

SABER PARTNERS, LLC

# Clearing up the Confusion: Why Utility Recovery Bonds Are Not Asset-Backed Securities

October 10, 2024

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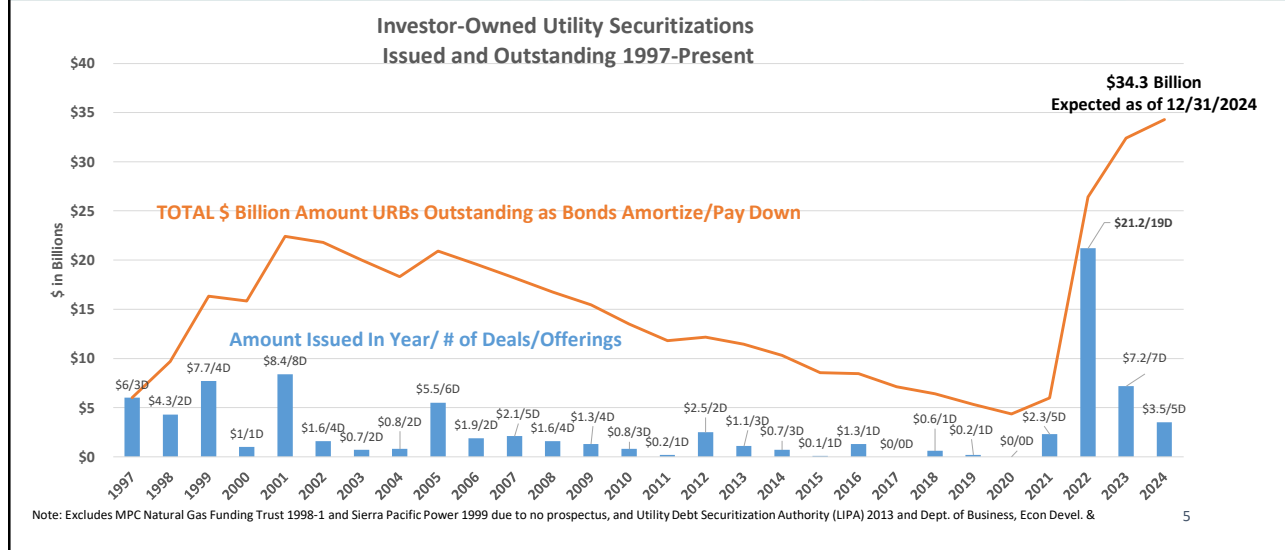
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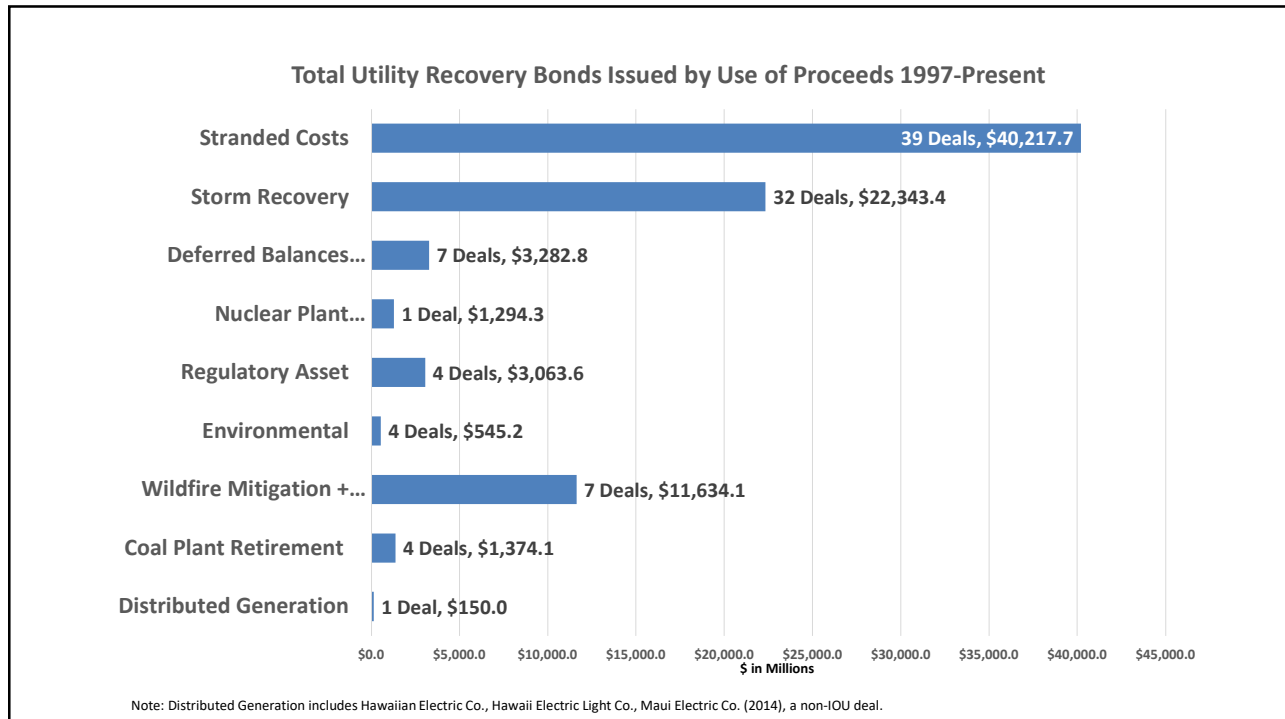
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# Utility Recovery Bonds Usage is Increasing as Cost Recovery Issues Have Expanded



