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US wind breaks

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US renewable power project developers have moved from being cautiously optimistic to quietly confident. The stimulus bill, otherwise known as the American Recovery & Reinvestment Act, has had a much more immediate impact on the renewables project finance market than on the lumbering US PPP sector. Sponsors, even those that have yet to decide which of the raft of incentives to use, have been able to raise both tax equity and debt.

Sponsors of every type – foreign and domestic independent power producers, foreign and domestic utilities, and, most intriguingly, foreign and domestic private equity players – are converging on US wind and the US Department of the Treasury, which is administering the provision of cash grants to renewables producers, has just issued a first tranche of $502 million in grants.

Gearing up for grants

The big winner from the first tranche was Iberdrola, which took in $294 million of the total, for five projects. Behind it was First Wind, which took in $114 million for three projects, then Horizon Wind and EverPower. Two small solar producers also won much smaller grants. The grants kick in when projects come online and are open to sponsors that are bringing their facilities online this year or next. Sponsors that start construction this year or next can also apply after construction has begun. Sponsors with the resources to bring projects online quickly enjoy first mover advantage.

Project	**Developer**	**Location**	**Capacity**	**Grant**
Movement Gym PV	Lighthouse Solar	Colorado		$157,000
Solaire Development	American Capital Energy	Connecticut	420kW	$2.58 million
Moraine II Wind	Iberdrola	Minnesota	49.5MW	$28 million
Evergreen Wind	First Wind	Stetson, Maine	57MW	$40.4 million
Canandaigua Wind I	First Wind	Cohocton, New York	125MW (I & II)	$52 million
Canandaigua Wind II	First Wind	Cohocton, New York	NA	$22 million
Wheat Field Wind.	Horizon Wind	Oregon	97MW	$47.7 million
Hay Canyon Wind	Iberdrola	Oregon	100MW	$47 million
Pebble Springs Wind	Iberdola	Oregon	99MW	$46 million
Highland Wind	EverPower	Pennsylvania	62.5MW	$42 million
Locust Ridge II	Iberdrola	Pennsylvania	102MW	$59.1 million
Penascal Wind	Iberdrola	Texas	202MW	$114 million

Iberdrola tends to eschew the use of non-recourse project finance, preferring to use corporate debt to fund new wind farms. While project debt markets did not completely close for wind developers post credit crunch, the process of gaining approvals from banks was slower, and Iberdrola was able to sidestep these complications.

It also benefited from having substantial development infrastructure in place, the legacy of its acquisition of PPM Energy. Nevertheless its success in snagging Treasury cash has impressed bankers, and it has indicated that it is in line for another $251 million.

The cash grants will reassure developers and lenders, especially those that have been structuring debt and tax equity financing, about the speed and assurance of the process. The Treasury has managed in just six months to set up a system to funnel cash to developers. Conversely, the Department of Energy is still working on finessing the infrastructure needed to guarantee loans to renewables projects.

The Treasury says that it expects to spend $3 billion in cash grants, although the programme does not have any limit on how much it will hand out. Sponsors only have to apply before 1 October 2011, and complete plants before 2013 (wind), 2014 (biomass, landfill, hydro) and 2017 (solar, combined heat and power).

Fixing on the new style

The period between the passing of stimulus and the first tranche of grants has been marked by a wide degree of experimentation in financing structures. "I don't think sponsors have settled on a single structure yet," remarks one banker who follows the market, "every single financing we see seems to offer some new twist."

"Before the crunch, sponsors would come to debt and equity providers with a relatively well-thought out deal structure, and maybe give them a chance to offer small tweaks to it," notes Jeffrey Davis, a tax partner at Mayer Brown. "Now, they'll come to market with fewer preconceptions, and offer providers a much greater role in structuring the deal. It seems that developers are willing to live with this process and the associated higher costs if it provides greater certainty of financing."

The new landscape of US wind finance includes the return of some old features – wind hedges, tax equity raised against the production tax credit, investment banks as tax equity providers and northern European banks as lenders. But it also includes some new features, including holding company financings, and the presence of institutional debt providers. Even the older features involve twists on established practice.

Probably the most distinctive financing to close so far this year is Naturener's Glacier II deal in Montana. The financing is notable not just for using the same lender, arranger and tax equity provider – Morgan Stanley – as the first Glacier phase, but two important tweaks on the earlier deal. The second phase was slightly smaller than the first ($117.5 million compared to $150 million), had two fewer wind turbines (69 rather than 71) and uses a collar hedging arrangement rather than a fixed price wind hedge.

