

VEJA MATE SCORES A GERMAN HAT TRICK

ON JUNE 29 2015, THE FINANCING FOR THE 400MW VEJA MATE OFFSHORE WIND PROJECT CLOSED. THE DEAL REPRESENTED THE THIRD GERMAN OFFSHORE WIND FARM TO ACHIEVE FINANCIAL CLOSE SINCE THE APPLICABLE GERMAN REGULATORY FRAMEWORK – THE EEG LAW – WAS REFORMED IN THE SUMMER OF 2014. BY **RANJAN MOULIK**, GLOBAL HEAD OF POWER AT **NATIXIS**, AND **JEROME GUILLET**, MANAGING DIRECTOR OF **GREEN GIRAFFE**.

The deal was the second very large-scale debt-financed project to start construction in the German Bight in the last four months, after Nordsee One. The transaction closed only 10 months after Highland Group Holdings (Highland) acquired the project, despite it representing the first venture into offshore wind construction for both Highland and one of its two partners, Copenhagen Infrastructure II (CI-II, a fund managed by CIP).

Veja Mate was originally owned and developed by a subsidiary of the Bard Group. Development works, however, essentially stopped when Bard decided in 2013 to cease its business. On September 11 2014, Highland acquired the project from Bard and set about developing the project with an ultimate target of achieving financial close by the end of June 2015, the date after which Veja Mate's exclusive rights to use its allocated grid connection through the BorWin 2 platform could be challenged.

At the time of acquisition, Veja Mate did not represent Highland's first activity in offshore wind as it already owned (and still owns) the neighbouring project Deutsche Bucht, which it acquired from Windreich in 2012. Highland thus had an established team already well under way with engineering and procurement activities for Veja Mate's very similar neighbour and it was this momentum and knowledge that put Highland in the unique position of developing this project in time for the June 2015 deadline.

Veja Mate is located approximately 95km north-west of the island of Borkum within the German Exclusive Economic Zone and – apart from the very favourable wind regime common in that part of the North Sea – had two key distinguishing features.

First, it was able to avoid the risk linked to grid connection delays – an issue seen on some German projects – thanks to the fact that its grid substation, BorWin 2, would be operational and exporting power from the Global Tech 1 wind farm, prior to financial close.

Second, the project's distance to shore and water depth meant it qualified for a bonus period under the feed-in tariff of 4.7 years, meaning the project will receive support for a total of 12 years

and seven months; the first eight years at €194/MWh and at €154/MWh thereafter.

While these characteristics lead to a longer support period, they represent perhaps the two most technically challenging aspects of this project; water depths of circa 40m are at the edge of what can be achieved by monopile foundations today (offshore wind's go-to foundation technology to-date), in particular when a large wind turbine is also chosen, and long distances to shore bring about additional logistical challenges during both construction and operation.

A unique attribute of Highland's approach to offshore wind is the exhaustive use of experienced advisers to manage the delivery of their projects. Under Highland's ultimate management, three advisory groups came together to deliver Veja Mate to financial close, each bringing their own distinct value; technical, commercial/financial and legal.

Right from the start, the project team decided to focus on limiting risks to the utmost for both lenders and investors by using the lessons learned from previous projects – about what did not work, but also about what did work. The team included a large number of people involved in earlier projects, and all brought their input.

A deliberate choice was made to go with experienced counterparties wherever possible, to limit the number of contracts in order to reduce formal interfaces, and to pass on a number of risks to them contractually. Contractors were brought in for their experience in the sector.

The primary decision for the project, taken right at the beginning, was to proceed with Siemens as wind turbine supplier, and specifically to use its reasonably new 6MW direct drive wind turbine. Offshore wind turbine technology is moving very quickly and in search of the highest

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returns a number of projects have been tempted to choose a less developed platform with the expectation that operational experience and type certification (a legal, engineering and banking requirement) would be achieved with time.

The 6MW Siemens turbine still represented new technology and provided the solid foundation for a project business case but at the same time represented manageable risks; the limited operational experience would be mitigated well in advance of installation for Veja Mate due to a number of firm orders for other projects scheduled to come on line in the intervening period and a clear plan to achieve type certification well in advance of financial close. This example of prudent risk management at the strategic level was applied across the project.

