

La Confluencia: Carbon copy

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Pacific Hydro and Stratkraft Norfund Power (SNPower) have closed the financing for La Confluencia, their 158MW run-of-river hydroelectric plant in Chile. The plant is the second such project in the region for the sponsors and, like its predecessor La Higuera, La Confluencia is eligible to apply for carbon credits.

The \$342 million project features \$208 million in debt financing arranged by the IFC. The debt is split into two tranches; an \$83 million A loan from the IFC's account, and a \$125 million B loan syndicated to DnB NOR Bank, HSH Nordbank, Nordea Bank, Banco Santander, and SEB.

The A loan has a 20-year maturity, longer than that of the B loan, which is 15 years. The tranches will be repaid pro rata, and both include a three-year grace period, thus reducing their average life to 17 years and 12 years respectively.

The sponsors each have a 50% stake in the project, and are providing 39% of the project's costs in equity. Though the loan has not yet disbursed, construction has started on the plant, and has been funded to date with equity. The IFC and participating banks are ready to disburse as soon as the debt is required.

The sponsors have not revealed the pricing on the debt, but Ole Gran, director of project finance at SNPower, based in Norway, describes the deal as a "fairly aggressive financing, with a power purchase agreement, and the pricing is in line with the market." AES recently closed an uncovered \$440 million construction plus 12-year financing for its Ventanas coal-fired project at just over 100bp over Libor.

Nabil Moukarbel, principal investment officer at the IFC, explained that these types of hydro projects are "capital intensive, hence the longer term maturities and non-recourse financing. The local bank markets cannot go that long on maturity." Uncovered international lenders can go almost as long as La Confluencia's 15 years, but not as long as the construction costs and solid revenue streams of a hydro project would dictate.

The plant is being constructed in the Tinguiririca Valley, roughly 150km south of the country's capital, Santiago. The plant will contribute to meeting the increasing high electricity demand growth in the country, particularly following the disruption of gas supplies from Argentina in 2004.

The water that runs the turbines is produced from melting snow, rather than the result of rainfall. La Confluencia is expected to produce energy at full capacity during the dry season when the rainfall-driven water levels in the system are at a lower level. Thermal power is normally used to produce power when conventional hydro is unavailable. La Confluencia displaces the fossil-fuel capacity that normally does this.

The plant can apply for carbon credits available under the Kyoto Protocol. The sponsor and the IFC estimate that the plant will avoid roughly 328,000 tonnes of carbon dioxide (CO₂) emissions annually, through displacement of thermal generation. The sponsor intends to register the project with the Clean Development Mechanism (CDM) board imminently, now that the financing is in place.

Both the sponsors and the IFC regard the transaction as straightforward, since it is remarkably similar to the La Higuera project, which closed at the end of 2005. La Confluencia is upstream of 155MW La Higuera, which is in its second year of

construction.

The financing for the former project was smaller than for La Confluencia, but the IFC arranged the financing for the sponsors with the same participating banks. The \$272 million plant was financed through an A loan of \$35 million, a B loan of \$115 million, and a C-loan of \$10 million.

Both projects involve long-term power-purchase agreements with Chilectra. But the second financing has an A loan maturity five years longer, and a B loan maturity two years longer, than the first. The improvement in the terms available, and the absence of an expensive C loan, is an indication of how far the market has moved in the intervening two years.

The sponsors registered the La Higuera project as a CDM in 2006. The plant was the first Chilean project to be approved, and is now eligible to sell carbon credits when the project comes online next year.

Gran explains that when these credits are available, each of the sponsors will purchase 50% of the certificates from their special purpose vehicle, Hydroelectrica La Confluencia SA, to create their own portfolios. He also anticipates that, if La Confluencia is also approved for CDM certificates, the sponsors will buy these credits too.

Once approved as a CDM, the sponsor has two options for receiving the carbon credits, which are granted annually, dependent on how much capacity is available. The first option is for a one-off approval for a 10-year crediting period. The second option is for up to a 21-year crediting period, but with a reassessment of the project's eligibility as a CDM every seven years. For La Higuera, the sponsor opted for the 3x seven-year crediting period, but Gran says that no decision has yet been made for La Confluencia.

Gran explains that the decision involves considering the regulatory risk, which is dependent on the country's carbon trading requirements: "If there is any likelihood that the project will not be re-certified after 7 years, then it makes sense to opt for the 10-year period," he says. "For example, regulatory issues make recertification more uncertain in India, but the chances are better in China, as more credits will be needed there in the future." He believes that there is a good chance of renewal in Chile, though the sponsors are still considering the options.

La Confluencia is the sort of transaction that will, in time, move beyond the province of a multilateral lender like the IFC. Commercial banks are eagerly chasing energy business in Chile, since this prosperous country is anxious to reduce its dependence on Argentinean energy. Even if the IFC does scale back its activities, borrowers can count on very attractive financing terms.

Hydroelectrica La Confluencia SA

Status: Closed October 2007

Size: \$342 million

Location: Tinguiririca Valley, Chile

Description: 158MW run-of-river hydro plant

Sponsor: Pacific Hydro and Stratkraft Norfund Power

Debt: \$83 million A-loan, and \$125 million B-loan

Maturity: 20 years for the A-loan; 15 years for the B-loan

Mandated lead arranger: IFC

Participating banks: DnB NOR Bank, HSH Nordbank, Nordea Bank, Banco Santander, and SEB

IFC legal: Chadbourne & Parke (US)

Sponsor legal: Freehills; Carey e Cia

Engineer: MWH

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