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Get out of that one

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Australian project financiers could be forgiven for looking back wistfully to the days when the power market was a state monopoly. Low pool and contract prices, fierce competition for market share and a lack of revenue regulation have made sections of Australia's electricity industry the toughest in the world. "There are still plenty of power deals in the market but financing risks have increased dramatically," says a banker at a major US bank, adding, "its a situation that makes the more questionable projects very difficult to finance."

It is a mistake, however, to think of low pool prices and electricity oversupply as a pan-Australian phenomenon. Queensland's power market is currently under supplied, an imbalance that threatens to get worse because of the high population growth rate in the south of the state.

At the moment Queensland is the source of two major deals to finance greenfield power projects with the promise of more to come. The two large deals are for the proposed Millmerran and Kogan Creek merchant power stations, rival baseload projects. The Millmerran plant, sponsored by InterGen (a US-based operator 50% owned by Shell and Bechtel) is currently running several months ahead of Kogan Creek.

Syndication of the financing for the A$935 million Millmerran non-recourse tranche closed oversubscribed on 15 October. ABN Amro, ANZ, Bank of America, Commonwealth Bank of Australia and National Australia Bank were appointed as lead arrangers last August, and are providing equal one-fifth shares of the underwriting commitment. The total financing of A$1.462 billion in senior bank debt funds the construction, development and operation of the 840MW plant. ANZ acted as facility agent; ABN Amro and National Australia Bank were joint syndication banks.

Currently, the lead arrangers have clubbed the A$527.6 million sponsor guaranteed tranche, but may syndicate at a later date says Steve Zuckerman at ABN Amro. The deal represents InterGen's first major investment in Australia and its largest project financing anywhere in the world.

After the construction period, which under the terms of the financing will be a maximum of 40 months, InterGen will provide equity to repay the sponsored guaranteed equity tranche. At the same time, the non recourse tranche will convert into a A$397.66 million five year bullet tranche and an A$537.34 million 12 year fully amortizing term loan tranche.

The 680MW Kogan Creek facility, sponsored by Consolidated Electric Power Asia (CEPA), part of the Southern group, is expected to be cheaper, at under A$1 billion. The power station, like Millmerran a coal-fired plant, plans to be up and running by mid to late 2002. With both projects tussling for future power business share, the market is awash with misinformation about the Kogan Creek deal, the financing of which is in the market now.

Despite rumours to the contrary, The Kogan Creek project director, Tom Metcalfe, says that the project has been given an allocation of water from the Great Artesian Basin's Precipice Sandstone sufficient to supply the station's water needs. The application was advertised and attracted little in the way of environmental opposition. The sponsor drilled, tested and constructed the water bore and an additional test bore to confirm the requested allocation. The results of the testing indicate that water is readily available and is in sustainable quantities.

In addition some market sources have claimed that Kogan Creek might not even be able to obtain a generating license. "The Queensland government is not likely to approve two new coal-fired power stations," a banker involved in the Millmerran project told *Project Finance* in October. Metcalfe, however, says that the sponsor has had a series of high level discussions with the state government during which government officials told CEPA that a license would be granted provided Kogan Creek met the same procedural standards met by Millmerran. "Since there have been no legislative, regulatory or policy changes since the Millmerran generating license was granted, we cannot find a reason to not to grant the license," says Metcalfe.

In Kogan Creek's favour the project is forecast to be more efficient and lower geared (in terms of debt-to-Megawatt-hour) post financing. Metcalfe also claims that Kogan Creek will be the lowest marginal cost black coal base load producer of electricity in the Australian market. The financing, which is via a limited recourse structure, is timetabled to close at the beginning of December. The project has five preferred banking arrangers Barclays, Citibank, Bank of Tokyo, Westpac and Deutsche Bank.

Also attempting to get underway is the financing for a third proposed power plant in Queensland - the Wambo project. The transaction is facing difficulties, however, both because of the particular nature of the project and constrictions in the Australian banking market.

