<u>Puerto Rican Public Debt Restructuring Plan</u>

(July 20, 2021; Annika Schultze)

Executive Summary

Based on the information provided in the disclosure statement for the restructuring and plan of adjustment for the island of Puerto Rico, it can be concluded that it is likely the island could exit bankruptcy by 2022 and recover from its accumulated debt stack of $74 billion which is not inclusive of an addition $54 billion in public pension liabilities.

With a confirmation hearing for the most recent revision of the disclosure statement on the horizon (November 2021), it is likely that court and creditor approval will occur, pushing the recovery process forward. This is likely to occur, based on the previous hearing on July 13th and 14th in which no objections that constituted major flaws were presented and minimal additional information was needed to have a final confirmation hearing.

A majority of the debt stack can be attributed to COFINA and GO bonds. A plan to restructure COFINA bonds was approved, and recovery of that debt is currently underway. With multiple defaults on payments, inaugurations of different governors, implementation of new leadership groups (i.e. the Oversight Management Board, FAFAA, etc.), natural disasters, and the COVID-19 pandemic, recovery from this accumulation of debt seemed difficult, however, Puerto Rico is beginning to see the light at the end of the tunnel.

The enactment of the Puerto Rico Oversight Management and Economic Stability Act helped begin to shape the recovery of Puerto Rico, allowing the island to recognize their financial crisis which was unable to be declared bankruptcy by the Bankruptcy Code of the United States. This act aided in recovery efforts through Title III and Title VI which drew on Chapters 9 and 11 of the United States Bankruptcy Code.

Through analysis of macroeconomic projections and trends, it is likely that despite slight decreases in population, the labor market, gross GNP, surplus, and revenue will all increase in Puerto Rico over the next few years while expenditures will steadily decrease.

Despite the largest accumulated debt stack in history, it is likely the island of Puerto Rico will be able to recover within the next few years after the approval of a revised version of the disclosure statement and plan of adjustment. Many hardships over the last several years have not been helpful in the recovery of the islands debt, however, positive projections are leaving creditors, the Oversight Management Board, and residents of Puerto Rico optimistic about the recovery of the island in the foreseeable future.

Introduction

As of June 2016, the public debt of Puerto Rico totaled approximately $74 billion with an additional (approximate) $50 billion of unfunded public pension liabilities. Currently, most of these debts are being restructured with what is the largest restructuring of public debt in the history of the United States. Much of this current restructuring can be attributed to the Puerto Rican Oversight, Management, and Economic Stability Act (PROMESA) which was signed into law by former president Barack Obama on June 30, 2016, establishing a plan for the restructuring of debt and new forms of oversight for the bankruptcy of Puerto Rico.

The debt that Puerto Rico has accumulated can be categorized into several categories: general obligation bonds, sales tax backed debt, debt of public corporations and debt issued by smaller entities and other county-like governments. This report will discuss the events leading up to the massive amount of accumulated debt in Puerto Rico, broad aspects of the restructuring plan that was implemented and modified several times within the past years in order to recover as much debt as possible, as well as the treatments of the different classes of creditors who own Puerto Rican Sales Tax Financing Corporation (COFINA) and General Obligation (GO) bonds. It should be noted that the restructuring plan is currently in litigation due to disputes over whether the plan meets statutory requirements and if the plan will benefit the island in as many ways as possible.

Background

Following World War II, Puerto Rico saw major economic growth that eventually slowed following the energy crisis and other geopolitical events. Puerto Rico entered a period of increasing debt that was almost equal to the territory's annual gross national product. Puerto Rico became far poorer than any mainland state with large portions of its debt coming from public corporations that provide electricity, water, public transportation, and more. As of 2000, Puerto Rico's outlays consistently outpaced its revenues with no signs of recovery in the near future.

a. The Beginning of Recession in Puerto Rico

The 1917 Jones Act made Puerto Rican bonds exempt from taxation. This was known as "triple-tax-exemption" and something that made Puerto Rican bonds incredibly attractive for potential and current investors.

In 1996, the Small Business Job Protection Act was put in place, repealing the Possession Tax Credit for taxable years beginning after 1995. This was enacted to increase the competitiveness for small businesses to exist and thrive in Puerto Rico. The act also allowed for a 10-year grandfather period for those corporations which claimed a credit under the Small Business Job Protection Act. However, despite these efforts to protect small businesses, over 27,000 jobs were lost in Puerto Rico.

Following the passage of this act, Puerto Rico suffered an economic recession, known to many as the "Great Recession." This recession led to an incredibly prominent decline in economic activity starting in 2000 and continuing to effect Puerto Rico's overall health and revenue to this day.

Multiple financial crises between 2006-16 caused a decline of over 10% for the Puerto Rican economy. As a result, employment declined by 14% during the same period. In 2016, only 42.5% of Puerto Rican residents over the age of 15 were actively employed with a 43.5% of residents living in poverty. During this large period of economic decline, spending commitments and entitlement programs expanded in Puerto Rico

Puerto Rico's status as a territory of the United States has not been beneficial in terms of access to funding from the United States Government. The lack of statehood causes Puerto Rico to receive considerably less funding that mainland states especially with respect to Medicare and Medicaid where federal funding covers only about 23% of the Medicaid expenditures in Puerto Rico. The combination of incredibly high unemployment rates and low per capita funding causes a greater dependence on the Puerto Rican government from residents because residents become more and more reliant on governmental support.

