TAILORING THE right funding structure for a wind development depends on where in the world you plan to build, what scale of project you have in mind, and whether it’s a purely private or community endeavour.

As the wind industry has matured and the market grown exponentially in recent years, so too has the very nature of doing business in the sector. The kinds of companies involved are no longer limited to small specialist developers; project sizes have rocketed, and the funding options for projects are now extensive.

While particularly popular for footing the high upfront bill of wind projects outside of the U.S., project finance (discussed in the previous article in this series - see links opposite) supplied by commercial banks or large investment funds is not the only route developers can pursue. “Although there are still many small, privately owned projects, a substantial shift towards bigger, utility-owned projects can be observed. This change brings new money to the industry and decreases dependence on banks for initial funding,” notes Wind Energy: The Facts, concluding: “Powerful sponsors are also arriving on the scene.”

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Finance tailor made

**Part four:** when it comes to financing a wind farm there is no one-size-fits-all solution.
That’s not to say banks do not still play a vital role, however: “Projects are increasing in size and large-scale offshore activity is taking off; since banks favour big projects, this is a change for the better.”

Another important aspect that needs to be taken into account is the specific regulatory landscape in different regions, where national and local public policy incentives will come heavily into play.

The U.S. wind market, for example, has historically been driven by tax incentives under the Federal Government’s Production Tax Credit (PTC) mechanism, while more recently cash grants and loans (and loan guarantees) have been made available under Federal programmes to encourage construction.

State and utility level renewable energy support programmes in the U.S. – generally more applicable to smaller scale and community-based projects – has mirrored this focus on direct incentives such as rebates and grants too. As a result, wind farm owners/sponsors have largely been non-energy companies with large tax burdens to reduce, and can afford to finance projects directly - although this has been changing recently and is set to even more in the coming years.

In the rest of the world public policy support mechanisms have centered around longer-term payment guarantees for the electricity a project will eventually deliver, such as feed-in tariffs (which offer guaranteed premium prices for the electricity over a fixed term of usually 15-20 years); or a system of renewable energy certificate trading. Under a certificate trading system, once a project is operating, companies get revenue by selling the certificates they create (with one certificate generally equivalent to a MWh of generation) in addition to the electricity they sell under negotiated power purchase agreements with retailers (usually at market, rather than premium, rates).

While such systems offer market participants a sense of revenue security for the long term (important for investors along with other risk mitigation measures) it does mean developers need to source virtually all the up-front funding for a project in the first place.

So, aside from traditional project finance deals, covered in the last report of this series (see links opposite), what are the options?

**Public sector support**

Naturally, looking to the public sector for assistance is not limited to banking on strong policy incentives, be they national pricing policies or international programmes such as the Clean Development Mechanism (CDM) (set up under the Kyoto Protocol); or the EU Emissions Trading System. Policy is there to help create market certainty and foster investor confidence that returns will be long term. But the public sector in many countries/regions is a good source of grant and/or loan funding to help finance projects.

For example, direct public finance schemes have ensured continued large-scale wind development in the U.S., with cash grants and loans made available from the federal Government under the American Recovery and Reinvestment Act in the last two years. The grants and loans available under America’s state and utility support programmes have similarly helped small-scale and community projects.

The UK too is set to have a Government-backed Green Investment Bank as of next year. This is being funded with £1 billion from taxpayers, and a further £2 billion is being raised from the sale of Government assets (the bank will not be able to borrow money in the way commercial banks do until 2015).

For developers in less economically powerful regions, or those planning projects in countries considered risky by private sector commercial banks, organisations like the European Bank for Reconstruction and Development (EBRD) or the World Bank’s Global Environment Facility have provided critical kick-start funding for many wind projects. While the EBRD has also helped with the fledgling offshore wind industry in Europe following the global credit crisis, its main focus has...
traditionally been on financing projects in central and eastern Europe and central Asia.

Meantime, for many western companies, taking their expertise overseas also means they can very often get some sort of financial support and backing from their national credit export agencies and trade departments. This is particularly so for projects being built in developing countries under the CDM.

