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DISTRESSED MUNICIPAL DEBT REPORT

PG&E FILES BANKRUPTCY

It seems that the California wildfires have not finished their devastating destruction. Although many lives of those who suffered losses of their property and loved ones will continue to be harmed, the lives of power company executives, shareholders and bondholders are now coming in for their turn. As the major utility in California, PG&E bears the liability for the property losses its equipment causes independent of any negligence claims. The order of magnitude of such claims exceeds the company's net worth, that is, before counting bondholders' investment in the company. It quickly became clear that this situation can only be settled over several years and a Chapter 11 bankruptcy appeared to be the best solution to avoid a scramble by claimants to get in line first.

The bondholder claims on the company are in the billions of dollars and they are not exempt from possible loss. Aside from its corporate bonds, some $823 million in various authority bonds are outstanding according to Bloomberg. Since these are conduit bonds, only PG&E or one of its subsidiaries is liable for them, albeit some are reset bonds with a bank buyback guarantee. This is not the first bankruptcy filing for PG&E. In 2002 they declared bankruptcy after having borrowed $11 billion to pay for electricity purchases at inflated prices due to Enron's market manipulations and the state's constraints on in-state power plants and refusal to raise rates to cover the higher cost of purchased power. It took a bankruptcy filing to get the state to see the light, or lack thereof, as brown-outs became a problem.

This promises to be a long drawn out bankruptcy involving the state government since the company must continue to operate, so both the state and rate payers will have to participate in any resolution. It's not as complicated as the Puerto Rico bankruptcy, which is a Chapter 9 bankruptcy proceeding, but it will involve many more lawyers and, after all, this is California where anything does happen. Already we are reading that San Francisco is studying whether they should take over the assets of PG&E which service their area much as utilities in Washington state are locally owned.

Below is a list of the municipal bond issues which are affected. Bond prices have not reacted so far since most are monthly reset issues with a buyback guarantee. However, trading has been heavy possibly due to sales by institutions that cannot hold bankruptcy bonds. Bondholders may be spared the severe haircut shareholders can expect but again, this is California.

Solano Irr Dist Hydroelec Auth	$2,080,000	CUSIP 834126BG0
Calif Pollu Cntrl Fin Auth Reset Bonds	$465,000,000	CUSIP 130534XA3, XD7, XX3
Calif Pollu Cntr Fin Auth	$148,550,000	CUSIP 130534XL9
Solano Irr Dist Hydroelec Auth	$9,335,000	CUSIP 834125BC9
Calif Infrastru & Econ Dev Auth	$50,000,000	CUSIP 13034ASX9
Calif Infrastru & Econ Dev Reset Bonds	$148,550,000	CUSIP 13033W3H4, 3J0

We note that electric utility bankruptcies have been a significant source of bond defaults in the past as in recent times. Presently, with PG&Es filing there are still three major utility defaults in bankruptcy; Puerto Rico's PREPA with $8.3 billion and FirstEnergy with $2.26 billion. Previously we had TXU with $855 million and PG&E with $823 million. There is, however, no concern that this is the start of a wave of such defaults since the underlying causes are quite diverse. Still, some $15 billion in defaults by electricity providers have occurred since 1980 which is about 5% of all defaults in that time period making it the single largest default source, in dollar amount, among conduit bonds. Housing bond defaults are much more common (783 defaults) but represent a much lower dollar amount ($9.4 billion) unless one adds in congregate care facilities.

