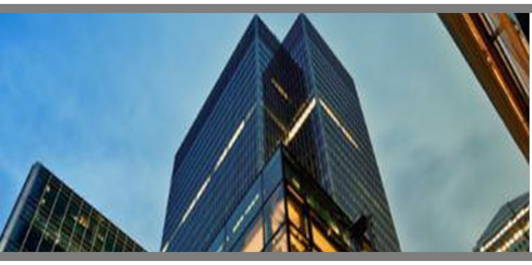
Securitized Products Special Topics

Wildfires: Recovery Bonds Buck California's Legislative Rollercoaster



Robust Ratepayer Securitization Laws Still Sensitive to State-specific Backdrop

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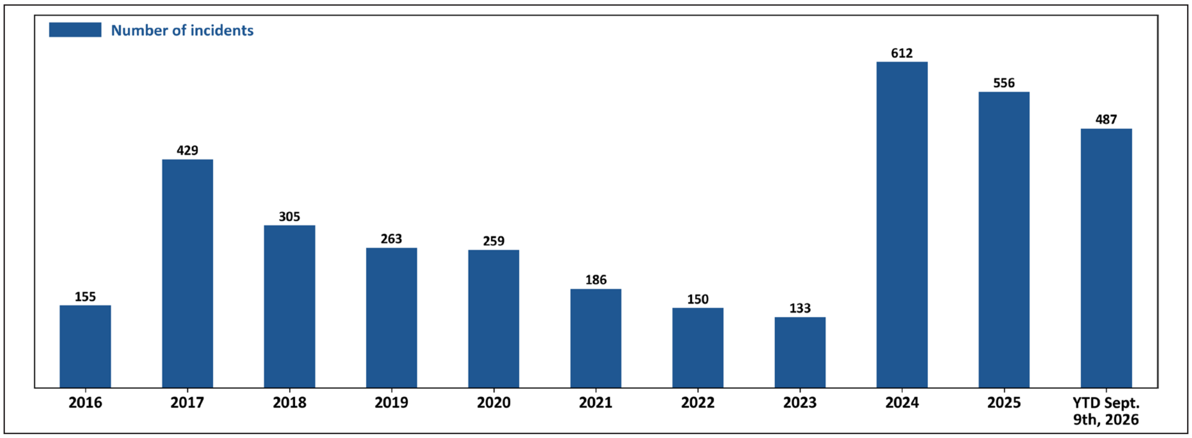
The legislative rollercoaster in California around who pays for wildfire damage underscores the relative robustness of the legal framework underpinning utility recovery bonds. The financial performance, bond spreads, and share prices of investor-owned utilities in California will remain very sensitive to the direction of the wildfire legislation. PG&E and Edison bond spreads widened significantly after the proposed legislation, Senate Bill 492, did not incorporate protections for utilities on wildfire liabilities. The utilities' share prices plunged. The shares recovered just a bit after lawmakers adjourned the other week without voting on the wildfire bill. Both utility shares are still significantly lower following the bill proposal. Further, PG&E announced it is planning to defer about $2 billion investments next year in response to the delays in the wildfire reform.

California's Wildfire Financing Law provisions and the Financing Orders that established the recovery bond issuances of PG&E and Edison's Southern California Edison (SCE) generally are separate from the twists and turns that now characterize the wildfire reform legislation. The state has pledged not to impair the value of the ratepayer charges that back the recovery bonds in deals such as the recently issued $1.95 billion SCE Recovery Funding 2026-A or the earlier $1.42 billion PG&E Recovery Funding 2024-A. The bonds "true-up" mechanism also works to periodically adjust the charges as necessary, in a way that ensures full bond payments.[1] Still, the acute focus in California on wildfire reform suggests that legislation considerations will increasingly play a role in ratepayer securitization issuance and investment decisions, as investors look at recovery bonds across different states.

