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Puerto Rico to Default on \$37 Million of Payments Due Jan. 1.

Puerto Rico will default on about \$37 million in bond payments due Jan. 1 and divert revenue to make others, escalating a conflict with investors as Governor Alejandro Garcia Padilla seeks to restructure a \$70 billion debt burden.

The amount is a fraction of the almost \$1 billion in interest due at the start of the year. The island will miss payments on \$35.9 million of non-commonwealth guaranteed Puerto Rico Infrastructure Financing Authority debt and \$1.4 million of Public Finance Corp. bonds. The money is being used to help pay investors who are owed \$328.7 million of interest on general-obligation debt.

Garcia Padilla has warned for weeks that if forced to choose between paying creditors and paying for essential services, he would favor his people. A skipped general-obligation payment would have marked a turning point in Puerto Rico's debt crisis because the securities are considered to have the strongest legal protections among the island's different issuers. The commonwealth's constitution states that general-obligation bonds must be repaid before other expenses.

"My government has the responsibility to protect, as much as possible, Puerto Ricans from grave consequences," Garcia Padilla said in a press conference in San Juan. "In recent months we have put up a tough fight in Congress, looking for the tools we need. We all know that the creditors have spent a fortune lobbying against Puerto Ricans in Congress."

Revenue Clawback

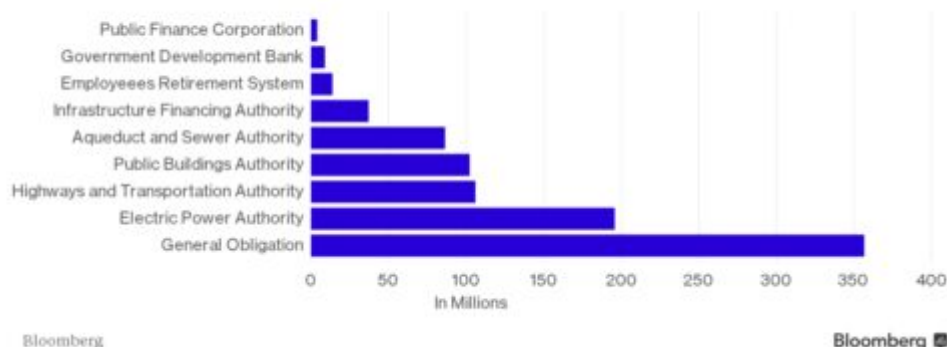
Puerto Rico general-obligation bonds with an 8 percent coupon and maturing 2035 gained after the governor said the payments will be made. The debt traded at an average price of 73 cents on the dollar, up from 71.5 cents Tuesday, data compiled by Bloomberg show. The average yield was 11.5 percent.

"In reality, this is a remarkably mild default, given the commonwealth's repeated claims about its inability to pay debt," said Daniel Hanson, an analyst at Height Securities, a Washington-based broker dealer. "When a debtor repeatedly claims they have no cash but then pay more than \$900 million in debt service, the credibility of the debtor must be called into question."

Garcia Padilla this month started redirecting revenue used to repay certain agency debt to the central government's coffers. About half of funds to make the general-obligation bond payment — \$164 million — is coming from the clawback. By keeping the commonwealth's pledge to those investors, he hopes to continue negotiating with bondholders as Congress works on a plan for the island, he said.

Puerto Rico's New Year's Eve Bill

Puerto Rico and its agencies face nearly \$1 billion in interest payments due Jan. 1.



Agencies such as the Highways & Transportation Authority and the Convention Center District Authority had said they'll use reserves to help pay their investors on Jan. 1. Holders of bonds issued by the Government Development Bank, the Public Buildings Authority, the Employees Retirement System, the Industrial Development Company and the University of Puerto Rico will also receive payments due in January.

The Infrastructure Financing Authority, while defaulting on some debt, will make payments that are guaranteed by the commonwealth. Holders of sales-tax revenue debt will also receive their payments- and for the future. Puerto Rico doesn't have plans to clawback sales-tax collections because the government doesn't have control over that revenue, Melba Acosta, president of the GDB, said Wednesday during a call with reporters.

Holders of sales-tax bonds, known as Cofinas, will receive the February payments totaling \$200 million, Acosta said. May will be the next time payments will be due on debt that is subject to the clawback — \$400 million on GDB securities, she said.

Initial Default

Only one Puerto Rico entity has already skipped debt payments. The Public Finance Corp., which borrowed to help cover the government's budget deficits, in August failed to pay principal and interest because lawmakers didn't appropriate the funds. Its bonds due in 2031 trade for about six cents on the dollar.

Because they're backed by a weaker legal pledge than other securities, there have been few repercussions.

Garcia Padilla in late June said the commonwealth was unable to repay all of its obligations on time and in full. Puerto Rico's economy shrank 15 percent in the past decade after federal tax breaks for U.S. manufacturers ended in 2006, taking away incentives for pharmaceutical companies and other businesses to remain on the island. Residents also left to find work on the U.S. mainland, resulting in a 9.2 percent population drop since 2004, according to U.S. Census data.

Congressional Action

The default follows Garcia Padilla's failed attempt to persuade Congress in December to include a provision in a \$1.1 trillion spending bill to allow commonwealth agencies to file for bankruptcy protection. House Speaker Paul Ryan directed committee heads to come up with a plan for Puerto

Rico by the end of March.

Congressional Democrats on Dec. 21 filed bills that would shield Puerto Rico from any lawsuits until then.

The \$3.7 trillion municipal-bond market has been anticipating a default on commonwealth debt because Puerto Rico securities have been trading at distressed levels for two years. Commonwealth debt has lost 8.1 percent this year through Dec. 29, compared with a 3.3 percent gain in the broader muni market, according to S&P Dow Jones Indices.

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by Michelle Kaske and Romy Varghese

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