In combination with reliance on the government from residents there became a larger need for the public corporations to be supported during this period. Many public corporations began projects and programs that were funded by the issuance of bonds. These public works projects, once finished, were not even breaking even, much less generating profit, causing losses of about $50 million per year.

b. Demographics of Puerto Rico and Population Decline

Between 2000-15, there was a mass exodus of Puerto Rican residents to the mainland states of the United States, causing a population decline of approximately 9%. Programs that were already underfunded, became even more insolvent because fewer individuals were paying local taxes due to the outward migration of people. This continuously increased their inability to pay for programs that had been enacted, leading to large amount of accumulated debt within the corporations.

One of the biggest issues that coincides with the decline of the population is the amount of young people leaving the island for the states. The lack of younger people causes the government to care for older citizens and pay pensions. As young people begin to leave the island, it is becoming apparent that knowledge and advancements in key sectors of the work force are much less common. Similarly, trained professionals are leaving the island which causes a lack of expertise in many of those same key areas.

While other circumstances are present, it was found that about 40% of the people who left Puerto Rico, left for work related reasons and an additional 40% of people left for family related reasons. Prominent sectors that have struggled due to people leaving for the states include medicine and teaching, two critical sectors which are important to the overall health and success of the country long term.

c. Accumulation of Debt and Financial Crises

Between 2005-14, $24 billion in newly bonded debt had been issued in Puerto Rico and the gross domestic product (GDP) of Puerto Rico remained negative for nearly every year between. Many different Puerto Rican entities at the time were issuing bonds to continue the operations for projects and programs that were being put into place, however, it was becoming increasingly difficult to fund operations. Similar to the underfunding of operations for public corporations, it was becoming much more difficult to fund the already underfunded pension funds. There is approximately $49 billion of pension liabilities, only 1.5% of which is funded by the government. As the population of young people declines and there is a greater ratio of elderly people to young people on the island, the beneficiaries of pensions continues to increase and the imbalance grows.

d. Categorization of Debt in Puerto Rico

The structure of Puerto Rico's debt stack can be ultimately attributed to the commonwealth of Puerto Rico (CPR) and approximately 50 public corporations. The Governmental Development Bank (GDB) controlled debt issuance and negotiated with investment banks. However, after payment defaults in 2016 and 2017, many of the negotiations over debt restructuring terms were taken over by the Fiscal Agency and Financial Advisory Authority (FAFAA).

The previously mentioned debt stack does not include the unfunded obligations of Puerto Rico's pension systems which amount to an additional approximation of $49 billion. The categories of public debt are divided by the source of funds in which are used to repay them. These four categories are as follows:

- The commonwealth general fund

- The sales and use tax or other specific revenue services
- Revenue from public corporations
- Other debts, which are inclusive of local governments, and nonrecourse debt.

Allocation of Puerto Rico's Public Debt (2018)					
Issuer	Bond Principal	CAB	Unpaid P&I	Private Loans	Total Bonds and Private Loans
COFINA	$ 11,425	$ 6,155	$ -	$ -	$ 17,580
Puerto Rico/GO	$ 12,013	$ 84	$ 1,146	$ 24	$ 13,267
PREPA	$ 8,259	$ -	$ 13	$ 697	$ 8,969
PRASA	$ 3,943	$ 28	$ 742	$ 584	$ 5,297
GDB	$ 3,182	$ -	$ 6	$ 203	$ 3,391
HTA	$ 3,983	$ 135	$ 117	$ -	$ 4,235
PBA	$ 3,980	$ -	$ -	$ -	$ 3,980
ERS	$ 2,658	$ 498	$ 232	$ -	$ 3,388
PRIFA	$ 1,566	$ 409	$ -	$ -	$ 1,975
Children's Trust	$ 847	$ 613	$ 172	$ -	$ 1,632
PFC	$ 1,025	$ -	$ -	$ -	$ 1,025
HFA	$ 542	$ -	$ -	$ -	$ 542
UPR	$ 496	$ -	$ -	$ -	$ 496
PRCCDA	$ 386	$ -	$ -	$ -	$ 386
PRIDCO	$ 145	$ 11	$ -	$ -	$ 156
PRIICO	$ -	$ -	$ -	$ 98	$ 98
AMA	$ -	$ -	$ -	$ 28	$ 28
Other Central Gov't Entities	$ 197	$ -	$ 29	$ 413	$ 639
Municipality Related Debt	$ 556	$ -	$ -	$ 1,140	$ 1,696
SUB TOTAL	$ 55,203	$ 7,933	$ 2,457	$ 3,187	$ 68,780
Less: GDB Bonds (excl. TDF)					$ (3,766)
Plus: Loans from GDB/MFA Entities					$ 8,795
Public Sector Debt					**$ 73,809**

