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Project Financing Finland

Core processes and legal issues

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Peter Jaspers
peter.jaspers@bergmann.fi

Project financing in Finland

An overview

Project finance is gaining importance in Finland at the same time as private and international investors become more active in Finnish energy and infrastructure projects.

You may meet some confusion when “project financing” is discussed in Finland. Most investment projects in Finland are financed in ways that rely in one way or the other on the balance sheets of the investors. Strictly non-recourse financing facilities are still a newcomer in Finland.

Finnish financiers

Finnish financing institutions have long been reluctant to enter the project financing market. In recent years, substantial movement has occurred, though. This has come mostly from two directions.

Banks have engaged in providing project financing for large PPP projects (public-private partnerships, which is also a new concept for Finland), most prominently the E18 motorway from Turku to Vaalimaa, which was the prime pilot project for a PPP structure in Finland. Additionally, project finance was applied

for the construction of wind power facilities in the period of time when sales revenues were secured by a generous feed-in tariff scheme.

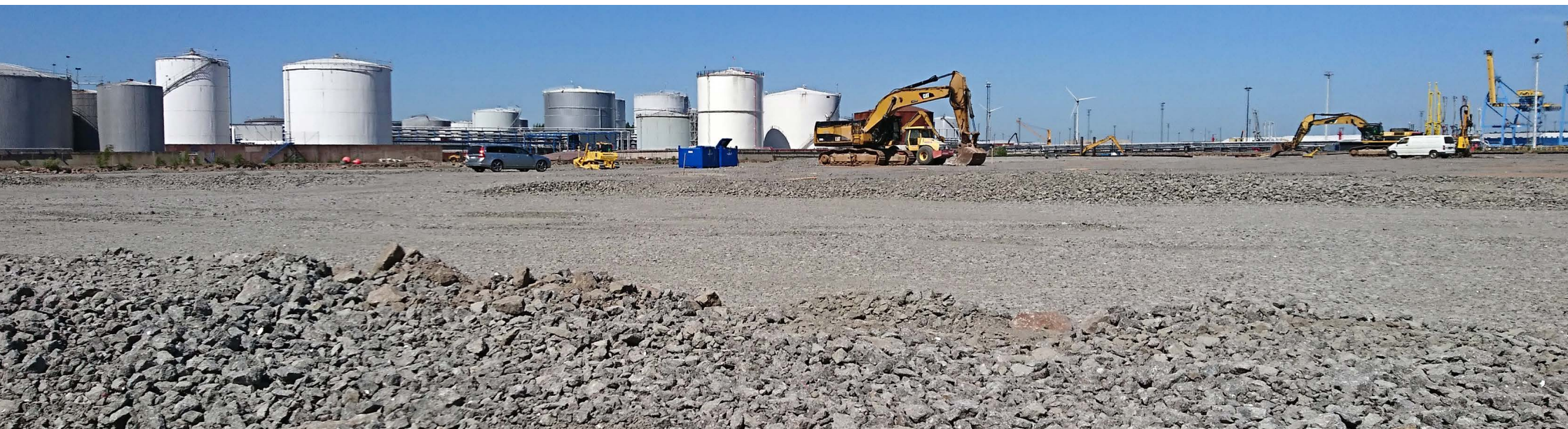
These were cases in which there was practically no risk with regard to the project's revenue. Time will tell how Finnish financiers position themselves when project revenues are not guaranteed by the state. So far, we can still observe a rather cautious approach, with a tendency to break up the non-recourse model in favor of hybrid solutions involving at least some degree of recourse to the project sponsors.

International finance markets

Foreign banks, in particular from Central Europe, have shown a strong interest in the Finnish project financing market in recent years. They have successfully financed a number of projects, especially in the wind power sector.

For project owners in Finland, including international institutions in the search for project financiers has the benefit of greatly enlarging the circle of possible partners as compared to the fistful of banks available in Finland. Increased competition is likely to lead to better financing terms. It can often be observed that foreign banks, stemming from well-established experience in project financing, offer better interest rates and act less conservative in the evaluation of project risks.

