HOULIHAN LOKEY

Puerto Rico Electric Power Authority

Comprehensive PREPA Revitalization Plan – Forbearing Bondholder Counterproposal

July 2015

CORPORATE FINANCE
FINANCIAL ADVISORY SERVICES
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Status of Negotiations

Summary of Negotiations

There are Major Areas of Agreement Between PREPA and the Forbearing Bondholders

- On June 1, PREPA publically released a transformation business and capital plan (the "PREPA Business Plan"), which provided for $2.3 billion of capital investment through 2030 in order to revitalize PREPA's operations, reduce long term electricity cost and comply with EPA regulations
  - The Forbearing PREPA Bondholders (the "Forbearing Bondholders") have indicated they could support this capital requirement, along with the operational restructuring initiatives and approach to reforming the rate structure outlined in the PREPA Business Plan
- PREPA has also contemplated using securitization financing as part of the PREPA recapitalization
  - The Forbearing Bondholders agree that securitization can be a viable part of the refinancing solution

Status of Current Negotiations

- The Forbearing Bondholders entered into negotiations with PREPA in July 2014. PREPA produced its first comprehensive plan to bondholders on June 1, 2015. Since June 1, PREPA and the Forbearing Bondholders have been engaged in negotiations around key restructuring elements including:
  - Specific terms of the refinancing / debt restructuring
  - The process for privatization of new generation assets
- On June 25, the Forbearing Bondholders received from PREPA a financing proposal (the "PREPA Financing Proposal") that outlined:
  - PREPA's intended treatment of legacy debt obligations
  - A proposed $1.1 billion of incremental, securitized debt to fund capital investment requirements
- Forbearing Bondholders subsequently rejected the PREPA Financing Proposal and focused on upsizing the securitization provision of the proposal as a means of bridging remaining PREPA / Forbearing Bondholder differences

Source: PA Consulting and Houlihan Lokey analysis
Note: All analyses are strictly illustrative in nature

Forbearing Bondholder Counterproposal

- On July 7, the Forbearing Bondholders met with certain of PREPA's advisors to present a counterproposal (the "Forbearing Bondholder Counterproposal") embracing and upsizing the securitization component of the PREPA Financing Proposal
- Compared to the PREPA Financing Proposal, the terms of the Forbearing Bondholder Counterproposal provide a number of advantages for PREPA and its stakeholders:

Forbearing Bondholder Counterproposal Advantages vs. PREPA Financing Proposal

- ✓ Lower overall electricity rates
- ✓ Lower post-transaction debt burden
- ✓ Lower total debt service
- ✓ Longer period of aggregate debt service relief

- The PREPA bond insurers have not expressed support for the proposal, and some changes to the proposal may be necessary to accommodate the insured bonds. Given the manifest benefits to all stakeholders, the Forbearing Bondholders believe the proposal provides the most compelling and equitable solution as illustrated further herein

Source: PA Consulting and Houlihan Lokey analysis
Note: All analyses are strictly illustrative in nature

