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Puerto Rico Nears Default as Debt Restructuring Beckons.

NEW YORK — Puerto Rico on Friday made a payment on debt owed by its Government Development Bank, but the U.S. territory may still be short of the funds needed to pay all of its imminent obligations.

“The GDB will make the \$169 million payment for the debt service on its bonds today,” GDB President Melba Acosta said in a statement released Friday. A payment on that debt was due to be made Saturday Aug. 1.

Puerto Rico, however, is expected to default on a \$58 million payment on Public Finance Corporation (PFC) bonds also due Saturday in what is seen as possibly just the first step in the largest U.S. municipal debt restructuring in history.

Whether Puerto Rico defaults may not be known until Monday. According to PFC documents, a payment falling on a weekend can be made on the next business day, which would be Monday, Aug. 3.

“What could surprise investors is when they actually hear the word ‘default,’ and that a default occurred,” said Lyle Fitterer, head of tax-exempt fixed income at Wells Capital Management, which holds mostly insured Puerto Rico debt.

“The immediate reaction might be a slight sell-off in the marketplace because I think people will start to anticipate, ‘OK, what’s the next series of debt they’re going to default on?’”

Puerto Rico Governor Alejandro Garcia Padilla shocked investors in June when he said the island’s debt, totaling \$72 billion, was unpayable and required restructuring.

The possible default on debt due this weekend would mark the first missed debt payment. According to a 2014 bond offering statement, Puerto Rico has never defaulted on the payment of principal or interest of debt.

A non-payment by Puerto Rico would be the most notable since Detroit, which had about \$8 billion of bonds, defaulted on \$1.45 billion of insured pension bonds before it filed for bankruptcy in 2013.

Victor Suarez, Puerto Rico’s chief of staff, has said the island will do “everything that is possible” to ensure that the \$169.6 million Government Development Bank (GDB) debt payment due Aug. 1 is paid.

The commonwealth is expected to send that payment to the trustee on Friday for payment on Monday, a source familiar with the situation said on Friday.

John Miller, co-head of fixed income for Nuveen Asset Management, had said it would be positive for the short term if Puerto Rico made the GDB payment. But he said if it failed to pay, it could be a negative sign for debt such as its general obligation debt.

Suarez said on Monday that the commonwealth did not have the current cash flow to pay the PFC bonds.

"I bought my (PFC) bonds with the anticipation of them defaulting," said Ben Eiler, managing partner at First Southern Securities in Puerto Rico. "They're going to restructure in some form or fashion, and I believe that restructure is going to be higher than that level."

The likelihood of a restructuring is leading investors to wonder how Puerto Rico will prioritize debt payments versus citizens' needs.

"We're beginning to discern a ... mindset on the island that the government is weighing the interest of investors against the economic interest of the island," said Thomas McLoughlin, UBS chief investment officer wealth management research.

DEFAULT DEBATE

Suarez told reporters in San Juan on Wednesday that a missed payment would not constitute default. Bond documents state that Puerto Rico's legislature is not legally bound to appropriate the funds for payment.

However, credit rating agency Standard & Poor's said it would view non-payment of rated PFC bonds on their due date as a default. Moody's said it would also consider it a default.

"It (would be) the first failure by the government to pay on a debt to public investors and indicates the weakness of the government's ability and willingness to pay," said Timothy Blake, managing director of Moody's Public Finance Group.

A default could open the door to a fight with investors, although that may be an uphill battle.

"Our reading of the legal documents is that bondholders have very limited remedies," said David Hitchcock, an analyst at S&P. "Puerto Rico could potentially just ignore the bondholders."

Officials may give information after a scheduled meeting by a working group created by the governor which was ongoing.

"It's going to be a long process, a very long, drawn-out process," said Michael Comes, portfolio manager and vice president of research at Cumberland Advisors in Florida, which holds insured Puerto Rico debt. "It's kind of like watching the Titanic sink."

By REUTERS

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