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North American Public Power Deal of the Year 2007

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Invenergy St Clair: Self-service

Recent power financings in Canada have illustrated some of the side benefits of a freeze in deregulation. New capacity in the provinces of Ontario and British Columbia benefits from long-term power purchases with state-owned buyers. These contracts have enabled developers to raise some of the most competitive financing packages around.

The only large-scale inspiration for what Invenergy achieved on its St Clair financing is the method by which Qatar Petroleum finances its projects in the Middle East. Those deals take a solid contract with the main sponsor, turn this into a well-developed term sheet, and ask banks to bid on the pricing that they would accept to sign on.

The process, managed by a co-ordinating financial adviser, is often referred to as a club-type financing, a designation that serves to minimise the role of the financial adviser and the bitterness of participants, which do not typically pick up large arranging fees. The process has also been called self-syndication, and for anything less than the most desirable sponsor, will upset lenders.

Invenergy started development on the project in response to a request for proposals from the province's Ministry of Energy for 2,500MW of new capacity. It won a 20-year clean energy supply contract from the Ontario Power Authority in March 2005. The contract was later amended after Invenergy struggled to gain the necessary permits at its first site, a force majeure event covered by the original agreement.

The contract is structured so that the offtaker will pay the power producer the difference between a set price and the price it receives from spot market sales. The agreement, with an Aa1/AA(low) (Moody's/DBRS) counterparty, provides a solid anchor for a project financing.

The St Clair project, located close to Windsor, Ontario, has a nameplate capacity of 584MW, runs on natural gas, and uses grey market equipment. St Clair uses two GE 7241 FA combustion turbines, which it bought at a discount from another developer, two GE A10 turbines, salvaged by Invenergy from another site, and two Foster Wheeler heat recovery steam generators, also brought from the other site.

These pieces of equipment do not come with a standard manufacturer's warranty, which makes lenders nervous. Instead, Invenergy signed tougher-than normal maintenance agreements with the two manufacturers that replicated a warranty as near as possible. It also has an interconnection and cost recovery agreement with Hydro One, and a ground lease with Shell.

The sponsor is not even using a fixed-priced engineering procurement and construction contract to complete the plant. The engineer for the project is Bibb and Associates, while Fluor is completing the project under an agreement with a target price, and a fee that is at risk if the project costs go over budget. The total project cost is C$470.8 million ($455.9 million), of which C$33.6 million is a contingency for overruns.

Invenergy also included a C$42.2. million contingent equity commitment, to be drawn upon in the event of cost overruns. This sum augments a C$97.9 million in straight equity and in-kind (the turbines) contribution, a C$16.7 million debt service letter of credit facility and a C$79.2 million project letter of credit facility. Joining Invenergy as an equity provider was Stark Investments, a Wisconsin-based hedge fund.

The C$382.9 million construction loan for the project was also assembled with an eye to minimising costs. Invenergy appointed Royal Bank of Canada as a financial adviser, and the two then set about putting together an indicative term sheet. RBC took the place of a lead arranger, without taking the fees and underwriter economics. The adviser and sponsor then asked banks to bid on pricing, with agent titles going to arrangers who came back quickly or generously.

The process hit roadblocks, not all of them predictable. Another clean energy supply contract project experienced cost overruns, and its lead arrangers were among the institutions considering St Clair. Banks took some time to get approval from their credit committees, since their recommendations did not come with the implicit due diligence of an underwriter.

Banks questioned the ability of Invenergy, an active and experienced, but small, developer whose management has a storied past, to command the terms that an oil major could. According to Jim Murphy, Invenergy's CFO, "we didn't look to any particular market for inspiration when designing the process, but we did hear of another wind sponsor in the US that had conducted a similar exercise." The sponsor, widely believed to be Shell, has not repeated the exercise since.

The debt financing's strengths included the 20-year PPA, a block on distributions with the debt service coverage below 1.2x, and draw blockage mechanisms. It still took from March, when the two first approached the market, to 14 September, when lenders signed up, to clear.

The construction plus five-year loan attracted 12 banks: RBC (as administrative agent, with C$48.8 million), Helaba, Natixis (both documentation agent, though helaba took C$70 million and Natixis took C$50 million), GE Capital, Bayern LB (both syndication agent with C$50 million commitments), Nord/LB, Sumitomo Mitsui Banking Corporation (both C$50 million), Allied Irish Banks, LloydsTSB, Mizuho Corporate Bank, Union Bank of California (all C$25 million), and Royal Bank of Scotland (C$10 million).

Murphy is sceptical about whether the syndication process could be repeated. "It's going to be possible on a very small number of transactions," he says. But if Invenergy snags another Canadian public power contract, and puts together a project with fewer technical risks, the resultant financing could approach the market with in a very similar fashion.

St Clair Power LP
Status: Closed 14 September 2007
Size: C$576.7 million
Location: Ontario, Canada
Description: Construction financing for 584MW gas-fired plant selling power to the Ontario Power Authority
Sponsors: Invenergy and Stark Investments
Equity: C$97.9 million
Coordinating financial adviser: RBC
Lead arrangers: RBC (administrative agent), Helaba, Natixis (both documentation agent), GE Capital, Bayern LB (both syndication agent), Nord/LB, Sumitomo Mitsui Banking Corporation, Allied Irish Banks, LloydsTSB, Mizuho Corporate Bank, Union Bank of California, Royal Bank of Scotland
Independent engineer: RW Beck
Sponsor legal: Dewey LeBoeuf (US finance), Blakes (Canada finance), Thelen Reid (PPA and construction)
Lender legal: Latham & Watkins (US), Stikeman Elliott (Canada)
Insurance adviser: Moore-McNeil
Market consultant: Navigant