Solar securitizers dance around disruption

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When the Covid-19 pandemic hit the US, the securitization market slammed shut, prompting Vivint Solar to pivot away from a deal that was "on the cusp of closing" to alternative sources of liquidity. But as Vivint put the finishing touches to its Plan B, a window opened up for ABS issuance and other solar securitizers started piling in.

Since its inception in the early 2010s, new issue volumes in the US solar securitization market have grown to roughly $6 billion a year, as rooftop solar installations become more popular and investors acquire a taste for the asset class.

And despite the sun setting on the investment tax credit for residential solar in 2021, the growth of this so-called esoteric ABS asset class remains on an upward trajectory, thanks to state-level mandates, PACE (Property Assessed Clean Energy) programs and the increasing competitiveness of solar panels.

The cost of capital was steadily falling and solar ABS issuance had become almost routine when the onset of the Covid-19 pandemic threw a wrench in the works in late March (2020), not just for Vivint's deal but for offerings of various sizes, both in 144a and private placement format.

In the investment grade bond market more broadly, the pandemic-related uncertainty actually led to record issuance in April and May, as corporations bolstered their cash reserves. But for issuers of asset-backed securities – whether in established asset classes like residential and commercial mortgages or more esoteric areas including solar leases, power purchase agreements and loans – the market suddenly closed.

"Everything ground to a halt in March," says a senior finance official at a solar finance company. "Not necessarily due to fundamental economic conditions, but because the world changed pretty much overnight."

Vivint's plan B

Faced with a market shutdown of indeterminate length, Vivint decided not to wait out the storm but instead to pursue an alternative source of funding late in the first quarter.

"We didn't wait for the market to open, because given where BB- paper was trading in the secondary market, we didn't think we'd get terribly good execution in the public ABS market," says Thomas Plagemann, chief commercial officer and head of capital markets at Vivint Solar. "It was largely a question around timing and wanting incremental liquidity at the company."

The abandoned ABS deal would have refinanced assets held under Vivint's warehouse facility, freeing up capacity there, and injected cash to Vivint's balance sheet. So the company set about trying to achieve the same goals through other means, allowing it to operate without significant liquidity constraints for the next 12 months.

"It will be a little more expensive than what we would have been doing with an ABS, but still a good capital structure for us," said the company's CFO, Dana Russell, during an earnings call on 7 May, by which time the company was close to clinching its alternative non-recourse transaction.

"Sometimes you want your capital now and may not really care about the cost of the funds," says Ron Borod, managing director at Ram Island Strategies, a structured finance advisory firm. "So you may get a higher rate in one-off deals, but get other benefits like fewer covenants or raising more proceeds."

By the end of May, Vivint had obtained the sought-after liquidity through 2 separate transactions – a holding company loan from Brookfield Asset Management's Infrastructure Debt Fund and an expansion of its existing warehouse facility, provided by commercial banks. The 2 deals added $545 million to Vivint's total debt capacity.

The first of the 2 transactions – the brand new $300 million holdco loan from Brookfield – closed on 27 May. The initial $200 million of the loan was funded 2 days later.

The 3-year loan bears interest at 8% and allows for additional borrowings on future contracted cash flows of up to $100 million.

The final structure of the deal was determined in part by the nature of the market recovery after the initial shock caused by the coronavirus pandemic.

"When we got shut out of the ABS market, we weren't sure how long the disruption would last, and particularly the sub-investment grade portions of the ABS market were impacted most severely," explains Plagemann. "The investment-grade tranches have recovered nicely since mid-March, so instead of taking a vertical slice of assets for a term transaction, we pivoted and did a horizontal holdco structure over multiple senior debt facilities."

From Brookfield's point of view, Vivint's sudden lack of access to the capital markets provided a unique opportunity to lend against assets underpinned by a strong customer value proposition, long contracted cash flows and strong underwriting requirements, including high FICO scores.

"We're always looking for good investment opportunities like Vivint, and because they could not tap the securitization market, they considered the private credit market," says Hadley Peer Marshall, Brookfield's managing director and head of infrastructure credit for the Americas. "From our lens, this is a way to support them through providing liquidity above and beyond what they need today in order to continue to grow their business."

Brookfield's prior exposure to residential solar portfolios meant that the firm had in-house knowledge, putting it at an advantage from a timing perspective.

All diligence and documentation was carried out remotely by the Vivint and Brookfield teams, and the deal was done in about 2 months. "Our due diligence is very thorough and they were able to provide detailed information and knew the kinds of questions lenders would have," says Marshall.

