Bond Case Briefs

Municipal Finance Law Since 1971

WSJ: Puerto Rico to Sell $1.2 Billion in Notes on Unusual Terms.

Puerto Rico is expected to sell up to $1.2 billion of short-term notes this week to large banks that have agreed to hold the debt until it matures in June, forestalling the heavy selling that followed a bond sale in March.

Lenders including J.P. Morgan Chase & Co., Bank of America Corp. and Morgan Stanley have said they won't sell the debt, which is often sold by purchasing banks to bond funds and other buyers, according to people familiar with Puerto Rico's financing plans. The sale of short-term notes, rated below investment grade, is expected to be arranged by J.P. Morgan, the people said. The $3.5 billion of bonds in March were purchased largely by hedge funds.

The unusual requirement tied to the proposed sale of tax- and revenue-anticipation notes reflects the financially strapped territory's efforts to broaden its funding base and to avoid the market unrest that followed the March deal, some of the people said. Banks don't usually agree to such lockups because regulators have increased capital charges for holding debt rated below investment grade, a bid to discourage lenders from holding risky assets.

The debt matures in June and will pay 7.75% annual interest, according to a notice posted on the website of Electronic Municipal Market Access, known as EMMA. The relatively high interest rate reflects investor fears that the island's economy won't turn a corner before the government runs out of cash.

The sale would mark the first time Puerto Rico has raised money in public markets since passing a law in June that allowed agencies such as the island's power, water and highway authorities to restructure their debts. Those three agencies have almost $20 billion in outstanding debt, according to Barclays PLC. The law doesn't apply to Puerto Rico's general obligation or sales tax debt.

Representatives for J.P. Morgan, Morgan Stanley and Bank of America declined to comment.

Puerto Rico has about $73 billion in total debt, which is widely held by mutual funds, hedge funds and individuals, and the island needs market access to cover expenses, including more than $1.2 billion in debt service due this year.

By selling new bonds, Puerto Rico buys itself time to try to restart the economy, plug its budget deficit and to restructure the Puerto Rico Electric Power Authority, which owes about $9 billion.

The previous sale was billed as crucial to give the new administration of Gov. Alejandro Garcia Padilla breathing room. The sale came after major credit-rating firms downgraded Puerto Rico to junk status.

By issuing debt only to banks, Puerto Rico is broadening its pool of investors, as it plans to sell longer-term bonds in coming months and may need hedge funds and mutual funds to buy that debt, said Robert Donahue, managing director at research firm Municipal Market Advisors. The commonwealth also may have wanted to keep the bonds from trading immediately to avoid the risk that falling prices might undermine investor confidence, he said.

Hedge funds like Och-Ziff Capital Management LLC, Fir Tree Partners and Perry Capital LLC bought most of Puerto Rico's bonds in March. Some still own the debt, but many sold out within weeks. The bond traded 2,539 times in its first month after issue, declining in value by about 8% in that period, according to data from EMMA.

In comparison, a California bond sale in March traded 717 times in its first month, according to EMMA.

Banks buying the new notes, which include Barclays and Banco Popular, are willing to put the risky debt on their balance sheets because it pays an unusually high rate for short-term debt. A bond backing bankrupt Detroit's development authority that matures in July traded in recent days at a yield of about 4.25%, according to EMMA.

Agreeing to buy debt now could also win the banks business underwriting billions of dollars in future bond sales Puerto Rico hopes to sell to fund managers in the next 12 months, analysts said.

A representative of Barclays declined to comment. Representatives for Banco Popular didn't immediately return requests for comment.

THE WALL STREET JOURNAL

By MATT WIRZ And AARON KURILOFF

Updated Oct. 7, 2014 6:12 p.m. ET