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Forbearance Agreements In Wind Farm Financing

Although arrangements vary, the key element in a forbearance agreement is the lender's covenant to forbear from foreclosing on a significant portion of its collateral.

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Over the past several years, the institutional investor has emerged as a central figure in the wind farm financing arena. As wind generation facilities have grown larger, requiring more capital, developers have sought out and benefited from sizable amounts of equity contributed by third-party institutional investors.

These investors – commonly known as tax equity investors – reap their own benefits from federal production tax credits (PTCs) and depreciation benefits that come with infusing cash into qualifying wind projects.

Lenders providing debt financing to wind projects also recognize the importance of tax equity investor participation. When the wind facility achieves commercial operation, tax equity investors contribute all of their equity commitment to the project company in exchange for passive ownership interests in that project company. Lenders rely on the funds contributed by the tax equity investors to help repay outstanding construction loans previously advanced to the project company.

If project-level term debt will be in place during the operating period of the wind project, then the tax equity investor and the lender must coexist, despite their interests not always being aligned. For example, once the tax equity investor makes its investment, it is required to pledge to the lenders, as security, its newly acquired ownership interests in the project company.

Although lenders receive a comprehensive collateral package, tax equity investors may be uneasy investing large amounts of capital in a wind project if their ownership interests could be foreclosed upon should the project company default on its term loan.

To address this risk, tax equity investors routinely seek to protect their ownership interests through the use of forbearance arrangements with the lenders.

Realizing the value of funds contributed by such investors, lenders agree to certain forbearance obligations to ensure the tax equity investors' participation in the transaction. Thus, forbearance agreements serve as a practical accommodation on the part of lenders to give the tax equity participants protection and comfort to take part in the transaction.

Lender's obligation

Although arrangements vary, the key element in a forbearance agreement is the lender's covenant to forbear from foreclosing on a significant portion of its collateral if the project defaults. As an exception, the lender may carve out a reserved right to enforce remedies with respect to certain collateral – other than the tax equity interests – at any time and without notice.

However, the lender would typically agree to forbear from foreclosing upon any collateral – including tax equity's ownership interests – unless a serious or material default has occurred. In these more critical circumstances, the lender would ordinarily be released from its forbearance accommodations.

If the lender seeks to foreclose upon the tax equity investor's ownership interests in the project company once the moratorium on foreclosure has been lifted, it is likely that the forbearance agreement will obligate the lender to first foreclose upon the developer's interests.

If the lender has foreclosed on the developer's equity interests in the project company but the tax equity's interests remain intact, then the forbearance agreement can prevent the lender from blocking project company distributions going to the tax equity investor.

This added protection helps preserve the integrity of the tax equity

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investment despite any conflicting interests of the lender while it retains management control of the project company. The lender will be excused from this obligation upon the occurrence of any one of a number of material defaults that the parties specifically set forth in the agreement.

Right to receive notice

The lender may eventually be able to exercise remedies with respect to its collateral in the scenarios previously described. The forbearance agreement, however, will provide that the lender's right to do so be subject to the tax equity investor's ability to first receive notice of potential issues that could impact the investment.

Many forbearance agreements require that the tax equity investor receive a copy of any notice delivered to the project company by the lender. Some agreements go so far as to obligate the lender to provide notice of any amendments to the debt documents or any lender waiver of a default under the debt documents.

Extended cure rights

The forbearance agreement will allow the tax equity investor to cure a default under the debt documents that may be remedied by the payment of money. Most forbearance agreements will also allow the tax equity investor to cure non-monetary defaults related to the project or its participants.

Some forbearance agreements work in conjunction with the debt documents to establish a special reserve account. This account is dedicated to reimbursing the tax equity investor – through distributions to the project company from such account – for amounts it has paid to cure monetary defaults.

Tax equity retained rights

In addition to restricting foreclosure on collateral, it is not uncommon for a forbearance agreement to delineate certain retained rights of the tax equity investor that are expressly made unavailable to the lender.

These tax equity retained rights are excluded from the lender's collateral, and the lender is prevented from taking any action that would in any way impair such retained rights.

Common examples of tax equity retained rights are the right to receive certain warranty payments from contractors or proceeds from separate title insurance obtained by the tax investors.

Purchase rights

Some forbearance agreements give the tax equity investor the option to purchase all of the project company's outstanding obligations under the debt documents following the occurrence of an event of default. The obligations are typically purchased at par, and the purchase right is conditioned upon the tax equity investor's delivery of advance notice indicating its intent to purchase.

Also, if the tax equity investor has failed to cure or purchase the project company's outstanding obligations, and if the lender then exercises remedies through a sale of such obligations or the assets of the project company, the forbearance agreement can include provisions allowing the tax equity investor to bid in such sale.

So long as developers look to both tax equity investment and project-level term debt for their facilities, the forbearance agreement will continue to play an important role in wind farm financing. NWP

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