Bond Case Briefs

Municipal Finance Law Since 1971

Puerto Rico Fiscal Plan Triggers Bond Rout.

Economic estimates stoke fears that creditors will be asked to take large losses

Investors in Puerto Rico debt are contending with the fallout from a tough fiscal plan approved Monday by the federal oversight board managing the island's financial overhaul.

The price of Puerto Rico's $3.5 billion general-obligation bond due in 2035 has fallen about 10% since Monday to 66 cents on the dollar, according to data from Electronic Municipal Market Access.

The economic estimates baked into the 10-year plan are far more bearish than analysts and fund managers expected, stoking fears that creditors will be asked to recognize large losses as part of an expected restructuring.

The larger the losses, or "haircuts," Puerto Rico tries to impose on the hedge-fund and mutual-fund managers who own much of its $70 billion in debt, the harder it will be to negotiate settlements with them. The most likely alternative is lengthy and expensive litigation between the island and its creditors, investors have said.

Bondholders were particularly surprised by the pressure the oversight board exerted over Puerto Rico's Gov. Ricardo Rossello to replace earlier estimates with more conservative figures, leaving less money for bond payments, said Andrew Gadlin, an analyst at Odeon Capital Group LLC, a broker specializing in distressed debt.

"We're dealing with a board that was thought to be creditor friendly that now looks to be pretty unfriendly," Mr. Gadlin said. "It's similar to what you saw in Detroit." Detroit filed in 2013 for the biggest-ever U.S. municipal bankruptcy.

Negotiations between Puerto Rico and bondholders had been on hold until Mr. Rossello's administration delivered a fiscal plan that the board approved. The governor initially proposed earmarking about $1.2 billion a year for debt repayment over the next decade, but the board forced him to revise his economic forecasts downward, leaving about $800 million for annual debt service.

When the oversight board publicized its conservative forecasts last week, Puerto Rico's two largest bondholders, Franklin Advisers Inc. and Oppenheimer Funds Inc., sent board members a letter asking that they postpone its March 15 deadline for plan certification to allow further review. Instead, the board approved the plan two days before the deadline.

The new plan gives Puerto Rico a concrete set of figures from which to launch restructuring talks with bondholders, but the commonwealth has little time to negotiate a deal. The commonwealth received a stay on creditor litigation as part of a debt-relief law passed by Congress in June, but that moratorium expires May 1.

Puerto Rico and its financial adviser, Rothschild & Co., now have less money with which to broker settlements among several factions of bondholders, some of which have already filed lawsuits demanding repayment.

Holders of Puerto Rico's $13 billion in general-obligation bonds have formed a committee. So have owners of $17 billion in bonds backed by sales tax and investors in about $9 billion of bonds issued by the Puerto Rico Electric Power Authority. Prices of sales-tax-backed bonds due in 2041 have dropped this week about 5.5% to 59.50 cents on the dollar.

The conservative assumptions enforced by the oversight board have a silver lining, said Daniel Solender, a municipal-bond portfolio manager at Lord Abbett, which owns about $100 million of Puerto Rico bonds across various funds. By basing its fiscal model on pessimistic forecasts, Puerto Rico is unlikely to repeat a longstanding pattern of overpromising economic performance and then underdelivering, he said.

Disappointing as the plan may be to some, it finally opens the door to real negotiations between Puerto Rico and its creditors, Mr. Solender said.

THE WALL STREET JOURNAL

By MATT WIRZ

Updated March 16, 2017 12:19 a.m. ET

Write to Matt Wirz at matthieu.wirz@wsj.com