Green frenzy

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The Puglia regional government in Southern Italy has been crawling with photovoltaic developers over the last year, but as one Rome-based lawyer says, "for every 10 solar proposals we are receiving, only about two are bankable".

The Puglia region had enacted a regional law that fast-tracked the authorisation procedure for small photovoltaic (PV) projects. The region held that PV projects under 1MW capacity would be subject to the dichiarazione di inizio di attività (DIA) provisions. Applicants under the DIA can avoid the single authorisation procedure of central government that, among other things, requires an independent environmental impact assessment.

The Conto Energia

Under the Conto Energia, or new solar law, introduced by central government, Italy has one of the most hospitable feed-in tariffs for solar PV in Europe: the tariffs for installations over 20kW are Eu0.36 ($0.49) per kWh for fixed and tracking units installed on the ground and Eu0.44 per kWh for integrated units installed on buildings. These tariffs are fixed for 20 years, provide 75-80% of project revenue and create a solid base for project financings. In 2009 these tariffs will fall by 2% for new applicants and by a further 2% in 2010. Adding generous tariffs to a relaxed regional permitting regime has created an alluring mix, and the rush to develop (or speculate) has brought the bureaucracy of regional authorities to a near standstill.

In Puglia, serious developers were being held up alongside speculators and opportunistic landowners (the Italians call such parties "furbo"), who were hoping to secure authorisations for projects that they never intended to develop, in the hope of selling on land at a profit. Some landowners were dividing blocks of land and securing authorisations for each segment, with the intention of selling individual parcels of land to developers.

Puglia has taken remedial steps to try and focus on serious developers, and further restrict the type of land that can be developed, by proposing new regulations on 14 October. Applicants are now filtered by a requirement to have a project certified as financeable by a bank, and land that has been divided within the last two years will not be eligible for the fast-track procedure.

Sizzling solar

For projects over 1MW sponsors must go through the single authorisation procedure. Most of the PV projects that are being developed have a capacity around or under 10MW. Deutsche Bank Overseas Holding has secured Eu45 million from Dexia Crediop and SG for a 4MW PV plant in Puglia. The Italian listed cement producer Uniland recently secured Eu24 million in project financing for a 4MW plant in Puglia from Interbanca. Interbanca is also working on a 5MW plant sponsored by Belgian renewables firm Enfinity.

Enfinity will appoint three banks before the end of 2008 for an 11MW plant: one Italian bank, thought to be Unicredit, and two foreign banks. Enfinity has also appointed IKB and Interbanca for a 7MW plant.

Besides Enfinity, a number of foreign investors are looking to string together a series of 5-10MW PV plants to make a sizeable portfolio, including Spain's Fotowatio, which is thought to have a framework funding agreement with Santander, Germany's Pheonix Solar, and the UK's Foresight Group and Platina Partners.

Foresight is close to raising Eu50 million in equity to invest in Italy and has set up an office in Rome; even at a fairly conservative 80/20 leverage Foresight could raise project financing of around Eu250 million for 60MW in capacity. Domestically, private equity firm Solar Ventures has a solar development pipeline of around 200MW outside the Puglia region, in Alessandria, Arezzo, Foggia, Bari and Cagliari in Sardinia.

Bank weakness could spur larger portfolios

So far Italy has only around 85MW of installed PV capacity, and the current tariff regime has a cap of 1,200MW. However, the demand for authorisations is set to easily outstrip supply. Spanish developer Global Solar Fund Capital, advised by Goldman Sachs, has already racked up 120MW-worth of PV authorisations in Puglia and Sicily and is sounding out banks for Eu400 million in debt, although this could be split up into three or four lots depending on bank liquidity. Close is expected in mid-2009.

In the nearer term, project financings of between Eu20-Eu50 million (5-10MW) better suit domestic banks, because they are chronically short of capital. It is estimated that Italy's top ten banks will need an injection of around Eu30 billion from the Italian government to bring their tier 1 capital ratios in line with those of their recently-bolstered peers across Europe. Italy's two largest banks, Unicredit and Intesa Sanpaolo, need Eu7.8 billion and Eu7 billion respectively, according to research from Banca Leonardo.

But only domestic banks will be interested in financing projects below Eu30 million or so. Foreign banks, such as Calyon, RBS, BNP Paribas and SG, will mostly only participate in larger financings because the returns do not warrant the lead times. It is also in the sponsors' interest to negotiate a framework agreement or build out a portfolio through equity to avoid the disproportionately high transaction costs for a series of small project financings.

Foreign banks are also heavily capital constrained. While central government has attempted to provide attractive incentive regimes for PV and wind, and regional governments are attempting to streamline the permitting procedures, the biggest concern for banks is still liquidity.

Wind margins

As a reflection of their strains in this regard, margins for wind farm loans are currently around the 200bp to 250bp mark. The IVPC 5 refinancing is facing a difficult syndication even after two flexes brought the margin to 200bp. Participant interest is patchy. The deal signed on 9 September with lead arrangers RBS, ING and BNP Paribas, but only Barclays is thought to have joined the lead arrangers. Financing comprises Eu228 million in debt split between a Eu198 million 14-year term loan, a Eu23 million five-year VAT facility and Eu7 million in 12-year mezzanine debt.

