

**PROJECT FINANCE
NO BANKS
NO RECOURSE
NO PROBLEM!**

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THE NEED FOR PROJECT FINANCE

- Pull back in debt markets, especially by banks
 - ▶ Lack of liquidity, regulatory constraints, lack of risk appetite
 - ▶ “Flight to Quality”
 - Most deals left behind.
- Credit enhancement for debt obligations?
 - ▶ Hard to find
- Loan tenors have decreased
 - ▶ Mini-perms
 - ▶ Bridge loans
- What has increased?
 - ▶ Time needed to close
- Where to find non-bank debt capital? That is the question.
 - Project Finance is the answer.

WHAT IS PROJECT FINANCE?

- Finance Revenue-Generating Project on a Stand-Alone Basis.
- Projects are “bankable” (financeable) without banks.
- Sponsors are not personally liable.
 - Non-Recourse.
 - Off-Balance Sheet.
- Some equity is needed.
 - Typically 80% LTV/LTC.
 - Leverage increases yield to equity, increases attractiveness to equity investors.

WHAT IS PROJECT FINANCE?

- Bonds (debt obligations) are issued.
 - Don't have to be tax-exempt.
 - ▶ If tax-exempt, then some advantages:
 - Lower interest rate
 - Longer term
 - Greater marketability
 - More availability of interest-only/capitalized interest
 - Smaller deals more do-able
 - Often tax-exempt bonds are accompanied by a tranche of taxable bonds (“taxable tail”).
- Bonds are custom-tailored to project.
 - “Build a Bond”

WHAT IS PROJECT FINANCE?

Examples of tax-exempt bonds

- Solid waste disposal bonds, such as-
 - ▶ MSW projects
 - ▶ Biomass-to-electricity projects
 - Facilitated by new IRS definition of solid waste disposal facilities
 - ▶ “No Value Rule” repealed
 - ▶ Feedstock focus- used material? residual material?
 - Other tax rules apply

WHAT IS PROJECT FINANCE?

Examples of tax-exempt bonds

- “Small issue” manufacturing bonds, such as-
 - Wood pellet plants
 - Biodiesel plants
- Usefulness limited by IRS limit on capital expenditures attributed to project
 - \$20 million capex limit during test period (3 years before bond issue through 3 years after bond issue)
 - Bond proceeds and other capex counted
 - Within limit, only \$10 million may be financed with tax-exempt “small issue” manufacturing bonds
- Other tax rules apply

WHAT IS PROJECT FINANCE?

Examples of tax-exempt bonds

- “Exempt Facilities” in addition to solid waste disposal-
 - airports
 - docks and wharves
 - mass commuting facilities
 - facilities for furnishing of water
 - sewage facilities
 - qualified residential rental facilities
 - facilities for the local furnishing of electric energy or gas
 - local district heating and cooling facilities
 - qualified hazardous waste facilities
 - high-speed intercity rail facilities
 - environmental enhancements of hydroelectric generating facilities
 - qualified public educational facilities
 - qualified green building and sustainable design projects
 - qualified highway or surface freight transfer facilities
- Others

Various tax rules apply

WHAT IS PROJECT FINANCE?

In today's low interest rate environment, some projects can be financed even if all of the bonds are taxable, assuming all other aspects of the financing are satisfactory.

- Example: Senior living facilities
- Practical minimum deal size if all taxable bonds: \$50 million
- Consider “bundling” projects to increase par amount if homogeneous credits

WHAT IS PROJECT FINANCE?

Build a Capital Stack for the Project

- Project Finance Bonds
- Other sources of funds
 - If specialized programs accessed, attention to their requirements needed
- Sources can complement each other
- Leveraging is possible

HOW PROJECT FINANCE WORKS- PREDICTABILITY

- The more certain the revenues and benefits, the more financeable the project.
- “Contracted-for cash flow” is critical.
 - Typical of some industries
 - ▶ biomass-to-electricity
 - Not typical of others
 - ▶ multifamily residential

HOW PROJECT FINANCE WORKS- PREDICTABILITY

- “Hybrid” situations
 - “merchant projects”
 - Example: Solid waste disposal
 - Electrical output- contracted for
 - Recyclables output- spot market
- In order to cope, consider-
 - More equity
 - Credit enhancement
- If project not suitable for Project Finance Bonds, still might benefit from “borrowing” some Project Finance techniques

