Bond Case Briefs

Municipal Finance Law Since 1971

Puerto Rico Menaces Mutual Funds That Resisted Market Exodus.

- **OppenheimerFunds is top mutual fund holder with $6.3 billion**
- **Mutual funds hold $15 billion of uninsured Puerto Rico debt**

The biggest restructuring in the history of the U.S. municipal-bond market will fall heavily on hedge funds that wagered Puerto Rico wouldn't go broke. But there's plenty of little guys left holding the bag, too.

More than two-dozen mutual funds hold about $15 billion of uninsured Puerto Rico bonds, about 20 percent of Puerto Rico's $74 billion debt, according to the most recent data compiled by Bloomberg. While that's less than what it was more than three years ago — before the island's rating was cut to junk — the figures show that smaller investors who own mutual fund shares still have a significant stake, despite a buying spree by speculators who scooped up about a third of the government's debt when others fled.

OppenheimerFunds Inc., a unit of Massachusetts Mutual Life Insurance Co., is the biggest mutual-fund holder with $6.3 billion. Franklin Resources Inc., the second-biggest, has about $3.1 billion. UBS Asset Managers of Puerto Rico funds hold $1.4 billion, followed by those run by Goldman Sachs Group Inc., which have about $1.2 billion.

Mutual funds bought the island's debt because it offered high-yields and was exempt from taxes across the nation.

While those investments have been jeopardized by the island's decision Wednesday to turn to a U.S. court to restructure its debt after a series of defaults, those mutual funds will likely see little immediate impact. The Caribbean territory's crisis has been building for two years, giving funds plenty of time to pare their exposure. And the court filing — allowed under emergency legislation enacted by Congress last year — had little impact on bond prices, which had already tumbled. One of the island's most active securities, general-obligation bonds that were first sold for 93 cents on the dollar in 2014, traded for 64 cents Friday.

The variety of bond holders, however, underscores the broad reach of the commonwealth's crisis, which will be sorted out under the supervision of U.S. District Judge Laura Taylor Swain after it proved too vast for the government to do out of court. Puerto Rico has issued many different classes of debt backed by different revenue sources: general revenue, sales taxes, utility fees — even rum-tax money.

While analysts say it's impossible to gauge exactly how much of their money various bondholders will get back, they won't be totally wiped out. Before seeking out court protection, Puerto Rico offered general-obligation bondholders at least 70 cents on the dollar, with the possibility for 20 cents more if the island's finances rebound.

Despite its stake in Puerto Rico, OppenheimerFunds' Rochester High Yield Municipal Fund is the top-performing municipal fund over the last three years, returning 8.3 percent annualized, according to data compiled by Bloomberg. The $5.8 billion fund is a large holder of junk-rated tobacco bonds, which returned an annual 11.3% in the three years ending March 31, according to the S&P Municipal Bond Tobacco Index.

"Rochester funds have long believed that a negotiated resolution and restructuring without the expensive delay of protracted litigation is the best way forward for all parties," said Kimberly Weinrick an OppenheimerFunds spokeswoman. "In view of the financial oversight board's Title III filing and its decision to ignore a serious and constructive plan that we put forward in good faith, we are considering all appropriate legal remedies to protect and preserve the rights of fund shareholders."

Franklin has reduced its exposure to Puerto Rico since 2012 because of the government's weakening finances, said Stacey Coleman, a spokeswoman for the company. Its mutual-fund investors are also relatively protected against what was retained: None of Franklin's funds have more than 5 percent of its assets invested in the island, and some have none at all, she said.

"We retained those investments that we believed were in the strongest position and felt had significant legal and constitutional protections by their indentures and the Puerto Rico constitution itself," she said.

Peter Stack, a UBS spokesman, declined to comment, as did Andrew Williams, a spokesman for Goldman Sachs.

Bloomberg calculated fund holdings as face value for non-zero coupon bonds and at accreted value of zero coupon bonds. Derivatives, fully refunded bonds, insured and tobacco debt weren't included.

Bloomberg Markets

by Martin Z Braun

May 8, 2017, 2:00 AM PDT May 8, 2017, 7:21 AM PDT