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Puerto Rico Released From Bankruptcy as Economic Problems Persist.

A federal judge approved the largest-ever restructuring of U.S. municipal bonds, easing the island's re-entry to capital markets

Puerto Rico received court approval to leave bankruptcy through the largest restructuring of U.S. municipal debt ever, ending years of conflict with creditors as the U.S. territory confronts other stubborn economic problems.

Tuesday's court ruling approved a write-down of $30.5 billion in public debts built up during an economic decline marked by high joblessness, outward migration and unsustainable borrowing that tipped Puerto Rico into bankruptcy in 2017. The restructuring plan calms tension between Puerto Rico and its Wall Street creditors dating to its debt default, the largest ever on bonds backed by the full faith and credit of a U.S. municipality.

In approving the bankruptcy plan, Judge Laura Taylor Swain overruled objections to the financial restructuring and said it enjoys "broad but not universal support" among affected creditors and will preserve Puerto Rico as a "viable public entity."

The restructuring marks a win for the oversight board steering Puerto Rico's finances, an unelected body that shares power with elected officials and has faced opposition from many of the island's three million residents, who have referred to it as the "junta." Judge Swain's ruling doesn't remove the board, which under federal law can only disband after four consecutive years of balanced budgets.

But slashing debt does free up cash for spending that would otherwise go to bondholders. Puerto Rico's debt-servicing costs will fall to roughly $666 million for the next 10 years, from $2.1 billion before its default. Creditors will receive $7.4 billion in new debt and $7 billion in cash, as well as tradable securities known as contingent value instruments that pay out if the economy improves.

Big investors including BlackRock Financial Management Inc. and Silver Point Capital LP backed the negotiated plan, which has pushed the value of some core government bonds to four times what they were worth after Hurricane Maria hit Puerto Rico in 2017. The benchmark general obligation bond has rallied to more than 90 cents on the dollar, compared with lows in 2017 of 21 cents on the dollar.

Puerto Rico joins Detroit; Jefferson County, Ala.; Orange County, Calif.; and the California cities of Stockton, San Bernardino and Vallejo as municipal borrowers that have shed debts through a court-supervised bankruptcy. The end of the bankruptcy case will slow the professional fees for lawyers, bankers and consultants who advised Puerto Rico on its restructuring and have racked up roughly $1 billion in bills so far, at taxpayers' expense.

The territory entered bankruptcy with $74 billion in bond debt and a $55 billion gap between the pension benefits promised to employees and retirees and the funding set aside to pay for them.

Public agencies were racked with cronyism and failed for years to draw up accurate budgets or account for expenses, according to a 2018 investigation commissioned by the board.

Sprawling bureaucracy and a high cost of doing business discouraged investment, especially after the expiration of some corporate tax breaks in 2006 pushed some pharmaceutical and other manufacturers to depart. To make up for a shrinking tax base, officials borrowed to paper over deficits and skimped on pension contributions, losing Puerto Rico its investment-grade credit rating in 2014.

Many residents of Puerto Rico, political leaders, and some investors have called for an independent audit of how the huge debt was built up and the prosecution of individuals who might have misspent public funds, according to Judge Swain's decision.

She said her ruling "does not foreclose further investigation, whether through regulatory, law enforcement, or civil litigation channels, into the origins of Puerto Rico's debt crisis."

Despite the board's sweeping powers over fiscal matters, many of its proposed overhauls of business rules and economic policy in Puerto Rico have languished. Lawmakers resisted the board's proposed cuts to pension benefits and quashed attempts to relax labor laws and tighten welfare requirements, reflecting popular anxiety that cutbacks to the safety net would push more into poverty.

The board's executive director, Natalie Jaresko, disputed on Tuesday that it had implemented harsh austerity measures, as its critics allege.

"There were no layoffs. There was not a single major agency of any size shut down. There were reductions in budget, but it wasn't austerity," said Ms. Jaresko. She said the plan of adjustment protects pensions and ensures that lawmakers don't go back to making promises that aren't paid for.

