Sources of Available Project Financing: Term Loan B Facilities

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A Practice Note discussing how Term Loan B (TLB) facilities, a loan product geared toward the non-bank investor market and designed to provide borrowers more flexibility than commercial bank debt, are used to finance projects on a limited recourse basis. This Practice Note includes information on the types of projects these loans finance, the investors that typically provide this type of financing, and the effect of these facilities on US project finance.

The development and construction of large-scale projects such as pipelines, mines, natural gas liquefaction facilities, and thermal power plants typically require significant capital that usually cannot be obtained from a single financing source. As a result, sponsors of these projects may seek capital from several different sources to complete the financing package, including commercial bank syndicates, institutional investors, and the capital markets. Where appropriate, financing may also be provided by export credit agencies (ECAs), bilateral and multilateral institutions, tax equity investors, and under municipal, state and federal government loan and grant programs. This Note focuses on one of these sources, Term Loan B (TLB) facilities.

The sources project sponsors use to finance their projects depend on several factors, including the project's risk profile, the lenders' risk appetite, and the degree of funding and operational flexibility the project sponsor requires (see Practice Note, Project Finance: Sources of Available Financing: Factors Affecting the Availability of Different Sources of Financing (8-422-4846)). For more information on the other sources of capital that may be used to finance projects on a limited recourse basis, see Practice Notes:

- Sources of Available Project Financing: Project Bonds (9-548-8227).
- Sources of Available Project Financing: Tax Equity (3-601-6606).
- Sources of Available Project Financing: The International Finance Corporation (3-527-6445).
- Sources of Available Project Financing: The Overseas Private Investment Corporation (3-603-6746).

DEFINING TLBs

TLBs are syndicated loans typically made to companies that are below investment grade. They are a hybrid of high-yield bonds and Term Loan A(TLA) facilities, with some similarities to both products. Like high-yield bonds, TLBs are rated instruments that are bought and sold on the secondary market, although the TLB investor pool is a smaller and more restricted group of domestic and international investors than high-yield debtholders. They also have fewer financial covenants that restrict the borrower's operation of its business. Like TLAs, TLBs are generally senior debt secured with a first priority lien on the borrower's assets. The mechanics for requesting a loan under a TLB facility are also akin to those of a TLA facility, including the timing for making loan requests, the amount and type of the loans that may be requested, and how interest on the loans is determined and calculated.

However, there are significant differences between TLBs and these other debt instruments that make these loans a unique financial product. The primary distinction between TLBs and these other instruments is that TLBs amortize more slowly. TLBs typically have scheduled amortization of 1% per year with a balloon payment for the remaining principal at maturity. By contrast, TLAs would generally require more amortization, with regularly scheduled principal payments that result in either payment in full by scheduled maturity or a reduction of the principal to a level that would more easily accommodate a refinancing with project bonds (see Practice Note, Sources of Available Project Financing: Project Bonds (9-548-8227)). In a project that is financed with both TLAs and TLBs, the TLBs also generally mature after the TLAs.

While they incorporate some of the attributes of high-yield debt, including allowing borrowers to access a wider investor pool, TLBs are not public debt. As a result, borrowers do not have to comply with, or incur the costs of, the registration requirements of the Securities Act or the reporting requirements of the Exchange Act (see Practice Notes, Registration Process: Overview (7-380-8736)

and Periodic Reporting and Disclosure Obligations: Overview (7-381-0961)). Borrowers also have more control over the holders of their TLB debt. TLBs typically include provisions that allow the borrower to disqualify or exclude certain institutions from holding their debt (see Practice Note, Assignments and Participations of Loans: Eligible Assignees (8-381-8532)).

For more information on these differences and similarities, see:

- Practice Note, Lending: Overview: Classifications of Bank Loans (0-381-0295).
- Article, Term Loans and High Yield Bonds: Current Status of the Convergence (3-577-7447).
- Standard Clause, Loan Agreement: Borrowing Mechanics (3-383-6717).

TLB LENDERS

Most investors in the TLB market are institutional or non-bank lenders, including:

- Collateralized loan obligations (CLOs), the largest segment of the TLB market representing about 60% to 65% of TLB deal volume.
- Hedge funds.
- Private equity funds.
- Insurance companies.
- Mutual funds.
- Prime funds. These are money market funds that primarily invest in corporate debt securities.
- Pension funds.
- Business development companies (BDC). As defined in the Investment Company Act of 1940, a BDC is a domestic closed-end company that operates to make investments in certain specified securities and, with limited exceptions, makes available "significant managerial assistance" with respect to the issuers of these securities and has elected BDC status. For more information on BDCs, see Practice Note, Business Development Companies (9-584-8625).

