African Power Deal of the Year 2013: DOE Peakers

21/02/2014

The 1,005MW gas-fired Department of Energy (DOE) Peakers project reached financial close in August 2013, eight years after its original tender, and is the largest project financing ever in South Africa. The deal features an ownership structure that pools cash from two project companies, a performance bond behind its power purchase agreement, foreign currency and interest rate hedging, and investment from an institutional investor. All of the above are rare in African financings.

The project entails the construction of two open-cycle gas-fired power plants the 335MW Dedisa plant in Eastern Cape province and the 670MW Avon plant in KwaZulu-Natal province. The South African government, through the DOE, launched the tender for the project in 2005.

As a pathfinder project, the deal was delayed for years as the government established a regulatory framework to support the development. The prequalified bidders finally submitted proposals in June 2007 and the DoE then named a consortium led by AES preferred bidder. By April 2008, however, talks with that group had broken down, and the DOE instead began negotiations with another bidder a consortium comprising GDF Suez, black economic empowerment group Legend Power Solutions (LPS), and broad-based black empowerment group Peaker Trust.

The involvement of LPS and Peaker Trust meets the local community ownership requirement common for most projects in South Africa, but each entity did not have the cash reserves required to fund on its respective equity stakes. The Development Bank of South Africa (DBSA) is funding the equity contributions of LPS and Peaker Trust.

LPS also benefits from a guarantee facility backing 27% of the performance bond that projects must post under their power purchase agreements (PPAs). The offtaker, state utility Eskom, can draw on roughly R150 million that the sponsors would put up if the projects do not meet specified milestones under their PPAs. DBSA is funding R560 million in equity commitments, and will be repaid through the project cash-flows that reach the special purpose vehicles (SPVs) that Peaker Trust and LPS have each set up for each plant.

These SPVs benefit from a cross-guarantee mechanism, which means that if one of the plants suffers a shortfall in distributions compared to the base-case, the SPV for the other plant can share any excess cash to service the DBSA equity loan as scheduled. The repayment period for DBSAs equity loans almost matches the length of the PPA, with a short tail on the tenor.

The sponsors spent much of the two years after the award finding an engineering, procurement and construction (EPC) contractor that could offer a competitive price. In 2010 the sponsors picked Fata and Ansaldo Energia as EPC contractors, while Total agreed to supply

Avon Peaking Power and Dedisa Peaking Power

STATUS

Reached financial close August 2013

SIZE

$1.06 billion

DESCRIPTION

The construction of two open-cycle gas turbine power plants in KwaZulu-Natal and Eastern Cape provinces, respectively.

OFFTAKER

Eskom

SPONSORS

GDF Suez (38%), Mitsui (25%),

Legend Power Solutions (27%), Peaker Trust (10%)

DEBT

$909 million

COMMERCIAL LENDERS

DBSA, Nedbank, Rand Merchant Bank, Absa, Investec, Sanlam Capital Markets

FINANCIAL ADVISER

DBSA

GRANTORS LEGAL COUNSEL

White & Case

SPONSORS LEGAL COUNSEL

Chadbourne & Parke; Edward Nathan Sonnenbergs

LENDERS LEGAL COUNSEL

Fasken Martineau

EPC CONTRACTOR

Ansaldo Energia, Fata Group

EQUIPMENT SUPPLIER

fuel to the plant and Mitsui joined the sponsor consortium. The final equity breakdown for the project company is GDF Suez, 38%; Mitsui, 25%; LPS, 27%; and Peaker Trust, 10%

The consortium had the financing for the deal more or less in place by 2011 but had to deal with more delays, thanks to the countrys renewable energy independent power producer programme (REIPPP), which was beginning to monopolise the time of South Africas small collection of local banks and law firms. In late 2012 the DOE and Eskom helped bring 28 independent renewables projects to financial close, while a further 19 reached close the following year.

Total

INSURANCE ADVISER TO SPONSORS
Marsh
INSURANCE ADVISER TO LENDERS
JLT Specialty Limited

The South African government requires that the power purchase agreements for the peakers, like those for the REIPPP projects, must be denominated in local currency, meaning all of their debt must be denominated in rand. Foreign lenders have tended to shy away from lending in volatile rand, and local lenders have experienced both liquidity and manpower constraints. A similar limit to the number of experienced personnel affected the law firms working in South African power finance.

After bringing the second round of renewables projects to close in May 2013, the DOE and state utility Eskom were ready to sign the PPA for the peaker plants the following month. Eskom is the sole offtaker from the plants under 15-year power purchase agreements. The sponsors had had most of their lender group in place for around two years, and quickly signed the financing documents on 17 July. The sponsors closed the financing on 5 August and made a first draw down on the debt on 23 August.

Investec, ABSA and DBSA were coordinating mandated lead arrangers for the R8.317 billion financing, with Rand Merchant Bank, Nedbank and Sanlam Capital Markets (SCM) also participating. Standard Bank was originally attached to the deal but dropped out in 2012, and RMB replaced it almost immediately.

The involvement of SCM is significant, as institutional lenders have not always been comfortable with African project risk. SCM was originally expected to provide a direct loan to the project, but eventually also participated in the deals interest rate hedges, alongside Investec, ABSA and Nedbank. The same group, with the exception of SCM, also wrote the deals foreign currency hedges.

We had been talking to Sanlam for some time. From a sponsors perspective the motivation is clear to expand the liquidity pool that you can tap. Sanlam had known about the project since 2007, because it was part of another bid at that time, underwriting the commitment of a bank lender. At that point it was not ready to be a mandated lead arranger, but since then we have been educating it on construction risk and when it did come in it was able to do so on very competitive terms, says Vincent Perrot, vice-president acquisition, investment and financial advisory (energy, southern Africa) at GDF Suez.

The R8.317 billion of construction-plus-17-years debt for the project consists of a base facility and a standby facility. Nedbank was the largest lender with a ticket of R2 billion, while Investec provided R1.983 billion, ABSA R1.433 billion, DBSA R1.4 billion, Rand Merchant Bank R750 billion and SCM R750 million. Along with the interest rate and foreign currency hedges, the project used an ICE Gasoil contract with ABSA to manage its exposure to diesel prices during construction.

It is a very significant amount of interest rate swaps R7 billion which we managed to execute in the market without creating any market movement, which is remarkable for a hedge of this size. It is hedged out for the full term of the debt. The construction period foreign exchange hedge is also sizable, in excess of 350 million, Perrot added.

The sponsors say that the deal is the largest project financing in the South African market. Although the total project size of the Gautrain rapid rail link project, which reached financial close in 2007, was bigger (at $1.65 billion equivalent), the debt portion of that deal was smaller than that of the Peakers. That deal also benefitted from some government guarantees, whereas the peakers lenders are taking on more project risk.