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## **Puerto Rico to Default on Constitutionally Guaranteed Debt.**

Puerto Rico will default on its constitutionally guaranteed debt for the first time Friday by failing to make most of some \$1 billion in payments due, officials said on Friday.

The island's Government Development Bank said the territory faces an imminent cash crunch and that its cash balances have dropped to "dangerously low" levels. As a result, the government isn't likely to make any of the \$779 million payment on general obligation bonds due Friday.

"Even if the commonwealth were to devote every last penny" in its operating account to Friday's debt payments, "it would still owe holders of the public debt hundreds of millions of dollars," the GDB said in a statement.

The government said Friday that even after it employs certain emergency measures to delay other payments to suppliers, which it has done in the past to scrape together the cash to pay bondholders, the island could still run out of money in August or September.

Puerto Rico's benchmark general obligation bond prices were up slightly Friday, with bonds selling for as much as 67 cents on the dollar compared with 65 cents on Monday. Analysts said the slight uptick in prices, which began Thursday, is likely a response not to Friday's default but to the enactment of federal restructuring legislation that authorizes the creation of a fiscal control board to oversee a debt work-out.

"I guess it's being viewed as a positive that Congress passed the bill," said Dan Solender, director of municipal bond management at Lord Abbett. "The big question is 'what is the control board going to focus on and how are they going to prioritize?'"

The restructuring legislation, which President Barack Obama signed Thursday, doesn't provide any mechanism to avoid such a default. Instead, it gives the island a stay against creditor litigation.

A default would force the three major insurers backing Puerto Rico's debt to pay out as much as hundreds of millions of dollars to bondholders. Ambac Financial Group backs \$122 million in Puerto Rico debt due Friday, company disclosures show. National Public Finance Guarantee Corp. backs \$173 million in general obligation debt coming due Friday, records show. Assured Guaranty Ltd. backs \$428 million coming due in the third quarter, most of it also due Friday.

All three insurers have money set aside for such claims. Insurers agree to pay only the amount due on the day it is due, not to accelerate payment on the defaulted bonds.

The law signed by Mr. Obama on Thursday doesn't commit any federal funding for the territory, meaning the bulk of any fiscal readjustment will fall on the island's creditors, government and residents. It empowers a seven-member oversight board, appointed by the president with the input of congressional leaders, to supervise a financial overhaul with the authority to initiate debt restructuring.

Puerto Rico's government for weeks has said that it would be unable to make debt payments, in part

because it hasn't been setting aside reserves. Still, some analysts have said the island would find a way to make the most senior payments, repeating a pattern seen over the past year in which the island said it couldn't afford to pay debt but drew on reserves and took other emergency steps to make payments.

Nearly \$2 billion in bond payments is due Friday, the majority of which are bonds protected by a constitutional lien on the island's revenues. The territory is unlikely to make more than \$900 million of the \$2 billion in payments, including all of the interest and principal due on general obligation bonds.

The island has been in a recession for most of the past decade and has seen a large drop in its population as residents, who are U.S. citizens, leave for the mainland.

"The market has been waiting for this default for two years, but really it's been 15 years in the making," said Matt Fabian, partner at research firm Municipal Market Analytics. "These defaults now are essentially Puerto Rico impounding funds for working capital."

Mr. Fabian said the defaults "will weigh on market psychology regardless of how prepared people are."

Puerto Rico has amassed nearly \$70 billion in debt across more than a dozen different issuers. The island had become "a colony of Wall Street," said Gov. Alejandro Garcia Padilla at a news conference Friday in San Juan. With Friday's default and the new federal legislation, "we are starting the process of putting it back in the hands of Puerto Ricans," he said.

Creditors have raised concerns that the federal legislation removes any urgency for the territory to continue good-faith efforts to make payments.

But other officials, including at the Treasury Department, have warned that the island lacked the resources to make the payments.

Without the legal stay in place before Friday to prevent a court from ordering payments to be made ahead of essential services, the island's debt crisis would have grown "much worse and might have been unsolvable," said Treasury Secretary Jacob Lew on Wednesday.

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