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Gundlach Joins Lasry Scooping Up Puerto Rico Debt as Prices Fall.

Even though Puerto Rico may be just weeks away from defaulting on some of its $70 billion of debt, a couple of the biggest names in the bond market are swooping in to buy its securities.

Jeffrey Gundlach of DoubleLine Capital LP and Avenue Capital Group's Marc Lasry both said this week that they're buying bonds from the commonwealth as prices take a new turn lower. Puerto Rico owes a combined $1.4 billion on those securities and others in the next six weeks, compared with just $209 million of payments since Sept. 1.

The purchases show how some distressed-debt investors are betting that prices have fallen too far and Governor Alejandro Garcia Padilla will have trouble following through on his pledge to prioritize public services and force losses on bondholders with constitutionally protected securities. Puerto Rico's benchmark general obligations traded Wednesday near the lowest price since August, data compiled by Bloomberg show.

"Entering at this point, the risk-reward calculus may make sense because it's pricing in as much of the downside risk possibility that there is," said David Tawil, who manages $80 million as co-founder of hedge fund Maglan Capital LP in New York.

"Distressed buyers have to be buyers when things are super out of favor — that's how they make real money," said Tawil, who used to own Puerto Rico debt but doesn't anymore. "A lot of time has passed, a lot of rhetoric has come and gone, and we're at do-or-die time."

Payment Schedule

Puerto Rico bond prices have plunged over the past two years as the commonwealth's economy staggered under its debt load. They fell to new lows after Garcia Padilla said in June that he wants investors to take a loss and delay principal payments. About one month later, the island defaulted for the first time on appropriation bonds from its Public Finance Corp.

Investors are watching to see if Puerto Rico will pay $467 million due Dec. 1, its biggest obligation since August, and then $958 million owed on Jan. 1.

Those funds focused on the $3.7 trillion municipal market who purchased the bonds at full value for their high tax-free yields have fared the worst as bond prices plunged. Speculative-grade Puerto Rico bonds have lost another 11 percent this year, according to Barclays Plc data.

General Obligations

Puerto Rico's benchmark 8 percent general obligations due in July 2035 traded Wednesday at an average 71.6 cents on the dollar, near the lowest price in three months, data compiled by Bloomberg show. Similarly, uninsured sales-tax and highway bonds that were the most-traded of the past month fell to the weakest since mid-September.

Those declines have lured hedge funds and distressed-debt buyers, who now own about one-third of the commonwealth’s securities, according to Mikhail Foux, head of municipal strategy at Barclays.

There’s “a substantial probability” that the island makes payments on general-obligation, general-obligation-guaranteed and sales-tax debt in the coming months, Foux wrote in a report Tuesday. Other issuers are at risk.

Lasry, the co-founder of hedge fund Avenue Capital, is buying more bonds because “it’s hard to get hurt now in Puerto Rico,” Reuters quoted him as saying at a conference it hosted Tuesday in New York.

Avenue Capital owned some Government Development Bank debt as of last month, people familiar with the holdings told Bloomberg News. Lasry didn’t say which Puerto Rico bonds his firm was buying, according to Reuters. He said he thinks he knows all the different options at the commonwealth’s disposal.

Todd Fogarty, a spokesman for Avenue Capital, said the company had no further comment.

Gundlach, DoubleLine’s chief investment officer, said in a conference call Tuesday that he was buying more Puerto Rico securities, though not large amounts and not for his core funds.

‘Smart Money’

He purchased $45 million of the commonwealth’s benchmark general-obligation debt for his $2 billion Income Solutions Fund in the first three months of 2015, according to data compiled by Bloomberg. He hasn’t reported adding any more since, though it remains the sixth-largest part of his fund by market value.

Loren Fleckenstein, an analyst at Los Angeles-based DoubleLine, didn’t respond to an e-mail or phone call seeking comment on the firm’s purchases.

Puerto Rico’s general obligations are where the “smart money” is going, said Mark Palmer, a managing director at BTIG LLC, a brokerage firm. Those bondholders can go on the offensive to divert money from highway and sales-tax debt, while investors in those securities have to defend their claims, he said.

“We think that ultimately the defenses the creditors have are going to be sufficiently strong,” Palmer, who analyzes the bond insurers backing some Puerto Rico securities, said in an interview at Bloomberg’s New York headquarters Wednesday.

“It’s becoming clear that it’s going to be extremely difficult, outside of U.S. government intervention, to bring upon its creditors any sort of restructuring that’s going to involve deep haircuts without their consent,” Palmer said. “And they’re not inclined to accept that.”

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by Brian Chappatta

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