These institutions are involved in the US project finance market to varying degrees. Private equity and hedge funds are very active in the US power sector. US power projects are also attracting Asian investors, most notably from South Korea and China, increasing the diversity and depth of the lending market. This is especially the case for projects that sell power into deregulated electricity markets like the PJM Interconnection (PJM) and the Electric Reliability Council of Texas (ERCOT). Several commercial banks also operate in this market.

The large number of institutional investors and banks operating in the TLB market has resulted in significant liquidity for US project financings which has not yet been fully absorbed. This liquidity has increased competition among TLB investors for projects and resulted in more borrower-friendly terms. For more information on Term B Lenders in the project finance market, see:

- Current State of the Market.
- Effect of TLBs on Traditional Project Finance.
- Article, US Project Finance: Key Developments and Trends from 2012 and the Outlook for 2013: Return of the Term B Loan Market (0-523-1991).
- Article, US Project Finance: Key Developments and Trends from 2017 and the Outlook for 2018 (W-013-0120).

TLBs generally attract investors that are looking for yield and are thus principally focused on the loan facility's key economic terms. They are ordinarily less concerned about the borrower's operations (including ongoing compliance with financial covenants). They are also usually not set up to monitor compliance with financial covenants.

But this is where the Term B Lenders' similarities end. Unlike commercial banks, which generally have similar approaches to loan underwriting, costs of funds and regulatory requirements, there is considerably more diversity among Term B Lenders. A CLO is quite different from a pension fund and a BDC. All have different risk appetites, costs of capital, time horizons, and investor mandates. As a result, the specifics of the types of projects in which they invest, the requirements they impose and the financial terms they need vary. In project finance transactions, some Term B Lenders (for example, BDCs) are willing to accept construction risk while others (for example CLOs) limit their investments to projects in operation, with the effect that they are essentially lending only to fund refinancings of construction debt. Similarly, some TLB lenders prefer single asset financings while others are willing to finance project portfolios. Certain Term B Lenders (for example, loan funds) are also more willing to participate in covenant-lite or covenant-loose deals (see Practice Notes, Covenant-Lite Loans: Overview (4-507-4687) and What's Market: Covenant-Lite Loans (8-506-5054)).

HOW TLBs ARE USED IN US PROJECT FINANCE

Funds advanced under TLB facilities can be used to finance a wide array of businesses and for a variety of purposes, including acquisitions, refinancings, general corporate purposes, and dividend recapitalizations. Starting with the 2012 financing of Panda Power Funds' Temple I project—a 758 MW natural gas-fired combined cycle electric generating facility in Texas—TLBs are also being used to finance greenfield projects on a limited recourse basis.

WHY TLBs WERE NEEDED

US project finance has historically been dominated by European commercial banks interested in financing projects that have long-term fixed-price offtake agreements with a creditworthy offtaker (for example, power purchase agreements (PPAs) with a utility). These banks rely on the revenues earned by the project company under these agreements to service the debt and to pay the other obligations of the project company (see Practice Note, Project Finance: Overview (7-382-7004) and Practice Note, Offtake Agreements: Issues and Considerations (W-001-5216)).

But in 2008, in the immediate wake of the global financial crisis, the US project finance market started to change. This shift was driven by several notable developments:

- The imposition of more stringent capital requirements on banks by government regulators.
- Diminished confidence in the financial integrity and viability of many European banks.
- The introduction of Basel III, which established new liquidity ratios to encourage banks to hold higher levels of unencumbered, high-quality liquid assets and imposed new capital requirements.

For more information, see:

- Practice Note, What's Market: Increased Costs from the Dodd-Frank Act and Basel III (3-504-6666).
- Article, The Eurozone Crisis and Loan Agreements (2-515-8268).
- Article, Basel III: Overview and Implementation in the US (6-503-9909).
- Article, Basel III and the New US Capital Framework Proposals (2-519-9023).

