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Puerto Rico Makes Bond Payments, but Muni Market Remains on Edge.

(Reuters) – Creditors to Puerto Rico's electricity provider were given a slight respite on Tuesday when the bonds' trustee made a scheduled payment, but the U.S. municipal bond market remained worried the Puerto Rico Electric Power Authority (PREPA) will soon use a new bankruptcy-like process to restructure its debts.

The law establishing the process has rattled the $3.7 trillion municipal market since it was passed last week and on Tuesday it prompted Moody's Investors Service to push ratings on Puerto Rico debt deeper into junk territory.

Puerto Rico bonds are widely held due to their tax exemption in every state and their high yields, making them a tempting asset despite the U.S. commonwealth's struggles to cope with a shrinking economy, chronic budget deficits and a $73 billion debt load.

PREPA could be the first corporation to test the law, as it faces increasing demands for its limited funds, including payments on expiring lines of credit and fuel purchases. Prices of its junk-rated bonds plummeted to the record low of 36.815 cents on the dollar, or a yield 14.887 percent.

The flight to Puerto Rico's $3.5 billion junk general obligation bonds ended as well – with prices falling to a record low of 84.5 cents or a 9.748 percent yield.

On Tuesday evening, the Chairman of the Government Development Bank for Puerto Rico David Chafey confirmed all bond payments maturing on Tuesday had been made, including $721.97 million paid to service general obligation bonds and $417.56 million for the PREPA bonds.

For most of the day, rumors whipped through the municipal market that bondholders may not receive any money.

The bond trustee is allowed to hold onto funds if it foresees large expenses looming, and Puerto Rico's new law allowing public corporations to restructure already threatens to rack up costs for PREPA. The authority is considered the most likely corporation to restructure, which could generate legal bills, and on Sunday mutual funds sued saying the law was unconstitutional.

U.S. Bancorp spokeswoman Teri Charest said the bank cannot comment on clients' accounts.

The fear is that PREPA is the first domino toward the restructuring of Puerto Rico's debts, a move akin to filing for bankruptcy, which the territory cannot do. The law passed last week excludes Puerto Rico and the Government Development Bank.

Puerto Rico has been fighting hard this year to pull its finances together, after years of population and economic declines led its revenues to shrink. Late on Monday, it passed a scaled-down budget for the fiscal year starting on Tuesday, but recent measures may not be enough to fix its economy.

Meanwhile, Moody's Investors Service cut the island's general obligation bonds to B2 from Ba2. Citing the restructuring law, it broadly swung its axe at the ratings of the Government Development Bank, PREPA, the aqueduct and sewer authority, the highway authority and even the sales-tax financing corporation known as COFINA, which is generally considered the safest Puerto Rico issuer.

The law "signals a depleted capacity for revenue increases and austerity measures, and a new preference for shifting fiscal pressures to creditors, which, in our view, has implications for all of Puerto Rico's debt, including that of the central government," Moody's said.

PREPA's $250 million line of credit from Citibank has already expired. On July 3, PREPA is required to pay the bank $10 million. It must turn over $146 million to the bank through the end of August. Likewise its $550 million line of credit from ScotiaBank de Puerto Rico expires next month, putting it on the hook for $525 million.

In response to the Moody's downgrade, GDB's Chafey said the bank was "proceeding with focus and determination to continue strengthening the Commonwealth's financial position and build a solid foundation for economic prosperity and development."

PREPA is currently negotiating extensions of the lines. Still, it also must find cash to pay a recent internal loan for buying fuel and then cover future fuel purchases.

In the past the GDB has stepped in to prop up the perennially struggling PREPA but now, dealing with its own liquidity worries, it is staying away. Meanwhile, Governor Alejandro Garcia Padilla has repeatedly said public corporations must become self-reliant.

"They're a cash-poor entity and have been for a long time," said Shawn O'Leary, senior vice president at Nuveen Asset Management, which holds $80.6 million of bonds that could be subject to the legislation. "The difference now is that the central government and the GDB said, 'We're no longer floating you loans'."

By Lisa Lambert

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