Springerville: A clean break?

01/11/2003

The Tri-State Generation and Transmission Association has completed a $760 million structured lease obligation bond (SLOB) issue for the Springerville unit 3 project. The deal, led by Credit Suisse First Boston, is the first SLOB issue to close this year, and is also a rare coal-fired financing. While current the current political outlook for coal generation is good, installed costs are high and emissions concerns are still substantial.

Tri-State is an electricity co-operative that serves Arizona, New Mexico, Colorado, Wyoming, and parts of Nebraska. It is made up of 44 smaller member distribution co-operatives, which own it and buy its output. It originally looked at buying power from an expansion project at the existing site of two coal-fired units owned by Tucson Electric, part of Unisource.

But Tri-State's service territory, while largely rural, is experiencing rapid population and demand growth. Its initial plan, to take 100MW of a proposed 400MW expansion, became a 300MW commitment. At this size, and given the ratings agencies' inclination to treat long-term power contracts as debt, the co-operative decided to increase its commitment to the project.

In this it was aided by the decline in credit quality both of the owner of the site, Unisource, and a number of local utilities. These might have been expected to offer an alternative offtake to Tri-State, but appeared unlikely to offer a solid enough credit to raise financing. As a result, Tucson Electric is the developer and operator of the plant, but the project is now Tri-State's. Tucson has a five-year power purchase agreement with the plant for 100MW, with the Salt River Project Agricultural Improvement and Power District taking 100MW over 30 years.

Tri-State, while a co-operative, is a taxpayer, but does not need the depreciation associated with a coal plant, which might take it dangerously close to the alternative minimum tax level. The generator, which also wants to take the plant off balance sheet, at least for accounting purposes, decided to structure the financing as a lease, and sell the tax benefits to GE Capital Structured Finance, the first time GE has agreed to do this on an incomplete plant.

While the financial benefits to the co-op are clear, the credit risks to GE are more substantial. Leveraged leases where equity is pledged before completion of a plant have often become unstuck after conditions precedent could not be met at completion. This has happened with several single asset deals, and indeed scuppered leases proposed for the previous units at the Springerville site.

However, GE's $180 million in equity has been provided in the form of a construction loan before completion, at which point it becomes the equity for a 34-year lease, and the deal has been structured to alleviate potential concerns. Tri-State is the construction manager, and has guaranteed the completion of construction, although it has in turn signed a robust fixed-price turnkey contract with Bechtel for the project.

As one of the first project financed greenfield projects in decades, lenders will be keen to see that the plant can be built on time, to spec, and come in inside emission regulations. According to Jonathan Baliff, director at CSFB, the deal, "will actually make the output of the three units, as well as a planned fourth, cleaner than units 1 and 2 are at present." The financing has been sized to include pollution control equipment installation, guaranteed by Bechtel, which will reduce carbon dioxide and sulphur dioxide emissions, among other pollutants.

The installed cost of the power, at $2000 per kW, is high, although coal prices are now so low, and poised for further depression, that the cost per kWh could be in the 4.8 cents range, making it one of the lowest cost producers in the south-west. If growth gets close to the 12.9% forecast for the region, the plant will be a vital part of Tri-State's service to New Mexico and Colorado. The lessee benefits from a 40-year power purchase agreements with its members, and is allowed to raise rates in line with its financing commitments. It did recently raise rates but, as Moody's noted in its analysis of the transaction, this was the first since the 1980's, and that since that date Tri-State had occasionally lowered rates.

The co-op is the subject of a Master Indenture, to which the financing must conform, and maintain debt service coverage ratios of at least 1.02x, although the target level is between 1.1x and 1.3X. The SLOB debt is probably the largest single obligation to which Tri-State is subject, although it has carried out a lease on the Craig 3 unit that it runs, and has some unsecured debt with the National Rural Cooperative Finance Corporation and CoBank.

The notes gained a rating of Baa2, AA, and AA-, from Moody's, S&P and Fitch, respectively, which is at the same level as Tri-State's rating, except for Fitch, which notched the issue down. The notes, underwritten by financial advisor and equity placement agent CSFB, were split into two tranches. The first, of $355 million, with a 12-year maturity and 8.8-year average life, priced at 170bp over the ten-year treasury, for a 6.04% coupon. The second, of $405 million with a 30-year maturity and 21.19-year average life, priced at 190bp over the 30-year treasury, for a 7.144% coupon.

The issue, which achieved a 2/3 hit rate for investors visited on the roadshow, sold down strongly, with the largest single commitment for $57 million. Other sponsors and investors, waiting to see how regulators view further coal capacity, will take note.

Tri-State Generation and Transmission Association Pass-Through Notes
Status: Closed October 2003
Size: $940 million
Location: Springerville, Arizona
Description: Lease financing of 400MW coal-fired power plant expansion.
Sponsor: Tri-State Generation and Transmission Association
Lease equity: GE Capital Structured Finance
Debt: two tranches of $355 million and $405 million
Underwriter, placement agent and advisor: CSFB
Underwriter legal: Simpson Thacher & Bartlett
Sponsor legal: Dorsey Whitney
Lease equity legal: Paul Hastings
Unisource legal: Orrick
Unisource engineer: Sargent & Lundy
Independent engineer: RW Beck
Contractor: Bechtel