The table above shows the allocation of Puerto Rican debt broken down by the issuers. This table does not contain the additional $54 million dollars of public pension liabilities. When understanding the debt of the island, it must be considered that debt is coming from multiple sectors of each individual issuer or entity. It can also be seen that most of the debt in Puerto Rico has been accumulated from COFINA and GO bonds.

e. Failed Efforts to Restructure

By the end of 2014, public debt had grown to 99% of gross national product from 71% where it was at the beginning of 2006. Additionally, $3.5 billion in GO bonds was issued in March of 2014, marking the last issuance of public debt. Once this debt had been issued, it was found that Puerto Rico could not file for bankruptcy under the Chapter 9 bankruptcy code because of its lack of statehood. This prompted passage of the Recovery Act which was quickly challenged by bondholders who questioned its validity. It was ultimately deemed invalid by the court and in June 2015, the debt of Puerto Rico was declared “unpayable” by the island’s governor.

In August of 2015, the Puerto Rican Finance Corporation (PFC) defaulted on approximately $58 million of payments. Following this first default, in December of the same year, a second default occurred on approximately $35.9 million due on infrastructure bonds and an additional $1.4 million due on PFC bonds.

Following the defaults of August and December of 2015, an Emergency Moratorium and Financial Rehabilitation Act (“Moratorium Act”) was established in April of 2016. This law was passed due to the government's inability to supply enough resources to comply with debt service obligations as well as the inability to provide essential services to the people of Puerto Rico. The Moratorium Act created the Fiscal Agency and Financial Advisory Authority (AAFAF) which assumed the financial responsibilities that were previously held by the GDB. The Moratorium Act also allowed for the Governor of Puerto Rico to declare a moratorium on debt service payments for the government, GDB, and other Puerto Rican instrumentalities.

In June of 2016, the first version of the PROMESA law was submitted to the U.S. House of Representatives. The ultimate passage of this version of PROMESA created the Oversight Board. The Oversight Board was comprised of 7 members, 6 of which were appointed by Congress and President Obama by vote, and one of which was solely appointed by Obama. This board took over a large portion of the responsibility for overseeing public debt related issues from the Governmental Development Bank. The Oversight Board filed the Title III voluntary petition to start the restructuring process for Puerto Rico's debt. Alongside the filing of the voluntary petition, some important statistics were noted:

- From 2007-16, Puerto Rico's GNP declined by over 14% and the total employment rate declined from approximately 1.25 million to slightly under 1 million.
- As of October 2016, the unemployment rate of Puerto Rico was 12.1% with only 987,000 people employed. This was down from 2006 in which the unemployment rate was 23% with 1.27 million employed.
- Labor participation has dropped to approximately 40%
- The Economic Activity Index fell from 160 to 124.1 between 2005-16
- The population of Puerto Rico has declined by about 10% between 2006-16
- About 46% of Puerto Rico's residents live below the poverty line with the percentage of children under 5 who live below the poverty line at approximately 63.7%
- The median household income in Puerto Rico was $18,626 as of 2015 compares with the median household income of the states of approximately $56,515

f. Impact of the Default of Payments

There has been an incredibly large impact on the territory of Puerto Rico due to the debt payment defaults. As of 2017, retirement benefits switched to a pay-as-you-go system where all future benefits would come out of tax revenue.

Aside from the impact the defaults have had on bondholders, the inability to fund any types of public services has increased very dramatically. These public services include education, health, and safety for the citizens of Puerto Rico. As of 2017, even the University of Puerto Rico owed $496 million to its creditors.

Because of Puerto Rico's lack of funding for public entities, there has also been a major decline in the quality of Puerto Rico's infrastructure. This has led to health and safety concerns for the population. Separately, with an intention to save $6 billion in health care costs, the Medicaid system has been hit incredibly hard. In addition to a plan to decrease health care funding, an outward migration of medical personnel to the states has led to 72 of 78 municipalities being deemed undeserved by the U.S. Health Resources and Services Administration.

g. Hurricanes Irma and Maria

In 2017, two, category 5 hurricanes devastated the island of Puerto Rico. Hurricanes Irma and Maria struck the island in September of 2017 taking many lives and leaving others without power, water, and any form of communication. The hurricanes both caused horrible damages to homes, business, water, telecommunications, transportation, and power infrastructure which further increased the ultimate number of people looking to immigrate from the island to the mainland. This increase in demographic outflow took a further toll on already-struggling public entities.

All the damage that was caused by the hurricanes impacted the debt restructuring process by disabling the electrical grid system, affecting health, housing, and income, and also forcing disaster responses from public officials and the public in general. The Oversight Board was forced to revise the commonwealth's fiscal plan to reflect reduced economic activity and tax revenues. The estimated funding that was required for recovery from the earthquakes was expected to enhance the ability for creditors to be repaid in the future. However, despite positive predictions, the repayments to creditors were slow in coming.

