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Analysts Pan Puerto Rico Restructuring Proposal.

Puerto Rico's debt restructuring proposal got a cold reception from analysts, with some saying it failed to even provide a starting point for negotiations.

On Monday, Puerto Rico made public details of the proposal, which would reduce the commonwealth's bond debt burden by 46% through a bond exchange.

Puerto Rico's tax-supported debt would be reduced to $26.5 billion from $49.2 billion under the proposal; annual debt payments would be capped at 15% of government revenue

"The restructuring plan is absolutely not credible and a very low starting point for negotiations," said Michael Ginestro, Bel Air Investment Advisors director of municipal research.

"In fact, I don't even think creditor groups would even consider responding," he said.

"The structure has major problems and, in MMA's opinion, the related discussion is apt to go nowhere," Municipal Market Analytics analysts said Monday in its Weekly Outlook.

Ginestro said there are legal issues with the proposal.

"How would the new entity's security provisions trump the general obligation security's clawback?" he said. "If Puerto Rico defaults on GO bonds, what would the new base bonds be rated?"

Puerto Rico's plan only works if there are few holdouts and that is unrealistic, Ginestro said. He doubts that investors would trust that Puerto Rico will honor the bonds.

The MMA analysts had some similar objections.

In addition, they say that hedge funds that have bought large amounts of Puerto Rico debt in recent years are unlikely to participate in the restructuring. The GO tranche of the new base bonds would likely sell for about 64 cents on the dollar of the original GOs' par value and the funds would not be happy with this.

MMA analysts also said that the plan assumes large amounts of additional unplanned federal dollars for the Puerto Rico government, which is far from certain.

Since the "growth bonds" could only possibly offer payment after 2026 and only to the extent Puerto Rico saw robust economic growth, they are "effectively worthless," the MMA analysts said.

Other analysts were not as dismissive as Ginestro and MMA but had objections and conditions on the restructuring. "This is clearly only the first salvo in what will surely be a protracted legal battle," said NewOak managing director Triet Nguyen.

"First and foremost, PR needs to convince creditors that the promised 'statutory lien' on the new bonds is superior to the constitutional protection of the GOs or the lockbox mechanism for COFINA," Nguyen said. “Secondly, in our view, the ‘growth bond’ concept is only viable if there is a federal control board in place to make sure the financial disclosure is timely and accurate and that government spending is kept under control to generate enough ‘excess revenues’ to repay bondholders.”

Evercore’s director of municipal research, Howard Cure, agreed with Nguyen, saying that investors would only be interested in a debt exchange if it was combined with a financial control board.

“Otherwise, I think most investors would rather take their chances in court,” Cure said.

“A commission that is congressionally approved has the best hope of coordinating the many other legislative changes that are necessary to help the island get back on its feet (like changing the Jones Act, passing the Earned Income Tax Credit, modernizing the healthcare system),” Wells Fargo Securities managing director Natalie Cohen wrote in an email.

Janney Montgomery Scott managing director Alan Schankel said adjustment to pension obligations was “notably lacking” from Puerto Rico’s plan.

Puerto Rico has already reduced promised pension benefits in its main Employees Retirement System. However, a local court struck down its attempt to do so for the Teachers Retirement System.

The third retirement system, the Judiciary Retirement System, is much smaller and has an unfunded actuarial accrued liability that is much smaller in dollars.

On Tuesday Kramer Levin Naftalis & Frankel partner Thomas Moers Mayer testified to the United States House of Representatives Subcommittee on Indian, Insular, and Alaska Native Affairs that a strong control board “which reduces [Puerto Rico] government, enhances management of public resources and supports the private sector has a chance of [working] – as it did in D.C. and in New York City. Any other solution leads the commonwealth, as it led General Motors and Chrysler, back to the federal government for cash the private markets will no longer supply.”

Kramer Levin is representing mutual fund companies OppenheimerFunds and Franklin Advisers concerning their investments in Puerto Rico municipal bonds.

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