El Encino-La Laguna gas pipeline, Mexico

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Mexican pipeline operator Fermaca obtained competitive terms on a $610 million mini-perm loan backing the $820 million El Encino-La Laguna natural gas pipeline project in Mexico. The loan closed in late July 2015.

Mexico's growing demand for natural gas has coincided with mounting shale gas reserves in part of the US. The combination of domestic demand and nearby supply prompted Mexican state-owned power company Comisión Federal de Electricidad (CFE) to launch a multi-billion dollar natural gas pipeline procurement programme in mid-2014.

Mini-perm versus long-term

Fermaca achieved a debt-to-equity ratio of roughly 74:26 on El Encino-La Laguna. The deal comprises a $590 million term loan and $20 million letter of credit, both of which are due to mature in 3.5 years. Bancomext is providing a value added tax facility of up to $100 million.

The pricing on the debt starts at 185bp over Libor, with a 25bp step-up within two years. The deal attracted a club of six international banks, including Goldman Sachs. Goldman prefers to lead bond issues and provide advisory; but as a relationship bank of Fermaca, it agreed to provide project-level debt to El Encino-La Laguna.

International banks are willing to provide long-term debt to contracted Mexican pipelines. In December 2014, for example, a joint venture between Engie (then GDF Suez) and state-owned oil and gas company Pemex closed a 20-year debt package for the Los Ramones II Sur project from seven banks The longer tenor meant higher pricing, however; the margin of Los Ramones II Sur started at 250bp, and will step-up to 350bp.

Fermaca preferred cheaper pricing for El Encino-La Laguna.

“The spread on the short-term bank facility better matched Fermaca’s bid price than a loan of construction plus 18 years,” said Octavio Berron, chief marketing officer at Fermaca in Mexico City.

Fermaca plans to refinance the bank facility in the capital markets as soon as the El Encino-La Laguna pipeline comes into operation in 2017. The deal will likely replicate the 144A/Reg S, $550 million issue that Fermaca closed in mid-2014 primarily to refinance construction debt on the Tarahumara pipeline.

“We’re not worried about refinancing risk,” Berron explained. “We think the nature of the project ensures that the market for a refinancing will be there.”

For a $300 million debt package supporting the Roadrunner gas pipeline project in Texas, Fermaca and co-sponsor ONEOK have chosen a nine-year mini-perm. The project will connect with the Tarahumara pipeline and transport up to 640 million cubic feet per day.

Pipeline boom

In December 2014 CFE awarded a 25-year take-or-pay agreement to Fermaca for El Encino-La Laguna. The project forms part of a large-scale procurement process announced by CFE following the passing of constitutional energy reforms in 2014, which is opening country’s exploration and production sectors to private participation. International investors, however, have long been able to play in Mexico's midstream sector.

To date, CFE has awarded five domestic pipelines as well as two international pipelines that are on the Mexico-US border. The pipelines will carry natural gas from Texas to new power plants across Mexico. CFE prefers gas to oil, which is dirtier and more expensive.

The CFE's pipeline programme has drawn interest from local heavyweights, including Carso and IEnova, the Mexican subsidiary of Sempra. North American players, including master limited partnership Energy Transfer Partners and Canadian construction firm ATCO, are also interested.

Not all pipeline projects will use non-recourse debt, however. IEnova, which won the San Isidro–Samalayuca in July 2015, is expected to use corporate finance for the project.

El Encino-La Laguna is one of the largest pipelines to be awarded by CFE in this round of tenders. Upon completion, slated for 2017, the pipeline will supply a pair of power plants owned by CFE. The pipeline will run between El Encino in the state of Chihuahua and La Laguna in Durango and also connect to Tarahumara. The pipe will transport up to 1.5 billion cubic feet of natural gas per day.

Partners Group acquired a majority stake in Fermaca in February 2014 for $750 million. The following May, it refinanced Fermaca's existing debt with the issuance of $550 million in investment-grade senior secured notes.

In May 2015 Partners Group announced that it had raised more than $500 million in equity to support the expansion of portfolio company Fermaca. The capital will help grow Fermaca's network of gas pipelines.

Advisers

Latham & Watkins and local firm Galicia advised the sponsors. Milbank and Ritch Mueller advised the lenders.