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Puerto Rico Investors May Shun Debt-Exchange Offer, Moody's Says.

Puerto Rico Governor Alejandro Garcia Padilla wants bondholders to accept less than they're owed to help the island dig out from its fiscal crisis. Few may be willing to go along, according to Moody's Investors Service.

The governor's advisers said in a report released Wednesday that the commonwealth should ask investors to voluntarily exchange their bonds for new securities, which would allow it to cut debt payments. Such a restructuring plan will be released in a few weeks, said Jim Millstein, chief executive officer of Millstein & Co., which is advising the government.

"It is unlikely that holders of the many Puerto Rico bonds will agree to forgo or defer substantial sums of promised principal and interest," Moody's analyst Ted Hampton said in a statement after the report's release. "There is a high probability of protracted litigation, particularly on the part of investors holding general obligation or other securities with strong legal protections."

The expected bondholder response shows the difficulty Puerto Rico faces as it embarks on a restructuring unprecedented in the $3.6 trillion municipal market. Puerto Rico general-obligation bonds are protected by the commonwealth constitution and others are backed by dedicated revenues, which may lead some investors to challenge the island in court.

The commonwealth has already clashed with bondholders over the issue. When Garcia Padilla signed a law that would've helped its public corporations reorganize, the mutual-fund companies OppenheimerFunds Inc. and Franklin Resources Inc. persuaded a federal judge in San Juan to throw out the act.

Detroit's $18 billion bankruptcy illustrates the difficulty of getting investors to part with their bonds. Seeking to cut its interest bills, the city offered to buy back $5.2 billion of water and sewer debt, with most investors receiving more than 100 cents on the dollar. Only 28 percent of the securities were ultimately sold back.

Puerto Rico says it has $13 billion less than it needs to cover debt payments over the next five years, even after taking into account proposed spending cuts and measures to raise revenue. That estimate excludes the electric and water utilities.

Island officials haven't indicated what terms may be offered to owners of its various classes of debt. Moody's, which projects that some investors may recoup as little as 35 cents on the dollar, said signs of steeper losses would lead to further rating cuts.

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