Puerto Rico and PROMESA:
A Primer on Municipal Bonds and the Puerto Rico Restructurings

37th Annual Jay L. Westbrook Bankruptcy Conference

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Background:
Quick Primer on Municipal Bonds

Municipal Bonds vs. Corporate Finance

Corporate Bonds

- $7.5 trillion U.S. corporate bond market
- Varying interest rate costs for issuers returns for investors depending on default risk
- Corporations may pledge any and all assets, including real property, personal property, receivables, IP, etc.
- Basis for creditor rights in contracts, security agreements, and control of collateral
- 770 chapter 11 filings in March 2018 alone

Municipal Bonds

- $3.9 trillion U.S. municipal bond market
- Traditionally low-cost/ low-interest rate, making municipal finance cheaper for tax base. Defaults are infrequent
- State law often prohibits pledge of hard assets. Municipalities often pledge a dedicated stream of revenues
- Basis for creditor rights is statutory and contract base, generally without UCC filings or control
- Fewer than 500 chapter 9 (or Title IX) filings, including PROMESA cases, filed since 1934

Municipal Bond Structures

- **Appropriation Bonds**
  - Bonds backed by the "moral obligation" to repay creditors, <u>subject to the legislature appropriating funds</u> sufficient to pay debt service
- **General Obligation Bonds ("GO")**
  - Bonds backed by "the full faith and credit" of the issuer. Many have state law priority over other state or municipal obligations to obtain low interest rate. Unclear to date whether state law priority is pre-empted by Bankruptcy Code.
  - In default, tension is between paying "essential services" and general obligation bonds.
- **Revenue Bonds**
  - Issuer pledges operating revenues such as customer payments or tuition payments to repay revenue bonds.
  - Can be gross or net revenue pledge of revenues.
  - Whether gross or net pledge, in default tension exists between paying "necessary operating expenses" and paying revenue bonds.
- **Securitization Bonds**
  - Bankruptcy remote entity is granted ownership of a revenue stream, like a sales and use tax or litigation settlement payments.
  - Like revenue bonds, creditors look to the revenue stream for repayment. Typically not subject to operating expenses (i.e., pension) risk.

Title search: Puerto Rico Lessons Learned

Also available as part of the eCourse
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