Ten year itch

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Debt margins in the Thai power market have continued to drop and have reached a 10-year low for greenfield deals. Although welcome news for sponsors, it is a situation that lenders believe cannot last.

The greenfield independent power project (IPP) that will benefit from the 10-year pricing low is Gulf Power, backed by Thailand's Electricity Generating Plc (in which China Light & Power has a stake) and Japan's Electric Power Development.

In most respects, the Gulf Power project is a conventional Thai IPP venture, with a standard 14.5-year term for the offshore loan and unremarkable gearing.

Colin Chen, at Bank of Tokyo-Mitsubishi – one of the five arrangers, alongside Fortis, ING, DZ Bank and Mizuho – says the $129 million offshore loan will replace part of the $660 million-equivalent onshore loans, provided by Thai banks, including Siam City Bank, UOB Radanasin Bank and Thai Military Bank. "Its not a refinancing," says Chen. "The intention was always to have a US dollar tranche."

Last year, the sponsors were anxious to get a financing agreement signed, since the terms of their power purchase agreement (PPA) specified that they had to reach financial close within 18 months of being awarded the concession. "The quickest way to do this was to initially sign an interim agreement with local lenders," Chen says. Gulf Power and its bankers have set 15 November as the target date to close the offshore financing.

The lending margin for the offshore facility is the most noteworthy element of the financing, particularly as the loan does not benefit from political risk insurance (PRI). The margin on the loan is understood to be 75bp over Libor, less than half that of previous offshore loans to Thai IPPs, most of which did benefit from PRI.

The two onshore loan facilities (provided in both Baht and US dollars) cost 350bp over the three-month fixed deposit rate for the Baht tranche, and 275bp over Libor for the US dollar tranche.

Why has the pricing on US dollar, offshore debt been driven down so far? The principal reasons relate both to the Thai market in general, and to the specifics of the deal. Nicolas Leclerc at SMBC in Singapore says that average pricing on clean commercial loans to Thai IPPs has fallen from between Libor plus 200bp and 250bp three to four years ago, to below 100bp today.

Another financier, whose project finance experience dates back over two decades, suggests that similar pricing levels were also in evidence in the early 1990s. "Given that lenders describe Thai IPP project financing as reasonably commoditized and given high liquidity in the local banking sector, it could be argued that pricing should be at least as low, if not lower than it was 15 years ago," he says.

Opportunities for foreign commercial banks to participate in this transaction are limited, since JBIC is providing Gulf Power with a direct loan under its Overseas Investment Loan scheme, which substantially reduced the cost of funding for the sponsors. The project also benefited from the involvement of highly-rated Mitsui & Co as the EPC contractor, and the project's very competitive electricity tariff.

Ratch not ratcheted

But the pricing differential between Gulf Power and Ratchaburi Power's financing, which will also close shortly, tells another story. The $880 million, 1,400MW, gas-fired, combined-cycle Ratchaburi Power project has a similarly competitive tariff and a similarly strong sponsor group, including: Ratchaburi Electricity Generating Holding, Hong Kong

Electric International, Chubu Electric Power, PTT, and Toyota Tsusho.

The overall financing package for Ratchaburi involves $650 million of debt, split between a $380 million JBIC direct loan and a $170 million-equivalent Baht-denominated loan provided by local Thai banks. The offshore financing is scheduled to sign by December.

The onshore loan is believed to be priced at 250bp below the fixed deposit rate for the first 30 months and thereafter at 150bp below the minimum lending rate. Bangkok Bank and Krung Thai Bank are providing the onshore loan, while Calyon, HSBC and SMBC are arranging a $490 million offshore portion. SMBC is also the project company's financial adviser.

Wai Ling Ho, a banker at HSBC in Singapore would not confirm these details, but says the 15-year, $100 million US dollar loan for Ratchaburi is priced on a stepping scale, with different pricing during construction, post construction, and five years post construction. A second banker involved in a rival deal says the offshore commercial debt is priced, even at the lowest end of the scale, at more than 100bp over Libor.

"Pricing for Ratchaburi was agreed in March and in the months between then and when the pricing for Gulf Power was agreed, I think lenders came to recognise that Gulf Power was the last chance to be involved in a greenfield Thai IPP under the old structure. Therefore, appetite was very strong," Ho says.

No index equals higher pricing

Future Thai power projects are sure to materialise, but observers agree that new IPP projects will feature a much reduced US Dollar indexation level, or possibly no US Dollar indexation at all, thus further constricting opportunities for foreign lenders.

No other aspect of Thai power financings has changed as dramatically as pricing. Indeed, in terms of debt sizing or loan tenors, little has changed in the Thai market. "15 years is pretty consistent for greenfield IPP loans," says Leclerc. "That's more or less the optimal term, so there really is little incentive to adjust tenors." Gearing ratios have also remained in a band between 80% and 75% debt.

Arguably, the fundamental reason for the rapid contraction in margins is the lack of alternative project finance opportunities in the region for international lenders. Similar margins are likely to persist for similar projects, if deal flow remains constricted and the high liquidity in the Thai banking industry is maintained.

