Overcoming financing challenges for Hydro Power Projects
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Project finance vs. Corporate Lending

Corporate Lending

• **Unsecured loan**

Under an “unsecured” corporate loan, the Lenders have recourse to all the assets of the company itself; regardless of whether the proceeds of the loan are used to finance a specific asset or not

• **Secured loan**

In the case of a secured loan, Lenders have recourse to a specific asset of the company

Project Finance

In Project Finance, the borrower (the Project Company) is a Special Purpose Vehicle and the principle Lender security is the future cashflows of the project itself
Project finance looks principally to the cash flows

- Project Finance covers a wide range of financing structures with 2 common features, namely **financing not primarily** dependent on:
  - The balance sheet of the sponsor; or
  - The physical assets of the project.

That is, the balance sheet of the project owner or the assets of the project company (SPV) do not therefore provide sufficient security to the lender

- The optimal structure for a project owner is to have “no recourse” to his balance sheet but that would practically never happen, rather limited recourse

- Degree of recourse changes through the project life:
  - During construction, higher guarantees required than once asset started producing income
Challenges posed by Project Finance

• Lenders do not take development risk
• Lenders required well structured projects with risks quantified and addressed
  • This includes geotechnical risk
• Requirement for fixed price EPC or extensive sponsor support
  • Who is best placed to take on risk
  • Balancing addressing risk with development cost
• Fully wrapped EPC might not be viable. Look at split contract structure with appropriate cross guarantees
Key project risks need to be mitigated

Set out below are the key risks that should be assessed:

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<th>WITHIN THE PROMOTERS CONTROL</th>
<th>OUTSIDE THE PROMOTERS CONTROL</th>
<th>WITHIN THE FINANCIER’S CONTROL</th>
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Completion risk

• As with all project finance, comfort that a single party will take risk that project operate effectively is key. Not always practical.

• What happens if completion does not take place (more likely late/cost more)
  • Delay-in-startup Insurances
  • Liquidated damages
    • Who takes the blame?
    • Who pays the costs?
Completion risk

• Completion tests
  • Objective completion tests after commissioning are usually the indication that the project is being handed over (Technical & Financial)
  • Do all the plant areas integrate properly – the completion tests must be designed to test this
    • Particularly pertinent if there is not one turnkey provider (i.e. split between civil contract and Electrical/Mechanical)
Example EPC Contract Structure

Kakamas Hydro Electric Power (Pty) Ltd

Coordination and Interface Agreement

CSV Hydro (Pty) Ltd (Civil Works Contractor)

Design Consultants

Distribution Line subcontract

Hydro Tasmania Neusberg (Pty) Ltd (E&M Supply and Install Contract)

HPP (Supply & Install Subcontract)
Project Structures can be complex
Consideration in Selecting a Structure

- Every Project needs a clear structure
- Spiders are a good discipline
- Use the 16 risks to assist with developing a structure
- Know the transaction well
- Develop a structure over time as transaction matures
- Know the market you are operating in well
Project Development Timeline

Funding is on critical path of a project. Needs to be considered in parallel with technical solution. The deal process and key milestones are:

**PRE FUNDING**
- Pre-Concept
- Feasibility
- Bankable Feasibility
- Fund raising
- Diagnosis
- Strategy & structuring
- Marketing to investors
- Due diligence
- Negotiation

**POST FUNDING**
- Implementation / construction
- Commission
- Operations
- Technical Completion
- Financial Completion

Post-closing support

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Conclusion

- Development and funding of Hydro Power projects are complex processes
- Development cost is relatively high
- To ensure success a structured and disciplined approach is required
- If the correct project development approach is followed there is no reason why Hydro Power projects cannot be successfully project financed
Questions?

Opportunities in SSAfrica
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