"This period of financial crisis is coming to an end," she said. "The uncertainty that every person, every business in Puerto Rico felt is coming to an end."

Many of the fiscal problems that drove Puerto Rico's decline haven't been fixed. Government audits remain years overdue. The economy relies heavily on tax breaks to spur development, issuing $21.4 billion in incentives to businesses and individuals in 2018, the most recent data available. The labor participation rate in Puerto Rico was 43.4% in November, well below the lowest rate among U.S. states, West Virginia's 55.1%.

Electricity service is dogged by outages, including after the business of delivering power was privatized last year at the board's urging. In November, a local court issued an arrest warrant for the chief executive whose company now runs the power grid after he allegedly failed to turn over information to lawmakers. The warrant was quickly rescinded. Power service remains costly and prone to outages after years of inadequate maintenance.

Jose Villamil, CEO of economic consulting firm Estudios Tecnicos, said there has been "relatively little private-sector investment in Puerto Rico in the past six to seven years," except for real estate. He doesn't expect that to change soon.

Puerto Rico has a big cash balance because the government hasn't been making debt payments during its bankruptcy, but could run up deficits once debt servicing resumes, Mr. Villamil said. The board also predicts that government deficits will reappear by 2035 unless lawmakers adopt labor, business and tax overhauls that so far have failed to gain traction.

As the restructuring plan gained momentum, the board backed off demands to cut pensions for retired teachers, judges and bureaucrats, bowing to Gov. Pedro Pierluisi and legislative leaders whose help it needed to close the debt deal with bondholders.

That concession left accrued retirement benefits fully intact, a potential source of fiscal stress in coming years. The pension funds at issue cover 167,000 retired workers, or 5% of the island's population, making them the largest creditor group in the bankruptcy.

At the same time, teachers' and judges' unions opposed the restructuring plan because it stops current employees from accumulating any more defined pension benefits while switching them to less generous 401(k)-style programs. Judge Swain agreed with the board that without the benefit freeze for active workers, the restructuring plan might not be feasible.

Puerto Rico in its journey through bankruptcy was confronted with catastrophic hurricanes in 2017, street protests that caused a governor's resignation and succession crisis in 2018, coastal earthquakes in 2019 and the arrival of Covid-19 in 2020. Its relationship with Washington, strained for years, deteriorated under former President Donald Trump, who criticized elected leaders on the island and restricted its access to federal disaster aid.

The territory forged a path out of bankruptcy despite the pandemic, buoyed by an influx of federal assistance and a broad rally in municipal bonds that eased investor concerns about the territory's return to capital markets after a long exile. The municipal-bond market has largely shrugged off Puerto Rico's troubles, viewing the default as an isolated incident and not an indicator of broader weakness among state and local governments.

Ignacio Alvarez, CEO of San Juan-based bank operator Popular Inc., said Tuesday that Puerto Rico has bounced back better than expected from the pandemic but still faces an uncertain economic future. The expected influx in federal funds won't last forever, he said.

The board "has tried to drive a fine line between those two extremes, where some people would say we should try to wipe out the debt, and the bondholders saying we should get 100%," he said.

The board hopes the aftermath of the restructuring will include "material new investments that turbocharge the economy" following a historic decline in population, board lawyer Martin Bienenstock said in court in November. By 2026, the island's population is projected to fall to 2.76 million, 10% less than in 2019, Mr. Bienenstock also said in court hearings over the restructuring plan. The population was close to 3.7 million in 2010, according to census data.

The board has worked to put safeguards in place to prevent Puerto Rico from again taking on too much debt, such as only allowing for long-term bond sales for capital investments, rather than for financing deficits, court filings show.

Board chairman David Skeel said Tuesday that critics of the adjustment plan are incorrect in arguing that it leaves Puerto Rico to face an unsustainable debt obligation. Under the plan, Puerto Rico will pay roughly 7.2 cents of every dollar collected in taxes and fees to bondholders, compared with 25 cents before the bankruptcy.

"This is absolutely sustainable," Mr. Skeel said. "It's not going to lead to more cuts."

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