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Puerto Rico's Human Catastrophe is Hedge Funds' Inhuman Nightmare.

But the recovery may allow the hedgies a chance at redemption.

Amid Donald Trump's most brain-dead tweets about the humanitarian crisis in Puerto Rico was one implying that he would have more sympathy for the gut-wrenching events there if the various debtors on the island had repaid the \$70 billion they owe creditors, many of which are American hedge-fund managers. "Texas & Florida are doing great but Puerto Rico, which was already suffering from broken infrastructure & massive debt, is in deep trouble," he wrote. "Much of the Island was destroyed, with billions of dollars owed to Wall Street and the banks which, sadly, must be dealt with." Water, food, and medical supplies, he added, are "top priorities." But the first two-thirds of his statement showed that it was Wall Street on his mind.

As usual, Trump's Twitter storm was beyond contemptible for all the obvious reasons. It was also obscene for the less obvious reasons that Trump himself knows well what it's like to stiff creditors bigly, since he made a habit of doing it regularly with properties such as his casinos in Atlantic City, the Plaza Hotel, and the Trump Shuttle. Companies he owned, or managed, left creditors holding the bag for billions of dollars. Closer to home in Puerto Rico, in 2008, Trump had a big hand in causing the government to lose its \$33 million investment in a golf resort when a licensing and management arrangement with the Trump Organization fell apart. Not for nothing did Lin-Manuel Miranda tweet to Trump, "You're going straight to hell, no long lines for you."

Back in the real world, the people of Puerto Rico—American citizens all—are experiencing unparalleled devastation, nearly two weeks after Maria hit. Many still have no power, no food, no water, and no way to communicate their needs. It is a moment for the American government and the American people to show their compassion and support for their fellow citizens, just as they did for the people of Houston and in Florida. There is nothing to debate.

But let me digress for one moment to discuss the fate of Puerto Rico's creditors, the ones various entities on the island owe \$70 billion. No one should feel terribly sorry for them. They are big boys, so to speak. They more or less knew what they were getting themselves into when they decided to invest in the island. There was plenty of risk, and they knew it and were hoping to be paid to take that risk. They bet wrong and will lose billions. Indeed, this was already pretty much the case before Maria hit the island. It's a near certainty now. One former Wall Street banker who has followed the Puerto Rico financial saga told me that he thinks much of the \$50 billion of debt owed generally by the island will get wiped out now.

Then there is the Puerto Rico Electric Power Authority, known as PREPA, which owes \$9 billion to creditors comprised of hedge funds such as Blue Mountain Capital, and bond funds managed by Oppenheimer and Franklin Templeton. Other large creditors include Assured Guaranty and The National Public Finance Guarantee Corporation, an indirect subsidiary of the insurer MBIA, Inc., which essentially will have to make up the difference between what some bond holders get from PREPA in a restructuring and 100 cents on the dollar. Before Maria hit the island, these creditors

had negotiated a deal with the company where they were to get around 75 cents on the dollar, in present value terms, for their bonds as part of a restructuring that would have required them to invest capital into PREPA to upgrade its physical plant and its power grid. That deal was scuttled, though, by the oversight board on the island created by the June 2016 passage of the Puerto Rico Oversight, Management, and Economic Stability Act, known as PROMESA. In rejecting the deal between PREPA and its creditors, the PROMESA oversight board correctly decided that the deal was too generous to creditors and too much of a future burden on PREPA's customers. In July, PREPA filed for bankruptcy.

The two sides were back at the negotiating table when Maria hit. And things weren't going that well for the creditors, having had the judge in the bankruptcy case rule against them in appointing a receiver and in forcing a rate increase. (The creditors are appealing both rulings.) Now, the PREPA bonds are trading around 35 cents on the dollar, and are probably on their way to zero or something close to it. As we have heard repeatedly in the past few weeks, the island's electric grid has been all but wiped out. It was already in terrible need of a long neglected and overdue upgrade, but now it appears the company has the chance—indeed will have little choice—but to rebuild from scratch. That could mean anything from solar power or wind power to a new version of the old power system with more efficient components.

This, it seems to me, is where the deep-pocketed creditors come in. Their only chance for a decent recovery on their \$9 billion of debt is if the company's power lines are rebuilt in a state-of-the-art way so that the current rate of 21 cents per kilowatt hour paid by PREPA's customers can be lowered to something more affordable. Lower rates would probably lead to higher usage and help the island achieve some semblance of an economic recovery. The choice is stark for PREPA's hedge fund, mutual fund, and bond insurance creditors. Either face nearly a wipe out, save for whatever money makes its way to PREPA from FEMA, or step up and invest serious money into the redesign and recovery of PREPA's power grid, giving them a shot at a total recovery down the road. So far, the PREPA creditors have gambled and lost.

But they might be beginning to get some religion. According to Reuters, In recent days, PREPA creditors have offered the utility a new \$1 billion loan and a discount on a portion of its existing debt. The new loan would help PREPA do its part to enable it to get FEMA funds of at least \$3 billion, and possibly as much as \$9 billion. That kind of money would allow for a rebuild of the power grid and a chance for creditors to get a recovery. The new \$1 billion from creditors would have a priority over the debt owed to other creditors and would need to be approved by the bankruptcy judge. The creditors might also think about working closely with new outside investors—for instance the Blackstone Group has a new \$20 billion or so infrastructure fund that might find PREPA an interesting opportunity—or a private utility on the mainland to rebuild PREPA to upgrade its physical plant and lower its costs.

At this particular moment, there's no reason to feel sorry for PREPA's creditors, especially when thousands of human lives still remain at risk on the island in the wake of Maria. But the dire straits for PREPA and its creditors leave them little choice but to stop bickering and to propose a restructuring plan—either alone or with new outside investors—that gets the utility into the 21st century and gives the creditors a viable chance to get more of their money back. Anything less does a terrible disservice to millions of people already suffering enough.

VANITY FAIR

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