

# **Bond Case Briefs**

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## **Moody's: PREPA's Planned Utility Charge Bonds Would Be Similar to Others in the Sector.**

New York, October 22, 2015 — Puerto Rico Electric Power Authority's (PREPA; Caa3 negative) anticipated issuance of new securitization bonds would carry risks that are typical of utility cost recovery charge (UCRC) bonds that we rate, such as legislative risk, servicing risk, customer payment delay and default risk as well as event risk stemming from severe weather conditions, Moody's Investors Service says in a new report which outlines how those risks might present themselves in the specific circumstances of PREPA and Puerto Rico.

The planned issuance of the UCRC bonds via a debt exchange with PREPA's uninsured power revenue bondholders is part of the utility's restructuring plan, calling for these bondholders to swap their bonds for new debt at a discount, as described in PREPA's "Ad Hoc Group Exchange Term Sheet" publicly disclosed on September 1st.

UCRC bonds are backed by surcharges on customer's utility bills. Securitization issuance is predicated on passage of state legislation that authorizes and protects these surcharges, according to the Moody's report, "Key Considerations of PREPA's Planned Utility Charge Bonds Would Be Similar to Those of Other Deals in the Sector."

"We view the risk of a legislative body changing or revoking utility charge legislation to the detriment of bondholders as remote in the outstanding UCRC securitizations that we rate, because a breach of the state non-impairment pledge would be a violation of the Contract Clause and the Takings Clause under the US Constitution and state constitutions," says Moody's Vice President — Senior Analyst Tracy Rice. "There is a risk in this type of deal that the authorizing legislation could be subject to a court challenge or to future political pressure for a jurisdiction to pass new laws that would rescind or revamp the charges. In assessing the credit risk of PREPA's planned securitization, we would consider the previous positions taken by the Puerto Rican government."

While the full details of a potential PREPA UCRC transaction are not yet available, Moody's expects PREPA would be the servicer, responsible, among other things, for billing and collecting customer utility payments and segregating the securitization charge payments. The financial stability, ability and experience of the transaction servicer are key considerations in Moody's credit analysis of UCRC securitizations.

"Although PREPA is the sole provider of electricity in Puerto Rico and provides an essential service, the quality of its servicing could deteriorate while the UCRC bonds are outstanding if PREPA's financial condition does not improve or weakens, " says Moody's Rice. "However, we believe that a UCRC securitization would help PREPA achieve longer-term financial stability."

By deferring and/or lowering its debt service through the securitization, the utility would be in a better position to cover its capital expenditures, which PREPA could use to help convert its largely oil-fired generation fleet of power plants to lower-cost and cleaner natural gas-fired plants, which would help PREPA save money and achieve longer-term financial stability, according to the Moody's

report.

The ability of a utility's customers to pay the special charges, allowing for collections to be sufficient to meet the debt service requirements on the bonds, is another key consideration in UCRC securitizations. However, true-up mechanisms in UCRC transactions, which are written into the authoring legislation, adjust for all shortfalls, including those that result from customer payment delays and defaults.

"PREPA has many late-paying customers, including its largest customer, the Puerto Rican government, so this could be a concern, but one that a true up mechanism could mitigate," says Moody's Rice.

In Moody's credit analysis of UCRC transactions, it also analyzes the exposure of the utility's service area to severe weather-related events that could lead to a decline in energy usage and therefore cash flow to the deal. True-up adjustments in the transactions are designed to address any material deviations between the securitization charge collections and the required debt service amount.

Puerto Rico has significant exposure to weather-related event risk such as that stemming from a severe hurricane of the magnitude of previous storms in the region such as Hurricane Irene in 2011. "One mitigant to this risk is that PREPA has taken steps to put a significant portion of its wires underground, especially on the north side of the island," according to Moody's Rice.

The report is available to Moody's subscribers [here](#).