Asset Managers To Buy Utility Bonds

Asset-management shops are preparing to snap up an expected wave of utility-fee bonds — purchases that will add to many of the firms' growing holdings of such securities.

BlackRock, Northern Trust Asset Management, Wellington Management and the asset-management arms of **Goldman Sachs** and **JPMorgan Chase** are among the firms planning to bid on the upcoming deals. Their purchases would reinforce a position asset managers have secured over the last year or so as the fastest-growing type of investor in such offerings.

Among the managers, BlackRock is the largest buyer of utility-fee bonds, according to **SEC** filings. It was holding $1 billion of such securities as of Feb. 13. Wellington Management was next with $943.6 million, followed by JPMorgan at $584 million, Goldman at $550 million and Northern Trust at $376 million.

The buying plans come as the flow of utility-fee securitizations continues to grow, with states increasingly leaning on the financing strategy to cover costs associated with natural disasters, the retirement of coal-fired plants and environmental upgrades.

Most recently, **Evergy** priced its inaugural bond offering on Feb. 14. The $331.1 million transaction was structured by **Citigroup** with a bookrunning assist from JPMorgan. The funds will be used to recover costs associated with a winter storm that hit portions of Missouri in February 2021.

Duke Energy in South Carolina and **American Electric Power** unit **Kentucky Power** will likely complete bond offerings by midyear, followed by power companies in Colorado and New Mexico.

Market participants have taken notice of the growing field of hungry buyers.

"I think there is greater awareness in the market about the sector," said **Stav Gaon,** head of securitized-product research and strategy at **Academy Securities.** "Folks are taking notice, especially as far as the strength of collateral [and] credit-enhancement mechanisms. ... From conversations with investors, we are seeing interest in the space."

The asset managers started buying in force in 2022, but their 2023 buying was also healthy, dovetailing with a healthy supply of new deals. Some of the companies had never purchased utility-fee bonds but became attracted to them due to their fat yields as spreads ballooned in tandem with rising interest rates. Indeed, the aggressive buying has put the asset managers' stockpiles of such bonds on par with that of insurance companies — the asset class' largest investor base.

But unlike insurers, which tend to buy longer-dated paper with maturities often exceeding 10 to 15 years, the asset-management shops prefer bonds with shorter terms. For example, $296.6 million of BlackRock's holdings — the largest subset of its utility-fee bond portfolio — carry maturities of less than one year. Goldman is next with $195.1 million of short-term securities, followed by Wellington at $183.6 million, JPMorgan with $181.8 million and Northern Trust at $146.2 million.

The managers' expansion into the sector has helped lower securitization costs for issuers.

For instance, the triple-A-rated, 8.6-year tranche of Evergy's transaction priced at a spread of 85 bp over the I-curve — 5 bp to 10 bp tight of guidance. In June, a 7.4-year piece of a **CenterPoint Energy** deal with similar ratings priced at a spread of 118 bp over U.S. Treasurys.

And a slice of a $1.3 billion **Dominion Energy** transaction, which consisted of bonds with 5.4-year lives and triple-A ratings, priced on Feb. 5 at 75 bp over Treasurys — 15 bp tighter than initial guidance from bookrunners **Atlas SP Partners,** Citi, **Jefferies, Morgan Stanley, Sumitomo Mitsui Banking Corp.** and **Wells Fargo.** In comparison, **Southern California Edison** in June priced bonds with similar lives and ratings at 125 bp over Treasurys.

That said, spreads for the bonds remain wider than historical levels after blowing out over the course of the past two years along with the rest of the market. Utility-fee bond advocates argue that spreads should be lower due to the fact that the securitizations are immune from payment interruptions because their collateral consists of unavoidable payments tacked on to consumers' monthly utility bills.

Spreads on triple-A-rated utility-fee bonds with 10-year lives are trading on the secondary market at an average spread of 90 bp over Treasurys, according to **Bank of America.** That's wider than the triple-A/double-A corporate index and roughly flat to single-A unsecured debt issued by utilities.

For example, on Feb. 13, unsecured bonds issued by **Entergy** with 9.1-year lives and single-A grades traded on the secondary market at 101 bp over Treasurys, which equates to a yield of 5.3%, according to **Finra's** Trade Reporting and Compliance Engine. In comparison, triple-A-rated 8.5-year unsecured bonds issued by **Apple** traded on Feb. 14 at a spread of 39 bp over Treasurys to yield 4.6%.

"The only reason the government guarantees to enforce a charge on all the utility's electricity sales is to give a fair deal to investors and get the lowest cost for customers," said **Joseph Fichera,** chief executive of **Saber Partners,** which advises public utility commissions on securitization. "Yields close [to] or on top of unsecured utility bonds or complex [asset-backed securities are] great for investors but not fair to customers." ❖

Search Prior Articles In Asset-Backed Alert

You can instantly find out about any issuer or investor or anything else ever mentioned in Asset-Backed Alert by searching the newsletter's archives at:

GreenStreet.com