

# Community Wind Projects Still Have Financing Options

*Although the capital markets appear to be easing, lenders are still hesitant to provide financing for community wind projects. However, developers have alternatives.*

BY CHRIS DIAZ

**C**ommunity wind projects – defined here as projects less than 10 MW – are facing a difficult time finding financing. The capital markets appear to be opening up, so why is it that lenders are still hesitant to provide financing for community wind projects? The simple answer may be either the loan size is cost prohibitive for a lender or the lender is not comfortable providing this type of financing.

If a lender does not fully understand the technology or the process, it is difficult for it to evaluate the risk. Who is willing to finance wind transactions, what type of security and assignments will be required, and what are the key issues these lenders will be considering?

It is no secret that large wind and utility-scale wind transactions – \$40 million projects and above – have an easier time finding financing than community wind transactions. Investment banks, insurance companies, European banks and large U.S. banks have the capital and the expertise to lend to large projects. These institutions have dedicated teams that understand the technology and the risks associated with large-scale wind transactions – most of the developers and/or off-takers are utilities or AAA-rated corporations, and the loan sizes are large enough to meet profitabil-

ity requirements of the institutions.

Community wind transactions rely on nontraditional boutique lenders, European banks, and terms from turbine manufacturers, state programs and a few regional banks. It is much harder to find these types of lenders that have a good understanding of community wind transactions. Most of these lenders, with the exception of the state programs and turbine manufacturers, have minimum loan requirements starting at \$3 million and do not want to take construction risks.

There are a few ways to attract lenders to community wind transactions. One option is to develop a pipeline of similar transactions. If multiple projects are similar in structure, the transactions' costs for a lender will go down and help smaller loans meet lender profitability requirements.

A second option is to bundle multiple small projects under one power purchase agreement (PPA) and one partnership. This can help loan amounts meet minimum size requirements. Another possibility is to assemble an experienced development team that includes the engineering, procurement and construction (EPC) contractor. Finally, the technology selected for the transaction should be a bankable technology with a well-established track record.

The investment tax credit (ITC) and the Section 1603 grant from the U.S. Department of the Treasury – commonly referred to as the “cash grant” – have been extremely helpful in the financing of community wind transactions. Tax-credit equity comprises about 30% of a transaction's capital structure. Theoretically speaking, because the ITC is a one-year credit compared to 10 years for the production tax credit (PTC), the interest from potential investors for the ITC is better. Once the tax-credit markets return to normal, the ITC will be well received by investors. In the interim, the cash grant has saved the day. This grant has kept tax-credit equity markets fluid at a time when tax credits, as a tax strategy, are rarely being used.

When negotiating the various contracts needed to put a community wind transaction together, be sure to keep the lender's needs in mind. Most of the time, it is easier to negotiate terms and conditions upfront rather than having to go back six months later to have the documents changed. The lender's needs would apply to any type of wind development, large or small. The site lease, PPA, interconnection agreement, equipment-purchase contract, and operations and maintenance contract must be assignable to the lender, allowing for a first security interest.

When structuring the site lease, include provisions for easement rights, allowing uninterrupted access to the site. In addition, proper entitlements, a ground lease Estoppel and a subordination/nondisturbance agreement might be required. The PPA and the site lease should be coterminous. The turbine manufacturer's warranty should be assignable to the lender. The requirements of each source of capital and the partnership structure can impact the loan, so be sure to get an experienced attorney and an experienced certified public accountant (CPA) involved in the process as early as possible. Being proactive will save time and money later on in the process.

To protect its interest in the unlikely event that an issue arises during construction, the construction lender will need assurances as well. These include rights to complete the project if the developer cannot, access to anticipated repayment sources, the ability to operate the project and derive income from operations, cure defaults, and the right to sell the project. In addition, the construction lender will need a first-lien position on all equipment associated with the wind development and improvements to the site, as well as a leasehold mortgage/deed of trust.

### **Look for experience**

As lenders evaluate wind transactions, certain issues can arise. It is important that lenders are aware of developers' experience. A number of developers with little or no experience are trying to build community wind projects, but lenders like to see developers who have done multiple wind transactions.

Team up with an experienced EPC contractor who can provide a payment and performance bond. Lenders will check references during under-

writing to confirm experience. An inexperienced EPC is much more difficult to mitigate, but there are a few options that might work.

Nonrecourse financing is rare for this segment of the wind industry; therefore, developers should be prepared to provide guarantees (personal and/or corporate). Lenders want to see a strong net worth and liquidity. Developers with less-than-stellar financials may want to consider bringing in a development partner to strengthen their balance sheet.

As mentioned earlier, the ITC grant provided a tremendous amount of support for the financing of wind transactions. When applying for the grant, lenders will require that the developer use an experienced CPA and will probably factor in a 10% cushion in case the anticipated full amount is not funded.

It is also important to keep in mind that the construction lender will require a first-lien position until a loan is repaid, and the permanent lender will require a clear first-lien position prior to funding a loan. It is critical to coordinate the timing of the ITC grant payment, any state grant/loan program payments and the permanent loan funding so the construction lender and the permanent lender are able to secure their needed lien positions.

Lenders want to see a proven wind technology with an established track record. They need to have a high level of comfort that the turbine will perform as promised and that, if there is an issue, the manufacturer will honor its warranty. If the chosen wind turbine does not have an extensive track record, one way to mitigate this is to reinsure the manufacturer's warranty with a reputable reinsurance company. This will give the lender some additional comfort.

Having a strong PPA with a credit-

worthy off-taker is vital to finding long-term financing. The permanent lender wants to know that if the turbines produce as expected, the PPA off-taker will have the capital to make the monthly payments for the power, thereby allowing the developer to repay its loan.

Because not all PPAs are signed with AAA-credited off-takers, it is important that the off-taker has good credit and can easily be underwritten by the lender. A well-established business with a good history or a public utility may not have AAA credit but can be considered a good credit risk by the lender.

As the project moves from the letter-of-intent stage to closing, coordinating the timing of approvals is key to ensuring a smooth closing. Permits, zoning, Federal Aviation Administration approval, equipment delivery and interconnection all take time, and all are needed to close the construction loan. Starting the process for these approvals as early as possible will speed up the timeline.

It is also important to coordinate the partnership documents, construction loan documents, permanent loan documents and tax-credit documents. Having all of these documents negotiated and signed at a simultaneous closing will prevent any financing issues from coming up later in the process.

Community wind financing is available. Having a well-organized, properly structured community wind transaction will greatly improve the odds of finding the financing and completing the development. **SNP**

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