Bond Case Briefs

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Puerto Rico Update: Bond Insurers Leading A Divided Charge.

Another courtroom battle is shaping up between holders of the Puerto Rico Sales Tax Corp (COFINA) bonds and Puerto Rico general obligation bonds. At stake are who has the first claim on the sales tax revenue, one of the few reliable revenue sources dedicated to bond service. The issue arises because the government has not guaranteed the COFINA bonds in a way that puts them on par with GO obligations. The issue is particularly critical to the bond insurers who differ on their exposure to the two issuers. AMBAC has insured some $7.3 billion and MBIA some $4.2 billion of COFINA bonds representing 75% of AMBAC's and 49% of MBIA's total exposure in Puerto Rico. Hence, a ruling that favors the GO bondholders could be devastating to AMBAC and windfall to Assured Guaranty (AGO) which has greater GO bond exposure. Some $26.3 billion of Puerto Rico's $73 billion in bonds carry monoline bond insurance, so all the carriers face serious write offs no matter who wins, however, the AMBAC exposure appears the most crippling. The total exposures are $8.5 billion for AGO, $9.7 for AMBAC and $8.5 billion for MBIA. While this battle takes shape COFINA has also gone into court to obtain relief from its $17 billion bond obligation through a mandatory reduction of the principal amount.

On another front, Governor Ricardo Rossello has thrown out a projection of a 70% to 90% recovery for island GO bondholders if all goes well over the next decade. This projection is more motivated by his power struggle with the oversight board, which wants deeper cuts in the Governor's budget, than by economic realities. The facts in support of any such projections would lead one to a different conclusion. The islands debt burden from bonds and pension obligations total some $123 billion. Divide this by a population of 5.3 million and you get an average debt burden per person of $35,142. Consider this in the light of a population where almost half live in poverty and the average income is $19,350 making the average debt burden 181%. Compare this to the USA where we worry about a 20 trillion national debt which works out to about $55,500 per citizen. Compared to an average income of $53,800 means we have a much lower average debt burden of only 103%. Oh, but I forgot to include our unfunded social security and Medicare obligations of at least another, say, $10 trillion? That would kick our average person debt burden up to 155%. Is that scary or what? Maybe those worrying about our unsustainable debt growth aren't so far off.

The economic hard facts are that, while a few select bondholders with better collateral may possibly achieve a 70% recovery, the average for the rest will likely achieve no more than 15%. This will be done in stages as agreements are reached which are unachievable but have to be dealt with by other than the current participants. A few years later the next generation gets to redo the agreements, blaming the incompetence of their predecessors and the inability to see into the future or anticipate the next hurricane. Isn't a Puerto Rico moment what politicians of all stripe are facing? Isn't that what's going on with those tobacco bonds or unfunded state and municipal pension promises? Yet the market must go on and we all play musical chairs without recognizing that high coupons on bonds mean a lower chance of getting your principal back. Want proof? Our Distressed Municipal Debt database, which contains over 4,000 defaults shows an average coupon rate since 1983 of 8.03%. So when you see yields of 8%, recognize that when they default, the average recovery was 8.7 cents on the dollar.

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