The collar has benefits for both sides, since it requires both counterparties to set aside much less capital against their obligations than a fixed price hedge: In the aftermath of the crunch, investment banks became much more cautious about fixed price hedges and wind projects that didn't include power purchase agreements.

NaturEner, which wants, ultimately, to sell its capacity into the Alberta electricity market, is looking for a bridge to when transmission capacity into Alberta comes online (for more on the prospect see News Analysis piece at front of magazine). According to Alfredo Cahuas, NaturEner's chief financial officer, the financing is structured around the assumption that the cash grant will be available to the project, with the receipt of the investment tax credit, which vests over a longer period, and needs to be credited against a tax payment.

Banks on baited breath

Banks are still not quite comfortable with the new arrangements. They used to complain bitterly about the difficulties of co-ordinating intercreditor arrangements with tax equity providers, and occasionally about the ability of tax equity providers to make good on their commitments to refinance banks' construction debt, in whole or in part. In the last instance, they may have felt justified in their caution when during the latter part of 2008 some of the largest names in the market vanished overnight.

Now they are worried about the possibility of the US Treasury being willing to refinance their construction loans. The issue this time is less one of counterparty strength, and more one of making sure that a project is eligible to receive the grants. The Treasury's speedy response so far has reassured them that the Obama administration is determined to funnel money to renewables projects.

Indeed, one lawyer familiar with the market notes that several of the winning projects may have only technically been completed in 2009. "The indication is that the Treasury is taking the engineer's certificate of completion as evidence of eligibility. In any case it's doubtful that the stimulus money stimulated a lot of those projects at all." Left un-noted so far by the more xenophobic corners of US politics is that a Spanish company took three-fifths of the first tranche of grants.

The pressure from the banks for some kind of reassurance from the Treasury has led it to consider producing comfort letters, indicating upon receiving applications for grants that a project seems to be eligible. The Treasury has also, so far, demonstrated a marked preference for wind applications over alternative technologies, and is dealing with wind applications, which are technologically more homogenous, first.

Banks have been more accepting of coming in alongside tax equity providers. They have had little choice, since while the number of tax equity providers has not decreased to dangerous levels, their appetite for substantial single-project commitments has. Tax equity providers have, in most of the structures to emerge in the market to date, been allocated the cash from the Treasury grants. Their remaining role in a project's capital structure after this point is to absorb the accelerated depreciation benefits (known as MACRS, after the modified accelerated cost recovery system used to account for them).

Even with this in mind, some sponsors still prefer to dispense with debt, particularly those with substantial resources but no US tax base. Horizon Wind, now a subsidiary of EDP Renovaveis, recently closed a $101.9 million unlevered tax equity financing that monetises the cash grant and MACRS on its 100.5MW Rail Splitter project. According to Jayshree Desai, Horizon's CFO: "We used the PTC tax equity deals as a template but modified significantly for the grant as well as the specifics of the project. We negotiated a structure that was value accretive relative to other structures and relative to doing nothing and carrying forward the tax benefits."

The leveraged PAYGO structure, where tax equity has been contributed over a period during the first few years of a project's life, rather than all at completion, allowing providers to reduce their upfront commitments, has all but disappeared. Banks always struggled to work with the risk that a provider would not meet its post-completion obligations, The PAYGO's acknowledged master, GE Energy Financial Services, has scaled back its tax equity activities, and has recently laid off staff.

Clipped wings

Pricing on bank loans is falling a little. Construction debt pricing has started for much of the year at 350bp over Libor, but sponsors, with BP and Dominion in the vanguard, are pushing for some relief. The two launched the $287 million financing for their Fowler Ridge project at nearer 300bp over Libor. The leads, BBVA, BTM-UFJ and SG, managed to bring in a number of participants into the process, particularly relationship banks of the sponsors, which have the balance sheet and tax capacity not to worry about the future of the US incentive regime.

The biggest obstacle to a clean syndication was the track record of the turbines that Fowler Ridge uses – 182 Vestas 1.65MW turbines, which have experienced problems with their gearboxes, and 40 Clipper 2.5MW turbines, many of which have experienced blade failures. The Clipper machinery has attracted the most attention, because its problems have been the most persistent.

