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Puerto Rico Finds Waning Demand for Water Bonds Amid Debt Talks.

Puerto Rico is running into resistance as the commonwealth tries to sell \$750 million in bonds while crafting a debt-restructuring plan that would likely leave some investors with deep losses.

After aiming to price the Puerto Rico Aqueduct & Sewer Authority issue as early as Tuesday, the bond sale is now listed as day-to-day. That's even after adding bondholder protections and raising the preliminary yield levels to more than three times the level of benchmark securities.

"It's a pretty difficult thing to try to raise money when out of the other side of your mouth you're talking default and trying to pass laws that allow you to default," said Matt Dalton, chief executive officer of Rye Brook, New York-based Belle Haven Investments, which manages \$3 billion of municipal securities, including Puerto Rico debt. He doesn't plan to buy any of the water bonds.

Puerto Rico raised the ire of investors by defaulting Aug. 3 on a \$58 million agency bond payment, saying the legislature hadn't appropriated the funds and cash was being conserved to provide basic services.

Governor Alejandro Garcia Padilla in June said the island was unable to repay all of its \$72 billion debt burden and directed officials to craft a debt-restructuring plan by the end of August that may suspend payments.

Price Talks

"We did not price yesterday in order to provide investors with the time they need to adequately review and analyze the materials so they can make the most informed decision about their potential investment," Barbara Morgan, who represents the Government Development Bank at SKDKnickerbocker in New York, said in an e-mail.

The bank works on the island's debt sales. Morgan declined to say when Prasa may sell the bonds.

Underwriters were talking Thursday about preliminary yields of 10 percent on the 30-year securities, up from 9.5 percent earlier in the week, according to two people familiar with the sale who requested anonymity because pricing wasn't final.

Kristen Kaus, a New York-based spokeswoman for Bank of America Merrill Lynch, the lead underwriter of the sale, declined to comment on when the bonds would be priced. Norma Munoz, a San Juan-based spokeswoman for the water agency, known by the Spanish acronym Prasa, didn't respond to e-mails.

Acceleration Fee

The utility also made adjustments to the deal that gives investors an acceleration fee in the event of a default and mandates that Prasa raise water rates by as much as 25 percent, if needed, to repay

the bonds, according to sale documents.

Prasa needs the proceeds of the bond sale to help repay a \$90 million bank loan with Banco Popular that expires Aug. 31. Other monies will finance infrastructure upgrades to help the utility meet clean-water requirements under a settlement agreement with the U.S. Environmental Protection Agency, according to bond documents.

Hedge funds are expected to purchase the bulk of the Prasa bonds, as they did when Puerto Rico sold \$3.5 billion of general-obligation debt in March 2014. Buyers of distressed securities have been investing in commonwealth debt for about two years as traditional municipal-bond investors have reduced or eliminated their exposure.

Puerto Rico and its agencies are reeling from years of borrowing to pay bills. The island's economy has shrunk every year but one since 2006 and is projected to contract 1.2 percent this fiscal year.

Restructuring Plan

The utility provides water to 97 percent of the island's population and wastewater service to more than half. As residents continue to leave for the U.S. mainland, that has cut into demand for its services. Average monthly customer consumption decreased by about 6 percent in the year that ended in June.

Prasa's bonds may not undergo a debt restructuring. Government Development Bank President Melba Acosta, the island's top debt official, said the bank doesn't foresee the water agency reorganizing its obligations if the debt sale is completed.

Credit-rating companies aren't so sure. Standard & Poor's, which rates the utility CCC-, its third-lowest junk grade, may downgrade the agency because "events could unfold within the next three months that could expose Prasa to greater restructuring efforts," S&P analyst Theodore Chapman wrote in a report Tuesday.

Relative Value

The preliminary 10 percent yield compares with 3.1 percent on benchmark 30-year municipal debt, according to data compiled by Bloomberg. With a proposed 8 percent coupon, that's equal to a price of about 83 cents on the dollar, the two people said.

That's more expensive than existing Puerto Rico bonds. General obligation debt sold in March 2014 with an 8 percent coupon and maturing July 2035 traded Friday at an average price of 70.5 cents, for an average yield of 11.9 percent, data compiled by Bloomberg show. Prasa bonds with a 5.25 percent coupon and maturing July 2042 traded Friday at an average price of 63 cents, for a yield of about 8.9 percent.

Adding to the investor reluctance to buy the bonds is concern that this is another example of a commonwealth entity borrowing money to paper-over shortfalls rather than investing in infrastructure to improve long-term finances.

"You still have the same broken-down infrastructure and collections are terrible," Belle Haven's Dalton said.

Bloomberg

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