MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades PREPA's ratings to Ba2 from Baa3; outlook negative

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Approximately $8.8 billion of debt securities affected

New York, February 07, 2014 -- Moody's Investors Service has downgraded the ratings for $8.8 billion of the Puerto Rico Electric Power Authority's (PREPA, Authority) Power Revenue Bonds to Ba2 from Baa3. This rating action concludes the rating review that Moody's initiated on December 20, 2013. PREPA's rating outlook is negative.

SUMMARY RATING RATIONALE

Today's rating action considers Moody's recent rating action on the Commonwealth of Puerto Rico's general obligation bonds, which were downgraded to Ba2 from Baa3 with a negative outlook, along with the ratings of related entities that are based on or capped at the Commonwealth's GO rating, including the Government Development Bank of Puerto Rico (GDB), an important source of liquidity for PREPA. Moody's believes that the PREPA's rating is closely tied to the rating of the Commonwealth given its reliance on GBD as a source of working capital liquidity as well as the importance of revenues from municipal authorities (estimated at 13% of PREPA's revenues). Moreover, the continued weakness in the economy of Puerto Rico, including the lack of economic growth drivers and negative demographic trends, weigh heavily on today's rating action and on PREPA's ability to meet numerous strategic initiatives.

The downgrade also considers PREPA's recent and prospective credit metrics which continue to remain weak with its adjusted debt service coverage ratio (DSCR) hovering in most years at or below 1.0x. In light of the combination of high electric rates, a weak economy, and the need to debt finance important capital expenditures over the next several years, we do not anticipate any appreciable improvement in PREPA's DSCR or its very high leverage over the next several years. We view the capital investment requirements, which are centered around the conversion of existing fuel oil generation to natural-gas fired generation, as an essential and important long-term investment strategy. Completion of the program will reduce the Authority's very high reliance on imported fuel oil as a generation fuel resource, which should lower electric rates and serve as a catalyst for economic growth within the Commonwealth. The capital investment program is multi-year and challenges remain including building a natural gas infrastructure to support the conversion. In addition to other credit considerations, we do not anticipate any improvement in PREPA's credit metrics until much of the transition to natural-gas fired generation occurs which we expect commencing in the 2017-2018 timeframe at the earliest.

The rating action further recognizes PREPA's tight liquidity profile as days cash on hand for year-end 2013 was only 11 days, and PREPA's committed bank lines remain largely drawn, and in need of renewal during 2014. We also note that the aging of accounts receivable has increased on a year-over-year basis, particularly among municipal entities, reflecting the persistent softness in the Puerto Rican economy. In that vein, the rating action recognizes the importance of GDB as a provider of additional liquidity for PREPA. While PREPA's liquidity position has constraints, we do recognize the sizeable amount of restricted funds available to PREPA to satisfy annual debt service and to prefund a portion of its capital investment program, such that PREPA's need to access the debt capital markets is not expected for the next two years.

Outlook

The negative outlook reflects the negative outlook for the Commonwealth and the GDB as well as our belief that liquidity pressures at PREPA will continue. The negative outlook also considers the uncertainty and obstacles about executing the long-term capital investment plan focused on converting oil-based power generation to natural gas in the face of a very challenging economic environment within the Commonwealth.

What could change the rating -- Up

In light of the negative outlook, the rating is not expected to move upward over the near-to-medium term. The outlook could stabilize if the rating outlook for the Commonwealth stabilizes and/or PREPA shows substantial

progress on the execution of its fuel diversification and cost reduction strategy.

What could change the rating -- Down

The rating could be pressured downward if debt service coverage ratios fall significantly below projected levels, or the ratings of the Commonwealth and GDB decline further. In addition, the rating could move down if PREPA fails to extend its bank facilities, which will further weaken PREPA's liquidity position.

The principal methodology used in this rating was U.S. Public Power Electric Utilities with Generation Ownership Exposure published in November 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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