

MEERWIND GETS PE APPROACH

THE MEERWIND OFFSHORE WIND FINANCING BOUGHT A PRIVATE EQUITY APPROACH TO A LARGE-SCALE, INDUSTRIAL-TYPE PROJECT. BY **ROD MORRISON**.

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Peter Giller is well known in the power project finance industry. In the 1990s, he was head of ABB Ventures and then moved to head the new International Power company in 2000 until 2002, opting to take all his pay in shares. US-based private equity firm Blackstone is well known in the independent power project (IPP) business too. It took over another well known name, Sithe Global, in 2005.

The two combined on the Meerwind project, one of the first offshore wind farms financed in Germany. Giller works for project company WindMW and Blackstone is the lead investor in the scheme.

The key to the Meerwind approach was negotiating the supply contracts, says Giller. A small team of a dozen employees and consultants based in Bremerhaven worked on getting the eight supply contracts into a bankable state. Giller worked closely with Watson Farley & Williams partner Malte Jordan on the contracts. While offshore construction risk scares quite a few, he said the contract work was straightforward – the issue is the multiple nature of the contracts. He contrast this to negotiating a much more complex lump-sum gas turbine contract with just one supplier.

While Giller worked closely with Jordan, Watson Farley & Williams was actually assigned as lenders' counsel on the deal. This avoided legal duplication on the contract work and in effect, Watson Farley acted for both the sponsor and the lenders. Once the contract work reached an advanced stage, Blackstone started working on the financing from its New York offices.

In a way, the project development work was fairly straightforward. There was no power offtake to negotiate given that the offtake is governed by tariffs set by the government. The focus is on the industrial side of the scheme – the construction and operations and maintenance (O&M).

Blackstone has clearly been encouraged by its experience in the sector. The day the Meerwind financing was announced in August, it announced its second German scheme – Nordlicher Grund, a 320MW project that is expected to cost €1.3bn. Blackstone bought the development from Eolia Renovables.

Giller said the Nordlicher scheme should be easier to transact, with many aspects adopting a

cookie cutter approach from the Meerwind experience. However, there could be important differences. Meerwind will use Siemens turbines while the choice of turbine supplier on Nordlicher is due to be decided within the next month. The project will have 64, 5MW machines and be located 100km from the coast. Construction is due to start in 2013 and be completed in 2016. Blackstone is solely focused on the German offshore market and no others in Europe.

The 288MW Meerwind scheme was initially developed by Windland Energieerzeugungs, a Berlin-based company headed by Joachim Falkenhagen. Blackstone bought into the project in 2008 and now holds 80% of the equity, with Falkenhagen keeping a residual interest.

Project development then stalled until early 2010 due to permitting issues with other wind farm sites. From the time work restarted to financial close was therefore relatively short, a year and a half, and certainly very short compared with other development timetables in the German offshore sector where deal closings have been few and far between – despite a large list of potential schemes.

The Meerwind project financing totals €1.2bn, with €822m coming from senior debt from seven project finance banks. One of the drivers for the financing package was having a 15-year tenor post-construction. This is actually two years beyond the feed-in tariff, which runs for 12 years plus one. The longer tenor allowed more debt to be raised on the project and kept the debt equity split at 70/30. This was an important consideration for a private equity sponsor such as Blackstone. To give the lenders' comfort, cash sweeps kick in earlier in order to repay the debt before the 13 years is reached.

The German tariff system has two options – the standard tariff and the compression tariff, which improves a project's upfront net present value (NPV) by paying higher tariffs upfront. Meerwind opted for the standard tariff, as the compression tariff details are still being finalised. However, with the agreement of its funding banks, it is likely to opt to switch at a later date.

The important driver on the financing – and on the project as a whole – was the

treatment of construction risk. Indeed, given the embryonic nature of the offshore wind market, this is a key viable for all deals currently seeking finance. Banks are nervous about taking construction risk.

The scheme follows the multi-contractor construction procurement route that has been accepted on the few offshore deals done thus far in Europe. There are eight construction contracts on site. The Meerwind project company and specialist local contractor K2 Management will provide the contract co-ordination services during construction, given there is no one single point of responsibility.

