Ofgem OFTO: Low risk transmission deals?

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Ofgem's tender for the Offshore Transmission Owner (OFTO) schemes for the ownership of nine offshore wind transmission lines under 20-year contracts is to open bids from a shortlist of six – Balfour Beatty Capital, DONG, Green Energy Transmission (Equitix/AMP Capital Investors), Macquarie Capital Group, National Grid Offshore and Transmission Capital Partners (Transmission Capital/ International Public Partnerships/Amber Infrastructure) – in April.

Together, the nine links will connect up to 2,000MW of electricity, as a first step in a £15 billion ($24 billion) programme to ensure links to future offshore wind farms. Final bids are due in April, and Ofgem is targeting June to make awards.

The nine lines are being offered under what Ofgem is calling the First Transitional Tender, as opposed to an Enduring Regime. The former is characterised by the fact that the lines acquired will be fully operational at the time of asset transfer, while the latter will also feature construction risk. This round of nine lines being tendered will be followed by a Second Transitional Tender of a smaller group of OFTO schemes. Once those have been allocated, a group of Enduring Regime tenders will be launched this summer.

With UK project finance lenders having suffered restrictions on the geographical remit of their activities in the wake of the financial crisis, this opportunity to lend into large domestic infrastructure is not something they will likely pass up. The fact that these deals will also be firmly on the radar of mainstream European project finance lenders means that competition will be intense. Banks are preparing to bid hard for business on these deals, which will be won on pricing and tenor.

Another factor that is likely to increase pressure on commercial banks is that the EIB is looking to lend between Eu300 million and Eu500 million across six of the contracts, reducing the prospective amount of debt across the nine contracts from £1.3 billion to around £800 million.

A potential hurdle to these deals being bankable is the fact that there is a UK general election due on 6 May, and some UK PPP projects that are still to be given solid financial structures are being held up because of it, with banks not expecting the deals to really get going before the third quarter of the year. As for the OFTO schemes, the Conservative party, which is favourite to win the election, is opposed to this transfer of assets. As a result, some in the market wonder whether an April deadline for bid submissions and a June award date is such a good idea.

But it is also worth considering another fact – these are assets with low risk profiles, featuring no construction risk and promising predictable, regulated returns over 20-year contracts. If competition will be so aggressive as to push margins down considerably (and it is expected that this will happen), why would banks work so hard for a limited, if secure, return when they could be earning, say, 300bp over Libor on a Slovakian road concession?

Looking more closely into the risk profile of these assets, though, there is the fact that the OFTO contracts include 20 years of maintenance. While the maintenance of the transmission cabling itself represents little risk, the OFTOs will also be responsible for the offshore platform and the onshore substation. Banks are still wondering about what the risk on the maintenance of the platforms and substations will be, as Ofgem has not released full technical documentation. The inability to perform technical due diligence on the assets is a frustration to some in the market. As one banker put it, "It's a potential waste of our time – there's just no technical or legal due diligence we can do. Without that, what's the point?" However, most lenders are upbeat about the tender, and see the deals as involving straightforward utility risk and the need for simple service-interruption insurance on the cables.

The OFTO schemes are most likely to be financed by small bank clubs with tenors matching the 20-year contracts and possible short tails. The degree of competition that is expected will keep pricing low and make it unlikely that we will see cash sweeps or mini-perm structures.
Some think that a possible financing route is indicated by the fact that these contracts, as they feature no construction risk and steady returns, would be well-suited to bond issuance. But the bond route for these transitional deals is not likely, at least in the short term. Bond investors will be much more likely to show interest when some of the larger offshore facilities and their separately-owned distribution lines are seen working together, at which point the OFTOs may have the option to refinance on the bond market.

The prize on the other side of the OFTO schemes is the 32GW of offshore licences granted by the Crown Estate in the Round 3 process. The nine prospective projects are being reckoned to cost around £80 billion in total, and developers are reportedly about to spend around two years studying the sites and designing their approaches to delivering capacity.

The Round 3 projects are not near enough to the market to say how their financial structures will come out, but it makes good sense for lenders to be involved in these transitional phases of OFTO schemes, as this will be solid preparation for the taking of OFTO risk once the Round 3 deals start being available to bid on, which will be some time around 2013.

The nine OFTO contracts being bid for under the First Transitional Tender are Barrow (90MW), Greater Gabbard (504MW), Gunfleet Sands 1&2 (164MW), Ormonde (150MW), Robin Rigg (180MW), Sheringham Shoal (315MW), Thanet (300MW), Walney 1 (178MW) and Walney 2 (183MW). Ernst & Young is advising Ofgem.