Aspects of the Debt Restructuring Plan

a. The Enactment of PROMESA

PROMESA, the Puerto Rican Oversight Management and Economic Stability Act, was signed into law in June of 2016 by former president, Barack Obama. This major portion of the restructuring plan formed a two-path way for the island to begin to recover. PROMESA was crafted by the Oversight Management Board (FOMB), made up of seven people, six of which were appointed by Obama and congress by vote, and one of which was appointed by Obama himself. This board held the responsibility of choosing which instrumentalities should submit fiscal plans and budgets, all of which are subject to board approval. Alongside approving plans and budgets, the board represents covered entities within the debt restructuring process. This board listed the Commonwealth's government as a territory as well as 62 public corporations and other entities as covered instrumentalities.

b. How PROMESA Established a Two-Path Plan

Due to the inability of Puerto Rico to file for bankruptcy under the United States Bankruptcy Code, its government established PROMESA which drew on Chapters 9 and 11 of the United States Bankruptcy Code. Title III and Title VI of PROMESA both draw on Chapters 9 and 11 to establish a process for reorganizing debts of the island.

Title III draws on Chapter 9, which outlines the reorganization of debt under the supervision of a federal court. State governments cannot file for bankruptcy; however, they can seek protection from creditors under the provisions of Chapter 9. Under Chapter 9, a municipality can only receive protection if the state government approves it, the municipality is insolvent, it wishes to implement a plan of adjustment, and it negotiates with creditors in good faith or is able to demonstrate that the negotiations are impractical.

Several differences between Chapter 9 and Title III PROMESA exist. Under Title III, Puerto Rico is considered a covered territory and not a municipality. Title III does not require for the territory to be insolvent like Chapter 9 does, Separately, under Title III, the territory must file a disclosure statement for its plan of adjustment to inform creditors of decisions, fiscal plans, reports, risks, etc. After this plan of adjustment has been filed, different classes of creditors may vote on the plan, approve the plan, and then receive value in accordance with the terms outlined by the plan.

c. **Restructuring COFINA and GO Bond Debt**

The beginning of Puerto Rico's debt restructuring process brought about a split in investor groups. Many controversies over the relative priority of general obligation (GO) debt claims and the claims of sales-and-use-tax-backed debt from the Puerto Rican Sales Tax Financing Corporation (COFINA) occurred.

During the beginning of the process, COFINA bonds were sold as “extraconstitutional debt” where bond proceeds and tax revenues supporting the COFINA debt service were not considered “available resources” to the Commonwealth of Puerto Rico (CPR). The invocation of a provision of the constitution prioritizing payments of the GO debt service, known widely as the “clawback”, protected COFINA bondholders. Despite the positive initial reaction to the concept of the clawback, there was doubt from at least one mainland law firm that a court would bar the clawback of COFINA funds. This information was not clearly disclosed with investor groups during the COFINA bond issuance. As a result, many major mutual funds sold off their holding of the island’s public debt and the bond prices dropped significantly as news about the clawback controversy surfaced. A large portion of these bonds were sold to hedge funds which were much more experienced buying into complex debt restructurings. The belief that the government would meet GO bond obligations, prompted contention between COFINA bondholding groups. This, alongside the default on bonds caused many tensions among the groups of bondholders.

Throughout the process of restructuring the COFINA and GO bonds, there were lawsuits and litigation claims, however, the Oversight Board ultimately concluded that the GO and COFINA dispute should be resolved through the PROMESA Title III process. Before the COFINA and GO bond dispute was resolved, Ricardo Nevares was inaugurated as the new Governor of Puerto Rico.

d. Inauguration of Ricardo Nevares

Ricardo Nevares was inaugurated as the new Governor of Puerto Rico in January of 2017 and he replaced Governor Garcia Padilla. Nevares took many steps to continue restructuring the debts of Puerto Rico. One prominent step was the introduction of the the Fiscal Agency and Financial Advisory Authority (“FAFAA”). The intention of this new advisory board was to take over the financial management roles that were currently being held by the Governmental Development Bank. Many of the current restructuring advisors were replaced by Governor Nevares while the PREPA restructuring support agreement was abandoned. Similarly, Nevares appointed a new Oversight Board. This further disbanded a commission that was set up by Padilla to audit the island’s public debt.

e. PROMESA Title III Petitions- May 2017

For the debt of Puerto Rico to be restructured, the Oversight Board needed to take several steps including designating covered instrumentalities to draft their fiscal plans. This designation is subject to specific certification by the board which could impose its own plans if the ones presented are deemed inadequate.

Wherever debt restructuring was deemed necessary, the Oversight Board needed to petition a federal district court to initiate Title III proceedings. Following this, three things happened. First, Puerto Rico enacted a measure to clawback COFINA funds to the general fund, triggering a default declaration by COFINA bondholders. Next, the Oversight Management Board filed a petition to restructure the Commonwealth’s obligations under Title III. Finally, the board filed a petition for COFINA and initiated a Title III process for PREPA which rejected the previous restructuring support agreement.

In addition to the petitions, Title VI was also used to settle debts and operations of the GDB. The bank was dissolved in November of 2018 and the functions the bank previously held were completely taken over by the FAFAA. In terms of representation, the UCC (The University in Puerto Rico) was appointed to represent the interests of the Commonwealth and Betting Whyte was appointed to represent the interests of COFINA.

f. How the COFINA and GO Bond Dispute was Resolved

The Coalition of Puerto Rico controlled approximately one third of all the outstanding senior COFINA debts and controlled a substantial amount of junior (also known as subordinate) COFINA bonds. This Coalition sold around one half of their junior bonds after the first hurricane in 2017, going on to increase their holdings of those bonds from about $700 million in October of 2017 to almost $2.2 billion by the following year.