Greentech Energy Systems, the Danish renewables firm and arguably the most constant foreign investor in Italian wind, closed a financing backing its 98.8MW Monte Grighine wind farm in Sardinia. Natixis provided a Eu100.3 million loan with a term of 15 years to the project. Greentech said in a statement that if the loan was fixed at close "the loan would carry a total interest rate of less than 6.5%" per year, which is equivalent to a margin of up to 260bp over Euribor. Upfront fees are thought to be around 100bp.

The corporate debt market is even harder hit than the project market, and that squeeze has provided some useful new business for project banks in Europe. Some European utilities are raising debt against their renewable assets or selling equity as an alternative to short-term corporate funding. The margin on corporate debt for an A-rated utility is around 300bp, against 200-250bp for project debt. The UK's Centrica is furthest down this route and has mandated BTM to provide debt for a wind asset-based loan. Portugal's EdP, the Czech utility CEZ and a host of other European utilities are thought to be looking at this strategy.

Enel favours an equity sale, and is looking to divest a minority stake of up to 40% Green Power, its renewables division with 4200MW installed capacity, for up to Eu2.5 billion by 2010.

Liquidity pools

The Italian government has made progress to address the problem of commercial bank liquidity by allowing SACE to provide direct commercial-risk guarantees to banks, and moves are afoot to tap the postal savings of Cassa Depositi e Prestiti (CDP), which could be permitted to lend up to an additional Eu100 billion. It is unlikely there is sufficient political will for such a substantial increase in CDP indebtedness (See the PPP section of Deals & Developments this issue for more) but CDP seems certain to play a more active road in transport financings and possibly energy projects.

SACE, better known as Italy's export credit agency, has been able to guarantee project debt within Italy since late 2007. The first time it did so was on the Trattamento Rifituti Metropolitani (TRM) waste to energy project in Turin, which closed at the beginning of December. Unlike a typical PPP, the sponsor is made up of a consortium of local municipalities.

BNP Paribas solely committed to the deal before the summer and underwrote a 20-year Eu375 million term loan and a Eu37 million 8.5-year VAT facility with margins of around 100bp but chunky fees of 200bp. SACE is covering Eu85 million of the debt, and the EIB and Unicredit have come in at senior syndication for Eu73.5 million and Eu180 million, respectively. This is the first time the EIB has directly lent on a project finance transaction in Italy.

SACE has quickly followed up with its second deal, which closed on 5 December, guaranteeing around one-third of the debt for Falck's 53MW wind farm in Minervino Murge. The deal was held up by the global banking turmoil but was eventually closed by Intesa arm, Banca Intesa Infrastrutture e Sviluppo, CDP and SG. BBVA was going to enter the deal as a lead arranger but pulled out, with Dexia expected to fill its place before later declining.

Because of EU state aid rules SACE cannot provide direct loans, only guarantees to projects, so its involvement only partially meets the problem of liquidity by reducing the regulatory capital banks must keep in reserve against the commitments under Basel I and II. Banks must still find the cash to fund these commitments.

While the EIB took an active role in the Turin waste-to-energy project, it is unlikely to take a large role in the Italian renewables market in the future. PV cells are not deemed technologically risky enough for wholesale EIB participation, although it could come in on large portfolio financings. On the other hand, the cost of wind power is prohibitively expensive for EIB guidelines: the EIB limits its participation to projects where the equivalent cost of power is below Eu1.1 million per MW, while in Italy the average cost is nearer Eu1.9 million per MW. According to one market participant, the principal reason why wind farms are comparably so expensive in Italy is because turbine suppliers include a mark-up to compensate for the longer lead times caused by permitting bureaucracy and legal challenges.

Changes to Law 488

Finding funding for wind farms in deprived areas in the South of Italy has benefited from the capital grants that were passed in the Budget Law 2003 by decree 289/2003. However, in a similar process to what happened in Puglia in the solar sector, this regime was open to speculators who acquired grants without serious intention of development. The capital grants were then changed to subsidised loans administered by CDP, which carried a flat 50bp margin, through reform of Law 488 by law decree 35/2005. This has in turn been superseded by an abrogation to law 488 via decree 81 in July 2007 which replaced the subsidised loan regime with tax concessions available to the project company on revenues along the life of a project.

The recent close of Iberdrola and API's 342.4MW Societá Energie Rinnovabili (SER) wind farm soft loan refinancing is therefore a legacy deal. The wind farms are located in Sicily and the Puglia region. RBS was the financial adviser and a lead arranger alongside Banca Intesa, BBVA, BNP Paribas, Calyon, Fortis, ING, and Unicredit. Local banks Centrobanca, Banca delle Marche and Banca Toscana came in at sub-level.

The deal has a complex double structure, split between a holding company that contains six wind farms that are not subsidised, with a capacity of 134.1MW or 39% of total capacity, and ten wind farms with a capacity of 208.3MW that benefit from Law 488 soft loans for their eligible costs. Eligible costs exclude costs such as IVA, insurance costs, interest during construction, reserve accounts pre-funding and hedging payments.

