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## Americas Deal of the Year Awards 2004

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# KPP/Oklahoma 1: Two's company

What Michael F. Lawler, executive vice-president and treasurer at Tenaska, wanted from the Kiowa Power Partners refinancing was "the ability to refinance in a highly efficient and cost effective way". What he got was the keenest BBB- rated power financing to date.

At 128bp over Treasuries for the 5.1-year average life A tranche, and 158bp for the 12.5-year average life B tranche – the spreads on Tenaska's Kiowa Power Partners bond refinancing were extremely fine.

The pricing is symptomatic of a tightly structured deal and appetite for Tenaska itself, which has a strong operating track record and is, apart from a small corporate revolver, debt remote at holding company level.

The deal was the second of two major Tenaska refinancings in 2004 – the other being Tenaska Virginia Partners – and both featured the same relationship arrangers, Lehman Brothers and Calyon, and the same offtaker, Coral Power.

However, in addition to its pricing, Kiowa set another benchmark for the US power market in 2004 – notably the first US power project to refinance both project holding company (Oklahoma 1) and operating company (Kiowa Power Partners) debt at the same time. The use of a holding company subordinated financing with a concurrent senior issue enabled Tenaska to achieve an effective leverage on the project of 104%.

The deal refinances a miniperm closed in 2001 well in advance of its 2010 scheduled maturity date. The miniperm featured a step up structure with pricing rising from 137.5bp over Libor to 187.5bp over the life of the loan.

The original loan funded construction of the 1,220MW Kiamichi power plant in Pittsburg County, Oklahoma, which has now been in operation since April 2003. Lenders to the refinancing could therefore take comfort from no construction risk.

The project has also demonstrated a fairly solid operational performance and uses tried and tested GE 7F turbine technology. Peak availability for the plant from August 2003 to April 2004 was 97%. In May 2004, KPP was forced to take an unscheduled outage due to a vibration problem with the steam turbine generator in one of its power blocks. As a result, plant peak availability for the first half of 2004 dropped to 94%.

The project has since returned to full capability and plant peak availability factor is estimated at around 95% and 86% off-peak for all of 2004.

The operating company (Kiowa Power Partners) refinancing comprises two pari passu tranches, rated BBB-/Baa3 by Standard & Poors (S&P) and Moody's respectively. The $361 million A tranche has a maturity of 2013 and a coupon of 4.811%. The B tranche, of $281 million, has a maturity of 2021 and a coupon of 5.737%. Both tranches are fully amortizing, but tranche B repays zero principal until tranche A is fully paid out in 2013.

The project holding company (Oklahoma 1) issue is a $73.25 million subordinated private placement with a coupon of 6.528% and due date of 2014. Rated BB-/Ba2 by S&P and Moody's respectively, the deal funds a $41.4 million one-off distribution to the sponsors – Tenaska and Diamond Generating – and the remainder goes towards the Kiowa miniperm repayment.

The Tenaska Oklahoma I notes have a higher sensitivity to default than the Kiowa bonds and are serviced only if Kiowa is able to distribute cash after meeting a 1.2x coverage test.

Bondholders on both issues are protected from short term cash flow shortfalls by a six month debt service reserve account that is backed by a $43 million letter of credit (L/C). If drawn upon, the L/C is replenished by a post debt service cash sweep.

The project itself is backed by strong offtake and supply contracts. The Kiamichi plant has the ability to dispatch power into both the Southwest Power Pool (SPP) and the Electric Reliability Council of Texas (ERCOT) grids – both of which are under-performing merchant markets.

However, the deal comes with no merchant risk because the plant has a 10-year electricity manufacturing agreement (EMA) with Coral Power, under which Kiowa provides 100% of the plant's capacity to Coral in exchange for fixed capacity payments (roughly 85% of all EMA revenues), fuel supplies, and a stream of individual variable charges designed to recover the plant's variable operating costs.

The EMA is extendable to 18 years and ultimately guaranteed by Shell Oil, which proved a major selling point with investors.

Nevertheless, Kiowa is not devoid of all lender discomfort. Initial capacity prices ($84/kilowatt-year) paid under the EMA were, at time of financing, above current market prices in both the SPP and ERCOT markets. ■

## Kiowa Power Partners/Oklahoma 1

**Status:** Closed 19 November 2004
**Size:** $715.5 million
**Holding company debt:** $73.5 million
**Operating company debt:** $642 million
**Description:** Refinancing of 1,220MW plant
**Sponsors:** Tenaska (70%); Diamond Generating (30%)
**Joint bookrunners:** Lehman Brothers; Calyon
**Co-managers:** HVB Capital Markets; Lloyds TSB Bank
**Legal counsel to sponsors:** Pillsbury Winthrop
**Legal counsel to lenders:** Skadden Arps Slate Meagher & Flom
**Independent technical consultancy:** E3

## DSCR stress tests

| Scenario | Average* | KPP 11-year average | Minimum | Consolidated Tenaska Oklahoma average (2004-14) | Minimum |
|---|---|---|---|---|---|
| Base case | 1.60 | 1.50 | 1.50 | 1.30** | 1.30** |
| Zero Dispatch | 1.55 | 1.46 | 1.44 | 1.26 | 1.25 |
| Capacity factor reduction to 33% | 1.56 | 1.47 | 1.46 | 1.27 | 1.26 |
| 5% Capacity reduction | 1.59 | 1.49 | 1.49 | 1.29 | 1.29 |
| 10% O&M increase | 1.59 | 1.49 | 1.48 | 1.29 | 1.29 |
| Availability reduction to 80% | 1.35 | 1.28 | 1.25 | 1.11 | 1.08 |
| Inflation rise to 5% | 1.58 | 1.49 | 1.48 | 1.29 | 1.28 |
| 10% increased HR | 1.38 | 1.32 | 1.25 | 1.15 | 1.10 |
| Combined downside*** | 1.50 | 1.41 | 1.39 | 1.22 | 1.20 |

**Total cash available for debt service during the life of the bonds divided by total debt service during the life of the bonds.*
***Cash distributions from KPP cover debt service on the Tenaska Oklahoma 1 note over 3 times in the base case.*
****30% reduction in capacity, 90% availability, 10% O&M increase, and 5% heat rate increase.*
*Source: Moody's*