STANDARD & POOR'S
RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

Puerto Rico Electric Power Authority; Retail Electric

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Summary:

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Credit Profile		
Puerto Rico Elec Pwr Auth pwr		
Unenhanced Rating	BBB-(SPUR)/Watch Neg	Downgraded, On CreditWatch Negative
Long Term Rating	BBB-/Watch Neg	Downgraded, On CreditWatch Negative

Rationale

Standard & Poor's Ratings Services has lowered its rating on Puerto Rico Electric Power Authority's (PREPA) power revenue bonds to 'BBB-' from 'BBB' and placed the rating on CreditWatch with negative implications.

The rating action reflects our view of the risk that the Government Development Bank (GDB) will not provide interim liquidity if PREPA does not renew its lines of credit, which it uses to purchase oil for the utility's generating plants.

PREPA has $8.6 billion of power revenue bonds outstanding. A pledge of the electric system net revenues secures the bonds.

A $250 million line of credit from Citibank N.A. matured Jan. 10, 2014, but PREPA and Citibank continue to negotiate terms for an extension. According to the authority, the bank intends to reduce the line to $150 million and, before extending the maturity, expects to see PREPA's long-term plan. The foundation for that long-term plan is the authority's proposal for a balanced budget, which must be completed by June 30. A base-rate increase, in combination with operating cost reductions, is one alternative. PREPA, the GDB, and the government are reviewing these alternatives.

Under the terms of Citibank's line of credit, PREPA will begin repaying the $146 million outstanding with $10 million July 3, $10 million in mid-August, and the rest in between those dates. The authority does not currently have the cash to pay the full amount.

PREPA also has $525 million outstanding under the $550 million line of credit from ScotiaBank de Puerto Rico, which matures Aug. 14, 2014, unless renewed. The authority has said that ScotiaBank is also expects to see PREPA's long-term plan before agreeing to renew the line.

Nonpayment is not a default under the revenue bond indenture. However, if PREPA can't purchase oil, it can't run its plants. If the authority cannot renew the lines and cannot procure supplemental liquidity -- either from other banks or from GDB -- we will lower the rating to reflect the lack of necessary liquidity. Our rating has always taken into account the fact that PREPA's high rates, due to the high cost of oil, preclude their ability to build up a strong level of liquidity, obliging them to rely on either the GDB or outside lenders to fund oil purchases.

The rating also incorporates our view of the support provided by a $100 million line of credit from GDB, which is sufficient to cover potential liquidity requirements associated with PREPA's swaps. Currently outstanding are a $200 million notional amount under the basis swap with Deutsche Bank and two insured swaps: a $169.5 million notional amount with JPMorgan Chase and $83.3 million with UBS AG.

The rating reflects our opinion of both the continuing weakness of the island's economy and the utility's own challenges, including:

- An isolated electric system, which requires the utility to maintain a capacity margin of at least 50%;
- High rates, due to dependence on fuel oil for 61% of energy production;
- Large capital requirements to convert generating plants to gas, bury distribution wires, and upgrade and extend the transmission system;
- Weak fixed charge coverage; and
- Limited liquidity, exacerbated by delinquency of public corporation receivables.

In our view, offsetting these weakness are the steps PREPA's management is taking to lower the cost of electricity by converting generating plants to gas, reducing operating costs and energy theft, increasing collection of government receivables, and strengthening transmission efficiency. Management also intends to increase the percentage of power renewable sources provide.

In our opinion, PREPA's credit profile is strongly linked to the economy it serves, although the utility has maintained fairly stable financial metrics through past economic cycles. The authority has also maintained a stable base rate of about 6 cents per kilowatt-hour (kWh). In the next five years, management expects the base rate to be about that amount despite significant investment in the system because of other cost reductions.

CreditWatch

The CreditWatch placement is pending the outcome of PREPA's negotiations with the banks. We expect to resolve the CreditWatch within the next few wee

Related Criteria And Research

Related Criteria

USPF Criteria: Electric Utility Ratings, June 15, 2007

Ratings Detail (As Of June 18, 2014)		
Puerto Rico Elec Pwr Auth pwr rev bnds ser 2012 A due 07/01/2041		
Long Term Rating	BBB-/Watch Neg	Downgraded, On CreditWatch Negative
Puerto Rico Elec Pwr Auth pwr rev ser N&O dtd 08/01/1989 due 07/01/2000 2004 2007 2010 2012 2014 2017		
Unenhanced Rating	BBB-(SPUR)/Watch Neg	Downgraded, On CreditWatch Negative

Ratings Detail (As Of June 18, 2014) (cont.)		
Puerto Rico Elec Pwr Auth pwr		
Unenhanced Rating	BBB-(SPUR)/Watch Neg	Downgraded, On CreditWatch Negative
Many issues are enhanced by bond insurance.		

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