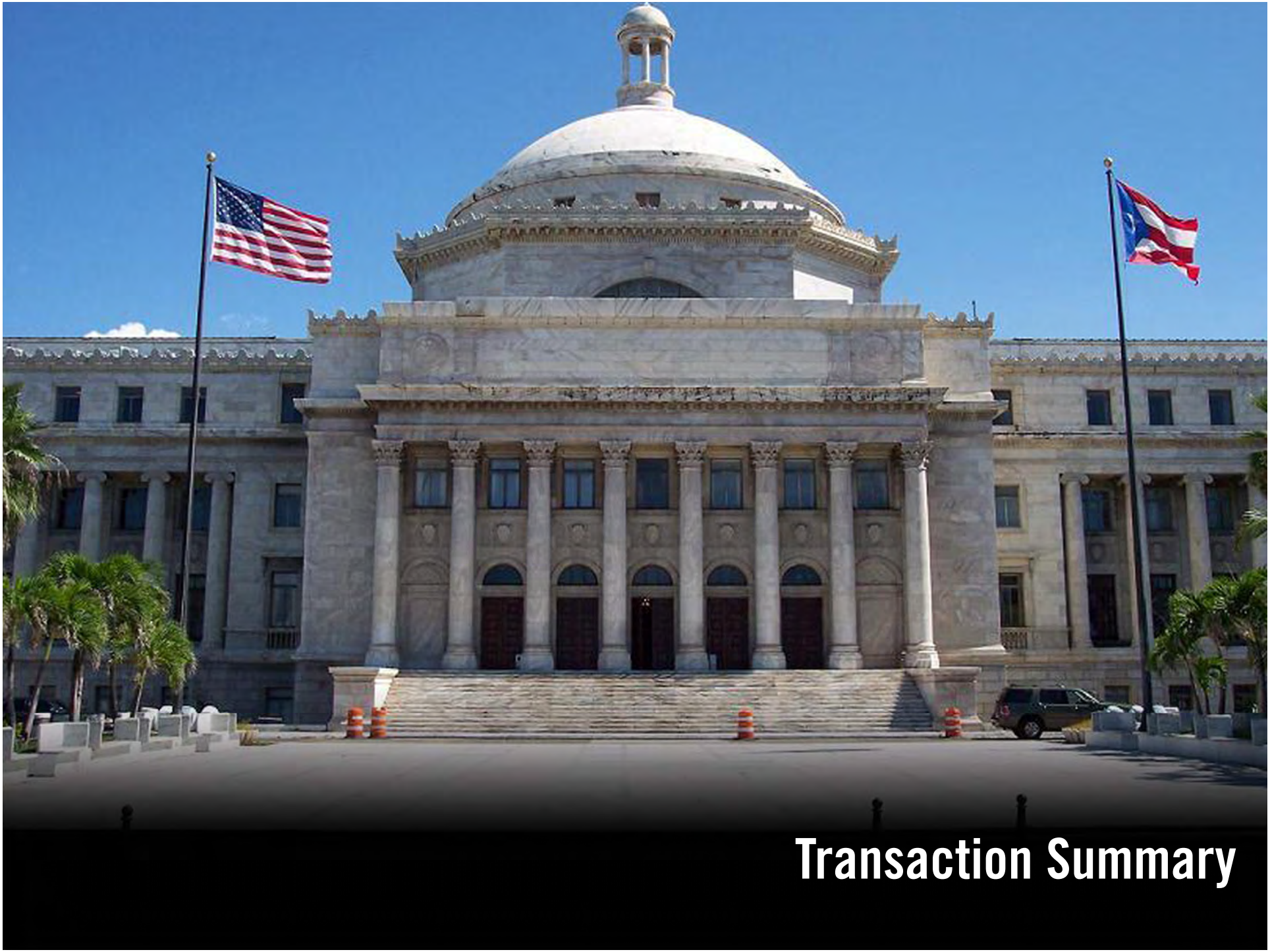
Forbearing Bondholder Counterproposal (cont.)

- Apart from its financial advantages, the Forbearing Bondholder Counterproposal offers the same advantages as the original Comprehensive PREPA Revitalization Plan presented by Forbearing Bondholders on April 1

Additional Forbearing Bondholder Counterproposal Advantages

- A diversified and lower cost power generation platform resulting in stable rates with a capacity to lower the rates for Puerto Rican customers
- Significant "Green Energy" job creation benefits as early as the second half of 2015
- Allows for incremental operating improvements and cost savings initiatives to benefit Puerto Rican customers instead of legacy bondholders
- A path to achieving investment grade ratings, restoration of capital markets access for PREPA and credit support for Puerto Rico

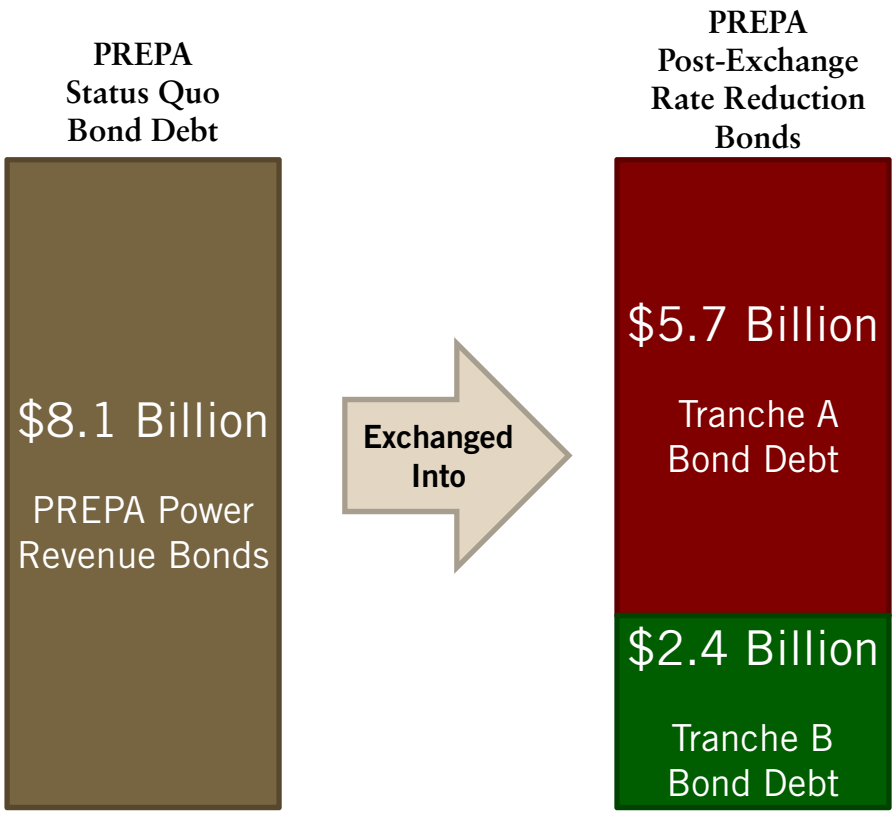
Source: *PA Consulting and Houlihan Lokey analysis*
Note: *All analyses are strictly illustrative in nature*



