Sarulla geothermal, Indonesia

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The successful signing of the financing for the $1.6 billion Sarulla geothermal power project is an early sign that 2014 should be more fruitful for international lenders than the last. It breathes new life into Indonesia's geothermal sector, which has been quiet since Standard Chartered led a $298 million financing for the Wayang Windu project in 2007.

Sarulla is the largest single-site geothermal project in the world, and gives a hint to the geothermal potential of Indonesia, which is home to around 40% of the world's geothermal resource. The project entails the development of a 330MW geothermal project in North Sumatra. It will consist of three phases of 110MW, with the first due to come online in 2016, the second in 2017 and the final phase in 2018.

Commercial lenders return

The Asian Development Bank (ADB) and the Japan Bank for International Cooperation (JBIC) were lead structuring banks. Several commercial lenders joined, comforted by the presence of JBIC and the support on offer from the Indonesian government.

The project's sponsors are:

- Medco (37.25%)
- Itochu (25%)
- Kyushu (25%)
- Ormat (12.75%)

The debt financing, which has a legal maturity of 20 years, comprises a $492 million loan from JBIC, a $250 million loan from the ADB, a $80 million mezzanine loan from the Clean Technology Fund CTF, (which is partially owned by the ADB), a $20 million mezzanine loan from the Canadian Climate Fund for Private Sector Investment, and a $328 million loan from six commercial banks that benefits from four-point political risk cover from JBIC.

The six banks on the deal are:

- MUFG (documentation bank)
- ING
- Mizuho (insurance bank, financial adviser, intercreditor, facility and security agent)
- NAB (environmental bank)
- SMBC (modeling bank)
- Société Generale (technical bank)

The commercial bank facility is priced at 210bp over six-month Libor for years one to four, 180bp for years four to 10, 220bp for years 10 to 15 and 250bp for years 15 to 20. The average debt service coverage ratio (DSCR) under the base case is 1.38x. Sweeps of excess cash take place in the event that the DSCR dips below 1.25x.

The commercial banks are hedging 90% of the debt, which includes all the senior debt and mezzanine facilities, on a pro rata basis, although the swaps will not be executed until financial close.

Rounding off the financing is $352 million in sponsor equity and $78 million in pre-operating revenue. The revenue can be included in Sarulla's capital structure because the project is being brought online in three phases and will not pay a dividend to its sponsors until all three units are complete.

Government guarantee

The sponsors were able to dispense with the completion guarantee that is typical on a geothermal project, although they are contributing $94 million in contingent equity. The Indonesian government is guaranteeing PLN's obligations under the project's energy sales contract (ESC), using its business viability guarantee letter. The commercial lenders will be able to draw on the guarantee from JBIC in the event that the government does not stand behind the letter.

In the event of a project default, the mezzanine debt will rank pari passu with the senior debt. Senior lenders are comfortable sharing the same level of security because the termination payment under the ESC is equivalent to 100% of both the senior and mezzanine debt.

The energy sales contract covers the development of the Sarulla geothermal resource, for which Pertamina Geothermal Energy (PGE) owns the concession, and the sale of power to Indonesian state utility PLN. The contract was prevalent in Indonesian power before PLN's recent fast track power programme.

The PLN offtake agreement is priced at $0.0679 per KWh, lower than the levels at which recent geothermal offtake agreements have signed. The project company, Sarulla Operations, receives the tariff from PLN and in turn makes a payment to PGE for the use of the resource.

Developers and lenders watching the market will hope that the Sarulla financing will have a catalytic effect. The use of a subordinated debt piece with shared security in the event of a default is not common in Asian project finance. The deal could inspire increased creativity in the face of less than promising offtake contracts in different sectors and regions altogether.

Latham & Watkins is advising the lenders, while Baker & McKenzie is advising the sponsors on the project documents and Milbank, Tweed, Hadley & McCloy is advising on the finance documents. Delphos International was financial adviser with respect to the ADB facilities, while Mizuho was financial adviser for the JBIC tranche.