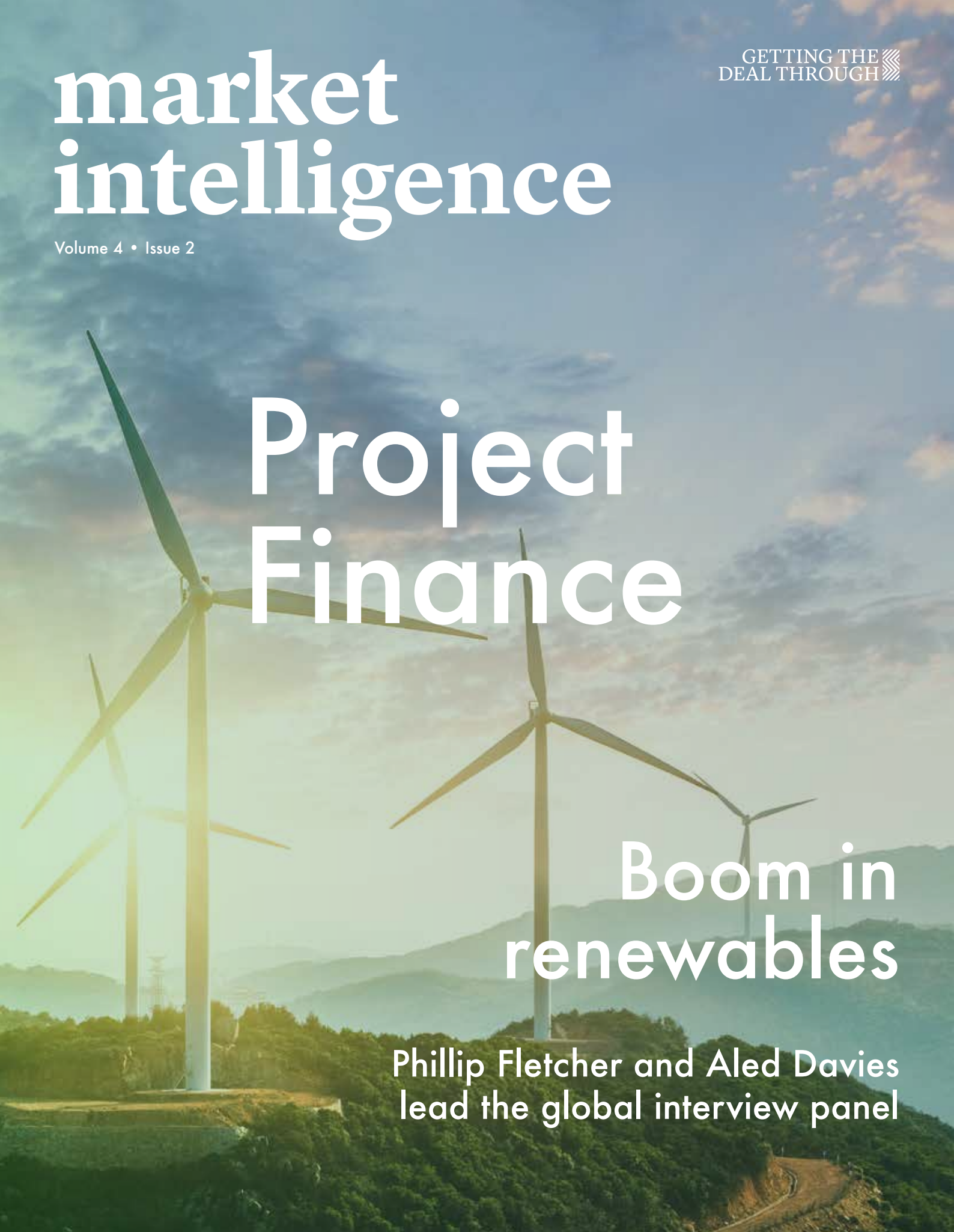
GETTING THE DEAL THROUGH

market intelligence

Volume 4 • Issue 2



Project Finance

Boom in renewables

Phillip Fletcher and Aled Davies lead the global interview panel

The Americas • Asia-Pacific • Europe • Africa • Middle East
Activity levels • Keynote deals • Industry sectors • PPP • 2017 outlook

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market intelligence

Welcome to *GTDT: Market Intelligence*.

