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Puerto Rico Electric Needs Insurers on Board by Thursday

The Puerto Rico Electric Power Authority needs to get insurance companies that guarantee a portion of the utility's debt against default to endorse a conditional restructuring agreement by Thursday to avoid the risk of the deal with bondholders falling apart.

If MBIA Inc., Assured Guaranty Ltd. and Syncora Guarantee Inc. don't sign on to the debt exchange finalized with some investors last week, then the utility known as Prepa, its fuel-line lenders and the bondholder group will work to implement a recovery plan "through a mechanism to be agreed among the parties that may include, without limitation, a judicial process, including an enforcement proceeding under applicable law," according to the Nov. 5 agreement posted on the Municipal Securities Rulemaking Board's website.

"It produces some pressure on Prepa to hurry up," said Philip Fischer, head of municipal research for Bank of America Merrill Lynch in New York. "The insurers would have a disproportionate amount of insurance liability and they're trying to negotiate their way around that."

The insurers run the risk being liable for the repayment of about $2.5 billion of bonds if Prepa fails to make payments and the restructuring is viewed as a default. Under the agreement, about 35 percent of the utility's bondholders agreed to absorb losses of as much as 15 percent and delay repayment to give the struggling utility more breathing room to restructure its finances as well as time to improve operations.

The agency is hampered by its inability to reorganize in bankruptcy court as utilities in the mainland U.S. can.

Possible Extension

A restructuring of Puerto Rico's main electricity provider would be the largest ever in the $3.7 trillion municipal-bond market. The utility has $8.2 billion of debt. It would be the first commonwealth entity to reduce its obligations. Puerto Rico and its agencies racked up $70 billion in part by borrowing to balance budgets. Governor Alejandro Garcia Padilla is seeking to cut that debt load and revive an economy that's struggled to grow since 2006.

An extension beyond Thursday wouldn't be a surprise, Fischer said. Bondholders and fuel-line lenders extended a forbearance accord 13 times since August 2014 until reaching the Nov. 5 pact. That contract kept discussions out of court. Bond insurers also participated in those extensions through September.

"All of these agreements have been extended repeatedly," Fischer said. "The idea that this one might also be extended is realistic."

Insurer Talks

A bondholder or fuel lender can withdraw from the agreement if insurers fail on Thursday to reach an accord with Prepa. The bondholder pact will automatically terminate if there's no monoline plan and also no strategy for how to implement a recovery plan without the insurers, according to the restructuring support agreement.

“While no agreement has yet been reached, negotiations are productive and ongoing,” Lisa Donahue, Prepa’s chief restructuring officer, said Tuesday before a Senate hearing in San Juan about talks with the bond insurers. “Any agreement that is ultimately reached with the monolines is contemplated to become part of the existing RSA.”

Greg Diamond, a spokesman for MBIA and Michael Corbally, a spokesman for Syncora, declined to comment. Ashweeta Durani, spokeswoman for Assured, declined to comment.

Possible Liability

A compromise with bond insurers is taking longer to reach than with the bondholder group because many of those investors purchased Prepa’s securities at distressed levels and are willing to accept less than 100 cents on the dollar, Fisher said. Monolines would be required to make up to investors whatever principal or interest the utility fails to pay on time and in full. The bondholder plan includes delaying certain payments for five years.

MBIA insures almost $770 million of Prepa debt-service payments in the next five years, Edwin Groshans, an analyst at Height Securities, a Washington-based broker dealer, wrote in a Nov. 9 report. Assured guarantees payment on $262 million of Prepa principal and interest due in the next five years.

Bondholder Group

Prepa faces a $196 million interest payment due Jan. 1. The proposed debt exchange involves bondholders of uninsured debt swapping their existing securities for new securitization bonds that pay, for the first five years, only interest at a rate of 4 percent to 4.75 percent. Or investors can exchange for other securities, called capital-appreciation bonds, that will accrue interest for the first five years. The bondholder group will negotiate with Prepa to backstop a cash tender for bonds held by non-forbearing investors.

Members of the bondholder group include Angelo, Gordon & Co., BlueMountain Capital Management LLC, D.E. Shaw & Co., Knighthead Capital Management LLC, Marathon Asset Management LP, Franklin Advisers Inc., Goldman Sachs Group Inc. and OppenheimerFunds Inc., according to the restructuring support agreement. The group held about $3 billion of uninsured Prepa bonds, as of Nov. 3, according to forbearance documents.

Along with legislative approval, the new bonds must receive an investment-grade rating and the exchange cannot leave more than $700 million of the agency’s current uninsured debt remaining. The utility’s debt is rated at junk-bond levels.

Prepa “would like help from the insurers to essentially allow the restructuring bonds to be investment grade,” Fischer said. “That appears to be a very sticky thing for them to get resolved. What is clear to us is they simply need to move forward.”

Prepa bonds maturing July 2040, the utility’s most-actively traded uninsured security in the past three months by volume, changed hands Monday at an average 60.5 cents on the dollar, to yield of about 9.4 percent, according to data compiled by Bloomberg. The debt traded at about 50 cents at the start of 2015.

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by Michelle Kaske

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