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Project Finance 2021

China: Trends & Developments
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Trends and Developments

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Overview

Infrastructure and fixed-asset investments have been a vital force to drive the Chinese economy during the past several decades. The impact of COVID-19 on the global economy is material, but the year of 2020 still saw a 2.9% growth rate in terms of fixed-asset investments in China. Interestingly, classic non-recourse or limited-recourse project finance models were not widely accepted by Chinese banks, notwithstanding the huge amount of financing raised for projects every year in China.

Chinese banks have traditionally placed more weight on the credit strength of the borrower (as the primary source of repayment) and the guarantor (a role normally taken by the parent company of the borrower, as the secondary source of repayment), supported by collaterals, among which the land-use right and buildings thereon are the most important in terms of credit assessment. Looking purely at the cash-flow to be generated by the project and the project assets to discharge the debts, even supported by a limited scope of guarantee provided by the sponsor during the construction stage, most Chinese banks still feel unease. As a result, the trend of project finance in China over the past few years has been a gradual acceptance of project financing rationale and techniques, accompanied by their application in selected sectors.

PPP Projects

One key area of application is the public-private partnership (PPP) model. The PPP is the main trend in the project finance market in China. Based on the data disclosed by the National Development and Reform Commission of the PRC (NDRC), up to 20 September 2021, there are

7,734 PPP projects in place, with a total investment amount of RMB10.87 trillion, as approved by or filed with the NDRC, with the top six sectors listed as urban infrastructures, agriculture, forestry and water conservancy, social utilities, transportation, and environmental protections.

During the past several years, the policy trend was to control and clean up unwarranted PPP projects with the aim of controlling the government-implicit debt risk. A major tool was to make the PPP rules more transparent and the PPP documentation more standardised. As a result, with the increasingly standard degree of PPP projects' rules and documentation, sponsors and project companies have focused more on project quality and project management. This also helps expand the base of participants in this market. For example, Chinese social security funds, insurance funds and other public funds, which have been allowed by the regulators to access the PPP market, have been seen to play an increasingly notable role in providing long-term funding to PPP projects in exchange for stable, predictable cash-flow in the long run. The financing takes the forms of debt, equity investment, and other ways. Compared to traditional bank loans, using more sophisticated and complex financial and legal instruments to finance large-scale PPP projects (especially those that are infrastructure-based) will become more popular in the near future.

The following are a few eye-catching project finance deals in the PPP sector completed during recent years:

- the Jinyidong Urban Rail Transit Project in 2018, an RMB20.7 billion syndicated facility,

which was voted the “Best Deal of 2018” by the China Banking Association;

- the issuance of green asset-backed securities (ABS), backed by subway fare-collection rights, by Guangzhou Metro Group in 2019, the first deal of asset-backed securities backed by subway fare-collection rights, amounting to RMB3.158 billion;
- the Shenghong 16 million tonnes per annum integrated refining and chemical project in 2020, an RMB41.5 billion syndication facility, which was listed as a major construction project in the “Petrochemical Industry Planning and Layout Programme” issued by the State Council of the PRC.

Green Finance

In the past two or three years, the rise of green finance as a key part of the project finance market in China has been witnessed. China has an initiative for carbon dioxide emissions to reach a peak before 2030 and to achieve carbon neutrality by 2060. With this initiative, the Chinese regulatory authorities have formed the five pillars of green finance.

- The establishment of a green financial standard system is being accelerated. The standards focus on climate change, pollution control and energy conservation and emission reduction, based on the comparative study of China-EU green finance standards.
- It is envisaged that the requirements for the information disclosure of financial institutions, securities’ issuers, and public sectors will be set in relation to environmental information.
- Through policies such as green financial performance evaluation and interest subsidies, the authorities guide the financial institutions to increase green-asset allocation and improve their environmental risk management.
- Green financial products and markets continue to be more comprehensive. As of the

end of 2020, the balance of green loans reached nearly RMB12 trillion, as the largest stock in the world; the aggregate balance of green bonds was RMB813.2 billion, ranking second in the world. The non-performing loan (NPL) rate of green loans was far lower than that of commercial banks across the country. In addition, there is no default under green bonds to date.

- International co-operation in green finance is deepening. The entities actively use various multi-lateral and bilateral platforms and co-operation mechanisms to promote international exchanges on green finance, and to increase the international community’s recognition and participation in China’s green finance policies, standards, products, and markets.

In general, the PRC’s green projects credit is showing the characteristics of “large scale, excellent structure and high quality”. The balance of green loans has ranked first in the world for many years, and the balance of the clean energy industry at the end of 2020 exceeded RMB3 trillion for the first time, which has exceeded the total amount of loans in the three main energy-intensive fields of steel, coal, and non-ferrous metals in the same period. The green loan NPL ratio was 1.6 percentage points lower than the banking industry’s NPL ratio and remained below 0.5% for three consecutive quarters.

