Core-Plus Infrastructure and Leveraged Financing: The Continued Convergence of Terms

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Introduction

Core infrastructure. Core-plus infrastructure. Value-add or opportunistic infrastructure. As the private infrastructure market has evolved and assets under management in infrastructure funds have continued to boom over recent years, the debate as to what assets constitute "infrastructure" remains ongoing, and can elicit some passionate views from those in the infrastructure community.

For those unfamiliar with the infrastructure market, their initial assumption may be that the private infrastructure market invests in essential physical assets, such as airports, roads, bridges and regulated water utilities. However, this "core" infrastructure investment is only part of the ever-expanding infrastructure asset class, with "core-plus" or "value-add" infrastructure investors tending to focus more on whether the characteristics of an investment are infrastructure-like – does it have stable and steady cash flows? Does it provide an essential service resilient to the economic cycle? Is there a diversified end-user base? Are there high barriers to entry in the sector? Is there an underlying real asset with some residual value? As a result, there are many investment opportunities that are attractive both to private equity (PE) funds and infrastructure funds, particularly in areas such as social infrastructure (such as care homes and education) and TMT (such as fibre-optic cables and data centres).

As a result of this interchangeability in PE/infrastructure ownership across certain assets, we are increasingly seeing, in the core-plus/value-add infrastructure debt market, infrastructure investors wanting to benefit from the flexibility in debt terms that PE funds have been able to obtain for similar assets. This chapter sets out some of those terms that we are seeing more commonly being sought by infrastructure funds for the debt financing of their assets, which traditionally would have been more commonly seen in the PE/leveraged buyout (LBO) debt market.

Before we look at these provisions, there are a few points to note on the scope of this chapter.

First, the debt products available in the infrastructure debt market are diverse, with lenders to greenfield assets (assets or structures that do not currently exist and need to be designed and constructed) having a distinct set of concerns and requirements as compared to those funding brownfield assets (existing operational assets or structures requiring ongoing improvements, repairs, or expansion). This chapter focuses on the financing of core-plus/value-add brownfield assets, and for ease, references to "core-plus" below should be taken to encompass both core-plus and value-add infrastructure assets.

Secondly, the debt products available in the PE/LBO debt market are equally diverse, with a range of products available from (among others) cov-lite large-cap loans, to bank/bond and US term loan B structures. As those familiar with the PE/LBO market will note, many of the converging provisions listed below are most aligned with those provisions found in the mid-market LBO space. When the LBO market is referred to below, the mid-market LBO market should be taken as the reference point, except in relation to the inclusion of permitted additional indebtedness, a feature more regularly seen in the large-cap LBO market.

Finally, as with all types of debt financing in any specific market, each deal is different, driven by bespoke deal dynamics. As such, there will, of course, be deals in the core-plus infrastructure market that include terms more preferential to borrowers than those listed below, and others that are more beneficial to lenders. The areas highlighted below are a selection of those provisions which we are currently most commonly seeing core-plus infrastructure borrowers seek to more closely align with LBO sponsor-backed borrowers.

Converging Terms

Security package

We are increasingly seeing infrastructure borrowers pushing for a more slimmed down security package granted by obligors and, if not an obligor (many deals in the infrastructure market have the holding company of the borrower as a third-party security provider only), the holding company of the borrower, with fewer categories of assets being subject to fixed security. This slimmed down security package can comprise:

- fixed security over material bank accounts, including the mandatory prepayment account (if any) and the lock-up account;
- fixed security over shares;
- assignment of receivables in respect of intra-group loans and loans from the Parent to members of the group;
- assignment of rights under hedging agreements;
- assignment of rights under the acquisition agreement (where an acquisition financing); and
- floating charge where the concept is permitted under local law.

Fixed security over real estate would also likely be included for assets with a material real estate portfolio (subject to materiality thresholds as to value and, in relation to leaseholds, remaining lease length).