HOW PROJECT FINANCE WORKS- “DE-RISK” THE PROJECT

Must Have-

- Qualified Sponsor
 - Management
 - Sometimes can outsource
 - Example: operator contracts very important in senior living industry
 - relationships
 - “skin in the game”
 - track record
- Project entity itself must be bankruptcy-remote
- Creditworthiness in-
 - Counterparties to Project Contracts

HOW PROJECT FINANCE WORKS- “DE-RISK” THE PROJECT

Can Have-

- Risks of the Business After Project Completion
 - Need Feasibility Study/Fatal Flaw Analysis
 - Consultant Nationally Recognized in the Industry

HOW PROJECT FINANCE WORKS- “DE-RISK” THE PROJECT

Can't Have-

- Technology Risk (if technology-based project)
 - Must have favorable report by Independent Engineer (IE) with national reputation in the industry
 - Best if technology already commercially deployed in the United States
 - Consider technology insurance to insure over technology issues that are open but manageable

HOW PROJECT FINANCE WORKS- “DE-RISK” THE PROJECT

Can't Have-

- Performance Risk (if production/processing project)
 - need creditworthy EPC (Engineering, Procurement, Construction) contractor who will provide overall performance guaranty (EPC wrap)
 - ▶ example: with biomass-to-electricity project, test for- net heat rate, net electrical output (point of delivery), emissions (noise, pollutants), derating curve and heat rate (over life of power purchase agreement)
- Construction Risk
 - Project completion guaranty
 - Payment and performance bonds
 - Lump-sum or GMAX contract
 - liquidated damages

HOW PROJECT FINANCE WORKS- “DE-RISK” THE PROJECT

Can't Have-

- Feedstock Risk (if production/processing project)
 - Need long-term supply contract(s) with creditworthy supplier(s)
 - ▶ Sometimes use aggregators or co-op's
 - ▶ Need report by fuel consultant/feedstock expert
 - ▶ These feedstock parameters must be financeable: availability, access, suppliers, competition, pricing, overall maturity of feedstock market

HOW PROJECT FINANCE WORKS- “DE-RISK” THE PROJECT

Can't Have-

- Revenue Risk
 - need long-term contract(s) with creditworthy customer(s) (offtake agreement, power purchase agreement (PPA), thermal delivery agreement, etc.)
 - Example: with a power project, these utility parameters must be financeable: interconnect agreement, stand-by rates/avoided cost rates/buy-back rates, any rebate amount, any available feed-in-tariff

HOW PROJECT FINANCE WORKS- “DE-RISK” THE PROJECT

Can't Have-

- **Site Risk**

- need infrastructure, permitted land use, air permit, environmental site assessment, local acceptance of project, etc.

HOW TO “BUILD A BOND”

GOAL- BOND MODEL COMPATIBLE WITH PROJECTIONS AND FEASIBILITY STUDY

- CONSIDER CREDIT ENHANCEMENT TO ADDRESS ANY ISSUES
 - POSSIBLE SOURCES-
 - ▶ EPC CONTRACTOR
 - ▶ FEDERAL GOVERNMENT GUARANTEES
 - USDA
 - DOE
 - EX-IM BANK
 - OTHER
 - ▶ CORPORATE LOAN GUARANTEES
 - ▶ EQUITY-FUNDED CREDIT ENHANCEMENT TECHNIQUES
 - ▶ SPONSOR CREDIT ENHANCEMENT
 - ▶ FOREIGN EX-IM BANK EQUIVALENTS

HOW TO “BUILD A BOND”

- CREDITWORTHINESS OF BONDS
 - Normally can't exceed creditworthiness of lowest rated counterparty
 - Different creditworthiness for different sources of revenues
 - “Blended” creditworthiness can result
- TERM OF BONDS
 - Directly related to duration of project contract(s)
 - Typically 10 years-20 years
- MARKET FOR PROJECT FINANCE BONDS- UNRATED/HIGH YIELD BOND MARKET
 - sold via limited offering
 - typical minimum deal size (if mostly tax-exempt): \$10 million
 - ▶ Consider “bundling” projects if homogeneous credits

HOW TO “BUILD A BOND”

