

Bond Case Briefs

Municipal Finance Law Since 1971

Bond Funds Dump Puerto Rico.

Franklin Resources Inc., one of Puerto Rico's largest creditors, sold hundreds of millions of dollars of the island's bonds in recent days, part of an exodus of investors hurt by accelerating losses in the wake of recent hurricanes.

A swath of mutual funds and hedge funds that held on to a portion of Puerto Rico's roughly \$70 billion of bonds even after the island started bankruptcy proceedings last year are now throwing in the towel. That includes Franklin Mutual Advisers LLC, a Short Hills, New Jersey-based unit of Franklin Resources, which has sold its entire \$294 million stake in Puerto Rico general obligation bonds, people familiar with the matter said.

Bonds with a total face value of \$8.24 billion have changed hands this month through Monday, more than in any full month since the beginning of 2015, according to Municipal Securities Rulemaking Board data. The only time trading approached that level was July 2015, after Puerto Rico's then governor said the island's debts were "not payable."

Puerto Rico bonds since 2014 have attracted a variety of distressed-debt investors, especially hedge funds, because of the bonds' relatively cheap prices in otherwise red-hot debt markets. Some of those funds are now selling. Varde Funds and Merced Capital recently sold their holdings of \$172 million in municipal bonds backed by Puerto Rico's tax collections to other existing bondholders, according to bankruptcy-court documents and a person familiar with the matter.

Franklin, widely known under its Franklin Templeton brand, has been the second-largest mutual-fund holder of Puerto Rico bonds, after OppenheimerFunds Inc. The two mutual funds have been part of a group of large Puerto Rico creditors fighting to recover some portion of their investments through a court-supervised restructuring.

Franklin Resource's main municipal-bond-fund arm, based in San Mateo, Calif., also owned general obligation bonds and other types of Puerto Rico debt worth more than \$1 billion at the end of the second quarter, according to data from Morningstar Inc. It is unclear whether any of those investments have changed.

Most mutual-fund managers are averse to keeping defaulted bonds through lengthy restructurings, and many sold their Puerto Rico bonds to hedge funds, such as Aurelius Capital Management LP, Autonomy Capital LP and Canyon Capital Advisors LLC, as the island's financial woes accelerated.

The new buyers paid as little as 65 cents on the dollar in this first bout of selling, betting that they would recover much more once Puerto Rico recovered economically.

Franklin and Oppenheimer stood out because they kept much of their investments. The firms have experience working through restructurings, and some analysts said they owned so many Puerto Rico bonds that it would have been difficult to quickly liquidate their holdings without swamping the market.

When Puerto Rico began restructuring its debt last year in the U.S.'s largest-ever municipal bankruptcy, investors holding different types of Puerto Rico bonds split into factions, battling the island's government and each other to get better treatment. Franklin and Oppenheimer had been seen as power brokers in the process because they owned big chunks of the island's different types of bonds.

The recent selling began this spring as the island's government and federal oversight board took a tougher stance with creditors in its bankruptcy process. Then came Hurricane Maria in September and the humanitarian and economic devastation left in its wake.

Surging Trades

Trades of Puerto Rico bonds have jumped to record levels as investors' hopes for recoveries have dimmed.

The storm, and comments by President Donald Trump hinting at debt forgiveness, upended bondholders' calculus. Prices of general obligation bonds sold by the Franklin Mutual Series have been cut in half since May and now trade around 30 cents on the dollar, according to data from the Municipal Securities Rulemaking Board.

The precipitous drop in prices has piqued the interest of some investors who have avoided Puerto Rico.

AllianceBernstein Holding LP sold the last of its Puerto Rico bonds in 2014 believing that the island's debt load was unsustainable, making default inevitable, says Joe Rosenblum, the investment firm's director of municipal research.

"The prices are so low that it makes us ask the question whether we're at the right levels to get back in," Mr. Rosenblum says.

But even at current valuations AllianceBernstein remains concerned about the risk that politics in Puerto Rico and in Washington, D.C., will undermine bondholders. The Senate on Tuesday passed legislation that extends emergency credit to Puerto Rico, and Mr. Trump has criticized corruption in Puerto Rico and questioned how long the federal commitment to disaster relief should last.

"You can run as many spreadsheets as you want but how do you interpret the politics around it," Mr. Rosenblum says.

The Wall Street Journal

By Matt Wirz, Andrew Scurria and Heather Gillers

Oct. 25, 2017 7:03 a.m. ET

Write to Matt Wirz at matthieu.wirz@wsj.com, Andrew Scurria at Andrew.Scurria@wsj.com and Heather Gillers at heather.gillers@wsj.com