PROJECT FINANCE

Israel

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SECTION 1: Market overview

1.1 Please provide an overview of the project finance market in your jurisdiction.

Project financing is a well-established finance scheme in Israel, widely implemented in the last 15-20 years. It is used for debt financing in a variety of sectors, particularly where public private partnership (PPP) projects are involved.

Water desalination, electricity, transportation (including heavy rail, LRT, ports and toll roads), are among the sectors where project finance is used, as well as in large-scale security related projects (for example, the IDF training base and the Israel Police training base) and residential projects (for example, student dormitories and long-term lease projects).

Project finance debt transactions are structured according to international standards, including customary security packages and agreements (senior debt agreements, common terms agreements, equity subscription deeds, intercreditor agreements, direct agreements with all major project parties, etc.).

1.2 What is the composition of the market in terms of the types of active lending institutions and has this been evolving?

While almost all Israeli banks and financial institutions are involved in project finance, the two largest banks – Bank Hapolaim and Bank Leumi – are the main arrangers of credit consortiums. Foreign financial institutions such as Deutsche Bank, the European Investment Bank, HSBC and others also play a role in the Israeli project finance market.

In recent years, it has become more common for non-bank financial institutions (for example, insurance companies and pension funds) to provide finance under project finance schemes without the involvement of banks as arrangers. This is done to avoid additional costs and to gain better control of projects.

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Gilad Winkler is a partner in FBC's corporate practice and co-head of its project finance, energy & infrastructure practice, which is one of the leading in Israel andadvises many of the world's most prominent companies in Israel's most significant projects and energy matters, totalling billions of dollars. The practice is ranked Tier 1 by the Israeli ranking guides, Dun's 100 and BDI Code.

With over 17 years of experience, Winkler has been involved in many of the highest profile and largest transactions in the Israeli market and has represented leading Israeli and multinational companies in a wide range of industries and sectors.

Winkler has been involved in many large-scale infrastructure and energy projects in Israel and abroad such as the Tel-Aviv Light Rail project and the Gilboa Pumped Storage Power Plant, as well as various other energy projects using renewable energy technologies and gas infrastructure. In addition to Israel, Winkler's representations in the project finance, infrastructure and energy fields have included projects in the UK, Kazakhstan, South Africa, Zambia, Zimbabwe and Nigeria.

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With over 10 years of experience both in corporate matters concerning project finance, infrastructure and energy, and in litigation proceedings in connection therewith, Horowitz offers in-depth knowledge of these fields. She represents a variety of participants in the project finance, infrastructure and energy fields, including, inter alia, financial institutions and banks, infrastructure and energy-specialised private equity funds, world-leading construction groups and governmental authorities, and major privately-owned business groups.

1.3 Please describe any major current projects or initiatives that are influencing activity.

On September 3 2017, the Israeli Government published for the first time a multi-year plan specifying 147 infrastructure projects, each having an estimated cost of at least ILS100 million ($30 million), which various offices of the government intend to pursue between 2017 and 2021, having a total value of ILS116 billion. The plan states that a majority of the projects described therein were already approved by the government or the applicable authority. The majority of these projects are in the transportation sector and include large-scale PPP projects such as the Tel Aviv Light Rail Green Line (ILS20 billion) and the Purple Line (ILS8.6 billion), the Jerusalem Light Rail Green Line (ILS8.5 billion), Fast Lanes for Road 2 and for Road 20, and the new Road 16 to Jerusalem.

In the energy sector, in December 2017, principles of a major reform initiative were agreed between the government and the Israel Electric Corporation (IEC). These include the sale of six power plants with a total capacity of about 2,000 MW to private investors and a green light for the IEC to develop two more gas based power plants in coming years. In the PV sector, there is a PPP project for the manufacturing of up to 500 MW, alongside other quotas available in the field of renewable energy (see Section 3.3).

SECTION 2: Transaction structures

2.1 Please review some recent notable transactions involving your market and outline any interesting aspects in their structures.