- FEATURES OF BONDS
 - Covenants
- RATIOS
 - Typical DSCR: 1.40-1.75+ depending on credit quality
- INTEREST RATES
 - If tax-exempt and highly creditworthy: 6.5%-7.5%
 - If taxable-
 - 8.5%-9.5% (if BBB equivalent)
 - 10%+ (if BB equivalent)

(Rates are indicative only and are subject to change)
- PROJECT FINANCE BONDS AVERAGE CREDITWORTHINESS:
 - B TO BB

HOW TO “BUILD A CAPITAL STACK”

Begin with equity

- Some equity needed
 - Liquidity
 - Cash, not just “sweat equity”
 - Can come from equity partner
- Equity level often needed: 20%
- Tax credit equity counted, if funded at closing, but somewhat discounted

HOW TO “BUILD A CAPITAL STACK”

EQUITY SOURCES

- Private equity funds
- Preferred equity through independent broker-dealer
 - Favored asset classes now-
 - Hospitality, senior living
- Sub Debt/Mezz Debt can be a functional equity substitute

HOW TO “BUILD A CAPITAL STACK”

- Project Finance Bonds are Senior Debt
 - “first lien”
 - Must be able to pledge entire project
 - Collateral must represent “going concern”
- Often need other sources of funds to round out capital stack
 - Must be compatible with first lien status of Project Finance Bonds

HOW TO “BUILD A CAPITAL STACK”

- Some examples of other sources of funding that are compatible with Project Finance Bonds
 - New Markets Tax Credits (NMTC) funding
 - Section 1603 grant
 - EB-5 immigrant investor funding
- Structuring is needed to insure compatibility

NMTC

HOW IT WORKS

- NMTC funding is sub debt
- normally NMTC proceeds are leveraged against senior debt proceeds (e.g., Project Finance Bonds)
 - Leveraged lender not allowed to have direct security interest in project assets
 - Right structure needed if Project Finance Bonds used
- result equivalent to “forgivable loan” equal to NMTC proceeds
- numerous tax issues apply

NMTC

HOW TO GET IT

- Treasury Department's CDFI Fund allocates tax credits to a Community Development Entity (CDE), which sells them to a private sector investor who gets a 39% federal tax credit over 7 years
- CDE invests the sale proceeds as loans or equity investments in a Qualified Active Low-Income Community Business (*i.e.*, the project entity) located in a qualified census tract or that serves a "targeted population"
 - NMTC qualified census tract
 - poverty rate of at least 20%, or
 - income level less than or equal to 80% of -
 - the statewide median (non-metropolitan census tract), or
 - statewide median family income or the metropolitan area median family income, whichever is greater (metropolitan census tract)

SECTION 1603 GRANT

HOW IT WORKS

- grant from US Treasury in lieu of federal investment tax credit or production tax credit
- pays 30% (10% in certain cases) of the costs of “specified energy property”
- not reduced if project also uses subsidized energy financing or tax-exempt bond financing
- grant not paid until after the project is placed in service (and all the other requirements are met)
- for the right project, grant can be anticipated (monetized, or forward funded) via “bridge bonds”
 - funded at closing to pay project costs
 - lien status/source of repayment negotiable
 - need approving opinion by CPA firm nationally recognized in the industry

SECTION 1603 GRANT

HOW TO GET IT

Project must produce electricity

- Biomass (closed-loop and open-loop)
- municipal solid waste
- solar
- wind
- geothermal
- marine
- hydrokinetic

SECTION 1603 GRANT

HOW TO GET IT

- renewable energy project must be “placed in service” (a term of art) by the end of 2011, or-
 - Before the end of 2011, begin construction (continuously conduct “physical work of a significant nature”, or comply with the “5% safe harbor”) and place the project in service before the applicable “credit termination date”, and
 - Before October 1, 2012, apply to the U.S. Treasury Department (“Treasury”) for the grant (regardless of whether or not the project has been placed in service.)
 - Placed in Service not later than
 - 12/31/2012 for wind
 - 12/31/2013 for most other renewables
 - 12/31/2016 for solar
- All other requirements must be satisfied