Transaction Summary

Transaction Summary

- PREPA's $8.1 billion[1][2] of Power Revenue Bonds are exchanged into a securitization structure comprising two tranches – 70% of principal in Tranche A and 30% of principal in Tranche B (together, the "Rate Reduction Bonds"). Cash debt service payment for Tranche B occurs after the maturity of Tranche A but is otherwise identical to Tranche A (i.e., no contractual subordination)
  - A "stranded cost" securitization charge would be assessed to ratepayers sufficient to cover debt service on the Rate Reduction Bonds



Exchange Debt Terms

- Tranche A – Current Interest Bond ($5.7 billion)[2]
  - Pricing
    - S&P AAA municipal bond yield curve + 150 basis points
    - 4.1% weighted average interest rate across maturity spectrum[3]
  - Amortization – Annually from 2019 to 2043 in amounts to mirror the existing maturity schedule of legacy bonds, deferred by 3 years
  - Liquidity Relief – 3 year principal deferral
- Tranche B – Capital Appreciation Bond ("CAB") ($2.4 billion)[2]
  - Pricing – 0% cash interest
  - Liquidity Relief – Up to 19 years of principal and interest deferral
  - Other Features
    - Accretes at 28 year S&P AAA municipal bond yield + 200 basis points[3]
    - Callable after 10 years at a 5% call premium. Call premium decreases by 0.5% each year until callable at par
    - Annual sinking fund payments of 10% of final maturity amount starting in 2035, until final maturity in 2044

Source: *Houlihan Lokey analysis*
Note: *All analyses are strictly illustrative in nature*
(1) *Excludes incremental debt issued to fund July 1, 2015 principal payment*
(2) *Purely for illustrative purposes, the graphics assume 100% participation of outstanding bonds*
(3) *Assumes Rate Reduction Bonds receive AAA rating. If Rate Reduction Bonds receive AA or A rating, the spread to the AAA yield curve varies as illustrated in Appendix A*

