Puerto Rico bonds buoyed by lack of supply expected to price in high 8% range
By Maryellen Tighe, Ellie Ismailidou and Maria Amante
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Puerto Rico's USD 3bn general obligation debt sale will price between 8.625% and 8.875%, according to a source working on the deal and two credit analysts.

The bonds will have an 8% coupon, according to information from the source working on the deal and Paul Nolan, head of municipal research at Asset Preservation Advisors.

The pricing is more aggressive than the traditional market was expecting, said Adam Mackey, managing director of municipal fixed income at PNC.

“They’re trying to get the market in a froth today over pricing, and with that coupon, you’re talking about bonds priced at a slight discount,” Mackey said. “Maybe a 98, clearly they feel they have it done there or they wouldn’t price it there.”

The close-to-par dollar price will drive away distressed buyers, Mackey said. The deal is drawing alternative investors, such as hedge funds, as this deal is not a good fit for most traditional municipal market participants. It also may be attracting corporate and sovereign buyers with a risk adjusted yield that compares favorably to other corporate and sovereign investment opportunities.

“Support for this deal could be corporate and sovereign-type buyers,” Mackey said.

“The Puerto Rico market has rallied greatly since February,” Nolan said.

The charge could be driven by market fundamentals – low supply – as credit fundamentals are essentially unchanged.

The credit analyst said there was talk of a 2020 par call, confirmed by the source working on the deal.

Jurisdiction changes and confusion

The preliminary offering statement (POS) noted that the laws of the state of New York will apply to the bonds, which will be subject to the jurisdiction of New York’s state and federal courts.

Also, the commonwealth has waived sovereign immunity as it relates to these bonds, according to the POS. Sovereign immunity is a judicial doctrine that prevents the government and its agencies from being sued without its consent.

“When I see language about public funds and the enforcement of remedies, I see an offshoot of the political and legislative discourse,” said Zachary Smith, a member in Moore Van Allen’s bankruptcy and restructuring group. “These issues are interesting to the restructuring community and given the nature of the disclosure, it seems likely that the analysis and discussion of these issues will only continue.”

The commonwealth consents to be sued in the courts of New York. But the waiver does not include attachment or execution with respect to any public property of the commonwealth, wherever located, according to the POS. Public property includes accounts, bank deposits, cash, revenues, securities, and rights against third parties, according to the POS.

What the commonwealth is saying, essentially, is that it consents to litigation being handled by a New York court; but that it does not give this court the power to enforce execution or attachment to public property, said a restructuring attorney familiar.

In this case, bondholders might get a ruling that recognizes there is debt owed to them by the commonwealth; but it is unclear whether they will have the power to force the commonwealth to appropriate the necessary funds to repay them, the restructuring attorney said.

“The vague language of the POS suggests that there is practically no experience implementing such a thing and who knows how it would work,” said a second restructuring attorney.

The fact that the commonwealth does not waive immunity around attachment or execution suggests that bondholders would probably need to get a Puerto Rico court to order the execution of a potential New York court ruling, the second attorney said. In this sense, only a Puerto Rico court could order the executive to appropriate the necessary funds for payment.

If bondholders attempt to avoid going through Puerto Rico’s judicial system, two main questions will arise: first, whether bondholders can find assets that belong to the commonwealth in US mainland; and second, whether bondholders can get a judge to execute a ruling against those assets, the first attorney said.

The situation resembles cases of sovereign debt litigation, where the question is not so much whether bondholders can get a favorable ruling but whether they can force the government that issued the debt to comply with the ruling, the first attorney said.

The books on the USD 3bn issuance are to open this afternoon and pricing will be official tomorrow, Nolan said.

The issuance is rated Ba2 by Moody’s Investors Service, BB+ by Standard & Poor’s and BB by Fitch Rating Service.

A USD 20.9m tranche of Series 2007 general obligation public improvement refunding bonds which mature in 2014 last traded in round lots 11 February between 98.3 and 98.5 yielding 9.3% to 10.0%, according to Electronic Municipal Market Access. The bonds were downgraded to BB by Fitch on 4 March, BB+ by S&P on 4 February and Ba2 by Moody’s on 7 February.