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Stunned Investors Reap 95% Gains on Defaulted Puerto Rico Bonds.

- **Debt once worth 21 cents on the dollar now trades for 41 cents**
- **Some have doubts: 'The numbers are still pretty ugly.'**

Of all the wild, head-scratching moves in financial markets this year, there are few that have surprised investors quite as much as the rally in defaulted Puerto Rico bonds. "It just blows my mind," says Matt Dalton, chief executive officer of Belle Haven Investments.

Since sinking to a mere 20.8 cents on the dollar in December, prices on the island's most frequently traded securities have climbed steadily and reached a high of 45 cents last week before paring gains during the past few days. Not only are Puerto Rico's bonds the top performer in the \$3.9 trillion municipal market, they've gained more than any other dollar-denominated debt in the world, according to data compiled by Bloomberg.

The rally started inconspicuously enough back in late December, with a penny gain here and there that analysts chalked up to bottom fishing after prices collapsed in the aftermath of Hurricane Maria.

But then the increases started coming in bigger chunks as word spread that the island may emerge from the devastation with more money on hand than anticipated, a development that creditors bet would translate into better debt-restructuring terms.

The bonds soared by more than 8 cents over two days late last month after Governor Ricardo Rossello released a revised fiscal plan that projects a \$6 billion surplus before debt payment through 2023, the second upward revision in as many months.

Many investors question the rally's staying power. Puerto Rico has a long history of botching its projections, they point out. And the federal oversight board that was empowered by Congress to enforce fiscal discipline on the territory and chart a financial turnaround doesn't appear to be nearly as sanguine as the bond market. On March 28, it demanded additional austerity measures that Rossello is resisting.

"We're miles away from having a resolution and concrete determination on where we're going to be," said Dalton, whose firm invests some of the \$7 billion it manages in insured Puerto Rico debt.

Municipal bankruptcies are so rare that trying to forecast how much investors will recover is little more than a guessing game. And there's never been a workout as big or as complicated as the one under way for Puerto Rico, which has sold some \$74 billion of debt with varying — and sometimes rival — claims to the government's tax revenue.

The outlook for investors looked even bleaker after the September storm when President Donald Trump suggested that Puerto Rico's debt would need to be erased to help it recover. But an influx of \$70 billion of federal funds and insurance money to rebuild is expected to give it a needed boost.

Rossello's plan forecasts that the island's long-sputtering economy will grow by 7.3 percent next year and continue to expand — albeit at a slower pace — for the next four years.

That would mark a sharp break for the island, whose debt crisis arose from years of borrowing to paper over budget shortfalls as the economy contracted year after year and residents continued to leave for jobs on the U.S. mainland. Puerto Rico is now counting on them largely sticking around: the plan relies on the population loss holding around one percent a year starting in fiscal 2019.

"I'm surprised by the amount that the bonds have rallied because there's still a lot of questions to be asked," said Mark Paris, senior portfolio manager at Invesco Advisers Inc. which oversees \$27.2 billion in municipal assets. "They need to do a lot for the people on the island before they start really worrying about bondholders. So I don't know how you calculate the recovery."

Rossello's fiscal plan calculates the island could pay as much as \$19.1 billion of principal over 30 years if the debt were restructured with an interest rate of 4.5 percent — enough to cover about half the outstanding principal the central government owes. But that's only a projection. The recoveries will ultimately be determined in bankruptcy court as the federal board and creditors negotiate on a deal.

"Many of the recoveries will be determined through negotiation essentially and it's unclear to me that the current fiscal plan that's been put on the table will have a great deal of influence on this process," said Ted Hampton, an analyst at Moody's Investors Service in New York.

Even with federal funds for rebuilding after the storm, Puerto Rico's faces challenges. More than 45 percent of residents live in poverty, workforce participation is about 40 percent and the fiscal plan projects the population will still shrink.

"The numbers are still pretty ugly," said Joe Rosenblum, director of municipal credit at AllianceBernstein LP, which oversees \$41 billion of municipal debt. "For now, I think the optimism has played out."

Bloomberg Markets

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April 3, 2018, 5:07 AM PDT

— *With assistance by Ye Xie*