PUERTO RICO UPDATE

Negotiations by the various municipal bondholder groups took a totally new twist this month when the federal oversight board asked the bankruptcy court to declare $6 billion of the island's general obligation bonds null and void because they exceeded the Commonwealth's constitutional debt limits. The specific debt issues involved were the bonds issued in 2012 and 2014, the last two GO issues before the collapse. The issue here, however, is more than just a technicality, but rather, why these bonds were issued. We recall that when Puerto Rico issue $3.5 billion in 2014, we questioned who would buy this issue given that it had become clear where things were headed. Our assumption at the time was that the bonds were being issued to meet the interest payments coming due that year. The only people we could see dumb enough to buy these bonds were the very institutions who stood to gain from having their bonds serviced. Hence, what they bought came right back to them. This was no different from bankers lending more money to a defaulting borrower so they could service their loans and allow the bank to continue to carry the debt as current and not have to provide a loss reserve thereto. The federal oversight board may well have been made aware of this situation and decided that such behavior should not be rewarded. However, this ignores the possibility that the current holders of the bonds are not the same buyers who received that bonds' proceeds. Nullifying the bonds raises the question of whether, thereby, the issue of securities fraud comes into play since the Commonwealth and its lawyers would have been guilty of misleading investors. This same situation occurred in the 1982 $2.25 billion 1982 Washington Public Power Supply System (WPPSS) bond default where the state supreme court ruled that the guarantors of the bonds, all locally owned Public Utility Districts, had exceeded their authority and were therefore not obligated on the debt. In that situation the trustee, then Chemical Bank, turned around and sued those utilities for securities fraud and would have prevailed had not the Washington state legislature passed a new statute, retroactively we might add, changing the securities fraud statutes exempting government entities from such fraud claims unless intent to defraud, or sinter, could be proven. Perhaps someone should review the fraud statutes in Puerto Rico before deciding to buy or sell these bonds in anticipation of a negative bankruptcy court ruling.

Another issue facing the bankruptcy court this month is the relative claim status of GO bondholders versus those backed by sales tax receipts. This fight involves way more in bonds and is more critical since sales taxes are the most reliable source of cash flow for debt service. The two bondholder groups have reached an agreement and are asking the court to ratify same. But like all such agreements, they leave out the citizens of Puerto Rico and the politicians who cater to them. There is always the risk that they gin-up a public relations campaign against those greedy capitalists who should have known that lending money involves risk of loss, now known as the WPPSS defense.

BLUE EARTH, MN BLUE RIDGE APTS BLUE RIDGE APARTMENTS

Just to show we keep track of defaults of all size and over a long time horizon, we present the subject bonds which were last reported on in our October 2006 newsletter. Hence, consider this your once a decade update. These $1.1 million of colorfully named multifamily housing revenue bonds were declared in default in June 2006. No foreclosure has been made on the property due to the fact that it is subject to a ground lease which expires in 2024 at which time the property belongs to the landholder. One can only wonder why anyone would underwrite or buy such a small squirrely deal. However, failures never cease and even this disaster has come to an end via the trustee distributing the funds he has on hand, or $70,000 which gave bondholders a 7 cent on the dollar recovery after 13 years without any interest. The lesson here is clearly, avoid very small issues. CUSIP 095461AD1

BUCKHORN VALLEY CO METRO DIST #2 LIMITED TAX REFUNDING

The latest non-payment of interest by this Colorado metropolitan district is a problem faced by bondholders of numerous districts and deserves an annual explanation lest we forget why bondholders are suffering. In their latest explanation of why the December 1, 2018 interest payment is not being made, the district presented a good recounting of the problems which caused this state-wide problem. It began in 2011, one year after the bonds were issued, when property values began falling. This continued through 2014 and resulted in a 72.7% reduction in property values. Hence, although the project is 100% developed and property owners are paying almost all their dues, the revenue shortfall is extreme. For example, the December tax revenues needed for debt service were $650,725 but revenues paid were $250,907 or 61.4% short of this amount.

The problem stems from a Colorado constitutional limit on how much property taxes can be increased annually. In the Buckhorn Valley case, the current rate is a ridiculously low 54.111 mill or just over a half cent on the dollar. Hence, the debt arrearage is growing faster than the rate increases. The bottom line is that this bond issue will not be retired at maturity in 2024 and 2039. On the other hand, the current revenue stream is unlikely to suffer further erosion. While unlikely, the state legislature may feel pressured to change the constitution of the state since new development bond funding may become too hard to obtain if bond buyers actually start reading their bond indentures and realize what 'Limited Tax' really means. Bonds have not traded since 2015. CUSIP 118383AC2

