

MARKETS

Puerto Rico's Pensions: \$2 Billion in Assets, \$45 Billion in Liabilities

Soon-to-be-named members of an oversight board are tasked with balancing the island's huge pension deficit with its \$70 billion debt load



Puerto Rico's public pensions are on track to exhaust their assets by 2019. PHOTO: ASSOCIATED PRESS

By **NICK TIMIRAOS**

Aug. 25, 2016 4:20 p.m. ET

San Juan, Puerto Rico—One of the thorniest tasks awaiting a seven-member board charged by Washington with cleaning up Puerto Rico's debt crisis is deciding how to balance a \$70 billion debt load with nearly \$43 billion in unfunded pension liabilities.

The issue is coming to a head now because the White House is set to name as soon as next week the members of that oversight board, drawn from lists of candidates submitted by congressional leaders in both parties.

Puerto Rico's constitution calls for the island to pay its general-obligation bonds ahead of public services or pensions, but a law signed by President Barack Obama in June

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For the oversight board, there are no good options here, said Matt Fabian, a partner at research firm Municipal Market Analytics. Cutting payouts to debt holders ahead of pensions will inflame creditors, but cutting pension payments to plan members could accelerate the migration and economic decline that the oversight board is tasked with stemming.

Creditors fired a pre-emptive volley last month when they sued the island's government in federal court after it passed a budget that increases funding for pensions without setting aside money for debt payment. The budget diverts "vast resources to purposes that apparently enjoy political favor but are indisputably junior to constitutional debt," the complaint said.



Puerto Rico Gov. Alejandro García Padilla signed an overhaul of the territory's public pension fund in 2013. PHOTO: YAMIL LAGE/AGENCE FRANCE-PRESSE-GETTY IMAGES

The lawsuit was brought by hedge-fund firms that include Aurelius Capital Management, Monarch Alternative Capital and Stone Lion Capital Partners.

Puerto Rico missed more than \$900 million in payments on \$2 billion in debts due July 1, including its first-ever default on general-obligation debt.

Bond investors fear that favorable treatment for pensioners in Puerto Rico will reinforce earlier precedents set in distressed municipal workouts in cities such as Detroit and Stockton, Calif. "Pensioners will see a better recovery than all or most bondholders," said Mr. Fabian. "They just can't swallow haircuts like bondholders can."

Puerto Rico's three public pensions have about \$2 billion in assets against \$45 billion in liabilities, a shortfall far worse than any U.S. state pension system. The pensions are on track to exhaust their assets by 2019. The government would have to spend \$700 million

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The problems facing Puerto Rico are an extreme version of one states face in the coming decades. Governments have funded an array of promises to public employees with debt that is growing faster than the population as a whole. The challenges are particularly dire in Puerto Rico because teachers and police officers don't participate in Social Security, leaving them with no fallback if pensions are reduced.

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debt restructuring needs to prevent further collateral damage to Puerto Rico's economy. "If people leave the island because they're not willing to work and pay into a system that isn't going to pay any benefits, how is that going to help the bondholders?" said Treasury Secretary Jacob Lew on a May visit to the island.

For years, Puerto Rico borrowed more—and incurred higher fixed costs—to buy time to stave off deeper economic overhauls. With government payrolls down over the last decade, pension funds have fewer workers contributing. Shortly after taking office in 2013, Puerto Rico Gov. Alejandro García Padilla signed an overhaul of the territory's public pension fund, raising retirement ages, reducing some benefits and boosting worker contributions.

Until that overhaul took effect, Irba Batista, 55 years old, would have been eligible to retire this year and take a pension worth 65% of her salary. The changes will leave her with a smaller payout after she turns 62. Her husband, whom she must care for because he is blind, collects a \$1,500 monthly government pension.

Some of the pension funds' assets aren't liquid because they have been lent to plan

members. The funds have extended around \$1 billion in mortgages and personal loans

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Ms. Batista, who works for the public sports and recreation agency, said she borrowed from the pension fund to pay off bills, including surgery for her husband, and to fix up their home in Carolina, east of San Juan. She doubts that her son, who is studying in Texas, will return after he graduates. There's no employment here," she says.