The liquidity in Thailand's banking industry is also evidenced by a pricing contraction over the past 12 months. Margins on Baht facilities for a wide range of infrastructure projects, not just power projects, have come down significantly since mid-2004.

This is not to say that foreign lenders involved in the Thai project finance market are not concerned about the lower pricing levels – they are. However, many are prepared to compete at present margins, since they have little choice if they want to remain active as project finance lenders in the region.

At least international lenders have grown comfortable with the risks of lending to Thailand's electricity sector, which explains why demand for unsecured lending opportunities is now so strong. BLCP was financed in 2003 and was the first Thai power project to include an uncovered debt tranche provided by foreign lenders, but the proportion of uncovered debt was modest. Sponsors of Thai power projects can now secure large uncovered commercial debt facilities at fairly attractive rates.

Not surprisingly, the ample supply of cheap funding is encouraging most sponsors to re-examine existing loans. In fact, one lender suggests: "every sponsor of a Thai power project which paid over 100bp on US dollar loans will be looking at refinancing."

A refinancing bonanza?

Glow IPP, the 713MW power plant owned by Suez Energy, is currently seeking a $300 million refinancing. SMBC, Calyon, Fortis and KBC are in discussions with the sponsor for the refinancing.

Another refinancing was signed in October for Tri Energy Company, which in mid-1998 became the first IPP to be financed in Thailand since the devaluation of the Baht. Market sources say Tri Energy has secured a new loan worth approximately $200 million, with a tenor of 7.5 years. BTM, SMBC and UFJ arranged the refinancing. The exact details of the deal, including pricing, were not revealed, but one market source says the margin is well below 100bp.

In 1998, Tri Energy agreed a US dollar loan worth $427.5 million and a small Baht loan of Bt750 million. Arrangers were BTM, Bayerische Landesbank, Citibank, Credit Suisse First Boston, DKB Asia, Fuji Bank, NationsBank, Sanwa Bank and Sumitomo Bank.

The deal was split into six tranches. The two key tranches were a $263.2 million loan provided by BTM, Bayerische Landesbank, CSFB, DKB Asia, Fuji Bank and Sanwa Bank and a $40.5 million term loan provided by Citibank and NationsBank. Both tranches had 15 year two month terms and were priced at 170bp over Libor from construction until year five, moving to 185bp for years six to 10 and then peaking at 205bp through to maturity. Both deals were backed by political risk insurance, with the larger tranche covered by Japan's Ministry of International Trade and Industry and the smaller tranche supported by OPIC.

According to one banker, the refinancing volume does not cover the full outstanding loan amount because one facility included PRI paid up front and could not be taken out by a new loan. "Most but not all of the existing lenders will participate in the refinancing," says a source involved in arranging the new loan. Other refinancings that are expected as a result of the margin contraction include a new transaction for BLCP.

Yet, just as price is the mechanism to match demand and supply in any other market, there are already signs that the supply of offshore debt is thinning out at current margins. Market observers say that Glow IPP is unlikely to secure all of the $300 million that it wants, at rates comparable with other recent Thai power deals.

So, as more power projects emerge in the region, in Thailand and elsewhere, loan margins can be expected to widen. In Thailand, sources say a new round of IPP tenders should be announced for the Electricity Generating Authority of Thailand, next year, accounting for about 8,000MW of new generating capacity. Ho suggests that the first of these new IPPs could seek funding about eight to nine months after being awarded.

Margins do not travel

There are also other power financing opportunities expected in the more challenging South East Asian markets, notably Vietnam, Indonesia and the Philippines.

Several banks suggest a first deal will emerge out of Indonesia. William Stevens at SMBC, Singapore, says that his bank is currently acting as financial adviser for a quasi-captive, relatively small-scale power project in Indonesia that will almost definitely be funded in the next 12 months. He declined to give further details while funding discussions are still ongoing. "It's a very bankable power project for Indonesia, as PLN is not the offtaker," indicates another financier close to the deal. The project is expected to seek equity funding in the next four weeks.

Bankers add that the first deal with PLN offtake risk to hit the financial markets is probably the Cirebon power project, located in West Java. The development is considered to be the flagship power generation project in Indonesia. The International Finance Corporation is advising PLN on the proposed financing.

Bankers stress that the Thai experience presents no pricing guidance for these other South East Asian markets. "As there has been no significant changes in the power market in Indonesia in recent years, we can expect spreads to be in line with those achieved in the Phu My 2.2 and Phu My 3 projects," says Joris Diercx at Fortis in Singapore.

Diercx says that project financings for Philippine, Vietnamese and Indonesia ventures will all require PRI, in contrast to the situation in Thailand. Banking sources add that this will be relatively easy to attain for Vietnamese projects, but particularly difficult for projects in the Philippines. "Clean commercial debt facilities are not going to be possible for Indonesian and Philippine power projects for the foreseeable future," agrees Stevens, "as such the pricing trends in the Thai market have little bearing on these other markets."