Over that year as the trading prices of those bonds rose, a framework was proposed by the senior bondholders to settle the dispute. This proposal was rejected because, as stated by the Oversight Board, it "did not offer meaningful relief." After the first rejection of this proposal, the COFINA bondholders reached an agreement which allocated 53.65% of the pledged sales tax base amount to COFINA. This was initially set at 5.5% of the 10.5% sales and use tax.

This newly proposed framework would allow for existing bonds to be exchanged for new securities and would be completely redesigned to reduce debt service obligations over the upcoming years. This new framework would also enforce stronger investor protection and allow the CPR government to have a greater share of sales and use tax revenues which would further benefit GO bondholders. Not only would these creditors benefit, but island taxpayers would benefit as well.

The deal with COFINA creditors was announced in August of 2018, a fiscal plan was certified, and a disclosure statement was filed. After this disclosure statement was filed for approval, it was voted on by classes of COFINA bondholders. Junior bondholders voted against the plan and argued it was an unfair attempt to give senior bondholders an advantage while driving up consummation. It was also reported that Puerto Rican credit unions stated that they were being pressured to buy COFINA junior bonds.

g. COFINA Approval

A member of the Oversight Board, Arthur Gonzalez, argued that the proposal for the COFINA agreement that was being looked at during that given time was ultimately a compromise which settled ongoing litigation. It was noted that under that agreement, funds available for other constituencies were reduced severely and it was possible for the Commonwealth to claw them back. The reason that this was not ideal was because a loss for the Commonwealth would set back the entire recovery plan, costing the government billions of dollars in reduced debt and recouped revenue.

An alternate plan was proposed shortly after the first contested plan of adjustment. This new plan focused on protracted litigation and introduced an "all-or-nothing" recovery for holders of Commonwealth claims of any existing COFINA bonds.

The revised COFINA settlement and restructuring plan was ultimately approved by the court in February of 2019 and the old COFINA debt that had a par value of $17.6 billion was exchanged for $12 billion of new COFINA bonds. These new COFINA bonds were then divided into several interest-bearing bonds; Capital Appreciation Bonds (CAB's) and Current Interest-Bearing Bonds. The last payments of these bonds were to be due in the far future, ending with the last payments in 2058.

Several concerns and ethical conflicts were made apparent during the settlement of the COFINA dispute. In general, it was observed that bondholders were being treated differently depending on the class the bondholder belonged to. Smaller scale bondholders stated that there was a mishandling of the bonds, and the new settlement did not serve their best interests. Other hedge funds were said to have made hundreds of millions of dollars in profit from the Puerto Rican debt in general, but more specifically, COFINA bonds.

Despite the objections and concerns from the smaller scale bondholders, any objections that were excluded from mediation were ultimately dismissed. Despite the scale of the debt and restructuring process, individual investors were given the opportunity to advocate for their own positions and they could object to proposals at their own discretion.

h. Oversight Board Pivots to GO Bond Restructuring

The recent resolution of the restructuring of COFINA bonds allowed the board to newely focus on restructuring the GO bonds. The board also began to start the restructuring process for debts of other entities that were tied closely to the Puerto Rican government. These entities included, but were not limited to, the Employee Retirement System and the Public Buildings Association.

The Oversight Board, alongside the special claims committee and the UCC, challenged the validity of $6 billion of GO bonds that were issued after 2011. These were bonds that were often referred to as "late vintage GO bonds." In May 2019, these groups filed over 250 avoidance action suits which allowed a trustee to challenge transactions that involved debtors before a bankruptcy petition was filed.

At the beginning of 2020, the Oversight Board announced a Plan Support Agreement (PSA) for GO bonds. This agreement was supported by the Lawful Constitutional Debt Coalition (LCDC), other hedge funds, as well as some retiree and labor groups.

February 2020 brought about an amended PSA that claimed the backing of holders of approximately $10 billion in GO and PBA bonds. The GO bond case was eventually delayed by a suspended consideration of whether the disclosure statement was adequate in light of the negative impacts from the COVID 19 pandemic. As of December 2020, those negotiations have continued.

A further motion to pivot the GO restructuring process was caused by calls for investigations over alleged insider trading activity in June 2020. Despite these calls to investigate possible illegal trading, the requests were denied to avoid saddling the Commonwealth with an investigation that would likely be incredibly expensive. This investigation was also denied because neither PROMESA nor any provision to the Title III bankruptcy code authorizes an independent investigation by the court. In this specific situation, there was not enough information to suggest insider trading was occurring in any event.

The restructuring of GO bonds in 2020 was ultimately put on hold due to the following:

(1) earthquakes and hurricanes
(2) COVID-19
(3) insider trading allegations
(4) the inauguration of another new governor
(5) the step down of several members of the Oversight Board
(6) lack of recovery funding.