CRAWFORD HLTH FACS DEV CORP
LIFELINE VENTURES PROJ

This Texas nursing home issue came out in 2016 and has had operating shortfalls due to construction delays and slower sign up for occupants. In January 2018 the majority bondholders advised the trustee to use any monies received to fund necessary maintenance and make debt service payments out of reserve funds. The trustee has now reached an operating agreement with the facilities' operator which was approved by the majority bondholders. For the January 1, 2019 interest payment, a draw on the reserve account had to be made to fund the $442,800 interest payment leaving only $140,586 in the interest payment reserve account. These 6.75% bonds traded at 50 on December 20, 2018. CUSIP 22502CAA8

CENTRAL FALLS RI FAC CO REV
DONALD WYATT DETENTION FACILITY

This $106 million bond has been in default since 2009 when it made its first draw on the interest reserve account. The reserve ran out and in 2015 and it reached a forbearance agreement with the trustee for continued operations with only partial interest payments. Fast forward to today and we have a facility that will miss making any interest payment on January 15 due to the government shutdown which cut off all payments from the Federal Government, its only customer. Since interest payments to bondholders is not the only cash obligation the facility has, the trustee has agreed to advance them a $1.5 million bridge loan, to be repaid when the shutdown payments are received. What is interesting here is that the trustee will make the loan out of its own funds but is offering bondholders the chance to participate in the loan. This is better than it sounds since the loan is made at an interest rate of 11.25% and would appear to be as secure as a prison bond gets. This loan default already has a pretty colorful history as detailed in our September 2018 issue and the story just keeps getting better. CUSIP 153457AX4

DISTRICT OF COLUMBIA
NTL CNTR FOR LAW ENFORCEMENT

This $103 million 2016 bond issue was for building the titled center in Washington DC. The revenues for its operation were principally to come from donations. However, this fell short by some $4.4 million and now requires a draw on the debt reserve to make the interest payments with the series C bonds not being paid. Operations are also not doing well since 4th quarter revenues were $313,000 and expense were $1.9 million with an operating loss for 2019 projected at $5.6 million. The director of the facility resigned effective December 31 and a search is underway for a new director. This looks like another feel good project that has come up short. The bonds were issued in three tranches of $48.1 million in A senior bonds, $30 million in B senior bonds and $25 million in C junior bonds and are worth examining for their structure. The A bonds mature in 2031 to 2049 with coupons of 7% to 7.75%. The B bonds mature in 2025 to 2027 with coupons of 5.75% to 6.375%. The C bonds mature in 2049 with a coupon of 10%. After the announcement of the shortfall the A bonds fell to a price of 67, the B bonds fell to 52 initially and then recovered to 85. The C bonds, no surprise, have not traded. The redemption of the B bonds was scheduled to be $11.2 million in 2018, but only $1.3 million were made due to the operating shortfall. CUSIPS 25483VQQ0, 25483VQR8, 25483VQT4

FREDERICK CNTY MD TAX INCR
JEFFERSON TECH PARK

An unscheduled draw was made on the debt reserves for this $40 million bond issue to make the January 2, 2019 interest payment on the B bonds due to the failure by the developer to make his special tax assessment payment. CUSIP 35561AA0

GREEN CNTY DEVELOP AUTH GLEN-I LLC PROJECT

This is another Georgia retirement facility for $41.9 million which had to invade its debt reserve to make the January 2, 2018 interest payment. The bonds were issued in 2015 for a new facility, so we assumed that this may just be a miscalculation of the startup delay. However, the July 2018 interest payment had to be funded from the reserve account leading one to question if this startup project has more serious problems. Finally, the January 1, 2019 interest payment was not made due to a lack of available funds. This led to the majority of bondholders asking the trustee to accelerate the bonds and proceed to file a court action appointing a receiver. The bonds have not traded recently. CUSIP 394376BT3