Figure 1. California Wildfire Incidents



Source: CAL Fire and Academy Securities

1 "Recovery Bonds: Deal Reporting Shows the Potency of True-Up Adjustments," Securitized Products Special Topics, Academy Securities, March 18, 2024

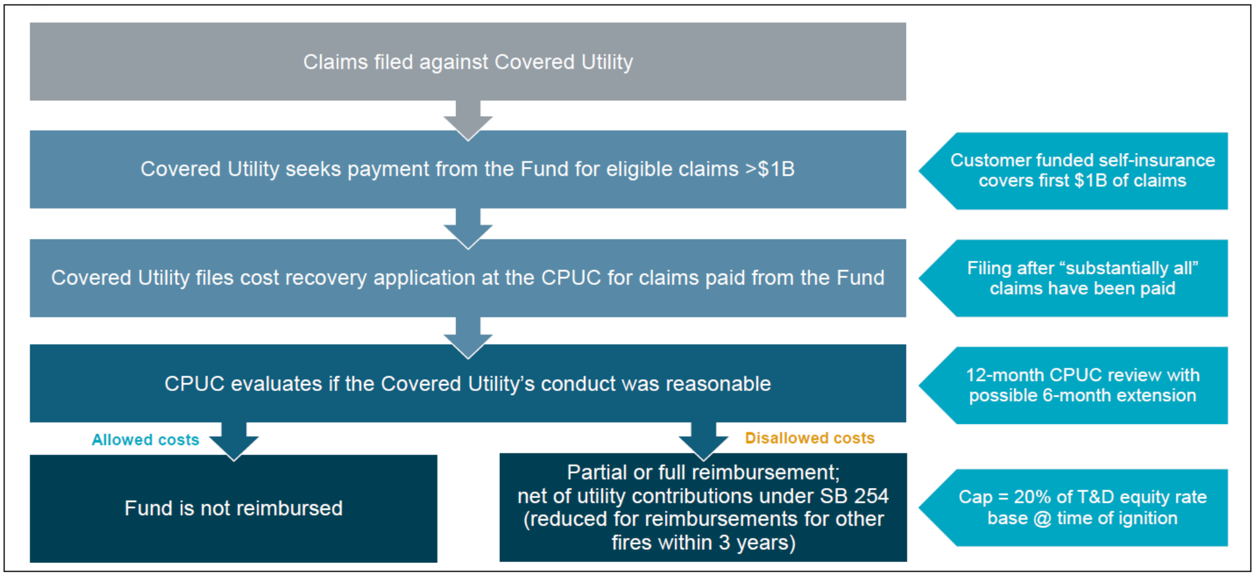
Wildfire Reform Allocates Damage Recovery between Utilities and Insurers

The California wildfire reform seeks to determine, via various mechanisms and cost allocations, who pays for utility-caused wildfire damages. Quite a few stakeholders are involved, including wildfire victims, local governments, and even hedge funds that may trade damage claims. But the situation is mostly about allocating liabilities between utilities and insurance companies, and by extension, the shareholders and clients of each of those groups – ratepayers and policyholders. As such, from a political standpoint, striking the right balance in a reform appears exceptionally tricky. There are tradeoffs to imposing excessive liabilities on either utilities or insurers. Any allocation scheme can have immediate consequences on electricity rate affordability and infrastructure investments, or insurance premium levels and coverage availability.

The way the wildfire reform pans out in legislative sessions down the road probably cannot be fully decoupled from recovery bonds collateral. If the reform does not eliminate or limit insurers' ability to recover damages from utilities (so-called "subrogation rights"), utilities may face financial squeeze or elevated bankruptcy risks.

The fate of California's multi-billion Wildfire Fund is also critical. The state established an initial $21 billion Fund back in 2019 via Assembly Bill 1054. Lawmakers followed on with $18 billion "Continuation Account" addition in 2025 via Senate Bill 254. The Fund can cover damage claims if utilities are found to have acted prudently, thereby alleviating utility wildfire liability burden (Figure 2). Utilities have drawn on the Fund in recent years. There is a possibility that the Fund may be exhausted following the payouts of damage related to the 2025 Eaton fire. The wildfire reform proposals this year contemplated replenishing the Fund.

