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How to keep on financing wind farms when banks have no money left.

Posted by [Jerome a Paris](#) on December 23, 2008 - 12:13pm in [The Oil Drum: Europe](#)

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My earlier wind diaries can all be found here: [Wind power series](#)

Banks are engaged in a massive deleveraging exercise right now. One part of that has been much described and commented upon: the elimination of bad assets, either by taking the losses or by dumping them on the tax payer. The other part of the process is much more devious, as it means choking off new activity, even when sound, to avoid any new build up of assets. Debts that mature and are paid help shrink the balance sheet; giving new loans goes against that process and is thus avoided as much as possible by banks right now.

New lending activity is therefore much more scrutinized from a risk perspective, sees its conditions made much less favorable than they used to be, and is especially frowned upon for long term commitments, as long term liquidity is scarce and expensive.

In my case, working in a bank that suffers from a huge gap between its predominantly long term assets, and its short term liabilities, was basically bankrupt earlier this autumn, had to be bailed out via nationalisation and has not yet announced its forthcoming strategy (ie I still don't know yet if my activity will be a "core business" or not), funding has been especially restricted.

The wind sector requires long term funding in order to spread out the initial investment over a long enough period (so that the levelized cost per MWh is low enough) and it was a massive user of debt finance to get investments done. This means that it is an industry particularly vulnerable to the credit crunch. And indeed, expectations are that the fourth quarter will show a severe drop in new activity. Construction will still be at a record high, as projects which got their financing in the past year and a half get built, but new funding is drying up and next year is thus likely see a significant drop in actual building activity as those investors that relied on debt finance have more difficulty finding it and have to delay their plans.

In this context, I must admit that I'm especially pleased to be able to announce that we closed the financing of a new wind project, with a \$60 million loan to build, over the next 12 months, a 30MW wind farm in the Caribbean island of Aruba (part of the Kingdom of the Netherlands).

The project makes particular sense as the island gets its electricity, right now, exclusively from oil-fired power plants, and it has an incredibly good wind resource. The wind farm, which will have a capacity factor in the 50-60% range (better than European offshore, and almost triple the German onshore figure) will replace about 15% of the island's electricity generation, thus saving on oil consumption, limiting pollution and emissions. The local utility will buy the power at a fixed price over 15 years, ensuring a steady revenue to repay the debt and hedging it, for that part of the island's consumption, from the variations in oil prices. The breakeven for the wind farm is at roughly \$50-55/barrel, which means that it's rather likely to be a good investment over the duration.

The interesting question is: how did we find \$60 million in December 2008 for a project in what is hard to call a priority location for any hard-pressed European bank (and with clients who are small developers - while highly experienced and competent, they could not be described as strategic customers, an increasingly strict requirement these days for banks to commit any funds)?

The answer is simple: we did not. My bank is not actually lending a cent of its own. The ways this has been possible is thanks to the involvement of two other entities - one is the export credit agency (ECA) of the country of origin of the turbines, and the other is a Scandinavian bank which has accepted to provide funds - but not for the project: only for the government of that Scandinavian ECA. So that bank is notionally the lender to the project, but it actually only takes government risk, being fully guaranteed for all sums by the ECA, which is a government-backed entity. My bank could then join the project by counter-guaranteeing the ECA for a share of the project risk. This is a deal where those that take the risk and those that do the funding are almost completely separate, and where a government provides the vital link, in a smart way (they take the risk on my bank, but it is as a backup to a project risk which they are

also taking, which they would have taken in any case in normal times, and which is not a bad risk per se). For the client, it is slightly more expensive than usual, as, in addition to the usual margin to cover project risk, they have on top of that to pay the funding cost of the other bank (based on the price of that scandinavian government debt), plus a fee to compensate that government for taking the risk on my bank. But from their point of view, it is a price worth paying, as they could not build the project without debt funding.

The project has sound economics and can bear that additional financing cost; if markets change for the better in the future, they will also be able to reduce the funding costs via a renegotiation or a refinancing (in addition, by then, the project will be built and operating and will be seen as an even smaller risk).

I literally had to harass my senior management to get them to agree to do the deal; I'm not sure if getting noticed by the top management is what you should do when your employer is preparing a massive plan of layoffs, but to me this project just had to be done. It's a good risk that would have been a no-brainer at any other time, it's the kind of activity that banks should support now in so many ways: it promotes economic activity at home, it's a good deal for the buyer of electricity, it's good for the climate, it's good if you worry about peak oil, the risks are understood and thus it's nicely profitable for everybody. And we found a way to do it without requiring my bank to come up with its own funding. So if we could not do it, I did not see much future for my activity in the bank anyway - the confrontation at senior management level was worthwhile as a way to force an answer on that, even if it does not tell me what the decisions will be like on future transactions.

I'm not sure yet if this is a lesson that the kind of banking that focuses on its actual core business (risk analysis and allocation) will survive the crisis, or a sign that even the most reasonable transactions will face tremendous hurdles. We'll see. Right now I'm just very happy that I pulled it through.