As a result, many European commercial banks began pulling back from the US project finance market (see Article, US Project Finance: Key Developments and Trends from 2012 and the Outlook for 2013: Continued Retreat of European Commercial Bank Lenders (0-523-1991)). Around the same time, however, project sponsors were still developing projects to take advantage of certain market trends, including:

- Increased demand for new generation in certain markets. Many state public utility commissions, Regional Transmission Organizations (RTOs) and Independent System Operators (ISOs) were predicting load growth in the markets under their jurisdictions requiring new power plants to be built.
- The need for a more diverse generation mix. Many load serving entities (LSEs) sought to source more of their electricity from renewable sources in response to new regulatory requirements (for example, renewable energy incentive programs). Somewhat counterintuitively, the quick growth of wind and solar farms in the US at the beginning of the 21st century led to additional natural gas-fired plants being built to address the intermittency of wind and solar power generation.
- The rapid pace of coal-fired plant retirements. In the last 10 years many coal-fired plants have been retired because of low natural gas prices and emissions regulations that are rendering coal generation uneconomical in some areas.

For more information on these issues, see:

- Practice Note, Power Dynamics: Forces Shaping the Future of Coal in the United States (W-000-7118).
- Practice Note, Renewable Energy: Overview (US): Wind Energy (4-518-1338) and Solar Energy (4-518-1338).
- Article, Update on the US's "All of the Above" Energy Strategy.
- Legal Update, Renewable Energy Update: Renewable Portfolio Standards 2016 Review (W-005-3456).

The unabated pace of development by project sponsors, despite the retreat of the European commercial banks, created a financing gap for some large projects. While some of this gap was closed by new banks entering the project finance market (for example, Canadian, Japanese, and US regional banks), they too are subject to regulations that limit the types of projects in which they can or want to invest. These banks also typically require long-term offtake agreements to support the financing.

For natural gas-fired plants in the US, however, PPAs have become difficult to secure. Low natural gas prices caused by new methods of extracting abundant natural gas have depressed electricity prices in some US markets (see Practice Note, Understanding Hydraulic Fracturing: Issues, Challenges, and Regulatory Regime (8-518-4410)). As a result, many utilities are unwilling to enter into long-term PPAs for natural gas-fired projects for fear that they will be locked into prices that are significantly higher than prevailing market prices. Without a reliable and steady revenue source, many commercial banks are unwilling to finance these so-called "merchant" projects.

Still in need of new sources of capital, investment banks and project sponsors turned to institutional investors. While many of these investors were initially unfamiliar with project finance paper, they were attracted to its stable returns and low default rates. Moody's Investors Service conducts an annual study on default and recovery rates for project finance bank loans globally. According to its findings, these default rates are consistent with a speculative-grade rating during the project's construction phase and tend towards a low investment grade rating after the project has been operational and generating revenue for a number of years. For the most recent survey, see Moody's, Default Research: Default and Recovery Rates for Project Finance Bank Loans, 1983-2016 on the Moody's website.

Institutional investors were more willing to assume the revenue and demand risk uncontracted or merchant gas projects presented. The diversity of the investor groups in this market, combined with their different funding costs, lack of regulatory restrictions, and greater risk tolerances enabled these investors to price the risk of these projects in a way that commercial banks could not.

PROJECTS FINANCED IN THE TLB MARKET

TLBs are used in many different ways in the project finance market. They are usually incurred at the project level, where the borrower is the project company that owns the project. In this case, the TLBs are repaid and secured by the revenues the project company earns under an offtake agreement, market sales or other agreements. They may also be incurred at the holding company level (the direct or indirect parent of the project company), where the holding company or "holdco" can use the proceeds to finance:

- The construction of a portfolio of projects.
- Dividend recapitalizations.
- Project acquisitions (whether single assets or project portfolios).

In these arrangements, the holdco lenders rely on dividend distributions made by the project company to the holdco to repay the loans. Holdco loans made where there is project level debt raise several issues that are beyond the scope of this Note. But, at the most basic level, holdco lenders need to understand:

- The conditions under which the project company may be prevented from making cash distributions to the holdco. Project finance credit agreements typically include dividend traps that prevent these distributions upon an event of default (see Project Finance Waterfall Provision Flowchart (9-500-7520)).
- That they have no direct rights to the assets of the project company.
- That they are structurally subordinated to the rights and interests of the project company's lenders and other creditors.

There is, therefore, a greater risk of non-payment or default in holdco loan transactions than in traditional project finance loans.

To compensate these lenders for the increased risk, the interest on these holdco loans is typically higher than on similar project-level debt.

