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California's Fix for Utility Crisis Depends on Munis, Again.

- **Municipal bonds key part of plan to prop up electric companies**
- **California sold munis in solution for earlier energy crisis**

While California's wildfire liability crisis can be seen clearly through the stock gyrations of the state's largest investor-owned electric utilities, it's the stolid municipal-bond market that stands to solve it. And it would be the second time that it's come to the aid of California.

A centerpiece of Governor Gavin Newsom's sweeping plan to help the companies cover the mounting costs from wildfires that their equipment keeps igniting is a fund seeded with $10.5 billion in municipal revenue bonds. The fund may expand from being used as a line of credit to a $21 billion insurance pool should the companies agree to make contributions.

Tapping municipal-bond investors is how California paid for its efforts to end rolling blackouts during the 2000-2001 energy crisis, sparked by a botched deregulation of electricity markets. It's also how Florida stopped insurers from leaving the state after Hurricane Andrew devastated coastal communities in 1992. Given the appetite for municipal bonds — a mainstay of retirement accounts that for the most part fails to draw headline-making trades — the strategy is likely to prove an effective one for the state when it's ready to sell the bonds.

"California taxpayers' thirst for supply right now is insatiable. The marketplace would be able to absorb it with no issues whatsoever," said David Alter, head of municipal bond research at Goldman Sachs Asset Management. "I don't think they'll do all $10.5 billion all at once, but in this environment, that wouldn't be a problem either, frankly."

Legislation passed Thursday seeks to address a multi-billion dollar problem that helped push the state's biggest utility, PG&E Corp., into bankruptcy in January: Wildfires are increasing in number and severity. And an unusual California doctrine holds utilities liable for wildfires that their equipment sparks, even if they aren't proven negligent, leaving officials worried about the reliability of power in the most-populous U.S. state. Just weeks into the fire season, utility lines are already sparking blazes.

Newsom's plan helps investor-owned utilities pay for future wildfire damages by setting up — at the minimum — a $10.5 billion fund to act as a line of credit. The state's Department of Water Resources would issue one or more series of the debt. It would be backed by extending a charge customers are already seeing on their bills from the $11.2 billion in bonds the state sold starting in 2002. That issuance reimbursed California from buying electricity for insolvent utilities hobbled by rising prices and manipulation by Enron Corp. and other companies in the deregulated market.

(Corporate bond investors may get a cut of the action if a utility that draws down on the line of credit gets permission to sell so-called recovery bonds. These deals would be backed by a different charge on ratepayers.)

Enough Yield

The bill explicitly notes that neither the faith and credit nor the taxing power of the state of California would be pledged to cover debt payments. While details have yet to be fleshed out, the legislation calls for investment-grade ratings.

Separately, PG&E is pushing lawmakers for legislation that would authorize a state entity to issue about $10 billion in tax-exempt bonds, with about $7 billion of the proceeds set aside for a $14 billion fund for claims from past wildfire victims. Another $3 billion would be earmarked for PG&E's contributions to the statewide fund, according to people familiar with the matter.

The tax-exempt status would allow more capital to be raised more quickly, with the debt being securitized by diverting a portion of the company's earnings over the life of the bonds, the people said.

While the municipal market is different today than it was 20 years ago, one aspect is still true: Californians flock to tax-free income because of the state's high taxes on the wealthy. A 2002 sale of the bonds saw good demand, according to Bloomberg reports at the time. It's accentuated now because of the low supply of bonds, due to a variety of reasons, including the federal tax overhaul that also resulted in a cap of state and local deductions. Yields on bonds issued by the state and many local governments are in line or below those for top-rated debt.

Craig Brothers, a senior portfolio manager at Bel Air Investment Advisors in Los Angeles, said the fact that the issuance is to cover wildfire costs may give investors pause. Fires are an annual occurrence, while East Coast governments have issued bonds after hurricanes, discrete natural disasters, he said.

Still, he said, any debt, particularly those issued now in California, could draw buyers with enough compensation. "If they give enough yield, that may cause people to overlook the flaws of the concept," Brothers said. "They can probably tempt people to overlook strict credit analysis with yield."

Bloomberg Business

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July 11, 2019, 11:51 AM PDT

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