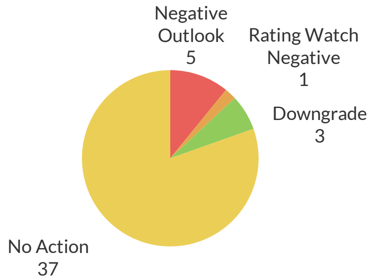
FitchRatings

North American Energy Projects Show Resilience Against Coronavirus Impact

Minimal Actions in Energy Project Ratings



Note: Rating actions in North American energy project finance since March 2020.
Source: Fitch Ratings.

A large majority of monitored credits in Fitch Ratings' portfolio of North American energy projects are investment grade and were affirmed over the past six months. Contractual features and stable operating profiles contributed to the resiliency of these projects and their ability to withstand the near- to medium-term impacts of the coronavirus.

Most credits did not experience any material changes in revenues or operations due to the coronavirus. The few rating actions taken on credits due to the coronavirus were mainly related to counterparty risk or market dynamics accelerated by the coronavirus.

Typical investment-grade credits include 'Stronger' to 'Midrange' attributes under Fitch's key rating driver assessments. These features combined with debt service coverage ratio (DSCR) profiles under Fitch's rating case support the ratings as appropriate to withstand a combination of stresses while maintaining a sufficient financial profile.

Review Demonstrates Limited Volatility

Fitch's review of its portfolio of North American energy projects conducted from March 2020 to August 2020 totaled 46 credits, or 62% of the rated portfolio, showed limited rating volatility due to coronavirus-related issues.

Most Fitch-rated North American energy projects are contracted under long-term power purchase agreements (PPAs) that insulate them from market volatility in price and dispatch risk. This resulted in fully contracted projects being better positioned to weather volatility in loads and wholesale power prices over the past several months.

However, counterparty risk has become a heightened concern, particularly for projects with off-takers in the oil and gas sector, and commercial and industrial customers. Projects with merchant exposure, weak contractual protections or counterparty linkage risk generally experienced higher rating volatility.

The portfolio showed operational resilience, as most projects have flexible operations with the ability to adjust maintenance and personnel schedules to adhere to local health guidelines. Sufficient spare parts availability also moderated the risk of delays in sourcing components for repairs.

Projects that historically maintained a stable operating performance with support from experienced operators were able to sufficiently adapt to new operational procedures in the coronavirus environment.

Applicable Criteria

Thermal Power Project Rating Criteria (May 2020)
Infrastructure and Project Finance Rating Criteria (March 2020)
Renewable Energy Project Rating Criteria (March 2020)

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Construction Risk

Limited Delays with Sufficient Timing Buffer

Rated projects under construction experienced limited impact from the coronavirus. Delays experienced were mainly due to equipment procurement or on-site personnel adjustments. For example, components sourced from China were delayed, but sufficient buffer existed in schedules to withstand the delays. The projects were also in advanced stages, with major works completed, limiting the dependence on equipment receipt for continued progress. The construction schedule allowed for continuation of critical work through personnel and schedule shifting to meet the required commercial operation dates as stipulated in the contracts.

Operation Risk

Flexible Operations Supported by Experienced Operators

Project operators adjusted personnel and work schedules to adhere to local health guidelines resulting from the coronavirus. These adjustments had limited operational impacts, as many projects had flexible operations, with renewable projects in particular benefiting from the ability to operate remotely. Some projects postponed elective maintenance activities and improvements due to the uncertainty over longer term impacts of the coronavirus. These delays did not affect operational performance.

Investment-grade projects are generally operated with experienced providers or self-operated by issuers with demonstrated experience and operating history. This allowed the project operations flexibility to adjust personnel and maintenance schedules without affecting expected performance.

Force Majeure Notices Impact Minimal

Some operators sent force majeure notices, mainly to notify the project about potential delays resulting from the coronavirus. However, few projects experienced material disruptions or actionable events after the notices. The few actionable events were related to operators seeking relief from guaranteed production shortfall payments associated with maintenance agreements. The shortfall payments were temporary and did not have a material impact on cash flows or expectations on long-term project performance. The relief notices were substantiated by the coronavirus-related delays in receipt of necessary components for repairs.

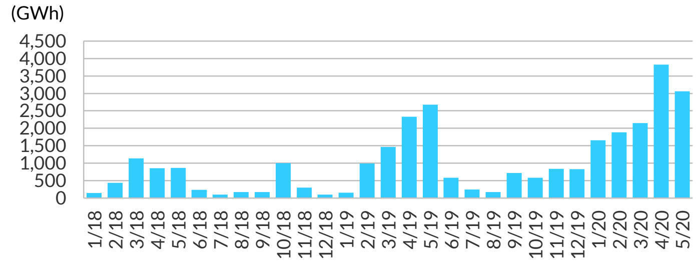
Overall, rated projects experienced no noticeable downtime or material disruptions in operations resulting from the coronavirus. Operators have been able to maintain the projects within expected levels and have sufficient spare parts available to absorb delays in noncritical maintenance needs.

