Bond Case Briefs

Municipal Finance Law Since 1971

Puerto Rico Lawsuit Suggesting Split Among Creditor Groups.

A closer look at the hedge funds behind the lawsuit contesting Puerto Rico's debt-moratorium law may suggest a widening division among the holders of the island's general-obligation bonds.

While the suit was filed this week against the commonwealth by little known entities specifically set up to limit liabilities, the firms are Aurelius Capital Management, Autonomy Capital, Fundamental Advisors and Monarch Alternative Capital, according to a person familiar with the parties involved in the legal dispute. Representatives for the four hedge funds didn't have any immediate comments.

"It's not a monolithic investor class," said Matt Fabian, a partner at Concord, Massachusetts-based Municipal Market Analytics. "They all have different strategies and positions, so we're seeing some of that diversity."

Aurelius, for example, is one of several hedge funds that rejected Argentina's debt-restructuring offers for years before finally agreeing in February to a deal. The moratorium law allows Governor Alejandro Garcia Padilla to suspend principal and interest payments on Puerto Rico's $70 billion in debt through January.

Repayment Pledge

Some general-obligation holders have maintained that Puerto Rico's constitution requires they be paid in full even though Congress is moving to pass a law that would allow the commonwealth to reorganize its finances under a control board. The suit was announced Tuesday, the same day Puerto Rico said that negotiations with creditors including general-obligation owners broke down after counter proposals were exchanged.

Other large general-obligation holders such as OppenheimerFunds, Franklin Resources, Goldman Sachs, Stone Lion Capital and Davidson Kempner Capital aren't part of the lawsuit. The claim was filed by so-called special purpose vehicles identified in the filing as Jacana Holdings, Lex Claims, MPR Investors and RRW.

"It's likely that these creditors wanted to file a lawsuit before, but held back in the name of broader negotiations and then once negotiations broke down, they felt like it was time to pursue their own strategy," Fabian said.

The law suit claims that Puerto Rico is unable to impose its moratorium law against its general obligations, including its most recent sale in 2014, because the island's constitution states that if the commonwealth's resources are insufficient to meet all of its desired spending, then the public debt will be paid first, according to the complaint. The firms are "substantial" holders of the 2014 general obligations, according to the complaint.

Looming Default

Puerto Rico and its agencies racked up its debt burden by borrowing for years to paper over budget shortfalls as its economy shrunk. The commonwealth and its agencies owe $2 billion of principal and interest on July 1, including $805 million for general obligations that Garcia Padilla said Thursday the island couldn't pay even if he shut down the government.

The bill under consideration by the Senate would also shield the commonwealth from creditor lawsuits through February. Bond insurance companies and investors, including holders of general-obligation debt, have lobbied federal lawmakers to make the legislation more favorable to creditors.

Congressional Action

Puerto Rico securities have plunged in price since Garcia Padilla announced in June 2015 that the commonwealth was unable to repay all of its obligations and would seek to restructure its debts. Whether an investor bought the bonds at par, a slight discount or a deep discount influences how the bondholder chooses to negotiate with Puerto Rico on repayment, said Brandon Barford, a partner at Beacon Policy Advisors in Washington.

The general obligations issued in 2014 carry an 8 percent coupon and were sold at 93 cents on the dollar.

Aurelius, Fundamental and Monarch bought a portion of the debt. The bonds climbed to as high as 96.6 cents in March 2014, before dropping to 66.6 cents in June 2015, according to data compiled by Bloomberg. The bonds dipped to an average 63.9 cents on April 6, the day Garcia Padilla signed the moratorium into law. They traded Thursday at an average 66.2 cents, to yield about 12.8 percent.

"The difference among the GO bondholders, it really depends on when you bought the bonds," Barford said about the different hedge funds and distressed-debt buyers.

The general-obligation holders not party to the suit may be choosing not to sue at this time because if the bill known as Promesa becomes law, any restructuring of debt would be determined by the federal control board and not Puerto Rico's administration, Barford said.

"The majority of funds are not engaged in litigation against the moratorium at this time because they assume if Promesa becomes law, then it's not worth the cost," Barford said.

Bloomberg Business

by Michelle Kaske

June 23, 2016 — 7:17 PM PDT Updated on June 24, 2016 — 4:31 AM PDT