Of course, involvement of foreign banks has the potential to lead to increased complexity of the financing project for both sides. However, the increase in complexity will remain small and be outweighed by the benefits of increased competition if the financing package is well prepared by the owner before potential financiers are approached.



Getting your financing package ready

Transaction costs for arranging project financing are usually substantial. A good process structure can go a long way in keeping the overall cost – and also the time needed until financial close is achieved – under control.

In general, this means that the documentation package to be scrutinized by the bank and their advisers should be as complete and final as possible before the bank is approached with a request for financing. In an optimal (theoretical) case, the financier is presented with a complete project package, performs their due diligence on this package, and then approves the loan.

Process considerations

In practice, it's not quite that simple. Different banks have different practices and internal guidelines as to the form of required documentation and acceptable risk levels, which will cause the need for some tailoring of the documentation in each case. Further, financing arrangements usually need to be kicked off at a point when important third-party contracts are still under negotiation and permitting processes are underway. This means that new developments will need to be reflected in the package and possible implications for the financing terms discussed with the bank.

Despite these challenges the owner should strive to provide a complete package, with drafts and plans in place of final documents where necessary, rather than leaving relevant items

open. This will also make it possible to obtain competing bids from different banks.

Documentation checklist

The exact documentation to be put together for a potential financier will depend on the nature of the project. In general terms, the financing package must include at least the following:

- detailed account of the project SPV, the project owner, the sponsors, financing sources other than project financing;
- account of the project's operating environment, including customers, competitors, regulatory restraints and permitting requirements;
- financial model for the project's lifetime (respectively the term of the envisaged loan), showing the achievement of a sufficient debt service coverage ratio (DSCR), with an analysis of uncertainties in terms of cash-flow;
- account of the existence of necessary permissions or other regulatory requirements;
- account of the project assets available for the bank's security package;
- contracts or drafts for the project's construction;
- contracts or drafts for the procurement of crucial operation-time goods and services (such as operation and maintenance agreements or raw material procurement);



- contracts or drafts for the sale of the project's goods or services.

The last point is usually a core element of the financing package. The bank needs to be confident that a sufficient flow of revenue is guaranteed for the term of the loan.

Revenue flow

Demonstrating revenue flow is simple in subsidized environments. For example, under the rule of the now-expired feed-in tariff scheme for Finnish wind power, a fixed sum was guaranteed for each MWh of produced power.

The question is more challenging in non-subsidized cases. The project will usually be required to have one or more contracts with offtakers that commit themselves to purchase sufficient amounts of the project's services at sufficient prices so as to reach the required DSCR. As an example, a wind power project

may conclude a long-term power purchase agreement with a corporate offtaker.

An offtake agreement with a private offtaker will satisfy the bank only if the offtaker itself is sufficiently creditworthy for the bank to trust that they will be able to honor their commitment. The bank's advisers will therefore extend their due diligence scrutiny to the offtaker's bankability.

Additional challenges emerge when the project's sale process itself is regulated, which is the case for important infrastructure projects. For example, an LNG terminal will not be allowed to commit to sell all capacity to only one offtaker, while the bank expects full commitment from the offtaker. A delicate network of contractual arrangements will need to be created in order to handle such situation.

Security arrangements for project financing in Finland

While recourse to the project owners and sponsors is generally excluded in project financing, a project financier will expect to receive a comprehensive security package covering the project company (SPV) and its assets, particularly such assets that are of central importance to the project.

Generally speaking, all assets that have economic value and are capable of being transferred are also capable of serving as security under Finnish law. The procedure varies by asset type, as does the efficiency of the security interest to be granted under Finnish law. With certain assets, the required procedures are prohibitively cumbersome for a project with ongoing operations. This is commonly taken into account when defining the security package.

Real property and land leases

In Finland, security over real property is taken in the form of a mortgage. The mortgage is a registered pledge that is accessory to the secured receivable.

The creation of the mortgage requires the mortgage to be registered in the land register. Upon registration, a mortgage certificate will be issued by the registry authority. The perfection of the mortgage requires that the mortgage certificate is handed over to the creditor.

As of June 2017, new mortgages certificates are issued in electronic form only. Physical handover is substituted by a registration in an electronic register upheld by the land registry authority.