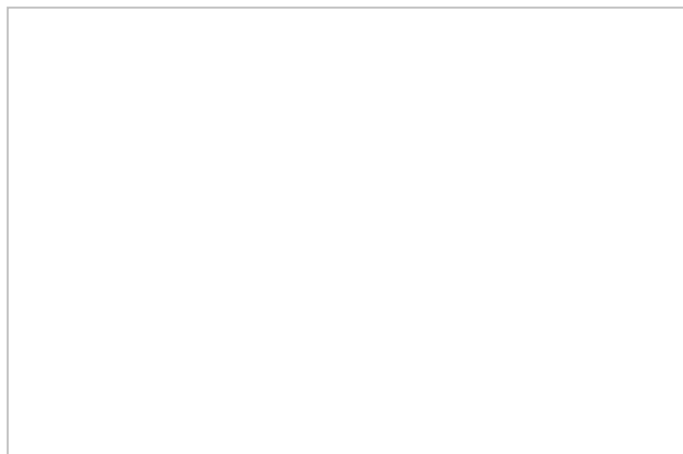
Some creditors and municipal credit analysts say Puerto Rico's crisis has been made worse by government overspending and promises to unions for employee benefits that officials knew they wouldn't have the resources to properly fund.

Sen. Orrin Hatch (R., Utah), who voted for the Puerto Rico bill in June, chided the Obama administration at the time for pushing for the "most comprehensive debt resolution authority possible in an obvious attempt to favor public pensions in Puerto Rico."

Union leaders fear the oversight board will further erode their power. Already, most negotiations in recent years have been "'give-back-or-give-up' negotiations," said Iram Ramírez, a senior labor leader in San Juan.

Write to Nick Timiraos at nick.timiraos@wsj.com

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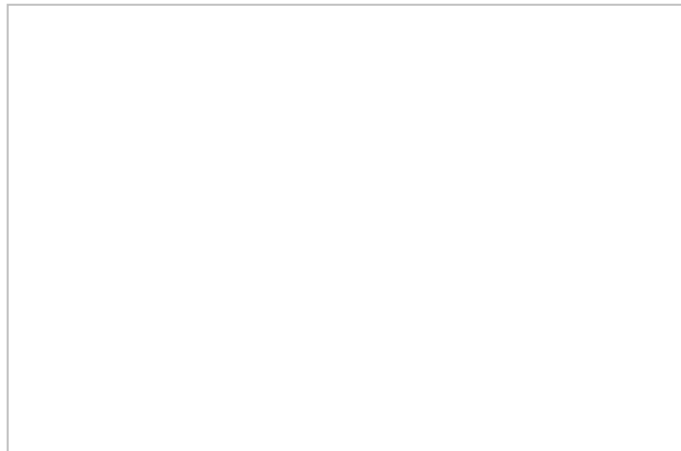
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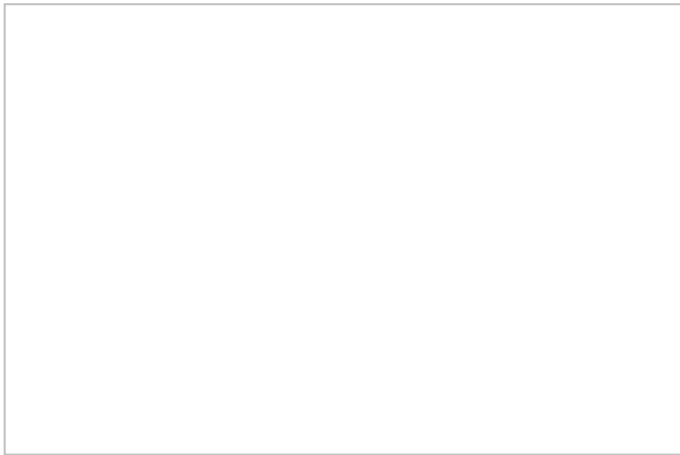
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