

## **Financing offshore wind – Past, current and future trends**

Presentation to RenewableUK Offshore Wind delivery group

02/10/2013

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# GGEB – the offshore wind finance specialists

We have an unparalleled track record in successfully closing deals for our clients

- 20 professionals in London (UK), Paris (FR), Utrecht (NL) and Hamburg (DE)
- Project & structured finance, full scope equity advisory and contracting expertise
- Focus on renewables and specifically offshore wind

Advisor to C-Power to raise project finance debt

325 MW



C-Power

Belgium  
2010



EUROMONEY  
Project Finance  
2010  
Deals of the Year



INFRASTRUCTURE  
AWARDS 2010



PFI  
AWARDS  
2010

Advisor to Northwind to raise project finance debt

216 MW



Northwind  
Offshore Energy

Belgium  
2012



Project Finance  
Deals of the Year  
2012



PFI  
AWARDS  
2012

Non-recourse financing of 25% stake in Walney offshore wind farm

367 MW



Walney  
Offshore Windfarms

UK  
2012



PFI  
AWARDS  
2012

(Sponsor)

Advisor to WindMW to raise project finance debt

288 MW



WindMW

The Blackstone Group\*

Germany  
2011



Project Finance  
Deals of the Year  
2011



PFI  
AWARDS  
2011

(Sponsor)

Financial advisory services French offshore wind tender

1,428 MW



EDF énergies nouvelles



DONG  
energy

France  
2012

Advisor to Highland in the acquisition of the Deutsche Bucht project

210 MW

Highland Group Holdings

Germany  
2012

## Financing renewables – EMR case study

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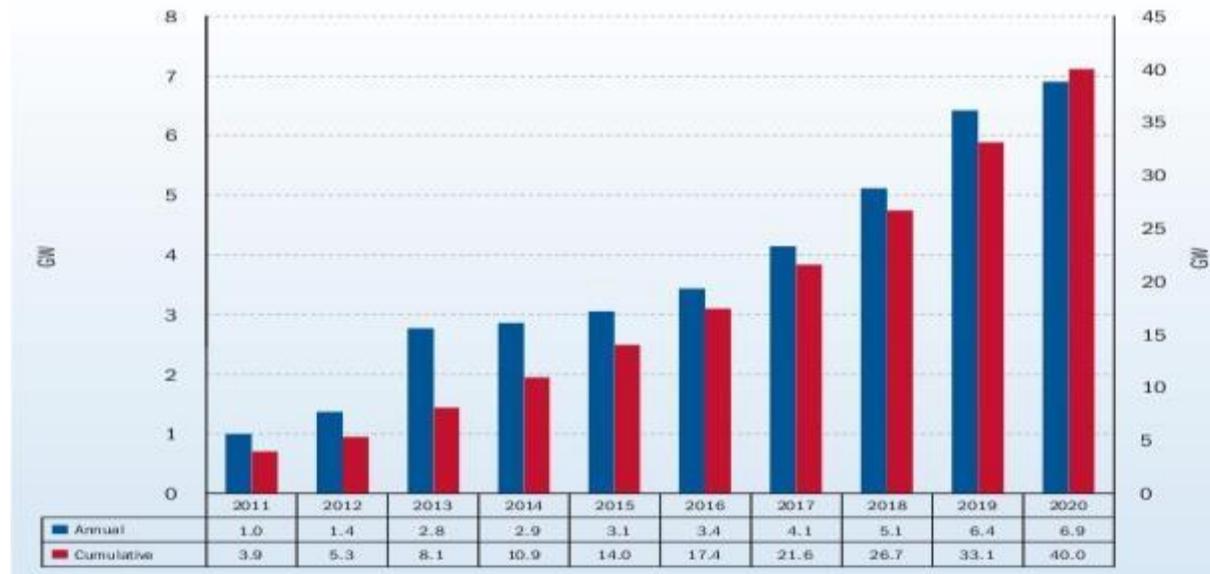
1. Overview of the offshore wind market
2. A massive need for capital
3. The equity market in offshore wind
4. Project finance market in offshore wind
5. Project finance processes and challenges

