Chambers
Global Practice Guides

Definitive global law guides offering
comparative analysis from top-ranked lawyers

Project Finance 2021

Portugal: Trends & Developments

Inês Pinto da Costa and Pedro Gaspar da Silva
PLMJ

practiceguides.chambers.com

Trends and Developments

Contributed by:
Inês Pinto da Costa and Pedro Gaspar da Silva
PLMJ ***see p.6***

The Portuguese Economy at a Glance

The COVID-19 pandemic hit economies across the world, and the Portuguese economy was no exception, with GDP decreasing by 7.6% in 2020.

Nonetheless, the Portuguese Public Finance Council anticipates a recovery in the real growth of the Portuguese economy to 4.7% in 2021 and 5.1% in 2022.

This outlook assumes that the COVID-19 pandemic will have a less severe economic impact in 2021 and 2022, based on the positive developments of the vaccination campaign in Portugal (which has one of the highest vaccination rates in the world), the decrease in infection rates and the ongoing reduction of restrictive measures on economic activity. It is also based on the initial effects of the implementation of the approved Recovery and Resilience Plan (RRP), which is expected to have an annual implementation close to EUR3 billion by the end of 2026.

The current scenario anticipates that private consumption growth will recover to 4.5% in 2021. This is principally a reflection of the increase in consumption (which was subdued during the pandemic crisis) and the inherent decrease in savings – as a result of the vaccination campaign against COVID-19 and the lifting of containment measures – and favourable prospects in the labour market. In 2022, private consumption is expected to resume to pre-pandemic levels, with growth of approximately 4.1%.

The above estimates foresee the recovery of the Portuguese economy to the pre-pandemic GDP level by early 2022. The gradual recovery of economic activity in 2021 and 2022 should translate into an improvement in labour market indicators, with an increase in employment of approximately 1.5% and 1.3%, respectively. The unemployment rate should increase to 7.3% in 2021 but will face a downward trajectory as soon as 2022. In the following years, the pace of employment growth should gradually decelerate to 0.3% in 2025, allowing a stabilisation of the unemployment rate at around 6.4%.

Nonetheless, Portugal's significant public and private debt continues to be one of the main macroeconomic risks to be monitored and tackled. A delay in the economy's recovery may increase the risk of insolvencies in the business sector and consequently lead to an increase in unemployment and a decrease in household income. Added to their historically high indebtedness, this increases the risk of non-performing loans, particularly when the loan moratorium granted in the first half of 2020 comes to an end (this is expected to occur in the fourth quarter of 2021). The high level of indebtedness of companies, households and the government may affect the current favourable financing conditions of the Portuguese economy.

The Portuguese Project Finance Ecosystem

In Portugal, project finance is typically put in place for the construction and operation of long-term financing for capital-intensive projects, either public (public-private partnerships – PPPs) or private (private finance initiatives – PFIs).

The following projects are usually covered by these types of arrangement:

- infrastructure – eg, roads, rail, ports and airports;
- energy – eg, renewables;
- social – eg, health and universities;
- water and sanitation; and
- technology – eg, data centres, 5G and surveillance.

There are no specific rules governing PFIs, other than the general rule of law. However, aside from any regulatory framework that needs to be complied with, general public partnerships are governed by Decree-Law 111/2012 of 23 May, setting out the rules applicable to the intervention of the State, the definition, design and preparation, tender procedures, supervision and amendments to the partnerships.

The PPP Technical Support Unit (*Unidade Técnica de Acompanhamento de Projetos* – UTAP) is the public body responsible for supervising PPPs in five sectors of activity: roads, rail, airports, health and safety.

According to UTAP, the road sector (ie, road infrastructure concessions) contains the most partnerships (21 out of 33), accumulated investment (91%) and net charges (67%). This demonstrates the political appetite in the PPP model to leverage the expansion of the National Road Network (RRN), particularly the National Highway Network (RNA) in the 1990s and 2000s (as no new road PPPs have been launched since 2009).

Most road concession and sub-concession contracts awarded are valid for 30 years, ending between 2028 and 2040.

Apart from the road sector, the last 20 years have seen an increase in new foreign PFIs, particularly in the renewable energy sector (solar and wind projects). The promotion of energy transition by supporting renewable energy has been a strategic goal of Portugal, particularly in electricity. Portugal currently has the fifth highest level of incorporation of renewables in electricity in the EU. Most wind projects developed in Portugal were operated under the feed-in tariff regime, which allowed banks to make the necessary credit risk assessment and provide project financing to those projects (based on the wind forecast).

The Portuguese project finance ecosystem has also witnessed the following:

- the renegotiation of the terms and conditions of project finance transactions (such as the PPP Litoral Centro road concession and the PPP Beira Interior road concession);
- M&A transactions regarding ongoing projects, with sponsors selling their stakes in project companies that own fully operational facilities (mainly in the renewable energy sector, but there is also a growing trend in the motorway concession sector); and
- a shift in the original lenders' positions, with banks reducing their exposure to these projects and investment funds taking over ongoing projects (especially if non-performing).

COVID-19 Temporary Measures: Impact on Project Finance Transactions

The COVID-19 pandemic also had an impact on project finance transactions in Portugal, particularly in the road sector, where the extraordinary measures adopted by the public authorities (notably, curfews and lockdowns) led to a 23% reduction in average daily traffic (ADT) between January and September 2020 compared with the same period in the previous year. The sharpest reduction occurred between March and June (-43%), with April registering the largest drop (-67%).

