Puerto Rico Fails Without Washington Help, Morgan Stanley Says.

Puerto Rico's attempt at a sovereign-like debt restructuring without complete lawmaking authority is likely to fall short in the absence of intervention by U.S. political leaders, according to Morgan Stanley.
"We doubt Puerto Rico's ability to execute this style of restructuring without U.S. Congressional action, keeping us from adopting a clearly bullish position," Michael Zezas, chief municipal strategist at Morgan Stanley in New York, wrote in a report dated Sept. 10.

Puerto Rico's fiscal crisis should spur Congress to help the island negotiate with its creditors, either by implementing a fiscal control board at the federal level or allowing some public corporations to file for Chapter 9 bankruptcy projection, Morgan Stanley said. Unlike cities and municipalities of U.S. states, the island's localities cannot access Chapter 9.

Governor Alejandro Garcia Padilla's administration on Wednesday unveiled a proposal that estimates Puerto Rico will have only $5 billion of available funds to repay $18 billion of debt-service costs over the next five years. The commonwealth may seek to defer principal payments for several years on some of its $72 billion debt burden.

It's unclear whether general-obligation bondholders will be offered smaller losses than owners of Puerto Rico's sales-tax supported debt under a restructuring, Morgan Stanley said. The island's constitution stipulates that general-obligations must be paid before other expenses. The revenue bonds, known as Cofina, are repaid from dedicated sales-tax revenue.

If general-obligation bonds are treated senior in repayment, then bondholders would receive a internal rate of return of 8 percent on debt that carries an 8 percent coupon and 6.6 percent on debt with a 5 percent coupon, Zezas wrote. The recovery rates will be lower if sales-tax bonds get first payment, he said.

General obligations with an 8 percent coupon and maturing July 2035 traded Friday at 73.1 cents on the dollar, down from an average 75.5 cents on Sept. 8, the day before the plan was released, according to data compiled by Bloomberg. The yield was 11.5 percent.

"There's a good argument to be made that general obligations appear fairly valued, particularly considering that the lower end of expected internal rate of returns would rise with greater austerity," Zezas wrote. "Yet, these reports imply that Puerto Rico can execute an effective sovereign-style restructuring in a timely manner, something we dispute."

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