ProjectFinance

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Deals of the Year 2003 – The Americas

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Tenaska Alabama II: Coral enabled

In the first part of 2003, when power finance deals were unpopular, bankers were asked which projects in the sector they were still prepared to finance. An unsurprising 90% said that they were prepared to finance a deal if it was well enough structured. This heartening sentiment obscured an important fact – well structured deals in 2003 went to the bond market. And Tenaska Alabama II was probably the best structured of the lot.

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Tenaska is one of the few independent single-asset developers left standing. Panda Energy, after overreaching itself with its TECO joint venture, has been quiet, while Cogentrix, on the wrong end of some tolling agreements with poor counterparties, succumbed to the charms of Goldman Sachs. Tenaska, like Panda, may now be in the distressed power business, but its core skill of striking a financeable power purchase agreement remains.

Its ability to attract solid bank support is also undimmed, and while it used a total of three banks – DZ Bank, Lehman Brothers and Credit Lyonnais – to underwrite the $406.7 million offering, its letter of credit business also attracted solid bank interest. The bonds, meanwhile attracted some of the keenest spreads yet encountered for an asset of its type.

Tenaska Alabama II Partners' sponsors are Tenaska and Diamond Generating, part of Mitsubishi. The issuer, a partnership, Tenaska Alabama II is 99%-owned by Tenaska Alabama B, LP (itself 70% owned by Tenaska and 30% by Diamond) and 0.70% by Tenaska Alabama II, Inc, with the remaining 0.30% held by Diamond Alabama II, LLC. The structure, while complex, resembles previous Tenaska financings.

The plant is an 885MW combined-cycle power plant located near Billingsley, in Autauga county, Alabama, about 30 miles northwest of Montgomery. The station is thus in the heart of the southern US, the overbuilt playground of utilities such as Southern and Entergy. As such the plant is lucky to operate without a utility partner.

Instead, the key strength underpinning the plant's credit is an energy conversion, or tolling, agreement with Coral Energy. This 20-year agreement is largely based on capacity agreements, and is thus largely insulated from dispatch risk – a key consideration in the region. Coral, moreover, is the strongest power marketer left in the US, owned by Shell, and carrying a AA rating on its own, and benefiting from its AAA-ownership. Indeed Alabama II is one of the few tolls that Coral has signed that carries a Shell guarantee, although this is subject to a maximum amount of $950 million reducing on an annual basis in accordance with an amortization table. .

In theory, the toll, unlike some signed by PG&E, TXU, or Xcel subsidiaries, is not a potential victim of an unregulated subsidiary's forced or unforced exit from US power. This desire to exit is understandable – indeed according to the Standard & Poor's analysis of the deal Alabama's toll is out of market. Nevertheless, a guarantee this strong enables the bookrunners to present the financing as a structured Shell credit.

The Coral toll is essential to understanding the popularity of the deal – the plant would have been an infinitely harder sell with Williams or Dyengy on the other end. The toll's capacity payments, whereby the operator is compensated according to availability, account for 80% of the project's revenues and 100% of debt service, under the base case. The plant is rewarded or penalized according to availability levels.

Additional enhancements come from a six-month debt service reserve, backed by a $20 million debt service reserve letter of credit, and interconnection letters of credit of $7.1 million for gas and $175,000 for electric interconnection, and a $5 million working capital facility. Credit Lyonnais, DZ Bank, HVB and Bank of Tokyo-Mitsubishi provided these facilities.

These four banks were among the five original lenders to the construction phase of the project. This group, as well as the since departed TD Securities, provided a loan of roughly $450 million in May 2001. This deal was structured to stick, and had a seven-year tenor, but cash sweeps that encouraged a move to the capital markets.

Lehman Brothers and Credit Lyonnais, as joint lead managers, and DZ Bank, as co-manager and 20% underwriter, sold down the bonds in October 2003. They had a maturity of May 2023, and carried a coupon of 6.125%. This represented a spread of just 185bp over the equivalent Treasury – extremely tight for a power project bond.

This is all the more impressive when the sponsors put in just $20.9 million in equity. 5% leverage, and coverages at 1.45x under the base case, are aggressive. Nevertheless, the bonds gained Baa3/BBB- (Moody's/S&P) ratings, and the sponsor while no doubt resigned to the level, may have wondered why they did not do better. Indeed, it suggests that pricing and rating agency perceptions might be starting to diverge again.

Indeed, the benefits of a Tenaska-style power purchase agreement can be examined through a recent change in outlook by Moody's of the Tenaska Georgia deal. This was a change in rating to negative, and noted that the plant's offtaker – Exelon – had barely dispatched the plant in 2003, even during the summer. Despite this, the capacity payments came in, and Georgia is current on its bonds. This is a toll that a bondholder can love, although there are doubtless few customers looking for similar power on demand. ■

Tenaska Alabama II Partners

Status: Closed October 2003
Size: $428.6 million
Description: 885MW combined-cycle power plant
Location: Billingsley, Alabama
Sponsors: Tenaska, Diamond Generating
Debt: $406.7 million
Bookrunners: Lehman Brothers, Credit Lyonnais, DZ Bank
Maturity: 2023
Coupon: 6.125%
Lawyers to the borrower: Pillsbury Winthrop
Lawyers to the bookrunners: Skadden Arps Slate Meagher & Flom
Independent engineer: E3