

Financing of Sustainable Energy Projects on the Hungarian Market

Nehéz Beáta

Director

Municipal Banking Department

2005 New York

Energy Market in Hungary

- Hungary
 - Absence of natural resources of energy – our energy needs is depend on international energy market and their prices
 - Has a lot of possibilities for sustainable energy production and using this kind of energy (e.g.: wind energy; solar energy, biogas, CHP)
- Insufficient liberalization of electricity market (mandatory sale to the State at fixed price)
- For renewable energy, favorable pricing until 2007, however pricing remains key risk factor for banks for projects with longer payback);
- Free market of heating energy; makes it a more attractive segment for banks
- Sustainable energy projects are subsidized by the State and the EU (e.g.: unrefundable subsidies) but only if energy savings are clearly demonstrable; subsidies help bankability of projects but not always necessary

Financing approaches for sustainable energy projects

- 1. Corporate finance based on client's balance sheet**
- 2. Project finance**
- 3. ESCO finance / PPP finance**

1. Corporate Finance Approach

- **Necessary condition:** a solvent corporate company
- **Bank service:** simple corporate loan
- Repayment of the loan from the normal corporate activity and NOT from the incomes of the produced and sold electricity and NOT from the incomes of energy saving
- **Collaterals:** pledge on corporate incomes, mortgage on the company's real estates, mortgage on the company's equipments (cost savings not considered)
- **Advantage:** the company is able to repay the loan even in case of project default
- **Disadvantage:** prevents good projects with weaker sponsors from getting financing
- **Experience:** First step in the evolution of financing sustainable energy projects ...

2. Project Finance

- **Necessary condition:** 20-30 % of the project as own investment of the project company; payback (incl. financing cost) of max. 10 years; contract for the selling of energy
- **Bank service:** project finance
- Repayment of the project loan from the incomes of the produced and sold electricity and from the incomes of energy saving
- **Collaterals:** cash-flow of the project and mortgage on the equipments which produce energy or energy saving
- **Advantage:** Risks factors limited to project
- **Disadvantage:** the company is not backing the loan in case of project default
- **Experiences:** This methodology becomes attractive to banks once they have better understanding of project risk

3. ESCO finance / PPP finance

- **ESCO** = special kind of project finance
- **Meaning:**
 - Construction + financing + operating of the project
 - Sales of produced energy to a client
 - The client can take over the total project at the end of maturity
 - Ideal structure for lease finance - leasing company of the bank-group is the project's owner until the end of maturity
- **Collaterals:** cash-flow of the project and mortgage on the equipments which produce energy or energy saving
- **Advantage:**
 - greatest bank control through involvement of leasing arm
 - Most profitable of the three financing schemes due to cross selling
 - complex service to the client
 - tax advantages due to use of lease finance
- **Disadvantage:** most expensive of the financing options for client
- **Experiences:** most advanced form of sustainable energy finance
 - In Hungary only three banks are actively engaged in this market

Business Case for Banks

- **Higher margin lending opportunities – better return to risk reward once bank understands real project risk**
- **Limited competition due to entry barriers (few banks have true understanding of this market)**
- **Cross selling opportunities (for example leasing)**

Obstacles to sustainable energy finance

- **Sale of produced energy depend on the State**
 - Possible solution: electricity market liberalization (decrease of the State dominance on the energy market); expected in 2010
- **Creditworthiness of energy producer companies is often a concern**
 - Possible solution: Capital investments, guarantee programs, longer term financing (min 10 yrs), interest subsidy
- **Difficult to predict the energy savings**
 - Possible solution: guaranteeing of the energy saving by instrument producer companies or by guarantee funds
- **High interest rates prevent project developers from completing projects**
- **Absence of special knowledge in the bank sector (focused on energy market)**