Desert Sky

01/03/2003

Americas Renewables Deal of the Year 2002

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When the Desert Sky wind project acquisition closed on 29 August 2002, it not only made sponsor American Electric Power (AEP) one of the biggest wind energy operations in the US, but also confirmed that bank appetite for US renewable power exists, albeit not in the US banking sector as yet. This was a US deal, for a US sponsor, done by European banks in a sector where technology is driving vastly improved deal economics against a backdrop of US power market despondency. Simply put ? a good sell in a hard market.

The deal, acquired by AEP post-construction from Enron, received a very strong response from European lenders. AEP went out to 12 institutions, both banks and insurance companies, to broadly test the market and received proposals from 10 of them. Offer tenors ranged from 10 to 19 years and rates were fairly consistent.

?We are very pleased with both the response and the final deal,? says Randy Boteler, director of wholesale finance, AEP. ?Fortis stepped up to underwrite the entire loan and quickly sold it down in an otherwise tough market.?

The $178.3 million project is split into a $120.7 million 15-year term loan and $57.6 million in equity. Pricing on the 15-year debt started at 162.5bp over libor for years1 to 3, stepping up to 175bp for 4 to 7, 187.5bp for 8 to 10 and 200bp plus for 10 to 15.

Lead arranger and underwriter Fortis took $19.6 million and pulled in Royal Bank of Canada, Dexia and Rabobank Ireland as co-arrangers with $17.7 million a piece. Participating banks were NIB Capital ($16.5 million), Landesbank Baden-Wurttemburg (16.5 million) and ANZ (15 million).

Milbank Tweed Hadley & McCloy were legal counsel for the lenders, with Jones Day acting for AEP. Garrad Hassan provided technical advisory.

Located near the far west Texas town of Iraan, the 160.5 MW wind farm consists of 107 1.5 MW turbines ? the largest wind turbines manufactured in the US ? spread over a 15 square mile area in Pecos County on Indian Mesa The farm can produce power for up to 54,000 average US homes, using 69KV and 138KV lines to carry power into the Texas network.

Risk on the project is mitigated by a full power purchase agreement (PPA) with City Public Service of San Antonio. PPA tenor is 20 years (84%) and 15 years (16%). Furthermore, GE Wind (which acquired Enron Wind) is providing certain maintenance and operations functions under warranty.

Evaluation of the long term wind risk has also been extensively studied ? Desert Sky has 8-plus years of historic data by meteorologists. Wind, like temperature and rainfall, tends to fall into long-term patterns and can be projected with an ?

acceptable amount of certainty,? says Boteler.

The transaction also benefited from a special tax component, under Section 45 of the federal tax code, which allows a 1.5 cent per kilowatt-hour production tax credit (PTC) for electricity produced using wind. And PTC may be extended further this year.

Given the pluses on Desert Sky, the lack of US banking input on the deal is hard to fathom. The US banks are unfamiliar with the sector while most of the Europeans, particularly Desert Sky arranger Fortis, have longstanding wind portfolios. Nevertheless, the US banking sector has also shown no real appetite to get into the market at a time when, as Boteler says, ?the cost to generate is becoming very competitive with gas-fired generation?.

Despite the perceived lack of US bank interest and the voiced ambivalence to global renewables by the Bush administration, the US wind market is strong and growing. New equity sources are coming into the market and that bodes well. But for the present, Desert Sky demonstrates a simple market facet ? that wind projects that are well-structured can attract good financing terms even in weak markets.