

ECA

Financing of wind power projects
with export credit agencies

Extract

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1 Foreword

Ladies and gentlemen,

Hamburg Commercial Bank and its predecessor institutions have been involved in renewable energy for more than 25 years. When many still considered the expansion of wind energy plants on an industrial scale to be an unrealistic flight of fancy, we had already financed the first wind turbines in Northern Germany. Even then, we were convinced by the opportunities provided by this type of energy generation, from both a business and ecological aspect. Our views have remained unchanged to this day.

This is why we remain closely associated with the strong growth of the sector, which plays a key role in meeting global climate targets. In Europe, we are among the leading providers of finance for renewable energies. We have long ago widened our focus beyond our German home market, which remains important to us, to neighbouring European countries. At the same time, we are also on hand to support projects in other countries – there are promising markets offering steadily high annual growth rates in Asia, in particular.

We regularly consolidate our profound sector knowledge with a range of different studies. The present study on the financing of wind energy projects with state export credit guarantees shows how project developers can realise wind farms outside Germany more easily, to name but one aspect.

The financing of projects in the renewables segment is and will remain a growth area for Hamburg Commercial Bank. The potential in this market is still great – as is the need to generate our energy in a sustainable and climate-friendly as possible way.

Enjoy reading!

Warmest regards,

Nils Driemeyer

Global Head Renewable Energy

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2 Introduction

The systemic change in the subsidy policy for renewable energies ('RE') in the EU is increasingly forcing developers of wind farm projects to face market price risks. On one hand, the disappearance of guaranteed access to a statutory fixed feed-in subsidy increases the general project risks. On the other hand, pressure on the economic viability of the projects is also growing. Falling levels of remuneration and, in some cases, the complete suspension of any feed-in subsidy represent new challenges in terms of revenue. Consequently, also turbine manufacturers are increasingly forced to make price concessions and must adapt to tougher market conditions. In this context, many project developers and manufacturers are increasingly expanding into growth markets outside the EU. The development of new wind power markets however involves new risks in other fields. Developers and financial backers of projects must therefore deal with sovereign risks particularly in comparably less developed non-European markets. For foreign investors and banks, the country-specific challenges and risks of the long-term project financing period can be difficult to estimate.

Here guarantees from government export credit agencies (referred to as 'ECA cover') can be used as a basis for risk limitation. With risk mitigation through a government-backed guarantee, a project developer can enter new markets more easily, develop business activity in the target country over the long-term, as well as maintain business relationships through difficult periods. Through the involvement of an export credit agency ('ECA') the target countries gain easier access to new, modern RE technologies. For lending banks, the government-backed credit risk guarantee reduces the risk costs of project financing, or facilitates such financing in the first place. The project company can benefit from ECA cover in the form of longer loan periods and lower interest rates compared to local project financing without ECA cover. However, as illustrated by the buyer credit guarantee provided by the German ECA Euler Hermes for a large Swedish wind power project, export subsidies are also an option in low-risk industrialised countries.

As the awarding practice of Euler Hermes illustrates, government export credit cover is already a tried-and-tested instrument, also in the field of RE. But how exactly can they be implemented in RE project financing? What conditions must be met for ECA cover? Which risks can be covered and how does the government-backed cover impact the financing conditions for wind power projects? We provide answers to these questions in this study. For this we conducted interviews with players who take varying stances on the implementation of RE projects and whose views are included in this study. At this we concentrate primarily on government-backed buyer credit cover within the scope of project financing.

3 What are government export credit guarantees?

ECA cover is an instrument of (industrialised) countries to enable exports to countries in which goods export risks are not covered by the private insurance sector. These include primarily economic risks (e.g. payment default, debtor insolvency), whereby political risks (e.g. embargoes, riot, payment moratorium, war) are also covered. The government-backed guarantee is often what makes a business transaction possible in the first place.

Government export credit guarantees protect exporters and lending banks against debt defaults due to economic and political circumstances in the export country. Where necessary, the scope of the guarantee can include complete cover from the start of manufacture, up to loan repayment and interest payments:

Manufacturing risk and export cover

The export cover includes the period from the start of production, through delivery and up to the receipt of payment. Up to 95 % of the cost price (normally production costs) and export receivables can be covered in this way, depending on the scope of cover.

