Is GE EFS now a sponsor's first resort?

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GE Energy Financial Services days of providing only niche and high-priced capital are long gone. With the winding down of the US Department of Energy (DoE) loan guarantee and Treasury cash grant programmes, GE EFS is well placed to be a mainstream provider of mainstream financial products.

One developer who recently worked with GE EFS on a project notes that until relatively recently sponsors would only approach the firm, which was simply a group in GE Capital until 2004, if they could not close financing elsewhere. And GE expected to make a handsome return on debt or equity.

GE EFS is now much more respectable. In just the last two years, it has taken equity stakes in Calpines 619MW Russell City natural gas-fired thermal power plant and Competitive Power Ventures (CPV) 850MW Sentinel gas-fired peaker projects in California, resurrected the bankrupt 300MW Dokie wind project in British Columbia and acted as a joint bookrunner in Entegra Powers $300 million secured refinancing of two units at the 2,200MW Gila River Power Station in Arizona.

We want to be seen as a value added provider of capital, says Alex Urquhart, since 2003 president and chief executive of GE EFS. Urquhart has overseen GE EFS increase in its asset portfolio to $19.6 billion at the end of 2010 from roughly $11 billion in 2004 and a broadening in its lending and investing activities.

Long-range investor

Now, more than ever, developers need more than capital, says Urquhart. Urquhart says developers typically approach it to work on a specific project. GE EFS tends not to pursue early-stage development work on its own to avoid competing with other developers, its potential clients. But developers do not have to have all of the needed approvals or offtake, construction and supply contracts in already place.

Russell City and Sentinel are two examples where developers approached GE EFS. Both faced issues with permitting that required extensions to their respective power purchase agreements (PPA). Urquhart says that it worked with Calpine on Russell City and CPV on Sentinel to renegotiate the various agreements and construction contracts. He says that GE was also able to develop financing plans for both projects.

The $845 million debt package for Russell City closed on 24 June. It was split between a $700 million construction plus 10-year term loan, a $77 million letter of credit (LC) and a $68 million debt service reserve letter of credit facility. Pricing started at 225bp over Libor. BMO, CoBank, Lloyds, ING and Union Bank were joint lead arrangers. GE EFS owns 25% and Calpine 75% of the plants equity. Pacific Gas & Electric (PG&E) has a signed a 20-year power purchase agreement with the project.

The $800 million financing for Sentinel closed on 1 June. The 10-year debt was split between a roughly $630 term loan and $170 million in credit facilities and LCs. Pricing also began at 225bp over Libor. Bank of Tokyo-Mitsubishi UFJ (BTMU), ING, Natixis, Royal Bank of Scotland (RBS) and Sumitomo Mitsui Banking Corporation (SMBC) were joint lead arrangers. GE EFS owns 25%, CPV 25% and Diamond Generating, which joined at financial close, 50% of the plants equity. Southern California Edison has signed a 10-year PPA with the facility.

But GE EFS can be opportunistic, take on projects at an early stage, and move unilaterally, if the occasion demands. In December 2009, it brought in Plutonic Power, now part of Alterra Power, to help buy the Dokie wind project in Canada out of EarthFirst Canadas bankruptcy for C$52.5 million ($52.7 million). Manulife closed a C$175 million syndicated private placement with a tenor of 20 years to finance construction of the 144MW first phase at the same time. Canada Life, Industrial Alliance Insurance and Sun Life participated. GE EFS finalised its interest in the project and joint venture with Plutonic in May 2009.

Managing margins

The presence of GE EFS as a sponsor on its own does little to reduce pricing on deals, though that says as much about the stickiness of margins in the US power market as about GEs ability to lean on lending groups. Calpine, Edison Mission Energy (EME) and NRG Energy all achieved financing terms comparable to Russell City and Sentinel for their own thermal plants in California.

Deals include the $373 million in debt for Calpines upgrade of its 188MW simple-cycle natural gas-fired Los Esteros plant in August, $617 million in debt for EMEs 479MW Walnut Creek simple-cycle peaker in July and $688 million in debt for NRGs 550MW El Segundo power plant in August. All three achieved pricing that begins at 225bp over Libor and have long-term PPAs with either PG&E or Southern California Edison.

GE does not confine itself to projects with GE-manufactured equipment, though deals with GE content account for the majority of its portfolio, and corporate familiarity with operating risk will provide it with some additional insight. Still, one sponsor who used GE equipment but was negotiating with GE EFS lending personnel said that the firm was, if anything, more conservative about technical risk allocation than commercial lenders. I started to wonder if they knew something that I didnt, he joked.

But having broad GE participation can bring benefits. GE and its affiliates have considerable incentive to perform as an owner, equipment supplier and service provider to the project, noted a Fitch Ratings report rating on the debt for the 845MW Shepherds Flat wind project in Oregon. It cited the operations and maintenance as well as turbine supply contracts with GE as positive rating factors. GE EFS owns a 37.5% class A tax equity stake, Itochu and Sumitomo a 25% A stake each and Google a 12.5% A stake in the project. Caithness Energy, also the developer, 100% of the class B shares.

