Securitized Products Special Topics

Gas Securitization: Shorter WAL Alternative to Electric Charge Deals

Utility Fee Gas Sub-Segment Features Some Unique Characteristics

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Utility fee securitizations backed by natural gas charges offer an alternative to deals with electricity fee collateral. The two recovery bond sub-segments share many similarities, especially around their legal structure and credit enhancement mechanisms. But gas and electric charges do have some distinct differences, putting a spotlight on collateral analysis. For example, the securitized gas charges are typically fixed, with mostly residential customer base. In contrast, electric charges would be usage-driven, with growing exposure to commercial and industrial customers.[1] Such differences could have implications for customer base shifts and cashflow stability. Still, both gas and electric securitizations should benefit from true-up adjustments. The adjustments work as nearly unlimited credit enhancement mechanism to outstanding bonds, essentially ensuring their full payment, as we previously discussed.[2]

Recent Developments Accentuate Gas and Electric Charge Differences

We see several recent developments accentuating the differences between gas and electric fee collateral.

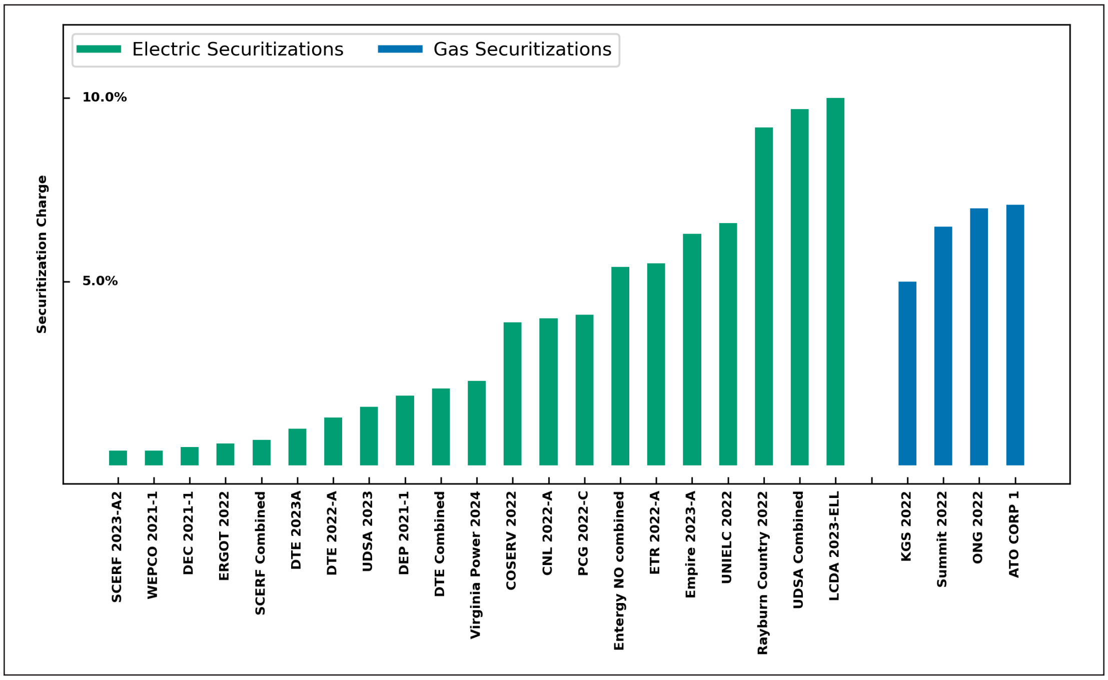
- **Long-term electric payment commitments.** Utility firms are increasingly demanding data centers and other commercial users make long-term commitments to pay for the electricity they request, even if they use less. Examples of electric providers that have put payment commitment structures in place or are about to do so include Duke Energy and American Electric Power (AEP). Specifically, AEP could require new data centers using its Ohio grid to make a 10-year commitment to pay for a minimum of 90% of the electricity they request, even if they use less, according to press reports. Data centers are fast becoming dominant users of electricity across several regions, including AEP's central Ohio region. Such arrangements could bolster electric charges predictability, especially across commercial users prone to usage variability or shifts to other energy sources, as we discussed in previous reports.