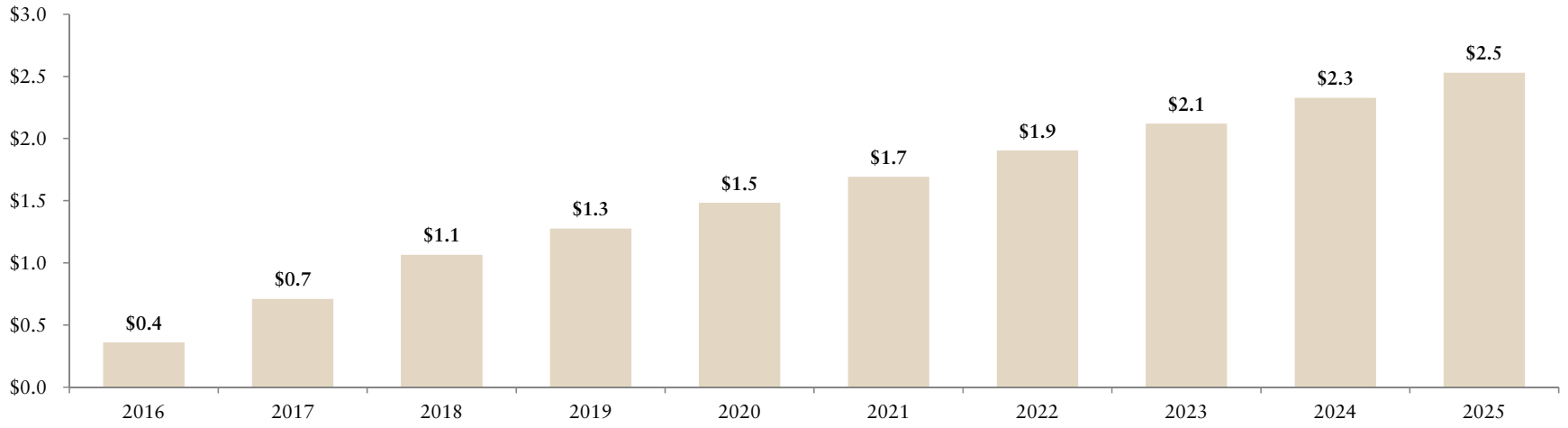
Transaction Financial Advantages

- Over the next 10 years, the Forbearing Bondholder Counterproposal saves $2.5 billion in bond financing costs compared to PREPA's status quo debt service[1]

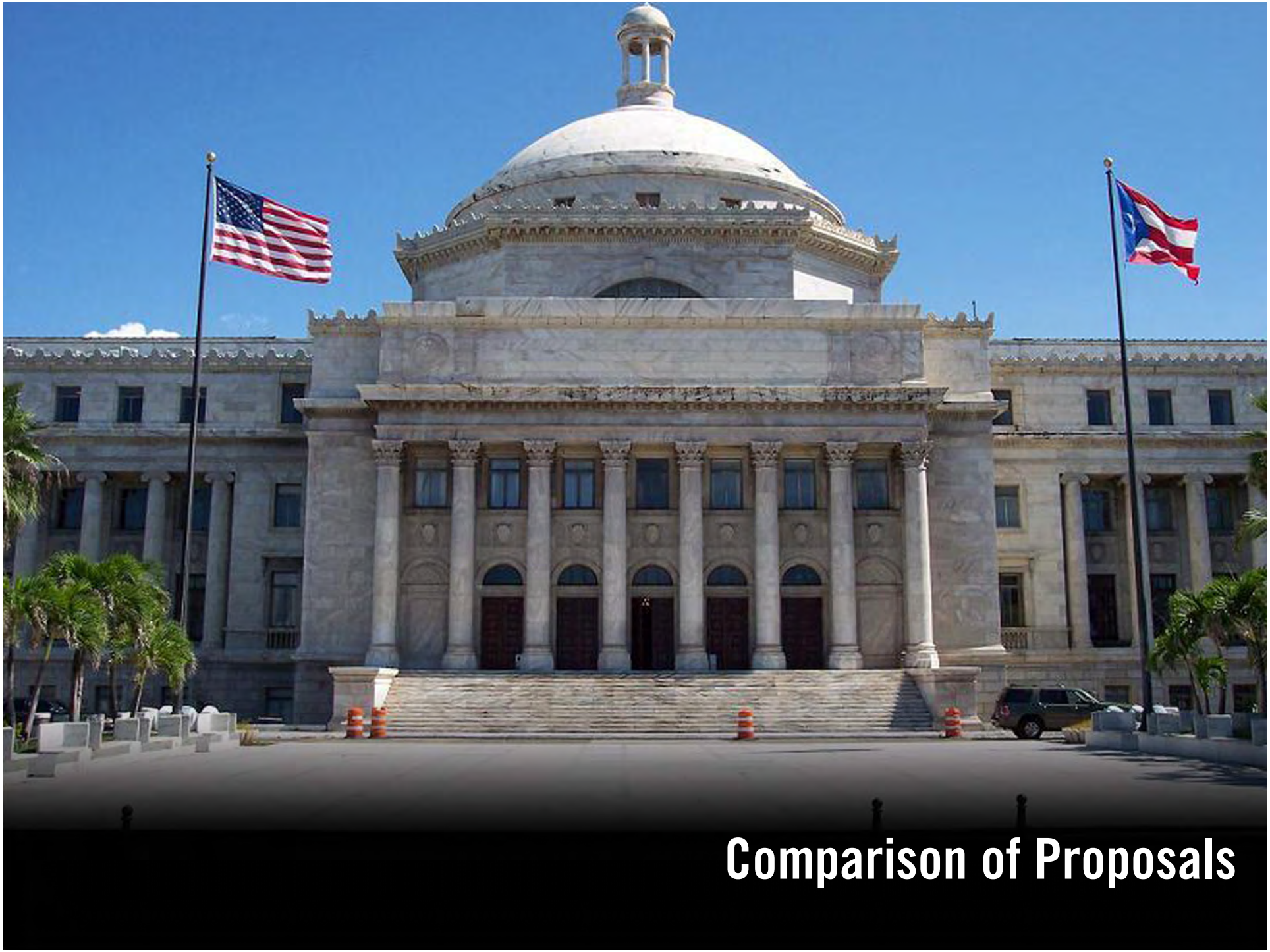
Forbearing Bondholder Counterproposal: Financial Advantages ($mm)

