LPC GOLD SHEETS

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MUNICIPAL UTILITIES

— by Faris Khan

Municipal-owned utilities seek corporate style Liquidity in loan market

Lack of lending capacity, an uptick in defaults and lower recoveries have left the loan market with little appetite for new issue. That has not deterred a group of municipal bond issuers from exploring the investment grade loan world as an alternative provider of liquidity that would actually reduce funding costs.

SIFMA Municipal Index spikes p. 21

Last year's collapse of the municipal bond insurance and auction rate markets has left highly rated municipal issuers, in particular municipal-owned utilities, facing a huge pricing increase for the liquidity that supports their variable-rate bond programs – prices that are much higher than a similarly rated, or even lower-rated, investor-owned utility might pay for liquidity.

As a result, a group of municipal-owned utilities has begun active negotiations to seek revolving lines of credit from the syndicated loan market. A successful completion of such credit lines can potentially open the loan market to a new class of borrower, which in many cases might provide lending banks much-needed exposure to clients with relatively higher credit ratings and a lower risk capital charge. These utilities are in a business line that

(**UTILITIES** cont'd on p. 22)

THE WEEK IN NEWS

SunGard gets lender nod on Amendment/extension plan

SunGard Data Systems and lead bank J.P. Morgan have managed to get the requisite lender support for the company's amendment and extension plan, sources in the deal said.

The company managed to sway holdouts to the plan after providing additional concessions Friday.

The latest set of changes will increase the amendment fee from 10 bps to 25 bps and the investment basket will be increased to $325 million rather than the $650 million as previously proposed.

The latest concessions to the deal came as a group of institutional lenders in the bank loan attempted to block the company's proposed amendment even after the borrower made revisions to the original amendment proposal late Wednesday, sources said.

(**SUNGARD** cont'd on p. 24)

NDS' $1.33B loan offering two Tickets – bankers

Digital pay-TV specialist NDS Group's $1.33 billion buyout loan, which was launched on May 29, is offering two levels of commitment, banking sources said last Monday.

Arrangers are being invited to commit $50 million for fees of 400 bps, while co-arrangers have been invited to commit $25 million for fees of 300 bps.

A bank meeting was held in London Wednesday for prospective bank and fund investors.

The loan, which was arranged by Bank of Ireland, BNP Paribas, J.P. Morgan, Lloyds TSB and Morgan Stanley, includes $990 million of senior debt and a $340 million mezzanine tranche.

It will be a key test of appetite and liquidity as the first major leveraged

(**NDS** cont'd on p. 24)

BROADLY SYNDICATED LOAN GRID

Applic. Rating	Avg. Undrawn	Min. Undrawn	Max. Undrawn	Avg. Fully Drawn (LIB+Ann. +Usage)	Avg. Fac Size ($Mils.)
364-day					
AA	19.17	10.00	37.50	127.77	3,428
A	20.63	10.00	37.50	160.00	2,275
BBB	43.75	37.50	50.00	246.88	356
Multi-year					
AA	N/A	N/A	N/A	N/A	N/A
A+	N/A	N/A	N/A	N/A	N/A
A	N/A	N/A	N/A	N/A	N/A
A-	N/A	N/A	N/A	N/A	N/A
BBB+	N/A	N/A	N/A	N/A	N/A
BBB	N/A	N/A	N/A	N/A	N/A
BBB-	N/A	N/A	N/A	N/A	N/A
BB+	N/A				
BB non-lev	N/A				

Due to the lack of adequate deal flow, the multi-year revolver category of the grid will not be posted until such time when there are sufficient deals to report.

