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North American Single-Asset Power Deal of the Year 2012: Arlington Valley

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The $466 million financing for LS Power and GE Energy Financial Services 127MW Arlington Valley solar photovoltaic project has created a viable and popular bank/bond template in North American power finance. The structure draws on the respective strengths of the bank and institutional markets, and could prove popular outside the sector and region of its birth.

In late 2010 lenders faced an increased cost of capital, both from market factors and the looming impact of the Basel III regulations on European banks ability to lend long. Some banks tried to promote underutilised or fledgling bond desks, but Santander and Prudential Capital revived a product that mixed bank and bond tranches under a single credit agreement with shared counsel. This structure is not unprecedented, but had not been a feature of US project finance since the pre-merchant era of the early 1990s.

In 2012, though, the structure became the envy of the bank market. Santander and Prudential closed five deals together last year, starting with a $465 million hybrid financing for LS Power and GE Energy Financial Services 127MW Arlington Valley solar photovoltaic project, which closed in January 2012. We needed to validate that this was a successful template, says Jorge Camiña, Santanders head of project and acquisition finance for North America. Arlington Valley did that.

Ric Abel, managing director of Prudentials energy finance group, approached lenders in early 2011, but didnt find a suitable bank until he presented the idea to Camiña in April 2011 at a conference in Las Vegas. Abel then drafted 12 bullets that covered voting rights, intercreditor agreements and a financings waterfall. I figured, Lets argue about it now, Abel recalls. So we agreed on it and havent broken from the spirit of that agreement. The bank debt and the fixed-rate note tranche, for instance, would both be first lien and pari passu.

In the third quarter of 2011, Santander and Prudential began pitching the structure to sponsors. Their first formal pitch, for a smaller solar deal that could eventually close using long-term debt from Japanese banks, was rejected. Their second pitch was to LS, one of the US more active and flexible power sponsors, for the $550 million Arlington Valley in Maricopa county, Arizona. LS had already been looking an equity investor that could monetise solar tax benefits, and eventually chose GE EFS. LS then examined both commercial bank and bond options, but found neither market sufficient on its own. The bank market had depth issues and the bond market had conservative credit demands. So, in November 2012, LS decided to use both markets.

Just six weeks later, on 31 December 2011, the deal reached soft close. It officially closed on 18 January 2012, alongside a $100 million equity investment from GE EFS. Banks provided $295 million of the $466 million, while institutional investors provided $171 million.

The Arlington Valley financing consists of four debt tranches: a bank loan with a tenor of construction plus 12 years, a bridge loan to the US Department of Treasury cash grant, a letter of credit facility, and a 25-year fixed-rate delayed-draw 4(2) private placement. The bank loan, the grant bridge facility and the fixed-note tranche fund during construction, though the fixed-rate debt typically funds last, into a dedicated proceeds account.

Under the hybrid structure, LS would minimise the effects of negative carry, by funding on the construction debt over a longer period of time than a generic standalone fixed-rate note. The tenor of the private placement would also match Arlington Valleys 25-year power purchase agreement with San Diego Gas & Electric.

The bank tranche has a conservative amortisation schedule, but also features a target loan balance feature, under which cash will be swept in the event that the financing falls short of this balance, and would be continue to be swept until the balance is back on track. The feature should boost the bank debts amortisation in early years, and improve the notes debt service coverage ratio later in their life. It would also mean that the notes would have a longer weighted average life than usual, which appeals to insurance companies and other institutional investors with long-term liabilities.

The Arlington Valley financing also includes a supplemental cash flow reserve designed to pay down the bank debt in the event of a delay to completion and to avoid clashing amortisations. It also features a large letter of credit facility, with each bank providing letters of credit separately to avoid fronting risk. Some features of the Arlington Valley financing appeared in later Santander-Prudential deals, including a targeted loan balance cash sweep and letters of credit.

Joining Santander as left lead coordinating bank, joint lead arranger and bookrunner, and co-documentation agent, Lloyds (as joint lead arranger and bookrunner, and co-documentation agent), Union Bank (as joint lead arranger and bookrunner, and syndication agent) and Rabobank (as joint lead arranger) participated in the bank piece alongside BMO, CIT and Sabadell. Pacific Life and John Hancock bought into the note placement, while Deutsche Bank was the administrative agent and collateral agent.

Almost immediately after closing the Arlington Valley financing, Invenergy mandated Santander and Prudential for a hybrid deal backing its 200MW California Ridge project in Illinois. In 2012 the two leads used the structure to mobilise more than $2.3 billion in debt for five projects, from six institutional investors and 16 bank lenders, including three Canadian lenders that normally dislike going beyond seven years. The shorter amortisation schedules on the bank tranches and the absence of refinancing risk make the product more appealing to these banks than miniperms.

Arlington Valley Solar Energy II
STATUS
Closed 18 January 2012
SIZE
$550 million
DESCRIPTION
127MW solar photovoltaic project in Marciopa county, Arizona
SPONSORS
LS Power,
GE Energy Financial Services
DEBT
$466 million, split between $295 million in bank debt and $171 million in fixed-rate notes
INSTITUTIONAL LENDERS
Prudential Capital, John Hancock, Pacific Life
BANK LENDERS
Santander, Lloyds, Union Bank, Rabobank, BMO, CIT, Sabadell
ADMINISTRATIVE AGENT AND COLLATERAL AGENT
Deutsche Bank
SPONSOR LEGAL COUNSEL
Chadbourne & Parke
LENDER LEGAL COUNSEL
Latham & Watkins and
Dewey & LeBouef

PANEL PROVIDER

Hyundai and Kyocera

EPC Contractor

Fluor

INSURANCE ADVISER

Moore-McNeil

INDEPENDENT ENGINEER

SAIC