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Moody's Comments on PREPA's Restructuring Proposal.

New York, August 06, 2015 — Moody's Investors Service has reviewed the new restructuring proposal filed by the Puerto Rico Electric Power Authority (PREPA; Caa3 negative), which states that non-forbearing bondholders would recover 65%-70% of the original legal promise in cash, depending on maturity, and which makes default a virtual certainty. The EMMA filing also includes alternative plans filed by PREPA, a bondholder group, and a bond insurers' group.

Although bondholder recoveries are volatile and hard to predict, recovery expectations play a large role in Moody's PREPA ratings, and the proposal's overall recovery rates are in line with Moody's expectations at PREPA's current Caa3 rating, which incorporate a recovery range of 65%-80%. Moody's outlines the proposal for the different bondholders in the new report, "Moody's Comments on PREPA's Restructuring Proposal."

In contrast to non-forbearing bondholders, forbearing bondholders would receive an exchange offer, nominally at par. However, these bondholders could still incur substantial losses because the original promise to pay cash would be replaced with a new security that defers interest and principal and would be subject to the risk that it will not be paid.

PREPA's forbearing bondholders, which comprise both insured and uninsured bondholders, hold just over 66% of the authority's $8.1 billion bonds; the uninsured non-forbearing bondholders hold the remainder.

"For the forbearing bondholders, our analysis suggests a mid-range recovery rate of 67%, based on a discount rate of 7.5%" says Rick Donner, a Moody's Vice President — Senior Credit Officer. "But regardless of the discount rate, we doubt the recovery rate for the forbearing bondholders would be any worse than the 65%-70% cash offer being presented to the non-forbearing bondholders."

Under PREPA's plan, the insured legacy bonds would be excluded from any transactions and would remain unchanged. However, the bond insurers could still incur economic losses, as they are being asked to provide a new wrap for up to $1.3 billion with zero compensation, even as they continue to carry the risk associated with the current insurance.

Finally, all of the publicly disclosed proposals, including PREPA's, call for deferring debt service for at least five years, to fund capital expenditures.

If a restructuring agreement can be reached, a default in the form of a distressed exchange sometime in the next few months is the most likely outcome. The broad consistency of the proposals and counter-proposals indicates ongoing progress, but substantive creditor issues could very well preclude a deal. And even if PREPA can reach an agreement with its creditors, the execution risk will be substantial, particularly in light of the island's weak economic conditions.

The report is available to subscribers here.