Annex 1: UK focus

## Financing offshore wind is becoming a challenge

### A massive need for capital

- Ambitious targets: total capacity should jump from 5 GW today to 50 GW in 10 years, including 60% of it for the UK
  - Building an offshore wind farm is very capital intensive and costs 3-4 MEUR/MW depending on location
  - It means that more than EUR 150 billion is needed by 2020 including around EUR 100 billion for the UK
  - In average, EUR 25 billion per year will be needed between 2015 and 2020 in the European offshore wind market
  - If we consider the constraints in the UK (levy control framework) and Germany (cable), still half of it should be built
- ➔ *While the needs are not so large compared to what has been done in other sectors, they are “chunky” (large projects)*



Anticipated annual and cumulative installed capacity in European offshore wind - Source: EWEA 2011

## Financing offshore wind is becoming a challenge

### Sources of liquidity are strained

- **European utilities under pressure**
  - Utilities have financed 77% of the EUR 16 billion spent to build the current 5 GW of operating capacity
  - Abundant and cheap corporate funding made that easy but things are changing, due to pressure on the revenue side (linked both to the economic crisis and to the downside impact of renewable energy penetration on wholesale prices) and increased focus on credit rating
  - ***While their involvement remains crucial for the offshore wind sector, utilities will likely seek to reduce the proportion of the required investments that they fund themselves***
- **There are no proven alternatives beyond project finance**
  - The bond market is recurrently played up a credible alternative
  - However, construction risk will likely remain impossible to fund by bond investors and capital markets will more likely become a way to recycle capital than to make the initial investments
  - Other tools like debt funds or other hybrid structures are unproven to date
  - ***New forms of financing are not likely to play a major role in the next few years***

## Alternative financing in the equity market

### Some lessons

- **An active market – and a wider range of investors beyond utilities than people assume**
  - Infrastructure funds and pensions funds (PensionDanmark, PKA, Industries Pension, TCW, PGGM)
  - Private equity groups (Blackstone, etc.)
  - Corporations with specific strategies (LEGO, Colruyt, Marubeni)
  - .... and many more sniffing around the sector
- **Trade off between construction risk and returns now closely examined**
  - As more assets are operational, the universe of investors grows and IRR targets are going down
  - A number of investors are now looking to take construction risk to improve returns (to double digits)
  - A “bankable” deal is also one which many investors can find attractive

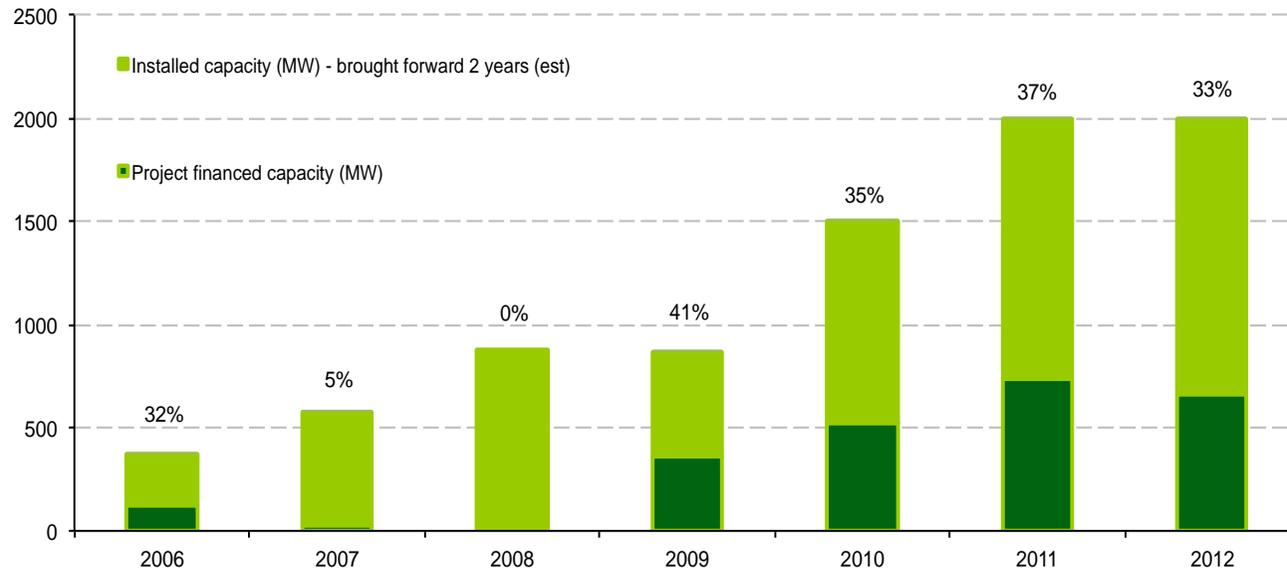
## Debt project finance: lessons learned from the early years

