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North American Project Bond Deal of the Year 2012: NextEra St. Clair

08/03/2013

It is coming up for 10 years since FPL Energy brought the first ever bond financing for wind assets to market. The 2003 FPL Energy American Wind portfolio has sparked few follow-ups, except for a follow-up from the same sponsor.

Now the renamed FPL, NextEra Energy Resources, has closed the first rated bond financing for a Canadian solar project. It has gone through the process of getting ratings agencies comfortable with solar risk because it hopes to bring several follow-ups to market.

The most important structural innovation in NextEras $171.8 million St Clair solar photovoltaic bond financing the incorporation of a degradation reserve looks like becoming market standard on Canadian solar bond financings. Sponsors may, however, try to minimise the use of such enhancements as investors become more comfortable with solar technology.

NextEra had a chance to close a different deal that would have been a market first in its own right. In 2011, US Ex-Im approved a C$184 million loan guarantee to the St Clair projects, with the loan funded with the proceeds of an 18-year bond issue. The structure, however, did not pass muster with the agencies.

St Clair consists of two 20MW plants located in the Ontario township of the same name. The project developer, First Solar, won a 20-year power purchase with the Ontario Power Authority under its Renewable Energy Standard Offer Programme. First Solar used its own thin-film cadmium telluride technology, and was the plants engineering, procurement and construction contractor, bringing them online in February 2012, and to final completion in June 2012.

NextEra financed the acquisition of the plants using an intercompany loan, though it did not wait long before closing the bond financing for the assets. It might have closed the deal long before the bonds September closing, had it not decided to wait for portfolio managers to return from their summer holidays before launching a roadshow.

The 19-year bonds priced at 295bp over the interpolated Government of Canada benchmark for a 4.88% coupon. Lead bookrunner RBC, and agents TD, Scotiabank and CIBC, attracted a 1.5% oversubscription, despite only obtaining one rating, a BBB from DBRS, and the deal featuring gearing of 88%.

As is typical with solar financings, investors had few questions about the amount of sunshine that the plants would receive. These levels are much less variable than those on wind financings, and can be modeled with reasonable confidence. The more pressing worry for agencies and investors was the speed at which the projects solar panels would degrade, and the ability of First Solar to make good on its warranty.

First Solar has been successful in helping its customers close long-dated debt for projects that it develop. It developed last years North American solar award winner, Desert Sunlight, and this years solar award winner, Topaz. But it still faces stiff competition from low-cost Chinese panel manufacturers, and even after ten years of manufacturing, lenders still worry, in the wake of the bankruptcies of several US solar panel makers, whether it will be around long enough to stand behind a promise to long-term debt providers.

NextEra has strong in-house technical due diligence capabilities, and was comfortable with degradation risk. But getting agencies on board involved creating the degradation reserve, in effect a shadow warranty. If the project experiences degradation of over 8% per year the reserve would be available to pay for repairs to panels, and would be replenished with the proceeds of any warranty claim against First Solar.

Offtake risk is minimal. The PPA is priced at C0.42 per kWh, and the OPA is provincially-owned and highly rated (DBRS has it at A (high)). The Ontario renewables programme has attracted large numbers of sponsors, not to mention European banks and life insurance companies.

The sponsor fielded more questions about comparisons with the PPP market than it was familiar with, and spent some time explaining that power projects would not typically feature a covenant package as tight as a PPP bond. But bond buyers are familiar with the provincial counterpartys credit, and this helped the leads broaden the bonds investor base.

NextEra will hope that the follow-ups to the St Clair financing will not have to rely on a degradation reserve, though it appears now to be market standard, and developers ability to close uncovered project bonds will make it easier for outside sponsors and panel suppliers to compete in Ontario.

The US Ex-Im product could well have had its day in Canada. Ontarios feed-in tariff programme requires such a high amount of local content that Ex-Im could guarantee no more than a small proportion of a bond issue.

GE Energy Financial Services and Alterra have mandated Manulife to lead a C$200 million ($201 million) financing for the 50MW First Solar-developed ABW portfolio, the other putative recipient of an Ex-Im guarantee. The sponsors are unlikely to use the proposed guarantee, but have also not yet indicated whether the portfolio will feature a degradation reserve.

St Clair Holding
Status
Closed 21 September 2012
Size
C$194.8 million
Description
Bond financing for 40MW solar photovoltaic power project in St Clair, Ontario
Sponsor
NextEra Energy Resources
Equity
C$23 million
Debt
C$171.8 million
Bookrunner
RBC
Agents
TD, Scotiabank and CIBC
Maturity
2032
Coupon
4.88%
Administrative agent
BNY Trust Company of Canada
Sponsor legal counsel
McCarthy Tetrault (Canadian);
Squire Sanders (US)
Underwriter legal counsel

Stikeman Elliott

Independent engineer and solar resource consultant

Luminate

Insurance adviser

Moore McNeil

Environmental consultant

AMEC