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## An Unexplained Changed Relationship Hurts Consumers

Published By Citigroup Research - January 27, 2023

VIEWPOINT | ABS Weekly

Rate Reduction Bonds: **Cheap Long Triple-As**



### CITI'S TAKE

Rate Reduction Bond (RRB) spreads at 135bp for 10+yr WAL bonds present an attractive entry point for investors. RRB, rated triple-A, are 40bp wide to triple-A/double-A corporate index and 15bp wide to single-A utilities. Almost 70% of 2022 RRB issuance has WAL of more than 10 years.

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## Bankers Identify Misclassification that Harms Consumers "CORP Ticker, but ABS..."

Published By Citigroup Research - January 27, 2023

### CORP Ticker, but in ABS Index

A total of \$25B (all triple-A) utility ABS is outstanding, comprised of 25 shelves (Figure 4), with only 8 shelves with \$500mm or more outstanding. One shelf, PCG, has \$9B outstanding, more than a third of the total. More than 70% of RRB bonds were issued with CORP ticker (modeled as sinkable bond), while only two shelves used MTGE ticker in 2022 (LCDA and ODFA). Starting in August 2022, all RRB are classified as ABS by Bloomberg and are part of Bloomberg US Agg ABS Index. As of January 2023, RRB account for 11% of the ABS Index.

Figure 4. Utility ABS Outstanding, Shelves with more than \$0.5B Outstanding

Shelf	Ticker	Issuer	Outstanding (\$B)
PCG	CORP	PG&E Energy Recovery Funding LLC	9.28
LCDA	MTGE	LA Local Gov't Environmental Facilities and Community Dev. Auth. Restoration	3.52
ODFA	MTGE	Oklahoma Development Finance Authority	2.81
ERCOTT	CORP	Texas Electric Market Stability Funding	2.12
DUK	CORP	Duke Energy (Carolinas/Progress NC Storm Funding, Florida Project Finance)	0.96
RAYCSC	CORP	Rayburn Country Securitization LLC	0.90
EIX	CORP	SCE Recovery Funding LLC	0.85
BRELPO	CORP	Brazos Securitization LLC	0.71