This is the third annual issue focusing on global project finance markets.

Getting the Deal Through invites leading practitioners to reflect on evolving legal and regulatory landscapes. Through engaging and analytical interviews, featuring a uniform set of questions to aid in jurisdictional comparison, *Market Intelligence* offers readers a highly accessible take on the crucial issues of the day and an opportunity to discover more about the people behind the most interesting cases and deals.

Market Intelligence is available in print and online at www.gettingthedealthrough.com/intelligence

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Santiago Sepúlveda

PROJECT FINANCE IN MEXICO

Santiago Sepúlveda leads Creel, García-Cuéllar, Aiza y Enríquez, SC's project development and finance practice, and has ample experience representing Mexican and transnational clients in the structuring, development and financing of large energy, telecommunication and infrastructure projects in Mexico. In addition to his recognised project finance expertise, Mr Sepúlveda regularly represents private equity funds investing in natural resource, energy and infrastructure projects with all M&A, regulatory and legal aspects of the transactions. He represented KKR in a landmark US$2.1 billion sale-and-leaseback and financing transaction with Pemex, and is currently representing Howard Energy Partners in the development and financing of a first-of-its-kind natural gas pipeline in northern Mexico.

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GTDT: What have been the trends over the past year or so in terms of deal activity in the project finance sector in your jurisdiction?

Santiago Sepúlveda: Project finance is well established in Mexico, especially in the oil, gas and power industries, as well as in the transportation and water sectors. Over the past decade, project financing has become the preferred method of funding large infrastructure in Mexico.

During the past couple of years, Mexico has seen an interesting shift in the project finance sector, mainly resulting from the Energy Reform enacted in 2014 and implemented over the course of the past two years. The Energy Reform essentially eliminated the long-standing state monopoly in the oil, petrochemical and power generation sectors, and opened these industries to private investment, including foreign investment.

The recent shift in the project finance sector was not necessarily the result of the Energy Reform allowing the development of oil, gas or power projects, since these have been financed for many years as part of projects linked with government concessions and contracts granted by Mexican state-owned companies such as the Comisión Federal de Electricidad (CFE) and Petróleos Mexicanos (Pemex). Rather, the shift has come by way of private parties developing new projects that are intended to take advantage of newly opened sectors and fill the void in areas that have been critically underserved, such as midstream services in the oil and gas industry, and transmission facilities in the power industry.

Project finance work has certainly seen important growth as a result, and we expect to see this continue, mainly in the oil, gas and electricity sectors, but also in more general areas of infrastructure. In the past year, we have capitalised on our long-standing reputation as a full-service firm with expertise in complex and innovative transactions, and have been engaged by important private equity firms such as KKR, First Reserve and Blackrock, and by public pension funds investing in infrastructure, such as OTPP, PSP, CPPIB, AIMCo and Brookfield, among others, to advise them in a variety of projects being developed in Mexico.

GTDT: In terms of project finance transactions, which industry sectors have been the most active and what have been the most significant deals to close in your jurisdiction?

SS: Over the past years, Mexican project finance transactions have concentrated on the power generation and natural gas sectors, as well as in the development of water and transportation infrastructure projects. Historically, most of these transactions have been anchored around government concessions for toll roads and airports, or contracts granted by CFE and Pemex.

Since its enactment, the Energy Reform has revolutionised the Mexican project finance market, and we certainly anticipate significant growth as the new projects being developed require funding to reach conclusion.

GTDT: Which project sponsors have been most active in driving activity? Which banks have been most active in providing debt finance?

SS: From the sponsors’ side, Mexican projects have typically attracted the main industry players

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THE INSIDE TRACK

What three things should a client consider when choosing counsel for a complex project financing?

First, the counsel selected must not only be an expert in project financing but also part of a larger firm that can seamlessly provide the same level of expertise in other areas that are relevant for the project, such as real estate, labour, tax and environmental matters. Second, since complex project financing has many phases, counsel must have ample experience beyond financing, which includes designing and implementing international consortium arrangements, as well as undertaking all of the project's regulatory and commercial requirements. Finally, counsel needs to demonstrate innovative thinking to address the particularities of each project.

