## Puerto Rico Defaults on Most of $58 Million Debt Payment.

Puerto Rico missed most of a $58 million bond payment Monday, marking the first default by the U.S. commonwealth and escalating its attempt to restructure about $72 billion in debt.

The payment to bondholders is the first skipped since Gov. Alejandro García Padilla in June said the island's debts were unsustainable and urged negotiations with creditors, which range from individuals to hedge funds.

Analysts said the missed payment isn't likely to provoke an acute marketwide reaction from investors, many of which have been inching away for the commonwealth for years amid dire economic news.

But the episode is the latest confirmation that Puerto Rico doesn't have the money to meet all of its coming obligations, said Emily Raimes, vice president at Moody's Investors Service.

"This is a first in what we believe will be broad defaults on commonwealth debt," she said.

The Government Development Bank for Puerto Rico said the island's legislature didn't set aside money for the appropriation bonds, a decision that reflects "serious concerns about the Commonwealth's liquidity" and its need to balance paying bondholders with maintaining essential services, according to a news release from the bank. The bank did pay about $628,000 remaining from prior funds.

The nonpayment is another setback for investors in debt from Puerto Rico, which is struggling with a decade of economic stagnation and high unemployment, underscoring the commonwealth's effort to prioritize payments as it attempts to preserve its cash and avoid a government shutdown.

About half of municipal-bond mutual funds in the U.S. have exposure to Puerto Rico, according to research firm Morningstar Inc.

Those investors have already suffered losses as the commonwealth's credit ratings fell to junk in recent years and bond prices plummeted.

Some Puerto Rico bonds sold in 2014 traded Monday at about 69.25 cents on the dollar, down from about 73 cents in mid-July, according to Thomson Reuters Municipal Market Data.

The corporation's missed payment suggests how Puerto Rico may treat different forms of debt going forward, said John Miller, co-head of fixed income at Nuveen Asset Management LLC in Chicago, which manages about $100 billion in tax-exempt bonds. Investors in the appropriation bonds have little recourse because the bonds are backed only by the legislature's willingness to find the money for them. Other bonds have greater legal protections.

"It is somewhat meaningful that this is their first monetary default," Mr. Miller said. "However, if people have been paying attention to the plans, this was anticipated, and it doesn't really change the orchestrated direction that the government's taking."

That direction has even some former boosters backing away. Monarch Alternative Capital LP, which at one point had about 5% of its now $5 billion under management invested in the commonwealth's general-obligation bonds, told investors late last week that it sold off part of the position in recent weeks.

"We believe that the probability of a default scenario has significantly increased and could risk extending the timeline for a resolution to the island's situation," co-founder Michael Weinstock and other firm executives wrote to investors in a letter reviewed by The Wall Street Journal.

In particular, he flagged the firm's discussions with the island's political leadership. "We ultimately came to the view that the sentiment of Puerto Rico's leadership had shifted and that they would be unwilling to implement the fiscal reform measures needed to regain the market's confidence and avoid a potential default," the letter said.

A group of Puerto Rico policy makers are working on a restructuring plan and scheduled to present their findings at the end of August. Creditors, including mutual funds, hedge funds and other distressed-debt investors, have been splitting into committees based on which bonds they own.

Puerto Rico has said its debt includes about $18.6 billion of general-obligation bonds and government-guaranteed debt, $15.2 billion of sales-tax-backed bonds and $24.1 billion of bonds issued by government agencies, like the Puerto Rico Electric Power Authority, which is already negotiating a restructuring with creditors. Many investors hold bonds across the different sectors, which could recover different amounts in a restructuring.

The restructuring process is uncertain in part because Puerto Rico is neither a U.S. state nor a sovereign nation.

All states are barred from filing for bankruptcy, but cities, such as Detroit, can seek protection under chapter 9 of the U.S. bankruptcy code. Puerto Rico is lobbying the U.S. Congress for a law allowing some of its entities to access chapter 9 protections. Until such a law passes, the island's leaders must negotiate with creditors without that process.

Matt Fabian, partner at research firm Municipal Market Analytics, Concord, Mass., said that while worries about Puerto Rico have had little impact on the broader market for municipal bonds, a missed payment could spur new selling in other commonwealth debt.

"The Puerto Rico market is huge and diverse," he said. "You have to presume there will be some knock-on selling."

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By AARON KURILOFF

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—Rob Copeland contributed to this article.

Write to Aaron Kuriloff at AARON.KURILOFF@wsj.com