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PASSAGE OR FAILURE OF FEDERAL EMERGENCY LAW FOR PUERTO RICO WILL NOT ASSURE PAYMENT OF JULY 1 DEBT SERVICE

No New Money For Cash-Strapped Puerto Rico, but Passage Is Its Only Way to Prevent a Total Melt-Down. There is precedent for a U.S. Treasury Aid Program

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Puerto Rico's Governor Padilla has stated that he will be short on $805 million dollars of General Obligation debt payments due on July 1, which have first priority under the Commonwealth's Constitution. That may or may not be true, but there is no doubt that by August/September, Puerto Rico will not have sufficient income to meet its bills for essential services. Normally, the Commonwealth would borrow on a temporary 10-month basis from its own Government Development Bank (GDB) for seasonal cash flow, but the GDB is broke and cannot pay its own bills.

Passage of today's House of Representatives vote on the Emergency Bill for Puerto Rico does not solve Puerto Rico's cash flow problem. At best, the control board provision might provide some high-yield investors enough confidence to advance some temporary funds to solve Puerto Rico's immediate cash crisis, and buy some time to do an orderly, voluntary restructuring of their debt. That's a plan built on a wing and a prayer, but it is the only hand left to Puerto Rico in this highstakes game of “Wall Street Poker”. The leadership of the Commonwealth has completely lost any credibility with its normal investor base. Many of the law’s provision may take months to install, which also adds risk to a quick solution to the immediate debt and cash crisis for Puerto Rico.

If the vote in the House fails, Puerto Rico is in “no-man’s land”, with no precedent to follow. Even Detroit’s bankruptcy of 2013 provides this U.S. territory no precedent, and the U.S. Supreme Court has yet to rule on Puerto Rico’s own version of a local bankruptcy law passed by its legislature in 2014. Failure surely means that investors are facing years of non-payment, costly and time consuming litigation for both Puerto Rico and its bondholders, and fight over who has first legal priority to Puerto Rico’s funds. And while investors should be concerned in this event, Puerto Rico’s taxpayers and citizens should have equal worries. How can Puerto Rico maintain its infrastructure and essential services if no one will lend them money? It sounds silly, but if Puerto Rico violates its constitution by failing to pay general obligation debt service, what are the consequences? What are they going to do, put the Governor behind bars?

One last historical footnote: when New York City faced its financial crisis in 1975 and requested assistance from the federal government, old-timers like me still remember the famous New York Daily News front-page headline : “President Ford to NYC—DROP DEAD”. What few people remember is that later, behind the scenes and the headlines, the U.S. Treasury Department agreed to provide federal guarantees on NYC’s debt totaling about $1.3 billion, for a fee (similar to bond insurance). The U.S. Government never had to make good on the guarantee, and made some money in the process. Could that happen in Puerto Rico? Stay tuned.

About the Author

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Richard Larkin is the Director of Credit Analysis specializing in municipal bonds, joining Stoever Glass in April 2016. Earlier in his career Dick spent 8 years at HJ Sims, where his first assignment was to testify before the House of Representatives on the Bond Insurance Crisis. Dick worked at J.B. Hanauer from 2003-2008, performing high-yield municipal bond analysis. Dick was also a Managing Director in Fitch’s public finance group as the Co-chairman of its Public Finance Criteria Committee. He covered high-profile tax-supported and revenue bond credits and had supervisory responsibility for credit surveillance and the development of public finance staff. Prior to joining Fitch in 1998, Dick was a Managing Director and Chief Municipal Rating Officer at Standard & Poor’s, responsible for municipal rating policies, practices, governance and criteria. Following twenty-one years at S&P, Dick worked as a financial advisor at Fairmount Capital Advisors where he developed credit enhancement programs for public pension funds. Later, he helped found Reliance SRL, a rating agency that performed local credit ratings in Uruguay.

From 1988-1992, Dick was a charter member of the Anthony Commission on Public Finance, created to protect federal tax law on the ability of state and local governments to carry out their responsibilities to their citizens at the lowest possible cost. From 1995-1998, Dick also served on the National Advisory Council on State & Local Budgeting (NACSLB). This industry task force, comprised of representatives from the private sector and officials from all levels of local government, identified and fostered 60 of the best budgeting practices that have been implemented by our best-run state and local governments. Dick earned his BA in *economics from Iona College and a Masters in economics from Fordham. In 1999-2000, he was a key participant in the implementation of Fitch's Default Study and revision of its criteria and ratings. During the same period, he authored the definitive study on the impact of municipal government's management practices on credit ratings, defining for issuers a rating agency's relative evaluation of best management practices. Dick has had hands-on rating experience in 42 states, at all levels of state and local government covering virtually every type of debt structure and security pledge. He has been a frequent speaker at state and national Government Finance Officers' Association (GFOA) conferences, and has articles published in national media and public finance textbooks.*

Dick has appeared frequently on CNBC, Bloomberg Television and Fox Business News, and has been widely quoted in the Wall Street Journal, BusinessWeek, the Bond Buyer and Bloomberg reports, as well as many other media outlets. Dick serves on the Policy Committee for the Securities Industry and Financial Markets Association (SIFMA), serves on the Governmental Advisory Standards Advisory Council (GASAC), is a member of Municipal Bonds For America (MBFA), a public/private group charged with educating government officials about the benefits of tax-exemption for municipal bonds for government issuers as well as the investment market. He was also awarded the National Federation of Municipal Analysts' Award for Excellence in 1996, and from 2008 through 2015 was elected as an "All-Star" Special Revenue Bond Analyst by Smith's Research & Gradings.

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