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Puerto Rico GDB at heart of financial crisis, legal changes needed to prevent wider-spread debt restructuring, says economist

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The **Government Development Bank for Puerto Rico** (GDB) is at the "heart" of the commonwealth's fiscal crisis and it needs legal changes to prevent public corporation defaults from affecting other debt, said Arturo Porzecanski, an economist at American University.

"The GDB facilitated the decade-long borrowing binge that paved the road to the Commonwealths' current fiscal crisis," said Porzecanksi, according to an advanced copy of a white paper released exclusively to *Debtwire Municipals*. "It came to be regarded as the government's 'piggy bank.'"

Porzecanski told *Debtwire Municipals* that he was motivated to write the white paper because, as central as the GDB is to the fiscal crisis, it has largely been ignored by Wall Street and remains a "black box".

Now, however, the GDB is "quite vulnerable" because of the loans that it has made to state entities, most notably the USD 2.2bn, almost a quarter of its portfolio, it loaned to the Highways and Transportation Authority (PRHTA).

The Debt Enforcement and Recovery Act Debt treats debt owed to the Government Development Bank (GDB) the same as debt owed to other creditors in the event a public corporation seeks its protection, as previously reported. The two exceptions are administrative expenses that the GDB has incurred, and loans that the GDB has made to public corporations within 60 days of their filing under Chapter 3.

In order to prevent defaults of the PRHTA from having a spillover effect and impacting the GDB's debt, the commonwealth's general obligation debt and **Sales Tax Refinancing Corporation** (COFINA) debt, legal changes are needed, said Porzecanski.

Specifically, he said, the legislature must pass a bill proposed earlier this year that would channel PRHTA revenues to the **Puerto Rico Infrastructure Financing Authority** (PRIFA) so that it could issue new bonds whose proceeds would pay off GDB loans.

"If this bill were to become law, it would immunize the GDB from taking a large haircut," Porzecanski wrote. "Indeed, its passage is essential for the credibility of the ring-fencing effort."

The bill, filed in June, has yet to be passed even though within a week of its introduction its committee recommended that it be approved with amendments, according to Puerto Rico's legislative tracking system.

Christopher Mier, managing director of the analytical services division at Loop Capital, said that predicting any given bill's chances of passage was difficult, but that "any legislation that has been drafted and is being discussed must be regarded as a real possibility for legislative action".

"Regardless of the bill's prospects, the bill may be more illuminating as an indication of intent or strategy," he said.

Jose Villamil, an economist with Puerto Rico-based Estudios Tecnicos who has previously warned that the GDB should restrict its lending, said that it would be difficult to roll back the GDB's role.

"You do not change these things overnight," he said. "My main concern at the moment is that the government has very little flexibility to put in place major restructurings, not only with respect to GDB, but with respect to a number of needed structural changes."

A USD 541m 5% Series 2012H tranche of GDB senior notes due in 2023 last traded in round lots on 16 September at 66.4, yielding 10.935%, according to *Electronic Municipal Market Access*. Standard & Poor's rated the bonds BB- on 11 July and Moody's Investors Service rated the bonds B3 on 1 July. Fitch Ratings does not rate the bonds.