China WindPower: the first western-financed wind project in China

Arron Merat

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Project finance lending is about taking calculated risks to reap calculated rewards. Risk is mitigated as far as possible, either by consultation with the sponsors or by offering less favourable terms, but there comes a point where the sum of component risks become too high to make a project untenable to debt-finance.

On the face of it the 201MW China WindPower development sounds like a fine example of a project that's a couple of miles beyond this point, and yet another to be added to the huge pile of projects that never materialised. But a mixture of determination and serendipity has seen 134 Sinovel wind turbines erected on the edge of the Gobi desert in one of China's poorest provinces [Transactions Database].

In terms of risk, the biggest elephants in the room were as follows:

- In China, the PPA is signed *after* construction; a prospect that is anathema to lenders from US and European markets
- China has a byzantine regulatory regime; understanding it is one thing, but having trust in it is quite another
- Wind PF is uncharted territory; foreign lenders have never lent to wind project in China

“It was hell for the standards of overseas financial institutions,” says Roger Lui, a partner at Allen & Overy, the law firm tasked with advising the lenders.

“People have been realistic coming into the deal, knowing that the whole bundle of project documentation is Chinese documentation and understanding that there is not going to be a perfect set of risk allocations or perfectly crisp terms.”

Wind power in China has been a thriving – but exclusively domestic – industry for several years because the country has the finance, the technology and the sponsors to meet its renewable targets. According to Lui, foreign investment in the country has in part been crowded out by Chinese lenders because “you're always up against the challenge of the sponsor saying ‘well, I can borrow without the hassle from a local bank’."

The 201MW China WindPower project has surmounted this challenge with the help of the World Bank. The International Finance Corporation, part of the World Bank Group, provided US$45 million on a twelve-year tenor in the form of an ‘A-loan’, as well as US$10 million in equity. The remainder of the debt, US$95 million, was syndicated out to three banks in the form of a ‘B-loan’, with equal status to the A-loan. The tenor on the B-loan was 10 years, the rate was 350 bps above LIBOR and the fee was 150 bps above LIBOR. The B-loan was financed in the following tranches:

- Intesa SanPaolo (US$35 million)
- Société Générale (US$35 million)
- Rabobank (US$25 million).

The sponsor, China WindPower, provided US$109 million of the equity, making the total project finance package worth US$259 million, with a debt to equity ratio of 58:42.

The World Bank's involvement turned the project from a risk into an opportunity for the commercial lenders. The IFC became involved because it was the first time the project sponsor was a private company, as the vast majority of power projects in China are developed by state enterprises. The multilateral held the hands of the lenders and gave them "soft protection" from political and regulatory risk by holding the ear of their shareholders, the Chinese government.

"These are risks that IFC as a development institution focused on the private sector is more open to," says Matt Morrison, head of IFC syndications in Asia, referring to the custom to sign PPAs after construction.

"The challenge was to get banks comfortable with them," he said. "There is a lot of enthusiasm from banks to do renewable deals and power deals in China but many banks that were initially interested dropped out because they could not get comfortable with some of the risks."

"We don't offer guarantees but the fact that we have access to the government acts as a risk mitigant that some of the banks valued."

Although the deal falls short in many places on contractual guarantees, lenders' fears were allayed by moves in recent years by China to incentivise renewable technology to meet its ambitious renewable targets: 15 per cent by 2020, including 150GW of wind.

A fine example on how risk was reduced in this project is the PPA. Officially it still has not been signed, but a 25-year agreement with the Gansu Provincial Grid Company has been "approved" by the National Development and Reform Commission (NDRC). Coupled with Lui's assertion that "the government wouldn't want a high-profile deal like this to fail, especially with the involvement of the IFC", the NDRC approval has been given the equivalent weight of a Western contract.

Marc-Henry Lebrun, who worked on the deal for Société Générale, said that the bank set up a tailor-made foreign exchange hedging strategy to ensure protect them against fluctuations in the Chinese Renminbi (RMB).

"It allows the project cash flows to be protected under a RMB devaluation while leaving in the upside of a RMB appreciation," says Lebrun.

"Interest rate hedging was tailor made to cover 90 per cent of senior debt while ensuring that no breakage costs would arise if the cash sweep is triggered."

China WindPower is a first for western commercial banks in the Chinese renewable sector, and could encourage domestic sponsors to embrace US and European PF models, but there is a long way to go yet.

A revealing rule in China's regulatory regime states that a low-carbon project with majority foreign ownership does not qualify for Clean Development Mechanism (CDM) concessions. China WindPower has passed a number of economic and political milestones, but though indisputably a success story it is no sign that China is opening the flood gates of its lucrative renewable sector to western financiers any time soon.