A more technically challenging decision was whether to proceed with the original plan to use a jacket foundation or to switch to well-known monopile technology.

Jackets – although more suited to deeper waters – represented higher uncertainty due to their limited deployment to-date and longer production lead times (an important consideration in this project) and ultimately the project was convinced that monopile production technology had moved on sufficiently to ensure that production of the large foundations needed could not only be achieved but could be done by more than one party, ensuring that some competition could be maintained for the EPCI tender.

Nevertheless, the limited number of contractors able to do the job did lead to a number of technical and commercial challenges, which all parties involved in the project worked together to solve in the months to financial close.

Under the new German support regime, the previous feed-in tariff was replaced by a contract for difference, which will pay the difference between the market price and the above described fixed rates of €194/MWh over the first eight years and €154/MWh for a further 4.7 years.

In addition, the direct marketing, ie, sale on the wholesale markets, of the energy generated has now become mandatory for new renewable energy power plants.

The project transferred the balancing risk and all trading risks associated with such direct marketing obligations to Vattenfall under an agreement spanning beyond the tenor of the term loan; thereby not only protecting lenders from any price and volume risk – as has been done on previous projects – but also locking in competitive terms from the beginning, thus isolating lenders from negative shifts in the terms of future agreements.

Delays – and ultimately knock-on delays – that have frustrated a number of projects were dealt with by the project opting for a conservative two-season installation programme, with all 67 foundations installed in 2016 and turbines installed in 2017. Creating such a substantial

timing contingency also proved to be an important argument to moderate financial contingency requirements. As a result, the wind turbine installation schedule – and thus pre-completion revenues – is very resistant to delays in balance of plant installation and commissioning.

While these development activities continued at a pace, an equity process was launched with ultimately CI-II and Siemens Financial Services (SFS) joining Highland to form a group of three sponsors that together provided the €575m equity required. In addition to contributing capital, each new sponsor brought complementary knowledge and skills to those of Highland:

- CI-II: Copenhagen Infrastructure Partners (CIP), the fund's manager, brings experience from its senior management's previous activities in offshore wind and will be taking an active role during the construction phase, providing experience and competences to the construction management organisation; and
- SFS: Siemens brings extensive experience in offshore wind project-financed transactions and – by virtue of its presence – ensures the interests of Siemens as contractor are aligned with those of the overall project.

Work on the financing structure started in September 2014, with concrete decisions on equity and commercial contracts being taken through October and November. The sponsors opted for a conservative financing structure primarily due to their own preferences but given the tight timelines and the absence of precedents in the sector for some of the sponsors, it was clear that taking a more aggressive approach in line with other recent transactions would have increased the risk of not achieving financial close in time.

In practice, and beyond the conservative construction schedule, the sponsors opted to limit gearing to 66.67% and to take very conservative assumptions for pre-completion revenues.

As is quite traditional for such transactions, a two-step approach to the lending market was chosen: first, public financial institutions were approached, to understand their constraints and evaluate their potential contribution, before the commercial banking market was tapped. Interest was generally high from the public institutions contacted, in particular as a number had missed out on the Nordsee One transaction, which was financed purely by commercial lenders

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(something that was made possible by the recent willingness by banks to underwrite larger tickets for well-structured offshore wind projects).

The project qualified for EKF support through Siemens' wind turbine supply and KfW was also available and keen to participate through its dedicated offshore wind programme. Both parties were involved from a very early stage and acted as sounding boards for various decisions.

Although no formal commitments were made at that point in time, having interest and engagement from these parties early on gave validation to the work being done by the project and helped bring confidence to the sponsors that interest from the commercial market would be forthcoming.

Ultimately, though, the participation of EKF and KfW took pressure off the process with the commercial banks and helped ensure its success by significantly reducing the amount of commercial commitments to be raised, thus enabling the project to focus solely on banks with a lot of experience in offshore wind.

Finally, this interest was tested in a socialisation round prior to formal bank launch, the results of which confirmed very high appetite for the transaction and the sponsor group, despite a number of banks being very busy on Nordsee One at the time.

