Shuweihat 2 IWPP Refinancing, Abu Dhabi

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*The re-financing of the Shuweihat 2 ("**S2**") independent water and power project ("**IWPP**") in the capital markets was a ground-breaking transaction for the UAE and GCC markets and demonstrates the substantial investor appetite for well structured transactions with strong underlying fundamentals.* **Ryan Wong**, Group Treasurer at TAQA and **Matthew Holland** Director of Project & Infrastructure Finance at Citi explain.

Background

The S2 power generation and seawater desalination plant was the eighth IWPP to be developed under the Abu Dhabi government's successful "build, own and operate" privatization program that was established in 1998 and has a net power and water capacity of 1,503 megawatts and 100 million imperial gallons per day respectively.

S2 is owned by TAQA (54 per cent), ADWEA (6 per cent), GDF SUEZ (20 per cent), Marubeni (10 per cent), Osaka Gas (10 per cent) (collectively the "**Sponsors**") and operated by S2 Operation & Maintenance Company W.L.L. (the "**Operator**") under a 25-year operation and maintenance agreement ("**O&M Agreement**"). The Operator is owned by GDF SUEZ (50 per cent), Marubeni (25 per cent) and by Osaka Gas (25 per cent).

S2 was completed in October 2011 with a total capital cost of US$2.61 billion.

S2 is critical to the electricity and water infrastructure in Abu Dhabi and represents approximately 11.6 per cent of the net installed power capacity and approximately 12.2 per cent of the net installed water capacity of independent power and/or water plants implemented by ADWEA.

The template for Abu Dhabi's successful programme for the privatisation of the water and power sector is considered one of the strongest contractual structures available in the IWPP market and benefits from:

- a long term PWPA with ADWEC underpinned by the Government of Abu Dhabi (Aa2 / AA / AA)
- fixed capacity payments on available power and water capacity regardless of dispatch
- government-owned offtaker responsible for supplying fuel at its own cost
- fixed price operating structure for the first 12 years under a 25-year O&M Agreement, after which it converts to a "cost plus" structure
- robust termination provisions where a termination of the PWPA triggers a mandatory purchase of S2 by ADWEC (other than for a Project Company Event of Default, where purchase is optional) where such purchase price is sufficient to repay senior debt

The Transaction

The refinancing of S2 not only involved raising US$825 million in new financing from the bond markets, but also the restructuring of the existing bank and JBIC facilities, including a material re-pricing of the bank tranche to bring it in line with pricing achieved for the S3 transaction, re-structuring the amortisation and swap profiles and the replacement of some lenders who wished to exit the deal. Bond proceeds were used to prepay a portion of the existing bank and JBIC facilities (US$484 million in total) as well as return capital to the Sponsors.

The bond received a rating of A3/A- from Moody's and Standard & Poors respectively, reflective of the strategic nature of the asset, absence of construction risk, the creditworthiness and experience of the Sponsors and the robust contractual structure which creates a strong alignment of interest amongst the Sponsors and offtaker as highlighted above.

The transaction therefore offered investors the opportunity to invest in a fully operational power and desalinated water asset in Abu Dhabi, which is highly strategic to the fast growing economy of the Emirate and which enjoys the active contractual involvement of multiple government entities and an operator owned by capable and experienced developers, owners and operators of power and desalination plants.

Transaction Rationale

The refinancing of S2 was driven by two factors. First, the desire to equalise all shareholder returns to levels in line with other comparable projects and second, to establish a template for capital markets financing of large infrastructure projects in this region going forward.

At the time of signing of the main project agreements in July 2008 a fully underwritten bank financing was in place, the tariffs were contractually fixed and interest rate swaps and exchange rate forward purchases were executed. Following dislocated market conditions in the wake of the collapse of Lehman Brothers in 2008, ADWEA restructured the original financing plan, putting in place a US$900 million interim bridge loan facility,that was guaranteed severally by ADWEA, and brining in Marubeni as an investor in March 2009 which facilitated a long term loan from JBIC.

The bridge loan was ultimately repaid in October 2009 through the proceeds of a US$2,025 million term facility provided by a group of commercial banks and JBIC, however to further support the project economics, ADWEA contributed US$34 million to S2 by way of an interest free subordinated loan in addition to its equity contribution, resulting in unequal equity returns amongst the Sponsors.

In addition to the desire to normalise all shareholder returns, the Sponsors were also keen to develop an alternative source of longer dated liquidity for future projects given the scarcity of long dated bank lending. In addition to establishing a regional template for future projects, the S2 refinancing has demonstrated the existence of strong investor interest for this type of fixed income instrument and establishes a framework for the refinancing of existing IWPP's and similar projects, some of which have been financed by mini-perm structures in the wake of the global financial crisis.

Challenges

A transaction of this type presented a number of interesting challenges.

The main challenge was retro fitting a bond structure into the existing JBIC/commercial bank loan framework and all of the issues that flow from that, particularly from an inter-creditor perspective.

The amortization structure of the bond was also unusual, with a WAL of 21 years and legal final of 23 years, driven by the term of the power water project agreement and the amortization profile of the existing commercial bank and JBIC facilities.

Achieving ratings of A3/A- was also a significant achievement given the universe of comparables is largely limited to rated US power transactions, where the risk allocation is different and coverage ratios substantially higher.

Finally, market conditions presented a number of execution related challenges given the Feds comments at the time around the tapering of QE. Despite a volatile credit market and rate environment with consequent heightened sensitivity to MTM risk on duration assets, the bond offering received strong support, with a book exceeding US$2.3 billion, and priced at the tight end of the revised 6.00 per cent to 6.125 per cent range after initial guidance of 6.25 per cent area.

Transaction Highlights

This transaction is the first project bond for an independent power project in the GCC and establishes a template for similar assets to follow into the capital markets. It also represents the first time that S&P have applied their government-related entity methodology to the public rating of a project finance transaction in the region.

The offering is also notable for its particularly long duration as well as the involvement of a number of US project bond investors who participated in size for the first time in the Middle East. Citi led the effort to bring these investors into the transaction, which is a significant step in the evolution of infrastructure financing markets for this region.

Summary Key Terms

- Issuer: **Ruwais Power Company PJSC**
- Issuer Ratings: **A3/A-**
- Ranking: **Senior Secured**
- Issue Size: **US$825 million**
- Coupon: **6.0 per cent**
- Spread: **Interpolated 21yr MS +246.1 bps / 30yr UST +233.3 bps**
- Format: **144A/RegS**
- Financial and Ratings Advisor: **Citi**
- Bookrunners: **Citi, BNPP, BTMU, HSBC, NBAD, SC**
- Pricing Date: **25 July 2013**
- WAL: **21 years**
- Maturity: **31 August 2036**

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