Citibank: Closet CLOs

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The third collateralised loan obligation of (CLO) of project debt is set to close later this month and this time it is Citibank which is lightening the load on its balance sheet. Moreover, this time Citi has chosen to dive straight in with a portfolio of projects located almost exclusively in emerging markets. When it goes through it will be only the second major arranging bank's loan portfolio to migrate to the capital markets this way.

The watchword this time is less the desire to open up an asset class than to make sure that its clients do not get the jitters about where their debt has gone. The issue has often been a touchy one, since not only does such a move send out mixed signals to the market it occasionally also sends out mixed signals to corporates about how their relationship banks view their credit. Whilst the CLO can be benignly represented as a means of freeing up capital to invest elsewhere, whether this capital is put back into the project lending business or funnelled into more lucrative investment banking activities is the subject of vicious speculation amongst competitors.

Citibank has therefore decided that although it will be open about the existence of the transaction (private placements being tricky for such an exotic asset class and its limited liquidity), the projects covered will be a closely guarded secret. Citi stresses that this has as much to do with their clients' wish to maintain confidentiality as anything else ? and the clients have been informed of the participation of the CLO. To this end it has decided to add another layer of enhancement rather than open up the pool to investors all and sundry. As one observer put it, ?they've added AAA-protection to a Triple-A deal?.

The issue differs markedly from the CSFB CLO in that Citibank has made fuller use of structural and external enhancements rather than adding a number of identifiable sweet loans to the portfolio. In its last project securitisation, CSFB added loans from BHF bank, which had recently been acquired by ING. All of the loans here were formerly on Citibank's books.

The portfolio behind the class A notes is described by ratings agency Standard & Poors as creditworthy enough to merit a AAA without giving effect to a surety bond provided by Assurances Generales de France. It stresses therefore, that a downgrade to AGF does not automatically lead to a downgrade of the notes. There are two further classes of notes, a class B, rated at AA, and backed by a bond from Allianz Risk Transfer, and an unrated C class, which is not backed up and will remain in Citibank's hands.

The structure works by the special purpose entity, Project Securitisation I, registered in Jersey, issuing bonds to purchase participations in project loans. It is understood that this take the form of buying the rights from Citibank, rather than the company becoming a participant, since this occasionally requires changes to documentation and may remove the deal's cloak of anonymity. Project companies continue to deal with Citi as before. Citibank acts as manager of the portfolio in return for a fee, and will run the portfolio as it would run its own ? and S&P expresses confidence in their abilities here.

There are 25 projects within the portfolio, and no further projects can be included. Although precise details are unlikely to emerge of their identities, it is believed that by and large these are assets that deal in commodities and have a strong stream of dollar revenues. These would include oil and gas, mining and petrochemical projects, although telecoms and power are represented. And, although much of Citibank's global project finance business is run out of London, and it is mostly its structured finance expertise there is working on the deal, the portfolio has a pronounced Latin American feel. According to sources close to the transaction, however, there are around two deals located in the Middle East and one in Eastern Europe.

There were a number of other reasons for basing the SPV in Jersey and working out of London. Confidentiality plays a key role in this again, since SEC registration requirements would impose burdensome disclosure ? Project Finance's New York office cannot legally be sent the prospectus. Moreover the Eurodollar market remains a far more avid buyer of floating rate debt, since mortgage banks, conduits and insurers are all frequent players. Finally, most of Citibank's existing CDOs have been structured through Jersey.

Credit analysis of the portfolio is a difficult task ? and methodology is constantly changing. Standard & Poor's has been able to say that 17 projects, or 70% by value, are located in countries with a rating of less than AA-. Four of them are already rated. S&P says it has used a multijurisdictional default model, which factors in multiple projects defaulting within one jurisdiction or suffering from regional adverse economic conditions. It does not believe that similar concentrations exist within industries, and only notches down concentration within regions. S&P also has the job of monitoring the portfolio throughout the transaction life, which is seventeen years.

The eventual size of the issue has yet to be determined, and is believed to be in the region of $350 million. Schroder Salomon Smith Barney, soon to become a dwindling name if present plans for the dominance of the Citigroup brand are realised, has the job of carrying out the roadshow. It is little secret that a second CLO is on the cards, and other European project lenders may be invited to participate in that vehicle.

The bonds to not entirely have the allure of some of the more straightforward CLOs, which are made up of shorter corporate debt and can often see its assets turned. Moreover, they are matched to rather complex and long-dated assets with which not all investors are comfortable. Nevertheless, at a stage in the instrument's development where every assault on the market brings a new benchmark, the deal will be watched with interest.