INFRONEER Holdings Inc.

[Kibe-log]

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Non-recourse loans that are not true non-recourse loans hinder infrastructure investment

I am Kazunari Kibe, the President and CEO of INFRONEER Holdings Inc.

Thank you for visiting "Kibe-log" again.
Thanks to you, INFRONEER's "de-contracting" is gradually being recognized in the market. As a pioneer in the infrastructure business, we will keep developing the market beyond the traditional construction industry. Thank you for your continuous support.

The reality of non-recourse loans that are not "non-recourse"

Now, as a sequel to the "The secondary market of infrastructure will bring more investment" that I talked about last time, I would like to give my personal opinions on the problems of project finance in Japan.

As I mentioned in the previous Kibe-log "The secondary market of infrastructure will bring more investment"(https://www.infroneer.com/en/topics/blog_assets/attachments/23/kibelog_en_vol4.pdf), it is indispensable for the expansion of the Japanese infrastructure project market to have a secondary market where the completed "projects" such as renewable energy facilities can be sold.

In other words, we take the risk in the "starting project" part, in which we set up a project based on our engineering capabilities and build social infrastructure. Then, we tailor it to a business that generates a stable return over the long term. While handling operation and maintenance of the project, we would then hand it over to investors such as pension funds at the appropriate time.

If this cycle is possible, high-quality infrastructure can be supplied to our society. At the same time, the pension funds that are expected to support the lives of Japanese retirees will be able to secure stable yields on their investments. The social infrastructure that many people have used for a long time is the perfect investment target for pension funds.

However, although I couldn't write it enough in the previous blog, building the secondary market is insufficient.
We need to solve the issues of financing the project when we formulate it, specifically the issues of non-recourse loans.

Stance of financial institutions seeking "one line for recourse”

When implementing an infrastructure project, it is common to establish an SPC (Special Purpose Company) as the implementing entity, and it is financed by the companies participating in the project. At the same time, the SPC borrows funds from financial institutions to build and operate facilities and equipment. It's so-called project finance.

Project finance usually takes the form of non-recourse loans. As translated as "non-retroactive financing," non-recourse loans are financing methods that lend money only based on the cash flow generated by actual equipment, such as turbines for wind power generation and solar panels.

Due to the limited target of debt, even if the SPC goes bankrupt, the lending financial institutions cannot ask the SPC's participating companies to repay it. In fact, non-recourse loans based on the revenue generated by real estate are the norm in real estate development projects.

However, in Japan, non-recourse loans are a misnomer, and in most cases, the contract says, "If it becomes difficult to repay the debt, the representative company will be responsible." This means that if the SPC defaults due to bankruptcy, the representative company will be required to repay it. We cannot call it a true non-recourse loan.

So why are non-recourse loans important for expanding infrastructure projects? That's because if they are not true non-recourse loans, it's harder to sell SPCs in the secondary market.
Let’s consider the case where project finance is a recourse loan that is an existing corporate loan and goes beyond the range of the asset in the project, such as the company’s assets or the personal guarantee of the owner of the company.

If the SPC raises funds with a recourse loan, it is necessary to refinance the loan when selling the SPC to a pension fund or the like. However, when making project finance, it is necessary to investigate the value and risk of the asset in detail. A legal check by a lawyer is also needed.
Similar due diligence is required for refinancing. As this adds an additional cost, the selling price is

affected as well.

An impediment to selling SPC

Some companies may hesitate to sell infrastructure projects in the secondary market if the number of buyers who can refinance is limited in the first place and the cost of selling is increased. It would be a risk for companies to be unable to sell infrastructure projects and need to keep them on their balance sheet for a long time.

The INFRONEER Group has organized nearly 10 infrastructure projects so far. We adopted real non-recourse loans without one line for recourse in all cases, as we were aware of the problems of non-recourse loans that are non-recourse in name only in Japan.

When I signed loan contracts with financial institutions, I was always asked for one line for recourse, which I mentioned above. But I stubbornly rejected that request. I told them "We explained that it was a non-recourse loan at the bidding. Did you understand that and bid correctly?"

As I wrote in my last blog, we were able to sell our renewable energy facilities to another investor because the debt portion of the SPC was a real non-recourse loan.

Non-recourse loans are risky loans for financial institutions, as they can lead to bad debt unless the value of the assets and future cash flows are accurately calculated beforehand.
If financial institutions lend it with a recourse like a corporate loan to avoid such a risk, their screening skills are not improved. Rather, they may be able to change their way of thinking and adapt their strategy to use screening skills as a source of their competitiveness.

Coincidentally, the Cabinet Office announced the "PPP/PFI Promotion Action Plan (Reiwa 4th Revised Edition)" on June 3rd. The target of business scale for PPPs such as concessions is expected to increase significantly to 30 trillion yen in the 10 years from 2022. Many of these businesses will be subject to project finance.

Non-recourse loans have been commonly adopted, especially in real estate financing. Isn't it time to switch to a real non-recourse loan? I think that will lead to the expansion of infrastructure projects and the improvement of the competitiveness of financial institutions as a result.