Jerome Guillt, managing director of one of the financial advisers on the scheme, Green Giraffe Energy Bankers, says the key to getting banks comfortable without the need for an overriding construction wrap or guarantee from one party is to negotiate detailed transparent contracts with the contractors and to make these available for the banks to review.

He believes that project developers from the utility side of industry can negotiate less detailed contracts with their suppliers, knowing that if anything goes wrong on a specific project they can exert pressure on their contractors through their other projects, current or future. For a single asset scheme being developed by private equity sponsors, this sort of pressure cannot be applied. Therefore, detailed negotiations are needed.

“The contracts are not necessarily better or worse from a risk perspective, but they are more explicit and more detailed,” he said. Areas nailed down include caps on variations, scope, duration, warranties and exit clauses. Operations and maintenance (O&M), once the key construction phase is out of the way, is another important factor. Indeed, after construction is complete, O&M and insurance are the main ongoing regular costs to the project.

Siemens is supplying 80, 3.6MW turbines to the scheme and will provide the ongoing O&M services for five years, plus an option to extend for a further five years. The O&M cost is fixed-priced and this pleases the banks, which like certainty. However, on future deals, the developers and the O&M contractors are likely to haggle over the O&M terms as there is a wide expectation that O&M costs are coming down.

Whether there is such a wide gap between the utility developer approach and the financial developer approach might be debated by utilities. However, the contingent facility on top of the senior debt on Meerwind, to cover construction risk, is hardly excessive, certainly compared with some other deals, at €63m or 7.1%.

Operational phase risks have, of course, yet to be tested to any great degree in the offshore wind sector. The Meerwind project will be 50km off the German coast in the North Sea, so it will face the full force of a bracing marine, salty environment.

In terms of energy yields from the wind – the great curse of the onshore wind industry, particularly in Germany – investors and funders are said to be more relaxed about the prospects in the offshore sector. Wind yields from onshore schemes have been notoriously poor, with many forecasts far too high, partly due to land geography impacting wind speeds.

Offshore, this is not such an issue as there is little in the way of the wind. However, one viable that has been exercising project financiers is the so-called wake effect, ie, the impact of turbines on wind yields from other turbines – both from within the same scheme and from other schemes. The wake effect can change yields by 10%–15%, a significant amount. That said, however, until now wind yields on existing schemes such as C-Power have been good.

The project’s funding package was put together with the help of three financial advisers – Green Giraffe Energy Bankers, KfW IpeX and Dexia. Other project company advisers included Gleiss Lutz, legal; NWA, insurance; and Ernst & Young, tax. For the lenders, the advisers were Watson Farley & Williams, legal and tax; Sgurr Energy, technical; PKF, model audit; and IPA, power market services.

The debt was split into three tranches – a KfW tranche, a commercial bank loan and a EKF-guaranteed loan. However, despite the differing nature of the lenders, the terms and conditions are the same across the board and the loans rank *pari passu*.

The €260m KfW tranche was the first to be provided by the development bank under its €5bn German offshore wind farm debt funding programme, which was only formally launched in June this year (PFI issue 459) although it had been muted for some time. Therefore, the project moved quickly to access this funding source before the financial close date in early August. Having KfW IpeX as a financial adviser presumably helped. The programme offers two funding options – a direct loan and a funding option guaranteed by commercial banks. Given the need to move quickly, the project opted for the loan.

The €385m commercial bank loan was oversubscribed and was provided by seven banks – BTMU with €40m, Commerzbank €75m, Dexia €30m, KfW IpeX €35m, Lloyds €50m, Santander €50m, and Siemens Bank €50m. Whereas the other two tranches were scaled back, the commercial bank tranche was not. The final tranche was a €250m facility from Danish export credit agency EKF, backing the Siemens turbines. The tranche was funded by BTMU and KfW IpeX and guaranteed by EKF.

The loan was priced at 300bp during construction, dipping slightly during initial operation before moving up to 325bp. Fees were around 250bp. The deal is banked on a debt service cover ratio (DSCR), linked to a P90 wind probability measurement, of 1.3x. ■