"Grower" baskets

The use of "grower" baskets – covenant baskets sized upon the greater of (a) a fixed monetary amount, and (b) a percentage of the most recently tested adjusted EBITDA – are increasing in prominence. These grower baskets do not tend to be included in the *de minimis* thresholds for events of default, with fixed monetary baskets remaining here.

Permitted acquisitions regime

There is an increasing focus on the flexibility required by group companies in the core-plus infrastructure market to make bolt-on acquisitions due to the more naturally acquisitive nature of such companies as compared to those more static entities holding core infrastructure assets. As a result, we are seeing the following limbs of a more "traditional" infrastructure financing permitted acquisitions regime being more widely negotiated:

- removal of caps on the value of acquisitions that are permitted over the life of the debt facilities;
- removal of caps on the value of an individual acquisition;
- removal of a *pro forma* leverage test (though compliance with lock-up levels is usually required) – noting that this is still common in mid-market LBO deals;
- removal of a requirement that the target is EBITDA positive on a last-12-month basis; and
- inclusion of a blanket ability to make acquisitions from retained excess cashflow (subject only to requirements of: there being no existing (or resulting from the acquisition) event of default; the target being in the same or substantially the same business as the group; and the target being incorporated in specified jurisdictions).

Permitted additional indebtedness

Many infrastructure financings continue to include an incremental facility (sometimes known as the accordion facility) – a *pari passu* "pre-baked" additional facility under the existing facilities agreement, fundable upon the satisfaction of certain criteria, the mechanics of which are included at the outset in the facilities documentation (including the intercreditor agreement). We are increasingly seeing borrowers seeking to include the ability to raise such additional indebtedness outside the existing facilities agreement framework (by way of loans or, in some deals, notes), subject to satisfaction of the same, or substantially the same, criteria required to raise the incremental facility, by way of "permitted additional indebtedness" (sometimes known as "sidecar debt"). The inclusion of such a concept is, of course, standard where an infrastructure financing has been set up to incorporate different forms of debt on a platform basis by way of a common terms agreement, master definitions agreement, security trust and intercreditor deed-type structure. Where the closer alignment to LBO financing has come is the inclusion of such a concept in LMA-style facilities documentation not set up on a platform basis.

Where such a concept is included, consideration is needed as to whether such permitted additional indebtedness should be included as a distinct class of creditor in the intercreditor agreement initially, or whether the intercreditor agreement should be amended if, as and when such debt is arranged. Where the permitted debt is only *pari passu* senior, our strong advice to clients (whether acting borrower or lender side) is to include such class of creditor in the intercreditor agreement at the outset for certainty for all parties, and efficiency and speed in being able to raise such debt. Where the raising of permitted additional debt that is subordinated is included (which is also being seen on some transactions), this is more of a balanced calculation – the reluctance of the senior lenders to be negotiating against themselves with no incumbent junior lender present has to be weighed against the efficiency and speed in being able to raise such debt that the borrower is seeking.

Though not a relevant point in the LBO market, it is also worth noting one further consequential intercreditor consideration where permitted additional indebtedness is included: the way in which intercreditor voting is regulated between creditor classes. The two options traditionally available in the infrastructure market are (expressed in a simplified way) (i) for *pari passu* creditors' votes to be calculated on a pound-for-pound basis (the "LMA position"), or (ii) for voting to be calculated on a "block voting" basis, whereby (x) if the requisite majority under a particular *pari passu* credit document vote in favour of a decision, then all funders under that credit document are deemed to vote in favour of that decision, or (y) if that requisite majority is not met under the credit document, then the *pari passu* creditors' votes under that credit document are calculated on a pound-for-pound basis. Where permitted additional indebtedness is included in the facilities agreement, it may be that the block voting regime is chosen, a decision that is unlikely to be required where only a *pari passu* incremental facility is included, the lenders of which are treated in the same way as other lenders under the day one facilities agreement.

Structural adjustments

We are increasingly seeing on core-plus infrastructure deals sponsors looking to include a structural adjustments concept – i.e. in respect of a given tranche or facility, the ability to increase or extend commitments, redenominate, or reschedule payments or reduce pricing with only the consent of the majority lenders, and each affected lender in that tranche or facility.

