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Research Update:

Spanish Solar Project Vela Energy Bonds 'BBB' Rating Affirmed Despite Regulatory Uncertainties; Outlook Stable

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Overview

- Luxembourg-based limited-purpose entity Vela Energy Finance S.A., which comprises 35 solar photovoltaic operating companies, achieved an aggregate real production level of 5% above our base-case estimations in 2017 a trend that began in 2016. Most of the parks also reported higher availability levels than the 98.5% we expected.
- Following the recent changes in the Spanish government, remuneration in the renewable sector remains uncertain. However, we consider that the transaction has some cushion and can absorb lower remuneration on its assets than currently reflected in our base case.
- We are therefore affirming our 'BBB' long-term issue rating on the bonds.
- The stable outlook on the rating reflects our expectation that the project will maintain strong debt service coverage ratios sustainably above 1.2x, thanks to high availability levels, the effective management of operations by an experienced operator, and limited major maintenance risk.

Rating Action

On June 22, 2018, S&P Global Ratings affirmed its 'BBB' long-term issue credit ratings on the bonds issued by Luxembourg-based limited-purpose entity Vela Energy Finance S.A. (the issuer). Specifically, it affirmed the ratings on the class A1 bond (principal amount €310.4 million), class A2 bond (principal amount €66.0 million), and class A3 bond (principal amount €28.0 million). The total issuance was €404.4 million and the notes have the same seniority and are due to mature in June 2036. The bonds have a coupon of 3.195%, which is paid semiannually, on June 30 and Dec. 31, from Jan. 2, 2017. The outlook on the ratings is stable.

Vela Energy Finance lent the proceeds of the bonds to Vela Energy Equityco SL under an on-loan agreement. The proceeds were then lent on by Vela Energy Equityco SL to the 35 special-purpose vehicles (ProjectCos) that own the solar photovoltaic parks.

Rationale

We affirmed the ratings following our review of the performance of the assets underpinning the Vela Energy Finance S.A. (Vela Energy) transaction. Vela Energy comprises 35 solar photovoltaic operating companies (the ProjectCos) that achieved an aggregate real production level of 5% above the level we estimated in our base-case scenario for the first half of 2017 and 6% for the second half of 2017.

In 2017, all but seven of the 35 solar panel parks reported higher availability levels for the first half of 2017 than the 98.5% we assumed in our base-case scenario. In the second half of the year, only one park reported availability levels below our 98.5% forecast because of recurring interruptions linked to the theft of copper cable. However, insurance covered the loss of revenue and cost of replacing materials, so the thefts had not financial impact on the project.

Despite the current uncertainties relating to the remuneration for renewable assets, following the recent changes in the Spanish government, we consider that the assets' solid operational performance, combined with strong cash-flow generation, gives the transaction sufficient cushion to absorb lower remuneration on its assets than is currently reflected in our base case. We understand that the rate of return that currently underpins the remuneration of the assets may be reviewed in 2019--the revised remuneration would come into effect in 2020. Given the current low interest rates, it is reasonable to expect a decline in the current level of remuneration.

The project benefits from a maintenance reserve account (MRA), which funds maintenance works and the replacement of inverters and modules. On the issue date, an initial amount of €2.1 million was credited to the MRA. The required amount could be reduced, subject to several technical tests on the solar panels in all the solar parks, such as 100% visual, 33% thermographic inspections, and 5% IV-curve tests.
Between 2016 and 2017, most of the photovoltaic plants (81% of the modules) were inspected to verify the state of the portfolio's modules and to identify defects that could affect the power output or safety of the modules. Based on the results, the independent technical advisor recommended setting aside €1.3 million to repair the affected modules. Subsequently, in January 2018, the project distributed the surplus €800,000 under the MRA. The affected modules will be remediated in the next two years--we do not expect to see a detrimental effect on the plants' operations during this time.

Our 'BBB' rating reflects:

- A supportive regulatory framework, under which around 80%-85% of total revenues are remunerated based on a predetermined regulated return, rather than being exposed to electricity price fluctuations--this results in a low exposure to market risk;
- The solid track record of the technology deployed, which has been in use

for over 30 years and has relatively simple routine maintenance requirements, managed by experienced operator Vela Energy SL;

- Low market risk, including a regulatory mechanism implemented to guarantee a reasonable rate of return and removing practically all the risk of pool price variations;
- Strong financial performance, reflecting the portfolio's level of energy output in megawatt hours;
- If equivalent working hours at any solar park fall to a level 15% above the minimum equivalent working hours, a lock-up could be triggered if corrective measures are not implemented; and
- A minimum debt service coverage ratio (DSCR) of 1.25x under our base case, an average DSCR of 1.47x, and robust performance under our downside scenario.

