OrCal: California steaming

01/12/2005

Ormat Technologies has completed a $165 million 144A issue to refinance its OrCal Geothermal portfolio. The financing, which closed on 8 December, indicates that geothermal assets are fast becoming popular with a new investor base. It also indicates that geothermal producers are able to get satisfactory, although not yet top-tier, pricing.

Ormat is a specialist operator and manufacturer of geothermal and heat recovery technology. Ormat Technologies has been listed on the New York Stock Exchange since November 2004, and was founded by Ormat Industries, an Israeli company. Ormat has operations in the US, Central America and Africa, among other regions.

Ormat is unique in its focus on geothermal assets, and has built up a sizeable portfolio in the western US. It has bought, expanded, and developed geothermal resources in Nevada, California and Hawaii. (For more on Ormat, please see the June 2005 profile in Renewable Finance).

On 18 December 2003, it paid $214 million for Covanta Energy's geothermal assets as part of a bankruptcy court-ordered auction. It financed this purchase through a $154 million loan from Beal Bank due 2019. This loan was priced at either the greater of 7.125%, which would have stepped up 55bp on 18 December 2011, or 512.5bp over the three-month Libor, with the margin stepping up over time. Ormat capped the Libor interest rate at 6% between 2007 and 2011 using cap transactions.

However, as Ormat's vice-president for business development, Ran Raviv, says, "we decided to refinance for economic reasons." There was, as part of the 2004 series of financings, which included a 144A Ormat Funding issue, and the November initial public offering, a substantial body of experience available to the borrower and underwriter, Lehman Brothers.

In many respects the financing resembles the Ormat Funding deal, a $190 million issue which closed in February 2004, is due 2020, and priced at 8.25%. It financed a portfolio of assets in California and Nevada, as well as upgrades and expansions. The new issue features many of the same principals and advisers.

This portfolio is concentrated in California, and thus benefits from the credit of the Californian utilities. It consists of the following assets:
• 100% ownership in the Heber I power plant, which has a nameplate capacity of 52MW and is located near Heber in Imperial County, Southern California,
• 100% ownership in the Heber II power plant, which has a nameplate capacity of 48MW, and is located next to the Heber plant, and
• 100% ownership in the 10MW Gould project.

The project benefits from power purchase agreements, with Baa1-rated (Moody's) Southern California Edison (SCE), that expire at 2015 and 2023. Since the purchase, Ormat has also signed a third PPA, with the Southern California Public Power Authority (SCPPA), that expires in 2030. Under the SCE contracts, the borrower is paid for capacity, a capacity bonus, and a fixed $0.0537 per kWh tariff until 2007.

The main worry for a producer in California is that after 2007 the energy rate will revert to being calculated under shortrun avoided cost formula. This is likely to remain closely tied to the price of natural gas in the state, and thus is likely to provide good margins to a geothermal producer. Indeed, it is possible that a geothermal plant would be well able to make good margins in a merchant environment, although such assets would find it difficult to raise competitive financing.

Much about the structure of the OrCal financing is a testament to its conservatism. As Raviv notes, the assets would likely be able to raise substantially more than the $165 million of the issue. However, the deal was sized entirely to pay off the Beal Bank financing and take care of transaction costs. It also provides the sponsor with fixed rather than floating interest rates.

The deal's strengths, according to a report issued by Moody's are the power contracts, Ormat's experience, and the strength of the financing covenants. Moody's was more worried, however, by the potential for changes to the power tariff, the concentration of offtake risk with SCE, and the project's leverage. It said that the debt per kW, at $1,919, was higher than many peers.

Moody's came back to the sponsor and underwriters with a Ba1 rating, just below investment grade. The other ratings agency, Fitch, had assigned the notes a BBB- rating, and the split rating did not match the goals of the sponsor in structuring the deal. Despite this setback, which discouraged some investors from buying into the transaction, Raviv says that Ormat is satisfied with the pricing, which came in at 170bp over the 10-year treasury for a coupon of 6.21%.

According to Ormat's most recent 10k, however, it entered before the issue into a seven-year treasury security rate-lock agreement at a locked-in rate of 4.047%, which it terminated after the notes were issued. The expected effective annual interest rate of the notes is now 5.75%.

A simple comparison with both the Ormat Funding issue and the Beal Bank loan indicates that the borrower got a good deal. Should any more geothermal assets come to market (the most likely candidate is the Geysers portfolio, which Calpine has been looking to sell, current legal entanglements permitting), the deal creates a strong benchmark.

OrCal Geothermal, Inc
Status: Closed 8 December
Size: $165 million
Location: California
Description: Refinancing of 120MW (gross) geothermal portfolio
Sponsor: Ormat Technologies
Debt: $165 million in 6.21% notes due 2020
Sole bookrunner: Lehman Brothers
Sponsor legal: Chadbourne & Parke
Underwriter legal: White & Case
Beal Bank legal: Latham & Watkins