What are the most important factors for a client to consider and address to successfully implement a project in your country?

In my experience over the past 20 years, every successful project in Mexico invariably has at its core a sponsor that is willing to understand and adapt to the particular nuances of the Mexican market, instead of trying to implement structures from other regions. As we noted earlier, the Mexican project finance sector is well established and has developed structures that offer the required security and certainty to all parties involved.

What was the most noteworthy deal that you have worked on recently and what features were of key interest?

For over a year we worked with KKR, structuring and implementing an extremely complex US$2.1 billion sale-and-leaseback transaction for Pemex, which required not only negotiating the sale-and-leaseback documents with Pemex, but also structuring the cross-border acquisition financing through a combination of a credit facility and a bond issuance.

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from Europe, the US and Japan, and more recently Korean companies, while China has yet to form a consistent presence. Often, these foreign companies form consortia with local companies to ensure local content and know-how. Interestingly, we are now seeing important participation from specialised private equity firms, which have started to lead in very significant transactions resulting from the opening of the oil, gas and power sectors following the Energy Reform.

Large infrastructure projects in Mexico are typically financed from a variety of sources. Typically, international commercial banks from the US, Europe (mostly Spain and France) and Asia (ie, Japan and Korea) form financing clubs with Mexican commercial banks, and team up with development banks (both Mexican and from the sponsors' jurisdictions), import-export agencies and multilaterals (ie, World Bank, Inter-American Development Bank) to finance infrastructure projects in Mexico.

GTDT: What are the biggest challenges that your clients face when implementing projects in your jurisdiction?

SS: The most significant challenges in developing infrastructure projects in Mexico typically derive from the multilayered regulatory framework that requires obtaining a large number of permits from different regulatory authorities, which operate under different standards and in an uncoordinated fashion. This complex regulatory scenario requires a lot of experience and expertise from the sponsors' advisers to navigate the process in a time-efficient manner, minimising the effects on the project. Fortunately, lenders have come to understand these issues and the market has developed standards to address them.

On the other hand, while project financing structures are quite mature and have been repeatedly used to finance infrastructure projects, there are still some issues with the effective enforcement of lender rights when foreclosure is triggered. Nevertheless, legislative changes have been implemented in Mexico to strengthen security and the enforcement actions available to lenders, and these have been well received by the market.

GTDT: Are there any proposed legal or regulatory changes that may give rise to new opportunities in project development and finance? Do you believe these changes will open the market up to a broader range of participants?

SS: The Energy Reform has represented a radical change in the Mexican regulatory landscape, and the Mexican authorities responsible for the oversight of the energy sectors have worked hard to issue all the laws, regulations, directives and standards that form the new regulatory framework, and to review and approve all the permit applications that have been presented for new projects.

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Given the importance and extensive scope of the Energy Reform, at this point we do not expect any further significant legal or regulatory changes that would give rise to new opportunities in project development and finance.

GTDT: What trends have you been seeing in terms of range of project participants? What factors have influenced negotiations on commercial terms and risk allocation? Are there any particularly innovative features?

SS: Generally, Mexican project finance transactions have enjoyed sustained support from international and Mexican commercial banks, with some reliance on development banks to anchor the debt financing. However, we have been seeing alternative sources of finance coming into play, including the placement of project bonds in the international markets, as well as the participation of insurance companies and pension fund investors taking a share of a project. Interestingly, the past years have seen many specialised funds being formed with the specific purpose of investing in new energy-related projects arising from the Energy Reform.

Traditionally, the financing of Mexican large infrastructure projects anchored on government concessions or contracts has been structured with limited recourse (or even no recourse) to the project sponsors. However, medium-sized or private project financings often rely on sponsor support, with lenders giving weight to relationship lending principles.

GTDT: What are the major changes in activity levels or new trends you anticipate over the next year or so?

SS: As we said earlier, the expectation is that we will continue to see significant growth in project finance work triggered by the Energy Reform, mainly in the oil, gas and electricity sectors. On a parallel track, as energy-related projects gain momentum, we also anticipate growth in other infrastructure areas such as telecoms, airports and toll roads that will be required to serve the growth resulting from the energy projects.

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