Buyer credit cover

Financial institutions can secure loan receivables from project companies, provided the project is based on a coverable export. The deductible of the lending bank is normally 5 % of the outstanding loan as standard for all covered risks.

In order to finance a wind power project in the country of the purchaser, banks can secure granted loans through a buyer credit guarantee from the ECA in the country of the turbine manufacturer. It is of secondary importance whether the bank comes from the country of the wind turbine exporter or importer, or from an external country. However, only the ECA in the country of the exporter can grant the buyer credit cover. In many export markets for European wind power technology, the loan and capital markets are usually less well developed than in industrialised nations. As an alternative to local financing, project developers have the option of securing finance for an international wind power project through a financial institution that possesses the corresponding know-how in RE financing and is in the position to provide the necessary scope of finance for a term suitable for the project. An ECA buyer credit guarantee normally allows considerably better credit conditions.

4 The ECA of the Federal Republic of Germany – Euler Hermes

In many industrialised nations, but also increasingly in emerging and developing countries, government or government-mandated ECAs have formed to promote the export of goods. The ECA umbrella organisation – Berner Union – meanwhile counts 83 state and private members worldwide. In Germany Euler Hermes AG is instructed as the responsible mandatory of the Federal Republic of Germany. In 2017 the Federal Republic of Germany secured new export contracts worth 16.9 billion euro through government-backed guarantees. 5.6 % or 943 million euro of which accounted for cover for RE projects. Presently the statutory framework for export credit guarantees allocated from the federal budget is limited to 160 billion euro. Currently approximately three-quarters of this is depleted.

The government regards the promotion of German exports as crucial to the overall economy, but can only award guarantees in accordance with the principle of subsidiarity. This means that the government – represented by Euler Hermes – may act as a guarantor, as long as no sufficient level of insurance protection is provided by the private sector, so as not to have a distorted impact on the market. Similarly government guarantees may not be granted if there is a high probability of a subsequent federal drawdown at the time the guarantee is granted. The government therefore is not permitted to cover ‘internal losses’. All applications for cover must be approved by the Interministerial Commission (‘IMC’) for export credit guarantees.¹

Contractually, these forms of government-backed cover must be primarily regarded as guarantor contracts, as the state is responsible for the success of the domestic exporter and this can be reliably ensured by the creditworthiness of the German State (AAA rating). The costs of buyer credit cover comprise application fees and guarantee fees. They are to be borne by the applicant and are payable upon application and when the guarantee is granted. Application fees are levied depending on the requested volume, whereas the payable guarantee fee reflects the risk (sovereign and buyer risk). The risk evaluation of a guarantee is thus Wreflected in its total costs. The sum of the guarantee fee is illustrated in a cost calculation later on.

¹ The IMC comprises members of the Federal Ministries for Economics and Technology, Finance and Economic Cooperation and Development, Foreign Affairs, as well as experts.

