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Debt Capital Markets Update: Recent Trends and Developments

November 29, 2017

Agenda

- Green Bonds: Financing power, utilities and infrastructure
- Investment Grade: Developments in the hybrid bond market
- High Yield: Recent trends and opportunities in the energy sector
- US private placements and developments with “make-wholes”

Green Bonds: Financing power, utilities and infrastructure

Presented By: Bill Gilliland

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Overview

- Deal example
- What makes a bond a "Green Bond"
- Pricing impact
- Other reasons to issue green bonds
- Dentons – first law firm to participate in Green Bond Principles
  - Legal advisory board participation for Climate Bond Initiative
  - Completed green bond deals
  - Relationships with market observers and verifiers to facilitate deals

Southern Power Company Green Bond offering (2015)

- US$1 billion green bond offering ($500 million 10 year / $500 million 2 year)
- Have completed two more green bond offerings since
- North American power producer
- Mixed generation fleet – i.e. green (wind/solar) and fossil fuel (coal)
- Eligible Green Projects include financing of, or investments in, solar and wind power generation facilities located in the United States
- Short term use of proceeds to pay down bank indebtedness
- Reporting on webpage:
  - An assertion by management that the net proceeds were allocated to qualifying Eligible Green Projects
  - An attestation report from an independent accountant in respect of the independent accountant's examination of management's assertion conducted in accordance with attestation standards established by the American Institute of Certified public Accountants

Power and utility Green Bond issuers (sample)

- GDF Suez (multiple deals)
- NRG Yield (multiple deals)
- Abengoa (multiple deals)
- Electricite de France (EDF) (multiple deals)
- Terraform Power (multiple deals)
- Vestas
- Goldwind
- Southern Power Company (two deals)
- Georgia Power
- Canadian Solar
- MidAmerican Energy
- Pattern Energy
- Brookfield Renewable
- China Three Gorges

What makes a bond a Green Bond?

Green Bond Definition:

Green Bonds are any type of bond instrument where the proceeds will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible Green Bond Projects and which are aligned with the four core components of the Green Bond Principles.

Green Bond Principles

- Organized by International Capital Markets Association (ICMA)
- Members of Green Bond Principles:
  - Bank of America Merrill Lynch
  - BMO Capital Markets
  - CIBC World Markets
  - JP Morgan Chase & Co.
  - National Bank Financial
  - RBC
  - Scotiabank
  - TD Bank
  - Wells Fargo Bank
  - Dentons Canada – first law firm to participate

Green Bond Principles (continued)

- Voluntary Process Guidelines developed by ICMA
- Four core components:
  1. Use of Proceeds
  2. Process for Project Evaluation and Selection
  3. Management of Proceeds
  4. Reporting

Green Bond Principles (continued)

- Selected indicative use of proceeds:
  - Renewable energy (including production, transmission, appliances and products)
  - Energy efficiency (such as in new and refurbished buildings, energy storage, district heating, smart grids, appliances and products)
  - Clean transportation (such as electric, hybrid, public, rail, non-motorized, multi-modal transportation, infrastructure for clean energy vehicles and reduction of harmful emissions)
  - Green buildings which meet regional, national or internationally recognized standards or certifications

Green Bonds

- "Green" components are outside bond documentation
  - Use of proceeds
  - Website/public disclosure of business
  - Social responsibility disclosure
  - Reporting
- Offering representations regarding use of proceeds and reporting

Canadian labelled Green Bond issuers

- TD Bank (2014 and 2017)
- EDC
- Province of Ontario (two issues)
- City of Ottawa
- Brookfield Renewable (2017 US project bond)
- Province of Quebec
- BC P3 Hospital Project
- Vancouver energy efficient office tower*
- Manulife

**Dentons acted as underwriters counsel*

Pricing advantage?

Climate Bond Initiative and IFC Study (Q2 2017)

- USD denominated green bonds price on average 15.4bps tighter than IPT

  This is tighter than vanilla bonds issued during the same period. EUR denominated green bonds price on average 6.3bps tighter than IPT, average for vanilla equivalents is 9.4bps

- 54% of green bonds were sold to green investors

  This was 62% for bonds originating from Developed Markets, and 25% for bonds originating from Emerging Markets

- EUR green bonds achieve slightly bigger order books (2.3 times covered) than a comparable vanilla sample (2.2 times covered)

  USD green bonds achieve the same sized order books (2.8 times cover) as vanilla equivalents

- All 5 EUR corporate green bonds perform well on all metrics

  Spreads tighten more than baskets of comparable vanilla bonds after both 7 and 28 days, and spreads tighten more than indices after both 7 and 28 days

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Why issue Green Bonds?

- Attract new investors
- Diversify investor base
- Expand “Green” brand to capital markets operation
- Marketing tool to highlight a strategic shift to green to investors
- Maintain pricing as defensive measure in sectors facing environmental challenges
- Differentiate renewal power play issuers
- Green attributes – slight competitive advantage most investors will choose
- Driving management improvement, a green “rating”, operating efficiencies, reducing contingent liabilities

Investment Grade: Developments in the hybrid bond market

Presented By: Toby Allan

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Hybrid bond structures

- Renewed interest in hybrid debt structures for Canadian corporate issuers
- Recent offerings by Enbridge Inc. (September/October 2017),* TransCanada Trust (May 2017) and Emera Incorporated (June 2016)
- May be attractive financing option for corporations with a regular need for capital or need to finance a significant acquisition or project and seeking to maintain their investment grade credit rating

