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[Puerto Rico Crisis Enters New Phase as Obama Signs Debt Bill.]

Puerto Rico's fiscal crisis reached a turning point as President Barack Obama signed bipartisan legislation Thursday that allows the island to escape from debts Wall Street once viewed as ironclad.

As Obama was signing the bill, Puerto Rico Governor Alejandro Garcia Padilla declared a moratorium on debt payments, one day before $2 billion are due, setting in motion its biggest default yet. It will be the first time the U.S. territory has failed to pay on its general-obligation bonds.

"We finally have legislation that at least is going to give Puerto Rico the capacity and opportunity to get out beyond its debt," Obama said at a signing ceremony. "People of Puerto Rico need to know they're not forgotten."

The legislation, which protects the island from creditors, creates a financial control board to help restructure Puerto Rico's $70 billion in debt and oversee the island's finances, marking the largest federal intervention ever into the U.S. municipal bond market. The Senate passed the bill Wednesday in a 68-30 vote.

The territory had continued to pay the securities even as it rapidly went broke. The bill signed by Obama doesn't provide any additional funding, but it allows Puerto Rico to turn to federal court to cut its obligations and protects the government from creditor lawsuits by putting them on hold.

In return, Puerto Rico is being forced to accept strict oversight by a control board that will have significant power over its day-to-day affairs. The legislation, S. 2328, also does little to alleviate the underlying economic conditions on the island that led to its vast accumulation of debt.

Ryan's Triumph

Enactment of the measure is a significant accomplishment for Republican leaders in Congress, particularly House Speaker Paul Ryan, who vowed late last year to address the burgeoning debt crisis. His promise came after demands for action by Minority Leader Nancy Pelosi, who also pushed Democrats to back the final bill.

"This bipartisan legislation addresses the fiscal crisis in Puerto Rico while protecting American taxpayers from a bailout of the territory," Ryan said in a statement after the vote.

The Obama administration also claimed victory after Treasury Secretary Jacob J. Lew worked hard to shape the bill and press lawmakers in both chambers to support it.

There were plenty of doubts along the way that Congress and the White House could come through with a serious plan to address the crisis, even as the territory's fiscal woes sparked migration from the island and took a toll on its public health services and economy.

Congressional leaders had to overcome strong opposition from conservatives to any kind of federal bailout, while many Democrats were unhappy about proposals they said would infringe on the sovereignty of a U.S. territory. In addition, public advertising campaigns funded by hedge funds with stakes in Puerto Rico's debt targeted lawmakers who voiced support for a debt restructuring.

In the end, nobody in Congress was fully satisfied with the final bill. Democratic Senators Bob Menendez and Bernie Sanders blasted it as "colonial," while several Republicans wanted to impose even stricter discipline on Puerto Rico's government.

But Majority Leader Mitch McConnell waited until nearly the last possible minute to bring up the bill, presenting senators with the choice to reluctantly back the measure or risk triggering an even deeper crisis.

"Thanks to the stubbornness of the Treasury Department and lack of transparency from the government of Puerto Rico, it is the only option on the table, and delaying action would only hurt the Americans who reside on the island," Senate Finance Chairman Orrin Hatch of Utah said Wednesday on the Senate floor, explaining why he voted to advance the measure.

Breathing Room

In the short term, the bill does help give Puerto Rico some breathing room, which has some investors concerned.

With passage, "the governor has zero incentive to pay debt service and every incentive to divert debt service to his pet causes and to establish his own reputation as a populist warrior," said Matt Fabian, a partner at Concord, Massachusetts-based Municipal Market Analytics. Fabian said this is "the last easy time" for Puerto Rican officials to divert money for their uses before the board is established.

"The fiscal control board has its work cut out for it," Fabian said. "It not only will have to remediate Puerto Rico's finances, it's going to have to do so with Puerto Rico probably working against it from the shadows."

The legislation is the beginning of an effort to address a problem that has been years in the making.

Because Puerto Rico bonds aren't taxed anywhere in the U.S., the commonwealth was able to raise money for years from mainland investors, who were assured that — unlike many cities — the government wouldn't be able to escape from its debts in bankruptcy court. That assurance also left investors less willing to negotiate, calculating that the government had no choice but to pay.

The bill also places a stay on bondholder litigation, which is aimed at averting disorderly legal battles as Puerto Rico defaults on a growing share of its debts.

While the law gives the commonwealth some breathing room, "it's not addressing the fundamental problems with the economy," said Howard Cure, head of municipal research in New York at Evercore Wealth Management, which oversees $6.3 billion of local debt.

'Creates a Framework'

Some investors have been eager for the legislation to pass because creditors can begin negotiating with a control board after months of talks with Puerto Rico officials have failed to result in a deal, said Daniel Solender, who oversees $19 billion, including Puerto Rico securities, as head of municipals at Lord Abbett & Co. in Jersey City, New Jersey.

The bill “creates a framework to start negotiations, which have not really occurred so far in any real constructive manner,” Solender said. “So it’s a positive that there’s a mechanism in place, but the negative is it’s still uncertain what the objectives of the board will be.”

The island’s debt restructuring is by far the largest ever in the $3.7 trillion U.S. municipal bond market, a haven for buy-and-hold investors seeking tax-exempt income with little risk. With the island’s $70 billion in debt, this far surpasses the record $18 billion bankruptcy of Detroit in 2014.

Bloomberg Business

by Billy House, Michelle Kaske & Steven T. Dennis

June 30, 2016 — 1:40 PM PDT Updated on June 30, 2016 — 1:54 PM PDT