In the final few months of 2020, the Oversight Board had discussions to revise the Plan of Adjustment so that it would accurately reflect the negative effects of the pandemic. However, because a member of the Oversight Board who recently left the meeting, the vote to modify the plan was blocked.

February 2021 brought about a revised PSA by the Oversight Board. This revised plan covered GO debt as well as debts of the PBA. The total recovery value of the new proposal was higher than the October plan but was much lower than the February 2020 and the August 2020 counterproposal.

In this revised plan, existing bonds that were covered by the agreement would be exchanged for cash, new GO bonds, Capital Appreciation bonds and contingent valuation instruments which would pay creditors extra amounts if the real economic growth of the island exceeded projections made by the Oversight Board. The estimated recovery rates ranged from 67.7% for 2014 Go bonds to 80.3% for pre 2011 PBA binds that did not include CVI payments. This plan also included 2-3% reductions in some pension payments that were above certain thresholds.

In April 2021, there was an agreement in principle with two bond insurers (Assured Guaranty and the National Public Finance Guarantee) and in May 2021 the new Plan Support Agreement was announced. This PSA removed a hurdle to the implementation of the Commonwealth PSA and it involved treatment of the Commonwealth clawback of revenues from certain public corporations. Before the final confirmation of the PSA by the Title III court, other approvals were required, but it was a major step forward for the PSA.

From the 11th revision of the Puerto Rico Fiscal Plan (April 2020) - Beginning of the COVID-19 Pandemic (Exhibit 28) p.93

Alternative Macroeconomic Forecast Scenarios

Upside Scenenario						
U.S. Mainland real GDP grows at -0.4% in FY2020 and 3.4% in FY2021						
	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025
Real GNP Change (%)	-2.9%	-3.8%	3.9%	0.0%	0.8%	0.7%
Var to Baseline	0.7%	4.0%	2.4%	-0.3%	0.0%	0.0%
Revenue (pre Fed Transfers)	14,218	14,618	14,699	14,970	15,214	15,453
Var to Baseline	3	370	637	682	703	722
Surplus (pre Debt Service	710	(344)	397	522	816	910
Var to Baseline	3	364	575	611	626	639
Baseline (2020 Fiscal Plan)						
U.S. Mainland real GDP grows at -1.7% in FY2020 and -2.2% in FY2021						
	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025
Real GNP Change %	-3.6%	-7.8%	1.5%	0.3%	0.8%	0.7%
Revenue (pre Fed Transfers)	14,215	14,248	14,062	14,288	14,511	14,731
Surplus (pre Debt Service)	707	(708)	(178)	(89)	190	271
Downside Scenenario						
U.S. Mainland real GDP grows at -1.7% in FY2020 and -2.2% in FY2021						
	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025
Real GNP Change (%)	-4.1%	-12.8%	-1.8%	-0.7%	0.8%	0.7%
Var to Baseline	-0.5%	-5.0%	-3.3%	-1.0%	0.0%	0.0%
Revenue (pre Fed Transfers)	14,214	13,786	13,274	13,449	13,647	13,844
Var to Baseline	(1)	(462)	(788)	(839)	(864)	(887)
Surplus (pre Debt Service	706	(1,161)	(889)	(840)	(579)	(512)
Var to Baseline	(1)	(453)	(711)	(751)	(769)	(783)

The table above describes the Fiscal Plan developed in 2020 which takes into account the initial impacts of the COVID-19 pandemic. It includes a baseline scenario as well as an upside scenario and a downside scenario. The downside scenario assumes a longer recession and a slow recovery from the effects of the pandemic. It assumes that the U.S. economy will experience a further economic decline through the third quarter and will not begin to recover until the fourth quarter. The upside scenario assumes lighter impact on the economy from the pandemic as well as a quicker recovery.

Market Impacts and Perspectives on the Debt Restructuring Process and General Predictions

a. Trends

Puerto Rican debt prices have varied dramatically and will continue to do so during the course of the debt restructuring process. Before the middle of 2013, many bonds were trading above par value and then they fell sharply after the Detroit bankruptcy in 2013. An article about the fiscal distress of Puerto Rico, local bankruptcy measures, a new governor, and the announcement that debts were now deemed unpayable also forced the prices of bonds to fall drastically. Similarly, COFINA junior bonds reacted more to the events that occurred in 2015 than the GO bonds did. At the end of June 2016, COFINA's default completely depressed senior and junior COFINA prices.

The Hurricanes in September also severely depressed most Puerto Rican bond prices. GO bonds at this time were trading at a quarter of par or even less in some circumstances while COFINA subordinate bonds were trading at about 10% of par, if even that.

Several activists[1] found that the relationship between bond prices and recovery rates (estimated) was worth looking into. They asserted that the marked recovery of bond prices after trading at very low levels implied that investors took advantage of Puerto Rican residents. However, trading prices do not prove that investors were doing anything that was wrong; rather, they reflect transfers of bonds to those willing to accept greater risks at lower prices.