Because the CDP requires that the financing of non-eligible costs has to be subordinated to the soft loan, some facilities will be provided to the holding company and then lent on to SER1.

The final structure comprises a Eu112 million facility A provided to SER to contribute share capital and subordinated debt into SER 1. These contributions will fund SER 1's non-eligible project costs. A Eu230 million Facility B is split 50/50 between a CDP soft loan and an RBS law 488 loan. RBS acts as lender of record for the facility, and in turn benefits from counter-guarantees from the other lenders on the transaction. The presence of the lender of record is driven by 488 law which allows only one additional lender to CDP.

In addition to the soft loan and the RBS loan, a revolving bridge of Eu142.8 million will be provided to SER and on-lent to SER 1 in order to fund working capital needs stemming from the fact that the CDP soft loan and the RBS loan can only be drawn semi-annually, while project costs will arise on a monthly basis.

Margins on the commercial debt are around 100bp over Euribor and the CDP and RBS soft loan bears a margin of just 50bp flat. The overall average debt service coverage ratio (DSCR) is 1.45x and minimum DSCR is 1.3x.

The SER project will benefit from green certificates. Under a new budget law, after 31 December 2008, renewable developers that apply for a Law 488 subsidy will not be issued green certificates to avoid a double subsidy.

Legal and regulatory uncertainty

While the 20-year Conto Energia fixed tariffs have supplied a stable footing for PV project financings, the green certificate regime for wind farms has become increasingly volatile since the Budget Law of 2007. The basic structure of the Italian tariff system for electricity generated by renewable energy remained unchanged so that the total tariff consists of the sum of the price of the electricity sold and the price of the green certificates sold.

The legislation increased the allocation of green certificates to 15 years from 12 years and increased the percentage of sales that utilities must generate from renewable sources or meet with a corresponding number of green certificates. The rules pushed up the percentage share for utilities in 2008 to 3.8%, increasing 0.75% a year until 2012.

The 2008 Budget law also set up a new tariff system with a reference price of Eu180 per MWh for the total settlement of electricity generated by renewable energy (green certificates plus market price of energy).

Under the system, GSE, a company owned by the Italian government, is set up as both a seller and buyer of green certificates: selling green certificates at a price calculated as the difference between the Eu180/MWh reference price and the average price of electricity in Italy in the previous year. It buys green certificates in the market at a price corresponding to the average price of green certificates in the year before until renewable energy equals 25% of all generation.

These changes were meant to bolster the price of green certificates and provide stability, but failed on both counts and the result has made wind farms more difficult to finance. In January 2008, following the changes, green certificate prices fell from a peak in 2007 of around Eu130 per MWh to just Eu65 per MWh. A decree is now being discussed to improve the stability of green certificates further, although most market participants are pessimistic about the government's willingness to boost green certificate prices.

The proposed changes include increasing the term when the average price of energy and certificates is calculated by GSE from one year to three years to dampen price volatility and allowing project companies to sell green certificates each year rather than at the end of three-year cycles.

Wind projects that have a long-term green certificate offtaker, or a power and green certificate offtaker from an industrial user, are at a distinct advantage in the current banking climate, allowing banks to model a floor to revenue.

Aside from the green certificate issue, there is also legal uncertainty regarding the permitting and incentive regime for the upgrading of wind farms, which makes new investment almost impossible.

Regional issues

Prospective sponsors of wind and solar capacity also have to deal with region-specific uncertainty. Sponsors that have received authorisation under Puglia's DIA before changes to the local law are concerned that the new regulations will take effect retroactively, and are seeking legal advice on case-by-case basis.

With high levels of irradiation in the south of the country, both Sicily and Calabria are looking to emulate Puglia's example in solar and are considering local laws. No region is perfect for solar, however, because sponsors will have to overcome poor interconnection infrastructure in remote areas and deal with politicised challenges to greenfield development. Most of Italy, but particularly the South and the islands, has to weigh the need for renewable energy against public opposition to the siting of facilities. Greentech, for instance, had to endure a lengthy moratorium in Sardinia before it could develop onshore windfarms.

Both Sicily and Calabria have moratoriums on renewable projects that are unlikely to be removed until the middle of 2009. Calabria's moratorium was placed on the back of an investigation into the bribery of public officers in the awarding of renewable project permits.

The moratoriums have suspended progress on a number of projects, particularly in Sicily. Enel and Sicilian developer Moncada Energy announced a Eu500 million joint venture for an offshore wind farm earlier this year. And Moncada is thought to be looking to develop two onshore wind farms in Sicily with a capacity of around 50MW each. Moncarda is also looking to integrate thin film solar film with its wind farms. Enel recently signed a JV with Sharp for a Eu2 billion investment in 189MW of solar plants by 2012 and a thin film factory.

Aside from Moncarda, there is evidence that the fragmented solar market in the South is changing, with larger and more creditworthy sponsors emerging such as Ecoware and Enerquos. While some progress has been made with the regulatory and incentive regimes, regional and central governments still cannot match developer ambition.