Therefore, it was no surprise to see a decline in new deals and an increase in the number of contractors declaring force majeure events, particularly PPPs in the road sector.

The Portuguese government adopted several measures in response to the COVID-19 pandemic, with the following being regarded as having impacted ongoing projects.

- Loan moratorium: a legal moratorium was approved and covered all types of lending transactions (including project finance transactions) entered into between regulated entities in Portugal and borrowers domiciled in Portugal. The moratorium could be applicable to principal and interest or just to principal payments, at the option of the borrower. It allowed borrowers to benefit, for a certain period of time, from:
  (a) a suspension of payment obligations for principal;
  (b) a prohibition on total or partial termination; and
  (c) an automatic extension of any security associated with loans subject to a moratorium. Interest would continue to accrue and would be capitalised.
- Financial rebalance: under a PPP, the private partner is granted the right – by operation of law or contract – to demand from the public party the financial rebalancing of the concession, under certain conditions. However, the Portuguese government enacted a special temporary legal framework pursuant to which the private parties:
  (a) were not entitled to financial rebalancing of the concession for the period between April and May 2020;
  (b) would only be granted an extension of the concession term for events after 3 May 2020 (obviously, provided that other financial rebalancing conditions were met); and
  (c) could not assert any non-contractual liability against the Portuguese state.

Project Finance Prospects

The European Union has already identified the need for suitable planning to address infrastructure bottlenecks in the coming years. In Portugal, the investment focus would be on port services and port connections to the interior by rail (and/or inland waterways), and on rail corridors and rail freight transport. However, those investments would not be the only ones.

The digital transition leveraged by the COVID-19 pandemic and the greater awareness among investors of Environmental, Social and Governance (ESG) matters will open up new opportunities not only in the technology sector, but also in the energy sector (solar, wind and hydrogen), sustainable mobility and public transportation.

Considering that Portugal has made a commitment to being carbon neutral by 2050, the RRP also highlighted the need for energy transition through supporting renewable energies, particularly hydrogen and other renewable gases, with investments amounting to EUR185 million.

By way of example, early this year, an investment of up to EUR3.5 billion was announced to create one of the largest data processing centres in Europe, with a usable capacity of 450 MW. The capacity to generate renewable energy at competitive costs in Portugal, and specifically in Sines, was a decisive factor in the choice of the site by the sponsors of the project, as 100% sustainable energy supply is an absolute requirement for success in this type of project.

More recently, another project was granted a licence to build a pilot wave energy project in Porto and connect it to the grid, with a limit of 1 MW.

Lastly, there are great expectations in respect of several hydrogen projects that have been announced or are expected to start being developed in the next few years.

In summary, even though project finance in Portugal may be facing some challenges, the fact is that its outlook is bright, as we identify a set of different activities that will be able to be developed or implemented through this financing scheme.

PLMJ is a law firm based in Portugal that combines a full service with bespoke legal craftsmanship. For more than 50 years, the firm has taken an innovative and creative approach to producing tailor-made solutions to effectively defend clients' interests. The firm supports its clients in all areas of the law, often with multidisciplinary teams, and always acting as a business partner in the most strategic decision-making processes. With the aim of being close to its clients, the firm created PLMJ Colab, its collaborative network of law firms spread across Portugal and other countries with which it has cultural and strategic ties. PLMJ Colab makes the best use of resources and provides a concerted response to the international challenges of its clients, wherever they are. International collaboration is ensured through firms specialising in the legal systems and local cultures of Angola, China/Macau, Guinea-Bissau, Mozambique, São Tome and Príncipe and Timor-Leste.

AUTHORS

Inês Pinto da Costa is a partner in the Corporate M&A practice at PLMJ, and also works in projects and infrastructures. She has more than 15 years' experience in project finance, M&A and private equity operations. Her work includes projects in the areas of infrastructure, energy, PPPs and the development of projects for industrial plants in Portugal and in Portuguese-speaking African countries. In recent years, she has been very active in the Angolan market, dealing with questions of financing as well as all other project documentation. Inês completed postgraduate courses in securities law and international trade law at the Faculty of Law of the University of Lisbon. She also has an executive master's in management for lawyers from Universidade Católica Portuguesa.

Pedro Gaspar da Silva is a senior associate in the Corporate M&A practice at PLMJ. He has ten years' experience of working in M&A, private equity (both investment and divestment operations) and financing matters (including in several project finance deals). Pedro provides regular advice to Portuguese and international clients from a wide variety of sectors. He has a master's in law and management from the Faculty of Law of Universidade Católica Portuguesa and the Católica Lisbon School of Business & Economics. He also completed a postgraduate course in securities law at the Securities Institute of the Faculty of Law of the University of Lisbon and an intensive course in the restructuring and recovery of companies at the Faculty of Law of Universidade Católica Portuguesa.

PLMJ

Av. Fontes Pereira de Melo, 43
1050-119
Lisbon
Portugal

Tel: +351 213 197 300
Fax: +351 213 197 400
Email: plmjlaw@plmj.pt
Web: www.plmj.com/en/