Thomson Reuters LPC uses the 3-5 latest transactions in each ratings category. The credits represent syndications that were not substantially under- or over-subscribed. Agent and syndications fees are not included. **Leveraged BSL Grid available at www.loanconnector.com**

CROSS MARKET COMPS GRID

Borrower	LT Rating	Sec' Loan	LCDS	Bond Swap	CDS
Avis Budget Car Rental LLC	CCC+	1036	992	1231	1144
Cablevision Systems Corp.	BB	333	247	639	398
Community Health Systems Inc.	B+	481	523	538	645
Freescale Semiconductor Inc.	CCC	1241	2501	1801	2020
Georgia-Pacific Corp.	BB-	348	318	639	473
HCA Inc.	B+	492	624	716	695
Mediacom LLC	B	429	631	790	695
Sabre Holdings Corp.	B	1116	1636	1060	1123
TRW Automotive Inc.	B+	471	752	1318	861
Univision Communications Inc	B-	1221	1931	1832	2038

Source: Reuters 3000 Xtra/CreditViews

See **www.loanconnector.com**. for more names and methodology.

NEXT WEEK

CDS Market Review

Market based Pricing Snapshot P. 5

is similar to investor-owned utilities already tapping the syndicated loan market. Though owned by a municipality, these utilities are monopolies on a basic commodity, set their own rates and release financial statements that are in accordance with GAAP.

"Initially, we are trying to obtain a syndicated facility to replace one supported by a German bank that was recently downgraded," says Gary Breaux, director of finance at the East Bay Municipal Utility District (EBMUD) in Oakland, Calif.

Breaux manages a portfolio of variable-rate debt and commercial paper worth more than $1 billion for one of the largest municipal water and sewage utilities in the San Francisco Bay area. EBMUD has about $446 million in revenues and is rated AAA/Aa2.

"We would like to augment our existing standby facilities with up to about $500 million," says Brian Thomas, chief financial officer of the Metropolitan Water District of Southern California. The Metropolitan Water District, which generates nearly $1.09 billion in revenue and has assets worth $11 billion, is also rated AAA/A2 and provides drinking water to nearly 19 million people in parts of Los Angeles, Orange, San Diego, Riverside, San Bernardino and Ventura counties. Both utilities have hired Saber Partners LLC a financial advisory firm for corporate and public sector companies.

"We're diligently working to strike the right risk-return pricing balance with a revolving credit facility that provides very favorable returns for short to intermediate duration with a modest capital commitment to a very low risk counterparty," says Saber Partners CEO Joseph Fichera.

Fig. 1: SIFMA Municipal Index spikes

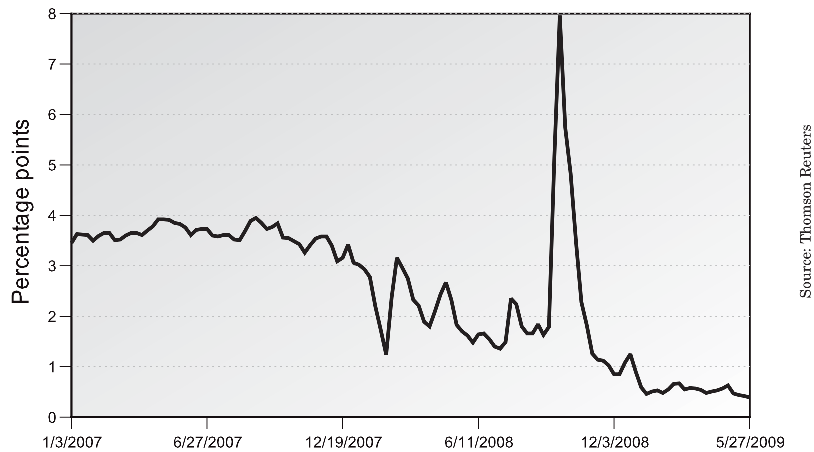
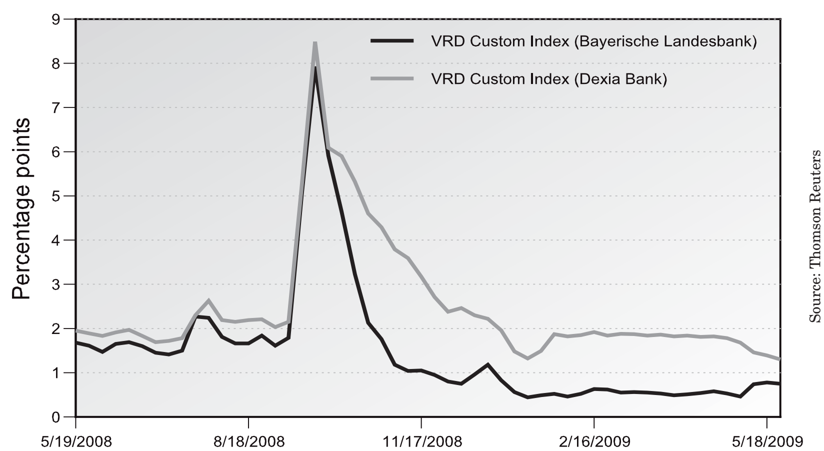