Financial close of many PFI projects initiated by the government in the last two years has taken place in 2017 (including two new large-scale governmental office complexes in Jerusalem). In the energy field, the second pumped storage power plant (300 MW) has secured finance under a project finance scheme. In addition, the two largest PV power plants in Israel (120 MW and 60 MW) have each secured the financing required for their execution. The first hospital in Israel implemented under a PPP framework commenced its commercial operation. Additional medium-scale renewable energy projects, residential PPP projects and conventional power plant projects also secured finance in the past year.

Over the last decade, the volume of credit provided by financial institutions has constantly increased as a result of major governmental led structural reforms in the financial sector. In addition, as provided above, such institutions have increased their direct involvement in credit arrangement and management.

2.2 What might the projects above mean for the market and have you noted other noteworthy developments in the way project finance transactions are being structured for a) energy projects and b) infrastructure development?

The projects described above were structured according to common practice principles applicable to the project finance scheme. Differences appear in the interface with the applicable governmental authority. In certain projects, a custom made set of arrangements was applied to secure the senior lenders' rights (in terms of securities package and step-in rights) and the financial robustness of the project.

In addition, the growing interest of banks and financial institutions in PPP projects, as demonstrated in the financing provided in various fields of infrastructure and energy in the past year, is a vote of confidence in the energy and infrastructure fields in Israel and the prospective revenues they will generate in the lifetime of such projects.

SECTION 3: Legislation and policy

3.1 Describe the key legislation and regulatory bodies that govern project financing in your jurisdiction.

Legislation: Project finance is not governed by a specific legal framework, but rather regulated under the general legislation applicable to the finance sector in Israel. The banking sector is regulated under the Banking Ordinance of 1941, the Banking (Licensing) Law of 1981, and the Banking (Service to Customers) Law of 1981. In addition, the banking supervision department of the Bank of Israel issues its Proper Conduct of Banking Business Directives, which further regulate various aspects of banking in Israel (including with respect to foreign banks operating in Israel). The key legislation applicable to other financial institutions (insurance companies, pension funds, etc.) is comprised of the Control of Financial Services (Insurance) Law of 1981 and Control of Financial Services (Provident Funds) Law of 2005, and the regulations promulgated thereunder.

Regulatory Bodies: The key applicable regulatory bodies in the finance sector are: the Commissioner of Capital Markets, Insurance and Savings at the Ministry of Finance, which is charged with responsibility to regulate the insurance sector, participants in the capital markets and pension funds; and the Banking Supervision Department of the Bank of Israel, which regulates the banking sector in Israel.

In the energy sector, the Israeli Electricity Authority plays a major role by issuing rules governing the electricity sector and establishing the legal framework for the implementation of energy projects and by its authority to issue licences that are required for the construction of power plants and the generation of electricity.

In the infrastructure sector, no single regulatory authority plays a dominant role. However, the Ministry of Finance (the Accountant General), the Ministry of National Infrastructure, Energy and Water, and the Ministry of Defence all play significant roles in planning future projects, publishing tenders for the implementation of projects, and managing projects under their responsibility.

3.2 Have there been any recent changes to regulations or regulators that may impact the finance structuring in terms of guarantee and security regimes, local currency rules and foreign investment restrictions?

Under Israeli law, save for anti-terrorism legislation and money laundering prevention legislation, there are no restrictions on foreign investments or foreign currency exchange control on inward or outward investment. No material changes in applicable law regarding finance structuring in terms of guarantee and security regimes were introduced in the last year.

3.3 Please describe the regime governing renewable energy investment.

The Israeli electricity sector is governed by the Electricity Sector Law of 1996 (ESL) and the regulations thereunder. In addition, and under the powers vested in it under the ESL, the Israeli Electricity Authority plays a major role in the electricity sector mainly by issuing rules that establish the legal framework in the sector. As for renewable energy, the goal set in July 2009 by the Israeli Government of a 10% share for renewable energy sources by 2020 has yet to be achieved. Accordingly, the EA has set additional quotas for PV, wind and Waste-to-Energy power plants with a total capacity of about 3,000 MW.

