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Briefing note

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Boosting power generation in Nigeria – the Azura-Edo independent power project

The Azura-Edo independent power project (IPP) lays claim to a number of firsts. It is Nigeria's first fully privately financed IPP – the first of a new wave of project-financed greenfield IPPs currently being developed in the country. It is also the first power generation project in Nigeria to receive World Bank Partial Risk Guarantee and Multilateral Investment Guarantee Agency (MIGA) support.

The 450MW open cycle gas-fired Azura project is due to come on-stream in 2018 and represents the first phase of what will ultimately be a 1,500MW power plant. The project will deliver much needed electricity to almost 12 million people in Nigeria, where the lack of power currently limits economic potential. Mobilising international capital through independent power plants is a vital part of the solution to the chronic power shortages in Nigeria. The successful closing of the Azura transaction has demonstrated that this international support exists.

What makes the project attractive to investors?

World Class Developers

The project's lead sponsor was Amaya Capital Limited, a principal investment firm that, over the past 8 years, has been at the cutting edge of market development in both the gas infrastructure sector and the IPP sector. Amaya's co-sponsors also included several African-focused infrastructure funds with exemplary track records in financing and developing large-scale infrastructure projects.

A strong PPA

The project may be important for Nigeria, but what's in it for investors? Firstly, and perhaps most importantly, the Azura project benefits from a strong, long term power purchase agreement (PPA), which has a classic tariff structure familiar to investors, split out into capacity and energy components. The capacity payment is payable so long as the plant is available to generate electricity (or, in certain circumstances, where it is deemed to be available) and covers, among other things, the scheduled principal and interest under the financing documentation.

Government support

The Federal Government of Nigeria (FGN) provides support to the project in the event of an early termination of the PPA through the mechanism of a put and call option agreement (PCOA). The PCOA allows the project company to 'put' the plant (or its shares) to the government in nearly all circumstances where the PPA is terminated early (including in circumstances where there has been a prolonged gas supply failure). In these circumstances the government is obliged to pay a 'purchase price' which, at a minimum, covers the outstanding debt.

The PCOA started off as something more akin to a letter of support. However, at a relatively early stage in the deal, the FGN decided to adopt a put and call option structure, not least because it ensured that the FGN was always receiving something (the plant or the shares) in return for the amount it paid out – (early), as opposed to simply guaranteeing the payment by the offtaker of a termination sum, as is traditionally the case with PPAs. The PCOA was heavily negotiated during the course of 2014, resulting in a robust agreement which is rapidly becoming the template for all future IPPs in Nigeria.

The success of the Azura PCOA structure is also spreading further afield as it is now starting to be used in other jurisdictions within Africa (and beyond).

Credible counterparties

The project benefits from an engineering, procurement and construction (EPC) contract with a consortium comprised of Siemens, an internationally recognised and experienced contractor, and Julius Berger, Nigeria's preeminent construction company. It also has a long term gas sales and purchase agreement with Nigerian Petroleum Development Company (NPDC), a fully-owned subsidiary of the Nigerian National Petroleum Corporation (NNPC) and with Seplat, a leading independent oil and gas exploration and production company in Nigeria. Seplat is the first indigenous company to acquire and become an operator of onshore oil and gas assets from international oil companies, in 2010. It was listed on both the London (SEPL) and Nigerian (SEPLAT) stock exchanges in April 2014.

World Bank support

An important aspect of the project was the availability of substantial support from the World Bank in the form of both political risk insurance and direct funding.

The political risk support included:

- Political risk cover for the commercial debt through a MIGA insurance policy and an IBRD political risk guarantee. The MIGA policy covers transfer/inconvertibility, expropriation, war and civil disturbance and breach of contract by the host government and the IBRD political risk guarantee covers breach by either NBET of the PPA or FGN of the PCOA;
- Political risk cover for the equity in favour of the shareholder, Azura Edo Limited, through a MIGA equity policy; and
- An IBRD liquidity political risk guarantee which supports the letter of credit issued by JP Morgan on behalf of NBET to cover its tariff obligations under the PPA.

On the funding side, International Finance Corporation is one of the lead DFI arrangers as well as being both a senior and mezzanine lender. OPIC also provided both senior and mezzanine debt.

