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Puerto Rico Avoids Default on Over \$350 Million in Bond Payments.

Prices of some Puerto Rico bonds rallied after Gov. Alejandro Garcia Padilla said the U.S. Commonwealth would begin clawing back revenue from other debt to provide for essential public services and pay obligations backed by the government's full faith and credit.

Some Puerto Rico bonds maturing in 2035 traded at about 75 cents on the dollar, up from around 71.75 cents Monday, according to the Electronic Municipal Market Access website. The rally came as Puerto Rico's Government Development Bank said it had paid principal and interest on the bank's debt due Tuesday.

The clawback would default on some debt "in an effort to attempt to repay bonds issued with the full faith and credit of the Commonwealth and secure sufficient resources to protect the life, health, safety and welfare of the people of Puerto Rico," the governor said in written testimony.

"Today's debt service payments reflect our commitment to honor our obligations notwithstanding the extreme fiscal challenges we face in an effort to facilitate a voluntary restructuring process with our creditors," said Melba Acosta, the GDB president, in a news release. "However, make no mistake, Puerto Rico's liquidity position is severely constrained at this time despite the extraordinary measures the Government has taken to improve it."

Puerto Rico is negotiating with bondholders over restructuring the commonwealth's debt, which exceeds \$70 billion, and paid only a fraction of around \$58 million due in August. While those bonds had weak legal protections for investors, a default on government-guaranteed debt could have disrupted talks and provoked lawsuits.

The more-than \$350 million due Tuesday included about \$270 million of the bank's debt guaranteed by the government, according to a report by Moody's Investors Service. Prices on government-backed debt rose as investors were reassured that the island was increasing efforts to pay its general obligation bonds while restructuring talks with investors continue, said John Miller, co-head of fixed income at Nuveen Asset Management LLC, which manages more than \$100 billion of municipal bonds. That means taking money from sources such as highway or convention center bonds, he said.

"It's a sign that, at least for now, the risk of general obligation default has been greatly reduced," said Matt Fabian, partner at the research firm Municipal Market Analytics. "Near-term payments in those bonds have become more likely, but the long term picture is less clear."

Moody's Investors Service said in a prepared statement that the governor's move to redirect money from nongeneral obligation debt "underscores the severity of the commonwealth's liquidity issues." Puerto Rico now owes \$945 million due Jan. 1, 2016, including \$363 million in general obligation debt service, and the ratings firm continues "to view default as likely" on future payments.

The governor's comments came at a Senate Judiciary Committee hearing on Puerto Rico's fiscal

crisis. He also said the government was out of cash and that, after Tuesday's payment, he would choose to fund essential public services before making payments to bondholders, triggering a default.

"If anyone put me into position of selecting to pay a creditor, or a policeman, teacher or firefighter, I will pay the policeman, the teacher and the firefighter. There is no doubt about it," he said. "And we are running out of cash. There's no more cash."

Mr. Garcia Padilla said that he would soon be forced to make that choice.

"There's no more tricks to be able to sustain the essential services to the people of Puerto Rico and pay the debt in the future. I have been saying this and inviting creditors to the table," he said. "Maybe now they will understand."

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