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Sullivan & Cromwell lawyers talk Latin America project finance trends, outlook

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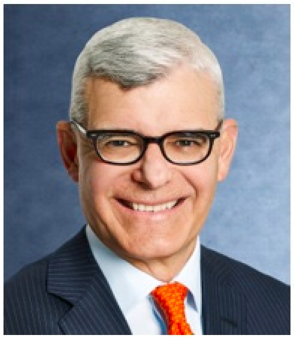

Sullivan & Cromwell partner Sergio Galvis (pictured, top) and special counsel Benjamin SD Kent (bottom)

In the wake of the Lava Jato crisis and the downturn in commodity and oil prices, the outlook on the Latin American project financing front started to brighten.

The coronavirus crisis then came along and whipped up fresh headwinds – which also partly snarled the wheels and cogs of M&A – but activity is forecast to pick up once again against a backdrop of strong investor demand and infrastructure gaps and miners looking to make capital expenditures.

To discuss demand trends, types of financing, ESG (environmental, social, governance) issues and more, BNamericas spoke with two project finance specialists from global law firm Sullivan & Cromwell: partner Sergio Galvis (pictured, left) and special counsel Benjamin SD Kent.

Sullivan & Cromwell has a long history of project financing transactions in Latin America, including work on the US$2.5bn Quebrada Blanca Phase 2 copper project in Chile.

BNamericas: What general trends are you seeing today in the sphere of project financing in Latin America?

Galvis: Before the COVID-19 pandemic hit the region, we were seeing very encouraging signs for project financing in Latin America. Many of the projects that had been canceled or delayed as a result of the low oil and commodity price environment in the middle of the last decade were coming back to market, and investor confidence, which had been hit by the sprawling Lava Jato corruption scandal in the second half of the 2010s, had returned, with strong demand for available assets from a diverse group of debt and equity investors.

Kent: The COVID-19 pandemic of course had a significant influence on transactions this year, both because of the devastating impact it had on the region's economies and because of the broader macroeconomic uncertainty that resulted from the pandemic's global nature. At a more micro level, the pandemic also posed a host of practical problems for project financing, such as the effective impossibility of conducting site visits at project locations given the various travel restrictions in place.

Galvis: Notwithstanding the pandemic's impact on transactions this year, we anticipate that Latin American project financing is well placed to recover quickly, not least because there remains a significant need for infrastructure in the region and investor demand is strong.

However, it is likely that we will see a disparity in the speed at which different sectors and different asset classes are able to recover from the pandemic. For example, although the Latin American mining sector has already ramped back up production that had been suspended earlier in the year, with companies already looking to make significant expansion capital expenditures, the oil and gas sector continues to cut capital expenditures as oil prices remain depressed.

Kent: In terms of sources of financing, we expect to see the continuation of the trends that were apparent before the pandemic, such as increasing sophistication of financing structures and diversity of financing providers. For example, many transportation and other infrastructure assets in the region have already switched from traditional project financings to multisource financings that involve both commercial bank loans and capital markets financings, and innovation continues apace, with private credit funds and other alternative lenders that have received significant inflows of capital in recent years becoming increasingly important players in project financing as they seek out new ways to deploy that capital to generate yield, particularly in asset classes that are less exposed to commodity prices.

Having said that, there will remain a place for financing structures that involve traditional project finance banks, as well as development banks and export credit agencies, particularly for the most complex projects with the greatest levels of risk.

BNamericas: What about mining in particular? Demand for energy metals, copper, lithium, etc., is expected to grow over the coming years. Do you sense mining companies are already preparing for this forecast new cycle and could this outlook for demand help ease access to financing for energy metals miners looking to develop, in Latin America, new mines or expand existing operations, etc?

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Galvis: Despite the impact of the pandemic, the mining sector in Latin America is certainly more confident about the future than it was during the depths of the commodity price trough a few years ago. As noted above, after various types of suspension and curtailment, production has now returned to close to normal levels at many mines across the region and demand for metals remains strong, and mining companies are now once again looking to make expansion capital expenditures.

However, there remain isolated examples of mines that have not yet been able to safely return to production, and there are still concerns about the potential for additional outbreaks or government measures related to or affecting mining activity.

Kent: Mines in Latin America were already planning expansions to their current operations prior to the pandemic, and although some of these plans have been paused as a result of the pandemic, there are many that will be coming on stream in the near future, including possible major expansions. Moreover, some greenfield projects appear to be continuing to be on track.

BNamericas: In terms of ESG criteria, how big of a role do you see this playing over the coming years? For example, do you think lenders will increasingly require borrowers to adopt these criteria or are borrowers (such as mining firms) already a step ahead of the game and entrenching ESG criteria into their business and operational models?

Galvis: Focus on ESG matters continues to increase around the world, and things are no different in Latin America. We expect that project finance lenders, particularly export credit agencies and bank lenders that have adopted the World Bank's updated Equator Principles, will continue to drive the market in terms of requiring borrowers to comply with ESG criteria as a condition to obtaining financing.

However, many of the more sophisticated borrowers in the region have already adopted ESG practices that go well beyond what is generally required by lenders, and recent environmental accidents, coupled with social unrest have only served to emphasize how important good ESG practices are to the responsible conduct of business. Given that many projects are located in environmentally sensitive regions or close to indigenous communities, best-in-class ESG practices should always be a key area of focus for any project's management team.

Kent: At the same time, recent years have seen an explosion in specific ESG financings in the region, particularly financings focused on environmental matters. The past few years have seen a number of "firsts," including Latin America's first green corporate bond (Energia Eolica's US$204mn issuance in 2014), first green corporate loan (Iberdrola's US$400mn corporate loan in 2018) and first green sovereign bond (Chile's US$950mn issuance in 2019), with the volume of green financings increasing every year and the type of borrower interested in these financings diversifying rapidly to encompass not merely traditional renewable energy borrowers, but also mining companies. For example, in 2019, Minera Los Pelambres, a mining company, closed a green loan financing, the proceeds of which are being deployed to fund a new water desalination plant and associated pipeline to avoid the use of potable water in mining activities.

BNamericas: Are you able to talk about any Latin America project finance deals you are currently working on or have recently closed? For example, the project, the amount of financing, any unique challenges it presents(ed), etc.?

Galvis: S&C continues to be a key player in the region. Recent large project financings on the sponsor side have included our representation of Teck Resources Limited in connection with the US$2.5bn project financing for the Quebrada Blanca Phase 2 copper mine in Chile and our representation of Minsur on the US$900mn project financing for the development of the Mina Justa copper project in Peru. Both of these transactions involved financing from a diversified pool of commercial banks and export credit agencies and posed a number of unique challenges.

Kent: S&C has also been active on the lender side, representing Société Générale, Citibanamex and BBVA, on a US$150mn credit facility to fund the development of a liquid fuel storage terminal project to be constructed and operated by a KKR portfolio company, in Mexico.