Some challenges

Foreign exchange regulations

Several aspects of the current Nigerian foreign exchange regulations posed challenges that would have had a direct impact on the proposed financing structure and therefore the feasibility of the project.

In particular, the project company's sole source of income consists of the Naira-denominated receivables due to it under its power purchase agreement but in certain circumstances the current foreign exchange regulations would have prevented it from converting these Naira receivables to US dollars on the official currency markets, particularly where required to fund various US dollar offshore reserve accounts, which are a typical requirement in the financing of an IPP.

To address these challenges, the lenders engaged with the Central Bank of Nigeria (CBN), which has oversight of foreign exchange regulations, in order to seek special regulatory dispensations. Following a series of productive meetings with the CBN and correspondence explaining the impact of the foreign exchange regulations on the proposed structure of the project, the CBN granted the dispensations requested by the lenders in order to facilitate the successful closing of this important project. It is hoped that this will pave the way for future large IPP (and other infrastructure) projects.

Gas risk allocation

Another challenge facing the project was the overall gas (supply and transportation) risk – and how best to manage and allocate that risk. The gas needs to pass through the Escravos-Lagos Pipeline System in order to reach the plant. The agreement reached with NBET is that, under the PPA, a failure in the gas supply will not in itself be treated as an availability event, i.e., capacity payments will not be payable during such period. However a prolonged failure will allow the parties to terminate the PPA and, critically, allows for the project company to exercise its put option under the PCOA.

A supply failure which is brought about due to an issue with the public gas transportation system (rather than with the gas supplier) is treated in the same way as a 'gas supply' failure, other than that NBET has accepted that this is a 'government risk' and, as such, capacity payments would remain payable during this period.

How the project was financed

Overview

The financing structure was complex, involving both senior and mezzanine debt and comprises approximately US$687 million of debt from a consortium of 15 international and local banks. Standard Chartered Bank was appointed as the global mandated lead arranger with the International Finance Corporation and Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden (FMO) acting as co-MLAs for the development finance institutions. On the senior side, in addition to international commercial and development finance tranches, there was also a locally denominated tranche provided by a state liquidity fund rather than bilateral funding.

The Sponsors, Amaya Capital, American Capital Energy and Infrastructure, the African Infrastructure Investment Fund 2, Asset & Resource Management Company Ltd, Aldwych International Ltd, Pan African Infrastructure Development Funds 2 LLC and the Edo State Government of Nigeria contributed total equity of approximately US$190 million.

The PAIF tranche

A significant portion of the debt financing (NGN 24 billion, approximately US$120 million) was sourced from the Nigerian Power and Aviation Intervention Fund (PAIF) which is administered by Bank of Industry (BOI), under the overall supervision of the CBN. This tranche of debt was arranged by First City Monument Bank Limited (FCMB), which on-lent the money to the project company.

The funds were provided subject to certain terms and conditions set out in an offer letter from PAIF. These included a requirement that FCMB comply with PAIF's guidelines and a right for the BOI to step into FCMB's position under the financing documents in the event that FCMB did not meet its obligations to BOI under the terms of the PAIF facility or in

the event of FCMB's banking licence being revoked.

