In addition, the huge market volatility is likely to affect underwriting appetite in the near-term, particularly until underwriting banks have reliable financial information quantifying the impact of Coronavirus on the relevant financing group.
3. **Accuracy of Disclosure:** a week is a long time in the current climate, and one of the challenges facing any prospective borrower, issuer or underwriting bank is the extent to which developments during the marketing phase need to be disclosed and adversely affect the marketing process.
4. **Debt Buy-backs/Liability Management and Make-Whole:** with many loans and corporate bonds trading below par in a “risk-off” environment, many borrowers and issuers are looking at opportunities to reduce their debt burden through debt buy-backs. Where there is fixed rate institutional debt in the structure, it is likely to be subject to make-whole on voluntary prepayment. The make-whole amount will be calculated based on a discount rate (which will have reduced as a result of lower interest rates) and, in the case of “swapped” USPP notes (i.e. local currency private placement notes provided by USPP investors who have swapped their local currency exposure into USD), include foreign exchange swap breakage. The combined effect of market developments on these two elements may be to increase the make-whole payable to investors on a voluntary refinancing. This is likely also to increase the price payable on any liability management exercise in the corporate bond market.

Key Consideration 4: Navigating Distress

Preserving yield or optimising the capital structure is one thing, but for those businesses further down the stress-curve the considerations will be quite different, as will the priorities. Our “**Financial difficulties triggered by the impact of Coronavirus: Issues for stakeholders**” briefing and other Coronavirus (Covid-19) materials at https://www.cliffordchance.com/insights/thought_leadership/coronavirus.html explore these issues, including force majeure, material adverse effect, identifying/notifying of events of default, and communication with stakeholders.

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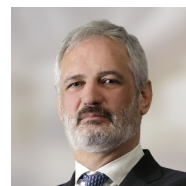
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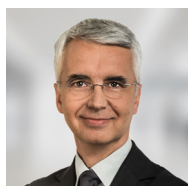
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