The award of such quotas is ongoing under different legal regimes, which span provisional licences (including mandatory milestones in the development of the applicable project), tariff based tenders, tenders for the implementation of PV projects under BOT scheme and a feed-in tariff regime. In each case, under the ESL, with respect to any power plant (with a capacity of over 5 MW), a production licence is required. Under such licence, the production of electricity is generally permitted for a period of 20 years or more.

3.4 Does your jurisdiction have incentive schemes in place for various types of energy or infrastructure project development?

In general, a tax incentive scheme in the form of increased depreciation rates is applicable to infrastructure and energy projects, according to the specific sub-field of project. In addition, in certain PPP projects, specific ad-hoc incentives are applicable which may establish exemptions from applicable taxes, lower rates of income tax, or an enhanced depreciation rate. For example, with respect to long term residential complexes, further incentives are applicable resulting in lower rates of income tax and exemption of VAT on the lease payment received by the project company, as well as a decreased rate of land betterment tax upon the transfer of the complex.

In addition, for waste-to-energy projects, the Ministry of Environmental Protection provides grants in sums of up to tens of millions of ILS (depending on the project scale) and for PV power plants, a decreased mandatory rate of municipal tax (Arnona) is in place, limiting the authority of individual municipalities to determine such rates at their own discretion. As with regard to infrastructure projects, an industrial construction method incentive plan was launched in 2016, entitling the eligible construction companies to grants in amounts of millions of ILS.

3.5 Are there any rules, legislation or policy frameworks under discussion that may impact project finance in your jurisdiction?

The governmental plan described in Section 1.3, if implemented, may have significant impact on the scale and magnitude of projects under development in the PPP scheme. In addition, the new rules published by the Israeli Electricity Authority as provided in Section 3.3 are likely to have a notable effect on the growth of the renewable energy field.

As for legislation, there is no general legislative framework for the implementation of PPP projects and no specific regulation applicable to finance on a project finance method. As for general reforms under discussion, a new insolvency proceeding statute has been published for a public hearing under which applicable insolvency legislation is proposed to be reformed in various aspects. However, this reform is in its very preliminary stages and may be removed, cancelled or modified.

SECTION 4: Market idiosyncrasies

4.1 Please describe any common mistakes or misconceptions that exist about the project finance market in your jurisdiction.

Israel is a relatively small state in terms of size and population; however, in terms of scale of projects which are or may be financed by a project finance scheme, the potential is vast and dis-proportional to the size of the state. As of the second quarter of 2016, total investment in completed PPP projects is approximately ILS19 billion, projects under construction account for an additional ILS10 billion, while currently tendered projects are estimated at an additional ILS4.6 billion.

As for the geo-political situation in Israel, while some international investors consider Israel to be a high-risk country for investments due to the current situation, in many of the large-scale PPP projects, this risk is mitigated to some degree by the state providing limited safety nets in the event of war, terror or hostile activity. Such safety nets secure the repayment of senior debt if any of the foregoing events occurs.

4.2 What measures should be taken to best prepare for your market idiosyncrasies?

Persons wishing to be involved in project finance should become familiar with the contractual and legislative framework applicable to the field and project in which they wish to invest. In addition, many of the applicable sectors such as energy, water, health and public transportation are highly regulated and investors should be prepared for significant interface with relevant governmental authorities. In highly complex infrastructure projects, in particular in urban areas, evaluating the risks associated with such projects requires in-depth familiarity with practices of the relevant authorities. To that end, in such projects, joint cooperation with local infrastructure groups is highly recommended.

SECTION 5: Practical considerations

5.1 How established is the legislative framework and authorities that govern public-private partnerships (PPP) and where have PPP structures most successfully been applied?

