Debt, politics and the price of oil

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The Nord Stream pipeline under the Baltic Sea, which will pump Russian gas into the German market, has become a source of political disagreements within the European Union, with those governments with a more anti-Russian stance criticising Germany's close links to Russia.

But having taken the decision to phase out its nuclear power stations, Germany urgently needs to put new fuel sources in place, and the pipeline, which comes ashore at Greifswald, 50km west of the Polish border, is of critical importance.

The last meeting of the Nord Stream shareholders committee took place in October, and the project was pronounced to be on schedule, with approval given for further contracts for the supply of materials and construction work to be signed before the end of 2008.

Nord Stream financing on track

Though it may get caught up in the broader disagreement within Europe about the relationship with Russia, the sheer size and importance of Nord Stream to German energy requirements will probably ensure its success within the banking community.

After the October committee meeting the company put out a statement that "Nord Stream, and its shareholders do not regard the financial crisis as an obstacle to financing the project," adding that "the project remains attractive to lenders since it has strong backing from its shareholders, a solid contractual framework and is an important infrastructure project in the energy market with long term and stable returns."

The equity ratio for the project, which has a total investment estimated at Eu7.4 billion ($10.2 billion), is planned to be 30%. This will be provided by the four companies which make up the joint venture – Gazprom; BASF/ Wintershall; E.ON Ruhrgas; and Gasunie.

Gazprom owns and operates the Unified Gas Supply System in Russia, which is the largest gas transportation, storage and processing system in the world.

The Nord Stream system will be 1,120km long, and will consist of two parallel lines. The first one, with a transmission capacity of around 27.5 billion cubic metres per year, is due for completion in 2011. The second line is due to be completed in 2012, and will almost double annual capacity to 55 billion cubic metres.

Even with the conservative 70:30 debt to equity ratio there is still Eu5.2 billion in limited recourse debt to find, which will place Nord Stream among the biggest transactions of the year globally.

"We are probably looking at the back end of 2009 for Nord Stream, while the other pipeline deals such as Trans Balkan are further off," comments one London based banker. "I would expect there to be some uncovered bank debt, in addition to the main export credit agency covered tranches," he adds.

In addition to Russian and German support, both as project sponsors and linked to pipe production being done by EUROPIPE of Germany and OMK of Russia, SACE will feature prominently, since Snamprogetti is heavily involved in design and engineering. And concrete weight coating and logistics from EUPEC of France will ensure support from Euler Hermes.

The European Investment Bank (EIB) could also get involved, especially since Nord Stream is designated as an energy sector Trans European Networks (TEN) project. However the project company has stressed that EIB financing is only a possibility, and that the financing can proceed with or without EIB support.

Meanwhile the Trans Balkan Pipeline, which is designed to pump Russian crude oil into Greece via Bulgaria, is slipping further behind schedule. Russia, Greece and Bulgaria signed the agreement in 2007, and it had been hoped that some construction work could be underway by late 2008. But construction start now looks to be slipping to late 2009 or early 2010.

Transneft, Rosneft, Gazprom Neft together own 51% of Trans Balkan, with a subsidiary of Hellenic Petroleum having a 23.5% stake and Bulgaria's Burgas Alexandroupolis 24.5%. The Greek government has a 1% holding. The 300km pipeline is expected to cost in the region of Eu1 billion. In October Societe Generale was appointed financial consultant to the project.

South Stream, another major Gazprom-linked pipeline bringing Russian gas into Bulgaria and on into the Balkans, has also been slipping behind schedule.

Drilling rigs

The big strategic projects have the benefit of government support, both in terms of ECA cover and the ability to do some arm-twisting to get banks to come in on deals. But further down the chain, at the level of drilling rigs, borrowers are faced with a difficult financing environment, where sizeable uncovered tranches are needed, alongside ECA covered debt.

The spike in oil prices up to $147 a barrel in July and back down again to $45 in December has caused problems right across the industry, as oil companies, drill rig operators and bankers have all been forced to re-adjust their cashflow assumptions.

Extremely high oil prices hastened plans for the development of marginal fields, and demand for offshore drilling rigs shot up. Rig owners were able to use their negotiating power to lock in longer charters, which made deals more bankable for smaller providers. But in the current cautious environment very small players will find it more difficult to obtain financing, and bankers will be looking for sponsors with a solid track record.