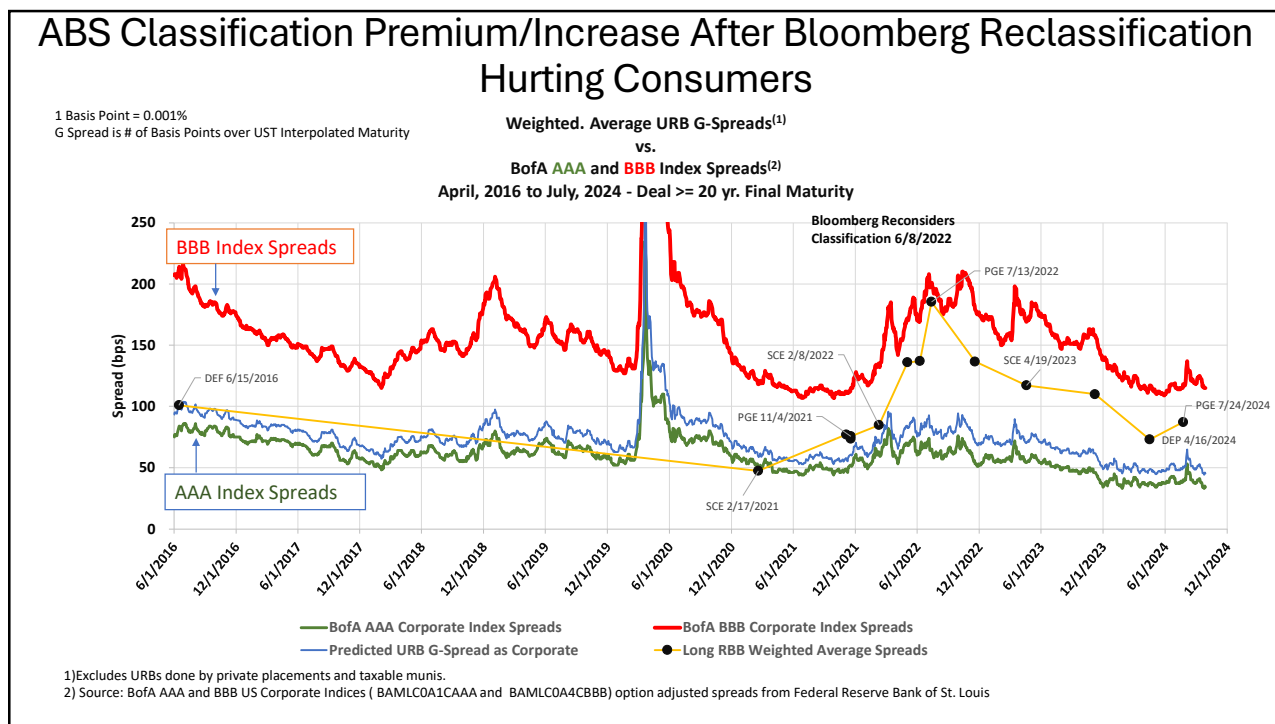
Source: Bloomberg, Citi Research

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### Clearing Up the Confusion, Part 1

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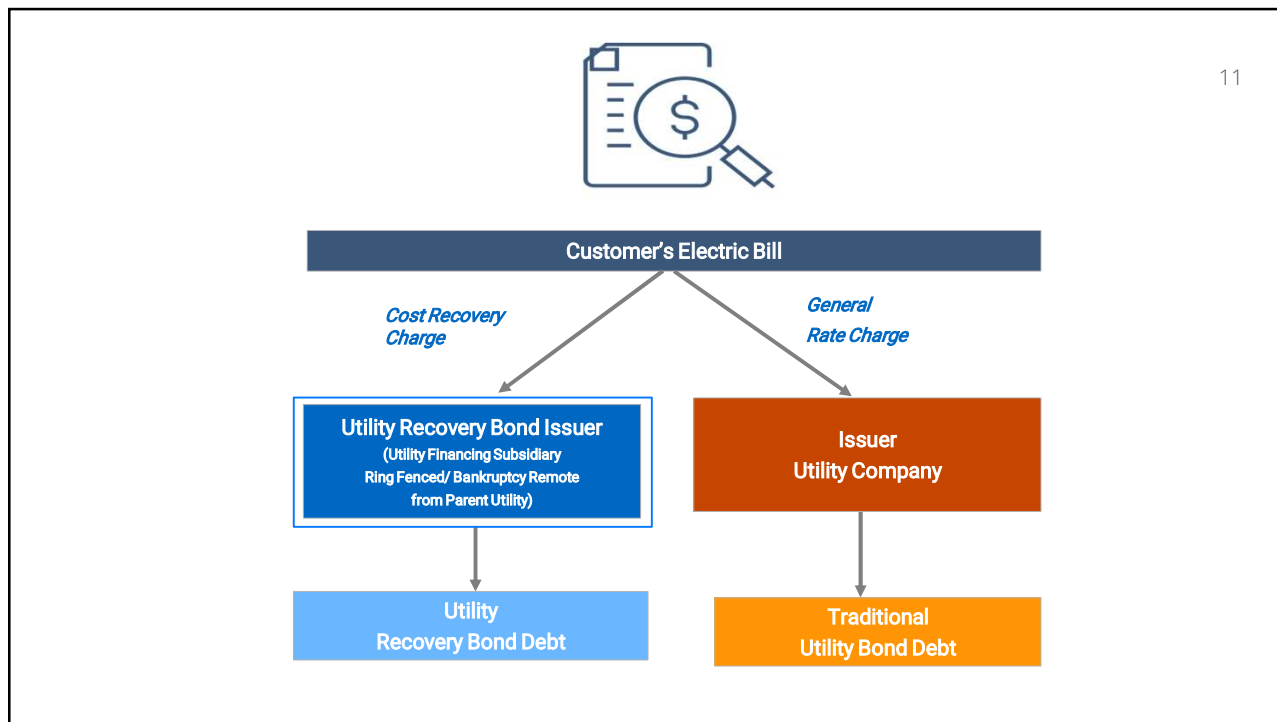
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## Quantification of Estimated ABS Classification Penalty A Little from a Lot Adds Up