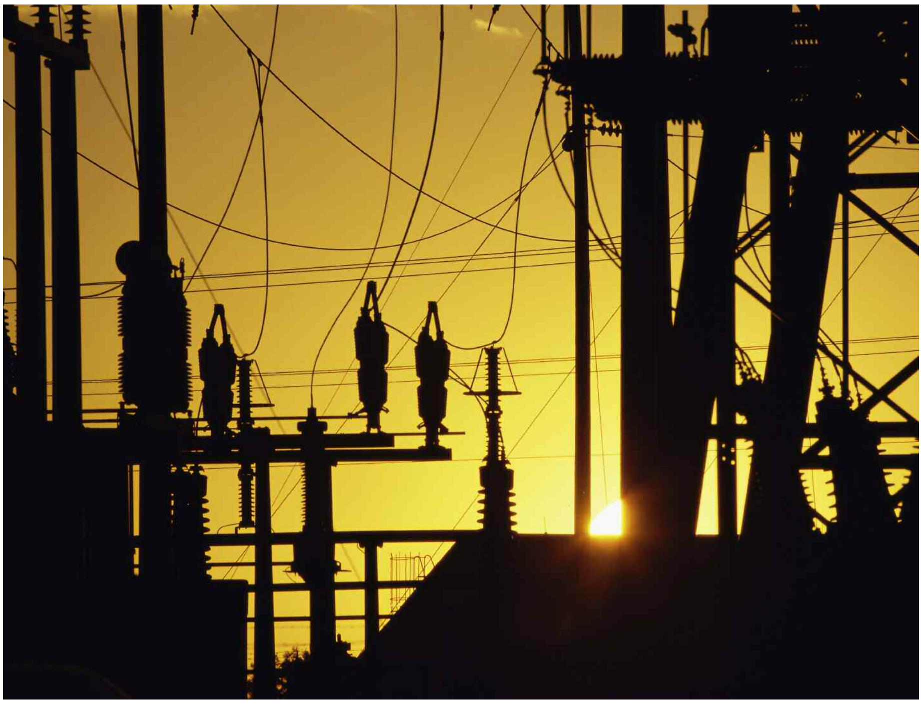
FCMB, on behalf of the lenders, engaged with the CBN to clarify the terms of the offer letter and apply for certain dispensations in relation to the project. These included a request to freeze the PAIF's guidelines, so that the PAIF funding could not be withdrawn for any breach of PAIF guidelines that were not in force at the date the offer letter was provided. The lenders also asked BOI to acknowledge that its step-in rights would be subject to the terms of an intercreditor agreement, which limits a lender's right to receive certain information if such lender is owned or controlled by a Nigerian public authority. The discussions were successful and the lenders' requests were accepted.

The mezzanine financing

Certain development finance institutions (IFC, Proparco, EAIF and OPIC) which are also senior lenders, provided a mezzanine tranche to the project. Aside from the usual intercreditor issues, since the mezzanine lenders are DFIs, they have certain policy requirements which they need to have full control of – notwithstanding the fact that they are mezzanine lenders – and very thorough discussions were had between the senior and mezzanine lenders to agree on a highly bespoke list of entrenched rights available to the DFI mezzanine lenders on the transaction.

Gas sales agreement letter of credit

The gas sales and purchase agreement (GSPA) required that the payment obligations of the project company be backed by a letter of credit (GSPA LC), issued by a bank with a minimum credit rating. Normally such a letter of credit would have been procured by the equity providers through a form of collateral arrangement but in this case it was provided by one of the lenders, Standard Chartered Bank, as part of the overall financing.



Given that the GSPA LC formed part of the overall financing, a highly bespoke intercreditor and project accounts structure was designed to address the different scenarios, taking into account the different phases of the project (e.g. before and after project completion), when the GSPA LC might be drawn, fully or partially, and what the potential exposure of the other senior lenders in the project would be at relevant times.

What next for power in Nigeria and Sub-Saharan Africa?