GULF COAST TEXAS IDA MICROGY HOLDINGS

Microgy Holdings is a company with a process to build plants that can convert 1.3 million wet tons of manure and 323,000 tons of food substrate into 1.952 trillion BTUs of RNG or fuel gas. Not that you can make money doing this, but you can sell carbon sequestration credits and what is described as "other marketable environmental benefits based on Microgy's anaerobic digester technology". Apparently you can't make money even doing this so, in less than two years the company filed Chapter 7 bankruptcy. For the uninitiated, Chapter 7 means you give up. In this case, two bond issues were launched to fund facilities in Texas and California at the same time. The issues were for $60 million and $62.4 million, of which $31.2 million was unspent and returned to bondholders before the bankruptcy filing. The bankruptcy case was quickly settled and from the asset sales, the California bondholders received $550,000 or 1 cent on the dollar. The Texas bondholders made out a little better, receiving $22 million or 36 cents on the dollar. All this happened back in 2010-2011with intimation that further recoveries may be in the offing. Alas we are in 2019 and no more offing. Chalk it up to another loser for the environmental movement. CUSIPs 13079KAA2 & 402205AF5

HARRISON CNTY WV CNTY CMSN CHARLES POINT PROJECTS 1 & 2

This $33 million sewer bond was issued in 2008 with a 7.00% coupon. The first bond, series B for $28.1 million defaulted in November 2012 when it had to draw on the debt reserve to make interest payments. Subsequent defaults by the district's developer lead to a standstill agreement and revised terms of payment into the bond funds. This in turn led to a reissuance of the bonds on June 26, 2013. This new payment arrangement lasted until June 3, 2014 when the trustee advised a shortfall of some $978,000 in payments due necessitating a draw on reserves to fund the interest payment. In addition, the series A bonds have also fallen in default by some $58,000 for the June 3 payment. These bonds represent an additional $4,895,000 of bonds. The default continues since the special assessments of $1.546 million being made in 2016 were not paid. As of December 1, 2018 three interest payments have been missed and reserve funds are depleted. The project is operating under a forbearance agreement. CUSIP 41525AAG2

HUNTSVILLE SPEC CARE FACS AUTH REDSTONE VILLAGE RETIR FACILITY

This Alabama retirement facility first began operations in 2007 with a $54.8 million bond issue which was followed up with a $1.8 million bond issue in 2008 and a $10 million issue in 2011 and a $6.7 million issue in 2012 for a grand total of $81.3 million. On July 1, 2018 the trustee advised that $240,571 had to be drawn from the debt service reserve to make the July 1 interest payment. But not to worry, since the cumulative debt reserves still has $5.8 million for future use. We did not fail to notice that this amount would appear to be the reason for the $6.7 million bond issue in 2012, i.e. are we seeing an iteration of a Ponzi scheme here? Key statistics are; an average of $289,000 of debt per occupant, pre-interest income for 2017 of $3.5 million versus an annual interest only expense of $4.7 million, and a debt coverage ratio of only .90 to 1. In its latest update, the trustee advised that total interest arrearage now totals $2,372,111 and principal arrearages amount to $1,375,000. Against these, however, the trustee still retains $5.9 million in debt service reserves for the various bond issues. The oddity here is that the various bond issues are trading from prices as low as 34 to a high of 100. This may have been what motivated the trustee to make such a thorough disclosure of the bond fund finances. CUSIP 447297AV4

MISSION ECON DEV CORP WATER SUPPLY ENVIRO WATER MINERALS

This $48 million bond issue is to finance a new technology for environmental cleanup where the cleanup process yields sufficient by-products to allow a cleanup without significant government help. The company is currently constructing a plant in El Paso, Texas to install technologies to recover minerals and desalinated water from brackish water and waste brine discharged from brackish water. The plant will chemically separate wastewater into high-purity, industrial-grade mineral products that are valued in commercial markets. All contaminants are extracted from the water streams, leaving only potable water and thereby alleviating the desalination plant's water discharge and its associated environmental hazards. Management anticipated the plant to be operational in the second quarter of 2017. The project is running behind on its startup and has had to resort to drawing on its debt reserves beyond planned needs. The project began drawing on its debt reserve in July 2017 and has still failed to become operational and generate revenues. On August 17, 2018 the project obtained a $6.675 million 15% second lien on the project to fund improvements on the project to make it commercially operational. That agreement called for the project to generate at least $750,000 in revenues during any four-week period prior to December 31, 2018. Also in August a new forbearance agreement was reached which will continue through December 2021. This probably means that the debt reserve will be exhausted sometime before then. The trustee has now taken the extraordinary step of declaring the bonds in default. This may be a preliminary to further, more drastic actions since the project did not achieve the $750,000 revenue target specified by the second lien holders, who then invoked their right to declare a default and seek legal remedies. This means a battle is shaping up between the secondary lien holders and the bond trustee. It looks like border security is not El Paso's only problem. It also looks like environmental cleanup can be messy in more ways than one. Bonds have not traded since issuance. CUSIP 605149AB9

