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Q&A CENTRAL AMERICA, SOUTH AMERICA, CARIBBEAN MEXICO MINING & METALS INFRASTRUCTURE POLITICAL RISK & MACRO OIL & GAS ELECTRIC POWER

The outlook for Latin America project financing

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The COVID-19 shock whipped up headwinds for project financing in Latin America – but they have eased and the outlook is brightening, supported by a strengthening of commodity prices.

The region's energy metal resources, chiefly lithium and copper, are blinking on investor radars amid favorable long-term demand forecasts.

New lithium projects in particular may require outlay not just to get production rolling but also to build the requisite logistics infrastructure.

Against this backdrop, prospective investors will be watching for any changes on the region's political and regulatory landscape.

To find out more about the state of play and what we can expect, BNamericas caught up with project financing specialists from the New York office of global law firm Sullivan & Cromwell: partner Sergio Galvis (pictured, left) and special counsel Benjamin SD Kent.

BNamericas previously spoke with Galvis and Kent in 2020. Click here to read that interview.

BNamericas: Latin America is recovering from the pandemic shock and commodity prices have strengthened. In general, is this trend impacting demand for project financing in the region?

Galvis: Certainly. The pandemic hit Latin America, like the rest of the world, quite hard, and that took a severe toll on project financing in the region as it did elsewhere. Many of the factors that drove the slowdown, however, have gradually begun to recede – or at least, we might say, project sponsors and investors are beginning to see the light at the end of the tunnel. You correctly observe that commodity prices have strengthened significantly. Commodities linked to construction and infrastructure, including, most importantly for Latin America, copper, have seen some of the most significant price increases. This is leading to renewed optimism and willingness to bet on project finance again.

Kent: It's not that the floodgates have opened – it may still be some time before things return to pre-pandemic levels of activity. But the appetite for project financing in Latin America is returning, as BNamericas has reported. For example, Dundee recently made a US$340mn investment in the Loma Larga gold project in southern Ecuador. The sector and the region are not yet in a full-on recovery, but movement is generally trending in a positive direction.

Galvis: It's worth noting, as well, that as hard as the pandemic has been on project financing in Latin America, it is also true that COVID-19 has clarified the need for many countries in the region to improve their public infrastructure. On a related point, as we have seen in the United States and throughout the world, pandemic-driven economic downturns have driven political leaders to think about economic stimulus, which can often take the shape of new infrastructure projects or renewed interest in projects that had fallen into limbo, so to speak. These factors may also point to a continuation of heightened levels of interest in and demand for public financing.

BNamericas: In terms of types of financing being sought and offered, what trends are you seeing in the region?

Kent: We continue to see a healthy mix of project and corporate financing in the infrastructure space. As we mentioned when we spoke with you last year, it continues to be true that we are seeing increasingly sophisticated financing structures as well as the proliferation of diverse financing providers – from commercial banks to private credit funds and other alternative lenders. As we look forward, these direct lenders are likely to become increasingly important players in the region.

Galvis: Green financing remains a huge focus, as it has been for a number of years. Even during the pandemic, Latin America more than doubled its share in the green bond market in 2020, with at least 13 green bond issuances totaling over US$5bn through September of last year. Issuances of ESG-related bonds in the region have continued at a fevered pace in 2021: There were US$16.55bn in such issuances from January to April of this year, a record for the region. And in May, Natura & Co issued a US$1bn sustainability bond that is the largest sustainability-linked issuance in Latin America.

Kent: The market for ESG-related financing continues to diversify. In past years when you saw these types of issuances they normally involved sovereign issuers. The recent surge, however, as with Natura & Co, has been driven by the private sector. Companies are increasingly feeling pressure to take action on ESG issues, and they are doing so when it comes to how they think about financing.

Galvis: Even as we see this increased focus on green financing, Latin America lags Europe and North America in these types of issuances. To me, that suggests that this is going to be a continued growth area for the region and we should expect it to be a focus for lenders, borrowers, and sponsors.

BNamericas: Bank lenders and multilaterals, it seems, are increasingly requiring borrowers to comply with ESG criteria. Today, what are the financing options for companies, such as a medium-sized oil and gas E&P firm, that, because of the very nature of its business, struggles to comply with the "E" requirement?

Kent: It is certainly true that there is a trend towards requiring compliance with ESG criteria, even when the borrower's product is not green per se. The World Bank, multilateral development banks, and even some commercial banks are now more likely to simply refuse to do business with organizations that cannot or will not comply with very strict environmental controls. Consideration of these issues is nothing new in the context of project finance transactions, where the potential environmental and social impacts of the relevant project have always been a focus. But these pressures have also increased across the board – not just for project financing – as a result of multiple factors. These include pressures from investors and activists, as well as a growing understanding that ESG considerations have a real impact on the financial performance of a business.