In February a comprehensive financing package was sent to the banks. It included detailed due diligence reports prepared by very experienced advisers hired to act from the outset from the perspective of lenders and an extremely detailed term sheet. The goal was to present a suitable transaction and provide enough information to the banks for them to obtain credit committee approval in a short time-frame and with as few conditions as possible. This allowed the project to quickly mandate a banking group on the basis of a harmonised term sheet and very precise conditions.

While having an allocated grid connection was a major positive for the project in view of delays experienced in Germany in the past, the timeframe to close imposed by the risk of re-allocation of that grid connection away from the project in June 2015 (if financial close was not achieved) was challenging and to a large extent defined the approach to the financing and the choice of banks. Realism reigned.

Taking the time to agree the detailed term sheet early meant the project was able to move to the documentation phase immediately after mandating the banks and, unusually, such documentation process was not the limiting factor in the transaction, given the parallel work on finalising the construction contracts and associated due diligence by the lenders.

The six banks to be chosen as MLAs included three German banks: Commerzbank, Deutsche Bank, modelling bank, and KfW IPEX, technical bank, and three international banks: Natixis, documentation bank and hedge execution bank, Santander, insurance bank, and SMBC,

TABLE 1 - PROJECT FINANCING

| | €M | % |
|----------------------------|--------------|--------------|
| Pre-completion revenues | 62 | 3.2 |
| Equity | 577 | 30.1 |
| Commercial term loan | 691 | 36.1 |
| KfW term loan | 400 | 20.9 |
| Guaranteed (EKF) term loan | 186 | 9.7 |
| Total | 1,916 | 100.0 |

coordinating bookrunner – each taking a pro-rata share in the commercial facility. KfW IPEX and Santander funded the guaranteed EKF tranche.

The common thread among these banks is that they had been involved in recent offshore wind transactions and were perfectly aware of the current state of art, and had previously demonstrated their ability to work on tight time-frames in a constructive manner. The debt was sized with a two-year construction period and a 12-year repayment phase (within the feed-in tariff period), on the basis of a 1.3 debt service cover ratio using P90 energy yield figures. Margins ranged between 200bp and 225bp over the term of the loan. The total budget was around €1.9bn, plus a contingent facility.

The debt was fully swapped to a fixed rate to take advantage of the currently extremely low interest rates in the market, and the average cost of debt for the project is well below 4%. Further, certain ancillary facilities (such as LCs required by the regulator for decommissioning and securities towards contractors) were also provided.

A deliberate decision by the sponsors was to appoint as documentation bank an experienced financial institution within the offshore wind industry to ensure the achievement of financial close in due time. Natixis was able to forge compromises within the bank group and with the sponsors swiftly and ensured that all parties concentrated on the most relevant issues.

Particular attention was given to maintaining a constant and good contact with all parties involved; this resulted in the establishment of a relationship of strong trust among all parties, thereby facilitating the resolution of certain key commercial issues during the documentation phase.

Immediately after financial close, which occurred on June 29 2015, a syndication process was launched with the aim of completing it by the end of July.

While the banks worked very hard to get this project over the line, worthy of special mention here are the lenders' advisers. Initially appointed by the project in autumn 2014, they worked tirelessly to review documentation and prepare report updates as and when developments occurred. This pragmatic approach was critical for the project to achieve the deadlines and was managed very well.

The main advisers involved – Martin Benatar, insurance, E&Y, tax and model, Sgurr, technical, and Watson Farley & Williams, legal, have great experience in German offshore wind and brought great credibility for the project and comfort to

the lenders throughout the process. Ultimately all parties combined to get this over the line; that it took 4.5 months from bank launch to get to financial close is a testimony to the commitment and professionalism of all.

Clearly, this project would not have been completed in time were it not able to benefit from the experience built up across recent years in offshore wind, and in particular in the last nine months in Germany. The closing itself does, however, highlight a number of key features/developments in offshore wind.

First, it shows that the industrialisation of this sector continues at a pace and that all sides of a project can come together to achieve financial close in a short period of time without compromising on quality. In a highly liquid environment it does also show that public finance institutions and export credit agencies continue to play a valuable role, albeit not purely in the sense of helping to provide or attract liquidity.