URB Issues with Final Scheduled Maturities = > / = 20 years



Issue	Final Scheduled Maturity (yrs.)	Longest Tranche (WAL)	URB Wtd Avg G-spread	AAA Spread (bps)	BBB Spread (bps)	Penalty Over AAA (bps)	Principal Amt. (\$millions)	WAL (yrs.)
DEF 6/15/2016	20.2	18.70	101	83	212	18	1,294.29	11.14
SCE 2/17/2021	22.7	20.16	47	50	118	-3	337.78	12.43
PGE 11/4/2021	24.69	19.93	77	48	112	29	860.40	13.83
DEC 11/17/2021	19.6	15.00	73	52	115	21	237.21	10.83
DEP 11/17/2021	19.6	17.80	76	52	115	24	769.63	10.75
SCE 2/8/2022	24.8	22.80	85	61	134	24	533.27	14.19
PGE (2) 5/3/2022	29.6	27.70	136	68	171	68	3,600.00	18.33
Cleco 6/9/2022	22.3	15.00	137	62	171	75	425.00	12.00
PGE 7/13/2022	29.9	27.94	185	64	200	121	3,900.00	18.86
PGE(4) 11/18/2022	26.7	20.52	137	53	179	84	983.36	15.56
SCE 4/19/2023	24.6	21.19	117	54	169	63	775.42	14.83
PSNM 11/07/2023	24.7	21.29	110	46	158	64	343.20	15.53
DEP 4/16/2024	19.9	11.78	73	38	117	35	177.37	11.78
PGE 7/24/2024	24.9	20.82	87	40	118	47	1,419.29	15.23
<b>Averages</b>								
				Pre-6/1/2022		26	1090.37	13.1
				Post 6/1/2022		70	1146.23	14.8
				Difference (bps)		44		
				Average Nominal Cost Per Deal (\$MM)		\$74.9		

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## Utility Debt and Recovery Bond Accounting and Tax Treatments are the Same

-  **Accounting SEC and FASB:** URBs on Consolidated Balance Sheet of Parent Utility as Utility Debt – **Not Financial Assets**
-  **Tax (Internal Revenue Service):** Obligations of (Parent) Utility – **Utility Debt for Tax**








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## Traditional Utility Financing Method

-  Assets/cost recovery financed long-term using both debt and equity
-  Utility cost recovery approved in general rate case and subsequent tariff
-  Tariffs set by regulator include operating and capital costs (debt service on utility bonds)
-  Credit rating of utility bonds based on coverage ratios and operating, business risks and regulatory environment
-  Tariffs may be changed by regulator with no guaranty to cover all costs or a specific equity return for shareholders or state law charges