Fig. 2: Letter of credit spreads backing VRDOs jump



Volatility strikes the Municipal market

Similar to investment grade corporate issuers, municipal-owned utilities have traditionally used variable-rate debt as a source of short-term liquidity. The most common form of variable-rate debt used by municipal-owned utilities is the variable rate demand obligation (VRDO), with a backstop provided in the form of a standby bond purchase agreement or a letter of credit from a bank.

Similar to a commercial paper backstop revolving credit line used in the investment grade loan market, this liquidity is key as municipal bond investors can, at a short notice, put VRDOs back to the issuer. Since most of the liquidity backstops, whether in the form of a bond purchase agreement or an LC facility, are provided by a small group of banks, or in some cases just one bank, municipal bond investors also try to limit their portfolio exposure to any one bank.

Utilities such as EBMUD have historically paid around 30-50 bps for their standby bond purchase agreements. In case a VRDO is put, the bank providing the backstop pays the investor and then is repaid by the municipality.

But with the collapse of the bond insurance and the auction rate securities markets in 2008, a large amount of auction rate securities issued by municipalities were refunded by VRDOs. As a result, the cost of the backup liquidity spiked up as reflected in the SIFMA Swap Index, which tracks the VRDO market (Fig. 1).

(***UTILITIES*** *cont'd on page 22)*

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Fig. 3: Investor-owned utility loan volume shrinks

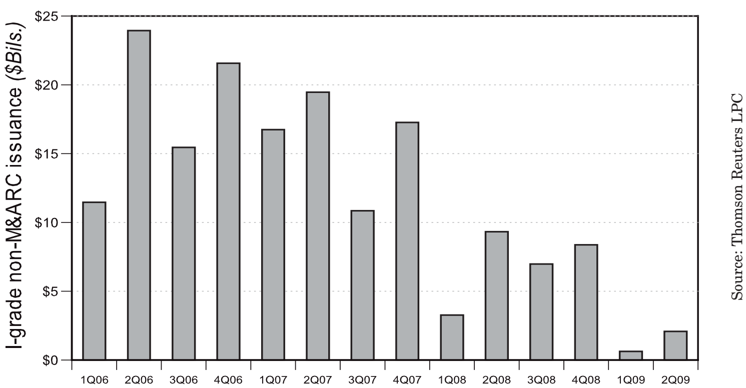
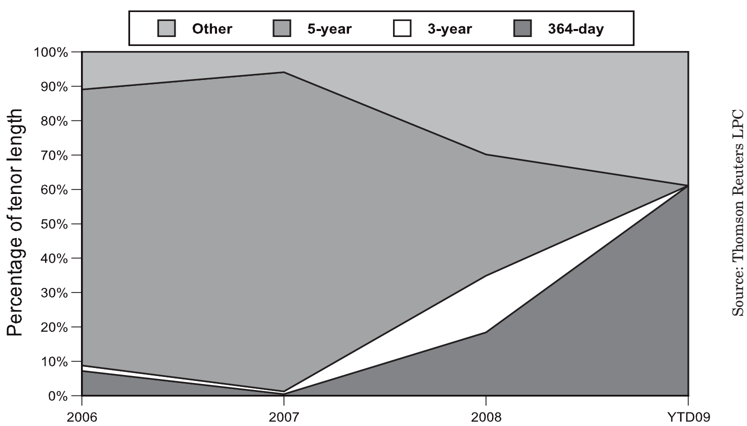


