ITALIAN RENEWABLE BONDS GO WINDY

THE GLENNMONT TRANSACTION IS THE FIRST BOND ISSUE BY A PROJECT COMPANY ACTIVE IN THE ITALIAN WIND SECTOR. BY OTTAVIANO SANSEVERINO, PARTNER AND HEAD OF THE ENERGY AND INFRASTRUCTURE DEPARTMENT, AND ORIANA GRANATO, PARTNER OF THE ENERGY AND INFRASTRUCTURE DEPARTMENT, AT GIANNI ORIGONI GRIPPO CAPPELLI & PARTNERS.

On October 25 2017, CEF 3 Wind Energy SpA, an Italian joint stock company controlled by Glennmont Partners and PGGM Vermogensbeheer, issued €170m in bonds at a fixed rate interest of 2.01%, amortising with a final repayment in June 2025, to refinance the existing project finance debt of the group. The bonds were issued in a single tranche in favour of international institutional investors. The bonds are listed on the ExtraMot Pro multilateral trading facility managed by Borsa Italiana and are unrated.

Natixis SA, Milan Branch, and UniCredit SpA acted as structuring MLAs and bookrunners and underwriters for the full transaction debt including ancillary €20m loan facilities granted to CEF3.

Sponsors and assets

In June 2016, Glennmont Partners and PGGM Vermogensbeheer acquired, through CEF3, the shares of SER and SER1, the project companies behind the wind power portfolio.

CEF3 controls Società Energie Rinnovabili SpA (SER) and, indirectly, Società Energie Rinnovabili 1 SpA (SER1), which in turn own and operate a total of 11 wind energy farms for an overall power capacity of approximately 244.7MW, located in the Apulia Region (≈ 66.4MW) and in the Siciliy Region (≈ 178.2MW). The wind farms are made up of, in total, 231 wind turbine generators (in further detail, types G52, G80 and G87) supplied by Gamesa. Gamesa also provides the O&M services regarding the wind turbine generators.

All wind farms benefit from feed-in tariffs paid by Gestore dei Servizi Energetici GSE SpA (a public entity whose corporate capital is entirely owned by the Italian Ministry of Economy and Finance) and have entered into power purchase agreements for the sale of electricity produced. All wind farms entered into operation between 2009 and 2012 and have met, in aggregate, their forecast production levels, which is telling of a project company's creditworthiness.

Glennmont Partners (formerly, BNP Paribas Clean Energy Partners) is a fund manager focused exclusively on investment in clean energy infrastructure, such as wind farms, biomass power stations, solar parks and small-scale hydro power plants, which may deliver sustained performance and predictable returns in the long term. Since 2007, Glennmont has invested more than €1.5bn in clean energy infrastructure projects generating about 860MW in total, located in particular in the UK, Ireland, France, Portugal and Italy.

PGGM Vermogensbeheer is a pension fund service provider and manages pensions for different pension funds, the affiliated employers and their employees. On June 30 2017, PGGM Vermogensbeheer managed pension assets worth €206bn.

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Structuring objectives and peculiarities

The construction of the SER and SER1 wind farms was financed in 2008 by means of two separate project finance loans. While, on the one hand, SER was granted a typical project finance loan by a pool of Italian and European banks, on the other hand, SER1 received subsidised loans from Cassa Depositi e Prestiti SpA (a public entity, whose majority shareholder is the Italian Ministry of Economy and Finance) together with project finance loans granted by UniCredit SpA.

The sponsors' goal in issuing the bonds was to optimise the financial conditions of the existing debt at SER level by maintaining the very favourable existing economic conditions of the subsidised CDP loans made available to SER 1. This goal was technically not easy to achieve considering that the financings at SER level and SER 1 level were strictly connected, among others, by way of equity support obligations from SER in favour of SER 1. Thus, the pre-existing financial structure did not allow ring-fencing of SER projects from SER 1 projects, and as a consequence to refinance exclusively the SER portfolio while keeping the subsidised CDP loans made available to SER 1.