The banking market is there if the transactions are well structured

### Lessons learned from the first projects – now up and running

- The first projects using project finance closed in the “early years” (2006-2009) are now in operation.
- Construction has never been easy (it is a full-time job for the banks as well) but mechanisms to limit the risk have proved to be successful and all projects using PF have been built on time and within budget (including contingencies)

Offshore wind project financed volumes



### An active PF market becoming mature

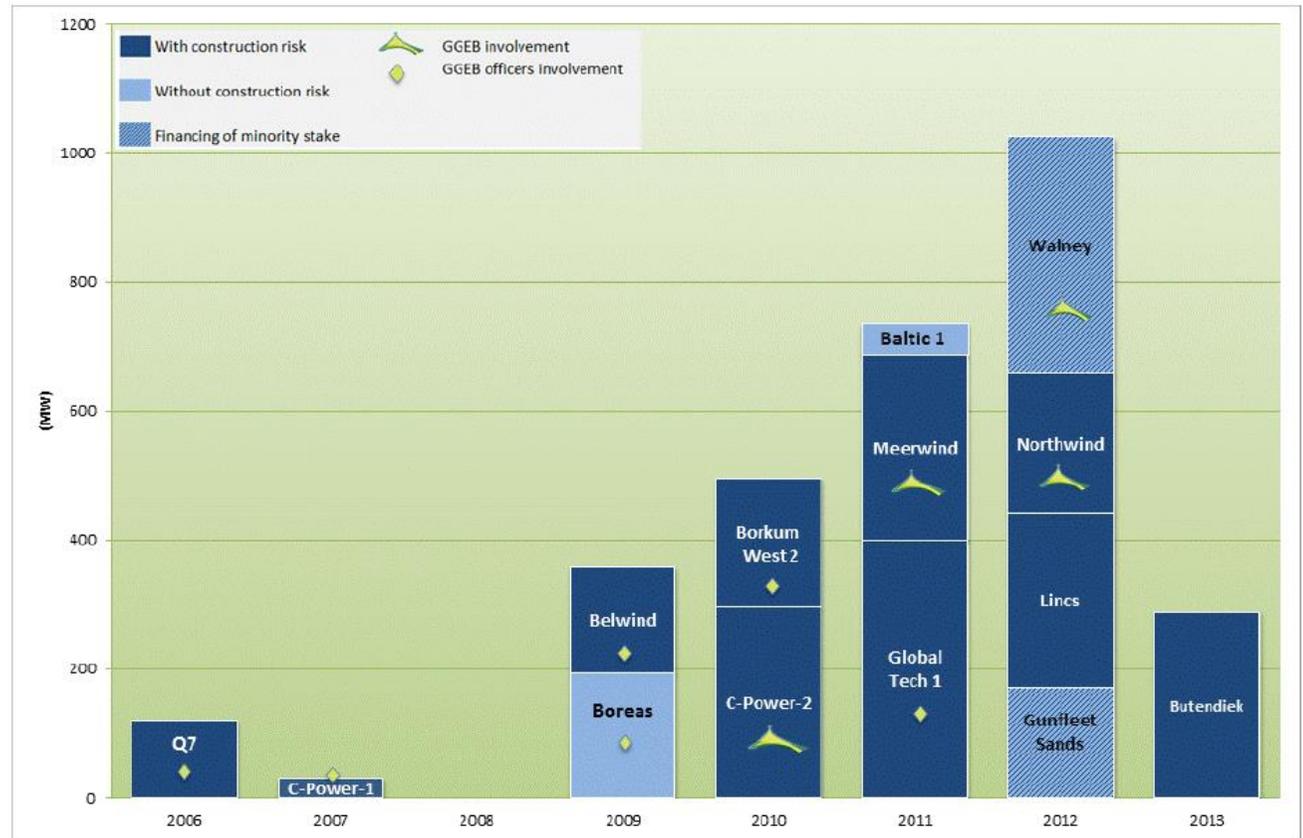
- Most active market ever, despite the crisis and the atmosphere of gloom
- No bank or individual institution is indispensable
- Debt sizing principles are quite stable and predictable
- Due diligence standards and main covenants are similar across transactions
- The same rules apply in different countries and with different banks involved

