

# **Bond Case Briefs**

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## **Puerto Rico's Bankruptcy: Template For Other Troubled Cities.**

“What-Me Worry?” are famous words from the fictitious Alfred E. Newman. It’s great to have a positive attitude in life. But there are times when investors need to observe and grasp the gravity of situations. That’s where we are with Puerto Rico.

Puerto Rico will soon become a legal catfight. It will be a lulu: General obligation bondholders versus sales tax revenue (Cofina) bondholders; AMBAC versus MBIA versus Assured Guaranty. This brawl won’t be a heavy weight fight. It will be a cage match because the hedge funds are vicious, wily beasts.

Even if you don’t invest in municipal bonds, as a taxpayer there are multiple lessons to be learned. First off, remember when we were taught that a state or territory cannot file for bankruptcy? Until it does. Puerto Rico, with help from Congress, filed for Title III, which is an in-court restructuring mechanism modeled after Chapter 9. No matter what you call it, it’s still bankruptcy.

I project this bankruptcy will become the template for all the cities, counties and a few states whose budgets, unfunded pension and health care liabilities are out of control. As a matter of fact, many of us in Bondland have a new word: Illi-Rico.

That’s right. Illinois, the state that is \$14 billion in arrears paying its bills, two years without a budget, with under funded pensions like you wouldn’t believe. The Illinois Policy Institute estimates \$203 billion total debt for state and local retirement benefits and oh—as the Institute points out, “the \$203 billion includes only the unfunded liabilities of the state’s five retirement systems, which ignores bonds issued to tide over the pension funds and debt taken on to provide retired government workers with generous health insurance.” And this doesn’t include all the bonds outstanding that the poor taxpayers are responsible for.

Certainly Illinois, Alaska, Hawaii, New Jersey, Connecticut et al are not carbon copies of Puerto Rico. Yet their crushing debt and liabilities look eerily similar.

So all you conservative municipal bond investors dig into your municipal open-end, closed-end or exchange-traded funds. Study the composition of your portfolio. If it’s too laden with general obligation bonds from states and cities that will one day have to actually deal with their problems—get out. Investors had years to get out of Puerto Rico bonds. Bond fund managers did too—yet many of them held on. After all, it was your money, not theirs.

It’s true, the worst offenders must pay significantly higher interest on their new bonds but it hasn’t yet reached the frenetic levels that concern or scare investors. If they keep up their incompetent bad behavior it will. Then we’ll be staring another Puerto Rico in the face. As we learned from the recent bankruptcies like Detroit, bondholders lose to pensioners who vote. Puerto Rico will be a carbon copy.

So reassess your portfolio. Make certain the percent of good quality revenue municipal bonds far

outweighs your general obligation holdings. The old rule of a GO issuer having the unlimited ability to tax its electorate no longer holds. We have learned issuers lose their ability and willingness to pay us bond investors. Just watch the Puerto Rico bond carnage to come.

Load up with airport revenue bonds from major hubs, the senior liens only. Names like Atlanta International Airport, Los Angeles, Dallas/Ft. Worth, JFK, San Francisco, Denver, Charlotte Douglas, McCarran International and Miami, to name a few. Stay away from the majority of small regionals. Invest in issues whose revenue stream is easily understood and underfunded pensions are not a consideration.

Keep it simple, keep it safe. Stay on top of the Puerto Rico news. It will matter.

## **Forbes**

by Marilyn Cohen, Contributor

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*Marilyn Cohen is founder and CEO of Envision Capital Management, a Los Angeles fixed-income money manager.*