Other than general statues such as the Mandatory Tender Law of 1993, the Contract Law (General Part) of 1973, and the Contract Law (Remedies for Breach of Contract) of 1970, there are no specific regulations or specific legal frameworks which apply to PPP projects. Over the years, applicable authorities have gained vast experience in the implementation of projects, especially in the fields of infrastructure and transportation in a PPP scheme. In practice, a contractual framework has been established, and most of the PPP projects are based upon the same general terms and allocation of project-related risks between the authority and the private investor.

5.2 What are the key considerations relating to foreign investment into projects as regards insurance and tax structures?

Foreign investors may structure their investment as either an Israeli subsidiary company or branch. A foreign entity, with no permanent establishment in Israel (subject to the applicable regulations), is generally not required to pay tax in Israel, except for specific types of income such as profits generated from a natural resource of the State of Israel. In accordance with a number of double taxation treaties, passive income, such as royalty income, dividends and interest, will be subject to tax at a reduced rate that is withheld at source, and against which credit will be allowed in the country of domicile. The State of Israel has entered into more than 50 double taxation treaties which set out the manner of allocation of the right to tax between the treaty parties. The taxation treaties include, inter alia, relief in the form of reduced tax payments in Israel for income of a foreign resident in Israel deemed from business profits, capital gains, royalties, dividends and interest.

If a foreign investor's activities in Israel will constitute a taxable presence in Israel, the main Israeli tax which applies is corporate tax (currently at the rate of 23%) on the profit (income less expenses) it will generate from its activities and operations in Israel. In addition, unless otherwise provided in double tax treaty, the withholding rate on dividends to a non-Israeli resident is 25%. Such withholding may not be required in case of a branch (and not a subsidiary). VAT shall apply to any charge for services provided by the permanent establishment (currently at the rate of 17%), which generally can be offset by an Israeli entity against the Israeli output VAT.

5.3 Are there any specific issues creditors should be mindful of regarding a bankruptcy and restructuring scenario?

Israeli law allows several types of proceedings to be instituted in case of insolvency: court-ordered liquidation; and voluntary liquidation (to be carried out by the company (in certain cases supervised by the court) or by the company's creditors). Israeli law also allows a secured creditor to commence a receivership process to realise all or specific assets of a company. Such a process does not necessarily require the company to be insolvent, and may also occur when the company is solvent, as long as the conditions for such a process, as provided in the debentures or deed of pledge (as applicable), are satisfied. Liquidation and receivership proceedings can be conducted simultaneously.

In addition, the Israeli Companies Law enables, and in some cases encourages, the use of restructuring proceedings even when a company is not necessarily insolvent. In order to facilitate the restructuring process, the court is authorised to order a stay of proceedings against the company for a limited time period of up to nine months and to appoint an officer of the court to continue running the company as a going concern during this period of time.

SECTION 6: Outlook

6.1 What are your predictions for the next 12 months in the project development and financing sector and how do you expect legal practice to respond?

