DEAL ANALYSIS: Salkhit

07/09/2012

Mongolia is exercising a strong pull on project finance lenders, particularly on the back of its booming resources economy. But the first project financing in the country, and its first independent power project, is a wind farm developed by a local conglomerate that studiously avoids mining.

The $122 million Salkhit wind project roped in $85 million in 15-year debt from two development banks the European Bank for Reconstruction and Development and FMO. It also attracted a substantial equity commitment from its turbine supplier, GE.

The Mongolian generation fleet consists of about 868MW of ageing coal-fired capacity, and the country benefits from some limited interconnection with the Chinese and Russian power grids. The country lacks access to gas, and its comparatively transparent government has embarked on a policy of attracting foreign investment that might lessen its dependence on its neighbours.

The 49.6MW Salkhit plant is located at Salkhit Uul (literally, Windy Mountain), 75km from Mongolias capital Ulaanbaatar. The Mongolian government embarked on wind studies from 2004, with funding from USAID and the US National Renewable Energy Laboratory. The studies confirmed an impressive resource, though as Bayanjargal Byambasaikhan, Newcoms chief executive officer, notes, back then the country wasnt really on any investors maps.

In 2005, the Mongolian government set a target for the proportion of its power coming from renewables to stand at 25% by 2020. Salkhit alone will account for about 5.4% of the generation mix, though economic growth is likely to drive additional demand for new power generation capacity of all types.

The founders of Newcom, which houses airline, telecoms operator and real estate development operations, enthusiastically pursued the Salkhit project until 2010. The plant, like future renewables projects, benefits from a 26-year feed-in tariff based power purchase agreement with the Mongolian National Transmission Company. The original version of the PPA, however, was not bankable, and so in 2010, Newcom started work on revising the PPA and producing a feasibility study for the plant.

The earliest version of the project proposed using 750kW turbines, because Mongolias climate, terrain, and poor transportation infrastructure would make installing and maintaining larger units difficult. Still, when Newcom held a tender for a turbine supply and maintenance contract it was able to narrow the field to GE and Siemens, with both offering larger machines.

The winner GE was willing to adapt its existing 1.6MW XLE turbines to operating in the unforgiving Mongolian climate, and assuring sufficient reliability despite the projects distance from sources of resupply. GE also took a 21.5% stake in the project through GE Pacific Private, when the equity and debt agreements signed in March 2012.

Export credit agency support was not a factor in the decision, because the EBRD had been assisting the developer since before 2010. It assumed some development risk, and ultimately took a 13.75% stake in the project company. Rounding out the equity contribution was Dutch development bank FMO, which started looking at the plant in 2009 and also took 13.75%, leaving Newcom with 51%.

The EBRD took slightly less of the debt for Salkhit $42.4 million to FMOs $42.6 million. Both lenders have experience of emerging renewables regimes, the EBRD in Eastern Europe and FMO in a variety of African and Latin American markets. They spent some time acclimatising themselves to the security regime on offer to credits, including the lack of a mortgage over the state-owned land on which the project was to be located, and over the shares of the project company. The financing does benefit from security over project assets.

The two lenders pronounced themselves broadly happy with the regulatory framework, and did not insist on the suite of sovereign guarantees that export credit agencies often demand on untested offtake contracts. The Mongolian government did issue a support letter promising that the project would be dispatched in priority to other generators.

The Mongolian market is currently undergoing reform, and there is likely to be a much bigger role for private generators, though the transmission operator will stay in state hands. The manufacturing and mining industries may be able to build captive capacity, though both industry and government will need to work hard to balance intermittent renewables capacity, because the most obvious sources of balancing capacity, including diesel, gas and hydro plants, are not plentiful.

Given the low base from which it is growing, additional development is likely to be incremental, with one large upcoming exception. The upcoming CHP5 combined-heat and power plant, while procured as a PPP, will benefit from the Salkhit experience. Newcom owns 10% of the consortium that is preferred bidder on the 415MW (power)/587MW (steam coal fired plant), while International Power (30%), Sojitz (30%), and POSCO (30%) are the remaining sponsors. Newcom also controls 260,000 hectares of the Gobi Desert that might be suitable for wind development, but may require Chinese offtakers.

Clean Energy LLC

Status

Signed March 2012, closed 17 July 2012

Size

$122 million

Description

49.6MW wind farm located in Salkhit Uul, Mongolia

Sponsors

Newcom (51%), GE Pacific Private (21.5%) EBRD (13.75%), FMO (13.75%)

Debt

$85 million 15-year loan

Turbine supplier

GE

Balance of plant contractor

Leighton

Providers

The European Bank for Reconstruction and Development, FMO

Sponsor technical adviser

Sgurr

Lender technical adviser

Mott MacDonald

Lender legal counsel

Norton Rose; GTS (local)

GE legal counsel

Hogan Lovells