** Dentons acted as underwriters counsel*

Key benefits

- Qualify for partial equity credit from rating agencies
  - Helps maintain investment grade rating
- Treated as debt for Canadian income tax purposes
  - Interest payments are deductible by the issuer for tax purposes
- Cost-effective means of raising capital
  - After tax cost of capital generally less than aggregate cost of issuing same amount of 50% debt and 50% equity

Key features

- Long maturity (60 years), but redeemable at par after 10 years
  - Redemption feature results in rate being closer to a 10 year rather than 60 year yield
- Earlier redemption permitted following certain tax or rating events
  - Change to amount of equity credit assigned by rating agencies or interest not being deductible for tax purposes
- Fixed interest rate for the first 10 years, which converts to a floating rate determined quarterly thereafter with an interest rate step-up in year 30
- Interest deferral right
  - Issuer may elect to defer interest for up to five consecutive years
  - Issuer undertakes not to pay dividends on equity or parity notes when interest is not being paid on the hybrid notes

Key features (continued)

- Automatic conversion of hybrid debt into preferred shares upon bankruptcy or insolvency events
- No financial covenants
- Events of default limited to failure to pay interest or principal when due
- Subordinated to senior indebtedness

High Yield: Recent trends and opportunities in the energy sector

Presented By: Dan Shea

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Recent trends and opportunities

- Year-to-date activity in the energy sector has rebounded from the lows seen in 2016
  - At least a dozen energy and energy-related deals have cleared the Canadian and US high yield markets year-to-date (compared to three in 2016)
  - First issuance in the Canadian high yield market by an E&P issuer (Crew Energy) since 2014*
  - Activity has occurred in several windows throughout the year, with transactions generally being well-received and oversubscribed
- Canadian market has shown increased receptivity to larger transactions
  - For *e.g.*, 2017 has produced the largest-ever tranche for a C$ high yield bond (Gibson Energy's $600 million of 5.25% 7-year non-call 3 bonds) along with a $500 million offering by Parkland Fuel (5.625% 8-year non-call 3 bonds)*
- Issuances throughout 2017 have been dominated by well-known and repeat issuers capitalizing on attractive spreads to achieve refinancings and to fund acquisitions

**Dentons acted as underwriters counsel*

Recent trends and opportunities (continued)

- With repeat issuers dominating new issuances throughout 2017, covenant patterns generally remained static, with right-sizing of baskets and some movement towards increased flexibility for certain issuers
  - Issuers continued to roll-forward dividend paying capacity from refinanced and/or previously issued bonds – but some traps for the weary exist in the details!
  - Select examples of covenant relaxation for certain issuers (and without bondholder push-back)
  - Conditional call features
- Improving commodity prices/outlook provide a favourable backdrop for additional issuances heading into 2018 (and potentially prior to year-end)
- Energy sector continues to be a key driver of the Canadian high yield market
- Although many E&P issuers continue to access the US$ market, we continue to see no meaningful benefits in the covenant patterns obtained in the US$ market

Recent trends and opportunities (continued)

- Canadian high yield market continues to be a compelling option for non-investment grade issuers
  - More flexible and incurrence-based covenant patterns compared to other common sources of debt capital to the energy sector, including US private placement notes (which use maintenance-based financial covenants) – i.e. cannot “fall-out” of compliance with high yield covenants
  - Broad flexibility for dividend paying issuers to maintain/grow dividend programs
  - Significant operational flexibility for E&P issuers to engage in all investment structures (including joint ventures) that are customary in the industry
  - Market can accommodate a broad range of uses of proceeds including refinancings, growth capital and acquisition financing, and transactions as small as $75 million
  - Longer-term (five to eight year) capital compared to bank debt
  - Bullet maturities with no amortizing payments and fixed interest rates (allowing issuers to capitalize on the current historic interest rate environment)
  - Generally unsecured or second lien, while permitting a specified amount of first lien debt that can grow over time if financial condition improves
  - Compared to US$ offerings, avoids currency risks and swap costs, and involves a less onerous offering process and disclosure requirements

US private placements and developments with “make-wholes”

Presented By: Bill Jenkins

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US private placements

- US private placement note market continues to be a popular source of debt financing for Calgary-based issuers
- Investors are typically insurance companies and endowments funds, some pension funds
- Issuer selects placement agent
- Requires an NAIC rating (typically easier to obtain than an S&P or Moody's rating, and not monitored as actively)
- Documented using one of the Model Forms of Note Purchase Agreement developed by the American College of Investment Counsel (no trust indenture)
- Covenants similar to bank market credit agreements (*e.g.* maintenance financial ratio covenants) but longer term debt, often five to seven years

US private placements (continued)

- Exiting these arrangements can be expensive:
  - Prepayment attracts “make-whole” premium similar to Canada Yield Price for Canadian public debt, calculated using a spread of 50 bps over treasuries
  - If issued in Canadian dollars, issuer will typically also have to pay swap breakage costs
- Can be problematic where issuer can no longer maintain covenants as drafting is typically clear that a make-whole is payable on default / acceleration

Developments with "make-wholes"

- Typical wording – *"Upon acceleration, the aggregate principal amount of, [premium, if any,] and accrued and unpaid interest on, the outstanding Notes shall become immediately due and payable…"*
- *Cash America* decision
- Subsequent market responses in the United States
- Bondholder association positions
  - Updated model covenants from the Canadian Bond Investors' Association
- Select Canadian issues relating to make-wholes and impacts of *Cash America*
  - Penalty
  - Secured by land
  - Bankruptcy

Thank you

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