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Puerto Rico Staring at $400 Million Short-Term Funding Squeeze.

Puerto Rico is approaching an inflection point that may prove to be more challenging than the commonwealth's decision this month to skip a bond payment for the first time.

After borrowing internally, omitting debt-service payments and slowing tax rebates, the island is at risk of running out of cash to fund day-to-day operations. Puerto Rico must raise $400 million through a bank loan or a sale of short-term securities by November, Victor Suarez, Governor Alejandro Garcia Padilla's chief of staff, said Aug. 10 in San Juan.

Garcia Padilla's administration had already alienated creditors before defaulting on $58 million of bonds Aug. 3 by saying they need to restructure a $72 billion debt burden that it can no longer sustain. Puerto Rico appears to be betting that investors will provide access to capital markets again once the commonwealth unveils a debt-restructuring proposal Sept. 1.

"They're going to have some severe liquidity issues," said David Hitchcock, a Standard & Poor's analyst in New York. "Without cash-flow financing, they're going to have a very difficult time trying to just pay for ongoing operations as well as their upcoming debt payments in the next six months."

It's not clear how much operating cash Puerto Rico has on hand. The island's Government Development Bank, which lends to the commonwealth and its localities, stopped providing monthly updates as of May, when it had $778 million of net liquidity. That was down from $2 billion in October.

Anticipation Notes

Like most U.S. states, Puerto Rico tends to sell tax-and-revenue anticipation notes in the first half of a fiscal year to help finance operating needs before revenue collections pick up.

When the GDB sold short-term debt in October, the last such borrowing for the island, it paid a yield of 7.75 percent for notes that matured in eight months. The discount rate on benchmark six-month U.S. Treasury bills was around 0.05 percent at the time.

Yields on an index of one-year Puerto Rico debt were 39 percent Thursday, more than three times the average of 9.9 percent over the past two years, according to data compiled by Bloomberg. Benchmark one-year municipal debt yields about 0.27 percent.

Mounting Payments

"Whatever little good faith we had has been completely wiped out by this missed payment" by the Public Finance Corp., said Sergio Marxuach, public-policy director at the Center for a New Economy, a research group in San Juan. "And after November, things become a little more unclear."

Puerto Rico and its agencies face $1.4 billion of principal and interest payments in December and

January, including $357 million for general-obligation debt, according to data compiled by Bloomberg.

Borrowing another $400 million may not be enough, Hitchcock said. In fiscal 2015, which ended June 30, the island sold $1.2 billion of short-term debt and still ended the year with a projected budget gap of as much as $740 million.

“Ability to access the market can be important for liquidity purposes,” Hitchcock said. “And we feel right now they have very limited market access, if any.”

Water Bonds

Puerto Rico may test market access as soon as Tuesday. The island’s Aqueduct and Sewer Authority, known by the Spanish acronym Prasa, wants to sell $750 million of bonds to fund capital improvements. While the bonds have a dedicated revenue source in the form of user fees, the agency still anticipates selling the debt at an average interest rate of at least 10 percent. Prasa bonds maturing July 2042 traded Thursday at an average yield of 8.3 percent, or 67.6 cents on the dollar, according to data compiled by Bloomberg.

“It would be amazing if they can get the deal done,” said Matt Dalton, chief executive office of Rye Brook, New York-based Belle Haven Investments, which manages $3 billion of munis, including Puerto Rico. “I’m just not sure who they’re going to sell it to.”

Moody’s assigned a Caa3 rating to the proposed sale Friday, saying exposure to the government’s financial, economic and political risks indicates a heightened loss potential.

Even though Puerto Rico isn’t setting aside cash every month to make the general-obligation debt payment, officials anticipate the island will have the cash flow to pay the January debt bill, Chief of Staff Suarez told reporters in San Juan on Aug. 10.

Selling $400 million of additional tax-and-revenue anticipation notes to outside investors would help finance day-to-day government operations beyond November, Suarez said.

Without additional borrowing, the administration would need to consider unpaid furloughs, additional payment suspensions to suppliers or extending IOUs, Marxuach said. That would force residents and businesses to spend less and banks might actually start reducing the amount of credit they extend to companies with contracting work through the government, he said.

“Obviously that’s going to have a negative ripple effect on the economy,” Marxuach said. “All that matters in the market is the perception, and the perception is Puerto Rico defaulted.”

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