Galvis: The upshot is that some companies have found that their traditional financing sources may be drying up somewhat. In the absence of being able to turn to a bank, companies like the hypothetical oil and gas E&P firm you describe are having to be more creative. In the United States we have seen this happen with coal companies, which are increasingly turning to private credit financing providers, which often have less of a public footprint and less regulatory focus. It's often more expensive than obtaining financing through more traditional lenders, but increasingly it is becoming a go-to option because other sources of funding simply aren't feasible.

BNamericas: Moving to mining, global demand for energy metals like copper and lithium is forecast to grow. Do you expect this to translate into an uptick in investment in new mining projects in Latin America?

Galvis: In short, yes. Copper has long been in demand in Latin America. It continues to be in demand – copper was one of the only spots in the mining sector that saw prices trend upwards in 2020. Fitch has said that it expects Latin America will outperform the rest of the world in terms of the growth of its mining industry, and I see no reason to disagree. In fact, it's already happening. For example, Panama's Cobre Panamá copper project is continuing to ramp up successfully after a year-plus of COVID-19-related difficulties. In October, Sumitomo Metal Mining Co. agreed to sell its interest in Chile's Sierra Gorda copper mine to South32, an Australian metals and mining company. It's clear that investors remain interested in breaking into Latin America's copper industry. There are huge challenges that lie ahead, however, including political developments in Peru and possible changes to tax policies in Chile.

Kent: Lithium projects have yet to obtain the same level of significance in Latin America that we've seen with copper and other mining projects, but there's no question that the demand exists. People, after all, are always going to need ways to power their cell phones. The lithium triangle of Argentina, Bolivia, and Chile holds more than half of the world's lithium deposits, although these deposits aren't always easily accessible. For that reason, continued and sustained investment will be needed. Latin America will likely become a popular place to invest in lithium projects because the region has a lot of mining experience and investors can have confidence that the people running these projects know how to extract the resources in a commercially viable way.

Galvis: As demand for copper grows, investment in Latin America, which is a proven, reliable location for copper mining, will grow. I think we'll see a similar trend for lithium mining and investment in the region, but perhaps that will take a longer time to develop due to the factors Ben has referenced, as well as the political risk – real and perceived – in some countries with the most promising prospects.

BNamericas: That's a good segue into our next question. Argentina and Bolivia – where political risk is a key consideration for potential investors – have lithium resources. Do you think that, if global demand for the metal is strong enough and the potential returns high enough, more investors will sharpen their focus on these countries?

Galvis: Well, as I alluded to, there are real concerns for investors beyond simply, "Can we get the lithium out of the ground at a cost that will keep these projects commercially viable?" They will also be focused on the political climate. In Bolivia, which former President Evo Morales long vowed to make the lithium capital of the world, fears over attempts to nationalize the element (as happened in 2006 with the country's oil and gas sector) have potential investors eyeing prospects there warily. The situation in Argentina is different, and is driven by macroeconomic considerations, including with respect to the IMF. Chile is also in the midst of a national discussion about changing the tax regime for mining companies – and, of course, the country is in the process of rewriting its constitution. Risks, in short, abound and investors are going to seek correspondingly higher returns.

BNamericas: There is much talk about the potential of Chile, Uruguay, Brazil and Colombia as green hydrogen producers. In the US legal and project financing world, from what you can see, is it generating interest, are enquiries being made by potential investors, etc?

Kent: Green hydrogen in Latin America is certainly a topic to watch. As you point out, several countries in the region have expressed an interest in producing green hydrogen. Chile has set a goal to become a top exporter of green hydrogen by 2040. Brazil announced in June that it plans to build the world's largest green hydrogen plant, capable of producing over 600,000t per year, in the next four years. Other countries in Latin America, including the ones you note, as well as Costa Rica and Argentina, are undertaking their own efforts.

In spite of these promising signs, significant challenges remain in Latin America. At present, the costs of the technology are high, and the production of green hydrogen at significant scale will require massive expansion of renewable energy generation. The planned green hydrogen plant in Brazil is going to cost at least US$5.4bn. To achieve its goal of becoming a top green hydrogen exporter, Chile has so far committed only US$50mn in funding. To be clear, this is seed money intended to encourage pilot projects, and much more investment can be expected if those projects prove successful.

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