	Fiscal Year Ending June 30th										
Forbearing Bondholder Counterproposal Debt Service	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**	**2025E**	**Total**
Bond Principal	$12	$26	$23	$171	$178	$184	$186	$189	$205	$218	$1,391
Bond Interest	253	253	252	251	246	241	235	229	222	215	2,397
Capitalized Interest	(24)	0	0	0	0	0	0	0	0	0	(24)
Total Bond Debt Service	**$241**	**$279**	**$275**	**$422**	**$424**	**$425**	**$421**	**$418**	**$427**	**$433**	**$3,764**
Status Quo Bond Debt Service	603	628	630	631	632	633	634	634	634	634	6,294
Savings vs Status Quo	**$361**	**$349**	**$355**	**$210**	**$208**	**$208**	**$213**	**$216**	**$207**	**$202**	**$2,529**

Forbearing Bondholder Counterproposal vs Status Quo Cumulative Savings ($bn)



Source: *Houlihan Lokey analysis*
Note: *All analyses are strictly illustrative in nature*
(1) *Assumes 90% participation of outstanding bonds*
(2) *Excludes debt service associated with incremental bonds issued to fund July 1, 2015 principal payment*



Comparison of Proposals

Proposal Debt Comparison

- The Forbearing Bondholders Counterproposal provides lower financing costs, and more debt service relief than the 5 year liquidity relief under the PREPA Financing Proposal

Category	Status Quo	PREPA Financing Proposal	Forbearing Bondholder Counterproposal	Advantages vs. PREPA Financing Proposal
Average Interest Rate[1]	5.24%	5.45%	4.11%[2]	1.34% lower
Total Debt Service through 2025[3]	$7.0 billion	[redacted]	$4.8 billion[2]	[redacted]
Incremental Debt	NA	$[1.1] billion new securitization bonds with 6% interest	None	No incremental debt
Post-Transaction Debt Outstanding	$9.0 billion	$[9.4] billion[4]	$9.0 billion	$[0.4] billion lower
Maturity Profile	FY2016 to FY2043	FY2021 to FY2048[5]	FY2019 to FY2044	3 year longer liquidity relief: reflects blended average principal deferral of 7.8 years for the Rate Reduction Bonds compared to 5.0 years in PREPA Financing Proposal
Forbearing Bondholder Treatment	NA	■ Exchanged for turbo bonds that defer principal payments for 5 years and pay 1% interest in the deferral period ■ Excess cash flow generated by PREPA used to prepay turbo bonds	■ 70% of principal exchanged for Tranche A Rate Reduction Bonds with no principal payment for 3 years ■ 30% of principal exchanged for Tranche B Rate Reduction Bonds maturing 2044	More flexibility for PREPA through lower debt service and ability to call Tranche B Rate Reduction Bonds
Monoline Treatment	NA	■ Status quo treatment of legacy bonds ■ Wrap $[1.3] billion in new bonds issued to finance tender of Non-Forbearing Bonds	Same as Forbearing Bondholders	Equal treatment for all bondholders
Non-Forbearing Bond Treatment	NA	Cash tender at 65% - 70% of par or receive same exchange as Forbearing Bondholders	Same as Forbearing Bondholders	Equal treatment for all bondholders

Source: *Houlihan Lokey analysis*
Note: *All analyses are strictly illustrative in nature*
(1) *Weighted average cash interest rate for all debt, excluding fuel lines of credit / GDB and incremental debt issued to fund July 1, 2015 principal payment*
(2) *Assumes 90% participation*
(3) *Excludes incremental debt issued to fund July 1, 2015 principal payment*
(4) *Assumes PREPA is able to capture a $0.7 billion debt reduction through its cash tender offer for Non-Forbearing Bonds*
(5) *Reflects expected maturity profile of Forbearing Bonds not taking into account early repayment*

