CalPeak: Contracts and collateral

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Tyr Capital and Starwood Energy Group closed the acquisition of Calpeak Power on 8 August. Lead arranger of the $123.4 million financing for the portfolio is Sumitomo Mitsui Banking Corporation. The deal resembles a B loan financing, albeit one led by project finance banks, but demonstrates the continued attraction of the post-crisis California power market to project lenders.

CalPeak is a 250MW portfolio of peaker projects located in San Diego and San Francisco. The assets consist of five 50MW units of which three are at San Diego, and two at San Francisco. The project is designed to operate at peak hours and serve demand at these two urban centres.

The units in question are four FT8 Pratt & Whitney Twinpac systems, with two gas turbine engines and one 49.5MW generator, and one Swiftpac unit. Pratt & Whitney, a division of United Technologies, installed the units in response to the state of emergency that California's then-governor, Gray Davis, declared after blackouts hit California in 2000.

The declaration meant that generating units were exempt from the normal environmental review process, provided that they were installed by September of that year. The developer was able to move quickly since its units, also known as mobile and marine power systems, are very easy to transport. The projects were operational by the middle of 2001.

Pratt & Whitney built the projects using its own resources, and had been operating them until this year. The operator signed power purchase agreements with the California Department of Water Resources for 42MW of capacity at four of the units (El Cajon, Borders, Enterprise and Vaca Dixon) running from 29 May 2002 until 1 January 2012. The reliability must run contracts mean that the operator must make the units available at all hours and all year, but is paid simply for doing this, rather than according to what it supplies.

The assets, but more particularly the contracts are very valuable to on operator. For United Technologies, the assets are a useful demonstration of its technology, but it is not principally known as a power plant operator. In late 2005 it decided to sell the projects, and in January 2006, it reached an agreement to sell to Tyr Energy.

Tyr, an Itochu subsidiary, is best known as an asset manager, but has been increasing its investments in power projects, beginning with Green County, an 800MW combined-cycle gas turbine plant in Oklahoma, and the Lincoln project, a 672MW gas project located near Chicago.

Tyr brought in Starwood Energy Group to provide the bulk of the project's equity – 80% – with Tyr providing the remainder. As the transaction was closing, however, Itochu bought out the founder of Tyr, who promptly moved to Starwood, and Itochu moved to recast Tyr as more of an investor than a manager.

But the project does benefit from both Itochu and Tyr expertise – Tyr will be the manager of the project, while another Itochu subsidiary – North American Energy Services, will be the plant's operations and management contractor. Coral Energy, a Shell subsidiary, will be providing gas to the plant, and will assist in scheduling its dispatch, but the cost of gas is passed on to the offtaker.

Starwood's expertise lay in arranging the financing. As Steve Zaminski, a principal at Starwood says, "we considered a lot of structures, and settled on the sweet spot between a very comfortable risk profile and our views concerning the residual value of the project." As he notes, the plants have previously been built using the resources of the turbine manufacturer. Starwood and Tyr therefore had to reframe the credit support in the context of a project finance asset-level deal. This required convincing lenders that they could accept project level credit support as opposed to the United Technologies balance sheet.

SMBC was mandated on 26 January following a competitive beauty contest, and the acquisition and bank financing closed concurrently on 26 May. Zaminski, who had joined Starwood in 2005, had followed the CDWR capacity auction, on which JPMorgan had advised, while at McManus and Miles in 2002.

In 2002 the credit of the CDWR was not widely understood or considered bankable. It took over the responsibility for buying power in the state after the state's main utilities ran into financial difficulties buying power on the spot market. Its bonds were initially rated at A3, were upgraded to A2, and have since had their rating reaffirmed. While in the interim the ratings of the state's utilities have recovered, these are not at the level of the CDWR.

SMBC's financing, therefore, is structured round this contract, and matures in 2012. Moreover, it consists of a $70 million A tranche, a $37.5 million B tranche, a $3 million working capital facility, and a $12.9 million letter of credit. The A tranche is a familiar term loan, which amortizes over time and is serviced using cashflows under the CDWR contract. The B tranche, however, does not amortize, and is designed to reflect the residual value of the turbines, which could readily be moved or redeployed should lenders need to foreclose on the loan.

Pricing on the debt reflects this, with the A tranche pricing at 100bp over Libor, the B tranche at 300bp over Libor, the working capital facility at 100bp, and the letter of credit, which supports the project's obligations under the project, carrying a fee of 100bp. The levels suggest that project lenders are currently competitive with non-traditional lenders for assets that fit their risk profile – Mizuho, DekaBank, Allied Irish Bank and Erste Bank are among the debt's participants.

The assets, therefore, have an unusual risk profile. They are almost fully contracted, which appeals to bank lenders, and have a collateral package that is not dependent on location or offtaker. The debt can thus appeal to a broad spectrum of lenders, and the pricing on the deal suggests, were there to be more assets like this, that project finance banks would be at the front. The universe of suitable assets is, however, limited.

CalPeak Power LLC
Status: Closed 29 May 2006, syndicated 8 August 2006
Debt size: $123 million
Location: California
Description: 250MW peaking power portfolio
Sponsors: Tyr Energy, Starwood Energy Group
Lead arranger: SMBC
Lender legal counsel: Paul, Hastings, Janofsky & Walker
Sponsor legal counsel: Bryan Cave
Financial adviser: Fieldstone Private Capital Group
Market consultant: Global Energy Decisions
Independent engineer: Burns & McDonnell
Equipment valuation: Lease Valuation, Inc