

Bond Case Briefs

Municipal Finance Law Since 1971

Feds Offer Puerto Rico Advice, But No Bailout.

Investors wondering about the U.S. government's role in the Puerto Rican debt crisis are hearing echoes of Detroit.

In 2013, lawmakers opposed a federal bailout of the auto-producing hub, and the Obama administration didn't step in to prevent the largest municipal bankruptcy in U.S. history, in July of that year. The Treasury has a similar no-rescue approach with the Caribbean island beset by unsustainable debt.

What Treasury officials are offering Puerto Rico is advice on how to help ease its fiscal burdens and ensure the U.S. territory receives all federal funding it's eligible for — about \$6 billion a year. More extensive aid such as loan guarantees requiring Congressional approval is unpopular with lawmakers, and it's unlikely the federal government will aid Puerto Rico after refusing to help Detroit, investors said.

"I can't see any way that they would do that when they didn't do it for Detroit," said Brandon Barford, partner at Beacon Policy Advisors LLC in Washington and a former Senate Banking Committee staffer. "Treasury could ask, but it would only exacerbate market disruptions if prices spiked and then fell even further after an inevitable congressional defeat."

Instead, the Obama administration is making a special effort to support the \$100 billion Puerto Rican economy by helping the commonwealth and its residents take full advantage of aid that's available to it through programs such as Social Security and Medicaid, and funds for nutrition, education and agriculture.

Infrastructure Funds

Another channel is financing for infrastructure expenditures with federal money that allows the Puerto Rican government to use its own funds elsewhere, said Daniel Hanson, an analyst at Height Securities LLC, a Washington-based broker-dealer.

Puerto Rico and its agencies owe \$73 billion. The U.S. municipal debt market, which includes securities of states, cities and counties, is worth \$3.6 trillion. While debt sold by the commonwealth and its agencies has lost 2.3 percent this year through Tuesday, the broader municipal market has gained about 0.3 percent.

Even though the law allows the Fed to buy municipal bonds in durations of up to six months, "it would be extraordinarily unlikely that the Fed would take such action on any muni debt, much less that of Puerto Rico," Hanson said in an e-mail Tuesday.

'Political Fallout'

"The Fed would need to be comfortable establishing such a precedent" and "be able to stomach the political fallout," he said.

While Puerto Rico's debt is tax-exempt and was once popular among traditional buyers of municipal bonds such as mutual funds, its financial troubles are pushing more of the securities into the hands of alternative asset managers and distressed buyers speculating on price swings.

As a result of the shift, the Fed no longer sees a Puerto Rico default as a threat to the broader U.S. financial system, Barford said.

A Fed spokesman declined to comment.

The Government Development Bank of Puerto Rico, which acts as the island's fiscal agent, financial adviser on bond sales and handles the same debt-management functions local treasury officials perform in the U.S. states, is not federally regulated and doesn't have access to Fed's discount window, a lending facility aimed at boosting liquidity, according to Hanson.

Weiss Visits

As the crisis dragged on, Treasury officials have traveled to the territory since at least 2013 to discuss its finances. Antonio Weiss, counselor to the Treasury secretary, and Kent Hiteshew, who runs the office of state and local finance, met with officials in San Juan earlier this year.

Secretary Jacob J. Lew spoke by phone with Puerto Rico Governor Alejandro Garcia Padilla, Senate President Eduardo Bhatia and House of Representatives President Jaime Perello Borrás on April 28. Lew urged the officials to develop a "credible" budget and implement a long-term fiscal plan.

Treasury spokesman Daniel Watson reiterated on Monday that "federal policy experts are sharing their expertise with the Puerto Rican officials that are leading the Commonwealth's economic policies, but these efforts should not be interpreted as any kind of federal intervention."

Options such as the federal government possibly guaranteeing a Puerto Rico financing haven't been offered by the U.S. Treasury or the Federal Reserve, Senator Jose Nadal Power, said in an interview May 5 in San Juan.

'Helpful' Advice

"So far they haven't been open to that," said Nadal Power, who chairs the Senate Finance Committee in the Puerto Rican legislature. "They've been very helpful in terms of advice. And they've been very aware of what is going on on the island."

The U.S. Treasury's efforts may include crisis planning and facilitating talks with investors, Barford said.

Another option would be to help Puerto Rico's electric authority by seeking legislation that would allow it to bypass some federal regulations, said Richard Larkin, senior vice president and director of credit analysis in Boca Raton, Florida, with Herbert J. Sims & Co.

Matt Fabian, a partner at Concord, Massachusetts-based Municipal Market Analytics, said the only situation in which the administration would be willing to provide aid to Puerto Rico would be to help keep order if a default leads to social unrest.

Cash Crunch

Puerto Rico, which has struggled to grow since 2006, faces a cash crunch and has been unable to pass a tax overhaul that would have paved the way for a \$2.9 billion debt sale.

Standard & Poor's, which downgraded Puerto Rico to CCC+ in April, doesn't expect any extraordinary federal assistance.

"Our general-obligation rating on the commonwealth does not assume any federal intervention to either improve the island's economy or to provide extraordinary financial assistance," S&P analyst David Hitchcock said in an e-mail Monday. "To the extent there was extraordinary federal assistance, it would be a positive rating development, but one that we do not expect."

After the financial crisis of 2008, Congress took some tools away from Treasury. For instance, the Exchange Stabilization Fund, which had been used to help Mexico during the 1990s, can no longer be tapped for emergency purposes, Barford said.

"Beyond asking for Congress to appropriate money or the Fed purchasing bonds — highly unlikely due to politics — there are no other pots of money that could be used for direct and unrestricted fiscal relief," he said.

Bankruptcy Bill

Even a bill that would allow Puerto Rico to file for Chapter 9 bankruptcy protection is unlikely to pass, according to analysts including Robert Donahue at Municipal Market Analytics in Concord, Massachusetts.

Intervening to rescue the island's finances could actually spook markets, signaling that problems are larger than investors now believe, Hanson said.

"If Treasury were to take such extraordinary steps, the types of steps that are supposed to be reserved for a Lehman-style crisis, to bail out Puerto Rico, that would send the wrong message," he said, referring to the \$613 billion collapse of investment bank Lehman Brothers Holdings Inc. in 2008.

Bloomberg

by Kasia Klimasinska

May 6, 2015