"Look, all manufacturers have had their problems," notes one banker that has financed Clipper turbines, "because this is still an emerging technology. But Clipper does seem to stick out." Clipper, based in the UK, was the first manufacturer to install 2.5MW turbines in the US, but its units suffered from severe gearbox problems, particularly at First Wind's Steelwinds site in upstate New York.

First Wind has closed two financings in 2009 for projects using Clipper turbines. In late March it raised $95 million from Nord/LB and HSH Nordbank for the Cohocton wind farm, which used 50 of Clipper's Liberty machines. Then, later in April, it closed a $376 million construction deal led by Royal Bank of Scotland for its Milford project, which used 58 Liberty turbines alongside 39 1.5 MW GE turbines.

But the process was bruising, and, partly at First Wind's urging, Clipper hired Andrew Mathews from Unicredit, where he was the New York office's head of project finance, to be its newly-minted vice-president of wind turbine financing. Mathews has, according to bankers following the market, spent substantial amounts of time showing his former competitors around Clipper production facilities.

Institutional lifeline

Developers can accommodate most of the banks' more querulous tendencies, but their most frequent complaint centres on the tyranny of the mini-perm. Banks' post-credit crunch preference to lend at tenors of construction-plus five years leaves sponsors struggling to leverage their assets effectively. The tenor works well with the expected usefulness of wind depreciation tax benefits, which is nearer six years than the ten years for production tax credits.

But sponsors are looking again at the potential for long-dated institutional debt – both public and private – in refinancing construction loans. The product is not new, since FPL completed public bond offerings for wind portfolios in 2003 and 2005, and RES included a private placement in the long-term financing for its Hackberry project from late 2007.

But the pressure on sponsors is more intense, and the logic of an institutional placement more compelling. The remaining commercial banks with private placement capabilities, as well as the investment banks, are hungry to connect developers with the life insurance companies that dominate this corner of the project debt market. The life companies already have substantial experience with wind through their tax equity businesses.

The first institutional tranche to close since the crunch was the long-term debt for Acciona's Red Hills wind farm. Red Hills, a 123MW project located in Oklahoma, closed a $100 million tax equity commitment from JP Morgan and Union Bank and a $65 million debt tranche with Prudential Capital.

The reason for the size of the tax equity tranche is that Acciona has opted to take the production tax credit, a production-linked incentive that most developers have abandoned in favour of cash grants. "We think that the plant will operate at a high enough capacity factor to make the PTC the more attractive option," says Susan Nickey, Acciona Energy North America's CFO.

"The European bank market has come back," adds Nickey, "and there's more liquidity. But they don't do loans of up to 18 years like they used to." But developers want to see debt terms that more closely match the power purchase agreements they sign. Red Hills, for instance, has a 20-year PPA with the Western Farmers Electric Cooperative.

Sponsors have also tentatively approached the institutional loan, or B loan, market for holding company financing, with mixed results. First Wind closed a $115 million 8.5-year corporate loan with Alberta Investment Management Corporation in July, saying it would use the proceeds for general corporate purposes. It has not explained why the loan was necessary, although First Wind has been one of the more active developers in 2009, and more than one observer noted that it was forced to scrap a $450 million initial public offering in 2008.

At the same time as it closed the Alberta debt, it signed a $95 million loan agreement with HSH for the Stetson wind farm in Maine, which subsequently picked up $40 million in Treasury grants during the first round of awards. But bankers following the developer say that after a period of turnover in its finance team, including the replacement of Tim Rosenzweig with FPL's Steve Schauer, it is slowing down for a period. "I think First Wind is taking a bit of a breather now," remarks one long-time relationship banker, charitably.

ArcLight-owned Terra-Gen had less luck closing a $275 million holding company financing. It decided to pull the Citigroup-led deal after potential lenders asked for pricing that was too rich and discounts that were too deep for the sponsor to bear. The deal had the misfortune to be subordinate to other financings – not least some Citi-led tax equity financing – and to follow the ill-starred BRSP B loan that Barclays led for a CIT-owned gas-fired portfolio. Much like First Wind, though, it succeeded in closing a smaller-scale deal with HSH, together with CIT, in the shape of a $115 million turbine loan for its Tehachapi prospect.

One much anticipated structure that has yet to make an appearance is the leveraged lease, thought to be the simplest way for a sponsor to take advantage of residual depreciation benefits. Lawyers and bankers suggest that debt costs are currently too high to make a leveraged lease economical. But sponsors have three years to take advantage of a project's depreciation benefits. They may finance now, and lease later.