Astoria Energy: making the vig

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New York City is en expensive place to build, as the sponsors of the 500MW Astoria Energy plant have discovered. But while construction costs in the city may carry a hefty premium, they must have been surprised at the mark-up attached to the financing. Nevertheless, the $690 million Term B construction financing assembled by Credit Suisse First Boston is a landmark.

Astoria Energy is a 552MW combined-cycle gas-fired plant located in the borough of Queens. The plant will sell capacity to New York's utility, Consolidated Edison (ConEd) under a ten-year power purchase agreement. ConEd bid out the plant in February 2003, and the request for proposals met with a number of responses, including one to transmit power into Queens from over the Hudson River in New Jersey. Market speculation was that the contract would be a lucrative earner for the ultimate winner.

SCS, short for Steam Control Systems, a small Massachusetts developer, held a site in Astoria, Queens, in conjunction with AE Investor, the vehicle for a private real estate developer. It bid aggressively, based on the fact it held an advantageous site, and had gained a permit for 1,000MW of capacity. By April it had won the contract.

The main peculiarity of the location is that local labour costs and the size of the site, which requires a large proportion of off-site assembly, make Astoria's cost per kW, at $1,760, one of the highest ever for a power plant. Moreover, the power purchase agreement with ConEd has a price floor that should assure debt service on the project is met, but only goes out for ten years, albeit with an option to go out a further five years. Given these challenges, the developers may have regretted not taking the $100 million the site commanded at the top of the merchant boom.

Project lenders in New York were eager to finance the plant, and several believed that they were close to winning the mandate. The stumbling block for them was the amount of debt that could be raised in the bank market, as well as the restrictions upon dividends that it would require. Since third-party equity would be averse to the latter, and the former would require some sort of subordinated element, SCS was looking for a particularly adventurous lender .

Credit Suisse First Boston, the adviser to the sponsor, examined the use of tax-exempt financing, though the New York City Economic Development Corporation's Liberty Bond programme. The use of such bonds would have meant for extremely attractively pricing, but the project would have found it difficult to gain an investment grade rating, despite ConEd's rating of A-/A2 (S&P/Moody's).

Another worry for lenders is that Stone & Webster, part of the financially shaky Shaw group, has the construction contract. The liquidated damages schedule in the contract provides for payment of interest on the debt, but would not cover the electricity supplies to ConEd called for under the project in the event of a delay. SNC Lavalin, has, for a fee, guaranteed Shaw's obligations. SNC, with $60 million, EIF, with $50 million, and Quebec's Caisse des Depots, with $100 million, provide the equity, with SCS and AE providing a further $73 million.

The Term B market has not been considered suitable for greenfield financings. Indeed, all previous deals have been for sets of operating assets, since lenders usually prefer to have easily valued collateral. Until May 2006, however, lenders look only to a piece of, admittedly prime, real estate as security, along with the contract. S&P's rating on the deal assigns it a recovery rating of 4, which it says is equivalent to 25-50%.

Institutional loan funds, money marketers, mutual funds, and other non-bank providers of floating rate debt, also tend to provide this at a high price. CSFB has arranged loans for the likes of CentrePoint Energy with double-digit interest rates. The current debt market obsession with chasing yield means that its pricing as keener. Nevertheless, it is above what the institutional lenders would offer for a BB/Ba level project.

And Astoria Energy has the dubious distinction of being one of the lowest rated projects ever financed. Non-recourse generation companies may have done as badly, but this is Ba3/B+ (Moody's/S&P) project has a contract. And Astoria is located in one of the most congested power markets on the country.

Zone J, which covers Queens, includes most of the city's industry, and is further from New Jersey, which supplies the island of Manhattan. Power runs west to east in the city, and Long Island, further east, has its own capacity constraints. ConEd's contract stipulates a five percent discount to the market price, but the new plant should be among the most efficient in the market, and studies of the marketplace in the years following the end of the contract suggest that it could be profitable.

Sempra Energy has a gas supply contract with the plant that is not directly indexed to the market price for power, but roughly tracks it. There is a potential for a mismatch on the contract, but it is small and relatively manageable. Pace Global, an early advisor to the project, provided the market study.

But the arranger did not find sufficient appetite for a $700 million senior financing at the 450bp over Libor level. Given that a merchant power deal could have priced at 350bp during the boom years, this level seemed optimistic. And CalGen, another Term B financing with a small amount of construction risk, also needed to flex its pricing to sell.

The restructured deal now features a $500 million first lien piece priced at 525bp over libor, and a $200 million second lien tranche with an 875bp margin. Sources close to the arranger are still adamant, however, that the deal is cheaper than that for a bank financing with a mezzanine piece, and was achieved in time for the plant to start construction.

Nevertheless, the agencies have focused on the fact that the amortization only includes 1% per year, although between 35% and 50% of cash is trapped to repay debt. There is likely to be a refinancing as soon as the plant is operational, possibly in the same market, but at a cheaper price.

Astoria Energy LLC

Status: closed April 2004

Size: $973 million

Location: Queens, New York

Description: 552MW power plant

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

Arranger: CSFB

Debt: $500 million in first lien Term B debt, $190 million in second lien debt

Margin: 525bp and 875bp over libor, respectively

Maturity: 2012

Engineer: Harris

Market consultant: Pace Global

Lawyers to the borrower: Bingham McCutchen

Lawyers to the lenders: Skadden Arps