Unlike Millmerran and Kogan Creek, Wambo is proposed as a gas-fired, peak merchant power station. Because the facility is planned as a so-called 'peaker' it is more difficult to estimate the revenue that the project could pull in. As one banking source says, "you can't really know when the plant will dispatch and at what pool price." With the added uncertainty in mind, several banks have already looked at and rejected the proposed financing (Babcock & Brown is understood to be the advisor to AIDC and Wambo's other sponsors). However, a number of other financial institutions are said to be still looking at the deal.

Wambo's peaker status is not the only issue. More generally, the consolidation that has taken place in Australia's banking market (the most recent development is Macquarie's acquisition of Bankers Trust's Australian investment banking business)and the spate of big acquisition deals in the power market over the last year are serving to restrict banking appetite for new merchant power risk. The sell-off of Victoria's power generation assets demanded a number of large scale financings that have already soaked up considerable quantities of bank industry exposure.

The cause of power project financing has also not been helped by the fact that the privatized Victorian generation assets have not performed particularly well, chiefly because pool prices in the state are well below what was forecast in 1996 or 1997. As Moody's analyst Anthony Flintoff points out, the generation market is not for the faint-hearted. "There is essentially no revenue regulation for generators," says Flintoff. "Unlike in the UK, there is no capacity payment for generators in the Australian market. If a generator does not get dispatched into the electricity pool, it will receive no payment at all," he adds.

The financing risks are therefore that much more acute. As confirmation of the market difficulties, Loy Yang B's proposed subordinated debt financing has been postponed until market conditions improve. "Pool prices have increased a little in the last six months in Victoria," says one Sydney-based banker. The pricing environment is expected to be eased as vesting contracts that were put in place to pave the way to a deregulated market fall away. "The vesting contracts allowed some price hedging and have distorted the pricing mechanism," says the source, "hopefully when the vesting contracts fall away over the next year, power operators are going to act in a more commercial way."

But most banks have also got one eye firmly on the massive ETSA (Electricity Trust of South Australia) privatization. Although bidders original assessments about the value of the businesses may be unrealistic, combined ETSA Utilities and ETSA Power are expected to fetch around A$4 billion, necessitating very large funding commitments from the banking community.

Like the Victorian power sell-off, ETSA is bound to be financed on a project basis to reduce risk to the sponsor and for balance sheet reasons. As Project Finance goes to press there are now just four bidders in the running: Credit Suisse First Boston is advising PowerGen backed by a banking group of National Australia Bank, ANZ, WestLB, Toronto Dominion and

Dresdner; Hong Kong Electric teamed up with Australia Gas and Light, reportedly being advised by Chase Manhattan; Edison Mission which is being advised by ANZ (also lender) with Citibank, Barclays, ABN Amro and Bank of America; and UtiliCorp, advised by Deutsche and supported by Chase, CBA, Deutsche, SG and Westpac. The fifth bid which comprised, Consolidated Edison and Texas Utilities has now fallen through because of the difficulties that Consolidated Edison was experiencing with its merger in the US. The tender deadline for the ETSA assets has been extended to December 6.

The power industry fundamentals in Australia are likely to shift again due to the impending connection of the Queensland grid to the New South Wales grid. Two new interconnectors are being built to link the markets - the 180MW Directlink and the 1000MW QNI link. The impact, says Flintoff, will be to alleviate the supply shortage in Queensland. But if three new power stations are built in Queensland as proposed, the fear is that the inter-state links could trigger a baseload surplus, dragging pool prices down in both states.

Poll price fears aside, Directlink, a private venture sponsored by Hydro-Quebec and North Power (QNI sponsored by Powerlink and Transgrid is a sovereign project), is under construction and is due to be operational in the first quarter of 2000. The financing requirement for Directlink will be in the A$100s of millions (Deutsche Bank the adviser was unwilling to give exact details at this stage).

First, however, Directlink and its advisors are trying to decide on the link's market positioning. As an unregulated interconnector and a merchant transmission line, Directlink is cutting edge. Nothing like it has been done before, anywhere in the world. Directlink will serve to bid price differentials into the market and will get dispatched just as though it were a power generator. For that reason, unlike QNI, Directlink will only receive revenue when it is used.

"Financing", says one observer, "won't be easy."