The Chinese central bank, the People’s Bank of China (PBOC) performs green credit-performance evaluations on banks on a quarterly basis, and the evaluation results are used in the central bank’s internal rating. From 1 July 2021, the PBOC has applied the “Green Financial Performance Evaluation Programme for Banking Depository Financial Institutions” to evaluate financial institutions’ green loans, green bonds and other businesses comprehensively and to expand the use of the relevant standards. For

example, when creating monetary policy support tools in the future, green financial performance evaluation results can be used as one benchmark.

For green financing projects, future developments in the following regards have been observed.

- Banking institutions will increase the tilt of internal resources such as green credit lines. Most banks will put forward goals for increasing the scale and proportion of green credit, and for some banks, even a goal of doubling them in five years.
- The government authorities will improve external policy incentives, explore the use of policy measures such as re-lending, fiscal interest discounts, guarantee mechanisms, and risk compensation to encourage financial institutions to develop green credit. For example, Guangzhou City provides a subsidy of 1% of the loan amount to companies that have obtained green loans, and a 20% compensation for the bank's green loan losses.
- Banks will promote innovative green credit products and services, such as project financing products on pollution-emission rights, carbon-emission rights, energy-use rights and other green rights and pledge-loan businesses, and will also provide professional financing services for entities participating in carbon emissions' trading.
- The communication and co-ordination among key green and low-carbon industry authorities will be strengthened. The NDRC and the PBOC may issue relevant policies jointly to encourage financial institutions to provide financial support for key green areas such as photovoltaic glass production projects, wind-power projects and solar power-generation projects.

Green Bonds

Chinese banks have also been issuing green bonds to finance green projects.

In 2015, the PBOC issued an announcement to clarify the definition standards and issuance process of green financial bonds, as well as the "Green Bond Support Project Directory", which was widely applauded by international organisations.

China's green-bond issuers now include various banking institutions and other entities, and a diversified socially responsible investment group with environmental, social, and governance (ESG) concepts has been formed. Green-bond products have covered multiple varieties such as financial bonds, debt financing instruments, enterprise bonds, and corporate bonds.

Overall, China's green bonds have achieved remarkable results. First, the issuance scale is relatively large. As of the end of 2020, the cumulative issuance of green bonds was about RMB1.2 trillion, second only to the United States and second in the world. The second factor is the long tenor of green bonds issued in the Chinese market. About 90% of the tenor of green bonds in China is over three years. The third is the significant effect of supporting environmental improvement. According to preliminary estimates, the projects funded by green bonds can save about 50 million tons of standard coal each year, equivalent to reducing carbon dioxide emissions by more than 100 million tons.

Green Financing Projects under the "Belt and Road Initiative"

Chinese financial institutions and investors are key to the financing and investment activities under the "Belt and Road Initiative" (BRI). The BRI countries have witnessed a rapid development of green financing projects, not only participated in by Chinese banks and investors but

also attracting international and local participants to join the initiative.

Chinese financial institutions have strengthened their support for green projects in the BRI countries through diversified channels such as loans, equity, and debt, including wind power, photovoltaic, solar power and other projects. They also work together with international development agencies to launch some green project co-operation programmes under the BRI.

For example, in 2019, the Industrial and Commercial Bank of China took the lead in the European Bank for Reconstruction and Development and other members of the BRI inter-bank normalisation co-operation mechanism, and jointly released the BRI Green Finance Index to help various investors quantitatively analyse the investment in this area. Green investment opportunities and environmental challenges have led to the flow of funds to the green field, too.

Furthermore, China has carried out the “Belt and Road” green-finance capacity-building through multiple channels to enhance the capacity of countries along the route to develop green finance. For example, the “China-IMF Capacity Building Centre”, jointly established by the PBOC and the International Monetary Fund (IMF), has provided relevant training for many countries along the route. The PBOC and the European Bank for Reconstruction and Development signed a memorandum of understanding in 2019 to strengthen capacity-building.

In short, the BRI green financing project represents a new trend of Chinese financial institutions and investors to access the project finance market, not only in China but also across the BRI countries. They are now playing a role beyond that of a funding partner, by sharing the experience, know-how and expertise gained from the financing of projects in China with the pool of global participants and aiming to build a better world to benefit the BRI countries and peoples.

CHINA TRENDS AND DEVELOPMENTS

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Global Law Office (GLO) dates back to the establishment of the Legal Consultant Office of China Council for the Promotion of International Trade (CCPIT) in 1979, when it became the first law firm in China to take an international perspective on its business, fully embracing the outside world. With more than 500 lawyers practising in the Beijing, Shanghai, Shenzhen and Chengdu offices, the firm is now considered to be one of the leading Chinese law firms which continue to set the pace as the PRC's most innovative and progressive legal practitioners. The project financing team has extensive experience,

providing wide-ranging services. Since the provision of legal services for the first power plant project and the first nuclear power plant project that successfully obtained overseas financing in China, GLO has been providing legal services for many significant infrastructure projects across China, including power plants, water plants, refineries, expressways, mines, ports, as well as modern agriculture, clean energy, new materials, energy conservation and environmental protection, transportation, urban construction, and township planning.

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