Puerto Rico: Do First Claims on Sales Taxes Really Protect Your Municipal Bond Investment?

A combination of poor financial oversight, non-adherence to fiscal policies and an overextension of its financial leverage has led Puerto Rico into a decade-long fiscal decline, which has resulted in its inability to meet the financial obligation to its crushing debt.

In May 2017, the Federal Financial Oversight Board pushed Puerto Rico into a restructuring process, known as Title III, which is quite like the restructuring processes that occurred in Detroit, MI, and Stockton, CA, amid their financial struggles. However, what sets this restructuring apart from Detroit or Stockton is its magnitude. Puerto Rico's financial restructuring process for its $70 billion debt portfolio, and potential restructuring of its $40 billion pension liabilities, will be one of the biggest undertakings for any local or state government in the history of the United States. The financial crisis of this U.S. commonwealth has contributed to a high poverty rate, where 40% of Puerto Rico's citizens are living under the poverty line and the unemployment rate has hit above 10%, along with a nearly insolvent public healthcare system.

In this article, we will take a closer look at Puerto Rico's general obligation debt and its revenue-backed debt and the implications of the restructuring process, as well as how under the financial insolvency of a local government, bonds with higher credit ratings could be subordinate to GO bonds with lower credit ratings.

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