1 "Recovery Bonds: Diversifying Exposure Moves Beyond Disasters," Securitized Products Special Topics, Academy Securities, February 7, 2024
2 "Recovery Bonds: Deal Reporting Shows the Potency of True-Up Adjustments," Securitized Products Special Topics, Academy Securities, March 18, 2024

- **Regulatory gas limitations**. Gas collateral appears more susceptible to state and/or federal legislation that limits natural gas usage. Local governments, especially in California, as well as states such as New York, have imposed various restrictions on natural gas usage. Such regulatory risk further supports preference for electric charges, all else being equal. Still, the regulatory risk can vary by state. For example, there could be low likelihood for restrictive measures on gas usage in state such as Oklahoma, supporting gas deals from the states including Summit 2022 or ONG 2022. Other gas deals came from states such as Texas and Kansas. Interestingly, the State of Texas passed legislature that aims to prevent local authorities from restricting customers' energy sources, such as mandating electric power only.

- **Natural disasters and rising utility costs.** Accumulation of electric charges, especially if they are usage-driven, may lead to political backlash on the heels of customer complaints. As firms impose a variety of new fees on their customers, future natural events, and their attendant costs, can present firms with a political or economic challenge to introduce additional fees to recover disaster costs. Issuers may be getting closer to maximizing the viable charges on their customers, with some deals featuring elevated securitization charges as percentage of residential customer bills (Figure 1). In contrast, fixed gas charges should lead to more limited customer resistance. If gas prices increase or consumption flows, the recovery charge becomes a smaller percentage of the overall bill. If prices decrease or consumption ebbs, the overall bill is lower in any event. Most recent gas securitizations featured fixed charges. Some exceptions do exist. The $3.5 billion Texas Natural Gas deal is backed by consumption-based charges, similar to other electric securitizations.

Figure 1. Gas vs Electric Securitization Charges (% of an Average Residential Customer's Bill)

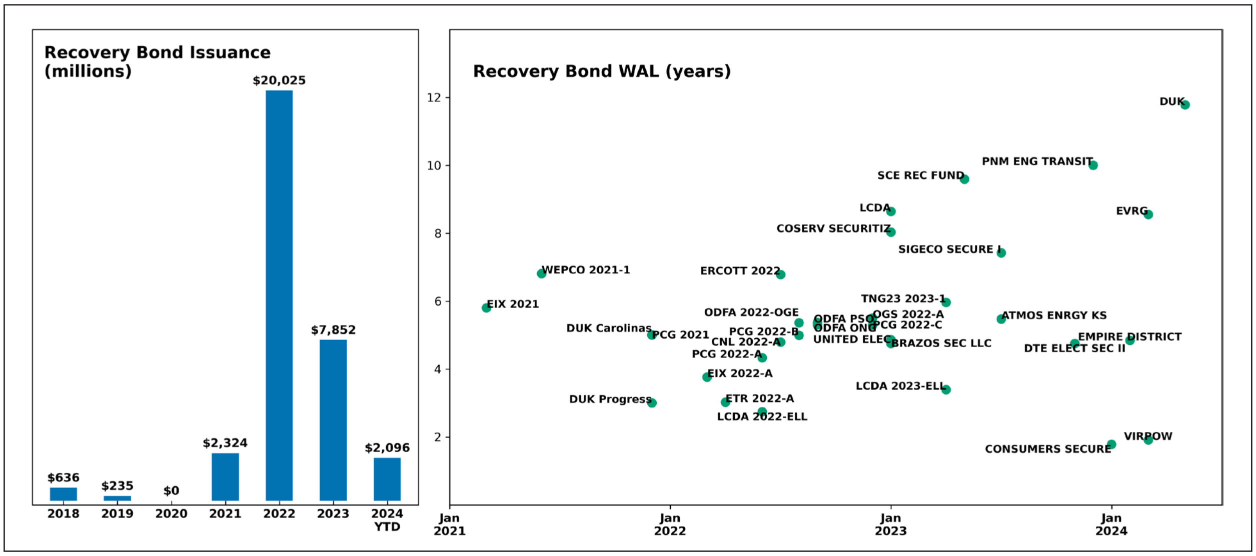


Source: Deal Documents, Ratings Agencies, and Academy Securities

Shorter WAL Bonds

Gas securitizations have been a bit spotty in recent years, compared to electric charge securitizations. But the deals also offered shorter WAL bonds that can become attractive as a wider spectrum of investors takes interest in the recovery bonds segment (Figure 2). For example, the Texas Natural Gas deal and the $1.35 billion ODFA 2022-ONG deals featured 5.9- and 5.3-year classes, respectively. Texas Natural Gas also includes a limited make-whole redemption provision, which could lead to bond repayment on or before April 2026.

Figure 2. Recovery Bonds Issuance and WAL, 2018-2024 YTD



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