Figure 2. California Wildfire Fund Mechanics



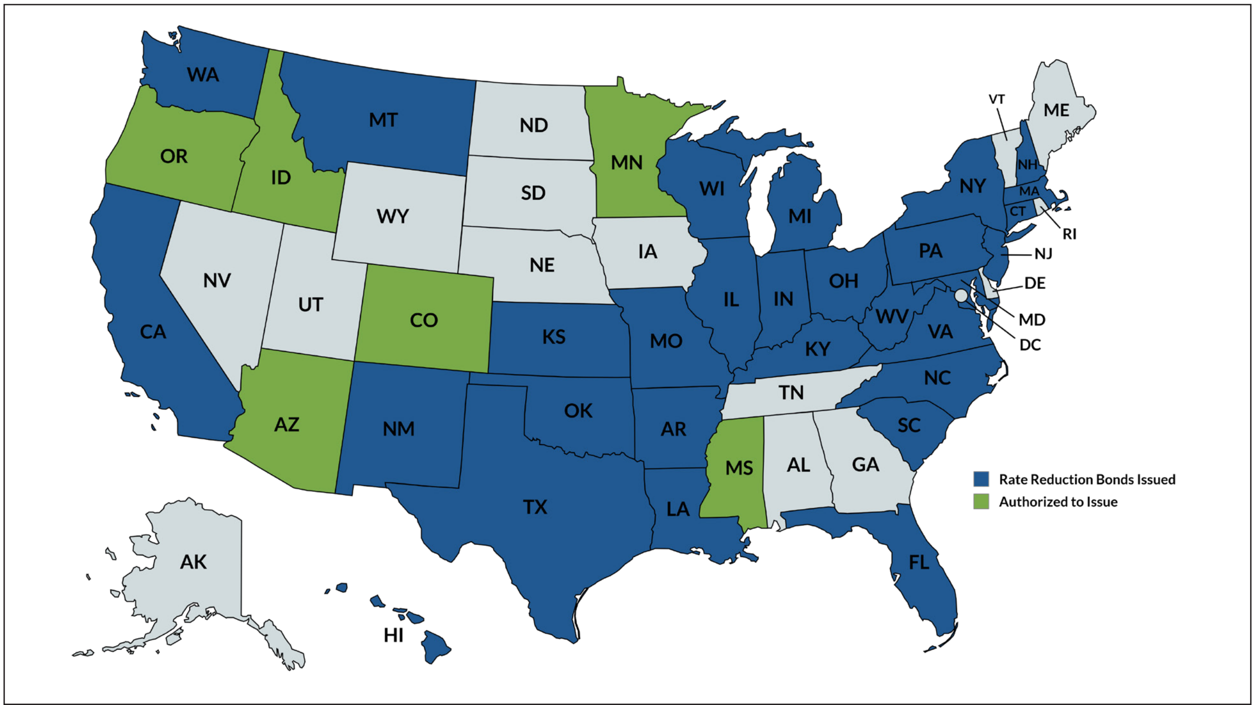
Source: PG&E and Academy Securities
Note: CPUC - California Public Utilities Commission; T&D equity rate base - Transmission and Distribution equity rate base is the dollar value of a utility's physical wires, poles, substations, and related capital investments financed by shareholders, upon which regulators allow the utility to earn a specific return on equity (ROE).

The connection between utility financial performance and recovery bond cashflows is tenuous. Even in distress, utilities may not be able to immediately raise electricity rates, which would trigger higher ratepayer delinquencies, and potential disruptions to the recovery bond collateral. Recovery bonds also weathered previous instances of utility bankruptcies, notably that of PG&E. But just like utility shareholders or corporate bondholders are likely to shift away from California utilities absent reform-driven liability shields, recovery bondholders may also seek ratepayer securitization transactions with less rocky backdrops.

Many States Have Securitization Laws, Very Few Focused on Wildfires

A growing number of states have been adopting ratepayer securitization frameworks (Figure 3). By our latest count, 29 states have already seen ratepayer securitization issuances (colloquially aka recovery bonds or rate reduction bonds, RRB).[2] Six states have authorized RRB issuance via securitization laws, though utilities in the states have not tapped the market yet.

Figure 3. States with Ratepayer Securitization Laws



Source: Deal documents, ratings agencies, and Academy Securities

Securitization laws typically address very specific recovery categories.[3] California is the only state that has seen RRB issuance focused on wildfire recovery. A few other states, such as Hawaii, Oregon, and Washington, have wildfire in the scope of their securitization laws, but have not seen specific wildfire recovery issuance yet. Some wildfire-prone states may also be looking to establish wildfire liability funds, similar to the one California has, based on conversations we had in recent utility regulation conferences.

