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NYT: Bonds Backed by Solar Power Payments Get Nod.

Over the decades, Wall Street has used many assets to back up the bonds it sells, including car loans, life insurance policies and future royalties on David Bowie's music. Now, in a milestone of sorts for the emerging solar industry, the finance wizards are embracing a new kind of security, this one backed by solar electricity payments.

Standard & Poor's has given its preliminary blessing to the first offering of this kind, rating a set of notes intended to raise $54.4 million for the fast-growing installation company SolarCity. On Monday, it gave a rating of BBB+, a low investment-grade designation, to the notes. SolarCity plans to sell the bonds, which are secured by a bundle of residential and commercial power contracts, privately this month.

The bonds are expected to have a yield of around 4.8 percent, which, in a time of low interest rates, is a relatively high rate that compensates investors for buying such an untested security. The offering is also relatively small and will be sold only to select institutional investors.

Many of the power contracts are with individual residences and businesses, which have increasingly turned to leasing solar systems to avoid the upfront costs. Under those terms, SolarCity pays for installing and maintaining the system in return for monthly payments for the electricity generated.

The deal will help finance the rapid expansion of SolarCity, which has become a leading installer of solar systems in the United States. It recently raised nearly $400 million through offerings of stocks and bonds, and bought a rival installer and a supplier of mounting equipment. It has signed up more than 82,000 customers so far, and expects to almost double the amount of solar capacity it installed this year in 2014. SolarCity declined to comment on the new security.

But the offering, which will be managed by Credit Suisse, is also an important validation for the solar industry, which has relied heavily on complex and esoteric tax equity investments and has struggled to tap the vast pools of cheaper capital available in the public markets.

The industry's need for new sources of financing has gained urgency recently with the federal tax credit for solar energy projects set to drop to 10 percent from 30 percent at the end of 2016, said Andrew Giudici, a senior director at Kroll Bond Ratings.

"Actually getting the first deal done will hopefully open up different outlets for other developers as well," he said. Analysts say other solar companies are exploring similar bond offerings.

Solar executives, bankers and analysts have been talking for years about selling bonds guaranteed by solar electricity contracts. In theory, they offer steady and reliable income. SolarCity, for instance, signs up customers with good credit histories to contracts that generally last 20 years and, even when under economic strain, people tend to pay their electricity bills.

But in practice, such bonds have been a challenge to pull off. Electric utilities have issued bonds backed by certain tariffs charged to customers, and in 2010 SunPower, a manufacturer of solar energy systems, issued bonds tied to an Italian solar farm.

The SolarCity deal is different, analysts said, and could show how much of a market exists for the asset class. Although rooftop installations have boomed in recent years, the contractual arrangements are relatively new and can vary from company to company and state to state. That means they often lack the performance history and standardized terms considered necessary for securitization, the process of bundling many loans into one investment.

“You’re looking at, from most of the proposals we’ve seen, 10-, 15-year bonds,” said Michael Dean, a managing director at Fitch Ratings. “Two years of history, three years of history doesn’t cut it for us.”

In addition, because the technology is evolving rapidly, there is the risk that more attractive systems will emerge over the life of a contract, or that utility rates will drop. Solar installers have used the fact that they can offer electricity to customers at a lower price than conventional utility rates as a big selling point. Without that, customers might seek to renegotiate their terms or abandon the systems.

Mr. Dean said utilities have had low default rates among customers because “they can turn your electricity off if you don’t pay.” But the solar companies “don’t have that same hammer,” he added, because the customers are still connected to the grid and can turn back to the utility for lost power if the solar company repossesses its equipment.

Other risks stem from the fact that the companies making, installing and maintaining the solar equipment are young and have tended to go out of business, raising questions about how to guarantee long-term performance.

SolarCity has addressed some of these risks by shortening the term for the bonds to 13 years, said Benjamin Shih, an analyst at Moody’s. “Once you start shortening the time horizon, then it’s less likely that the utility rates will change drastically,” he said, or that the equipment would become obsolete.

S.&P. analysts recognized these risks in a preliminary rating report, as well as the uncertainty surrounding the fate of the tax credits, mandates and other incentives that help solar energy compete with fossil fuels. They also identified several benefits and mitigating factors, like the inclusion of extra collateral and a special reserve account to cover equipment failures.

“Because this asset class has a limited operating history, we expect the rating to be constrained to low investment-grade for the near future,” the analysts wrote, predicting that the market would continue to grow rapidly.