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Repricings in the US power market

Jinjoo Lee

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In 2011, Competitive Power Ventures (CPV) closed an attractively priced financing for the Sentinel gas-fired peaking power project in Southern California – 225bp over Libor. But margins in the US power market have since compressed, such that CPV today could obtain a spread beneath 225bp.

CPV will likely reprice Sentinel before year-end, either as a traditional refinancing or as an amendment to existing credit documents. Several other top-tier sponsors in the US, including NRG and GDF Suez, have recently chosen the latter option – an amendment that effectively lowers existing margins and, in some cases, extends maturities.

Sponsors have different reasons for refinancing project-level debt. Some sponsors may simply want to extend tenor – many financings are five to seven-year mini perms, which have longer amortization schedules. Once a project becomes operational, sponsors can usually get lenders to extend the tenor. Some sponsors may want to increase leverage, or amend heavy covenant terms to covenant lite. But most recent refinancings have been driven by the sponsors' desire to reprice deals, observers say.

Price pressure

The fall in pricing reflects a bank market starved of deals. After the expiration of the federal production tax credit (PTC) in 2013 the number of wind projects seeking debt has decreased, and sluggish demand growth in most regions has discouraged the construction of new gas-fired projects (and few such projects boast power purchase agreements, which underpin most independent power projects).

This sponsor-friendly landscape first emerged in late 2012, but margins didn't begin falling precipitously until a year later. The plants seeking repricings today were closed after the 2008 financial collapse, when European lenders either retreated from the US or enforced costlier terms.

The majority of refinancings close within one year's maturity of existing debt. But with the favourable market conditions in the US, sponsors have been taking advantage of bank liquidity by repricing well before maturity. Sentinel, for example, closed with a tenor of construction plus 10 years. The facility began operating in May 2013, so the debt would still have at least nine years left – but sponsors are looking to reprice before year-end.

Today, lenders are so desperate for deals – even deals that offer limited returns – that some bankers have suggested repricing debt to sponsors of operating plants. "We're trading future margins for a fee today," one lender told *IJGlobal*. Amendments tend to involve less fees to bankers, which could be the reason why some sponsors are opting to reprice by simply amending the credit document, instead of refinancing. Sponsors can sometimes reprice without giving fees to bankers – lenders know that other banks can easily replace their spot.

Restatement or amendment?

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A refinancing may be documented as either a restatement of the underlying credit agreement or an amendment to the credit agreement. A restatement – technically an amended and restated credit agreement – often involves extensive amendments to the credit agreement, and sometimes also introduces new lenders or new parties to the refinancing. The changes are often drawn up in a new credit agreement. An amendment, however, involves smaller tweaks – such as specific changes to pricing, maturity or other conditions of the underlying credit agreement.

Since late July 2014, two operating plants have been repriced through amendments. On 23 July, NRG Yield lowered the two tranches in the Marsh Landing gas-fired plant in California by 75- 87.5bp over Libor in an amend-and-restate deal. On 4 August, the sponsors of the Astoria II gas-fired generator in New York repriced the non-recourse debt to 162.5-175bp over Libor, down from the original margin of 300bp. The sponsors – GDF Suez, SNC Lavalin and Gulf Pacific Power – chose to amend, extend and restate the Astoria II debt. Other operating projects will close repricings – and extensions of tenor – before January.

Thus far, only elite sponsors – those with strong bank relationships and solid development pipelines – have closed repricings. After all, banks have a large incentive to sustain their relationships with such sponsors. The stronger the sponsor, the more lender relationships they can draw on for repricings. But less experienced sponsors may follow.

“If you’re a junior developer with a strong project, with great offtakers with good credit, there’s no reason you shouldn’t be able to get the same benefits,” said Patricia Hammes, partner at Shearman & Sterling based in New York.

Repricings (either as traditional refinancings or as amendments) typically require fees, including swap breakage fees. Most bank-provided project financings in the US are initially priced against Libor, a floating benchmark – but then swapped to fixed-rate (also for a fee). But the cost to break the initial swaps hasn’t discouraged borrowers today from pursuing repricings.

The reason: the benefits of lowered margins exceeds the costs of fees, including swap breakage fees. Also, lower-priced debt has enabled some plants – including Marsh Landing – to borrow additional debt without tweaking debt sizing parameters.

Other factors also account for tighter margins. Sponsors usually can obtain better terms for operating plants than projects awaiting construction, because the risk of construction is often the costliest risk. But some attorneys say that lowered risk alone cannot drive pricing down – right now, repricings are primarily driven by favourable market conditions.

If current market conditions continue, market observers say that the stream of repricings will likely continue next year.

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