Revenue Risk

Contractual Protections Against Dispatch and Price Risk

Projects contracted under long-term PPAs benefited from protections against dispatch and price risk that affected the power markets. Lower energy demand did not have a material impact on contracted projects, as some PPAs included provisions for reimbursements resulting from non-emergency curtailments. Contracted projects continued to receive payments based on actual generation during the period.

Renewable Curtailments Spiked in Spring 2020

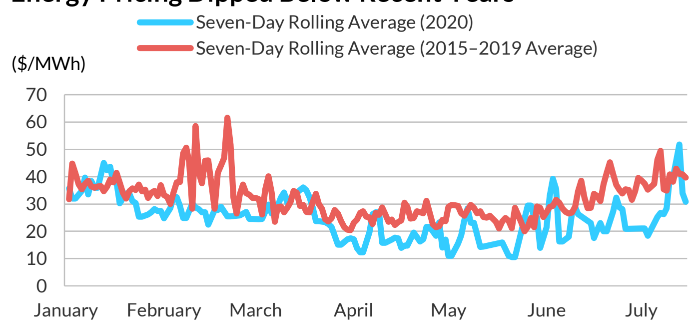


GWh – Gigawatt-hour. Note: California Independent System Operator (CAISO) monthly wind and solar curtailments.
Source: CAISO.

The price terms of PPAs insulate projects from fluctuations in wholesale market prices while projects with merchant exposure experienced some cash flow erosion due to declining wholesale power prices and more conservative forward-looking price curves. Merchant impact was limited to a few projects, but those deals were structured with higher DSCRs during the merchant period to absorb these types of price shocks. As merchant price forecasts are updated to reflect long-term price expectations, these projects may experience an erosion of their coverage profile.

Projects with higher coverage cushions or robust structural protections are better positioned to weather lower price forecasts with no material impact to their rating.

Energy Pricing Dipped Below Recent Years



Note: California Independent System Operator (CAISO) SP15 peak prices.
Source: U.S. Energy Information Administration.

Counterparty Credit Quality a Growing Concern

Projects contracted with a single or few off-takers are exposed to counterparty linkage risk with erosion of the counterparty credit quality potentially materially affecting the project rating. This raises the risk the off-taker may have reduced ability to honor the revenue contract through the debt term, potentially exposing the project to uncompensated contract-termination risk. This was a main driver of the few negative rating actions taken over the past six months.

Some projects also received force majeure notices, where the off-takers could potentially seek relief from making payments due to the coronavirus. However, no project reported any action being taken from the notices.

Overall, contracted projects generally did not experience material disruptions in revenues or shortfalls in payments for services delivered to off-takers under the PPA terms.

Few Coronavirus-Related Rating Actions

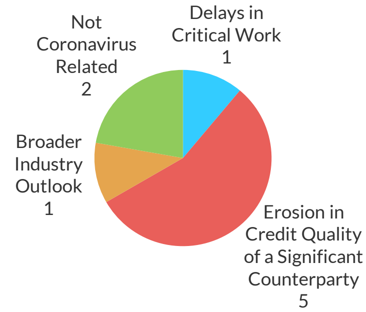
Downward rating actions have thus far been limited to those related to counterparty risk and market fluctuations that were accelerated due to the coronavirus. Of the 46 total ratings reviewed from March through August 2020, nine credits experienced negative rating actions.

Five downgrades were related solely to counterparty actions, one downgrade was due to delays in critical work to improve lower than expected performance and one downgrade was due to market dynamics attributed to the coronavirus — specifically, heightened weakness in the oil and gas sector contributed to rating actions for credits exposed to a combination of weak revenue counterparties and merchant price assumptions. The remaining two downgrades were due to other events not attributed to the coronavirus.

Fitch continues to monitor the portfolio amid the ongoing pandemic. Close attention will be paid to further deterioration of counterparty credit quality, maintenance activities and credits with merchant exposure, which are potentially more sensitive to impacts from a second wave.

Overall power project ratings demonstrated resilience to the coronavirus, which is mainly attributed to the contracted nature of the assets. Operational flexibility provided further mitigation and allowed projects to maintain sufficient performance while adhering to local health guidelines. The 'Midrange' to 'Stronger' key rating driver attributes and maintenance of coverage profiles within Fitch's coverage thresholds further supported the resiliency of power projects in the coronavirus environment.

Rating Action Reasons



Source: Fitch Ratings.