Middle East Renewables Deal of the Year 2011: Zorlu Enerji Pakistan

09/02/2012

The 56.4MW Zorlu Enerji Pakistan wind project (also known as Jhimpir Wind) is the first internationally financed wind farm in Pakistan with a foreign investor Turkish developer Zorlu. With four years of bankable wind data and a strong risk allocation structure, the deal incorporates the groundwork for future foreign investment and financing in the fledgling Pakistani renewables sector.

Pakistan relies heavily on imported fossil fuels for its energy needs. Even so, 30% of the population does not have access to electricity. Furthermore, power demand has surged by over 40% in five years, resulting in regular brownouts in all major urban centres and the introduction of power rationing.

On the back of an estimated 50GW national wind power potential Pakistans government has pledged to diversify its power mix. In October 2011, the National Electric Power Regulatory Authority (NEPRA) approved a Rs12.61 per kWh feed-in tariff for foreign- financed wind power projects, and Rs17.28 per kWh for locally financed projects that reach financial close before December 2012. It has also set a target of generating 1,500MW from wind power within the next three years.

But while state support for wind is in place, given the political risk in Pakistan, bankable deals require sponsors with a strong track record. Zorlu has such a record seven small hydro electric power plants with a total capacity of 111MW, 15MW of geothermal and its 135MW Rotor Elektrik wind farm in Turkey (PFs European onshore wind deal of the year 2009). Like Zorlus Rotor financing, Zorlu Pakistan is both commercial and multilateral lender-backed, with debt from the Asian Development Bank, International Finance Corporation (which also lent on Rotor), Eco Trade and Development Bank and Habib Bank.

The financing is relatively straightforward a 70/30 debt to equity ratio, with Zorlu investing $48 million of equity and the lenders providing $111 million of 12-year (inclusive of two year grace period) debt at the following levels: IFC $38.1 million, ADB

$36.8 million, Eco Trade $20 million and Habib Bank $16.2 million equivalent in rupees. Pricing on the dollar-denominated debt is 450bp over Libor and on the rupee debt 300bp over Kibor.

As with many cutting edge emerging market deals, the project did not have a completely smooth transition to financial close. The scheme started life in 2007 when Pakistan awarded Zorlu Enerji a letter of intent for a 49.5MW wind plant in two phases a first phase of 6MW (5 Vensys 1.2MW wind turbines) and a 43.5MW second phase (29 Vensys 1.5MW turbines). In 2007 and 2008 approvals were granted, pre-feasibility studies completed and financing arrangements put in place.

After the start of first phase construction the 2008 global financial crisis hit. The projects lenders (Standard Chartered, DEG, KfW, Proparco) stepped away and the Czech equipment supplier Vensys CKD folded. Zorlu was thus forced to complete construction of the 6MW phase 1 with 100% equity in 2009.

By 2010 Zorlu was again in a position to look at financing for phase 2 and signed new turbine contracts with Vestas for V90 1.8MW machines, and increased the total capacity of the project to 56.4MW. Consents were renewed and all the project development activities repeated for the new equipment supply and lender line- up. Equipment supply agreements were signed in February 2011.

The deal benefits from Pakistans cost-plus model adapted to renewables from the thermal independent power project sector but with the government also assuming wind risk. The NEPRA looks closely at the project costs of a sponsor and the tariff is approved with a pre-defined internal rate of return (IRR) for the sponsor. On thermal projects the IRR is 15%, while for wind projects it is nearer 17%. The sponsor may squeeze slightly higher returns than 17% with cost savings on the O&M contract.

The project will sell power to Pakistans National Transmission and Dispatch Company (NTDC) through its Central Power Purchasing Authority under a 20-year take-or-pay power purchase agreement that comes with a full sovereign counter-guarantee. The existing 6MW wind farm has been dispatching power to the Hyderabad Electric Supply Company but will also be part pf the NTDC PPA once the second construction phase is complete.The tariff drops by around two-thirds once the project debt is paid down 10 years after completion.

At the heart of the deal is the risk allocation structure. In addition to taking on the wind risk, the Pakistani government is also providing exchange rate risk coverage, interest rate coverage and tax exemptions. Furthermore, the remaining risks are allocated to project contractors (both engineering, procurement and construction and operations and maintenance) with Zorlu Holding covering overall construction risk.

Zorlu Enerji Pakistan
STATUS: Signed 26 October 2011
TOTAL PROJECT COST: $158 million
DEBT: $111.1 million
DESCRIPTION: Development of 65.4MW wind farm in Jhimpir, Thatta, Pakistan
SPONSOR: Zorlu Enerji Elektrik Uretim
GUARANTOR: Zorlu Holding
MLAS: ADB, IFC, Eco Trade & Development Bank, Habib Bank
SPONSOR LEGAL COUNSEL: Clifford Chance (international); Mandviwalla & Zafar (local)
LENDER LEGAL COUNSEL: Shearman & Sterling (international); Haidermoto & Co (local)
INTERCREDITOR AGENT: Bank of New York Mellon
SECURITY AGENTS: Bank of New York Mellon; Habib Bank
SPONSORS TECHNICAL ADVISOR: Ipek Energy GmbH
LENDER TECHNICAL ADVISER: Sgurr Energy Limited EPC Zorlu Industrial Pakistan; Vestas O&M Zorlu O&M Pakistan; Vestas