TLB facilities are used in the US project finance market to:

- Finance greenfield merchant and quasi-merchant natural gas-fired projects. In this context, neither "merchant" nor "quasi-merchant" projects have PPAs, but "quasi-merchant" projects have substitutes for PPAs. While Term B Lenders are willing to invest in projects with riskier profiles, they nevertheless require mechanisms to mitigate the uncertainty created by the lack of a long term offtake agreement. These loans are typically supported by hedges that ensure the project receives some minimum revenue for a portion of the loan term (see Practice Note, Mitigating Merchant Risk in Power Projects: Hedging Contracts (5-607-8325)). Where hedges are unavailable or only cover a portion of the loan term, TLB lenders finance projects in markets where there is sufficient demand or support. As a result, many new natural gas-fired projects in the US sell power into ERCOT or PJM, mature wholesale markets with strong fundamentals. The market forces underpinning growth in these two markets differ:
  - In ERCOT, there is consistent load growth requiring more generation to come online. In addition, there is significant wind energy penetration requiring natural gas generation to balance out supply and avoid brownouts and blackouts due to intermittency; and
  - In PJM, the rapid pace of coal retirements has created a need for new generation to replace these plants.
- Finance fully contracted renewable energy and other types of projects. While quasi-merchant gas projects dominate the TLB market, they are not the only projects being financed. Project sponsors that require more operational and financial flexibility are also turning to this market even when commercial bank debt is available. They are also turning to this market where public pressure or public relations issues are causing banks to rethink certain projects. Following the controversy surrounding the Dakota Access Pipeline, some sponsors turned to the TLB market to finance their pipeline projects, including:
  - the Utopia pipeline project, a pipeline being developed by Kinder Morgan and Riverstone Holdings to transport ethane from the Utica and Marcellus Shale to petrochemical companies in Ontario; and
  - the Rover pipeline project, a pipeline partially owned by Traverse Midstream Partners that is expected to transport 3.25 billion cubic feet per day of natural gas from the Marcellus and Utica Shale production areas.
  - For more information on these and other pipelines, see Article, Natural Gas Pipelines: 2017 in Review (W-011-7878).
- Refinance existing commercial bank debt. Many commercial bank loans are structured as mini perms that require the project company to refinance the loans using project bonds or another financing source within a few years of construction being completed. Project sponsors use TLBs for this purpose across a variety of industry sectors.
- Finance acquisitions of single assets or portfolios of projects.
- Finance dividend recapitalization transactions to allow project sponsors to recoup a portion of their investment without selling the asset.

CURRENT STATE OF THE MARKET

The project finance TLB lending market has changed significantly since the Panda Temple project was financed in 2012. It is no longer solely for the riskier projects that commercial banks would not underwrite. While the commercial bank market is still the go-to financing source for complex, single asset new construction projects with long-term offtake agreements, project sponsors are increasingly turning to the TLB market to finance projects that until recently would have been the exclusive domain of the commercial banks. The distinction between deals that can be financed in the commercial bank market versus the TLB market is, therefore, blurred. This is because:

- Commercial banks and TLB lenders are both financing quasi-merchant projects on a limited recourse basis and making holdco loans, sometimes on the same projects.
- TLB lenders are financing fully contracted renewable energy projects more regularly.
- The spread between commercial bank debt and TLB facilities is narrowing as the large number of investors competing for projects in this market puts downward pressure on pricing. In 2012, these loans were pricing at 600 basis points (bps) to 1000 bps above LIBOR. The high costs of financing limited the number of projects that could be financed with TLBs. These loans are now pricing at anywhere from 300 bps to 500 bps above LIBOR, depending on the project's risk profile.

The increased involvement of private equity is also changing the project finance market. Funds have been raising significant amounts of capital to invest in the energy and infrastructure sectors and are bringing to the project finance market some of the structures and features they are used to from the standard leveraged loan market, such as covenant-lite terms (see Effect of TLBs on Traditional Project Finance).

For more information on the current state of the TLB lending market, see Article, US Project Finance: Key Developments and Trends from 2017 and the Outlook for 2018 (W-013-0120).

KEY ECONOMIC TERMS OF TLBs

There can be significant variations in TLB credit agreements, and this applies to project finance style credit agreements as well. These loans do, however, share some common features.