Some big loans have syndicated during the second half of 2008, though these were mostly already underway earlier in the year. In October a $300 million project debt facility closed for the Sevan Voyageur FPSO, which will be deployed on Oilexco's Shelley field in the central North Sea, under a 5 plus 5-year charter.

Sevan Marine specialises in building, owning and operating floating units for offshore applications. It currently has four floating production, storage and offloading units (FPSOs) and three drilling units contracted to clients.

Mandated Lead Arrangers were GE Energy Financial Services and GE Transportation Finance. The Norwegian Guarantee Institute for Export Credits (GIEK) partially guaranteed the facility, with Eksportfinans funding GIEK's position.

The $300 million financing was fully underwritten, and was signed in May 2008 during difficult market conditions, but before the September failure of Lehman Brothers and the much more severe phase of the global financial crisis. Following syndication in October ING Bank, Natixis Singapore Branch and Fortis Bank had come in alongside the GE units.

In September a club deal closed for Neptune Marine Oil & Gas, led by HVB UniCredit. In came DVB, United Overseas Bank, ING, OCBC and Fortis. Two drilling vessels were financed, via a $120 million four-year term loan and a $170 million three-year term loan.

"Neptune was a club deal, and with banks unwilling to underwrite loans it is the only way to get things done at the moment," comments a syndicate member.

Indeed bankers say that as of December there was very little transparency in the loan markets, in terms of either lending appetite or pricing trends. Underwriting appetite could be back in the second half, though most bankers expect to see a cautious start to 2009.

"Smaller deals will be easier to do, with four or five banks who know each other well, and individuals who have done deals together," comments one lender. "The larger billion dollar-plus deals will be more difficult to close in 2009, and a brand new semi-sub can cost a billion."

"In the second half of 2008 we closed deals where the loans will be repaid within the life of the charter contract, so we are not exposed to any market risk with loans outstanding but no contract in place," he adds. "But three-year or five-year drilling contracts are historically unusual. As the oil price peaked and overheated, the negotiating power was on the side of the drill ships or rig providers, and they were extracting much longer tenors than was usual."

Indeed, some drilling contracts will now be cancelled by smaller independent companies. "A lot depends on the contract," says the banker. "If there are fixed termination fees in there they may just go ahead with the drilling, so falling oil prices may have no impact on the drilling rig provider. But in other cases the contract will be terminated and there will be drill rigs or ships out there looking for work. The effects of falling oil prices will take months to filter through, but it is going to boil down to individual contracts."

Some fields are being developed by smaller oil companies, and rigs supplied by small operators could find it hard to attract finance. And work on some marginal fields is likely to be stopped if oil prices stay down in the $40 to $50 range.

However global demand for drilling rigs remains generally strong. For example, Brazil is pressing ahead with plans to assist the development of offshore oil reserves, under the name Petrobras Fleet and Support Vessel Modernisation and Expansion Program.

The programme cost could top $20 billion. Much of this is likely to be financed on-balance sheet by Petrobras, but bankers say that the size of the programme makes it likely that Petrobras will charter drilling rigs from third parties. It will, however, be the name of Petrobras as charter party that makes these deals attractive to lenders.

Enter the IDB

In January 2008 Inter-American Development Bank made its first loan into the oil and gas sector, and IDB support will become increasingly important in the coming years.

In its first deal, IDB came in with a $100 million A Loan and a $388 million B Loan to Delba Drilling International for the construction and operation of a semi submersible offshore mobile oil drilling vessel. The vessel is currently being built under a fixed price turnkey contract with Single Buoy Moorings of Switzerland. The work is taking place at a yard in Abu Dhabi owned by Gulf Piping Company.

The vessel is scheduled to commence operations in August 2010, and is on a seven-year charter to Petrobras. The loan was arranged by WestLB, and the B portion was placed with institutions including Dexia, DVB, KfW, Depfa, Itau, BBA, Natixis and Caterpillar Financial Services.

WestLB also arranged $130 million of equity, initially provided by MPC Capital of Hamburg, and provided bridge financing as the equity was put in place.

Such integrated solutions may become more widely used during 2009, as the credit environment gradually recovers. Bringing in institutional equity investors will be one route to follow, which with a mixture of development bank financing and ECA cover should keep up the supply of much-needed new deep water drilling equipment.