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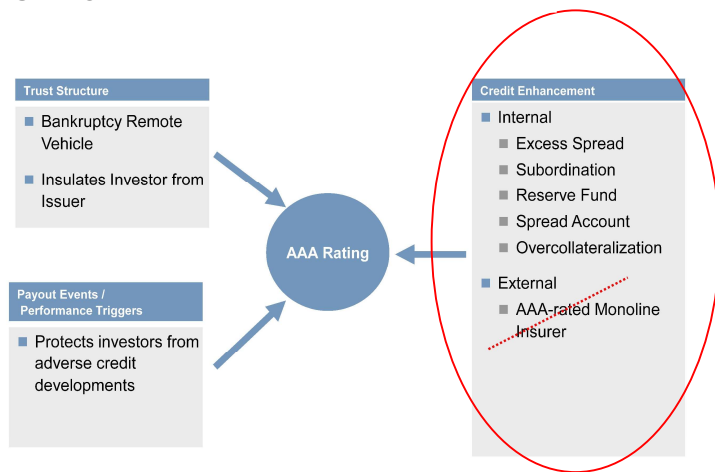
## Utility Recovery Bond Financing Method

-  Assets/cost recovery financed using long-term debt
-  Cost recovery approved within legislatively authorized irrevocable financing order
-  Tariff approved by regulator includes parent's utility costs deemed prudent for recovery and financing through new finance subsidiary
-  Tariff recovery right sold to ring fenced / bankruptcy remote financing subsidiary
-  Regulator mandated and enforceable tariff true up adjustments actively managed by parent utility
-  URB credit rating based on future utility service sales and legal and regulatory approvals and enforcement rights and capabilities
-  Includes state pledge of non-Interference of tariff also embedded in legislation and included in financing order

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## Wall Street ABS Investment Analysis Shows that ABS Credits Have Nothing in Common with URBs

- JPMORGAN research on “How do ABS get AAA ratings?”
- None of the internal or external credit enhancements listed (See Circle) apply to URBs
- URBs are not ABS



INTRODUCTION TO ABS

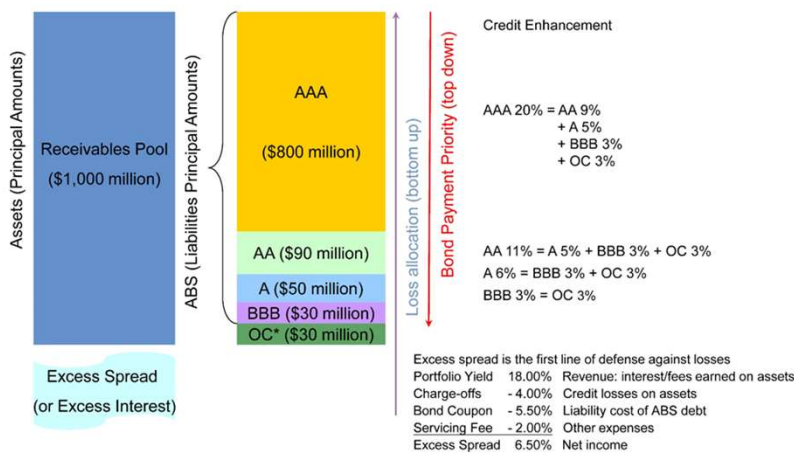
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J.P.Morgan

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## ABS Credit Complex Unlike URBs

### Structure and credit enhancement



INTRODUCTION TO ABS

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<p>Utility Recovery Bonds</p> <p>No ABS Credit Features</p> <p>It's Common Sense</p> <p>URBs are Not ABS</p>	<del>Excess Spread?</del>
	<del>Subordination?</del>
	<del>Reserve Fund?</del>
	<del>Spread Account?</del>
	<del>Overcollateralization?</del>
	<p>URBs have a form of "Regulatory Guaranty" with a "State Pledge" never to interfere with rights of bondholders to be paid i.e., no new legislation or action to revoke or impair the regulator's financing order and guaranty to implement the true-up – adjustment of rates. etc. Continued existence of a corporate entity providing service is essential unlike ABS.</p>

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