Proposal Capital Plan Comparison

- The Forbearing Bondholder Counterproposal contemplates both the possibility of PREPA owned generation and privatized generation at Aguirre
- The Forbearing Bondholders believe privatized generation can provide further rate reduction benefits for PREPA customers. PREPA's advisors have stated that there could be substantial delays in permitting and authorization of privatized generation assets, which makes the incorporation of privatization in a current comprehensive agreement infeasible. However, PREPA can pursue privatization and further reduce rates for PREPA customers

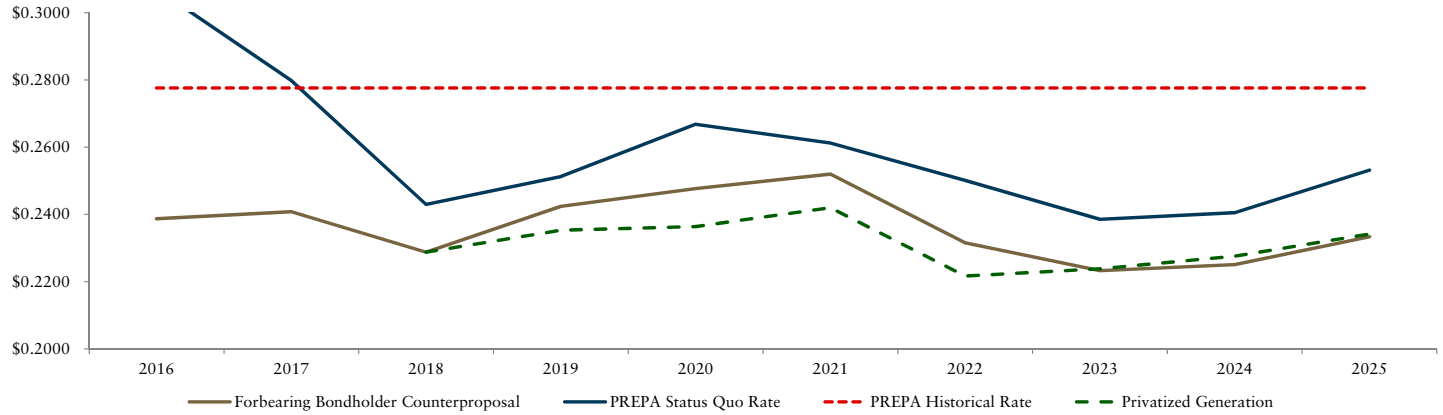
Category	PREPA Business Plan	At PREPA's Option	
		PREPA Owned Generation	Privatized Generation
Aguirre Generation	■ Repowering of existing Aguirre CCs units to improve efficiency ■ Estimated total capex spend of $387 million from FY2020 to FY2022 for repowering through internally-generated cash flow	■ Same as PREPA Business Plan	■ 800 MW new combined cycle build at Aguirre under a Power Purchase Tolling Agreement ("PPTA"), in which a third party owns and operates the facility while PREPA pays for power and is responsible for the storage and delivery of fuel ■ Both Aguirre steam units are retired ■ Existing Aguirre CC units remain online and repowered
Maintenance Capex	■ Average maintenance capex of $292 million from FY2016 to FY2025	■ Same as PREPA Business Plan	■ Assumes same maintenance capex schedule as the PREPA Business Plan with the exception of reduced annual maintenance capex of ~$36 million from FY2022 onward to account for the Aguirre CC PPTA structure
Unit Retirements	■ Retirement of units at Palo Seco, Costa Sur and San Juan	■ Same as PREPA Business Plan	■ Retirement of Aguirre steam, Palo Seco and San Juan units
Generation Repowering	■ Repowering at Costa Sur and Aguirre (steam and CC) to improve efficiency	■ Same as PREPA Business Plan	■ Repowering of Aguirre CC units to improve efficiency

Source: PA Consulting, Houlihan Lokey analysis and PREPA Business Plan
Note: All analyses are strictly illustrative in nature

Proposal Rate Comparison

- Consistent with the PREPA Business Plan, the Forbearing Bondholder Counterproposal assumes a rate that covers all expenses including fuel and purchased power expenses
  - All operational expenses including fuel and purchased power expenses are passed through to customers, without any markup, through a rate that is adjusted monthly to reflect actual costs incurred
  - Forbearing Bondholder Counterproposal assumes a rate case occurs every third year beginning in 2016 for the Base Rate
    - The Base Rate consists of operational expenses and excludes fuel and purchased power expenses, securitization debt service, working capital adjustments, CILT and other subsidies
- The Forbearing Bondholder Counterproposal results in electricity rates substantially below both PREPA's historical and status quo rates
- The Forbearing Bondholder Counterproposal offers PREPA customers further savings if PREPA elects to pursue privatized generation

