

# **Bond Case Briefs**

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## **Puerto Rico Bankruptcy-Exit Plan Offers Island a Fresh Start.**

- **Workout cuts \$33 billion of debt, creates pension reserve fund**
- **Exit 'removes a huge cloud' over the economy: Marxuach**

Puerto Rico is inching closer to ending its more than four-year bankruptcy as the judge overseeing the workout is reviewing a restructuring plan that cuts billions in debt, fixes a broke pension system and potentially returns the commonwealth to balanced budgets.

U.S. District Court Judge Laura Taylor Swain may rule as soon as next month on the debt adjustment deal. If she approves it, Puerto Rico will be able to move past its bankruptcy and focus on boosting its economy and modernizing the island's electrical grid to end chronic outages.

"It removes a huge cloud that's been hanging over the economy for four years now," said Sergio Marxuach, policy director at the Center for a New Economy, a San Juan-based research institute that analyzes the commonwealth's finances. "We can start to change the narrative from 'Puerto Rico is in bankruptcy' to 'Puerto Rico is recovering,' which is positive in terms of attracting investment."

Puerto Rico's been in bankruptcy since May 2017 after years of borrowing to cover operating expenses, economic contraction and population decline as residents left to find work on the mainland. Since then, natural disasters like Hurricane Maria — which left many Puerto Ricans in the dark for a year — as well as political turmoil and the pandemic delayed efforts to emerge from the largest debt restructuring ever in the \$4 trillion municipal-bond market.

The lengthy process has pushed Puerto Rico's bankruptcy costs to more than \$1 billion.

### **Debt Service**

The debt plan would slash \$33 billion of debt and other obligations, including cutting \$22 billion of bonds, to \$7.4 billion. Investors would exchange their holdings for a lesser amount of new bonds, reducing what the government owes. Bondholders would also receive \$7 billion in cash and a so-called contingent value instrument that would pay out if Puerto Rico's sales-tax collections surpass estimates.

The overall reduction means Puerto Rico would only have to pay an average of \$666 million for debt service on commonwealth-guaranteed bonds annually for the first 10 years, down from an average \$1.6 billion.

The workout plan also is intended to help fix the commonwealth's broke pension system — which owes current and future retirees an estimated \$55 billion — by establishing a reserve fund that Puerto Rico would contribute to annually.

Still, Puerto Rico lawmakers likely will struggle to balance budgets as the commonwealth must allocate about \$2.3 billion each year in pension payments to retired public workers and as Medicaid

costs may increase.

Retirement costs could rise as island lawmakers passed legislation to boost pension benefits for public workers. A federally appointed financial oversight board is asking the court to pre-empt those laws. The judge late Tuesday asked the board for more details to justify nullifying the legislation.

That stress could again make it difficult for the island to pay debt service. Puerto Rico is estimated to face deficits again in fiscal 2036 with a \$119 million shortfall, even if island lawmakers implement changes such as making it easier to do business there and programs to expand workforce participation, according to the commonwealth's current multi-year fiscal plan.

### **'Grow the Economy'**

The commonwealth's ability to pay debt service once out of bankruptcy also depends on its economy growing after federal disaster aid and pandemic funds dry up.

"We need to come up with a medium to longer-term plan to grow the economy," Marxuach said.

Investors are watching to see if Puerto Rico leaders stick to sound fiscal policies once the oversight board is disbanded. The panel is set to expire after four consecutive years of balanced budgets and when the commonwealth regains access credit markets.

"There's a lot of uncertainty about where Puerto Rico policies will go," said Matt Fabian, a partner at research firm Municipal Market Analytics. "Will we return to the early 2000s of how Puerto Rico ran itself in or will Puerto Rico actually run itself similar to how other states run themselves?"

Prices on some commonwealth general obligations bonds are trading higher than what bondholders will receive in the exchange as investors factor in the upfront cash payment and potential sales-tax revenue. General obligation bonds with an 8% coupon and maturing in 2035 traded Tuesday at 89 cents on the dollar, above the 67.7 cents that bondholders will receive for that security, according to data compiled by Bloomberg.

The oversight board that manages Puerto Rico's bankruptcy negotiated the debt adjustment deal rather than the commonwealth's elected officials. That has created animosity on the island against the oversight board, especially as the panel has sought to cut spending on colleges and aid to municipalities while lawmakers have balked at cuts to public employee pensions. Governor Pedro Pierluisi supports the debt restructuring plan.

"The last thing you want is the people nominally in charge working against the plan," said Steven Rhodes, a retired federal judge who oversaw Detroit's 2013 bankruptcy. In Puerto Rico, "the people and their leaders feel cut out of the process."

### **Bloomberg Markets**

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— *With assistance by Steven Church*