CREDIT RATINGS

Broadly speaking, the target for the US project finance bank market is a low investment grade credit rating (Baa2/BBB to Baa3/BBB-). Companies with less favorable credit ratings generally cannot access the commercial bank market and must seek capital in the more expensive high-yield debt, TLB lending and mezzanine debt markets. TLB lenders provide financing to companies rated from B2/B to investment grade, although these loans are typically made to borrowers that are below investment grade. In the case of project financings, these loans are typically rated from B2/B to Ba1/BB+. While most natural gas-fired projects that seek financing

in this market are quasi-merchant and have mechanisms in place to mitigate revenue and demand risk—for example, revenue puts and other types of hedging arrangements—the partial reliance on merchant sales increases the risk profile of these projects.

Ratings agencies consider several factors when rating project finance TLB facilities, including:

- The project's construction risk.
- The experience and creditworthiness of the project's construction contractor and operator.
- The extent of the project's merchant exposure. In the case of power projects, this includes an analysis of energy prices, capacity factors and heat rates (or efficiency of the project in converting natural gas to electricity).
- The level of sponsor support. The debt to equity ratio in project finance transactions is typically 70:30 or even 80:20 for well-structured projects, but riskier projects may have a ratio as low as 50:50 (see Practice Note, Financial Covenants: Project Finance Transactions: Debt to Equity (DTE) Ratio (2-578-6126)).

These loans may also be assigned a recovery rating if the credit rating is BB+ or lower. Recovery ratings (which are categorized from 1 to 6) focus solely on expected recovery in the event of a payment default under the loan. The recovery rating is not linked to, or limited by, the issuer credit rating or any other rating, and provides a specific opinion about the expected recovery. A recovery rating of '1' denotes an expectation of very high recovery (for example, 90% to 100%) in the event of a default. Most project finance TLB loans receive a recovery rating of '2', which denotes an expectation of substantial recovery (for example, 70% to 90%) in the event of a default.

TENOR

In the traditional leveraged loan market, TLBs have longer tenors than TLAs. TLBs generally mature within five to seven years while TLAs mature within three to six years. However, these generalities around tenor do not always hold true in the project finance market. Commercial bank loans (TLAs) made in connection with a project finance transaction often mature within seven to ten years, which is sometimes expressed as construction plus five (or seven) years. Many of these loans are structured as mini perm financings where there is pressure on the project company to refinance the loans within a few years of the completion of project construction. However, depending on the project and the lending group, these loans can have maturities as long as 15 to 18 years. For example, some banks have been willing to provide long tenors to projects that have PPAs with 20 to 25 year terms. While this was more common in projects that were financed in the 1990s, it is not unheard of in recent years.

Project finance TLBs generally have tenors in the six to eight year range, with seven years being the most common. While these loans generally remain outstanding until they are refinanced or repaid at maturity, they may be refinanced or repriced much earlier depending on the state of the credit markets (and subject to compliance with certain other requirements (see Call Protection)).

LOAN SIZE AND AMORTIZATION

TLB facilities are generally valued at a minimum of $250 million to justify the additional costs of the loan process. For project finance transactions, this includes the added expense of the ratings agencies reviewing loan and project documents to furnish the required rating (see Credit Ratings). Project finance TLBs can be significantly smaller for certain projects, however. For example, TLBs for renewable energy projects can be as low as $100 to $150 million.

TLBs have minimal scheduled amortization of about 1% annually during the early years of these loans. Unless paid earlier with cash sweeps or to maintain a target debt balance, most of the principal does not become due until final maturity.

MARGIN AND ALL-IN YIELD

Interest rates on TLBs are usually higher than on traditional bank term loans, although still lower than what would be typical on mezzanine debt. For project financings, TLB loans are priced at LIBOR plus 300 to 500 bps. That is compared to LIBOR plus 125 to 200 bps for commercial bank loans for fully contracted single asset projects in operation. However, for projects with riskier profiles (for example, projects with volatile revenue streams), the interest on the TLB loans can be as high as LIBOR plus 600 bps. The higher rates are intended to compensate Term B Lenders for the increased risk of non-payment or default.

This is due to:

- The demand and revenue risk many of these projects present.
- Looser financial covenants that impose fewer restrictions on project cash flows.
- In the case of some holdco loans, the structural subordination of these loans to project-level debt which may increase the likelihood of these loans not being repaid in the event of a bankruptcy of the project company.