Average Rate Comparison ($/kWh)



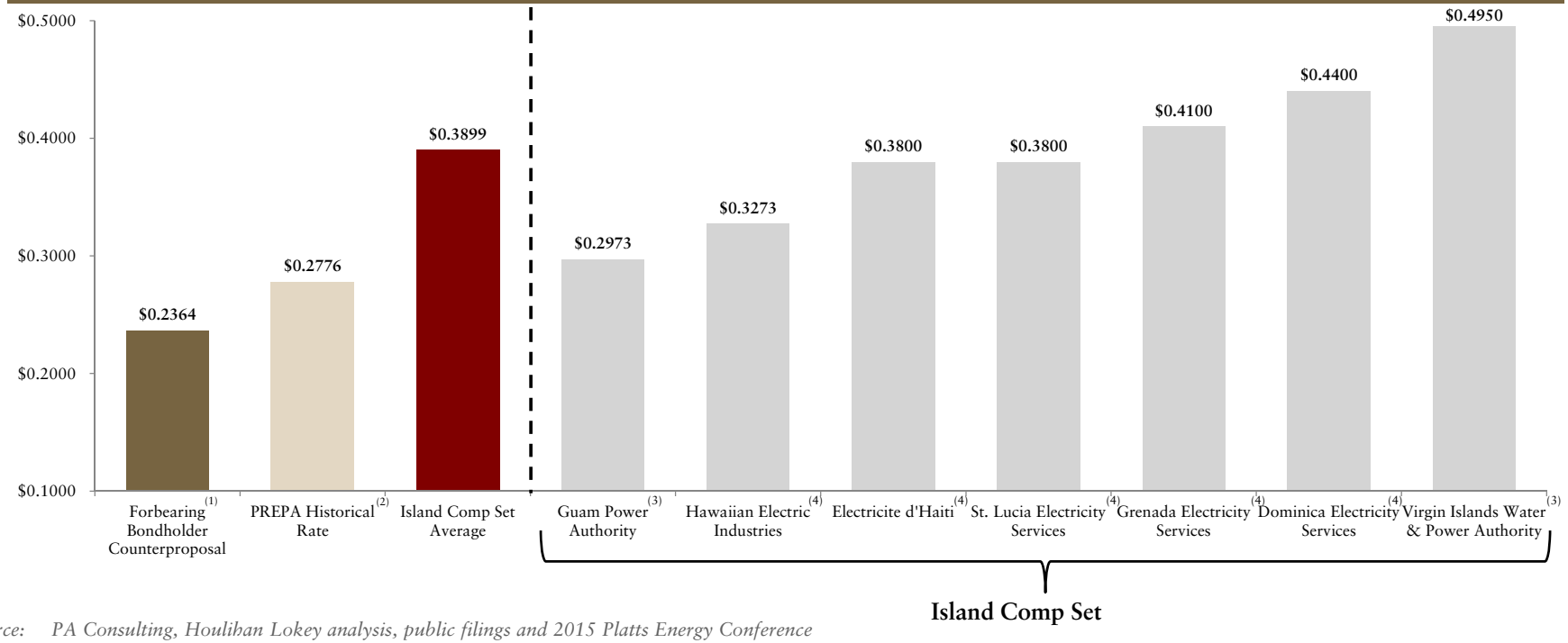
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Average
Forbearing Bondholder Counterproposal[1]	$0.2387	$0.2408	$0.2288	$0.2424	$0.2477	$0.2520	$0.2316	$0.2233	$0.2251	$0.2334	$0.2364
PREPA Status Quo Rate[2]	0.3071	0.2798	0.2430	0.2512	0.2668	0.2613	0.2501	0.2386	0.2405	0.2532	0.2592
PREPA Historical Rate[3]	0.2776	0.2776	0.2776	0.2776	0.2776	0.2776	0.2776	0.2776	0.2776	0.2776	0.2776