NW ARKANSAS REGIONAL SOLID WASTE MNGT DIST WASTE DISPOSAL

This $11.3 million solid waste disposal bond was issued in 2005 with a 7.00% coupon. The obligor defaulted when it did not make all payments due, beginning in November 2012. A trustee letter of demand did not elicit cash or a response from the obligor. According to the trustee, the project has violated numerous environmental standards in its landfill operation and has shut down the operation. The district filed a Chapter 9 bankruptcy proceeding on January 16, 2014, but this filing was challenged by Bank of the Ozarks, the trustee. This challenge was sustained by the court and the case was dismissed. On December 2, 2014, the trustee filed a complaint against the district seeking the appointment of a Receiver who is now operating the facility. On November 15, 2016 the Receiver filed a report in the Pulaski County Circuit Court recommending it order the levy of an annual service fee in the amount of $18 per residence and business located in the District with the proceeds to be used to satisfy $11.09 million of the bond principal with the rest of the obligation to be paid in 19 annual installments from 2017 through 2035. Note the bonds original maturity is November 1, 2017. This arrangement was challenged in court via 6 class action suits. The trustee appears to have thrown up his hands and advised bondholders where they can find the information on the cases and not to depend on him for periodic updates. Bonds had dropped to a low of 12 but rose to 83 when the court upheld the $18 assessment, however, this story may be old but far from over. CUSIP 66732TAL6

OKLAHOMA DEV FIN AUTH INVERNESS VILLAGE CMMTY

As we reported last month, the trustee sought a court order appointing a receiver of the facility for purposes of its sale. This was contested and subsequent negotiations followed. It has now been agreed and a consent order filed with the court appointing a receiver and investment banker to expedite the sale. Given the outstanding issues and uncertainties, the trustee has delayed making the coupon payment for January 1, 2019. The trustee continues to have discussions with the majority holders as to the amount of funds to be retained in the trust estate given the current issues. CUSIP 7884WAJ8

DEFAULT SUMMARY BY YEAR

		2007/2011	2012/2016	2017	2018	2019
TOTAL	#	648	296	42	27	4
DEFAULTS	$(000)	$30,768,672	$83,684,068	$1,211,873	$2,951,520	$966,605
INSURED DEFAULTS	$(000)	$2,590,518	$27,897,817	$356,600	$45,085	
SETTLED DEFAULTS	$(000)	$20,774,330	$6,449,423	$174,920	$9,315	
DISTRESSED	#	156	109	22	14	1
ISSUES	$(000)	$21,439,594	$6,412,965	$1,911,937	$911,991	$40,000

Largest Unsettled Defaults

Issuer	Project	$Amount (Millions)
Puerto Rico	Various	63,500
Puerto Rico	PREPA	8,500
First Energy Corp	Various	2,260
Mashantucket Pequot Tribe	Casino	2,200
Pacific Gas & Elec	Utility	823
Chukchansi Indian	Casino	250
Lombard IL	Public Facs Corp	246

Largest Distressed Issues

Issuer	Project	$Amount (Millions)
Golden State CA	Tobacco Settlement	11,398
Buckeye H	Tobacco Settlement	5,531
New Jersey	Tobacco Settlement	3,622
Virginia	Tobacco Settlement	1,149
TSASC NY City	Tobacco Settlement	1,100
Rhode Island	Tobacco Settlement	800
Suffolk Cnty NY	Tobacco Settlement	226

RESEARCH REPORTS & PUBLICATIONS

Richard Lehmann & Assoc Inc maintains a database of information on over 4,000 defaulted municipal bonds. We are able to provide customized research reports on these issues upon request.

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