

# Terra-Gen completes first sale-leaseback transaction

Jesse Broehl, Windpower Monthly Magazine, 01 September 2010, 12:00am

UNITED STATES: Despite a depressed wind market in the US, one of the largest financing deals in history has been completed in California. The 570MW wind plant deal is notable both for its scale and for its unique financing structure, which is likely to be repeated in some of the larger upcoming wind projects.



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The \$1.2 billion project by developer and operator Terra-Gen Power is split into four phases, all located at the same site in the Tehachapi Pass north of Los Angeles. The four phases, collectively called Alta II-V, were wrapped up in one financing package in August. The project is the first example in the US of so-called sale-leaseback financing.

Sale-leaseback was introduced in the 2009 American Recovery and Reinvestment Act (Arra), better known as the economic stimulus bill. The act also included the cash grant option for wind plant financing that has been critical in helping the US wind industry through the financial downturn.

While the grants have been used by many wind developers, the sale-leaseback has not been used until now. It is a particularly complex and highly structured deal that centres on unusually long repayment terms for the project capital. The Terra-Gen deal is a very big transaction with a number of innovative features, says Jeff Chester, who heads the wind energy practice at law firm Kaye Scholer.

Initial construction and turbine financing is funded partly through the sale of \$580.2 million in secured investment debt that will be sold to institutional investors, typically in increments of \$100,000. This is 24-year debt maturing in 2034. There is also a construction bridging-loan package of \$499 million, plus additional credit of \$127 million, both provided by a consortium of banks.

The project uses 190 Vestas 3MW turbines, which represents Vestas' largest order for a single project site. The wind turbines make up 60% of the project's total cost and include a five-year warranty and service contract.

Once the project is complete, at the end of 2011, a trust company arranged under Citibank NA will buy the entire 570MW Alta II-V. The trust will then lease back the project to Terra-Gen, which will make semi-annual payments averaging around \$51 million a year for 24 years, according to analysis by FitchRatings.

The developer, Terra-Gen, will in effect rent its own project while building up equity in the wind farm and paying off the turbine and construction debt. The trust company that owns the project in the meantime recoups the federal subsidies that provide 30% of capital cost of a wind project built before 2012.

The deal is complex, but provides the greatest amount of financing at the lowest cost, due to the 24-year lease, explains Chester.

"There is a lot of controversy as to whether or not the structure is suitable for wind, but what made it feasible is that there is a lot of headroom in the project, meaning there was a very robust power purchase agreement (PPA)," says Chester. Southern California Edison signed a PPA with Terra-Gen, agreeing to pay a fixed price of \$117.30/MWh for 25 years, ending in 2035. "In deals where cash flows are thinner and the terms are marginal, this probably would not work," Chester says.

Kaye Scholer is currently working on other sale-leaseback deals and expects more to be announced by the wind sector, he adds.

### **Educating the investors**

Andrew Redinger, managing director and group head of the alternative energy group of KeyBank Capital Markets, says the sale-leaseback model is efficient for wind and is surprised it has not been more prevalent.

"There are two reasons why I think leasing did not take hold: one is that the rents have to be consistent and there is a perception - reality or not - that wind is variable so, therefore, the rents would be too variable and could risk blowing up the lease," he says.

"The other hurdle was that, to the investors, this was a whole new asset class. There is a lot of education needed to get them comfortable in this space with wind," says Redinger.

The \$580.2 million securities, so-called pass-through certificates, will be sold to investors, such as insurance companies, that for decades have bought leveraged leases and long-term bonds in sectors with which they are more familiar. Examples include traditional power plants. Leveraged leases were a popular way to finance nuclear plants in the 1980s.

But traditional power plants have a longer history of proven, steady incomes. Wind projects regularly experience variability in available wind resource and, thus, their income and ability to pay off a lease is less certain.

Robust independent third-party analysis of the wind project's expected performance is part of the solution. Wind projects make various projections for power production over time, based on pre-construction wind measurements, to obtain financing.

In Terra-Gen's case, usable data for the strong wind resource at the site was extracted for 6.5 years. Most projects measure for closer to two years before reaching out to the banking and investment community.

Redinger says that what makes this a better way to finance wind is that there is no need for an outside tax-equity investor (see page 41).

The sale-leaseback system is more efficient and removes the issue of tax equity, adds Redinger. "You get rid of the whole tax-equity issue, in a sense. Instead of going out and selling tax equity separately and then finding someone to take the debt, it is combined and called a lease."