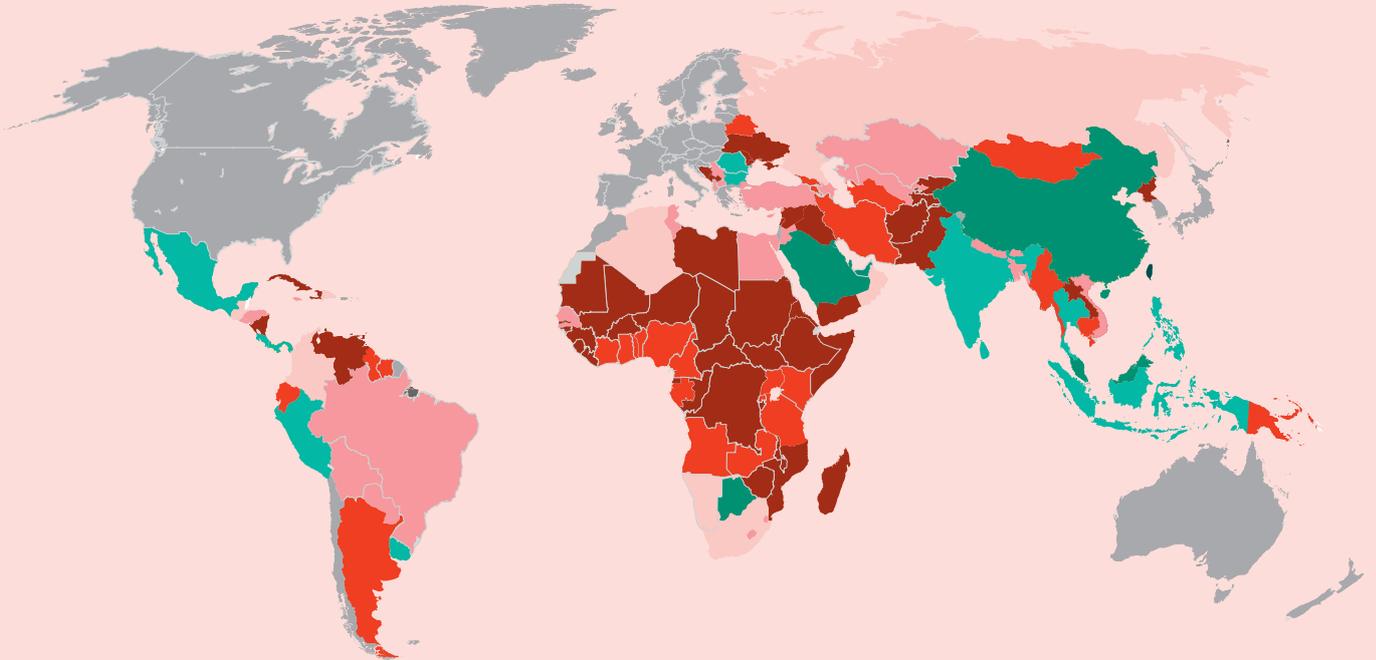
5 Risk evaluation within the scope of ECA cover

As practically all major industrialised countries operate business development schemes with the help of ECAs, as a matter of principle there is the chance that individual states can have a distorted impact on international competition. In this context, the OECD member states have agreed on guidelines and minimum standards for ECA cover. The most important cornerstones of the OECD agreement (referred to as OECD-Consensus) include the financial general conditions (e.g. sovereign risk evaluation, interest, advance payment volume, loan periods), the contract conclusion proceedings with an ECA, as well as the supplementary agreements for individual fields of application (including RE or project financing). The latter include special guidelines aimed at the specific features of the export goods concerned, and the financing of these.

The OECD currently ranks 179 countries into risk classes. The country ranks are then binding for all ECAs in the member states, thus no competition distortion should occur at this level. The OECD risks assessment classifies countries on an integer scale from 0 to 7. States that are ranked high-income countries by the World Bank, members of the OECD and the EU are ranked in the top risk class (0). All other countries are assigned to risk classes 1 to 7 based on their risk.

The current OECD risk classifications are shown on the world map below. In another illustration the national wind power markets are colour-coded by their aggregated net capacity increase in the years 2013 to 2017. Looking at both illustrations it is evident that there are a range of high-volume markets (high capacity additions) whose sovereign risk classification renders the use of ECA cover meaningful. For example in the current OECD ranking, India, which recorded a net increase in wind power capacity of 12.7 GW, is graded with moderate risk (Risk Class 3). Brazil (net increase of wind power capacity 10.1 GW) is currently rated as high-risk country (Risk Class 5).