Financial Projections Post-Measures and Structured Reforms as of March 26, 2021: Macroeconomic Overview of Puerto Rico, FY21-26								
Item	Unit	FY21	FY22	FY23	FY24	FY25	FY26	FY21-26
Population	#, Thousands	3,168	3,149	3,127	3,102	3,075	3,045	
Population Growth Rate	%	-0.54%	-0.60%	-0.70%	-0.81%	-0.88%	-0.99%	
Real GNP Growth	%	0.65%	4.00%	2.05%	0.41%	-1.20%	-0.61%	
Nominal GNP	$M	71,169	74,925	77,539	78,988	79,171	79,841	
Nominal GNP Per Capita	$	22,465	23,793	24,797	25,464	25,747	26,220	
Nominal GNP Per Capita Growth	%	1.9%	5.58%	4.05%	2.62%	1.10%	1.81%	
Inflation	%	0.75%	1.22%	1.41%	1.45%	1.45%	1.47%	
Disaster Funding	$M	2,182	6,078	7,467	7,968	7,085	8,963	39,743
Revenues[1]	$M	25,015	25,746	26,167	26,938	27,226	27,725	158,817
Commonwealth Revenues		16,118	15,517	15,284	15,492	15,478	15,669	93,558
Federal Transfers		8,897	10,229	10,883	11,446	11,748	12,056	65,259
Expenditures[1]	$M	(23,805)	(23,638)	(24,308)	(25,020)	(25,364)	(25,723)	(147,858)
Commonwealth-Funded Expenditures		(13,330)	(12,459)	(12,483)	(12,619)	(12,648)	(12,686)	(76,225)
Federally Funded Expenditures		(8,897)	(10,229)	(10,883)	(11,446)	(11,748)	(12,056)	(65,259)
Other Expenditures Outside of the Budget		(1,578)	(950)	(942)	(955)	(968)	(981)	(6,374)
Gap/Surplus	$M	1,210	2,108	1,859	1,918	1,862	2,002	10,959
Contractual Debt Service Payments[2]	$M		(790)	(771)	(752)	(625)	(604)	(3,542)
Net Gap/Surplus[3]	$M	1,210	1,318	1,088	1,166	1,237	1,398	7,417

1 Revenues and expenditures excluding gross up adjustments

2 Debt service based on prepetition contractual debt obligations. Presented for illustrative purposes only and does not represent anticipated future payments on restructured debt. Includes GO, PBA,CCDA, PRIFA , PFC<, ERS, PRIDCO. The 2020 Fiscal Plan does not assume any predetermined outcome of ongoing litigation with respect to GO bonds.

3 These surplus amounts are generated by Commonwealth corporations and the Commonwealth's ability to access such surplus amounts could be at risk without further legislative actions.There could be a surplus amount that is potentially unavaliable.

The previous table shows macroeconomic forecasts of the Puerto Rican economy within the next six years. While there is a consistent decline of the population, nominal GNP, revenues, and surplus are all increasing. In general, this table shows hopeful projections for the next few years for Puerto Rico as they restructure their debt and attempt to overcome bankruptcy.

1 Pablo Gluzmann and Martin Guzman, *Puerto Rico's Debt Dilemma*, Espacios Abiertos working paper, May 2019, http://espaciosabiertos.org/wp-content/uploads/Puerto-Ricos-Debt-Dilemma-Final-Report-May-2019.pdf; and Omaya Sosa Pascual and Luis Valentín Ortiz

Financial Projections Post-Measures and Structured Reforms as of March 8, 2021: Revenue Breakdown Y21-26

Fiscal Year Ending June 30, $M	FY21	FY22	FY23	FY24	FY25	FY26	FY21-26
General Fund Revenues							
Individual Income Taxes	2,147	1,702	1,657	1,697	1,738	1,758	**10,699**
Corporate Income Taxes	2,152	1,699	1,623	1,662	1,701	1,722	**10,559**
Non-Resident Withholdings	405	366	351	356	363	365	**2,206**
SUT Collections (General Fund)	2,133	2,144	2,213	2,259	2,308	2,319	**13,376**
Act 154 Collections	1,602	1,447	1,199	1,199	1,199	1,199	**7,845**
Alcoholic Beverages	277	278	280	281	283	284	**1,683**
Cigarettes	98	99	100	101	102	102	**602**
Motor Vehicles	471	408	419	425	432	433	**2,588**
Excises on Off-Shore Shipment Rum	238	217	197	198	199	200	**1,249**
Other General Fund Revenue	940	824	852	873	895	905	**5,289**
Sub-Total, General Fund Revenues	**10,463**	**9,184**	**8,891**	**9,051**	**9,220**	**9,287**	**56,096**
Other Revenues							
Other Tax Revenues	2,074	2,063	2,070	2,096	2,122	2,137	**12,562**
Component Unit Revenue	1,053	1,092	1,211	1,237	1,262	1,277	**7,132**
SRF Revenue for CW Agencies	1,786	1,773	1,816	1,848	1,879	1,896	**10,998**
Third Party ASES Receipts	309	320	333	347	361	376	**2,046**
Additional SUT (FAM & CINE)	120	121	125	128	131	132	**757**
Sub-Total, Federal Transfers	**5,342**	**5,369**	**5,555**	**5,656**	**5,755**	**5,818**	**33,495**
Total, Own Source Revenues	**15,805**	**14,553**	**14,446**	**14,707**	**14,975**	**15,105**	**89,591**
Federal Transfers							
Fed Transfers - Central Gov't (Exc. Medicaid)	5,728	5,829	5,906	5,990	6,077	6,166	**35,696**
Fed Transfers - to IFCU's (Exc. Medicaid)	327	226	237	240	243	246	**1,519**
Fed Transfers - Medicaid	2,842	4,757	5,069	5,302	5,516	5,735	**29,221**
Sub-Total, Federal Transfers	**8,897**	**10,812**	**11,212**	**11,532**	**11,836**	**12,147**	**66,436**
Total, Revenues	**24,702**	**25,365**	**25,658**	**26,239**	**26,811**	**27,252**	**156,027**

