Salalah II IPP, Oman

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Acwa Power and Mitsui’s financing for the 445MW Salalah II independent power producer (IPP) project is a further step in the privatisation of Oman's power market.

Until the introduction of the Sector Law in 2004, Oman’s Ministry of Housing, Electricity and Water (MHEW) was responsible for generation, transmission, and distribution of electricity. Rising demand for power and water as well as the need for private investment to modernise power facilities has since driven the unbundling and gradual privatisation of the country’s state-owned electricity and water industries.

Oman has unbundled generation, transmission, and distribution assets in order to devise sector-specific regulation and allow for greater private participation, according to Marc Norman, a project finance lawyer at Chadbourne & Parke.

“The unbundling is driven by a desire to move away from a highly centralised model where all assets are held in a single entity,” Norman said. “By hiving asset categories off into distinct entities, then applying regulation to specific sectors the government opens the door to greater private sector participation.”

Market liberalisation

The Sector Law provided the framework to unbundle Oman’s vertically integrated power sector. Unbundling began with generation, transmission, and distribution assets being spun-out from MHEW to publicly owned successors such as the Al-Rusail Power Company, the Oman Electricity Transmission Company (OETC) and the Rural Areas Electricity Company. The Sector Law also established a single procurement company – Oman Power and Water Procurement Company (OPWP) – and the Electricity Holding Company (EHC).

Another successor company, established and licensed to operate all generation, transmission and distribution assets in the Dhofar region, was the Dhofar Power Company (DPC).

Oman began to dilute the regional monopoly held by DPC when OPWP picked Sembcorp to develop the first Salalah independent water and power producer (IWPP) project, which reached financial close in 2009.

Now with the Salalah II project, the government has taken this market liberalisation further. The project involves privatising an existing generating asset held by DPC and procuring a new power plant for the region, all through a single tender.

“In 2014 DPC was unbundled by the Omani government, which split generation, transmission and distribution assets – this created the Dhofar Generating Company (DPG),” Norman said. “DPG’s key asset was the 273MW brownfield Raysut project which was the subject of the privatisation process in the Salalah II project.”

“Without the unbundling process, it would have more challenging to hive off the generation assets and make it subject to such an efficient tender.”

Acquisition and greenfield

The Salalah II project entails the acquisition of the 273MW Raysut project and construction, ownership and operation of a new 445MW power plant. Under Omani law the sponsors will be required to eventually sell 40% of the combined assets through a public offering on the Muscat Securities Market.

State utility OETC and DPC will retain the transmission and distribution infrastructure respectively, with no plans to privatise either utility yet announced.

Chadbourne's Norman explains however that the law does allow for further market liberalisation, which OPWP has indicated may include the disposal of the government’s interest in EHC; the purchase of power by entities other than OPWP; the import or export of power by entities other than OPWP or the Rural Areas Electricity Company; and competition amongst licenced suppliers.

“Oman’s power market is one of the most liberalised, regulated and sophisticated markets in the region,” Norman said. “The procurement model developed by OPWP over the years is a well-oiled machine that runs very fast.

“The project documents released to bidders have been banked so many times and there’s an expectation on the government to have virtually no alteration on their forms – and an understanding on the part of developers that the combination of limited mark-ups and a competitive tariff is key to securing an OPWP project.”

Financing

A sponsor consortium led by Acwa Power and Mitsui reached financial close on the natural gas-fired 445MW Salalah II at the end of August 2015. The financing will fund construction of Salalah II and refinance a bridge loan raised earlier this year to fund the acquisition of the 273MW Raysut project.

Acwa (45%), Mitsui (45%), and Dhofar International Development and Investment Holding (DIDIC, 10%) provided $190 million in equity, with the total split according to their respective equity stakes. The sponsors also closed on a further $450 million in senior debt, according to Leslie Abraham, senior manager in the acquisitions and project finance team at Acwa.

A group of international banks lent $300 million, split equally between them. They were:

- Standard Chartered
- Sumitomo Mitsui Trust Bank
- SMBC
- KfW Ipex
- Mizuho

Two local banks lent a further $150 million, denominated in Omani rials:

- Bank Muscat ($120 million)
- Bank Dhofar ($30 million)

The debt has a tenor of 18 years and is priced at 140bp over Libor for construction plus five years. The pricing then steps up to 180bps, and five years later rises to 205bp for the remainder of the loan. The senior debt replaces a bridge loan to fund the acquisition of Raysut, signed on 26 April 2015, and provided by a similar bank group. That loan was priced at 105bps over Libor.

“This is a unique deal because it optimises the various pockets of liquidity available by utilising both dollar and Omani Rial tranches,” Abraham said. “The investors come in on the basis of the power purchase agreement [PPA], which gives the deal a strong and consistent underpinning.”

Acwa and Mitsui signed a 15-year PPA with OPWP earlier this year for the Salalah II deal.

"Acwa bid with very aggressive pricing on this deal in part because it believes that OPWP is likely to consider extending the PPA at the end of the 15-year period," Abraham said. "The PPA could be extended by up to ten years, to the end of the technical life of the project."

SEPCO III is undertaking the lump-sum turnkey engineering procurement and construction contract for the greenfield development. First National Operation & Maintenance Company (NOMAC, a subsidiary of Acwa) will provide operations and maintenance services.

Advisers

OPWC's advisors on Salalah II included PwC, DLA Piper, and Fichtner.

Legal adviser to lenders on the Raysut acquisition deal are Shearman & Sterling. Allen & Overy was legal adviser to the sponsors, who used Acwa's in-house team for financial advisory.