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Puerto Rico Tax Plan Spurs Bet Island Will End Bond Logjam.

The $3.6 trillion municipal-bond market is signaling growing confidence that Puerto Rico lawmakers can enact a tax increase that would open the door to a debt sale and ease the island's cash crunch.

Prices on the commonwealth's most frequently traded bonds have risen to almost seven-week highs as its House of Representatives prepares to meet Wednesday and potentially vote on a plan to raise the sales levy. The governor and legislative leaders agreed on the tax proposal last week, part of efforts to boost revenue and revive an economy that's saddled with $72 billion of debt.

The accord, after the House rejected a previous tax overhaul last month, is feeding optimism that the junk-rated U.S. territory will be able to sell long-term debt for the first time since March 2014 and gain breathing room to repair its finances.

"It makes sense that the investors want to see a tax increase that will bring some balance and stability," said Bob Donahue, a managing director at Concord, Massachusetts-based research firm Municipal Market Analytics.

While still trading at distressed levels, the island's bonds have drawn renewed interest this week. Commonwealth general obligations maturing in July 2035 traded Wednesday at an average price of about 82 cents on the dollar, the highest since early April, according to data compiled by Bloomberg. That's up from 79.13 cents May 13, the day before the announcement of the tax proposal.

Way Out

Wednesday's average yield of about 10.1 percent is about seven percentage points above benchmark debt. The securities are the most-traded commonwealth general obligations in the past three months. Puerto Rico debt has gained for five straight days, the longest stretch since mid-March, S&P Dow Jones Indices show.

Puerto Rico bonds have still lost 2.3 percent in the past three months, underperforming the 0.7 percent decline for the broader municipal market, according to S&P Dow Jones Indices.

Governor Alejandro Garcia Padilla on Monday night sent legislators a plan that would raise the sales tax to 11.5 percent and convert that levy into a value-added tax by April 1. Signs of a broader consensus than in April are bolstering the debt.

"It increases the possibility that the commonwealth will be able to negotiate itself out of this difficult immediate financial position," said Gary Pollack, who manages $6 billion of munis as head of fixed-income trading at Deutsche Bank AG's Private Wealth Management unit in New York.

The tax change requires at least 26 votes to pass the House. It had support from 27 members as of last week, Rafael "Tatito" Hernandez, who chairs the House Treasury Committee, said from San Juan. Members are reviewing the governor's proposal, he said.

Opposition Plan

Opposition lawmakers plan to vote against the bill, according to Representative Jose “Quiquito” Melendez of the minority New Progressive Party.

The tax increase would help Puerto Rico balance its budget for the fiscal year starting July 1 and attract investors to a planned $2.9 billion sale of bonds backed by oil-tax revenue, according to the Government Development Bank, which lends to the commonwealth and its localities. Proceeds would repay money the highways authority owes the bank and help avert a partial government shutdown.

The GDB needs the cash. Its net liquidity dropped to $1.02 billion as of April 30, from $2 billion in October.

The island, with an unemployment rate that’s double the national average, faces challenges even if lawmakers approve the tax increase and pass a spending plan by June 30, said Joseph Rosenblum, director of muni credit in New York at AllianceBernstein Holding LP. The company manages about $32 billion of state and city bonds.

“It’s a step forward, but in the grand scheme of things it’s just a small piece of much larger problems they need to address,” Rosenblum said.

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