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CPV's St. Charles and EIF's Newark power projects

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As commercial banks look for market share in the US power market many are turning to merchant power projects, albeit with hedges that provide pricing certainty similar to a short term power purchase agreement (PPA). Since 2012, five US greenfield gas-fired projects with merchant exposure closed high-yield debt financings. But between 2012 and early June 2014 only one merchant project closed – the Woodbridge gas-fired combined-cycle project in New Jersey - and this was with commercial bank debt.

Following Woodbridge, the market has just witnessed the financial close of two gas-fired projects with merchant exposure – most recently the 725MW St. Charles combined-cycle project in Maryland, on 8 August. Developer Competitive Power Ventures (CPV) brought in Marubeni and Toyota Tsusho as equity providers on St. Charles. Seven weeks earlier, Energy Investors Funds (EIF) signed the bank debt financing for the Newark combined-cycle project in New Jersey. Both projects rely on five-year hedges instead of PPAs.

The Woodbridge model

Newark and St. Charles were loosely modelled on CPV's Woodbridge project, noted Carl Peterson, a GE Energy Financial Services (GE EFS) managing director in Stamford, Connecticut. GE EFS was one of the lead arrangers on the Woodbridge, Newark and St. Charles deals.

Newark, which featured a 12-strong bank group, advanced slightly on Woodbridge, which closed in September 2013 with seven lenders. All 12 banks returned for St. Charles, and three additional lenders participated – Deutsche Bank, Bank of America Merrill Lynch and Société Générale.

The financings for Newark and St. Charles feature similar structures, and are both designed to serve growing power demand in the PJM Interconnection region, where there are few new rival generators. But only a small, if growing, pool of lenders will accept even a small slice of merchant exposure.

The other St. Charles lenders are:

- CIT
- CoBank
- *Crédit Agricole*
- *IFM*
- ING
- Union Bank (part of Mitsubishi UFJ Financial Group)
- Mizuho
- Natixis

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- NordLB
- OneWest
- Siemens

Newark and St. Charles closed their debt financings at different stages in their development. Newark had begun construction at the time of financing, unlike St. Charles. But the lesser construction risk on Newark did not translate into significant debt pricing savings over St. Charles.

The margins on both deals began at 350bp over Libor – 75bp lower than Woodbridge's starting level. Spreads have tightened since Woodbridge closed, reflecting strong market liquidity, depressed deal flow, and increased bank familiarity with merchant risk.

Bank appeal

Banks – sometimes grudgingly – have loosened credit standards to help make their annual budgets. Most would prefer PPA-based projects, but utilities have been reluctant in the last few years to sign such offtake agreements.

"As the opportunities for long-term contracts diminished and long-term PPA-based project financing opportunities [became] less plentiful, banks had to start considering different risk profile investments," said Paul Buckovich, chief financial officer at CPV in Braintree, Massachusetts.

Sponsors have tried to educate lenders about merchant projects' risks. But only experienced developers – those with established bank relationships and steady project pipelines – have managed to close hedged gas-fired projects in the US. Newer developers will struggle to close such financings, and may be tempted to sell projects at early developmental stages.

In July 2014, Connecticut-based Starwood Energy agreed to join untested developer FGE Power's two-phase combined-cycle project in Mitchell county, Texas. With Starwood aboard, FGE may now find it easier to close on bank debt for the first 747MW phase. FGE is planning to begin construction in late 2014.

FGE has considered high-yield term loan B debt. But the bank market tends to offer tighter margins, and best accommodates staggered draws.

Banks are more flexible than the term loan B market, suggested Donald Kyle, senior managing director at GE Capital Markets, Inc. in Stamford. Kyle said banks can more easily process waivers, consents and amendments that sometimes arise during construction, and are more willing to allow distributions to shareholders.

Additional banks may also join the hedge-based greenfield gas-fired project financings that are nearing market, according to observers.

Market factors

Most hedged greenfield gas-fired projects that have closed debt financings since 2012 – either in the bank or term loan B markets – will provide power to the PJM or the Electric Reliability Council of Texas (ERCOT) regions. The sponsors of these projects are betting on continued load growth in these markets.

But new hedged gas-fired projects may be feasible today elsewhere in the US. GE EFS, for instance, is monitoring projects in New England and the US midwest, Kyle noted.

Some states have attempted to push utilities into signing offtake contracts. Courts, though, rejected such efforts by the states of Maryland and New Jersey.

Three Maryland utilities went to state court to challenge an April 2012 order by the Maryland Public Service Commission that they sign new long-term offtake agreements. Owners of existing PJM-based generators filed challenges in federal court. A federal district court deemed the commission's order unconstitutional.

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Chadbourne & Parke was the legal adviser for the lenders on St.Charles, and Latham & Watkins advised the borrowers.

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