"The fact we got it done as smoothly as we did is testament to our ability to access multiple markets, the level of confidence investors have in our assets, and the level of sophistication of the investors we're dealing with," adds Plagemann.

The parties involved in the deal included:

- BofA Securities – sole structurer and arranger (holdco loan)
- Latham & Watkins – borrower counsel
- Mayer Brown – counsel to Brookfield

In the second of the 2 transactions, Vivint topped up its existing multi-lender warehouse facility by $245 million, bringing the total commitments under this line of credit to $570 million. The amendment was signed on 29 May.

The 4-year loan was originally priced at Libor +237.5bp and signed in 2019. With the additional flexibility comes an increase in cost, as the margin has risen to 310bp. The maturity date, advance rate and other commercial terms remain as before.

Despite having been forced to resort to alternative sources of liquidity, Vivint noted that the 2 deals implied an all-in interest rate of about 4.4% on new assets originated, which it says is still about 70bp inside what it paid on its first securitization of 2018.

The $466 million offering in 2018 comprised a $400 million Class A tranche and a $66 million Class B tranche, priced with coupons of 4.73% and 7.37%, respectively.

Vivint's financing strategy has been slightly different to some of its competitors in the residential solar space, in that it has taken less upfront cash. "We haven't fully leveraged all of our assets and that's how we raised the new debt," says Plagemann.

Vivint also recently expanded an existing tax equity partnership by an additional $50 million to fund investments in leases and power purchase agreements.

Choices, choices...

Vivint's deal with Brookfield is emblematic of the wide range of financing options that has become available to residential solar companies in recent years, such that bilateral transactions in the private credit market are sometimes favored over new issuances in the public market, particularly at moments of market volatility.

"There's always a choice between one-off deals and ABS execution, and a lot of times there's something in between which is the private 4(a)(2) market," says Borod. "It's really a function of how does your timeline converge with market forces at the time you want your money."

The more "vanilla" route of issuing solar ABS in the 144a market requires engagement with about 100 investors, going through price discovery and building a book. But residential solar companies have taken to streamlining the time-consuming process by finding the most likely investor and dealing with them 1-on-1.

In turbulent markets, established borrowers with strong lender relationships will have the most financing options, especially given the impact of lock-down measures and travel restrictions on networking face-to-face.

Open window

But as the market recovers, more traditional structures are making a come-back. Several other residential solar companies – Sunnova, Mosaic and Loanpal – sat out the storm in the ABS market, and over the past few weeks have launched a spate of securitizations in the 144a market as confidence returns, boosted by a rally in the stock market.

Although the economic shutdown and rise in unemployment are still weighing on investors' minds – particularly for assets with direct exposure to consumers like residential solar – and pricing is wider than it was before the crisis, deal watchers point out that issuing into imperfect conditions is better than not being able to access the markets at all. "You take it as you find it, and there is a do-it-now mentality," says the official at the solar finance company.

"Cost of funds may be a little bit higher right now, so if someone has the ability to wait for things to settle down, it's worth waiting," adds Borod. "But there is another psychology which is that before things get better, they could get a lot worse – like if there is a second spike in Covid-19. So we could be in a very attractive window right now for someone to go into the ABS market or debt market and get a deal done rather than wait."

Sunnova – which kicked off the solar securitization market for 2020 with a $313.5 million dual-tranche offering in February – is back with a $158.5 million offering led by Credit Suisse.

Meanwhile, Goldman Sachs is lead structuring agent for Loanpal's $161.6 million triple-tranche Mill City Solar Loan 2020-21 transaction.

And Deutsche Bank is leading on a $271.3 million quadruple-tranche deal for Mosaic.

Pricing on the double-B tranche of Mosaic's offering is between 735bp and 750bp over swaps, says a deal watcher, who notes that this is not dissimilar to the cost of capital Vivint secured for its alternative financing with Brookfield.

Hardship plans

On the buy-side, investors are paying more attention than usual to the credit fundamentals of residential solar customers, and Kroll Bond Rating Agency has increased its base case default assumptions for pools of residential solar assets as a result of rising unemployment.

"Solar loan issuers and servicers have begun to offer borrowers temporary financial hardship plans, such as modifications, extensions, or deferrals to their loan payments," the rating agency noted in a report on 12 May.

And while the percentage of borrowers taking advantage of these plans so far is low, Kroll expects the figure to rise.

On the other hand, because of the sheer size and diversity of residential solar portfolios, and the fact that FICO scores of borrowers in residential solar ABS are in the mid-600s and higher, Borod expects the asset class to be protected from wider market risks: "People for the most part will continue to pay their utility bills."

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