Reventazón hydro power plant, Costa Rica

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Costa Rica’s state-owned utility Instituto Costarricense de Electricidad (ICE) reached financial close on the 305.5MW Reventazón hydro power plant at the end of January 2014. The project, which will be Central America’s largest hydro power plant upon completion, is a crucial step towards meeting growing power supply demand, in a country heavily reliant upon hydro generation.

The project

Located in Límon province, the project entails the construction of support transmission lines, substations and access roads that will accompany Reventazón. Construction of the project is about 55 per cent complete, after beginning in 2010. ICE expects Reventazón to be operational in 2016.

ICE will build, operate and maintain Reventazón, but will lease the plant from the borrower trust. Such a structure should allow ICE to pass operational risks to the plant.

The Financing

Reventazón’s debt structure advanced a tested formula in Latin American project finance. For the financing, the Inter-American Development Bank (IDB) offered a new guarantee mechanism under its traditional A/B loan structure. Most IDB-led A/B structures marry a direct loan from the multilateral to a tranche funded by a coterie of commercial banks. Reventazón, however, issued a private placement in lieu of bank debt to partially complement an IDB loan. That was unprecedented in Central America, and also marks the initial greenfield project bond in the region.

The hybrid Reventazón deal borrows elements from both classic project finance and corporate structuring. ICE created an issuer trust, Reventazón Finance Trust (RFT), to issue the notes. That trust will purchase the B-tranche issued to borrower trust Fideicomiso P.H.Reventazón by the IDB. ICE also created trusts to help fund earlier generators, including the Cariblanco, Peñas Blancas and Angostura hydro plants. Scotiabank was trustee to ICE on the two Reventazón trusts.

The financial structure also includes a sovereign guaranteed portion. In 2012, the IDB granted a US$250 million loan to ICE, of which approximately US$80 million was used for Reventazón.

The adoption of a project finance structure had some obvious benefits for ICE. Most significantly, all lease payments made by ICE to the trust are expected to be passed through to electricity tariffs. Had ICE opted for a corporate finance basis, it would only have been able to pass the yearly amortisation of the asset to tariff, thus creating a mismatch between the expected 50-year life of the asset and the maturity of the underlying financial obligations.

For Reventazón, ICE sought more than US$900 million in long-dated debt. A distant maturity would enable the project to lower monthly repayments and electricity tariffs.

Long-dated bank debt became more finite globally after the 2008 financial collapse, and again during the eurozone crisis. It's even more limited for projects in countries – including Costa Rica – with credit ratings below investment-grade.

Reventazón posed little incentive for an export credit agency to join a debt financing, as project turbines were financed with a sovereign guaranteed loan. So ICE decided on a project bond, which can be difficult to structure and market, but offered an obvious benefit: institutional investors typically offer more sponsor-favourable tenors than banks. ICE mandated BNP Paribas as financial adviser on the issue.

"The IDB and other multilateral institutions offer tenors that are benchmarked against the private capital raised," said Philippe Birebent, BNP director of project finance in New York. "If we had gone to the commercial bank market and got 13 or 15 years, the IDB would have extended tenors in that vicinity. However, by tapping the institutional market and raising 20-year capital, the IDB and the IFC were also able to deploy 20-year capital."

Investor participation also encouraged local banks to justify a term loan of 20 years, which a grace of 3.5 years. The loan was one of the longest that the IDB has ever granted to a Latin American project.

IDB's preferred creditor status helped the issue achieve an investment-grade rating, from both Fitch and Moody's for the notes. Fitch's BBB- rating pierced both ICE's and Costa Rica's sovereign rating.

When ICE funded the Reventazón debt on 29 January 2014, the private placement was lower than the proposed US$415 million issue that it floated in 2013, and confirmed in a Moody's report published in November 2013. Instead, the bond portion consisted of a US$135 million package of 4(a)(2) Reg-S notes. The notes have a coupon of 8.1 per cent.

The IDB maintains that ICE sought a US$100-415 million private placement, with the final size dependent on market capacity at launch. ICE brought the issue forward in late December. The IADB was prepared for an issue at the smaller end of the spectrum, said project team leader Gian Franco Carassale head of syndications Jozef Henriquez, and were able to quickly make up the difference.

Market observers suggest that a US$400 million issue proved too ambitious for feebly rated Costa Rica. Still, the issue attracted five North American investors new to ICE and Costa Rica.

On Reventazón, ICE opted to fill the debt gap with an increased colon-denominated local bank debt tranche, which rose from about US$200 million to US$469 million-equivalent. Banco de Costa Rica provided C80 million, Banco Nacional de Costa Rica and Banco Popular y de Desarrollo Comunal lent C75 million and Banco Crédito Agricola de Cartage lent C9.5 million. The overall debt fell US$30 million due to foreign exchange differences between the bond and multilateral loans, which funded in US dollar, and the colon-denominated tranche.

The financing also includes a US$200 million A-loan from the Inter-American Development Bank (IDB) and US$100 million from the International Finance Corporation (IFC). ICE is understood to be providing US$475 million in equity to the US$1.4 billion project, which would make the debt-to-equity ratio 66:34.

The future

The Reventazón financial structure may prove a model for future deals. Commercial banks are increasingly reticent to join the B tranche of A/B structures, and some suggest that the traditional structure may be stale.

The IDB-provided guarantee mechanism may help limit negative carry (whereby borrowers pay full interest on debt, even those undrawn), which bond issuers are understandably sensitive to. According to the IDB, the mechanism is designed to allow institutional investors to fund ahead of the other senior lenders. In the event of acceleration of the IADB B-loan, the multilateral is required to partially buy back the B-loan from investors. This amount is equal to the A-loan that the IADB would have paid out had disbursement occurred on a pro-rata basis, resulting in a reduction of about US$50 million in the overall project cost.

Jean-Valerie Patin, BNP's head of Latin American project finance, said the Reventazón issue could be replicated for larger deals. "Importantly, the transaction's price compares favourably to the corporate one on a relative basis," he said. Indeed, the price was better than ICE's 144A issue of US$500 million in 30-year corporate bonds in May 2013 to fund infrastructure projects in Costa Rica.

After Reventazón closed, a market participant indicated that ratings agencies have received a number of enquiries from other Central American entities looking to replicate this formula. But that may depend on the IDB's willingness to co-finance those projects.

Advisors

BNP Paribas was financial advisor to ICE. Milbank and Consortium provided legal counsel to the sponsor and borrower and Clifford Chance and local firm BLP Abogados provided legal counsel to the lenders.