Second, it firmly establishes the EPCI/limited contracts structure as being both effective from the investor perspective and acceptable in the market to obtain non-recourse financing for offshore wind projects.

Third, the growing maturity of the sector is symbolised by the fact that CIP as an asset manager for a group of institutional investors including pension funds effectively took construction risk on the project. We expect this to go a long way to attracting a new set investors to this asset class, both on the equity and the debt side.

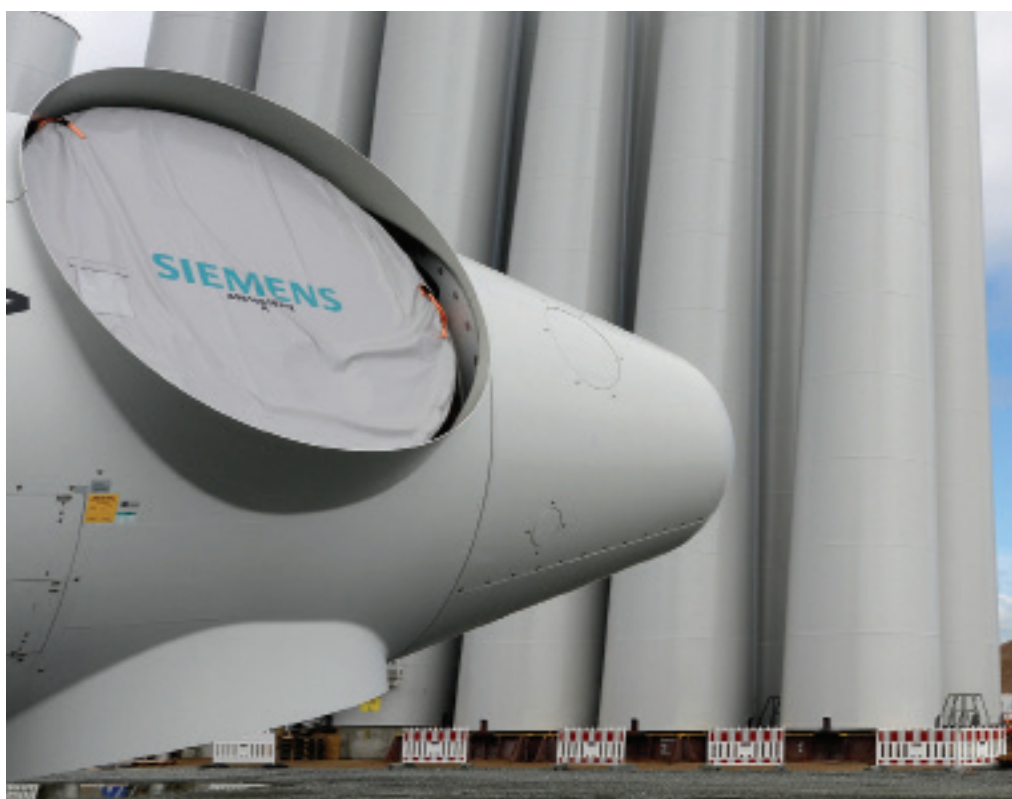
Fourth, this efficient and swift financing success is illustrative of what a small group of

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experienced, pragmatic banks, sponsors and advisers can achieve in a tight timeframe.

Finally, with margins having reduced systematically across previous transactions, it is likely that the 200bp achieved on this transaction will represent the lower limit for offshore wind, especially in view of the liquidity required for the sector in the EU going up to 2020. What is certain is that the relatively low leverage on Veja Mate helped to secure these lower margins, and perhaps the question should rather be: When will leverage above 70% start being acceptable for well-structured offshore wind farms?

The answer is not obvious: with public tenders being the future preferred route for offshore wind procurement in the EU, tariffs can be expected to fall significantly – as demonstrated recently in the UK and Denmark – and sponsors can be expected to push for increasingly aggressive debt structures; conversely, the number of projects seeking non-recourse debt – a dozen are expected before the end of 2016 – will allow banks to become selective again and stick to the high standards that have been met to-date, most recently on Veja Mate. ■



REUTERS/Fabian Bimmer - A hub and towers are pictured at Siemens Wind Power's port of export in Esbjerg