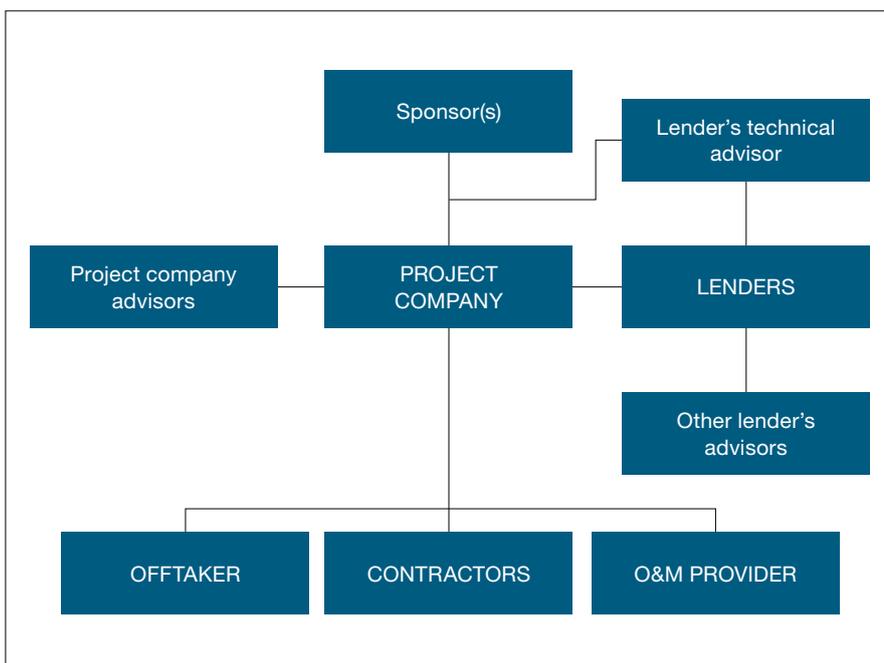


The lender's engineer: friend not foe

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With the potential exception of being a referee or a traffic warden, for the most part, a lender's engineer or lender's technical advisor (LTA) may be one of the most polarising professions available. And yet, a professional and competent LTA can bring significant value to a project, save a sponsor millions of pounds and can be personally rewarding.



First things first – why do we need an LTA?

The need for an LTA stems directly from the involvement of lenders on a project. There are a number of ways of financing a project, one of which is using debt financing. Depending on the level of financing required from the lenders, there will be different types of products that satisfy the funding needs of the sponsors. In this article, we will be looking at project finance or non-recourse finance as it is also known.

A basic schematic of project finance is shown below.

As you can see from the diagram, the sponsors will typically establish a special purpose vehicle (SPV) or project company with the responsibility of making the project a reality – in our case a wind farm. The sponsors will be shareholders of the project company, but will not have any further liabilities to other funding sources. The project company will employ its own



advisors for technical, legal and insurance matters – and with their advisors’ help, will implement a plan of action and ultimately engage with contractors for the implementation and operation of the project. Furthermore, the company will engage with an offtaker via a power purchase agreement (PPA) to sell electricity and thus create a revenue stream for the project. Depending on the performance of the project, the sponsors should be able to get a return on their investment via a number of streams.

The sponsors are not alone in this adventure. They either do not have all the funds required or they do not wish to invest all of their money in a single project. As such they will approach lenders to provide typically between 70-80% of a project’s funding requirements via a loan. This arrangement allows the sponsors to de-risk their investments as they are potentially able to fund, for example, five projects for the same amount of equity, rather than relying exclusively on the performance of a single project. Lenders are therefore required to carry the majority of the financial risk, especially at the beginning of such a process as they are investing the majority of money in the project. At the same time, the lenders have no collateral as the project is just an idea and there are no assets built yet. Furthermore, since the loan

is between the lenders and the project company, the lenders typically have no recourse to the sponsors – thus the term ‘non-recourse finance’. As you can imagine, this does not sit naturally with lenders as institutions as they tend to be very conservative. To gain comfort that they are not throwing money away, the lenders will engage with a number of advisors to assess the project to establish any risks and to determine if the risks are acceptable or not. This is where the LTA comes in.

Role of the LTA

If we were to put it in very basic terms, the role of the LTA is to confirm the base case assumptions of the financial model of a project from a technical perspective. Typically this will cover:

- Energy yield assessment review to confirm the potential driver behind the revenue stream of the project
- Availability assumptions, similar to the above to identify if the projections are plausible
- Capex projections – is the budget reasonable, justifiable and what provisions should there be for contingency?
- Opex projections – how much will it cost to keep it going to achieve the aforementioned performance?

“Smart project companies have used LTAs to full advantage by learning from their knowledge”



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Apart from the assumptions of the financial model, the LTA will need to be convinced that the project can be built to a good quality standard and delivered on time. The LTA will also need to confirm that the project will work at takeover and that it will continue to work for the duration of its operational lifecycle as envisaged in the financial model. The LTA's process for addressing all of these issues is complex and calls upon years of knowledge and experience in identifying risks, from the obvious to the obscure. For project companies of course would rather not be questioned on their projects as it is often seen as an interrogation of a project they have spent years in developing in the best way possible. And yet, such interaction should not be seen as an interrogation, but instead as confirmation that all is well with the project and – if the LTA is good – will be an opportunity to improve the project.

Lessons

Inevitably, and understandably, personnel with the project company will be completely absorbed by project details. This is good as it is fundamentally important that the details are correct. However, this also often results in the bigger picture being lost and the impact of decisions that are being made as part of the normal development process of a project not being fully appreciated and understood. Once a decision is made, it is very difficult for developers to backtrack on some basic fundamental questions such as will it fit, will it take the weight, does it all come together, etc.

A few examples from some unfortunate but true findings of wind energy developments:

- Asia – No substation
- Central Africa – No transmission lines
- Latin America – Wind turbines were being delivered in Spain
- Northern Europe – Never-ending base price in the PPA
- Southern Europe – Developing on disputed land
- Offshore – No vessel

- Central Europe – No construction contracts

There are many more examples of preventable situations arising in wind developments, but the above highlights some of the basics. In most cases, the findings were discovered well into the project financing process which resulted in delays in reaching financial close, inevitable budget adjustments to account for the delays and of course items that needed to be added on at a very late date.

It is not only negative findings that LTAs discover. As part of standard LTA duties, we have managed to improve energy yield predictions, reducing the uncertainty of the energy yield, thus resulting in a much smaller spread between P50 and P90 projections, which in turn improved the financial picture of the project. We have assisted in making construction contracts robust, allocating the risk to the right parties, thus removing the risk from the project company which could have resulted in significant overspend. Based on our view of the marketplace gained from the number of projects we work on every year, we have been able to advise project companies as to what is the norm in the market and enable them to secure better terms. Smart project companies have used LTAs to full advantage by learning from their knowledge. This is only achievable if there is open communication between the parties and an appreciation of the value that an LTA can bring.

Conclusion

Sponsors who seek funding via project finance for their project are likely to encounter an LTA at some point in the process of seeking project finance. A competent LTA should be seen as someone who can add value to a project; not necessarily a negative force. By viewing the LTA in a positive light, the project, and in turn, the sponsors have much to gain to benefit their investments. ■