European Hydro Deal of the Year 2011: Karakuz HEPP

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Last year, in a Turkish market where dollar-denominated hydro financings have become almost vanilla, Altek Alarko Elektrik signed a small but significant 10-year project facility for the 76MW Karakuz HEPP project in Southern Anatolia significant in that it was the first Turkish lira denominated project financing.

Arranged and underwritten by Garanti, the TL120 million ($70.6 million) loan is complemented by TL80 million of equity on a 60:40 debt-to-equity ratio. The 10-year tenor includes a three-year grace period.

Because the projects leverage is low and the financial ratios solid, both in base case and downside sensitivities, there is no cash sweep mechanism on the debt, just mandatory prepayment mechanisms and the usual covenants.

Historically Turkish banks have been unable to offer domestic debt because interest rates have been too high for the project borrower. But the liras growing strength a month after Karakuz reached financial close Standard & Poors raised the Turkish lira long term credit rating to investment grade (BBB-) for the first time and historically low interest rates at the time of pricing the debt made borrowing in local currency and exchanging that debt to hard currency both viable and competitive with dollar and euro denominated loans.

Although between the term sheet pricing and the signing date local currency interest rates hiked by around 40% - more than 350bp in fixed rate terms the deal is fixed-rate (unconfirmed pricing is 11.6% per annum) and at the pricing agreed in the term sheet.

The project facility backs construction of a 76MW dam and hydroelectric plant in Southern Anatolia in the province of Adana on the Korkun river. A water usage permit and all other necessary consents for the scheme are in place. The project also benefits from the certainty of Turkeys hydro tariff of 7.3 usd cents/kwh for 10 years.

The sponsor is a subsidiary of one of the largest Turkish conglomorates, Alarko Holding, and there is corporate guarantee in place until project completion in case of cost overruns.

Once completed the project is expected to generate 206 GWh of electricity annually and prevent 200,000 tonnes of carbon emissions per year. Electricity will initially be sold to state-owned TEAS through a balancing and settlement market mechanism, but the Turkish governments privatization program means that during the life of the project the distribution companies will probably become private buyers and hydro power plants with reserve capacities are eventually likely to benefit from long-term power purchase agreements.

With the rise in Turkish interest rates and uncertainty over interest rates going forward, a rush of lira-denominated project financings is unlikely until the global economic forces creating that interest rate ambiguity are stabilized. Altek Alarko will be exploring local currency financings for future projects but the viability of a repeat deal in the short term is difficult to predict.

Karakuz HEPP
STATUS: Financial close 11 August 2011
TOTAL PROJECT COST: TL200 million
DEBT: TL120 million
DESCRIPTION
Development of a 76MW hydro project in Turkey via the first TL project financing.
SPONSOR: Altek Alarko Elektrik
MANDATED LEAD ARRANGER: Garanti Bank
LEGAL COUNSEL In-house
CONSULTANT: ENYA Enerji
EPC: Alsim Alarko