lavery
Lawyers

Renewable energies: the trend is toward hybrid financing

December 7, 2016

For about two years now, most renewable energy projects, particularly wind farm projects, have been financed using a so-called “hybrid” model, i.e. a combination of medium-term bank debt and long-term financing or private placements.

The term “hybrid” is derived from the vocabulary of the Public-Private Partnerships industry, particularly projects involving an operational and maintenance component as part of a long-term concession. Indeed, during the construction phase, these projects generally involve a bank construction loan with a term of 2 to 5 years, combined with a long-term bond issue. In most cases, the bank financing is to be repaid upon project completion by payments from the Public Authority, while the bond financing is amortized over the duration of the project’s operational phase.

Until not so long ago, renewable energy projects were financed through one of two different models: medium-term bank financing of 5 to 7 years, or more rarely 10 years (i.e. “mini-perm financing”), or long-term financing (or a private placement) whose term was as close as possible to the term of the power purchase agreement — generally 18 to 20 years.

Bank type loans were primarily granted by the large Canadian banks, while long-term financings were generally the hallmark of the insurance companies and foreign banks.

More recently, particularly for the wind farm projects stemming from the latest call for tenders for community projects in Quebec, we have witnessed the emergence of hybrid financings which allow for the optimization of the project’s financial cost and benefit from a lower interest rate on the mini-perm tranche, while still enabling the financing to be secured over the full duration of the project.

One of the features of this type of financing is that the long-term lenders must agree to grant a capital repayment holiday for the duration of the amortization of the bank’s tranche. Indeed, if the two tranches were required to be amortized at the same time, the burden of repayment would have an excessive impact on the project’s cash flows. Also, the long-term lenders generally prefer the bank’s tranche to be fully amortized over its initial term to avoid any risk of refinancing at maturity.

It is technically possible using modeling to work up a plan to simultaneously amortize the two financing tranches that could be absorbed economically by the project. However, this would require a substantial reduction in the amount of the bank’s tranche, and therefore minimize the financial benefits of the hybrid structure.

Other technical issues must also be addressed, such as, for example, how disbursements are to be made during the construction phase. The simplest way is to proceed in a similar fashion to PPPs, i.e., by fully disbursing the long-term financing at the start of the construction and starting the

Copyright (c) Lavery, de Billy, S.E.N.C.R.L. - L.L.P.

progressive payouts on the bank's tranche once the funds of the long-term tranche have been fully spent. Another way of proceeding is to pay out the two tranches at the same time with progressive payouts made pro rata to each other. This method is sometimes less suitable for institutional lenders for administrative and cash management reasons.

Copyright (c) Lavery, de Billy, S.E.N.C.R.L. - L.L.P.