[Bond Case Briefs]

Municipal Finance Law Since 1971

[Puerto Rico Turmoil Sinks Sewer Bond.]

Up against a deadline to reveal its plan to restructure its staggering debt, Puerto Rico has decided not to move ahead with a controversial proposal to borrow an additional $750 million to pay for improvements to its water and sewer authority.

It attributed the decision, made late Monday, to the turmoil in the global markets. But the government also appears to have decided it could not borrow the money — by issuing bonds — at an affordable interest rate.

Just a few days earlier, Puerto Rico petitioned the United States Supreme Court asking for the right to restructure its debt — which has reached $72 billion — under its own quasi-bankruptcy law. Puerto Rico, a United States commonwealth, enacted the law last year because it has no access to the federal bankruptcy courts. But the law was later found unconstitutional and was voided by the courts.

Investors who at one time might have been potential buyers of the water and sewer bonds seemed taken aback by the island's move, on the one hand, to sell new bonds (and incur new debt) while also telling the Supreme Court that it had to restructure its old debt.

"You could take it on face value and say, 'Either they're lying to investors about the bonds being payable, or lying to the Supreme Court about the bonds being unpayable,' " said Matt Fabian, a partner at Municipal Market Analytics, a financial research firm. "I see it as a blunder, ultimately, and not anything more heinous, but it really undermines their ability to negotiate."

Taken together, the steps demonstrate some of the confusion within the government as it faces a Sept. 1 deadline to outline its restructuring plan. A working group, appointed by the governor, has been trying to put a proposal together for several months. But in a signal of political conflicts to come, the island's main opposition party has dropped out of the group.

"It's not like we wait till Sept. 1 and then we've got a road map to fixing everything," said Kent Collier, chief of Reorg Research, a firm that monitors Puerto Rican affairs for clients that include hedge funds.

About two months after the restructuring plan is issued, he said, the government is supposed to seek the authorizing legislation, setting off an unpredictable political process.

Eventually, Puerto Rican officials have expressed hopes of resolving their problems through a global debt-for-debt swap, in which the holders of the island's bonds would turn those in and receive new bonds that would be worth less but be far more likely to be paid off. But the details are sketchy and many other things must happen first.

"Their economy does need to grow, and I don't disagree that their debt is too high to do all the things they need to do to make their economy grow and provide for the health and welfare of their citizens," said Gerry Durr, senior municipal credit analyst at Wilmington Trust. "But you know, I think the only way this thing really gets solved is if there’s a strong, independent control board, and I don’t think Congress has the appetite to impose one.”

Until recently, senior Puerto Rican officials had sought to reassure investors that its water and sewer authority, known as Prasa, was a credible borrower.

Puerto Rico announced Prasa’s plans to issue the $750 million of bonds just days after another branch of the government had defaulted on a different group of bonds, but the president of the Government Development Bank, Melba Acosta Febo, said that was not relevant.

It “reflects the individual financial circumstances of the various debt issuers across the commonwealth,” she said.

The bonds that defaulted were issued by the Public Finance Corporation, a small, single-purpose entity that has no power to levy taxes. Its bond-marketing materials warn that investors will have little or no recourse in the event of a default.

Prasa, by contrast, provides essential services and can increase rates, within reason, because it is a monopoly. Prasa’s bondholders have a first claim on that revenue if cash gets tight, and they can bring in a receiver to enforce collections.

In addition, the new Prasa bonds were expected to include such investor-friendly terms as a make-whole agreement, which would discourage Puerto Rico from refinancing them at lower interest rates in the future, if Puerto Rico’s fortunes changed for the better.

“They were within striking distance of settling this deal,” said Stephen Snowder, an associate editor at Reorg Research.

But the deal started to come unglued on Friday, after Puerto Rico filed its petition to the Supreme Court. It sought a review of the legality of its so-called Recovery Act, which tried to create a bankruptcylike restructuring framework for public corporations on the island. Among other things, the petition said that it needed to have a legal framework in case Prasa’s debts have to be restructured.

“That’s not the phrase you want in the middle of a bond deal,” said Mr. Fabian.

On Monday, Prasa filed a statement from Victor Suárez Meléndez, the governor’s chief of staff. “We currently do not contemplate Prasa necessitating a restructuring of its debt,” he said.

But Mr. Suarez also tried to explain why Puerto Rico needed a safe place to restructure: “If any Puerto Rico utility ever needs to restructure its debts, it should be done in a way that is fair not only to their creditors but also to the people such utilities serve.”

The next thing Mr. Snowder knew, he said, the deal was off. He said a colleague called Prasa’s executive president, Alberto Lázaro, Monday evening to find out what was going on.

“Victor Suarez was making nice statements, and then a couple of hours later, we had Lázaro telling us that the deal was delayed, postponed or canceled,” said Mr. Snowder. “No one has explained it to me.”

THE NEW YORK TIMES

By MARY WILLIAMS WALSH

AUG. 25, 2015