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Washington Still Haggling as Puerto Rico Debt Deadline Looms.

In December, House Speaker Paul D. Ryan instructed lawmakers to find a “responsible solution” to Puerto Rico’s debt crisis in the first three months of this year, giving the island plenty of time to prepare for a May 1 deadline on a \$422 million debt payment.

So much for that.

That deadline is imminent, but Republicans in the House and Democrats in the administration are still haggling over the terms of a bill to rescue Puerto Rico. Missing the payment risks further destabilizing its shrunken economy. And there are concerns that the passage of any legislation could be delayed until the island nears the tipping point of its debt woes: a \$2 billion debt payment due on July 1.

The May 1 payment consists mainly of principal and interest due from Puerto Rico’s Government Development Bank, a uniquely powerful institution that has played a leading role in the island’s borrowing and financial affairs for decades. Its activities are so numerous and critical that analysts have worried for months that the bank’s failure would have untold ripple effects across the island. Puerto Rico’s governor, Alejandro García Padilla, who has warned about defaults for months, has expressed frustration with Washington’s inability to act quickly.

“On Monday there will be a default,” he said on Wednesday. The bank has until the close of business on Monday, since the May 1 due date falls on a Sunday.

But the bigger issue may be that second, larger debt bill due in July, roughly \$800 million of which is constitutionally guaranteed, giving the payment of it legal priority even over the funding of essential public services, such as police patrols, ambulances or drinking water. Investors who hold the guaranteed debt say they are prepared to fight to enforce their legal rights, no matter how much it may shock and anger the island’s residents.

“There’s too much discord,” said Matt Fabian, a managing director at Municipal Market Analytics, referring to the rancor over the rescue bill. “This was supposed to be a very controlled process, and it just got out of hand.”

When Mr. Ryan ordered debt relief for Puerto Rico, he may not have known just how intractable the differences were going to be — not only between Democrats and Republicans, but also among certain classes of creditors, some of whom are intent on avoiding the sort of losses that Detroit bondholders were forced to bear after that city went bankrupt in 2013.

In addition to lobbying Congress, some of the bondholders are sponsoring television ads that depict the rescue of Puerto Rico as an odious taxpayer bailout. And some other creditors are in quiet talks with representatives of the Puerto Rican government, testing the waters for a sweeping negotiated debt reduction that might obviate congressional action.

Despite the power and importance of the Government Development Bank, its debts are not backed by any taxing power or constitutional guarantee. If it defaults on the looming \$422 million payment, its creditors have little legal recourse. And much of the bank's debt, in the form of municipal bonds, is held by more than 100 credit unions on the island — financial institutions that tend to serve mom-and-pop savers in Puerto Rico's poor and remote communities.

"The island's credit unions represent the nest egg of nearly 1,000,000 Puerto Rican families (one of every four Puerto Ricans) that trust their livelihood and savings in these financial institutions," said the credit unions' primary regulator in a statement released last year, when the sector held Government Development Bank debt with a face value of slightly more than \$500 million, according to regulatory records. The regulator's spokesman did not answer messages Thursday.

Historically, the credit unions were required to invest only in very safe assets. But in 2009 their regulators made an exception, allowing them to buy and hold riskier bonds, as long as the bonds were issued by some branch of the Puerto Rican government. The change gave the Government Development Bank a new way to raise money, by selling its bonds to the credit unions.

As a result, those institutions wound up with outsize exposure to the bank, which itself was found insolvent last year by Puerto Rico's Commissioner of Financial Institutions. Officials on the island have been seeking a way to protect the credit unions from the bank's expected default, but it is not clear what the mechanism would be, or whether it could even be put in place in time.

A payment default by the Government Development Bank would add to the list of extreme measures that Puerto Rico has undertaken to stretch its dwindling cash while waiting for Congress to enact its rescue package. It has already removed assets from its workers' compensation pool and public pension system to pay bills, taken cash from low-priority bonds to make payments due on high-priority bonds, and extended a highway privatization, giving up future toll revenue in exchange for upfront payments of \$115 million.

On Monday, holders of roughly \$9 billion of bonds issued by the island's Electric Power Authority are scheduled to buy \$111 million more in bonds as part of a complicated agreement to keep the power company liquid and preserve a consensual restructuring deal. Those investors must decide by Monday whether handing over \$111 million is worth it, under the current confused and deteriorating circumstances. But Puerto Rico has warned that if the new money does not materialize it may sue the creditors.

This group of bondholders, mainly mutual funds and other financial institutions, has emerged as one of four main creditor groups with a stake in the rescue legislation.

Another major group consists of bond insurers, known as "monolines," which have insured about one-fifth of Puerto Rico's total \$72 billion of outstanding bonds. Their backing promised to make the affected investors whole every time Puerto Rico defaulted on an insured bond. Along with the first group, the monolines are deeply concerned about the methods the rescue legislation would use to ensure that different types of creditors are treated equally.

A third creditor group consists of financial institutions that bought roughly \$3.5 billion of general-obligation bonds that Puerto Rico sold in 2014, its last borrowing before losing virtually all market access after ratings agencies downgraded it to junk status. The 2014 bonds were purchased eagerly by hedge funds because they promised a high yield and because general-obligation bonds are explicitly guaranteed by Puerto Rico's constitution.

Holders of this block now argue that Congress should not interfere with Puerto Rico's constitutional

promises; the Treasury Department has argued that none of Puerto Rico's bonds should be exempt from the bill's restructuring framework.

The fourth major creditor group consists of investors who hold so-called Cofina bonds, which were sold from 2006 onward, backed by a dedicated sales tax. These bonds were advertised as virtually default-proof, but as Puerto Rico's troubles have mounted over the last year, the Cofina investors have grown worried that the island may decide to divert their sales tax revenue to pay some other creditor group, such as the general-obligation bondholders, who say the constitution gives them first calling rights on all the island's resources.

The Cofina bondholders' secret weapon is an agreement that the bonds will "accelerate" in the event of a payment default, meaning that instead of waiting for a 30-year maturity, the holders would immediately be entitled their full present value. This feature makes the Cofina bondholders the only group that would actually benefit from a default on their holdings — and a wild card in the deck that Congress keeps shuffling.

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