Securing such public sector finance strengthens any chance of securing investment from the private sector, particularly in these credit crunch times. As discussed in previous articles, the number of lenders in the private sector prepared to fund wind projects has diminished in recent years. At the same time, the public policy push for green projects has grown and the number of players in the market has jumped.

The result is that developers need to ensure their business plans and due diligence are stronger than ever to benefit from the limited commercial money now available. It has also given birth in recent years to a host of new and creative ways to fund a project, not previously seen in the wind industry.

**Balance sheet and portfolio**

With the swarm of large utility-scale companies becoming active in the sector, for example, there has been a move towards on-balance sheet funding, mainly for construction. This is where a parent or sister company of the project owner provides all the necessary financing for the project and/or secures debt (usually a term loan for when the project is operational rather than for the initial construction loan) on the basis of its entire business portfolio (so debt is not project specific) and balance sheet. The project’s assets and liabilities are thus all directly accounted for at company level. This type of debt financing structure is sometimes referred to as full recourse financing. The term loan lender can enforce payment of the debt by the bigger company that has effectively underwritten the loan via its balance sheet.

If they have yet to secure a term loan, these larger companies will sometimes group multiple balance sheet projects in a single portfolio, and arrange for a loan to cover the entire portfolio, as it is easier to raise a loan for the portfolio than for each individual project.

The greater the diversity of the operational portfolio, then the lesser the perceived risks for any potential lender: “The portfolio will usually include a range of projects separated by significant physical distances, with a range of turbine types. The use of different turbine types reduces the risk of widespread (or at least simultaneous) design faults, and the geographical spread ‘evens out the wind’,” explains Wind Energy: The Facts. “Finally, if the wind farms are in different countries, then the portfolio also reduces regulatory risks.”

While such portfolio financing has been driven by the entry of large utility players into the market, the approach is extendable to smaller players who already own a number of projects but may want to seek out more favourable loan conditions. “The risk associated with such portfolio financing is significantly lower than that of financing a single wind farm before construction, and attracts more favourable terms.”

Portfolio financing can be adopted even after the initial financing has been in place for some time. It is now quite common to see an owner collecting together a number of individually financed projects and refinancing them as a portfolio.

The limitation of balance sheet financing deals is that they are only viable for the biggest companies with financial muscles of steel, and a credit rating to match.

For smaller, independent wind developers, a better route may be project financing - or taking advantage of the growing number of targeted clean tech investor initiatives. There are now plenty of alternatives thanks to the structured finance markets, or specialist green banks and venture capital fund managers like Triodos, a Dutch group with offices around the world that helps finance projects via its three renewable energy funds, or Ventus Funds, part of the bigger investment giant Climate Change Capital.

**Structured finance options**

Often involving public or private sector bond or share issues, the structured finance markets in Europe and North America have grown in their importance for funding wind projects.

Structured finance deals are like a loan transaction, whereby a project is provided with an investment in return for capital repayment and interest. However, the way in which transactions are set up is quite different to traditional project finance loan, and far more complex, almost certainly requiring the skills of an investment bank (one familiar with renewables) to act as arranger when it comes to setting up the structure of the transaction.

No two structured finance deals are the same. However, the key basis of structured finance deals is a devaluation or shifting of key risks to other third parties under the financing agreement.

Predictable cash flows are a critical lending criteria too as the financier will want to be assured that if all goes to
plan they will get their money back on schedule. But the deal will be structured so that if anything goes wrong, it has recourse to some assets as collateral. This is often known as Asset Back Securitisation (Securitisation is the financial pooling of various contractual debts). This debt pool is then sold, for example as bonds, to other investors. The capital and interest of the loan is then paid back to the investors.

An appealing element of structured finance deals for a developer is that unlike project finance deals, it is the creditworthiness of the deal only, rather than the company as well, which is taken into account when assessing whether to provide the loan. That is to say it is direct and indirect factors relating only to the deal itself - cash flow; risks; etc. - that are taken into account, rather than the borrower. Loan terms also tend to be more favourable, for example via lower interest rates, while many of the potential risks and costs associated should something go wrong, are transferred to others who should be better placed to manage those risks.