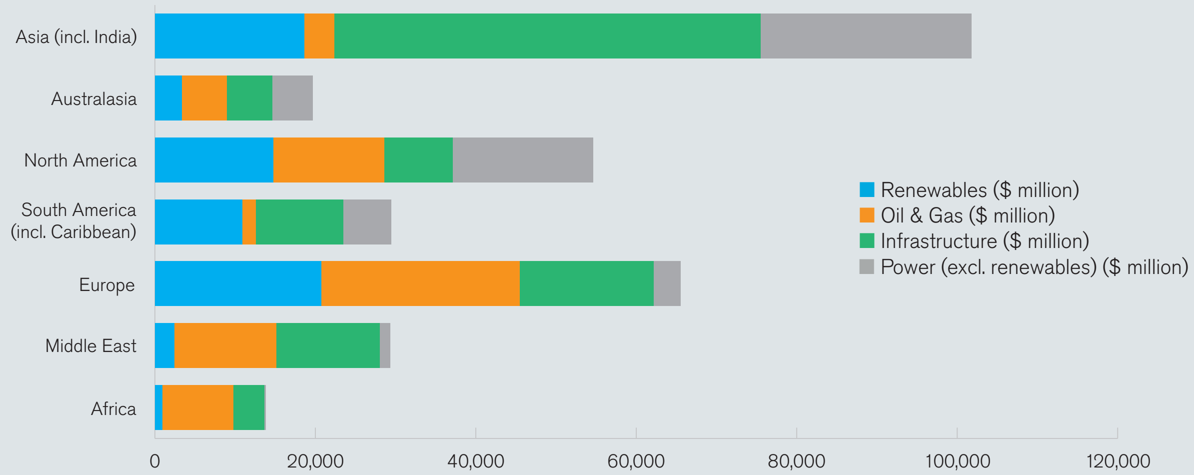
In the coming year, the development of large-scale PPP projects is likely to continue. The award of the Road 16 project (ILS1.5 billion) and of the IDF Communication Base Project (ILS2 billion) are anticipated to take place. The following tenders will be published: the Jerusalem LRT Green Line Project (ILS1.5 billion), the IDF Intelligence Base Project (ILS1.5 billion), and the Gush-Dan Fast Lanes Project (ILS1.5 billion). In the PV field, at least one tender is expected to be published in 2018 for large scale PV power plants (MW 200); medium scale and small-scale PV projects will continue to be constructed under applicable regulations. In addition, at least one financial close of a conventional power plant is anticipated to take place, while the wind farms projects may also mature and secure construction financing.

Year in numbers

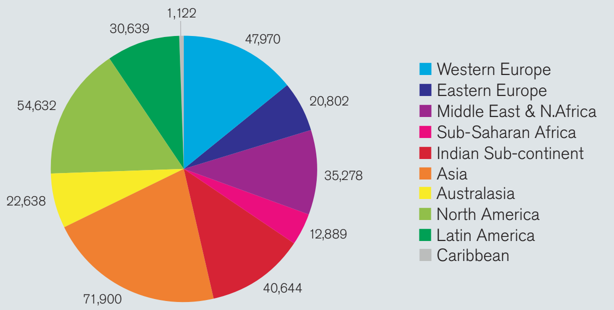
Some key statistics on project financing during 2017

Source: Dealogic. Data period: Jan 1-Dec 31. Value: $ million.

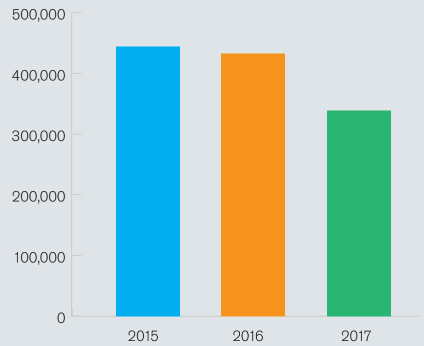
Biggest four sectors by region 2017



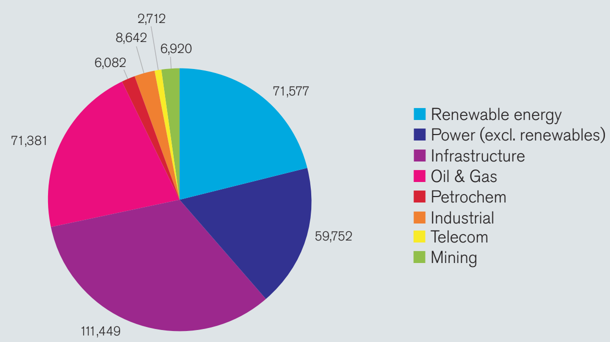
By region in 2017



Totals 2015-2017



By sector in 2017



Top 10 countries for project finance 2017

Country	$ million	No. of deals
US	43 871	128
India	38 264	279
China	33 585	24
Australia	22 472	52
Indonesia	17 922	19
Russia	16 611	3
UK	13 640	46
Brazil	13 330	149
Canada	10 761	28
Mozambique	10 393	3