Gaining traction

Synthetic securitisation is expected to play a key role in assisting Europe's transition towards a more sustainable economy. Vincent Nadeau explores the significance of project finance SRT transactions within this context.

Given the challenging macroeconomic conditions over the past 12 months and the unprecedented write-down of Credit Suisse's AT1 bonds, banks are increasingly adopting synthetic securitisation as a way to optimise balance sheets and free up capital. Against this backdrop, a shift within the specialised infrastructure and project finance SRT investor community is underway.

"Certain portfolios – namely corporate portfolios, where interest rate risk cannot be entirely passed over to the end consumer – all of a sudden, had an attractive risk profile for those generalist credit funds that tend to take higher risks in pursuit of higher short-term relative returns," says Alberto Treglia, investment director at Glennmont Partners. "Therefore, in this hunt for yield, we are seeing a shift from investors, exiting infrastructure investments and looking into the higher risk corporate portfolios. However, if you are a more conservative infrastructure debt investor, you are still benefiting from these conditions as the return increased thanks to the increase in base rates, while the inherent risk remained unchanged."

He additionally notes the asset class's intrinsic link to wholesale energy markets as currently benefiting specialised investors. "Given that ▶

Alberto Treglia, Glennmont Partners

energy prices move in line with inflation, if a bank goes to a specialised investor, like us at Glennmont, we can still price the infrastructure risk return profile less opportunistically than your generalist credit investor, since we look for long-term, stable and predictable total returns."

While these developments point to significant expertise and high barriers to entry for investors, technical and structural developments in the sector appear to have been relatively nuanced. Parya Badie, partner at Allen & Overy, notes: "It is a very difficult asset type to get exposure to because you typically have to be one of the major banks in order to participate in those syndicated deals. SRT instruments offer different types of investors a way to invest in this asset class."

She continues: "But, given that these loans tend to be large (both in notional value and in terms of documentation) and complex, investors will generally want to diligence certain aspects of the projects. Whereas for an SME or an auto loan portfolio, for example, investors may rely more on the eligibility criteria, any portfolio criteria, historical data and their understanding of the bank's credit and collection policies. The deals are tailored for the project finance market, yet from a legal perspective, the structural features are still similar to those for SRT deals in respect of other asset types."

Treglia, however, identifies an evolution within the sector in terms of addressing concentration and construction risk. As regulations discourage long-term investments for banks, portfolios now include increased merchant or demand-based risk and construction risk.

He says: "SRT structures reflect the bank's portfolio as is, but also what it will be in the near term. If you look at infrastructure and renewable energy back in the day, some of the portfolios had brownfield assets, mostly contracted revenues with feed in tariffs, etc. What happens nowadays is that banks are starting to finance merchant and construction risk more and more, since the sector is mature, the assets and the risks have become very well understood, and with project finance being a very secure form of lending."

Nevertheless, regulators attach a high price in terms of RWA to infrastructure lending, partially due to its long-term nature. "Consequently, SRTs are somewhat evolving in that direction, with the risk/return profile slightly changing as banks go a little bit earlier in the asset lifecycle. This will open up new lending opportunities for banks, which means we'll see more portfolios coming to market, especially since the regulation keeps pushing banks more and more towards 'originate to distribute' or 'originate to transfer the risk' kind of models," Treglia suggests.

While the climate crisis is underscoring the growing importance of project finance transactions generally, it appears that SRT will play a crucial role in financing climate solutions. Given a context in which green investments will be pivotal, is appetite for project finance SRTs therefore set to grow exponentially? Treglia points to both the nature of the portfolios, as well as the growing influence of investors in this sector.

"It has definitely become more of a global market. More and more portfolios have a mix of European, US and – to a certain extent – Latin American assets," he notes.

He adds: "On the one hand, portfolios tend not be as granular as for other SRTs. However, if you have expertise in the sector, then you can do loan level due diligence, rather than rely on pure statistics. And to compensate for that, portfolios are becoming increasingly diversified, as we see more and more technologies – and not just your average solar and wind portfolios, but also by country."

Furthermore, investors in this space are seeking to be solution providers for banks. As such, a shift is underway from being a deal-taker to more of a deal-maker position, meaning investors can partner with and structure ad hoc solutions for the banks.

"I feel that's what's needed moving forward, especially with Basel 4 coming soon, which should push even further the need for SRTs," observes Treglia. "It is a great time to be an investor in this space, but also for banks, as they have a wider choice of investors to choose from.

Parya Badie, Allen & Overy

Ultimately, I think SRTs can be a real lever for the energy transition, as banks can free-up capital tied to legacy assets and redeploy it into new energy transition financings."

Although she highlights a growing appetite for the asset class, Badie offers a measured view moving forward, noting the limited availability of green deals currently. She says: "There are a fair number of SRT trades that focus on renewable energy, but portfolios that consist entirely of 'green' loans are less common at the moment."

She concludes: "However, while there are a number of factors that are currently impacting the growth of the SRT market for renewables, it's likely that we will see this market grow over time, given the wider focus on ESG issues and the green energy transition in particular. Originators will want to focus on capital relief as their renewable portfolios grow, so that they can efficiently support these long-dated projects. Investors, on the other hand, will be keen to seek out the opportunity to invest in a market that's otherwise tricky to access."

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