“There have been a number of relatively short-term investments offered in the market, which have been useful products for project owners considering project refinancing after a few years of operation,” says Wind Energy: The Facts. “Structured finance investors have had a considerable appetite for cross-border deals, and have had a significant effect on liquidity for wind (and other renewable energy) projects.”

Small and specialist

Specialist banks and fund managers like Triodos, The Co-Operative Bank or Ventus Funds may be a better option for smaller scale and community wind farm developers seeking venture capital or project finance equity injections.

Operating in the sustainable energy sector since the 1980s, Dutch group Triodos, with offices across Europe, manages three institutional funds, which enable it to finance, develop, own and operate green projects, for example. In currently finances 300 sustainable energy projects across Europe (Netherlands, UK, Germany, Spain, Belgium, France, Italy and Ireland) and in total, it has managed investment portfolios and exits of around €100 million.

The bank’s Ampere Equity Fund, for example, invests in European projects, including onshore and offshore wind. Projects at any stage are considered, whether under development, under construction or fully operational. The minimum investment is €10 million per project, while the maximum is €50 million.

Its latest major wind investment was in Dong Energy’s 367 MW Walney offshore wind farm planned for the UK, acquiring a 24.8% stake in the project at the end of last year for €16 million as part of a consortium with pension fund manager PGGM.

Meantime, its UK-specific investment fund arm, Triodos Renewables, currently owns and operates 7 wind farms and one hydroelectric project, and holds investments in several renewable energy companies. It also has exclusive options over 60 MW of wind farm sites yet to be exercised. It focuses almost exclusively on onshore wind projects in the 2-20 MW range at present, although will help finance larger projects too, offering capital from £1 million-100 million.

“Conventional venture capital and private equity investment tends to focus primarily on short term returns, often at a cost to the wellbeing of stakeholders,” the company says, explaining the benefits of specialist green banks. “In contrast, we take a distinctively sustainable approach. Our private equity funds have been developed in line with Triodos Bank’s overall mission, investing exclusively in businesses that make a positive social and environmental impact. We work exclusively with sustainable businesses to identify their funding requirements and determine which forms of capital are most suitable.”

It can structure and carry out both equity and debt fundraisings and raise funds from institutional and individual shareholders alike to help finance projects. The types of finance assistance it offers varies, from loans; debt; equity; subordinated loans; co-financing and corporate finance. “For larger projects, we have a network through which we arrange co-financing, syndicated loans or ‘club deals’,” it adds.

UK wind developer Ecotricity was one of the first to benefit from Triodos’s help, with finance being provided for its first wind park back in the late 1990s, and a further €2.5 million being raised by Triodos through a five-year bond issue to help fund the company’s continued growth.

Venture capital

While offering similar project finance equity help for small and community onshore wind projects - and assistance in securing debt finance from banks and off-take contracts - firms like Ventus raise funds via Venture Capital Trusts (VCTs).

Under Government rules, VCTs can only be used to support small projects needing no more than £15-£20 million. For help from Ventus, projects have to be shovel-ready in that planning permission has been granted. Critically, it can provide 100% construction finance for developers, something many commercial banks are unwilling to do.

“Before the Ventus funds many small to medium sized local renewable energy schemes, even those with planning permission, found it hard to attract the finance required to complete their development and deliver returns for project owners and developers,” the company explains. “Given the target project size, most investments are in projects too small to be of interest to large development companies, utilities and larger investment funds. Generally these are projects that have been initiated by small-scale developers, landowners, community groups or on small industrial sites.”

The added benefit for smaller developers is that the focus is on helping them specifically. “We do not look to own majority stakes in portfolio companies. This approach allows project developers to retain significant ownership while benefiting from the experience of the Ventus team,” it says. “With over £60 million of capital raised and an investment management team that has helped create over 1,000 megawatts of renewable energy capacity, we are well placed to provide detailed understanding of the financial, technical and contractual requirements to deliver projects.”

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