We have maintained our base-case and downside assumptions. These may be subject to review once we gain more clarity on the potential changes to the regulated return. We expect the transaction to maintain debt service coverage ratios commensurate with the current rating unless the regulated return drops materially below 5% over the life of the transactions.

Base-case assumptions

- Generation: An electricity production amount exceeding 90% when assessed statistically over a one-year period (P90 one year).
- Availability: 98.5%.
- Reasonable rate of return: 7.398% for the whole of the transaction's life.
- Degradation: 1.3% per year.
- Operations and maintenance (O&M) expenses: +10% on the original contract for 2016-2023, followed by +20% for 2023-2030; and a 30% increase until maturity.
- Inflation: 1.4% for 2018; 1.5% for 2019; 1.6% for 2020; 1.8% for 2021-2030 and 1.9% thereafter, in line with our global macroeconomic assumptions.
- Useful life of the modules: 30 years since the commercial operation date (COD).
- Inverter costs: We assume a cost to replace the inverter of €11.4 million every 10 years (in 2019 and then in 2029), distributed as payments of €1.425 million every six months for the first four years. This is in addition to the assumption on O&M costs describe above.

Downside Assumptions

- Generation: An electricity production amount exceeding 99% when assessed statistically over a one-year period (P99 one year).
- Availability: 92%.

- Reasonable rate of return: 7.398% up to 2020, followed by 6% for the second (years) and third (years) regulatory periods.
- Inflation: +1% from S&P Global Ratings' base-case assumptions for the first five years, followed by our base-case assumptions.
- O&M expenses: 20% higher than our base case.
- Useful life of the modules: 30 years from the COD.
- Inverter costs: same as base case.

Liquidity

Our liquidity assessment is neutral, based on the presence of a debt service reserve account equivalent to 50% of the following two semiannual payments.

The project also benefits from an MRA to fund maintenance works and the replacement of inverters and modules. Furthermore, if the DSRA and MRA are not at the required level, there is no distribution to the subordinated noteholders.

Outlook

The stable outlook reflects our expectation that the project will maintain strong DSCRs sustainably above 1.2x, thanks to high availability levels, the effective management of operations by an experienced operator, and limited major maintenance risk.

Downside scenario

We could lower the ratings on the bonds if the minimum DSCRs under our base case were to drop materially below 1.2x. This could happen if, for instance, the reasonable rate of return in 2020 dropped materially below 5%. A downgrade could also follow unexpected and far-reaching adverse regulatory changes causing us to revise our base-case and downside-case assumptions, although we view such changes as highly unlikely in light of the recent sector reform and the fact that the current regulatory period runs to Dec. 31, 2019.

Furthermore, we could lower the rating on the notes if we lowered the rating on the bank account provider (CaixaBank) below the current rating on the project, given the direct exposure the project has to this counterparty.

Upside scenario

We see limited upside at this stage. However we would consider raising the rating on the notes if the project demonstrates that it can sustain DSCRs above 1.4x, for instance, due to higher-than-expected efficiency.

Ratings Score Snapshot

Operations Phase SACP (Senior Debt)

Operations Phase Business Assessment (1=best to 12=worst): 4

- Preliminary SACP: bbb-
- Downside Impact on Prelim SACP: +1 notch
- Capital Structure and Avg. DSCR Impact on Prelim SACP: Neutral
- Liquidity: Neutral
- Operations Phase SACP precounterparty limitation: bbb
- Counterparty Assessment Limitation: bbb+
- Operations Phase SACP: bbb

Modifiers (Senior Debt)

- Parent Linkage: Delinked
- Structural Protection: Neutral
- Senior Debt Issue Rating: 'BBB'

Related Criteria

- Criteria - Corporates - Project Finance: Key Credit Factors For Power Project Financings, Sept. 16, 2014
- Criteria - Corporates - Project Finance: Project Finance Operations Methodology, Sept. 16, 2014
- Criteria - Corporates - Project Finance: Project Finance Transaction Structure Methodology, Sept. 16, 2014
- Criteria - Corporates - Project Finance: Project Finance Framework Methodology, Sept. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Structured Finance - General: Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- Criteria - Corporates - Project Finance: Project Finance Construction And Operations Counterparty Methodology, Dec. 20, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Vela Energy Finance S.A., Oct. 5, 2016

Ratings List

Ratings Affirmed

Vela Energy Finance S.A.	
Senior Secured	BBB/Stable

Additional Contact:
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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