Changing World of Wind Financing

CBED Project Finance – 2009 – 2011

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Introduction

A number of circumstances in the broader economy and in the wind industry have altered the landscape for wind financing in the next year or two, including:

- General economic downturn
- Transmission constraints
- Financial/lending crisis
- Stimulus legislation

Introduction (continued)

The consequences for financing of wind projects include:

- Exit of many lenders from market, and, for those which remain, heightened scrutiny of potential loans, especially for wind resource, turbine quality, and offtake quality
- Loss of equity investors who can no longer use tax benefits or wish to devote scarce cash resources to core business

Introduction (continued)

- Failure or sale of developers and development assets with longer waiting time for project completion
- Diminished offtake opportunities and lower PPA and market prices
- Changes in return and other expectations of equity investors

Effect on CBED Projects

For CBED projects, changes may ultimately be beneficial if CBED developers and owners make certain adaptations to the market place.

- Traditional CBED Structures and Financing
    - All local equity ownership with high leverage (Minwind)
    - Flip structures
    - Modified Flip

All involve substantial term debt and, with exception of Minwind and cash deals, an outside equity investor.

In the current environment, successful projects will need to adjust.

Effects on CBED Projects (continued)

- Premium on Expertise

  More risk adverse lenders and investors are likely to steer away from "do-it-yourself" projects and require some higher level of development expertise

- Smaller Projects

  Historically, smaller projects are disfavored by developers, investors, lenders. With transmission constraints, offtakers unwilling or unable to absorb large projects, and lenders less willing or able to place large debt, smaller, thoughtfully located, projects may be well-positioned in the marketplace.

Effects on CBED Projects (continued)

- New Sources of Capital
  - Section 1603 Grants
    - Section 1603 of the American Recovery and Reinvestment Act provides certain options to new project owners. In lieu of PTCs, for example, owners can receive a cash grant of 30% of eligible project costs from the federal government, or may elect a 30% investment tax credit. The project also incurs a reduction of basis for depreciation purposes of 15 percent.
    - Intent was to delink project financing from reliance on entities who can use production tax credits and allow a broader range of possible equity investors. Principal remaining tax benefit is MACRS depreciation/net losses, received over the first six years of project.

Effects on CBED Projects (continued)

- Effect may be to
  - Reduce total equity requirement; instead of a capital structure which is 50% debt and 50% equity, the structure may be 50% debt, 30% grant, and 20% equity
  - This could make the Minwind model more viable by reducing total local equity required, and lessening the tax benefits that may be unusable by local investors
  - May accelerate “flip” date, and improve total local benefits received
  - May allow use of capital leases previously precluded by PTC restrictions

Effects on CBED Projects (continued)

- Only available for taxable entities. Non profits and governmental entities, however, may use either a blocker corporation or an option to purchase to still take advantage of the grant
  - Blocker corporation – a taxable corporation owns the project; it shares are held, in turn, by the nontaxable entity
  - Option arrangement – a tax investor owns the project for the MACRS period plus any other required holding period to avoid adverse recapture or reimbursement obligations, subject to an option in favor of the nontaxable entity to purchase the project from the tax investor. This is effectively a “flip” with control and financial allocation issues addressed in the option agreement, not the project entity’s governing documents.

Other New Capital Sources

- European investors – generally not interested in "flip" structures
- Manufacturers and contractors
  - Some are financing turbine purchases and BOP during construction to overcome lack of traditional credit for construction
  - Some are taking longer positions in projects to encourage purchases of their turbines – in particular, Chinese manufacturers are exploring longer term equity positions in projects using their turbines
  - May involve loans or investments that require dedication of all net revenues to repayment, especially if foreign investor cannot use tax benefits

Current CBED Financing Options

CBED projects that (i) are willing to acquire and use the correct amount and type of competent development assistance; (ii) size and locate projects to avoid transmission constraints and offtake and loan barriers; (iii) consider non-flip or modified flip structures, including use of available grants and raising a higher level of local equity and debt; and (iv) will take advantage of available manufacturer and contractor financing, can benefit from the current environment. This means moving away from the more common “flip” arrangement and its dependence on an outside equity investor not just for funds but also for development.

Current CBED Financing Options (continued)

Even in the cases where a “flip” structure makes sense, use of the stimulus grant may diminish the role of the outside equity investor, or allow the use of such investors who are more passive, especially as the economy improves.

About Jeffrey C. Paulson

- Jeffrey C. Paulson is the principal in his own law firm in Minneapolis, and has been practicing in the area of energy law for over thirty years. After graduation from Carleton College in 1978 and the University of Chicago Law School in 1981, he practiced utility law and litigation in Illinois. From 1987 to 1994 he practiced in the Twin Cities in construction law and representation of developers and banks in real estate workouts and financings.
- He joined Northern States Power Company in 1994, where he was the attorney primarily responsible for the development and financing of its original large wind and biomass projects, including related permitting and regulatory approvals.

About Jeffrey C. Paulson (continued)

- He left NSP in 1998 to establish his own practice representing clients developing, financing and owning renewable energy projects in Minnesota and around the country including debt and equity financing of such projects. While his clients include large national and international manufacturers, developers, and project owners, a greater portion of his time is spent representing local developers and owners working on projects to be owned by individual community members, colleges, nonprofits and other nontraditional generation owners.
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