EWEA
THE EUROPEAN WIND ENERGY ASSOCIATION

EC Public consultation paper on the Europe 2020 project bond initiative

Response from the European Wind Energy Association

Questions:

1. **Is the chosen mechanism likely to attract private sector institutional investors to the sectors of transport, energy and ICT in particular? If you are an investor, would you be prepared to buy such project bonds?**

EWEA believes that institutional investors will be attracted to investments within the mentioned sectors through this mechanism providing reliable future cash flows for a given level of risk. Under the condition that the initiative can address their risk reward profile, institutional investors will be drawn to the investment space.

However, with regards to the badly needed investments in electricity transmission infrastructure EWEA has its doubts about the practicability for TSOs and their stakeholders to invest in these long term debt instruments. A revised regulatory approach with the national energy regulators recognising that that properly selected network upgrades will lower operational costs of power generation, which should be beneficial rather than costly for consumers, would be more helpful to trigger investments in cross-border transmission infrastructure.

Such a revised regulatory approach should be able to quantify the level of EU financial support for projects of wider European interest capturing the specifics of electricity networks provisioning, which might stand in contrast to the existing reference in TEN-E Guidelines to “self-financing” and “market-driven” energy networks. Rather, it should take into account that infrastructure sectors are characterised by multiple market failures, mainly due to natural monopoly and competition effects and thus cannot obey to a short-term private business Net Present Value calculus.

However, the European wind industry is in continuous contact with the financial community discussing the financing needs of our sector in view of the increasing size and complexity of wind power projects, in particular offshore. There is consensus that given the scale of investment required in the energy sector in general, a bond solution as described in this proposal, will absolutely be needed.

2. Are there other sectors with large-scale infrastructure financing needs that should be included?

EWEA believes that wind energy should be specifically mentioned as a sector with its own allocation need, in particular offshore projects. Furthermore, the associated grid investments needed to facilitate Europe's 2020 renewable energy commitments are sufficiently large to warrant their own category. The investments needed in offshore grid infrastructure alone are €32 billion according to the EC communication on energy infrastructure priorities for 2020 and beyond.

Given the scale of European investments in offshore wind projects as identified by EWEA of approaching 150 GW of projects which have been announced, there is a demand for capital to bring these projects into operation. In EWEA's view the additional targeting of European offshore wind projects and according grid infrastructure as a recipient of this envisaged bond funding will attract more capital into the offshore market in addition to other means given the perceived confidence the Member States are placing in this market as outlined in their NREAPs and its objectives to install over 43 GW offshore wind power capacity by 2020.

EWEA's call for an inclusion of the wind sector under the 2020 Project Bond Initiative may furthermore be substantiated by recent developments in the financing sector. Despite the positive trend seen in 2010 with the arrival of new financial investors, namely pension funds, and the support of national and international finance institutions such as the EIB and export credit agencies, various finance institutions still indicate financing offshore projects as a high risk business with financing offshore wind farms continuing to be a complex endeavour rather than a mainstream activity for lenders. Continuing restrictions on underwriting by banks means that large transactions will continue to require large numbers of participating banks at financial close, and entail complex coordination tasks for offshore developers. This difficult financing environment is likely to persist if the current financing structures remain conservative and willingness – and the adequate tools to trigger it – to take risks in the offshore wind sector for well structured transactions will not improve.

Furthermore, the timeline to bring this initiative in play seems to be long especially when looking at the expected implementation of the large offshore parks. EWEA regards it as positive that the pension funds become more active in the infrastructure investments. However, EIB and export credit agencies are reaching their capacity limits and it is important that the capital markets are brought into play.

Preferably, the initiative will focus on the parts that are most difficult to get bank financing for, e.g. in the construction phase and a couple of years into operation. This will also secure a faster re-circulation of the funds and therefore spread to more transactions.

Specific questions

3) Would the credit enhancement facilitate/accelerate the conclusion of financing packages?

Yes, if the EU/EIB can give sufficient guarantees, ahead of construction beginning, that the 2020 Bond will be available in a certain time range (at cash on delivery (COD) and COD+2 years), financing during construction will become more liquid as financiers such as commercial banks and private equity houses will see an exit strategy available to them in 4-5 years following their investment, allowing them to recycle their capital back into the sector.
Solving the long term debt funding of a project first provides comfort to providers of bridging capital during development/construction to enter the market. If the 2020 Bond has the right level of commitment at the appropriate stage in a project's lifecycle – ahead of financial close/Ready to Build – it will both facilitate and accelerate the conclusion of financing packages. Determining exactly what shape the commitment takes is a task that will require consultation directly with institutional investors.
The consultation paper does refer to funding construction, which for a sector such as offshore wind is likely to be too risky for institutional investors to bear. As well as the additional risk the construction phase introduces, there will also be a negative drag on such a bond investment that must be accounted for in the coupon.

4) What minimum rating of the bonds would be sufficient to attract investors?

The bond rating will have to be considered alongside the return/coupon generated by the bond. Institutional investors currently appear comfortable with a coupon in the region of 6-8%. A Euro 2020 bond would likely have to have a credit rating comparable to other products delivering a 6-8% return in order to compete in the market.

5) What degree of credit enhancement would be necessary to achieve this rating?

The degree of credit enhancement required will vary across industries/sectors and between projects within a specific sector i.e. offshore wind projects will differ from grid infrastructure projects. Any enhancement will likely need to firm out the cash flows of a project year to year, taking wind resource variability risk, equipment availability risk and any regulatory risk associated to contracts for energy and carbon certificates, away from an institutional investor. This form of enhancement should only be required for the initial bonds taken to the market. As investors become more sophisticated in the offshore space, these levels of enhancements can be expected to reduce.

6) Which impact would the Initiative have on financing costs and on maturities?

The credit enhancement would likely reduce the risk of a tranche of the underlying debt and thereby reduce the cost of that particular piece of debt. This should be especially true of project finance debt where interest rates typically ratchet up over the term of the loan

As noted in the paper, the enhancement will come at a price given the level of risk being assumed by the EU/EIB. One would expect the enhancement to cost not more than the difference between the cost of traditional project finance debt and the lower cost of the bond financing. This is due to the overall risk of the debt being allocated into separate tranches.

7) Is it essential that a single entity acts as controlling creditor?

A single entity as a controlling creditor will reduce administration and whilst unlikely to act as a significant attraction to the product, will not act as a deterrent as multiple creditors might.

For further information please contact: Paul Wilczek, EWEA: pwi@ewea.org