Asset Securitization Report

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Duke's Utility Fee Securitization Sets Important Precedent

By Allison Bisbey

Duke Energy Florida marketed its $1.3 billion securitization of utility fees as a corporate bond, and the strategy appears to have paid off. The deal was priced last week at interest rates in line with those of some the highest rated U.S. companies and government agencies.

DEF's bonds are tied to a special charge on the utility's electric delivery and transmission services that is associated with the retirement of the Crystal River Unit 3 nuclear power plant. The bonds are also backed by a guarantee of the state's utility regulator to adjust the charge every six months to whatever level is necessary to pay the bonds on time.

The securities have unusually long durations for this sector; over $500 million had maturities from 15 to almost 19 years. By comparison, most other deals in the utility sector have original terms under 10 years. The tranche with the longest duration pays a spread over Treasuries similar to those of triple-A rated bonds issued by Johnson & Johnson and the Tennessee Valley Authority.

The all-in duration adjust cost of the $1.297 billion offering was 2.72%, an all-time low for a bond offering with such long maturities, according to Andrew Maurey, director of the division of accounting and finance at the Florida Public Service Commission.

Even so, DEF may have left some money on the table. That's because it wasn't until Friday, after the deal priced, that Barclays announced it would classify the bonds as corporates for the purposes of its bond indexes – which could attract a broader investment base.

Had this determination been made before the bonds were priced, DEF might have lowered its funding costs even further.

The two-year tranche priced at a spread of 47 basis points over Treasuries, several basis points wide of where similarly rated credit card securitizations from Chase and Citigroup were trading in the secondary market; the five-year tranche priced at Treasuries plus 60 basis points, wide of comparable credit card deals; the 10-year tranche priced at 93 basis points over Treasuries, more than 10 basis points wide of comparable bonds issued by companies like the TVA and Johnson & Johnson.

RBC Capital Markets and Guggenheim Securities served as joint bookrunning managers.

Still, inclusion in Barclays' corporate index could set a precedent for future utility deals structured in a similar manner.

The bonds will be issued by DEF's wholly owned, but bankruptcy remote, subsidiary, Duke Energy Florida Project Finance. The offering prospectus was filed with the Securities and Exchange Commission on a form SF-1, which is designated for asset-backeds. Yet this filing describes the bonds as "a type of ratepayer obligation charge bond." It goes on to state that the bonds are "corporate securities," and "are not asset-backed securities as defined by the SEC governing regulations."

Notably, there is no tranching for credit risk; all five tranches of securities issued by DEF Project Finance are rated triple-A by three credit rating agencies: Moody's Investors Service, Standard & Poor's, and Fitch Ratings. That means neither investors nor rating agencies need to analyze how cash flows might be diverted to different classes of bonds under different scenarios. The only difference between the classes is the maturity dates.

The bonds will be included on DEF's consolidated balance sheet and treated as debt of DEF for U.S. corporate income tax purposes.

(Unlike corporate bonds, most asset-backeds are subject to a requirement that sponsors retain at least 5% of the credit risk of the collateral. However DEF did not need to argue that its deal is a corporate bond in order to avoid this requirement. Utility fee securitizations already benefit from a carve-out from risk retention rules.)

DEF may have left some money on the table in another respect: it did not market the bonds to European investors, traditionally important buyers of utility fee securitizations.
Maurey said that the Commission did consider the European market, but concluded that the bonds could be priced and sold cost effectively in the US without having to cross the pond.
"Given how the markets reacted to Brexit news at the time of pricing, perhaps a European effort would have produced even better results," he said. "We had a great outcome with this issuance. But if the need to issue these type of bonds arises in the future, expanding the marketing beyond the US should receive stronger consideration."