The margin on the loans is only one part of the TLB lenders' return, however. When analyzing their return, TLB lenders must consider the all-in yield of these facilities. The all-in-yield takes into account the following components:

- The loan's original issue discount **(**OID). Although historically a standard feature of high-yield debt, OID is now a standard component of TLB pricing. Project finance TLBs typically have an OID between 1% and 1.5%.
- LIBOR floors. In many cases, LIBOR may not accurately reflect a lender's cost of funds in the London interbank market. To minimize the likelihood of funding loans at a loss, many loan agreements provide that LIBOR cannot be lower than their actual cost of funds or a certain percentage. This is typically 1% for TLBs. For more information, see Practice Note, Finance Fundamentals: LIBOR (2-622-0716) and Article, Current Trends in LIBOR Successor Rate Provisions (W-013-6542).
- Prepayment premiums. TLB credit agreements typically require the borrower to pay a prepayment premium or penalty (also known as call protection) if it prepays or reprices all or a portion of the loans within a specified time period after closing.

CALL PROTECTION

Typically, borrowers negotiate the right to prepay loans at par. In a commercial bank loan, the borrower may be required to pay breakage costs with a prepayment, but usually no penalties or

premiums are otherwise payable. By contrast, in TLB transactions borrowers are typically required to pay a premium to the lenders if they prepay, refinance or reprice their loans. This is because many TLB lenders expect to hold their loans long term and these transactions reduce their overall returns.

A TLB transaction may include the following types of protections for TLB lenders:

- Soft call. In transactions that have a "soft call", the prepayment premium is payable only with respect to repricings and refinancings.
- Hard call. In transactions that have a "hard call", the prepayment premium is payable in connection with all prepayments whether as a result of a refinancing, repricing, an initial public offering or a change of control.

The call protection period is typically between 6 and 12 months for a traditional commercial bank loan. This period is the same in project finance TLB transactions, although this period may be longer in limited cases (see No-Call Provisions). The premium is generally equal to 1% to 2% of the outstanding principal amount of the loan being repriced or refinanced.

For more information on call protection, see What's Market: Current Trends in Call Protection (as of August 2016) (W-003-1234).

Repricings

The TLB lending market is more liquid than the commercial bank market with a wide and varied investor base interested in acquiring project finance paper. Many borrowers take advantage of this liquidity and the competition it creates to reprice their loans. This may occur even within a few months of the initial closing of the facility. Repricing refers to the prepayment or refinancing of all or a portion of a TLB loan by incurring long-term debt financing that has an effective interest cost or weighted average yield (excluding any arrangement or commitment fees that may be payable) that is less than the effective interest cost or weighted average yield of the existing TLB loan. A repricing may be effected by either amending the credit agreement or entering into a new loan transaction.

Depending on when the loan is being repriced, the borrower may have to pay 1% to 2% of the amount being repriced as a penalty. The new interest rate the borrower achieves following the repricing must, therefore, be low enough to justify payment of this premium and the transaction costs incurred to consummate the transaction.

While the ability to reprice or refinance is a benefit to borrowers—enabling them to reduce their costs of financing and the overall costs of the project—it is not as advantageous for lenders since it reduces the return the investors can expect to earn on the loans. The inclusion of a call protection provision gives investors some cover, although limited, against this reduced return, ensuring some income stream while still affording borrowers the flexibility they come to the TLB market to secure.

The scope of the call protection provision and the exceptions to the payment of the premium are highly negotiated issues between the borrower and its TLB lenders. But generally, the premium is payable if the purpose of the transaction is to lower the interest rate on the loans.

For more information on repricing project finance TLBs, see Article, US Project Finance: Key Developments and Trends from 2017 and the Outlook for 2018: Term Loan B Market (W-013-0120).

No-Call Provisions

TLB facilities incorporate many of the benefits of the high-yield debt market (see Defining TLBs). One key attribute of the high-yield debt market that has not been widely accepted in TLB transactions, however, is the no-call period. The no-call period prohibits the borrower from prepaying the loan for a specified amount of time. However, some TLB credit agreements that were entered into when the TLB market emerged as a major source of financing for power projects did include this provision. In these transactions, after the termination of the no-call period, the loans are typically callable subject to the payment of the prepayment premium which decreases in each successive year for which the premium is payable. The total call protection period in these cases is typically two to three years.

