

Bond Case Briefs

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Insurance Stocks to Watch as Puerto Rico Defaults.

The Greek crisis is still fresh in our memories but there seems no end to bad news. Unable to repay its huge debt, Puerto Rico has defaulted. The island's Government Development Bank could pay back only \$0.6 million of the \$58 million due to its creditors of Public Finance Corporation. The amount was part of the interest on bonds.

Puerto Rico has a hefty debt balance of over \$70 billion. Melba Acosta-Febo, President of the Government Development Bank, stated, "the partial payment was made from funds remaining from prior legislative appropriations in respect of the outstanding promissory notes securing the PFC bonds."

"First Time Defaulter"

While the default is the first time in Puerto Rico's history, it raises concerns about the economic future of the island as well as the liquidity of the commonwealth. The picture is of widespread gloom as Moody's sees this as among the first of bigger defaults on commonwealth debt and Standard & Poor's portends other defaults over the next few months and signs of dismal liquidity. Going by a Reuters report, Puerto Rico had halted monthly deposits to its general obligation redemption fund for a temporary period.

The \$58 million in bonds were issued by a subsidiary of the Government Development Bank to procure funds for school construction and the creation of landfills among others. While the government bank financed those projects initially, it prudently shifted the liabilities from its own balance sheet by refinancing them through its subsidiary, the Public Finance Corporation. The bonds were already facing downgrades and moved to the junk territory in March by Moody's Investors Service and Standard & Poor's.

The Puerto Rico debt includes approximately \$18.6 billion of general-obligation bonds and government-guaranteed debt, \$15.2 billion of sales-tax-backed bonds and \$24.1 billion of bonds issued by government agencies, like the Puerto Rico Electric Power Authority.

Puerto Rico has been stressed by government debt crisis for several years. The island owed many debt payments on Aug 1, of which it could pay only the interest portion of \$58 million.

Way Out for Puerto Rico

The Puerto Rico debt crisis is worse than Detroit's \$20-billion crisis (Detroit filed for bankruptcy two years back) but much lesser than the \$350-billion crisis of Greece. However, Puerto Rico cannot file for bankruptcy as the island is not covered under the U.S. Bankruptcy Code. Moreover, it is unlikely that any institution will come for rescue as we saw in the case of the Greek distress where International Monetary Fund came to rescue.

Nonetheless, Puerto Rico intends to restructure its debt with policymakers so that they can work a way out with creditors and investors. Puerto Rico even fears a government shut down if further

funds are not raised.

To add to its woes, the residents of Puerto Rico are moving out as high unemployment and economic instability are forcing them to look for survival outside the island. This, in turn, will hit Puerto Rico even harder as it lowers the tax base of the island — the major source of revenue for any economy.

According to Morningstar Inc., about half of the U.S. municipal-bond mutual funds have coverage in Puerto Rico. So the island's default could cause serious damage to the concerned investors, who have already incurred heavy losses after the commonwealth's credit ratings were downgraded to junk and bond prices collapsed.

Sensing tough times, Monarch Alternative Capital LP, which had invested in commonwealth's general-obligation bonds, got rid of some. However, the latest crisis will surely act as a dampener to the fortunes New York-based MBIA Inc. and Bermuda based Assured Guaranty Ltd. (AGO - Analyst Report) that are exposed to Puerto Rico

MBIA Inc. has almost twice the exposure of Assured to Puerto Rico's stressed power authority called Prepa. While the crisis could eat away the statutory capital of MBIA's National Public Finance Guarantee Corp., about 40% of Assured's funds will be washed out as together they insure about 20% of the islands through municipal debt as per media reports.

While MBIA Inc. lost 2% in yesterday's trading, another bond insurer Ambac Financial Group, Inc.'s shares dropped 3.4%.

by Zacks Equity Research

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