# Bond Case Briefs

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## Puerto Rico Bankruptcy Is 'Beginning of the Story' for Investors.

***Hedge funds, bond insurers, mutual funds and other creditors have competing interests***

Puerto Rico's entry into court protection ends a chaotic period of lawsuits and defaults. But the process likely won't satisfy everyone.

A federal oversight board created by Congress placed the struggling U.S. territory under a court-supervised restructuring proceeding akin to bankruptcy on Wednesday, creating a single forum to sort out Puerto Rico's mountain of liabilities to bondholders, pensioners and service providers. The U.S. territory and its agencies owe $73 billion in municipal bond debt accumulated through years of borrowing to finance deficits against a declining tax base.

Wednesday's filing, however, is only "the beginning of the story," said Richard Ravitch, who was involved in the negotiations that helped New York City avoid bankruptcy in the 1970s as well as the bankruptcy negotiations in Detroit.

The bankruptcy proceeding pits Puerto Rico against its creditors, and its creditors against each other. Puerto Rico's investor base includes mutual funds, bond insurers, hedge funds and individual retail bondholders, who either bought commonwealth debt or agreed to guarantee it. They all acquired exposure at different prices and want different restructuring terms.

Some hedge funds scooped up bonds at cut-rate prices as Puerto Rico lost the confidence of the financial markets and they have placed bets on specific tranches of debt, said Craig Barbarosh, a restructuring attorney at Katten Muchin Rosenman. Meanwhile big mutual-fund managers generally purchase debt closer to par values, meaning they have greater incentive to agitate for the maximum recovery across bond classes.

Bond insurance companies Assured Guaranty Ltd AGO 1.17% , MBIA Inc. MBI -0.12% and Ambac Financial Group AMBC 0.54% have billions of dollars in guarantees on the line that make them jointly liable for Puerto Rico's obligations. But the insurers' interests are not aligned either. Ambac guarantees roughly $8 billion in sales-tax bonds maturing decades from now, while Assured wraps a different universe of debt comprised mostly of general obligation and utility bonds, according to their financial disclosures.

In addition to its obligations to bondholders, the commonwealth has roughly $45 billion in pension debt and education and health care costs to cover. Mr. Ravitch said he believes the restructuring proceeding will strengthen Puerto Rico's hand with creditors, who now have the threat of a court-enforced settlement hanging over their head.

An estimated $13 billion in debt is held by local bondholders and financial institutions, a potential drag on growth if those bonds are restructured and island residents lose income streams they depend on.

Treating local holders preferentially is also problematic because of restructuring principles that call for equal payment among creditors.

Complicating matters, Puerto Rico hasn't yet decided which creditors have priority in a restructuring. Competing groups of hedge funds holding general obligation and sales-tax bonds each have claims to top status, but no court has ever defined their respective payment rights.

"We always talked about the rock fight that would break out between these two and now this is the rock fight," said Rob Amodeo, head of municipals at Western Asset Management, which sold its Puerto Rico debt several years ago.

Advisers to Gov. Ricardo Rossello nearly reached an agreement with general obligation creditors this week, before the board intervened in a late-night conference call to stop negotiations, according to people familiar with the matter.

The fiscal plan that formed the basis for negotiations allocates $800 million annually for debt service in the next decade, treatment creditors have objected to when they are owed more than four times as much.

The board is also caught between current creditors who say Puerto Rico can't risk alienating credit markets by writing down bonds too deeply, and firms that previously sold out of Puerto Rico debt and now argue for aggressive debt restructuring to revive the island economy and make its debt attractive again.

Puerto Rico was cut off from the credit markets in 2015 after nearly a decade of decline, and restoring market access is a must for the federal oversight board tasked with cleaning up its financial mess.

Dave Hammer, head of municipal bond portfolio management at Pacific Investment Management Co., said bond values should be cut below their current trading values to get investors who have shunned Puerto Rico off the sidelines.

Creditors are also competing with pensioners who the board wants to pay 90% on average for the next 10 years.

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