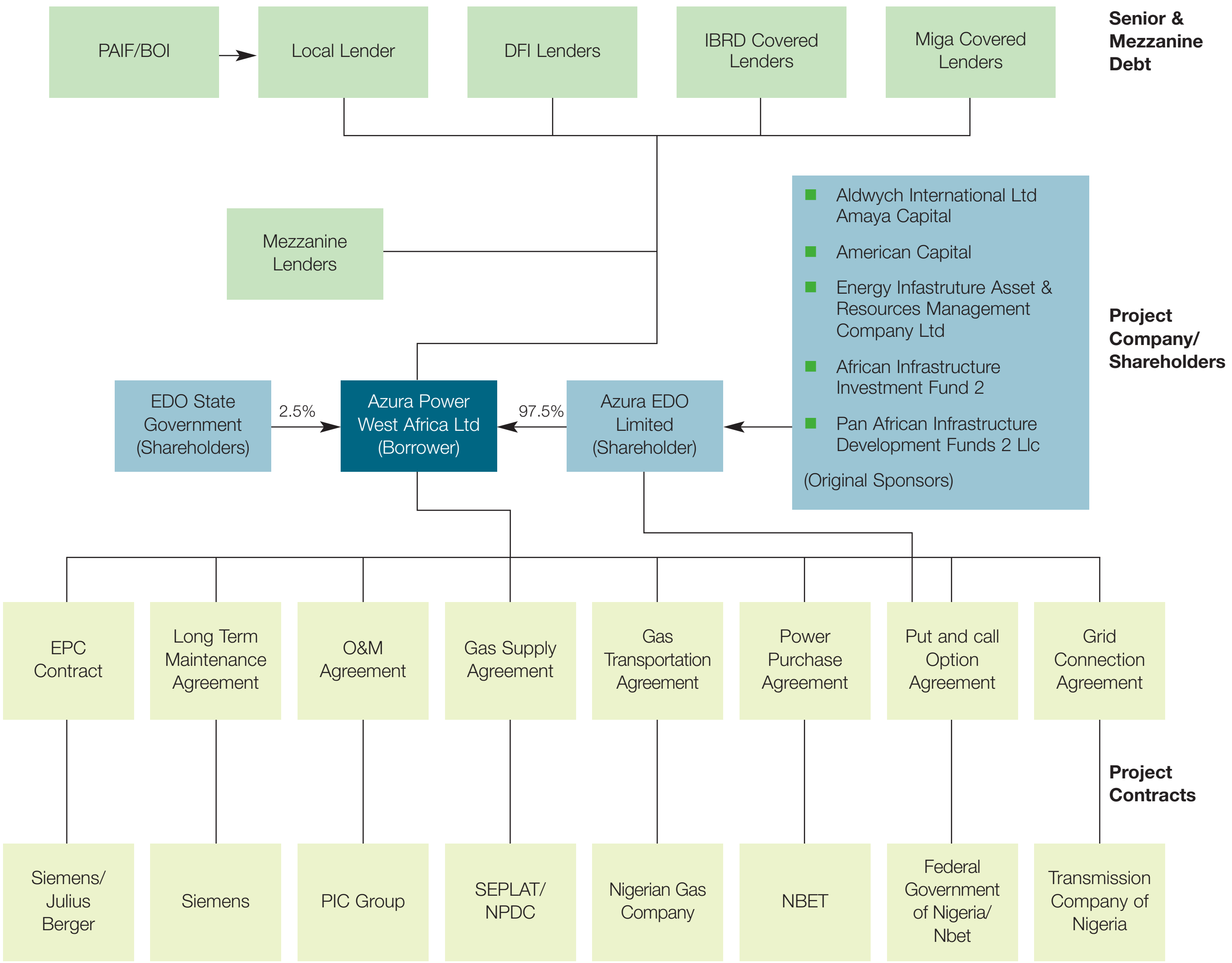
Azura has become known as the pathfinder project for the Nigerian power sector. There is still a huge amount of work to be done to resolve a number of structural, legal and technical issues in the sector which have buffeted the Azura project. For Azura, through the tireless work of all the parties – sponsors, lenders, government agencies and advisors – these challenges were overcome and the project has opened the way for a number of further gas-fired (and solar) IPPs to progress to financial close over the next 12 to 24 months. These include:

- the Qua Iboe Power Project currently being developed by Mobil Producing Nigeria;
- the OMA Power Project, a 1080MW 3-phase green-field gas-fired power plant located in Abia State, being co-developed by Geometric Power Limited (GP), a Nigerian independent power producer and General Electric (GE) of the USA;
- Century Power Generation Ltd., a Nigerian energy company, plans to raise US$700 million to finance the first phase of a 1,500MW gas-fired plant power plant in Okija in Anambra state; and
- Three or four solar plants (circa 100MW each) that are spread across the north of the country.

There will understandably still be many challenges ahead in closing these, and other, power projects in Nigeria. Not the least of these will be the strain on the foreign currency reserves caused by the low oil price and the knock on effect that will have on the development of the nascent gas industry. Nevertheless the demand for power is there and the Azura project has shown that the willingness and ability of the private sector to respond to that demand is there too. For the sake of the Nigerian people, we hope that remains the case for a while to come.

* This article was originally published in Project Finance International on 10 February 2016.

Azura Structure Chart



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