

Puerto Rico Barely Avoids Second Default

Puerto Rico made a crucial debt payment on Tuesday but warned that its deteriorating finances could trigger future defaults, as the governor granted the U.S. territory power to take revenues from public agencies.

There had been speculation Puerto Rico would default on all or part of the \$355 million notes issued by its financing arm, the Government Development Bank. The U.S. territory said in a statement that it made the Dec. 1 bond payment despite “extreme fiscal challenges.”

While Puerto Rico first defaulted in August, failure to make the payment on Tuesday would have been more significant because part of that debt was protected by the commonwealth’s constitution.

Another default could have triggered lawsuits, further spooked investors and undermined the island’s efforts to climb out of \$72 billion in debt and forced it to take drastic measures to keep public services running.

A Puerto Rico executive order signed on Monday by Governor Alejandro Garcia Padilla said it gives the commonwealth the ability to claw back revenues from certain government agencies, including the highway authority HTA and the infrastructure authority PRIFA.

Garcia Padilla earlier told a U.S. Senate Judiciary Committee that Puerto Rico would have to “claw back revenues pledged to certain bonds issued in order to maintain public services” and to repay bonds issued with the full faith and credit of the commonwealth.

Moody’s ratings agency said in a statement that the bank’s

payment does not change Moody's ratings or outlook for Puerto Rico's debt.

The payment indicated the "commonwealth is making an effort to avoid litigation and prevent further deterioration in relations with its creditors," Moody's said, but the ratings agency would "continue to view default as likely on future commonwealth debt payments."

Puerto Rico's 8 percent General Obligation Bond rallied to trade at an average price of 75 cents on the dollar, with a yield dropping to percent versus a yield of percent on Monday.

Joseph Rosenblum, director of municipal credit research at AllianceBernstein in New York, said that while there had been no impact on the rest of the market, "that may start to change if and when owners don't receive payments."

With 45 percent of its 3.5 million population in poverty, Puerto Rico is a meteorological paradise mired in economic purgatory. Years of over-spending and the expiration of corporate tax incentives stuck it with debt that gets harder to pay as residents increasingly emigrate to the United States.

"Puerto Rico's debt crisis didn't happen overnight, it's been years in the making," said Senator Chuck Grassley, who chairs the committee at Tuesday's hearing. "The starting point is to identify the problem."

The commonwealth would use the clawbacks to fund payments on top-priority debt carrying constitutional protections, Garcia Padilla said in written testimony to the Senate panel.

Garcia Padilla wrote: "In simple terms, we have begun to default on our debt in an effort to attempt to repay bonds issued with the full faith and credit of the commonwealth and secure sufficient resources to protect the life, health, safety and welfare of the people of Puerto Rico."

Height Securities analyst Daniel Hanson said the comments meant Puerto Rico was defaulting on “instrumentality debt, not debt with a constitutional pledge.” General obligation bonds, along with GDB bonds that have constitutional guarantees, should be safe, he said, but bonds from entities such as highway authority PRHTA and infrastructure financing authority PRIFA are at risk.

Of the \$355 million paid on Tuesday, \$81.4 million was to service non-general obligation-backed debt and \$273.3 million was for notes backed by the commonwealth’s general obligation guarantee.

The payment on bonds issued by the GDB was crucial as Puerto Rico tries to stretch its liquidity into 2016 to provide more time to restructure debt.

In August, Puerto Rico paid only \$628,000 of a \$58 million payment due on its Public Finance Corp bonds. {eo}

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