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ASSET-BASED LENDERS FACE NEW CHALLENGES IN DISRUPTED ENERGY SECTOR

--Thirty-year loans for coal and nuclear plants are giving way to short-term agreements with energy startups, but changes also represent new opportunities and customers, writes LeClairRyan's Roy M. Palk

GLEN ALLEN, VA. (8/28/18) – In today's rapidly changing energy sector, asset-based lenders face greater challenges related to reassessing risks involving technology, demand, regulations and the creditworthiness of borrowers, writes attorney Roy M. Palk, Senior Energy Industry Advisor for LeClairRyan, in a column for ABLAdvisor.com.

With long-term, low-risk financing for coal-fired power plants that could operate for half a century, the U.S. power industry once epitomized stability for asset-based lenders, says Palk, who is based in the national law firm's Glen Allen, Va., office. But in comparison to when coal was king, deals involving the likes of wind, solar, bio-gas or battery-storage generally feature shorter terms—and substantially altered risk profiles. "Asset-based lenders need to account for this in the appraisals, loan structures and due diligence methodologies they employ moving forward," the attorney writes.

In the Aug. 21 column ("State of Flux: U.S. Energy Sector Creates Challenges, Opportunities for ABLs"), the former CEO of the East Kentucky Power Cooperative notes that energy deals in earlier eras typically involved 30-year loans to public utilities for the construction of coal or nuclear plants. But those days, he notes, are gone. "Uncertainty has supplanted what once was a seemingly safe assumption—namely, that the power business would stay the same save for the fluctuation of regulatory enforcement under different political administrations," Palk writes.

Among the changes is the revolution in natural gas. Twenty years ago, when energy buyers and sellers negotiated a contract, the price of natural gas was $15 for a million BTUs of energy, Palk relates. But today, it has plummeted to $3. Likewise, gas companies used to routinely sign 20-year contracts with utilities in which the price was locked in.

"Now those contracts have shriveled to five years or less in length," Palk explains. "Thanks to rising global demand and continued investment in LNG export infrastructure, gas companies understand that today's price could easily double or triple in a few years."

Under the old model, moreover, lenders could count on all-requirements contracts to guarantee stable revenue streams for borrowers. Under these agreements, buyers agreed to pay a single energy producer to meet all of their energy needs. Now the capital markets are watching closely to determine the extent to which this will give way to flexible, multi-party agreements involving providers of solar, energy, wind, battery-storage or some combination, Palk writes.

The role of both state regulations and the corporate policies of energy customers are more important as well, he maintains.

"Users like Amazon, IKEA and Google have aggressive targets for renewables," Palk writes. "As they enter into flexible power purchase agreements, this will create opportunities for asset-based lenders to work with startups supplying renewable energy to these corporate giants." Other targets for lenders might include companies looking to finance solar installations on the rooftops of their distribution or manufacturing facilities, he says.

With respect to terms, lenders need to mirror their practices to the shorter-term contracts and higher-risk levels that are becoming the norm, Palk writes. And as more startups enter the picture, the ABL community may also need to ferret out potential credit problems with these neophyte market entrants.

Other strategies could range from refinancing the remaining term on legacy assets, to paying closer attention to the nature of interconnection agreements and regulatory trends.

"Like so many American industries," Palk concludes, "the power business has moved from stability to a state of flux. Coping with these changes—and capitalizing on the opportunities—requires adaptation on all fronts."

The full column is available at http://www.abladvisor.com/articles/14573/state-of-flux-u-s-energy-sector-creates-challenges-opportunities-for-abls

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