Source: PA Consulting, Houlihan Lokey analysis and PREPA Business Plan
Note: All analyses are strictly illustrative in nature
(1) For illustrative purposes, fuel lines and GDB LOC are treated the same as under the PREPA Financing Proposal
(2) Assumes fuel lines and GDB LOC are repaid at the beginning of FY2016 and status quo payments for the power revenue bonds
(3) Based on August 2014 average electricity rate for residential, commercial, industrial and other customers

Broader Rate Comparison

- By converting legacy bonds to Rate Reduction Bonds and investing approximately $2.3 billion in fuel and generation infrastructure, the Forbearing Bondholder Counterproposal enables PREPA to generate power at a substantial discount relative to the PREPA Financing Proposal, PREPA's historical electricity costs and other comparable island utilities
  - The Forbearing Bondholder Counterproposal rate is approximately 15% lower than PREPA's August 2014 average electricity rate and 39% below other comparable islands' electricity rates
  - The Forbearing Bondholder Counterproposal uses the same assumptions on MATS compliance, renewable investment, electricity sales and energy efficiency as the PREPA Business Plan

Forbearing Bondholder Counterproposal Average Rate Comparison ($/kWh)



Source: *PA Consulting, Houlihan Lokey analysis, public filings and 2015 Platts Energy Conference*
Note: *All analyses are strictly illustrative in nature*
(1) *Represents average of expected rates from FY2016 to FY2025*
(2) *Based on August 2014 average electricity rate for residential, commercial, industrial and other customers*
(3) *Reflects average electricity rate for residential, commercial and industrial customers during the last reported fiscal year*
(4) *Reflects 2012 average electricity rates for the island*

Appendix

Appendix A: Grid Pricing for AA & A Ratings

Illustrative Securitization Pricing Curve								
Term	Maturity	S&P	Interest Rate Adder			Applicable Interest Rate		
Years	Year	AAA Curve	AAA	AA	A	AAA	AA	A
3	2019	0.91%	1.50%	1.75%	2.00%	2.41%	2.66%	2.91%
4	2020	1.08%	1.50%	1.75%	2.00%	2.58%	2.83%	3.08%
5	2021	1.32%	1.50%	1.75%	2.00%	2.82%	3.07%	3.32%
6	2022	1.59%	1.50%	1.75%	2.00%	3.09%	3.34%	3.59%
7	2023	1.87%	1.50%	1.75%	2.00%	3.37%	3.62%	3.87%
8	2024	2.05%	1.50%	1.75%	2.00%	3.55%	3.80%	4.05%
9	2025	2.20%	1.50%	1.75%	2.00%	3.70%	3.95%	4.20%
10	2026	2.32%	1.50%	1.75%	2.00%	3.82%	4.07%	4.32%
11	2027	2.45%	1.50%	1.75%	2.00%	3.95%	4.20%	4.45%
12	2028	2.57%	1.50%	1.75%	2.00%	4.07%	4.32%	4.57%
13	2029	2.66%	1.50%	1.75%	2.00%	4.16%	4.41%	4.66%
14	2030	2.73%	1.50%	1.75%	2.00%	4.23%	4.48%	4.73%
15	2031	2.79%	1.50%	1.75%	2.00%	4.29%	4.54%	4.79%
16	2032	2.84%	1.50%	1.75%	2.00%	4.34%	4.59%	4.84%
17	2033	2.89%	1.50%	1.75%	2.00%	4.39%	4.64%	4.89%
18	2034	2.94%	1.50%	1.75%	2.00%	4.44%	4.69%	4.94%
19	2035	2.98%	1.50%	1.75%	2.00%	4.48%	4.73%	4.98%
20	2036	3.02%	1.50%	1.75%	2.00%	4.52%	4.77%	5.02%
21	2037	3.06%	1.50%	1.75%	2.00%	4.56%	4.81%	5.06%
22	2038	3.10%	1.50%	1.75%	2.00%	4.60%	4.85%	5.10%
23	2039	3.13%	1.50%	1.75%	2.00%	4.63%	4.88%	5.13%
24	2040	3.17%	1.50%	1.75%	2.00%	4.67%	4.92%	5.17%
25	2041	3.20%	1.50%	1.75%	2.00%	4.70%	4.95%	5.20%
26	2042	3.23%	1.50%	1.75%	2.00%	4.73%	4.98%	5.23%
27	2043	3.25%	1.50%	1.75%	2.00%	4.75%	5.00%	5.25%
28	2044 (CAB)	3.26%	2.00%	2.25%	2.50%	5.26%	5.51%	5.76%

Source: S&P AAA municipal bond yield curve as of 07/15/15
Note: All analyses are strictly illustrative in nature