

## **BRIEFING NOTE**

To: Shetland Charitable Trust

4 October 2010

From: Financial Controller

### **Project Finance and Viking Energy**

#### **Introduction**

This note sets out to give an overview of one possible route to finance the Viking Energy windfarm, should it go ahead. The note also looks at the cash consequences for the Trust. All the numbers quoted are derived from projections and estimates, and so they cannot be regarded as certain. However, they are derived from a prudent set of assumptions and are robust enough to be the basis for investment decisions by various banks and SSE, as well as Trustees.

The windfarm as set out in the addendum to the application for consent from the Scottish Government is 127 turbines, 457.2 MW and it is estimated that it will cost £685 million to build.

#### **Non-Recourse Project Finance**

£685 million is a lot of money. However, around 80% of the money can be raised by the project itself. This manner of funding is known as 'non-recourse project finance' and the loans are usually long term - around 15 years.

This means that Viking Energy can borrow from the banks without any need for security or a guarantee from the Trust. The banks will lend on the basis of the income coming into Viking Energy when the wind farm starts producing electricity.

The banks have got to the point where they believe that an onshore windfarm, built by a company like SSE, is a safe investment for them. The Head of Energy Structured Finance at RBS has said:

"Most banks who are active in this area [onshore wind] do not now see renewables as a hugely risky sector. The mainstream technologies are well-established and people will bank them. There is a track record of these things working pretty well."

#### **Cashflows Affecting the Trust**

After allowing for the costs of repaying the project finance and for all other operating costs, it is estimated that the Trust will receive an average income of just over £23 million pa. As I explain below to get this income, the Trust will need to finance £62 million (and I will suggest that the Trust borrows half of that sum). The

Trust would normally be pleased to get an investment income of £5 million pa from an investment of this size.

With project finance providing 80% or £548 million, the underlying partners will need to provide the other 20%. Half of this will come from SSE, £68.5 million, and the other half, also £68.5 million will need to come from the shareholders of Viking Energy Limited. The Trust holds 90% of the shares and will need to provide 90% of £68.5 million - just under £62 million.

The Trust will not have to find £62 million in a lump sum, but will be able to pay it over a few years. Trustees will have to decide whether to simply sell stockmarket shares to raise all of this sum, or perhaps borrow part, or all of it. Borrowing will reduce the immediate hit on the Trust's investment income, but will have an ultimate cost in the form of interest. On balance, I expect that I will be recommending that the Trust uses £31 million of its own money and borrows the other £31 million.

The capital expenditure will be over 5 years, but some turbines will be generating electricity and income after 3 years. This means that not all of the Trust's £31 million will be invested before there is an income. I have modelled the cashflows in and out of the Trust and estimate that the maximum amount of the Trust's own money needed will be limited to £22 million.

|                              | £ million     |   |
|------------------------------|---------------|---|
| <u>Project Finance</u>       | 548           | Viking Energy Partnership loans from banks – no security or guarantee needed from Shetland Charitable Trust |
| <br><u>Partners' Finance</u> |               |   |
| SSE                          | 68.5          |   |
| Minority Shareholders        | 6.85          |   |
| Shetland Charitable Trust    | 30.825        | Borrowed by the Trust   |
| Shetland Charitable Trust    | <u>30.825</u> | The Trust's own resources   |
|                              | <u>685</u>    |   |

**Conclusion**

The build cost for the Viking Energy windfarm is estimated at £685 million. Fortunately the Trust will only need to provide a small portion of this, with the banks through project finance, and SSE and the minority shareholders providing £623 million in the financing route I currently favour. This will leave the Trust to finance £62 million, and I expect to recommend, when and if the time comes, that the Trust should borrow half of this, £31 million, and raise the rest by selling off existing stockmarket investments. The cashflows of the project might limit the Trust's cash outflow to a maximum of £22 million. The income projected for the Trust from the project averages out at £23 million pa, and will quickly rebuild the Trust's balance sheet and put Trustees in the position to be able to decide what to do with the extra income in the best interests of the inhabitants of Shetland. No other investment offers anything like this level of return.

Reference: JPG/IS3