Bond Case Briefs

Municipal Finance Law Since 1971

Puerto Rico Crisis Leaves Few Market Ripples as Yields Fall.

The $3.6 trillion municipal-bond market's first reaction to Puerto Rico saying it can't pay its $72 billion of debt? A collective yawn, as far as prices went.

While the commonwealth's securities tumbled after Governor Alejandro Garcia Padilla said his administration will seek to restructure its debt, the fallout has so far been contained: Yields on top-rated 10-year municipal bonds declined 0.02 percentage point, or 2 basis points, this week, as prices rose, according to data compiled by Bloomberg. Top-rated 30-year bond yields were little changed, even as investors pulled money from municipal-bond funds for a ninth straight week.

Puerto Rico securities have traded at speculative levels for more than a year, which has given investors time to pare holdings of the junk-rated island. The long-building strains on the U.S. commonwealth, which has more debt per resident than any state, are also unique.

"Problems with Puerto Rico aren't news," said Phil Fischer, head of municipal research at Bank of America Merrill Lynch in New York. "Puerto Rico paper has been treated as speculative for a long time now."

Garcia Padilla said this week that his administration will seek to put off some debt payments for a "number of years." The specter of such a restructuring caused Puerto Rico's newest general-obligation bonds to trade at an average of 69.8 cents on the dollar Thursday, down from 77.3 cents last week.

Risk Appetite

Fischer said individual investors have reduced their holdings of Puerto Rico bonds, many of which are now owned by hedge funds and other buyers with more appetite for risk. About half of U.S. mutual funds that focus on municipal debt hold the securities, down from 77 percent in October 2013, according to Morningstar Inc.

The island's debt crisis could force fund managers to sell other bonds if losses lead investors to withdraw their money. Investors have pulled cash from municipal-bond funds for the past two months, and some analysts say a Puerto Rico restructuring could weigh on a market already bracing for higher interest rates.

Investors withdrew $1.2 billion from municipal bond funds in the week ended Wednesday, the most since Jan. 2014, Lipper US Fund Flows data released Thursday show. About 40 percent of that total was from high-yield funds.

High Yield

If Puerto Rico defaults, some high yield funds, which have higher concentrations of the commonwealth's bonds, may be the hardest hit. Municipal debt backed by a 1998 national settlement with tobacco companies and those issued by lower-rated hospitals may be vulnerable, said Mikhail Foux, municipal debt strategist at Barclays Plc.

Still, Bank of America’s Fischer said Puerto Rico’s struggles don’t reflect any broader financial pressure on state and local governments.

“The risk with regard to Puerto Rice is not in some sense a contamination of other municipal credits,” he said. “There’s almost no economic dependency of other muni issuers on Puerto Rico.”

Bloomberg

by Martin Z Braun

July 2, 2015 — 12:19 PM PDT Updated on July 2, 2015 — 3:16 PM PDT