

Astoria: Tranched to go?

01/05/2005

The Astoria power project, while one of the most unique financing challenges of the past several years, has rapidly become a bellweather of the state of the US power finance market. The deal's latest iteration, a refinancing led by Calyon, leaves several questions open, and has sparked some adverse, possibly envious, comment in the market. But it provides, at the very least, a marginally more sustainable and stable basis for the project as it approaches completion.

Astoria is in part a favourite topic of conversation because it is located roughly 5 miles from the offices of the major lending banks, in an electricity market that market participants can easily comprehend. It features a disparate group of developers, contractors and private equity firms as sponsors, and has a coveted contract with one of the better-rated investor owned utilities.

But the project, and the contract, and the participants, created challenges to putting together a successful financing. These have been widely discussed (search Astoria on projectfinancemagazine.com for details) and have been often cited in support of the use of the original financing package.

In brief, the 552MW plant is probably the most expensive combined-cycle plant, by cost per kW, ever constructed. Located in Astoria, Queens, it sells power to Consolidated Edison under a 10-year contract. It was financed in April 2004 using a total of \$690 million in term B debt from Credit Suisse First Boston.

The CSFB deal was richly-priced – the first and second lien debt was priced at 525bp and 875bp over libor, respectively – but the bookrunner maintained that it was the best deal available in the circumstances. These were, variously, the collapse in bank sentiment towards power assets, the plant's construction arrangements, and the tight terms of the power purchase agreement with ConEd.

Towards the end of 2004 Calyon went to the sponsors – AE Investor, SCS Energy, EIF, SNC Lavalin and Caisse Des Depots – with a proposal for a refinancing. A refinancing, given the price of the debt and the minimal amortization on the B loans, was a given. But the speed of the Calyon proposal was surprising.

Initial market reaction was sceptical – the most likely solution was a bond financing, and it was difficult to see how the new arranger could improve upon the original deal before the completion of the project. Moreover, the prepayment fees associated with retiring the previous debt had the potential to affect the economics of any refinancing.

According to Olivier Delay, director in the US Global fixed income group at Calyon Securities, "the biggest challenge for the refinancing was the prepayment penalty that typically applies in this type of transaction. However, the overall merits of the refinancing did largely outweigh the penalty cost."

The original deal, which followed an abortive attempt to finance the plant using a single B tranche, featured a \$500 million first priority piece and a \$190 million second priority piece, and the two were largely differentiated by their security positions. The two deal is both longer-dated, and tranched in a slightly more sophisticated fashion. Or as Delay puts it "Calyon's perception was that this transaction could be approached as a contracted deal, with a residual merchant tail both of which had constituencies with financiers."

The original deal worked on the assumption that in April 2004 there was unlikely to be sufficient bank appetite to cover the cost of the plant. Since then there has been sufficient appetite to cover Calpine's recent contracted deals, some of them featuring an element of Calpine construction risk.

The deal now consists of two separate tranches – a merchant tranche and a contracted tranche. The contracted tranche is \$515 million in size, is senior secured, and has a tenor of construction plus 10 years. The contracted tranche is serviced from the revenues under the power purchase agreement and fully amortizing. The merchant tranche is \$210 million, senior secured, and has a tenor of 15 years. However, it is interest-only for the first ten years of its life, and will only be repaid after the contracted tranche.

Nevertheless, lenders to the contracted tranche are still exposed to the fluctuations that are possible under the ConEd contract. The contract, in Delay's words, "offers more volatility in revenues. The contract leaves potentially more upside to the project than what is typically seen. It also offers more downside, but such downside is limited by a floor." The new deal mitigates the downside by offering some flexibility in repayment schedules, with shortfalls met through cashflows trapped during periods of above average prices.

The final area where the new deal has introduced some innovation is in the mitigation of construction risk. Stone & Webster is the lead contractor, although given the weakened credit profile of S&W's parent, the Shaw Group, SNC Lavalin wrapped the completion of the project in exchange for a premium. The project is ahead of the original schedule and within budget, making it more likely that Astoria will be able to perform under the PPA. The residual construction risk is addressed, according to Delay by an "increased contingency line item designed to cover consequences of a construction related issue."

The new financing is fixed rate, and CSFB is understood to be providing hedging for the plant's debt. Among the rumours that have been prevalent in the market has been the suggestion that the hedge business might have been a way to compensate CSFB for giving up its right to lead the refinancing, although none of the participants have confirmed this.

The other area of uncertainty lies with Calyon's intention for the debt. More than one bank active in the market has questioned what the arranger might be doing with the debt, which, given the tenor and interest rate, might be best placed to institutions. Delay, whose answers to earlier questions was by email, had not responded to additional questions by the time Project Finance went to press.

But the details that have emerged so far suggest a transaction that – in part – should be palatable to the bank market. It also demonstrates one clear drawback of the term B market – that its tenors and pricing are not within the optimal parameters for a long-lived contracted asset. But the April 2004 market still made it necessary.

Astoria Energy Refinancing

Status: Closed April 2005

Size: \$725 million

Location: Queens, New York

Description: Refinancing of 552MW power plant

Sponsors: AE Investor, SCS Energy, EIF, SNC Lavalin, Caisse Des Depots

Arranger: Calyon

Debt: \$515 million contracted tranche and \$210 million merchant tranche

Maturity: 10 years (contracted), 15 years (merchant)

Borrower legal: Bingham McCutchen

Lender legal: Winston & Strawn

Thank you for printing this article from IJGlobal.

As the leading online publication serving the infrastructure investment market, IJGlobal is read daily by decision-makers within investment banks, international law firms, advisory firms, institutional investors and governments.

If you have been given this article by a subscriber, you can contact us through www.ijglobal.com/sign-in, or call our London office on +44 (0)20 7779 8870 to discuss our subscription options.