EB-5 IMMIGRANT INVESTOR FUNDING

HOW IT WORKS

- qualified immigrants invest requisite capital, obtained from a lawful source, into a qualifying new commercial enterprise (i.e., the project)
- a Regional Center (RC) is usually the conduit through which the investments are made; i.e., the RC's entity (usually a limited partnership) is the investor in the project
- the investment must be “at risk” but otherwise structure of investment is negotiable
- projects prefer EB-5 investment as sub debt, but investment as senior debt or equity is more common
- if invested as senior debt, EB-5 investment must be coordinated with Project Finance Bonds

EB-5 IMMIGRANT INVESTOR FUNDING

HOW IT WORKS

- yield on EB-5 investment is below domestic market if structured as senior debt or sub debt
- return on EB-5 investment follows private equity model if structured as equity
- horizon for EB-5 investment is generally 5 years
 - need to plan for liquidity event
- per investor requirement is \$1 million, unless project is located in a Targeted Employment Area (“**TEA**”)
 - Within TEA, allows minimum of \$500,000 per investor
 - EB-5 market is the same – investors only willing to invest \$500,000 each
 - So EB-5 funding really available just within TEAs
- EB-5 funding can be used to leverage NMTC funding

EB-5 IMMIGRANT INVESTOR FUNDING

HOW TO GET IT

- 10 or more new full time jobs, per each investor, must be created for the investor to obtain a temporary “green card” (permanent resident visa)
- If the jobs are created within a two year period and other requirements are satisfied, the green card can become permanent and clear the way for citizenship.
- For a minimum investment level of \$500,000 (as opposed to the standard minimum of \$1,000,000) to apply, the investment location must be a Targeted Employment Area (“**TEA**”)

EB-5 IMMIGRANT INVESTOR FUNDING

HOW TO GET IT

TEA

- a Rural Area (areas with populations under 20,000), or
- an area of high unemployment (areas with unemployment rates at least 150% of the national rate).

EB-5 IMMIGRANT INVESTOR FUNDING

REGIONAL CENTER (RC)

- EB-5 investment can be made by an investor on a stand-alone basis, or through a USCIS-designated Regional Center (RC).
- RCs are the norm.
 - If the investment is stand-alone, indirect jobs are not counted, and practically speaking, the immigrant investor is typically required to reside where the business is located.
 - RCs use an economic model to calculate and substantiate job creation
- RC's are geography-based.
 - Each RC has a territory.
 - The territory is not exclusive.

CONCLUSION

- THE WORLD CHANGES, AND DEAL STRUCTURES CHANGE WITH IT
- WITH THE RIGHT DEAL STRUCTURE, EVEN DIFFICULT DEVELOPMENTS GET DONE
- PROJECT FINANCE CAN BE THE RIGHT DEAL STRUCTURE FOR YOUR PROJECT

REFERENCES

THIS PRESENTATION AND OTHER REFERENCES CAN BE DOWNLOADED AS FOLLOWS:

- October 2011- “Project Finance- No Banks, No Recourse, No Problem!”
- August 2011- "Green Energy/Green Dollars"
- August 2011- "Definition of Solid Waste Disposal Facilities for Tax-Exempt Bond Purposes"
- January 2011- “Bonds 101”
- January 2011- “Introduction to Tax-Exempt Bonds”
- January 2011 - “Introduction to 'Taxable Floaters' ”

at <http://danmcrae.info/whitepapers>

- September 2011-Quick Takes: "Section 1603 Grants" for Renewable Energy Projects: Take the Money and Run!"
- August 2011-Quick Takes: “New Regs, New Rush- Finance Your Renewable Energy and Solid Waste Disposal Projects Now!”
- June 2011- Quick Takes: “Easy Equity- the NMTC and EB-5 programs”
- January 2011-Quick Takes: “After ARRA- What Bonds Can We Use Now to Finance Projects?”

at <http://danmcrae.info/quicktakes>

QUESTIONS?

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MORE INFORMATION

This presentation is a quick-reference guide for company executives and managers, elected and appointed officials and their staffs, economic developers, participants in the real estate and financial industries, and their advisors. The information in this presentation is general in nature. Various points which could be important in a particular case have been condensed or omitted in the interest of readability. Specific professional advice should be obtained before this information is applied to any particular case. Any tax information or written tax advice contained herein is not intended to be and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. (The foregoing legend has been affixed pursuant to U.S. Treasury Regulations governing tax practice.)