North American Single Asset Power Deal of the Year 2007

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Sandy Creek: Turned on a dime

The best way of examining what happened to the US project debt markets in 2007 is to look at Sandy Creek's path to financial close. LS Power and Dynegy's 900MW Sandy Creek project was set to follow the same path to market as its precursor Plum Point. But the collapse in sentiment in the B loan market in 2007 forced it to return to commercial banks for its construction financing.

Even without this unsettled backdrop, the financing package would impress. The project is not the largest power deal to come to market this year (that honour goes to fellow winner Longview), but its permitting process was a lot more challenging and banks were extremely accommodating of this.

The forced restructuring should not obscure the fact that Sandy Creek involved banks accepting – with very few modifications – a flexible B loan structure. The speed with which lead arrangers Credit Suisse and Royal Bank of Scotland were able to recast the deal highlights its strong fundamentals and compelling commercial rationale.

Sandy Creek is a 900MW supercritical coal-fired plant located in Riesel, Texas. It sells power into the Electrical Reliability Council of Texas (ERCOT) market, where power prices are usually set with reference to the price of gas. Several developers, most notably TXU, have wanted to build new coal capacity to exploit coal's relative cheapness, although TXU, which recently underwent a buy-out, later scaled back its plans.

New coal plants in the state have encountered considerable opposition, from both community groups and many of the state's mayors. Sandy Creek was one of the first coal plants to seek a permit in the state since 1988. It attracted opposition both to its air permit and to a proposed $5 million local tax incentive package. The project was the subject of a lawsuit opposing its air permit, although the challenge was on its fourth attempt as the financing closed.

The plant's permitting process was exhaustive, and banks had to structure the deal around the risk of the plant not receiving its final permits, something that project lenders are not always happy to do. The plant does have one local champion, in the shape of the Brazos Electric Cooperative, a local, customer-owned utility. Brazos owns 25% of the project, is financing this share of the costs separately, and signed a 30-year contract for 150MW of LS' share of the plant's output.

The project shares some similarities with Plum Point, another LS-sponsored coal plant, which was refinanced earlier in 2007 (for more details search "Plum Point"). But Sandy Creek is roughly 40% larger, runs on slightly cleaner supercritical technology, and has sold a much smaller proportion of its capacity to outside municipal utilities.
Sandy Creek has opted to enhance the project's merchant credit by use of a gas put hedge on another 150MW of capacity with Credit Suisse Energy, which provides the project with protection if the gas price falls below $7.25 per million BTU and threatens the plant's cost advantage. This constitutes the only outside enhancement of the project's economics, since it lacked even a firm coal supply contract at close.

Given the limited energy risk mitigation and unfinished suite of contracts, the developer intended to pitch the financing for the project to the B loan market, as it did with Plum Point, which was closed with institutional lenders but then refinanced in the wrapped bank debt market after signing up more offtakers.

However, the B loan market, suffering fallout from the collapse of the structured credit market, did not prove accommodating. Credit Suisse and Royal Bank of Scotland, facing scant interest in a $1.2 billion B loan, recast the deal as a bank financing, and achieved substantially similar pricing.

The revised financing consisted of an $800 million construction loan and $200 million term loan, both with a term of eight years and priced at 250bp over Libor, reducing to 200bp post-completion. The two sponsors contributed an additional $100 million each as a subordinated sponsor loan, which they will sell on if market conditions permit. Combined with $223 million from Dynegy, roughly $124 million from LS Power Equity Partners II and $100 million from a combination of LS Power Associates and GE Energy Financial Services, the effective total equity is $647 million.

Additional support comes from a $75 million debt service letter of credit, which will be put in place six months before operations, and contingent equity obligations from sponsors. The lenders also benefit from a cashflow waterfall, a six-month debt service reserve, and a 100% excess cash sweep.

The financing, which was rated Ba3, still resembles a B loan deal more than a classic project financing. Nevertheless, the two leads brought in a club of banks that spanned both occasional B loan players and power project finance purists. Participants and subunderwriters are ING Capital, Natixis, Union Bank of California, Bank of Nova Scotia, CoBank, Calyon, BNP Paribas, GE, WestLB, and Dexia Credit Local. The ten banks signalled their willingness to sign on for $100 million takes with alacrity.

The financing closed on 29 August, and work at the site – an engineering procurement and construction contract with a Zachry/Black & Veatch/Kiewit joint venture – is underway. Bank participation brings some burdens to the project developer, including restrictions on expenditure, and a more lengthy approvals process for waivers. But banks have put together a much more generous drawdown schedule, and do not require prepayment penalties. Still, if the sponsors manage to bring in additional offtakers, as planned, then a bond market refinancing, and with it looser covenants, is likely.

Sandy Creek Energy Associates
Status: Closed 29 August 2007
Size: $1.64 billion
Location: Riesel, Texas
Description: Construction financing for 75% of a 900MW coal-fired power project (Brazos Electric Cooperative owns and finances separately the other 25%)
Sponsors: Dynegy (50%), LS Power Equity Partners II (30%) LS Power Associates, GE Energy Financial Services
Equity: $647 million
Lead arrangers and bookrunners: Credit Suisse (administrative agent) and Royal Bank of Scotland
Participants: ING Capital, Natixis, Union Bank of California (all co-documentation agents), Bank of Nova Scotia, CoBank, Calyon, BNP Paribas, General Electric Energy Financial Services, WestLB, Dexia Credit Local (all senior managing agents)
Debt: $800 million construction loan and $200 million term loan
Tenor: Seven years
Pricing: 250bp over Libor
Legal counsel to the lenders: Latham & Watkins
Legal counsel to the sponsors: White & Case
Independent engineer: Stone & Webster
Insurance adviser: Moore-McNeil
Market consultant: ICF