Figure 1: OECD-Country Risk Classification for Buyer Credit Cover

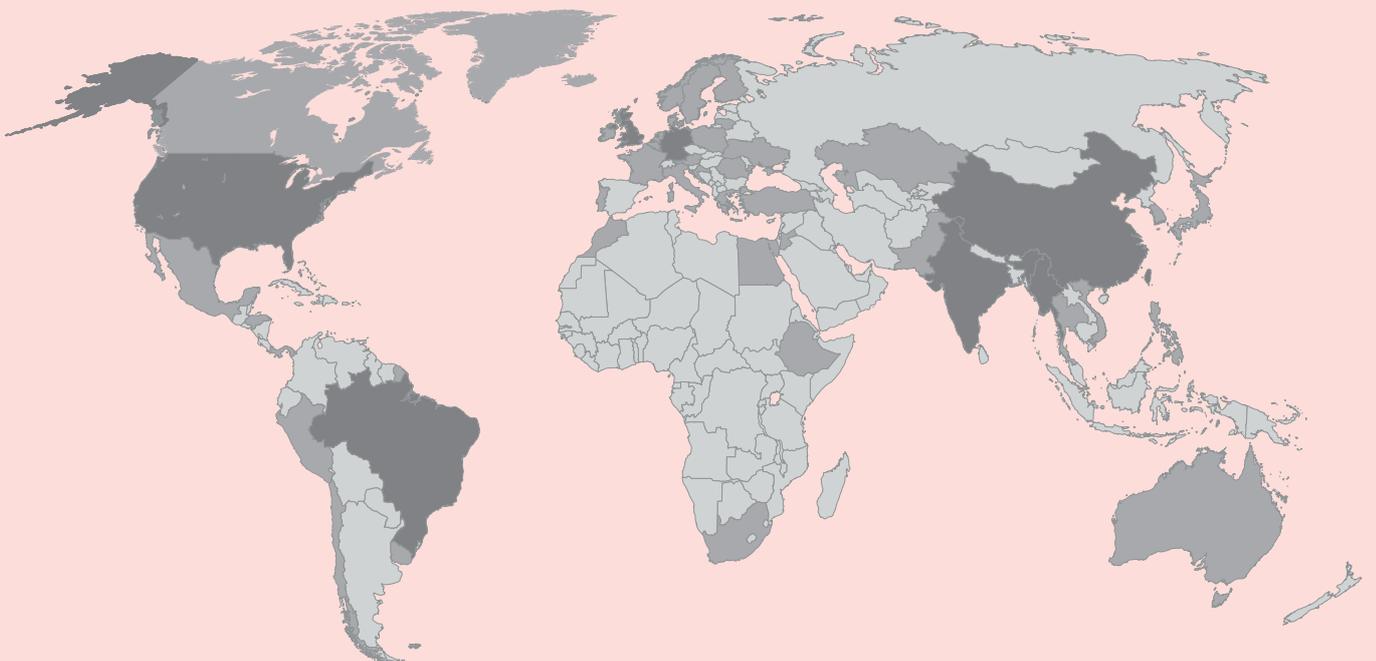


Legend

Risk Class ● = 0 ● = 1 ● = 2 ● = 3 ● = 4 ● = 5 ● = 6 ● = 7

Sources: OECD, Hamburg Commercial Bank

Figure 2: Net increase in wind energy capacity from 2013 to 2017



Legend

● < 100 MW ● 100 < 5,000 MW ● > 5,000 MW

Sources: IRENA, Hamburg Commercial Bank

„In the past the German government has worked very hard to improve the hedging terms for renewable energy projects.“

Interview

First of all, please give us some background information about government export credit guarantees.

Ulrich Schulte-Lünzum → The German government aims to promote German exports in order to strengthen Germany as a manufacturing and business location. For this reason it offers German exporters protection against debt default risks in foreign business by way of government export credit guarantees. The protection covers both direct receivables of German exporters, as well as bank finance for German exports. In principle the government acts as a subsidiary, i.e. to supplement the private credit insurance and banking market. In general, all export businesses can be covered independent of scale.

Could you briefly describe the application process up to the closing of an export credit guarantee?

USL → For applications based on project financing – the common form of financing for renewable energy projects – the process is based largely on the progress of the project, as well as the finance concept. Firstly supportability, i.e. in essence to what extent German exports are concerned, and secondly justifiability of the risk are checked. And finally – analogously to the bank – the loan and project risk is checked. Unlike the bank however we are not initially included in the structuring; this is and remains the task of the bank. To be able to start our process we require an initial representation of the project, as well as a preliminary financing concept that has been structured by the bank in advance.

The process is commenced formally upon application by the financing bank, which is accompanied by preliminary project documentation, a project information memorandum, as well as the financial model. Within a relatively short period we are then in the position to decide whether the business is suitable for government-backed project financing. This gives planning security to all parties involved in the project at an early point in



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