BTMU, Citi, RBS and WestLB were joint lead arrangers of the $1.73 billion financing package for Shepherds Flat that closed in December 2010. The US DoE provided a loan guarantee of 80% of the project debt. Tenors ranged from construction plus 12 years to plus 19.5 years. Pricing on the guaranteed funds started at 175bp over Libor and the un-guaranteed at 300bp over Libor, and the latter was comparable to other wind deals in the market at the time. Banco Sabadell, Banco Santander, BayernLB, BBVA, CoBank, Dexia, Helaba, Intesa, Scotiabank and UOB participated. Fitch rated the $1.2 billion in guaranteed loans and $105 million unguaranteed bonds BBB- and the $420 million guaranteed bonds AAA.

Competitive lender

One of the more unusual aspects of GE EFS market position is its ability to provide both debt and equity, and it has built up a solid track record as a non-recourse project lender. This role is closer to the core business of parent division GE Capital than taking principal positions in power projects, although the straight equity business sprang from GEs history of providing lease equity for buyers of power, rail and aviation equipment. GE Capital accounts for about 30% of GEs revenues, more than any other division, and its dominance has led to criticism that GE relies too much upon revenues from non-industrial businesses.

GE EFS, alongside GE Capital Markets, led a $72.7 million senior dividend deal for ArcLight Capital Partners Katahdin Power assets in 2006, and the $143.9 million senior debt financing for Tyr Energy and ArcLights purchase of the 672MW Lincoln generating plant in Illinois in 2005. GE EFS tends to be cagey about the margins that it earns on sole-arranged deals, though it has distinguished itself by its willingness to look at leveraged and subordinated deals and its interest in accepting small amounts of merchant risk.

Entegras Gila River refinancing was EFS most recent debt deal. It joined Union Bank and WestLB as joint bookrunners and BNP Paribas and CIT as joint lead arrangers to close a $300 million financing in August. The six-year debt was split between a $220 million term loan and an $80 million revolver and is backed by electricity sold from two of the facilitys four power blocks. Proceeds of the debt were to be used to repay $250 million in outstanding second-lien debt from 2007 and an undrawn $30 million synthetic letter of credit.

The loan priced at 275bp over Libor with step-ups to maturity, according to market rumour. This is a small premium over the non-recourse financings for the four greenfield thermal plants in California, which priced at 225bp over Libor. Half of the capacity backing the loan, the 536MW block three, sells electricity on the merchant market. The 536MW block four has a long-term PPA with the Arizona Public Service. While the debt also demonstrates an increasing willingness among lenders to take merchant risk, lenders per kW commitments, at roughly $280 million, are low enough that recovery in the event of default is almost assured.

On at least one occasion, GE has been in the position, as swing debt provider, to command an increase in margins. Senior debt margins on Carlyle/Riverstones $1.3 billion Topaz power repowering financing, which closed in 2008 shortly before the crunch hit in earnest, were increased from 325bp to 350bp over Libor at the same time as EFS came in to provide $100 million of the $750 million senior debt requirement.

More capital needed

At least part of the reason for GE EFS new focus on straight debt and equity is the poor state of demand for tax-driven products like tax equity and lease equity. Leases have made limited headway in the US wind market, though where they do close, GE is well placed to participate. GE, together with Union Bank, participated in the equity for the sale-leaseback Terra-Gen Powers 150MW Alta I plant in California with Union Bank in December 2010. The tax equity market shrank as the profitability of financial services providers, the backbone of the market, collapsed in 2008.

While few can beat its balance sheet, funding costs and track record, new equity and tax equity investors are entering the market. Im excited about new players, says Urquhart on the subject. An increase in the number of investors creates more available capital for projects. Its intuitively bad but it gets more projects done.

Google is a notable new player. The online search provider has invested more than $400 million in equity and tax equity in renewables projects since 2007. These include $55 million in lease equity in Terra-Gens Alta wind phase IV in May and a $168 million equity investment in BrightSource Energys 392MW Ivanpah solar concentrating project in April. It also bought a $100 million tax equity stake in Shepherds Flat from GE EFS in April. Tax equity investors need to have the right corporate and tax structure to benefit from US wind incentives, but Googles rapid expansion into the sector shows that a standing start in power need not be an obstacle.

The influx is not expected to meet demand. Renewable energy projects will no longer have the option of US DoE loan guarantees the 1705 programme, the cornerstone of its offering, is set to conclude on 30 September or US Treasury cash grants, set to expire at the end of the year, which leaves few federal incentives for the sector. Tax equity, the pre-2008 way of monetising federal renewables incentives, remains a viable financing option but sponsors and lenders agree that the current availability of tax equity falls far short of demand. GE EFS estimates a $3 billion to $6 billion shortfall in available tax equity in coming years.

Urquhart says the pool of investors must expand. This is a dynamic period in the [US] market, he says. He says that there will be more natural gas-fired and more renewables capacity over the medium term but the latter only if the proper incentive regimes are put in place. There is room for all of the technologies in the market and any long-range [energy] plan should include all of them. ■