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Puerto Rico Seizes on Junk-Bond Rally With \$1.8 Billion Sale.

- **Territory plans to refinance bonds sold by water agency**
- **High-yield muni funds see third-biggest cash influx on record**

Puerto Rico, the U.S. territory still in the midst of a four-year-long bankruptcy, is seizing on demand for risky bonds.

The Puerto Rico Aqueduct and Sewer Authority, the island's main water supplier, is planning to refinance as much as \$1.8 billion of debt after the yield penalty it faces in the bond market tumbled. It would be the biggest high-yield municipal debt deal since Ohio's sale of more than \$3 billion tobacco-settlement bonds in February 2020, according to data compiled by Bloomberg.

The growing confidence among investors that the Federal Reserve is poised to keep interest rates low as the U.S. economy rebounds has fueled demand for high-yield securities across the world's bond markets. The riskiest municipal securities are no exception, with junk-bond yields sliding from 3.72% in mid-March to 3.55%, not far from the lows seen before the pandemic shutdowns began in the U.S., according to a Bloomberg Barclays index.

High-yield municipal-debt funds picked up \$821 million of cash from investors during the week ended Wednesday, the third largest on record, according to Refinitiv Lipper US Fund Flows data.

Puerto Rico has yet to determine the exact size of the refunding deal and when the bonds may price, Ivan Caraballo, a spokesperson for the commonwealth's Fiscal Agency and Financial Advisory Authority, said in an email.

Prasa, as the utility is known, did a similar refinancing in December and the bonds have since rallied. Debt maturing in 2047 last traded on March 24 with an average yield of 3.03%, 130 basis points more than top-rated bonds, according to data compiled by Bloomberg. That yield spread — a key measure of perceived risk — is down from 276 basis points when the securities were first sold.

The Prasa securities have benefited from the limited supply of high-yield bonds, said Daniel Solender, head of municipal securities at Lord Abbett & Co., which holds \$33 billion of state and local debt, including Puerto Rico's.

High-yield municipal bonds have returned 2.65% this year, beating the overall market's 0.7% loss, according to Bloomberg Barclays indexes.

"There's just not a lot of options out there right now," Solender said. "There's a really good amount of money flowing into high-yield muni funds and supply is pretty thin."

Prasa is one of the few Puerto Rico entities that has avoided bankruptcy and continues to pay bondholders on time. The anticipated refinancing will be the second major debt offering for Puerto Rico — after December's sale — since the commonwealth sought bankruptcy in May 2017.

Puerto Rico and competing bondholder groups struck a tentative deal in February on how to reduce \$18.8 billion of debt tied to the commonwealth's central government, a major step that could resolve Puerto Rico's bankruptcy this year. That headway benefits the water utility, Solender said.

"They've made it through this long period of time without defaulting, which is definitely a big positive," Solender said about Prasa. "There's progress being made. It seems like there could be an end in sight in the future."

While Prasa has avoided restructuring its debt through bankruptcy, the securities have risk. The agency warned investors before its December sale that they faced potential losses, the bonds may have limited or no secondary market and Prasa will need to raise rates and cut expenses in order to repay bondholders in the future. In November, Fitch Ratings held the utility deeply in junk when it boosted the rating one notch to CCC, 8 steps below investment grade.

Even with those risks, Prasa could get enough interest from investors to execute the refinancing, Solender said.

"The high-yield spreads have come in this year, so they should be able to benefit from that," he said.

Bloomberg Economics

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