Astoria Generating: Old but good

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The acquisition of the Reliant New York assets presents a unique financing proposition, but one that will become more prevalent if capacity markets develop more widely in the US. It is also the first acquisition for US Power Generating, the asset buyer formed by Jay Worenklein after he left SG, in its almost three-year history. Like many financings for New York City projects, it makes up with location what it lacks in asset quality.

The Astoria Generating Company's principal assets are the Astoria units in Queens, New York, which were constructed during the 1950s and 1960s and have a capacity of 1,090MW. The rest of the portfolio is located in Brooklyn – Gowanus, with 32 units totalling 494MW, and Narrows, with 16 units totalling 271MW – and is both barge-mounted and more modern. The Astoria Generating Station runs on fuel oil and gas, and is a baseload facility, while the barges run on gas and operate at peak times.

The plants are located in Zone J of the New York Independent System Operator region. The area is extremely constrained in its ability to import power, more so by the New York Power Authority's rules that 83% of generation must be located within New York City. NY ISO's power market is based on making capacity available, and thus the Astoria plant needs to be available much more than it needs to produce cheap power.

So, while the Astoria project is a price taker, the two barge-mounted peakers are used for system reliability, and are fired in particular during the height of New York's sweltering summer. The assets, nevertheless were highly prized – they fetched $550 million when ConEd, the New York utility, sold them to Orion Power in August 1999. Goldman Sachs and Constellation sold Orion to Reliant Energy in 2002.

Reliant has since suffered from the decline in merchant energy markets, and for overpaying for several assets. It has also had to navigate deregulation in Texas, and was implicated in the power trading scandals that accompanied the California crisis. It has steadily been selling off assets from that period, including Orion's upstate New York hydro assets – sold to Brascan (now Brookfield) in 2004.

The New York facilities – both the upstate hydro and the in-city thermal capacity – were widely regarded as among Orion's most profitable. However, it has taken Reliant several years to find a buyer for the plants, or at least one prepared to pay a price that matched its expectations. Attempts in 2003 and 2004 both fizzled, as the merchant power collapse kept buyers away from all but the most solid contracted assets.

Bank lenders are already very familiar with the plants – Orion raised $730 million debt against them in 2000, and Reliant refinanced its Orion acquisition in February 2003 with $3.8 billion in term debt. As part of that deal, Orion's two main generating companies – in New York and in the Midwest – were cross-collateralised.

By mid-2005, the ability of asset buyers to operate plants on a merchant basis, or at least to find a counterparty willing to take merchant risk, had improved immeasurably. Thus, US PowerGen, backed by Madison Dearborn, was able to offer Reliant $975 million – largely on the back of hedging arrangements with Morgan Stanley Capital Group. The hedges, as with most private equity asset purchases, are central to the financing. They protect holders of first lien debt. They remove the ability of the sponsors to benefit from peak capacity payments to the power barges, but enhance the credit profile of the assets.

The sponsors mandated a large group of banks on the acquisition financing – Goldman Sachs, Morgan Stanley, Merrill Lynch and BNP Paribas. Of this group, the first two banks are probably the most experienced – this is, for instance, BNP's first B loan for a power acquisition. Such promiscuity however, highlights the fact that US PowerGen is anxious to build up a large bank following, should it pursue additional assets.

The financing consists of $730 million in term debt, which breaks down into a B1-rated $430 million first lien piece and a B3-rated $300 million second lien facility (both due 2013). The buyers also raised a $100 million revolving working capital facility (due 2012), and $120 million in synthetic letters of credit (due 2011), of which $100 million backs power sales counterparty obligations and $20 million additional obligations.

The deal also includes an unfunded, unrated letter of credit from Deutsche Bank, which is in the region of $150 million and covers additional obligations under the hedging programme. The sponsors are also putting $314 million of equity into the deal.

The debt priced competitively, even though one of the tranches received a split rating. Moody's assigned the first lien debt a B1 rating, while S&P, unusually, pegged the debt one notch higher, at BB-. The second lien was B3/B-, and priced at 375bp over Libor, while the first lien priced at 200bp.

The New York capacity market probably receives disproportionate attention from banks, and this means that the bookrunners were able to sell down debt to a market familiar with its dynamics. However, there is some capital expenditure associated with the plants, including an environmental consent order, as well as higher than normal operations and management costs.

The working capital facility is particularly useful, since the financing does not feature a dedicated debt service reserve account (DSRA). The lack of a DSRA is a tribute to the competitive nature of the B loan market – several recent financings have also dispensed with the feature. Nevertheless, the portfolio is estimated to produce $660 million in net hedged revenue over the next two years, and thus coverages of 1.3x.

The assets, while familiar to much of the market, are unique – few markets at present exhibit the characteristics of New York's. But this might change. Several independent system operators, as well as the Federal Energy Regulatory Commission, are moving towards markets where generators are paid for providing capacity, rather than energy.

Astoria Generating Company Acquisitions
Status: Closed 23 February 2006
Size: $925 million
Location: New York City
Description: Acquisition of 2,100MW of peak and baseload generating capacity
Sponsors: US Power Generating, Madison Dearborn, Hunt Oil and Hunt family affiliate
Debt: $950 million
Arrangers: Goldman Sachs, Morgan Stanley, Merrill Lynch and BNP Paribas
Tenor: Seven years
LC provider: Deutsche Bank
Independent engineer: Burns & Roe
Buyer legal counsel: Kirkland & Ellis
Legal adviser to the seller: Vinson & Elkins
Legal adviser to USPG: Paul Weiss Rifkind Wharton & Garrison
Lender legal counsel: Shearman & Sterling, Latham & Watkins