



Current Status of Puerto Rico Debt Restructuring

Jayden Sangha Mar 20, 2019

After a decade-long fiscal decline, Puerto Rico filed for bankruptcy protection and has been in federal court since May 2017 to restructure its \$120 billion debt portfolio comprised of public debt and unfunded liabilities. The financial crisis of this U.S. commonwealth has contributed to a high poverty rate, in which 40% of Puerto Rican citizens are living under the poverty line and the unemployment rate has been above double digits, along with a nearly insolvent public healthcare system.

The prospect of Puerto Rico's debt restructuring, negotiations with its creditors, and getting a plan of adjustment approved by the bankruptcy court became even more uncertain after a U.S. Appeals Court ruled in February 2019 that the federal oversight board overseeing the bankruptcy process was unconstitutionally appointed.

The court also set a 90-day period for the U.S. president and the Senate to either validate the appointments or reestablish the oversight board. As things were looking promising and progress was being made to achieve the objective of debt restructuring for Puerto Rico, this new ruling has knocked any progress off its rails.

In this article, we will take a closer look at the future of Puerto Rico's restructuring process, additional lawsuits, delays in reaching negotiated agreements and mounting legal fees for Puerto Rico.

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Invalidation of the Oversight Board

Under the 2016 federal law known as PROMESA (Puerto Rico Oversight, Management, and Economic Stability Act), the fiscal oversight board was established to oversee Puerto Rico's debt restructuring process. During the process, Congress presented a list of recommended candidates to be on the board and Barack Obama, then-president, appointed the board members. These appointments were not subject to Senate confirmations. Like other municipal bankruptcy processes, the board was responsible for negotiation with creditors, crafting a plan of adjusting and presenting that to the bankruptcy court.

The progress on this restructuring process and the negotiation efforts were halted on Feb. 15, when the federal appeals court ruled the oversight board unconstitutional by stating that oversight board members are principal U.S. officers and should have been appointed by the U.S. president with the advice and consent of the Senate. The lawsuit to invalidate the oversight board and to ask for the dismissal of Puerto Rico's bankruptcy case was brought forward by two of the major creditors of Puerto Rico, hedge fund Aurelius Investment LLC and bond insurer Assured Guaranty Corp. Where the court ruled in favor of these two creditors on the unconstitutionality of the oversight board, the appeals court rejected their litigation to dismiss the bankruptcy proceedings.

Click [here](#) for more on what the oversight board suggested last summer.

The Mounting Legal and Consulting Costs

Throughout the restructuring process, the one thing that has remained constant is the increasing legal and consultant fees charged by the industry experts assigned by the oversight board. By the end of last year, the fees (charged by both legal and financial experts) associated with these restructuring efforts were above \$225 million. Along the same lines, the federal judge overseeing the bankruptcy proceedings has approved over \$160 million in legal fees invoiced during the first year. The longer it takes for the oversight board to present a plan of adjustment, the legal and consultant fees are

expected to increase exponentially and the island residents are bearing the burden of all fees associated with this process.

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What's Next?

After the court's verdict, the U.S. president will either decide to reestablish the oversight board or validate the current board – either action will need to take place with Senate approval. Although in their litigation, the creditors also requested to nullify all efforts the board has taken thus far to restructure the debt and negotiations. The court rejected the notion and stated that the board's actions were constitutional.

This means that all negotiations and the progress made on the restructuring efforts by the board will remain in place. These efforts include the progress made on the restructuring of \$4 billion of Government Development Bank debt through a consensual deal with the creditor.

Being a U.S. territory, the legal turmoil and outcome of various litigations brought forward by its debt holders in Puerto Rico can have a profound impact on the decision making of debt holders and portfolio managers in the United States. The same applies for mainland municipalities when structuring their debt to raise capital in the United States. For example: Many investors assume, rightfully so, that revenue-backed debt is a relatively safer investment option and consider its position to be higher than general obligation debt, due to the specific revenue streams that are typically collateralized to make payment on these bonds. However, this assumption is being challenged in Puerto Rico during its restructuring efforts and this conundrum has caused quite a stir among Puerto Rico's GO and COFINA debt holders.

Last year, GO bondholders and their legal representatives have brought forward lawsuits claiming that their debt obligations must be met by the island's government before COFINA's are paid, irrespective of any revenue pledges, liens or secured debt. Click [here](#) to learn more about this.

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The Bottom Line

The fiscal crisis in Puerto Rico, combined with recent natural disasters, has created even bigger challenges for the commonwealth and its people. For the everyday municipal debt investor, Puerto Rico serves as a great example that highlights the intricacies of municipal debt markets and challenges the common beliefs held by many investors about their municipal debt investment holdings.

The uncertainty around the political decision-making that will decide the fate of the current oversight board will dictate the direction of Puerto Rico's restructuring efforts.

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