## Debt project finance: some recent highlights

A number of large transactions have taken place

### Notable transactions:

- **C-Power** – Belgium – 2010: billion-euro senior debt can be raised with construction risk for a project with new turbine
- **Meerwind** – Germany – 2011: private equity enters into the market and uses PF
- **Lincs** – UK – 2012: there is no “UK malediction” with construction risk and project finance
- **Walney** – UK – 2012: first commercial financing of a minority stake



## Debt project finance: current market – volumes available

### Commercial banks

#### The bank market is broader and broader

- More than 30 banks have taken offshore wind risk today
- More than 20 banks have construction exposure
- Experienced banks – an active pool of banks able to structure and lead transactions:
  - Rabobank, KfW-IPEX, Unicredit, BoTM, SocGen, BNPP, Santander, Commerzbank, (Dexia)
  - HSH, NordLB (German focus)
- Many banks were involved in recent deals in the last 2 years:
  - Lloyds, ING, KBC, Siemens Bank, Deutsche Bank, NIBC, ASN
  - Calyon, BayLB, NAB, Helaba, SEB, Deka, DnB Nor, Natixis, NIBC, Sabadell, Nordea, BBVA, LBBW, Mizuho, SMBC
  - RBS, HSBC (UK focus)
- More have expressed their appetite

#### An average EUR 100 M available per bank per year

- EUR 30-150 M exposure per bank per year, in 1-3 deals

At least EUR 2.5 billion available per year

## Debt project finance: current market – volumes available

### Public Financial Institutions

#### Several active public financial institutions

- **EIB** – historic key player with cheaper funds (support to European offshore projects), but generally conservative
- **EKF** – offshore wind’s “best kept secret”: participation linked to Danish exports, up to EUR 250 M per transaction
- **Euler-Hermes** – participation linked to German exports, can do large tickets
- **KfW** – potentially large amounts available (in Germany): able to provide cheaper funding in significant volumes
- **GIB** – UK Green Investment Bank, first involved in Walney

#### Their role has been instrumental to get deals done

- Will typically bear approximately half of the risk and/or funding of a transaction
- Will normally take the same risks as the commercial banks, but they usually run their own internal assessment
- Some geographical / national restrictions
- Small deal teams, so availability is a constraint

Can contribute as much as the commercial banks

Altogether, there are EUR 5 billion of debt funding available for 4-6 industrial size projects (400 MW) per year today

## Debt project finance: current market – financial conditions

### Market trends

#### Structures have been quite stable since 2007

- Long-term debt is still available
- Consensus on 70% leverage
- DSCR reflects price risk in the UK

#### Debt is not that expensive

- Margins rise reflects higher bank cost of funding rather than higher cost of risk, but the overall cost of debt is stable or decreasing
- Recent deals have seen overall cost of >15-year debt at 6.0% or less

| Typical project finance conditions offshore | Leverage | Maturity post-completion | Margins    | Maximum underwriting |
|---|----------|--------------------------|------------|----------------------|
| 2006-2007                                   | 60:40    | 10-15 years              | 150-200 bp | 50-100 M             |
| 2009  | 70:30    | 15 years                 | 300 bp     | 30-50 M              |
| 2010-2011                                   | 65:35    | 12-15 years              | 250-300 bp | 50-75 M              |
| Current market                              | 70:30    | 10-15 years              | 275-375 bp | 30-50 M              |

