

Bond Case Briefs

Municipal Finance Law Since 1971

Puerto Rico Debt Plan at Risk as Economic Outlook Darkens.

(Bloomberg) — Puerto Rico and a group of investors in February agreed to a debt-cutting deal that would allow them to recover as much as 77.6 cents on the dollar from their investment in the island's bonds. But that deal may have to be revisited as the coronavirus darkens the outlook for the economy.

While the commonwealth estimates its economy has been growing after more than a decade of contraction, the coronavirus could exert a considerable drag on Puerto Rico's economy over the next two quarters.

The tentative plan for how to slash nearly \$18 billion of Puerto Rico's debt is on hold after the judge overseeing the record bankruptcy canceled hearings set for early June as island officials work to slow the spread of the disease. They'll also be working with Puerto Rico's financial oversight board to assess the economic impact of the virus on the island's ability to repay bondholders, the commonwealth's Fiscal Agency and Financial Advisory Authority said in a court document filed Thursday.

"This is going to make it harder to give the same level of revenue growth and it's going to force them to cut deeper into bondholder principal," said Matt Fabian, a partner at Municipal Markets Analytics.

Economy Halts

States and cities throughout the U.S. are struggling to get a handle on how bad their finances will be hit as businesses, schools and cultural institutions close. In Puerto Rico's case, it must also work through its nearly three-year old bankruptcy as most economic activity halts.

The latest challenge will likely force island official to place the debt restructuring on the back burner, as it did after being battered by Hurricane Maria in 2017. Depending on how Puerto Rico weathers the economic blow, the amount of money to pay debt service may change.

"It may impact recoveries," said John Ceffalio, municipal credit research analyst at AllianceBernstein, which manages \$47 billion of debt, including Puerto Rico securities. "Our desired outcome from the board's work is sustainability for the island — sustainable economy, sustainable budget, sustainable debt service — and given the uncertainty with the virus there are a lot of questions right now as to what is sustainable."

While addressing Puerto Rico's finances is a central task for the oversight board, the virus has become the main issue in the near term.

"The oversight board's focus right now is on supporting the government to help Puerto Rico through the COVID-19 crisis," Matthias Rieker, a spokesman for the board, said in a statement. "The oversight board's goal continues to be to reduce Puerto Rico's debt to a sustainable level."

The debt restructuring plan faced hurdles even before the coronavirus. Bond insurers hadn't signed

on to the tentative deal and Governor Wanda Vazquez criticized the proposal.

The oversight board on Feb. 9 struck the tentative deal with Aurelius Capital Management and other investors. It includes a range of recoveries depending on the security. General obligations sold in 2014 with an 8% coupon would get 65.4 cents on the dollar while Public Buildings Authority debt sold before 2011 would get 77.6 cents.

Trading Below

Some Puerto Rico bonds are trading below those levels following the steep sell-off in the municipal market earlier this month. General obligation bonds with an 8% coupon and maturing in 2035 traded Monday at about 59 cents on the dollar, down from an average 73.8 cents in February, according to data compiled by Bloomberg.

Puerto Rico is set to file by May 1 a status report to the court on the effects of the virus on the economy. Island officials will also be reviewing the debt adjustment plan.

“During this adjournment, the government, in collaboration with the oversight board, will work to assess the economic impact of COVID-19 on Puerto Rico’s debt service capacity under the proposed plan of adjustment (or any future plan),” AAFAF, the fiscal agency, said in a court document filed Thursday.

While the oversight board and Puerto Rico will work to achieve the best settlements in their interest, the debt adjustment plan spans many years and doesn’t rely just on the economy’s immediate performance, said Howard Sitzer, senior municipal analyst at CreditSights Inc.

That longer horizon and the potential federal aid that Puerto Rico will receive along with Governor Vazquez’s \$787 million stimulus plan will help support the island’s economy, Sitzer said.

“The question is what kind of drag will the pandemic have in terms of the intermediate to longer range economic performance of Puerto Rico?” Sitzer said.

Bloomberg Markets

by Michelle Kaske

March 30, 2020