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Puerto Rico Closer to Default After Missed Funds Transfer.

Puerto Rico lurched one step closer to default, saying one of its agencies failed to transfer cash to a trustee to cover an Aug. 1 debt payment because the legislature didn't appropriate the funds.

It's unclear whether the Public Finance Corp. will pay \$36.3 million of bonds maturing that day. If it doesn't, that would mark the first time Puerto Rico has defaulted on a debt payment and would come as the commonwealth seeks to negotiate with creditors to restructure \$72 billion of obligations.

The missed transfer underscores the fiscal squeeze on the U.S. commonwealth, which is pushing for Congress to allow some of its public corporations to file for Chapter 9 bankruptcy protection.

"This payment may not be made and will probably lead to the government trying to exchange this paper," Luis Fortuno, Puerto Rico's governor from 2009 through 2012, said during a telephone interview. "I don't think this, in and by itself, is enough to cause Congress to act on Chapter 9. There is a lot of talks about some strings attached to Chapter 9, although it's not clear exactly what that would be."

The Public Finance Corp. owes about \$1 billion of debt repaid through legislative appropriation, according to the Government Development Bank, which works on the island's debt sales.

Legislative Approval

"In accordance with the terms of these bonds, the transfer was not made due to the non-appropriation of funds," Melba Acosta, president of the GDB, said Wednesday in an e-mailed statement.

Puerto Rico is in need of cash because investors have effectively closed the island's access to the capital markets by demanding high interest rates

Last month, lawmakers included about \$300 million in the current budget to repay GDB debt. The bank may be able to use the money to pay bondholders next month, though it would need legislative approval to do so. The legislature is out of session until mid-August.

"Should resources be required from this fund, the GDB only needs to inform, request, and justify the need for these funds to the legislature," Senator Jose Nadal Power, who chairs the Senate Finance Committee, said in a statement Thursday that was in Spanish.

Debt of the Public Finance Corp., which has borrowed to help pay the government's bills, traded July 1 at an average 68 cents on the dollar, a record low, according to data compiled by Bloomberg.

Default Expectations

"Most PFC debt is held on-island, but some is held by U.S. mutual funds and in retail accounts and a further small portion is held by the hedge fund community," Daniel Hanson, an analyst at Height Securities, a Washington-based broker dealer, wrote in a report Thursday. "We expect the technical

default event will signal that more defaults are coming and draw further attention to the liquidity issues facing the commonwealth.”

The trustee, U.S. Bank, has hired the law firm Hogan Lovells “to advise it in connection with this matter,” according to a filing with the Municipal Securities Rulemaking Board.

Puerto Rico is in need of cash because investors have effectively closed the island’s access to the capital markets by demanding high interest rates. The development bank, a source of available cash for the commonwealth, had \$778 million of net liquidity as of May 31, down from \$2 billion in October. To avoid running out of cash by Sept. 30, the bank wants to exchange its notes for longer-maturity debt.

Next Payment

Another \$140 million of development bank bonds mature Aug. 1, Bloomberg data show. The GDB said last week it may purchase its notes “from time to time” with cash, new securities or a combination. Such purchases are expected to be at prices “that are materially less than par,” according to a filing through the Municipal Securities Rulemaking Board.

Governor Alejandro Garcia Padilla last month directed island officials to create a debt-restructuring plan by Aug. 30. The governor says Puerto Rico cannot afford to repay what it owes.

Key Democrats including U.S. Senator Chuck Schumer, who represents New York, are backing legislation that would allow Puerto Rico’s public corporations to file for Chapter 9, just as U.S. cities can. A bill to do so has stalled for lack of Republican support.

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