Registered leaseholds and other rights of use that meet certain criteria can also be mortgaged. If a project relies on leased land, it is essential for eventual project financing to ensure that the leases fulfil the requirements for being mortgaged. In this case, they will provide the financing bank with the same comfort as land ownership.

Mortgages provide the lenders a high degree of protection against third-party creditors. However, enforcement is somewhat cumbersome, always requiring a court judgment or arbitral award, after which the actual enforcement is performed by a bailiff in an execution procedure regulated by law, usually through a public auction or a private sale.

Movable property

Movable property such as machinery and equipment can be used as security in several ways.

If movable property (including, under Finnish law, buildings) serves the purpose of the real property and is sufficiently integrated therein, it can be regarded as components or accessories of the property. In these cases, the security over the real estate covers the movable property, which is generally favorable from the lenders' point of view. It may not be obvious whether certain movable property is accessory to the property. It is possible (and in many cases advisable) to clarify the accessory relationship in the land register.

Security over other movable property could basically be created by way of a pledge. However, the perfection of the pledge requires delivery of the respective asset to the possession of the creditor (the lenders). Obviously, this defeats the purpose of financing ongoing business operations. Therefore, individual pledges on movable property are not usually applied in project financing.

Instead, movable property is usually included in the security package by way of a so-called business mortgage. The business mortgage is created through registration in the relevant register and covers all movable property of a business that is not capable of being mortgaged otherwise. The business mortgage does not provide full security, but in case of bankruptcy it will give the pledgee a right to receive with priority half of the proceeds out of the realization of the covered assets.

Receivables and bank accounts

Pledges over the rights emerging from central project agreements are an essential part of the security package. Security over receivables can be created with a pledge agreement

between the pledgor (i.e. the creditor of the pledged receivable) and the pledgee. The pledge will be protected against third parties only from the moment when the debtor is notified of the pledge.

In practice, it is commonly agreed that the pledgor is free to collect the receivables in the absence of default. It is important to note that in such case, the security is not fully protected until the debtor is instructed not to make payments to the original creditor. This effect is generally accepted by project financier in Finland, as routing the flow of payments through the lenders would often obstruct the project to a prohibitive degree.

A bank account can be pledged in a similar way as receivables. Again, full perfection of the pledge would require that the bank is instructed not to make any payments to the pledgor, i.e. the account holder. It is common market practice to defer this instruction and to allow the use of the pledged bank account until an event of default occurs.



Shares

In project financing, the project owners will be expected to use their shares in the project vehicle as security. Security can be taken over shares by simple agreement.

The method of perfection of the pledge depends on whether share certificates have been issued. If this is the case, the share certificate must be endorsed and handed over to the pledgee. Otherwise, the perfection of the pledge requires that the company whose shares have been pledged is notified of the pledge and registers the same in the shareholder register.

Enforcement of share pledges is substantially easier than in the case of mortgages. Parties may generally agree upon the method of enforcement, and project financing arrangements commonly include the lenders' right to sell the shares directly in the context of their agreed step-in rights.

Security agent

While Finnish law does not know the concept of a trust, using security agents for syndicated loans has long been common practice and has now (as of 2017) also been recognized explicitly by law.

The security agent can act as a representative and enforce the security on behalf of the secured creditors if so agreed in the relevant finance documents. One will often find the role of security agent defined even in loan arrangements with only one lender, with the purpose of facilitating later syndication of the loan.

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Legal Services – Project Financing

For project owners

- Drafting and negotiation of supply and construction contracts, and other important project agreements
- Drafting and negotiation of offtake agreement
- Development of security concept
- Management of documentation package for financier's due diligence
- Negotiation of loan agreement and other finance documents

For financiers

- Project due diligence
- Drafting and negotiation of loan agreement and other finance documents
- Legal project monitoring

BERGMANN

Helsinki

INDUSTRY-FOCUSED LAWYERS
DEDICATED TO YOUR SUCCESS

Bergmann Attorneys at Law

Pohjoisesplanadi 35 E
00100 Helsinki, Finland
Phone: +358 10 339 8800
office@bergmann.fi
www.bergmann.fi

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