

# **Bond Case Briefs**

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## **Hedge Funds Vie With Puerto Rico Workers Over Getting Paid First.**

- **Commonwealth's pension systems set to go broke this year**
- **Island's \$123 billion bankruptcy biggest in municipal history**

The message in Puerto Rico is blunt: pay us, not Wall Street.

Anger over the biggest municipal bankruptcy in U.S. history has centered on the urgent question of public pensions. Puerto Rico has promised its workers and retirees \$49 billion in benefits, but it's guaranteed bondholders even more.

The pension system is scheduled to run out of money as soon as July, and many on the island fear, with benefit cuts already under discussion, that the hedge funds who own one-third of the commonwealth's bonds will wrangle a better deal than ordinary Puerto Ricans.

"The whole situation is unfair," said Maria Rodriguez, a 64-year-old retired employee of the Public Building Administration. "I worked for over 35 years for the government and now it's apparently clear that my pension will be cut by at least 10 percent. This is the result of the actions of multiple administrations from both parties."

It's a no-win situation for Puerto Rico and its 3.5 million people. Schools are being closed, talented residents are leaving and the economy has been contracting for years.

That's the mess confronting U.S. District Judge Laura Taylor Swain as the adversaries face off for the first time in federal court May 17 in San Juan. They'll be tussling over \$123 billion owed to retirees and creditors.

### **'Don't Care'**

In pre-hearing rhetoric, labor groups are painting rich hedge funds as uncaring vultures looking to extract money from less-wealthy public workers. The creditors say there would be more money for everyone if Puerto Rico improved its revenue collections and thinned its hulking government bureaucracy.

"Hedge funds don't care what happens to the people, they want to get more profits," said Emilio Nieves, president of Puerto Rico's National Union of Educators and Education Workers. "They are our oppressors. We will resist and the government of Puerto Rico must decide if they are in favor of the people or the bondholders."

Average annual pension benefits are \$14,000, according to Puerto Rico's federal oversight board, and roughly one-third of employees are ineligible for Social Security benefits. Nearly half of island residents live in poverty and the median household income is \$19,350, compared with \$53,889 in the 50 states, according to U.S. Census data.

The commonwealth's federal oversight board anticipates a 10 percent cut in pension expenses. That's more generous than what Governor Ricardo Rossello offered bondholders in his latest public proposal. General-obligation bonds, or GOs, which the island's constitution says must be repaid before other bills, would receive a best-case recovery of 90 cents on the dollar. Since that estimate depends on an improvement in the government's finances, the recovery could be as low as 70 percent.

## **Divide Payments**

Rossello's fiscal plan would pay bondholders less than a quarter of what they're owed in principal and interest through 2026. The government hasn't said how they would divide those payments, or which group is first in line.

"As much as there were promises made to various stakeholders on the island — pensioners, current government employees or contractors who work for the government — those are all implicit promises," said David Tawil, president and co-founder of Maglan Capital LP in New York, who bought Puerto Rico bonds in 2013 but has since sold them. "The bondholders have explicit promises whether they be in offering documentation or whether they be pursuant to the constitution."

The court hearing comes two weeks after Puerto Rico's federal oversight board filed a form of bankruptcy called Title III to help reduce its \$74 billion of debt and tackle its unfunded pension crisis. It will be the largest restructuring in the history of the \$3.8 trillion municipal-bond market.

Title III, a provision in the Puerto Rico relief law that Congress passed last year, is the only way for the island to force pension recipients to accept benefit cuts in court. Puerto Rico needed to pursue Title III in part because of its pension crisis, the board wrote in its May 3 filing. Another negotiating provision called Title VI didn't include retirement savings.

## **Official Committee**

The various parties have already begun wrestling over repayment. A coalition of retiree groups has asked Swain to appoint an official committee to represent government pensioners in the court battle. Until now, pensioners have been excluded from talks between bondholders and Puerto Rico because the negotiations took place under Title VI.

A court-recognized committee would give retirees an equal footing with other creditors, said Robert Gordon, a lawyer with Clark Hill PLC, who's representing more than half the island's 160,000 public employee retirees.

"We need a voice in the case," said Gordon, who also represented the retirement systems in Detroit's bankruptcy case.

In a separate suit, a labor group representing more than 12,300 commonwealth workers and retirees is asking a court to declare Rossello's fiscal plan unlawful because of its proposed pension cuts, though it doesn't specify the impact on a retiree's monthly check. That lawsuit is on hold while the bankruptcy case goes forward. Other suits directly affecting the restructuring will also likely be put on hold.

## **Detroit's Example**

In Detroit, retired police and firefighters saw no reduction, while general employees got about 95 percent of what they were promised. Cost-of-living increases were cut for police and firefighters and eliminated for general employees. Both groups also saw health benefits cut. The changes were

expected to result in a 74 percent reduction in the city's total post-employment benefit costs.

It may be difficult for pensioners to avoid taking losses. Puerto Rico's constitution says that general obligations must be repaid before other bills, and retirement expenses don't have the same repayment pledge, said Ted Hampton, a Moody's Investors Service Inc. analyst in New York.

"Pensions are not up there with GOs," Hampton said. "The judge is going to have to think about what that means."

### **Sales-Tax Bonds**

Another class of creditors, those who own sales-tax bonds, have a dedicated claim on levy revenues. Rossello's plan offers them as much as 58 cents on the dollar, if Puerto Rico's finances improve, and as little as 39 cents on the dollar.

Hedge funds, like public workers, find fault with Rossello's fiscal plan, which estimates annual government expenses, including essential services, will total \$17.9 billion this year and reach \$22.3 billion in 2026. Creditors want to see a breakdown of which services are deemed essential.

Hedge funds holding \$1.4 billion of general-obligation bonds sold in 2014, including Aurelius Capital Management and Monarch Alternative Capital, sued the commonwealth on May 2, seeking overdue payments. Another group of hedge funds holding \$1.9 billion of senior sales-tax bonds, including Whitebox Advisors, Merced Partners and Tilden Park Capital Management, also sued the governor on May 2 to stop his fiscal plan from redirecting sales-tax revenue to the island's general fund and away from bond repayments.

Puerto Rico only has roughly \$1 billion of the \$49 billion promised to current and future retirees. That gap is a result of the commonwealth skipping employer contributions to the system, offering benefits without adequate funding and extending loans to retirement-fund participants.

"Puerto Rico's pensions unfortunately had a history of engaging in practices that were not common elsewhere and that were very threatening to their long-term solvency," Hampton said. "Part of what the court will look at is the legacy of those unusual or ill-advised practices."

### **Bloomberg Markets**

by Michelle Kaske and Steven Church

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