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Puerto Rico Seen Sliding Toward Bankruptcy as Deadline Nears.

NEW YORK — Bankruptcy for Puerto Rico is looking ever more likely as the clock ticks down toward a May 1 deadline to restructure $70 billion in debt, ramping up uncertainty for anyone betting on returns from the island's widely held U.S. municipal bonds.

When U.S. Congress last year passed the Puerto Rico rescue law dubbed PROMESA, it froze creditor lawsuits against the island so its federally appointed oversight board and creditors could negotiate out of court on the biggest debt restructuring in U.S. municipal history.

The freeze expires on May 1, however, and an extension by Congress is "not going to happen," said a Republican aide to the House Committee on Natural Resources, which is in charge of territory matters.

A round of mediated talks is scheduled to begin on Thursday. But absent an agreement soon, a growing number of analysts say Puerto Rico will seek protection from creditors under PROMESA's court-sanctioned restructuring process, akin to U.S. bankruptcy.

Forbearance deals could let negotiations continue past May 1, but a source directly involved in the talks said avoiding an eventual bankruptcy is "impossible."

The source, who declined to be named because the talks are private, said parties have grown further apart since Governor Ricardo Rossello took office in January.

The negotiating tactics of Rossello and the board have jarred investors who expected more creditor-friendly approaches from both. The board is pushing debt repayment cuts more than double those proposed by former Governor Alejandro Garcia Padilla, a populist whose policies had already alienated creditors.

Disparate stakeholders have united to question the legality of a fiscal turnaround blueprint approved by the board, and to resist mediation efforts.

Hector Negroni, whose Fundamental Credit Opportunities fund holds Puerto Rico debt, said he recalled "constructive comments" from Rossello and board members "about protecting the priorities of creditors" during the board's early days. "But their words are not being followed up by their actions," Negroni said.

Bankruptcy is now "the most likely outcome," said Height Securities analyst Ed Groshans, who increased loss projections for bond insurers like MBIA Inc and Assured Guaranty Ltd in an April 3 note.

Elias Sanchez, Rossello's liaison to the board, said the government holds out hope for at least partial compromise. "We feel very confident we can strike some deals by May 1, maybe not all of them," Sanchez said.

The oversight board is committed to pursuing agreements out of court, its spokesman, Francisco Cimadevilla, said. “A transaction is always better than a lawsuit,” he said.

But with myriad creditor classes competing for priority, compromise over Puerto Rico – once a rising star of U.S. high-yield muni funds – could be tough.

“The more creditors insist that part of their position is that no one fare better than they do, the more difficult that is to effectuate outside of bankruptcy,” said restructuring expert Melissa Jacoby, a professor at the University of North Carolina School of Law.

Puerto Rico is trying to escape a crisis marked by a 45 percent poverty rate and rampant emigration.

Since bankruptcy gives debtors the ability to impose payment cuts over creditor objections, it is seen as a negative for bond markets, Jacoby said.

Trading prices of Puerto Rico’s benchmark 2035 general obligation bonds have reflected that concern, falling precipitously in recent weeks.

But risk cuts both ways and Sanchez said the government wants to avoid bankruptcy as much as creditors.

Putting Puerto Rico’s fate in the unpredictable hands of a judge “could go really bad for the government too,” he said.

By REUTERS

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(Reporting by Nick Brown; Editing by Tom Brown)