#### Banks have refocused on known clients, core countries and strategic sectors of activity

- The good news is that offshore wind is unambiguously “strategic” for many banks today
- Countries where offshore wind is developing are seen as “safe” (Germany – until now) and core for most banks

## The project finance process: challenges for the equity partners

### The commercially sensitive items in transactions

#### **Lenders ideally want strong equity commitments**

- Offshore wind transactions require a traditional PF security package, with pledge on accounts, assets and shares of the project company
- A strong majority investor is usually a must have
- An good project management team through a dedicated team
- Equity commitments paid upfront or backed by strong entities
- A long term commitment to the sector by the majority investor (track record, strategy...)
- Long term equity retention commitments restricting the majority investor's rights to sell out: these clauses are stronger than in other sectors
- Requirement for direct agreements are traditional in PF but more systematic in offshore wind; Lenders also want stronger involvement in commercial contracts (right to allow or veto changes)
- More intrusive due diligence in contracts & subcontractors and more information provisions

#### **Conversely, investors want less interference**

- No micro-management of the project by lenders through intrusive covenants
- Flexibility to sell stakes
- Limited restrictions to dividend payments, in downside (lockups, reserve accounts) and upside (sweeps) scenarios

## The project finance process: challenges for the contractors

Understand the challenges and opportunities in a non-recourse finance environment

- **Investors who need or seek finance have different contractual requirements**
  - They need their contracts to be acceptable to the banks
  - If this is not done during the initial negotiations, the contracts will be re-opened by the banks if they do not find them acceptable; Conversely, the contractors who anticipate the needs of their clients can be more competitive
- **Projects with external finance no longer are a zero-sum game for contractors**
  - Some contractual features are valued more highly by banks, which are willing to “reward” the project accordingly, and the surplus can be shared with the contractor. For example, the ability to discuss the order of payments between banks, contractors and investors can lead to significant financial gains
  - Banks favourable to profit sharing in case of superior performance (as this incentivizes contractors to perform)
- **Banks need a number of legal clauses in contracts**
  - From contract rights assignment and information covenants to direct agreements and restriction on termination
- **Banks also want slightly different contractual packages**
  - Risk-adverse approach: interfaces with other contractors more detailed, preference for certain risks (construction delays) to be passed on to the contractor, focus on “worst case” scenarios, (upside ignored)
  - Specific commercial requirement for penalties and LDs, with higher caps than corporate clients need
- **Transparency on design, processes, factories and corporate information is highly valued by the banks**

## Conclusion: PF is available for well-structured projects

### How to make a deal bankable

#### Structuring a deal is time-intensive

- Non-recourse finance requires a specific discipline and approach to project risks
- Multiple complex tasks to run in parallel, with numerous third parties (with often contradictory requirements)
- Several critical paths to manage
  - ongoing development work
  - external advisors
  - contract negotiations
  - internal approvals

#### The quality of the contracts can help bridge the difference

- The more « bankable » the contracts are, and the more flexible banks will be on equity issues
- The stronger the contractual commitments, the less important the owner will be
- No zero-sum game: enhancing some terms can lead to win-win-win solutions

Offshore wind projects have access to a very diverse project finance universe, as long as some rules are respected

- the contractual package has to include banks requirements as early as possible
- experienced advisors consulted upstream
- timing adapted to the banking process

