MATL: Tonbridge debuts

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Tonbridge Power closed its debut project financing for its Montana-Alberta transmission line with the Western Area Power Administration on 27 October. The $161 million financing, for project company Montana Alberta Tie Ltd (MATL), is the first that Western has completed using its $3.25 billion borrowing authority under the American Recovery and Reinvestment Act. It boasts a 30-year tenor, low pricing, and it overturned obstacles – financial, legal and regulatory – that came close on several occasions to sinking the project.

The financing, which funded on 29 October brings to a close a protracted and difficult financing and permitting process. The developer, listed on Toronto's TSX Venture Exchange, defeated the final challenge to the project from a group of Alberta landowners in Canada's Supreme Court on 22 October. The developer hopes to start construction before the end of this year, and complete the line before the middle of 2011.

The debt has an all-in annual interest rate of 2% during construction, and converts to a 30-year term loan priced at the 30-year US Treasury rate on completion. The term financing is amortizing fully in a stright line in quarterly installments, while the construction loan accrues interest quarterly, and the borrower would have the option to prepay the deal with 30 days' notice. The construction loan would not convert to term unless the line's customers make their capacity payments and are complying with their transmission service rights agreements.

As part of the agreement, Western gets a 1/12 equity interest in the project, equivalent to the first 28.7km of the line, as well as rights to 50MW of capacity southbound, and and the first 50MW of capacity northbound on any expansion of the line. The sponsor can take a distribution, after operational expenses and debt repayment, equivalent to 15% of the book value of the project, if it meets coverage and reserves maintenance tests. It will use these distributions to pay off a $31 million loan from Anchorage Capital Master Offshore III, a hedge fund.

The MATL project is a 300MW 240kV transmission line that would run 345km from Lethbridge, Alberta to Great Falls, Montana. It was originally a joint venture between two small developers, Rocky Mountain Power and LECTRIX, which in 2004 brought in Tonbridge, then a small Canadian developer to help finance the project. As Tonbridge sunk more and more time and money into the project, including the proceeds from its 2005 initial public offering, it took over the process.

The opportunity involves linking up two historically separate power grids – the Western Electricity Coordinating Council and the deregulated Alberta Interconnected Electric System. In the wake of the province's deregulation, and during a period of high gas prices Alberta power prices spiked. The line was designed to allow projected coal, wind and hydroelectric generators access to this lucrative market at peak times, as well as export baseload power at off peak times. In the intervening five years, electricity markets have been turned upside down. Even though Montana enjoys plentiful reserves of coal, new coal capacity finds it difficult to get permits, and wind has enjoyed a substantial boom, though gas prices have since fallen.

Transmission lines have usually enjoyed an easy time gaining financing, mostly because the ones that have come to market to date enjoy long-term capacity agreements with large public or private power distributors. MATL, on the other hand, is a generator-led venture, and generator capacity contracts are usually less creditworthy.

The anchor customer for MATL is Spanish renewables developer Naturener, which has a strng track record, but nothing like to the appeal of a large utility to potential lenders. The line has also drawn interest from Invenergy and GreenHunter, the first of which is well-known to banks, but the two developers have not signed any contracts with MATL yet.

Tonbridge first turned to HSH-Nordbank to finance the line, signing a C$13 million ($12 million at today's rates) development loan in December 2006. Tonbridge also granted HSH 15 million warrants, as an indication of the project's speculative nature. Listed Canadian start-ups frequently reach such arrangements with early-stage debt providers, though more usually in the mining and natural resources sectors.

Since then, legal challenges from landowners, rising commodities and financial market conditions have all disrupted the project. A 2006 construction contract with SNC-Lavalin to build the line did not transfer enough risk to the contractor, and Tonbridge replaced it with a subsidiary of MDU Resources, Rocky Mountain Contractors, in October 2008. The price of the line was set at $118 million, and HSH, which held the title of project finance bank, gave the developer a commitment letter for a $108 million debt package.

Even as HSH was in place on the debt deal, however, the developer replaced its development loan with the Anchorage debt, and as HSH's troubles in Germany mounted, HSH was under pressure to restrict its lending activities to key clients and traditional industries.

The developer maintained that the HSH debt was available as a fall-back, to be supplemented with a $35 million capacity prepayment from Naturener (for the revenues of years 11 to 25 of the agreement), and a $25 million preferred share subscription, also from Naturener. There is little indication, however, that significant time and attention was devoted to this fall-back. Tonbridge might have had the commitment letter, but it might not have been able to make HSH follow up on it.

Tonbridge had enjoyed considerable success on the regulatory front in 2008. In August 2008 the Alberta Energy Board granted it a licence, followed by a permit from the Montana Department of Environmental Quality in October 2008, and November 2008 final approval from the US Department of Energy, which in turn acted upon approvals from the US State Department, the Department of Defense, the Federal Aviation Administration, the Department of Homeland Security and the Environmental Protection Agency, which all had a say in the siting of an international power line. Canada's National Energy Board granted the line a permit, and extended this in March 2009, but gave the developer a deadline of the end of 2009 to start construction.

The scope of Western's powers under the ARRA is little understood. Its previous involvement in a transmission financing – California's Path 15 – involved it taking nominal ownership of the line for regulatory purposes, but providing little financing. The ARRA provision attracted little attention even from the law firms that normally breathlessly follow such developments, and Western's own guidelines on how it would deploy the $3.25 billion were studiously vague. But the Western senators that supported the line and had a part in the provision's inclusion gave the developer an attractive enough option to close in a difficult market.

The loan has some similarities with the TIFIA loans that the US Department of Transportation provides to US transport projects, not least the low pricing and long tenor. But Western does not insist on commercial lenders being present, and therefore does not require the attention to intercreditor arrangements that TIFIA debt does, and does not insist on an investment grade rating, as TIFIA does. And because the line already had to comply with the requirements of two national and two subnational regulators it did not suffer from the sudden need to comply with Federal financing requirements, as another recent late-stage recipient of a federal loan, the Port of Miami Tunnel, did.

Western moved fast and worked late to put together a term sheet with the sponsors, despite having little in-house credit expertise. It was able to subcontract much of the work to its financial adviser, Deloitte.

According to Rob MacFarlane, a managing director at Tonbridge, the WAPA programme will be a workable template for Tonbridge's future transmission deals.

While the financing can be prepaid at any point, it would be difficult for a commercial financing to match the terms of the

Western debt. But the mandatory sweep, which takes place following the sponsor receiving its annual 15% distribution, should allow Western to redeploy the capital quickly.

Montana Alberta Tie Ltd.
Status: Signed 27 October 2009
Size: $209 million
Location: Montana, US, and Alberta, Canada
Description: 300MW, 240kV, 345km transmission line
Sponsor: Tonbridge Power
Equity: $48 million
Debt: $161 million
Provider: Western Area Power Administration
Sponsor legal counsel: Cassels Brock (financing), Winston & Strawn (regulatory)
Lender financial adviser: Deloitte
Lender legal counsel: In-house
Insurance advisers: Willis, Aon
Engineering: Pondera and Power Engineers