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North American Renewables and Overall North American Deal of the Year 2003

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US wind developers often hear that they have a lot to learn from the European experience. Indeed, the US incentive regime is less flexible and focused on the tax system, while permitting remains an emotive issue. However one area where the US has strode ahead of Europe is in accessing the capital markets. FPL Energy's $380 million project bond for part of its wind portfolio is the first capital markets financing ever in the sector.

FPL Energy is by far the largest wind developer in the US - only AEP comes close. So acquisitive is it that smaller developers often present their financing options as finding a financial investor or selling to FPL. FPL, sister to Florida Power & Light, now has over 2,719MW of wind assets in operation. It recently bought out 109MW of wind capacity from Enron.

FPL, like its peers, has usually used the bank market to finance its wind ventures, relying on the small number of European banks interested in lending against wind credits. But this money carries a high margin and relatively short maturities - 13 years is a respectable effort. To take a substantial slice of its portfolio off balance sheet it looked over the heads of the European players to the domestic capital markets, which had not previously tasted wind risk.

But the timing was perfect for an approach to bond investors, since, like other award winners this year, low interest rates have made well-structured bond deals very attractive. The biggest challenge is persuading potential investors that wind risk is understandable and manageable - since it affects both the underlying economics and the incentive package. The deal also had to pass assessment by the rating agencies, which had not publicly done this analysis before.

The FPL Energy American Wind portfolio consists of 685 turbines with 697MW of capacity located in six states across the US. Of that total, 350MW was not operational at the time the bonds went out. The deal, however, was not going to include construction risk - completion carries a guarantee from FPL Group Capital, which has an A2/A- (Moody's/S&P) rating.

The projects are: High Winds (California, 145.8MW, Vestas V47, selling to PPM, part of Pacificorp), Cerro Gordo (Iowa, 41.2MW, NEGM 750, to Interstate Power & Light), Hancock (Iowa, 97.7MW, Vestas V47, to Interstate, as well as three Iowan municipals), Lake Benton II (Minnesota, 103.5MW, Zond Z-50), to Northern States Power, part of Xcel), Montfort (Wisconsin, 30MW, GE 1.5, to Wisconsin Electric), New Mexico (204MW, GE 1.5, to Public Service Company of New Mexico) and Southwest Mesa (Texas, 74.9MW, NEGM, AEP and Southwestern Electric Power).

The portfolio has the advantages often assigned to a merchant power portfolio - that of geographical diversity, but also contracts running from between 2011 and 2028. Only 15% of the portfolio will be out of contract when the bonds mature. All but Cerro Gordo (enXco) and Montfort (GE Wind) have FPL as operator.

The other key element underpinning wind's economics is the Section 45 production tax credit - which provides 1.8 cents in tax credits for every kWh produced. This must be renewed by Congress periodically, and applies to projects installed before a certain deadline. At present, the credit, which lasts for 10 years, has expired, and projects coming online in 2004 will not benefit, unless a new energy bill passes, or another bill carries the credit.In this uncertain environment, many bank lenders have said that they are uncomfortable with a project relying on the tax system to be economical. As such, and although the cost of wind power approaches that of gas-fired power, the sponsor has decided to make the provision of the tax credits a corporate obligation, with the result that FPL will be responsible for between 36.6% and 24% of the project's cashflow over the life of the notes.

On two of the most unfamiliar aspects of the credit, therefore, the sponsor has stepped up to provide comfort to bondholders. Indeed, in the offering circular, the issuer highlighted FPL's ownership as a key strength. Nevertheless, on wind and interconnection risk, the bondholders and agencies need to understand the risks involved.

This is an area where European bankers and sponsors are much more comfortable, since despite the efforts of wind's proponents it is still perceived as a risky and untested technology, and wind as a resource is seen as difficult to quantify. This judgement, while probably unfair, explains the lengths to which the sponsor went in explaining the varied wind resources to investors. It also explains Garrard Hassan's stranglehold on the independent engineer work in the sector.

The project garnered a BBB-/Baa3 (Moody's/S&P) rating, a level that participants have suggested could have been higher. The bonds, underwritten by Credit Suisse First Boston, and co-managed by Scotia Capital and Credit Lyonnais, priced at 295bp over the 10-year Treasury for a 6.639% coupon. The scale of demand was such that FPL issued a $125 million holding company subordinated financing, again through CSFB, that also sold strongly. These bonds, with a 14-year maturity and Ba2/BB- rating, carried a 6.75% coupon. FPL will continue to finance plants in the bank market, usually for smaller sized deals. But the original wind bond should be an example to its peers both in the US and globally of what the bond market can do. Further growth in sponsor's portfolios can only encourage this migration.

FPL Energy American Wind

Status: Closed June 2003

Size: $380 million

Location: United States

Description: 692MW wind farm portfolio financing

Sponsor: FPL Energy

Underwriter: Credit Suisse First Boston

Coupon: 6.639%, or 295bp over the 10-year Treasury

Maturity: 2023

Lawyers to the underwriter: White & Case

Lawyers to the sponsor: Hogan & Hartson

Wind resource consultant: Garrard Hassan