Nord Stream Natural Gas Pipeline Phase 2

Josh Posaner

08/06/2011

The consortium behind the Nord Stream natural gas pipeline concluded the second phase of its €7.4 billion (US$10.8 billion) debt facility this spring, bringing the curtain down on two years of project finance activity.

Nord Stream stands as one of the most successful mega-projects of recent times, with oversubscription on both phases of debt finance and a number of market precedents set, as described in last year's case study on Phase 1, winner of *IJ's Oil & Gas Deal of the Year 2010*.

At €2.5 billion, Phase 2 [Projects Database] was smaller than its €3.9 billion predecessor [Projects Database], and infinitely easier to arrange. One senior deal insider told *IJ* in May that "Nord Stream is without doubt the best deal I have worked on. There were some concerns at the onset, given the sponsor group and the political dynamic behind the project, but Phase 2 picked up exactly where Phase 1 left off."

An official signing ceremony on 4 March in Berlin was followed by a private financial close little over a month later. Then, one warm Thursday evening in May, the sponsors, advisers, lenders and ECAs met in Florence to commemorate the financing and look forward to first gas flowing through the pipeline later this year.

The Project

At a total length of 1,222km Nord Stream will stretch from Vyborg in the Leningrad Oblast of Russia underneath the Baltic Sea to Lubmin in Germany passing through the jurisdiction of five European states.

It will supply an initial 27.5 billion cubic metres (bcm) of Russian natural gas to the European market at the end of this year with that total to double to 55 bcm following completion of the second phase in 2012.

Ownership of the Nord Stream special purpose vehicle (SPV) is split as follows:

- Gazprom - 51 per cent
- BASF Wintershall -15.5 per cent
- E.ON Ruhrgas -15.5 per cent
- Nederlandse Gasunie - 9 per cent
- GDF Suez - 9 per cent

Originally mooted by Gazprom in 1998, it was not until 2006 that the project got underway with the completion of feasibility studies and the creation of the SPV, the North European Gas Pipeline Company.

The following year the project was rebranded as Nord Stream with Société Générale hired as financial adviser and White & Case brought on board for legal support.

Over the course of the project Clifford Chance also supplied legal advice to the banks and ECAs, while Linklaters worked with Gazprom. Both RBS and Commerzbank acted as financial adviser to the sponsors, with UniCredit advising it on the tranche guaranteed by Germany's Untied Loan Guarantee Programme (UFK).

Split across a dual pipeline, the project is financed in parallel to the technical arrangement with a predictable income stream guaranteed through the 22-year transport agreement. *IJ's* Editor John Kjorstad recently travelled to Turku, Finland to check on the projects progress.

The €3.9 billion project finance facility for phase one reached financial close on 16 March 2010 and was followed by the €2.5 billion financing for phase two in March 2011.

It's fair to say that the project faced its challenges at the outset – not least politically. Following Gazprom's dispute with Ukraine that led to gas switch-offs in successive winters, the project, and its route circumnavigating the former Soviet space, came under intense scrutiny as many believed it was a project that would be used by Moscow to undermine the energy security of Ukraine and its neighbours.

Financially, the project also hit the market for Phase 1 at its most turbulent time post millenium with the project's chief financial officer Paul Corcoran writing for *IJ* about the difficulty in financing a project in times of market turmoil.

However, much of the market uncertainty had evaporated by the time Phase 2 closed, with banks falling over themselves to get on the deal and pricing significantly lower than Phase 1. Phase 2 had a €1.5 billion oversubscription with €4 billion in total committed by banks.

The Financing

Following the success of Phase 1 the second round of financing was never really in substantial doubt, as long as the market held up post-financial crisis the sponsors and advisers were confident favourable terms could be reached.

A thorough documentation template was already established, a willing pool of investors was on standby and, most importantly, construction on the asset itself was well underway and ahead of schedule.

Gas market fundamentals and examination of the rationale behind Nord Stream as a project had been established over 2008 and 2009, with independent reports proving to lenders that the ambitious project would remain bankable in the long-term and was in line with projected European energy trends.

With all this work out of the way, the major job was to accommodate a club of banks that was proposing far more debt than was required. Banks that were unable to commit to Phase 1 were now coming forward and promising to meet tight deadlines for proposals.

Phase 2 closed with 24 lenders, just down from the 26 involved on Phase 1. However, well over 30 banks showed significant interest in the second deal.

The finance itself was structured broadly along the lines of Phase 1, with ECA guarantees featuring on three out of the four tranches, and over 75 per cent of the total debt.

Phase 2 is split across the following tranches:

- €750 million commercial tranche maturing over a 10 year tenor
- €750 million tranche backed by Hermes maturing over a 16 year tenor
- €500 million tranche backed by UFK maturing over a 16 year tenor
- €500 million tranche backed by Sace maturing over a 16 year tenor

The 24 banks supplying debt are:

- BBVA
- Bank of Tokyo-Mitsubishi UFJ
- Barclays Bank
- Bayerische Landesbank
- BNP Paribas
- Caja Madrid
- Citibank
- Crédit Agricole CIB
- Crédit Suisse
- Commerzbank Aktiengesellschaft
- DekaBank Deutsche Girozentrale
- Intesa SanPaolo Bank
- ING Bank
- KfW IPEX-Bank
- Mediobanca International
- Mizuho Corporate Bank
- Natixis
- Nordea Bank
- SEB
- Société Générale
- SMBC
- RBS
- UniCredit
- WestLB

Pricing on Phase 2 is set at 160bp during construction on the commercial tranche with the ECA-backed tranches priced at between 110bp and 120bp. A full breakdown of bank ticket sizes can be found in here.

Once again, ECA support played a key role on the deal. Nord Stream's chief financial officer Paul Corcoran has always been clear about how valuable such support was, even indicating that the deal would not have been possible were it not for Sace, Hermes and UFK.

The Future

There can be little doubt that Phase 2 gave the project consortium the kind of competitive terms that it had hoped for on Phase 1 pre-financial crisis. This in itself raises the question of a Phase 1 refinance on the original €3.9 billion project finance package.

IJ understands that senior figures at Nord Stream are considering launching a refi deal to market later this year, although there also remains a chance that both stages of financing could be bundled together and launched as one larger refi deal in 2012.

Nord Stream is also just the second stage is what Gazprom, and its relationship sponsors, hope will be a Stream pipeline project trilogy. First up was Blue Stream, a far shorter pipeline running from Russia to Turkey, then came Nord Stream and next is the even larger €15 billion South Stream project [Projects Database].

It is widely expected that a sizeable project finance facility will be sought for South Stream, and it would make perfect sense for senior figures at Nord Stream to move over to work on the new project, expected to take a final investment decision [FID] and proceed early next year.

So, this isn't the last of Europe's major pipeline projects - and in some ways Nord Stream as a deal is a highly successful prologue to projects in the EU-designated Southern Corridor. Nord Stream had a relatively free run at the market but South Stream, and any Nord Stream refinance, are likely to be up against very simillar EU-backed deals like Nabucco and the Trans-Adriatic Pipeline. 2011 and 2012 may see Europe's political pipelines become competitors in the market.