Fig. 4: Banks push for shorter tenors



To add further to the woes of the municipalities, a large number of the backup facilities came up for renewal at the same time the number of banks providing liquidity was dwindling. Major liquidity providers in the municipal market historically include European banks such as Dexia and Landesbank Baden-Wuerttemberg (LBBW). The banking crisis has taken a huge toll on these institutions. Dexia already received a €6.4 billion ($8.9 billion) bailout by France, Belgium, Luxembourg and key shareholders last September. The bank has discontinued its public financing activities in a number of countries to focus on core operations in Europe and is in the process of selling U.S. monoline insurer FSA.

LBBW, meanwhile, requires a €5 billion capital increase and €12.7 billion in risk guarantees to keep it afloat amidst a capital shortage and mounting write-downs related to the financial crisis. As a result, the average rate on VRDOs backed by an LC facility backed by particular banks shot up (Fig. 2). According to Breaux, the high demand for liquidity, coupled with the decline in liquidity providers, resulted in costs increasing significantly for a backstop.

Contraction in the loan world

While the municipal bond market has been plagued by problems, the corporate loan market has been dealing with its own set of challenges. With the economy in a deep recession, a rapid deterioration in credit quality and a banking system struggling to survive, syndicated loan issuance in 1Q09 declined from 1Q08 levels by nearly 42% to $105 billion.

The investment grade loan world was not immune from the contraction seen in the riskier loan market segments, though the dynamics were different. Investment grade loan issuance in 1Q09 came in at $61.8 billion, a contraction of 16% from levels seen a year ago. Bank consolidation and balance sheet contraction took their toll, leaving lenders to focus mostly on core relationships. Banks showed reluctance to recommit to deals where there was insufficient ancillary business.

In this environment, investor-owned utilities have followed the larger market trend and have seen their footprint in the market contract. In all, utility loan volume contracted from around $64 billion in 2007 to just $28 billion in 2008 (Fig. 3). And given that there was only $630 million in utility issuance in 1Q09, the outlook for the rest of the year looks dismal.

It was not only issuance that took a major haircut. Contracting balance sheets ensured that bank appetite for long tenors on revolving credit lines rapidly declined. As such, the market share for five-year revolvers for investor-owned utilities declined from as high as 80% in 2006 to just 35% last year (Fig. 5). Similarly, undrawn fees for investor-owned utilities, especially in the BBB rating zone, have climbed over the last year (Fig. 5).

Municipal-owned utilities Make their case

Despite the fact that credit has been tight in the syndicated loan market, municipal-owned utilities believe they stand to benefit due to certain key differences they have when compared to investor-owned utilities.

One key differentiator between a municipal-owned utility and an investor-owned utility is that banks face a lower risk capital charge if they lend to a municipal-owned utility. The regulatory charge on a municipal-owned utility can be between 1.6-4%. Meanwhile, for an investor-owned utility under the current Basel framework, the capital charge on undrawn portions of a multi-year revolver is 4% and 8% on the drawn portion.

Additionally, most municipal-owned utilities are better rated than their investor-owned counterparts. Last November, Standard & Poor's upgraded ratings of 130 municipal-owned water and sewage utilities citing their strong financial metrics. S&P noted that municipal-owned utility ratings are supported by the fact that almost all of them are monopolistic service providers that enjoy local rate autonomy. All of the 130 issuers were upgraded to A- or above, while 16 were upgraded to AAA.

Other characteristics that municipal-owned utilities hope to benefit from are that they do not pay taxes or dividends, and they can finance their capital improvements with tax-exempt debt that results in a lower cost of capital.

Syndicated credit lines also offer advantages for the municipal borrower. For one, a syndicated credit line will allow investors in a borrower's VRDO program to better manage risk; right now many investors are at their limit for holding debt supported by a diminished group of liquidity providers in the municipal market. A widely syndicated revolving credit line would give a VRDO investor direct exposure to the borrower, rather than a bank providing the backup liquidity.