For example, in:

- January 2015, M3 Midstream closed a $350 million TLB facility for its Stonewall Gas Gathering project that was non-callable in the first year and callable at 1% in the second year.
- January 2014, Panda Power Funds closed a $385 million TLB facility to back its Moxie Patriot project that was non-callable for 2.5 years. After the no-call expired, the loan was callable at 2% and 1% each succeeding year.
- November 2013, Northeast Wind Capital closed a $320 million TLB facility to back a portfolio of operating wind assets. This loan was non-callable in the first year and callable at 2% and 1% in the next two years.
- November 2012, a Riverstone Holdings' portfolio company closed a $175 million TLB facility to finance the acquisition of three coal-fired power plants which was non-callable in the first year and callable at 2% in the second year.
- September 2012, Panda Power Funds closed a $350 million TLB facility for its Sherman natural gas project which was non-callable for the first two years, and callable at 2% in the third year and 1% in the fourth year.

Again, recent deals have not included no-call provisions.

OTHER NOTABLE PROVISIONS

COLLATERAL

Loans in the TLB market are generally secured. In the case of non-project finance TLBs, the collateral is typically the assets and equity interests of the borrower and its subsidiaries. In a project finance TLB transaction, however, the collateral may vary depending on the type of financing:

- In the case of single asset and portfolio financings, the collateral typically consists of equity interests in the project company and all the project company's rights under the contracts for the project (including, the offtake agreements, the engineering, procurement and construction contract, the operation and maintenance agreement, and any hedge contracts).
- In the case of holdco loans (for portfolios with project level debt), the collateral usually consists of the holdco's equity interest in the

projects, including its rights to receive any dividend distributions from the project companies under the terms of the waterfalls set out in the project companies' loan documents.

MANDATORY PREPAYMENTS

Project finance transactions tend to include waterfall provisions that set out how revenues generated by the project will be applied to meet the project company's obligations (including debt service). In a commercial bank loan agreement the amount the project company is required to pay is fixed and, provided that no event of default has occurred, any amounts remaining once the project company's operating costs and debt service are paid can be distributed to the project sponsor (see Project Finance Waterfall Provision Flowchart). TLB credit agreements operate differently.

TLB agreements have minimal amortization. As a result, depending on the project's cash flows, the project company may have significant cash in its accounts after paying scheduled debt service and operating costs. To address this issue, these credit agreements typically include a cash sweep that requires the borrower to use all or some percentage of this cash to pay down loans. The specified percentage is a matter to be agreed by the parties, but this provision may be fairly non-restrictive in more liquid credit markets when borrowers can negotiate looser covenants and more borrower-friendly financial terms.

In addition to prepaying loans with the excess cash generated from normal business operations, the borrower may also be required to prepay the loans if it:

- Sells or otherwise disposes of certain assets. This obligation is not absolute, however. The requirement to prepay the TLB with the net proceeds of these dispositions is subject to many carve-outs, including per-transaction and aggregate materiality thresholds (below which the prepayment requirement does not apply) and permissive reinvestment rights during 12 to 18 month periods following the receipt of the relevant net proceeds.
- Issues additional equity.
- Receives insurance proceeds from the loss of assets, subject to reinvestment provisions.
- Is required to achieve a target debt balance. For example, a target debt balance may be lower if the market price for capacity drops.

EFFECT OF TLBS ON TRADITIONAL PROJECT FINANCE

Traditional project finance credit agreements typically include several provisions that are intended to protect the project's revenue flow and ensure it is available to pay debt service. TLB loans are far less restrictive on these issues.

The increased involvement of private equity investors as owners of power and other energy projects has brought to the project finance market terms that may be standard in the leveraged loan market but which are relatively new to project finance. These new terms include:

- Looser or no financial covenants.
- Dividend distribution flexibility.
- Relaxed defaults.
- Broader asset sales permissions.
- Incremental debt provisions.

In the quest for yield in a tight market for deals, many Term B Lenders are willing to accept these provisions for certain transactions.

OTHER ASPECTS OF TLB FINANCINGS

DOCUMENTATION

TLBs are documented largely like bank loans, but the broader investor pool may make it harder to get consent from investors than from a bank syndicate. As a result, the documents tend to be more sponsor-friendly, affording more running room before amendments are required to the loan documents than what might be typical in a more closely-held loan.

TIMING

TLB transactions close fairly quickly once they go to market. Unlike traditional project finance commercial bank loans that can take months to negotiate and close, a TLB transaction can close in three months or less, with most of the time spent producing the materials needed to secure a rating. After the rating is received, these loans typically close within 10 to 14 days.