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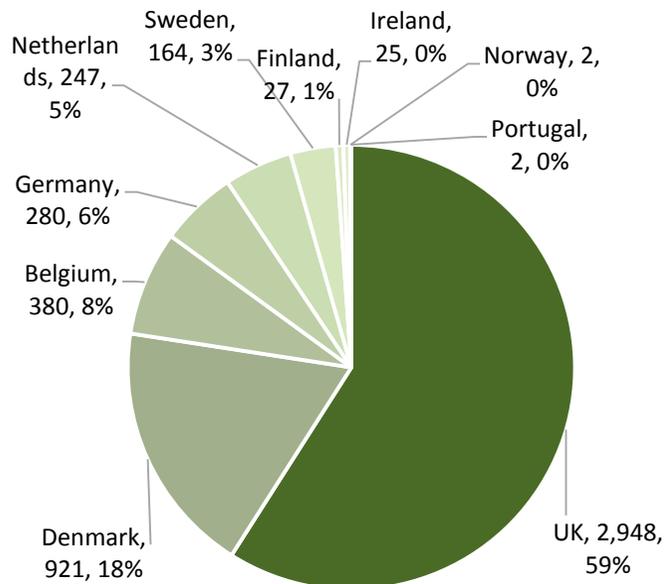
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## Annex1: UK focus

The most dynamic market is on hold, pending the Electricity Market Reform

### The largest market in Europe: more than half of all installed capacity

Installed capacity by country (MW)



Source: "The European offshore wind industry key 2011 trends and statistics", EWEA, January 2013

### Long term leases are allocated in "rounds"

8 GW under Rounds 1 and 2 ; 25 GW from Round 3

### The sector is largely dominated by utilities

- Main European utilities are in the market
- On project finance, first projects in 2012 after a long process
  - Mutual perception by utilities and banks that the other group was not reasonable (intrusive due diligence, micro-managing...)
  - Banks anxiety generated by persistent, if relatively minor, technical glitches (ie grouting issues)

### A market on hold

- The whole industry is waiting for the new regulatory framework
- Move from market-based incentives towards fixed price support. Strike prices will be finalized by end 2013 and apply from April 2017

### Current scheme based on market mechanisms

- Electricity sold to the market or through PPA
- ROCs and LECs bought to fulfil obligations
- Accepted by most investors and banks
- Customised mechanisms (blended DSCR)

## Annex 1: UK focus – EMR, an opportunity for financing the sector

The frustration coming from the long process should not overshadow the positive outputs

### Better for the developers

- The key PPA issue that has risen during the last years in the UK mainly solved by EMR
- Lower cost of capital due to lower risk on the offtake price
- Strike prices that have been published are challenging but should be manageable (at least onshore)

### Better for public acceptability

- Capacity market for the base load generation plants
- Cost for the consumer capped by the LCF
- No risk for the consumer to overpay the support to renewables, as the support decrease when the price increase (and ultimately, money paid back by the generator if above the strike price)

### Better for the investors and banks

- Much greater certainty on price (however not as clear as Germany)
- Long term support (15 years, not as long as before, but more than in Germany)

### Better for the whole industry

- Moving forward to the new framework is good in itself: everything better than the uncertainty

## Annex 1: UK focus – EMR, the major remaining issues

### Issues pending

#### Risks related to the completion of the bill

- EU rules – State aid
- Linked to nuclear
- Royal assent, lords and commons approval needed

#### Risks during transition period from ROCs to CfD

No mention on the possibility of switching from one to the other

| Risks related to LCF | Issue  | Sponsors  | Banks   | Mitigation  |
|----------------------|--|---|---|---|
| Cap by sector        | The yearly cap has been released, but no mention of sub-caps   |        | -   |   |
| Allocation process   | After the 50% FCFS stage, risk that the CfD is not granted, or at a lower strike price (constrained ARs) |        | -   | Do not wait for the second stage and submit during FCFS |
| Yearly adjustment    | In a windy year, the yearly threshold may be hit. No certainty on what happens then                      | Up to  | Up to  | Depends on mechanisms, financial mitigation conceivable |
| Risks related to CfD | Issue  | Sponsors  | Banks   | Mitigation  |
| Long Stop Date       | If completion after Long Stop Date, risk of missing the tariff   |      |      | Depends on cause for delay<br>Legal DD on force majeure |
| Counterparty risk    | In case of default of a supplier, is the generator impacted?   |      |      | Contingencies at project level                          |
| Reference price      | Based on day-ahead, so small discrepancy   |      |      | In the PPA or hedging mechanisms                        |
| Size of collateral   | Security required in case of negative CfD  |      | -   | Financial security or PCG                               |