A syndicated credit line also ensures that a municipal-owned utility is not being tied directly to a bond issue as is in the case of a standby bond purchase agreement backed by a weak lender.

"With the recent downgrades of banks that are the sole liquidity providers of a bond issue, we have seen the interest rates we pay increase by over 300 bps," says Breaux.

The spike in spreads is substantially higher than the pricing increase in the syndicated loan market for investor-owned utilities. At least just on an undrawn spread basis, investor-owned utilities have not seen their costs jump as significantly as compared to the municipal market. For instance, the undrawn spread on BBB+/Baa2 rated Portland General Electric's $125 million revolving credit line from December 2008 was 25 bps (Fig. 6).

Breaux, whose EBMUD was one of the municipal-owned utilities to be upgraded last November to AAA, is hoping to successfully negotiate a credit line that will have terms comparable to investor-owned utilities.

With a VRDO program in the range of $1 billion, EBMUD is hoping its status as a frequent capital market issuer will be recognized in the loan market. The Metropolitan Water District has a VRDO program that is about $2 billion.

Fig. 5: Undrawn fees on A and BBB rated investor-owned Utilities climb

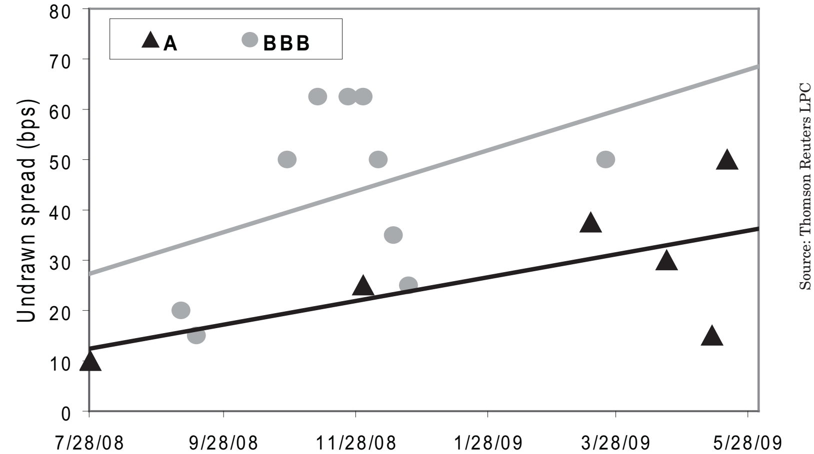


Fig. 6: Select investor-owned utility loans

Company_name	Quarter	S&P	Moody's	Undrawn spread
Dominion Resources Inc	3Q08	A-	Baa2	10
Oneok Inc	3Q08	BBB	Aa3	20
Piedmont Natural Gas Co	4Q08	A	A3	25
Southern California Edison Co	1Q09	BBB+	A3	37.5
Dayton Power & Light	2Q09	BB+	A3 (ISSUER)	30
Northern Illinois Gas Co	2Q09	NR	A2 (issuer)	15
Integrys Energy Services Inc	2Q09	BBB+	A3	50

Company_name	Quarter	S&P	Moody's	Undrawn spread
PPL Energy Supply LLC	3Q08	BBB	Baa2	20
Consumers Energy Co	3Q08	BBB-	Baa1	15
Atmos Energy Corp	4Q08	BBB	Baa3	50
DCP Midstream Partners LP	4Q08	BBB+	Baa2	62.5
Pepco Holdings	4Q08	BBB	Baa3	62.5
Constellation Energy Group Inc	4Q08	BBB	Baa2	62.5
Pepco Holdings	4Q08	BBB	Baa3	62.5
CenterPoint Energy Houston Electric LLC	4Q08	BBB	Baa3	50
Avista Corp	4Q08	BBB-	Baa3	35
Portland General Electric Co	4Q08	BBB+	Baa2	25
Atmos Energy Marketing LLC	4Q08	BBB	Baa3	50
Atmos Energy Marketing LLC	1Q09	BBB	Baa3	50

Source: Thomson Reuters LPC