2 "Utility Rates: Rising Bills Can Bolster RRB Deals," Securitized Products Special Topics, Academy Securities, July 21, 2025

3 "Energy Transition: Expect Broader Definitions in Securitization Laws," Securitized Products Special Topics, Academy Securities, May 22, 2025

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Sports Securitization: Vet League Revenues and Stadium Cashflows

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Music ABS: Pool Variations Emerge Amid Constructive Sector View

Tower ABS: Tenant Preferences Bode Well for Leasing Demand

Aircraft ABS: Momentum Builds for Insurance Booster

Data Centers: Tenant Rosters Poised to Change

Container ABS: Geopolitical Tailwinds as Issuance Picks Up

Gas Securitization: Shorter WAL Alternative to Electric Charge Deals

Net Leases: Scarcity Value as Issuance Poised to Pick Up

Recovery Bonds: Deal Reporting Shows True-Up Adjustments Potency

Data Centers: Performance Wrinkles to Test Operators' Role

Recovery Bonds: Diversifying Exposure Moves Beyond Disasters

Device Payment ABS: Expect Stable Performance as Collateral Evolves

Aircraft ABS: Waterfalls Playing Catch-Up as Fundamentals Recover

Data Centers: Teakeaways from 2023-Vintage Deals

Litigation ABS: Tailwinds in Place for an Uncorrelated Segment

Equipment ABS: Pick Your Spots Amid Diverging Collateral Trends

Commercial Solar ABS: Emergent Segment to Alleviate Headline Risks

Cell Towers: Lender-Friendly Features Dovetail with Secular Tailwinds

Timeshare ABS: Exposure to Favorable Hospitality Segments

Recovery Bonds: No Need to Closely Watch the Fed or the Economy Here

Data Centers: A Strong Segment Juggles ABS and CMBS

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Data Center Campuses: Phase Buildouts to Scatter Investor Exposures

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Payment Priorities: Mobile & Electric Bills Upend Consumer Waterfall

Stranded Assets: Power Plants and Data Centers Performance Intertwine

Infrastructure CLO: Concentrated Exposures in Favored Segments

Fiber ABS: Distinct Sub-segments and Diverse Performance Drivers

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Backup Servicing: Tricolor Spotlights Backup Servicer Temperature

Euro Stadiums: Check Blueprints for Upcoming US Transactions

Data Centers Capex: Mixed Estimates on a Key Cashflow Driver

ARDs: Missing Anticipated Repayment Not Unusual, May Warrant Workout

BBnB: Check Your Booked-But-not-Billed Data Center Exposure

Stadium Finance: Shift to Private Funding Sets Stage for Securitization

Early Terminations: Tenant-friendly Provisions to Move Up Data Center Rollovers

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Investor Non-QM: Pockets of Value as Underwriting Tightens

Multifamily Prepays: Becoming Less Common, as Property Sales Drop

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Agency Floaters: Adjusting Interest Rate Cap Escrows

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Affordable Mortgages: Fee Elimination Spotlights Convexity Profile

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Small Balance Multifamily: Value Ahead of Slow Prepays

Future Funding: Potential Key Performance Driver as CRE CLO Pipeline Builds Up

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Manufactured Housing: Resilient Segment Amid Potential Multifamily Softness

Tender Offers: Expect More to Come, Though Not on a Predictable Schedule

NYC Multifamily: Rent Increases to Support Cashflows Amid Regulatory Restrictions

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Senior Housing: Focus on Segment Selection Amid Pandemic Impact

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Negative ASER: Unexpected Upside for Subordinate Bonds

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Distressed Office: 522 Fifth Avenue Trade Illustrates Office Upside

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Interest Adjustments: Track Shortfalls Repayment and Priority

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Parkmerced: Abundance of Structural Angles to Determine Bond Cashflows

Pro-rata Prepays: Surprise Booster for Subordinate Bonds

PILOT: Check Another Wrinkle of Ground Leases

Non-Trust Debt: Check the Seniority of Your CMBS Collateral

Recovering Shortfalls: Credit IO Value in Distressed Office

Releasing Holdbacks: RENT is Writing Up Bonds

Reserves vs Advances: Servicers Tap Reserves to Lower Advances

Forward Forbearances: One Market Plaza Introduces a Twist to Mods

Loan Assumptions: Watch Waterfalls as New Borrowers Redevelop

Holdbacks: RENT in the Limelight, as Other Cases Brewing

Blanket NRAs: Shutting Down Advances Upends Credit IO Trades

Credit 2024: Workout Nuances Come to the Fore

Recovering the Non-Recoverable: Liquidation Nuance Bolsters Paydowns

Special Servicer Replacements: 1740 Broadway Crystalizes Implications

Crossgates Liquidation: Holdbacks Complicate Severity Projections

WODRA: Bond Cashflows Under Stress in Post-Mod Advance Recovery

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