PROJECT FINANCE

Powering on

Independent power projects and the discovery of natural gas are giving the market a boost

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Project finance is no longer a new phenomenon in Israel. It has become increasingly popular in comparison with traditional methods to fund major energy and infrastructure projects such as sovereign borrowing and corporate finance. In the past decade, much experience has been gained in the realm of project finance in Israel. Specifically, a defined methodology for structuring financial covenants has been established; both foreign lenders and local banks and institutional lenders are now taking part in the long-term financing of projects; and most importantly, a benchmark for a risk allocation mechanism in infrastructure projects has been formulated and is currently being used in most of the public tenders issued by the Ministry of Finance (MoF).

Water and power generation projects

Israel has long suffered from ongoing water and electricity droughts. The MoF and Ministry of Energy and Water Resourses (MEWR) have decided to tackle both of these shortages through project finance in order to develop largescale projects with minimum immediate reliance on allocations from the national budget.

The coming years are expected to be groundbreaking for several reasons: first, after the inception of the 150 million m^3/annum Sorek desalination plant (financed by the European Investment Bank and Israel's two largest banks) and additional facility in Ashdod (financed by Bank Hapoalim and Israeli institutional lenders), which will be completed by the end of 2013, more than 70 per cent of Israeli households will be using desalinated water. Second, for the first time in Israel's history, independent power producers are expected to own and operate several largescale conventional power stations – the largest of which is the 870MW natural gas-fired power plant in the Tel Tzafit region, which achieved financial close in the fourth quarter of 2012. Third, pursuant to several governmental decisions, by 2014, 5 per cent of Israel's electricity will be produced from renewable energy sources and by 2020, 10 per cent of the electricity will be produced from renewable energy sources – all financed by the private sector. Although Israeli projects usually adhere to the build-operate-transfer (BOT) delivery system (particularly in transportation and water desalination), some renewable energy projects and conventional energy projects are tariff-based.

Natural gas extraction and distribution

Development of the recently discovered natural gas fields – the Tamar and Leviathan reservoirs in the Mediterranean Sea – will likely turn Israel, which relies heavily on imported fossil fuels, into an exporter of natural gas. In 2012 the Israeli government decided on an accelerated procedure to examine 15 locations for the construction of reception facilities for the offshore gas. The final plan for such facilities is expected to be submitted for approval during 2013. So far, Israel Natural Gas Lines (INGL) has completed construction in 2012 of a marine liquefied natural gas receiving buoy, for the import of LNG to Israel until the gas reservoirs come on tap. The holders of the gas licences require the support of prominent international oil and gas companies in developing the reservoirs and the necessary infrastructure in order link them to Israel's distribution network. Such support is conditional on how much of the natural gas will be exported. In this regard, the Israeli government is likely to approve the recommendations of a committee headed by Shaul Tzemach, the director general of the MEWR, thus promulgating a clear export policy for its natural gas reserves.

Ministry of Defence projects

The expertise gained in transportation, water desalination and power generation projects is now being applied to new sectors such as the Ministry of Defence projects. In April 2011, the Israeli government decided to embark on a groundbreaking PPP programme regarding the relocation and consolidation of multiple army bases with a guaranteed budget and set timetable. The first phase constitutes a \$5bn (£3.3bn) project aimed to be completed by 2020. The second phase is the implementation of projects estimated at \$4bn.

Globilisation of the project finance market

In recent years we have witnessed an increasing involvement of offshore banks in project finance transactions in Israel.

Traditionally, Israeli banks lead-arranged almost all of the transaction and the debt was syndicated locally. However, with the advent of the water, power and natural gas projects, an increasing number of offshore lenders, including European and US commercial banks, have taken leading roles in structuring and financing projects. In the other direction, 2012 saw encouraging signs of Israeli companies starting to compete in energy and infrastructure projects in international markets. Particularly, transportation, water desalination and water treatment projects in North America, South America and Sub-Saharan Africa; and renewable energy projects in Eastern Europe and Africa. Both trends are expected to continue in 2013.

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