In order to implement such ring-fencing of the closely connected SER and SER 1 projects, existing SER 1 lenders have accepted – *inter alia* – to renounce the equity support originally granted by SER in favour of SER 1 on the basis that such equity support obligations were originally granted to cover construction risk connected to the SER 1 wind plants, being now in operation.

On the other hand, in order to compensate such effort made by the existing SER 1 lenders, SER has granted a pledge over its shares in SER 1 and CEF has assigned certain receivables relating to the SER 1 projects in favour of CDP and UniCredit.

Thus, having obtained full "financial independence" between the SER and SER 1 projects, it was possible to implement the refinancing of the SER portfolio through the issuance of the bonds.

An additional goal of the sponsors was to bring the ratings of the deal to an investment grade level so as to attract a major number of investors.

To do this, it was not sufficient to optimise the financial conditions of the existing debt at SER 1 level by maintaining the very favourable existing economic conditions of the subsidised CDP loans. It was also necessary to consider the SER 1 cashflows into the SER ratios for the purpose of debt sizing so as to permit a calculation of such ratios on a group basis and to pledge in favour of the SER subscribers the SER 1 assets.

However, these two structural incentives – given the SER 1 existing financing and the need for ring-fencing of the two portfolios – have been contractually guaranteed only after the full reimbursement of the SER 1 existing loans. Also the amortisation plan of the bonds has been sculpted taking into account the fact that the SER 1 cashflows will be used to support the debt service obligations of the SER bonds only after full reimbursement of the SER 1 existing loans.

Moreover, given the size of the financing, another goal of the transaction was to minimise the number of counterparties. In such regard, the experience in Italy is that banks generally do not commit more than €40m–€50m in a single transaction, while bond investors may purchase higher stakes, having in any case a take-and-hold strategy. This may lead to even closer relationships between the issuer and project bond subscribers rather than with a large number of lenders.

In order to structure this complex transaction, Glennmont selected Natixis and UniCredit, which underwrote the full debt amount and distributed the bond notes to a leading investment manager following competitive marketing and negotiation phases with multiple infrastructure-focused debt funds.

At the end of the competitive process, which involved many investors ready to subscribe a high minimum ticket stake, loans at the SER level were refinanced with proceeds of senior notes while the SER 1 financing structure remained in place. Natixis and UniCredit acted as joint underwriters, structuring MLAs and bookrunners of the €170m senior secured notes placement and €20m joint DSRF providers in the refinancing.

Some additional peculiarities of the deal: as described above, a €20m liquidity facility was granted to CEF3 by the arrangers of the transaction, Natixis SA, Milan Branch and UniCredit SpA, acting also in their roles of lender. The liquidity facility was meant to be an alternative to a debt service reserve account funded through cash. This liquidity facility has been tailored in order to take into account possible failures of SER1 to contribute to the reimbursement of the SER bonds, for instance in case of delay of the reimbursement by SER1 of its existing subsidised loans at the expected maturity date.

The existence of the liquidity facility technically makes this deal a hybrid financing, in fact characterised by the presence of both investors and banks, which entailed the necessity to draft a balanced intercreditor agreement, both in terms of voting mechanics and voting quorums and majorities.

Finally, the choice of listing the bonds was necessary since, pursuant to Italian law, non-listed companies encounter certain quantitative restrictions regarding bonds issue. These restrictions, however, do not apply if the bonds are listed on a regulated market or on a multilateral trading facility such as ExtraMot Pro.

ExtraMot Pro requires the issuer to submit an admission document setting out the features of the transaction, the main risks related thereto, as well as a description of the issuer and of the issuer's group. The process for approval by ExtraMot Pro, which is by now well-tested and efficient, was managed in parallel to the negotiation of the other aspects of the deal.