Equity cures

Some infrastructure sponsors are successful in including EBITDA equity cures – the ability to recalculate a breached leverage ratio financial covenant by increasing the EBITDA side of the ratio calculation by the amount of the new shareholder injection, rather than decreasing the debt side of the calculation. Where such EBITDA cures are included, lenders are looking to include a cap on how many times this EBITDA cure can be used. Where the inclusion of such restriction is not successful, a middle ground is sometimes reached whereby all such cures can be EBITDA cures, but the number of equity cures available over the life of the facilities is reduced.

In addition, we are seeing some infrastructure sponsors push to include a deemed cure provision, whereby if a borrower is in compliance with its financial covenant tests on the next testing date, then any prior breach of a financial covenant shall be deemed cured (if the lenders have not taken any enforcement action in the meantime).

Revolving credit facility clean down

We are seeing more deals in the market that do not include an annual requirement to "clean down", or repay to zero, the revolving credit facility, a feature now relatively common in the LBO market.

Transferability

Given the take-and-hold nature of much of the infrastructure lending market, transferability remains a key area of focus for lenders and borrowers. Transfer without borrower consent to entities on an approved list remains usual, in addition to the usual permissions for transfers without consent to lenders, affiliates of lenders, and related funds, unless (in the majority of deals) such entities are competitors of the borrower or the sponsor, or a hedge fund or loan-to-own/distressed debt investor. In addition, transfers to other entities can freely be made in the majority of transactions following an event of default (even to competitors of the borrower or the sponsor, or a hedge fund or loan-to-own/distressed debt investor).

The points where we are increasingly seeing negotiation aligning more with the LBO market are:

- Should borrower consent (in its sole discretion) be required for transfers to sponsor competitors or industry competitors, even following an event of default?
- Should borrower consent (in its sole discretion) be required for transfers to a hedge fund or loan-to-own/distressed debt investor, even following an event of default?
- Should borrower consent (in its sole discretion) still be required for transfers to entities not on the approved list/lenders/affiliates of lenders/related funds following an event of default, unless that event of default is due to a non-payment, insolvency, insolvency proceedings or creditors' process event of default?

The last of these bullets is currently more rarely accepted by lenders in the core-plus infrastructure space, but the fact that it is starting to be pushed by sponsors is a clear example of how LBO and infrastructure financing terms continue to move closer.

Financial covenant *pro forma* adjustments

One of the clearest areas of convergence is in *pro forma* financial covenant calculation adjustments. The following *pro forma* adjustments, historically rarely included in infrastructure financings, are now prevalent in core-plus infrastructure transactions:

- cost savings and synergies reasonably anticipated to be achieved within [12] months of an acquisition or other group initiative (with the scope of such "group initiatives" a negotiated point);
- certification of such adjustments by the company CFO/CEO (on some deals for any adjustments, on others, if any such event exceeds 5% of consolidated EBITDA of the group);
- supporting evidence from auditors or a reputable accountancy firm if any such event exceeds [5–10]% of consolidated EBITDA of the group; and
- an aggregate cap on all such adjustments in any relevant testing period of [15]%.

Looking Forward

As infrastructure funds and PE funds continue to look at similar opportunities in the coming months, our view is that the flexibility in debt terms will continue to converge, potentially focusing, in particular, on further basket flexibilities, use of proceeds of equity cures, and conditions to incurring an incremental facility or permitted additional indebtedness. Watch this space!

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He advises on a broad range of issues in banking law, structuring and documenting the debt, equity and security arrangements involved in complex finance transactions for both UK and international lenders, corporate and private equity clients in the infrastructure sector.
Prior to specialising in the infrastructure sector, Ben advised private equity sponsors, banks and direct lenders on leveraged and general acquisition finance transactions in both London and New York, including spending over 18 months on secondment to international financial institutions. He also has experience in fund finance, general corporate lending and real estate finance transactions.

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