Security package

The bonds and the loan granted to CEF3 rank pari passu and benefit from typical bank project financing security – including share pledge, mortgage, special privilege, pledge over project accounts, pledge over general receivables – necessary to ensure the ring-fencing of the project. However, also in terms of security package, the transaction is characterised by certain specific complexities. In light of certain recent case law, as an element of innovation it was chosen not to include in the security package the standard assignment by way of security of the receivables *vis-à-vis* the GSE arising from the feed-in tariffs. The reason was that, in case of revocation of the feed-in tariffs, the GSE has often deemed the assignees of the feed-in tariff receivables jointly liable with the borrower to reimburse to the GSE the feed-in tariff unduly paid.

Even if this approach is commonly regarded as questionable from a legal standpoint, certain administrative courts have acknowledged the GSE's practice and have confirmed the right of the GSE to demand payment from the lenders that are assignees of the receivables.

To avoid this risk, the bonds and the loan of the Glennmont transaction are instead "secured" by specific payment mandates (from a technical legal perspective, payment mandates are not a proper security) whereby the security agent will be delegated to receive all payments from the GSE. From a practical point of view, in the absence of events of default, payments will be received by the issuer; however, in case of enforcement, the security agent will be entitled to receive payments of the feed-in tariff directly on its own accounts, on behalf of the secured creditors.

Moreover, as described above, SER1's assets will be pledged in favour of the secured creditors upon the full reimbursement of its existing bank loans.

In line with standard market practice, the security package is held, for the benefit of all secured creditors by a security agent, which also acts as representative of the bondholders *vis-à-vis* the issuer and the other secured creditors.

The market – sun or wind

The Italian project bond market may now rightly be considered in competition with the traditional infrastructure bank loan market, especially when the assets that ensure the reimbursement of the loans have entered into operation. Project bonds are attractive for the issuers since they have a longer duration than bank loans and may so allow for higher levels of distributions during the life of the bond. At the same time, there are a number of institutional investors seeking securities with stable and predictable cashflows, but at an interest rate higher than European government bonds.

The Glennmont transaction further confirms that among project bonds, renewable bonds are a growing category, which includes not only photovoltaic plants, but also other assets that benefit from feed-in tariffs and regular revenue streams. In this regard, to-date the Glennmont bond is the biggest project bond in the renewables sector in Italy and the largest euro-denominated renewable project bond in Europe in 2017 so far.

The similarities between wind farm projects and photovoltaic plant projects, both from a regulatory and risk assessment perspective, are such that, at a first glance it may seem surprising that the Glennmont transaction is indeed the first Italian wind bond issue.

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This could appear even more unexpected considering that wind farm projects have been developed and granted by the Italian government with public incentives since the early 2000s, while photovoltaic plants became eligible for incentives only starting from the second half of the decade.

However, the photovoltaic plants' industry quickly gained momentum and today installed photovoltaic capacity in Italy is greater than installed wind capacity (19,300MW vs 9,400MW). Most photovoltaic plants were financed during the credit crunch crisis that occurred in Italy between 2010 and 2012, therefore today's interest rates are significantly more convenient.

On the contrary, most of the wind farms were financed before the credit crunch and thus, until now, the need to optimise the relevant financial conditions was not as urgent. In addition, photovoltaic plants tend to be smaller than wind farms, which has led to a more active M&A market in the solar sector, allowing for consolidation. The refinancing wave of photovoltaic plants thus had a head start.

Looking forward

The transaction described above resulted in an attractive interest rate for the issuer, certainly cheaper than could have been obtained in the bank debt market. This reflects, on the one side, the quality of the assets financed and the level of confidence of investors in the renewables market in Italy and, on the other side, the optimised contractual structure described above, which has been achieved by means of exploiting the co-existence of the two SER and SER 1 portfolios.

This transaction may certainly serve as a model for other deals involving project companies seeking to refinance their portfolios and institutional investors on the lookout for opportunities. It is reasonable to expect that competition for Italian renewables assets will increase as new players will see the potential of the Italian project bond market. ■