This table above shows the projected revenue breakdown for Puerto Rico during the next 6 years. The revenue in Puerto Rico is expected to consistently increase over the next few years as the restructuring plan is implemented and approved. This table shows hopeful forecasts for the recovery of Puerto Rico.

Financial Projections Post-Measures and Structured Reforms as of March 8, 2021: Summary of Expenditures Y21-26							
Fiscal Year Ending June 30, $M	**FY21**	**FY22**	**FY23**	**FY24**	**FY25**	**FY26**	**FY21-26**
General Fund Expenses							
Payroll Expense	(2,875)	(2,746)	(2,721)	(2,754)	(2,789)	(2,824)	(16,709)
Operating Expense	(1,293)	(1,205)	(1,194)	(1,205)	(1,216)	(1,228)	(7,341)
Pension Expense	(2,055)	(2,114)	(2,055)	(2,055)	(2,049)	(2,043)	(12,371)
Capital Expenditures	(332)	(316)	(322)	(327)	(332)	(337)	(1,966)
Medicaid Expenditures	(316)	(470)	(566)	(590)	(611)	(635)	(3,188)
Appropriations	(973)	(983)	(943)	(878)	(877)	(838)	(5,492)
Other Misc. Items - Recurring	(963)	(1,041)	(1,210)	(1,143)	(1,176)	(1,022)	(6,555)
Other Misc. Items - Non-Recurring	(1,237)	(458)	(349)	(257)	(219)	(188)	(2,708)
Sub-Total, General Fund Expenses	**(10,044)**	**(9,333)**	**(9,360)**	**(9,209)**	**(9,269)**	**(9,115)**	**(56,330)**
Special Revenue Fund Expenses							
Component Units	(1,190)	(1,158)	(1,167)	(1,185)	(1,202)	(1,218)	(7,120)
CW Agencies	(1,786)	(1,773)	(1,810)	(1,840)	(1,870)	(1,886)	(10,965)
Medicaid	(309)	(320)	(333)	(347)	(361)	(376)	(2,046)
Sub-Total, Special SRF Expenses	**(3,285)**	**(3,251)**	**(3,310)**	**(3,372)**	**(3,433)**	**(3,480)**	**(20,131)**
Federal Fund Expenses							
FF - Central Gov't (Exc. Medicaid)	(5,728)	(5,829)	(5,906)	(5,990)	(6,077)	(6,166)	(35,696)
FF - to IFCU's (Exc. Medicaid)	(327)	(226)	(237)	(240)	(243)	(246)	(1,519)
FF - Medicaid	(2,842)	(4,757)	(5,069)	(5,302)	(5,516)	(5,735)	(29,221)
Sub-Total, Federal Fund Expenses	**(8,897)**	**(10,812)**	**(11,212)**	**(11,532)**	**(11,836)**	**(12,147)**	**(66,436)**
Other Expenditures Outside of Budget	(858)	(906)	(931)	(945)	(958)	(972)	(5,570)
Total, Expenses	**(23,084)**	**(24,302)**	**(24,813)**	**(25,058)**	**(25,496)**	**(25,714)**	**(148,467)**
Surplus/(Deficit) - Excl. Debt Payments	**1,210**	**2,108**	**1,859**	**1,918**	**1,862**	**2,002**	**10,959**
Debt Service	-	(790)	(771)	(752)	(625)	(604)	(3,542)
Surplus/(Deficit) - Incl. Debt Payments[1]	**1,210**	**1,318**	**1,088**	**1,166**	**1,237**	**1,398**	**7,417**

Similar to how Puerto Rican revenue projections are steadily increasing, the above table shows how expenditures are expected to decrease over the next 6 years. While these numbers are forecasted, it gives hope that the economy of Puerto Rico is beginning to recover.

b. **Puerto Rico's Economy Over Time**

The GO bonds restructuring disclosure statement projects that the Puerto Rican economy will shrink over time. In previous years, growth has been uneven and if not uneven, it has been stagnant. They have continued to show incredibly slow recovery from hurricanes, the pandemic, and earthquakes and overall, their economy shrunk by about 3% in 2020. In the future, stronger growth is projected due to relief funds but after those years of recovery, the economy is expected to shrink once again. The statistics of Puerto Rico somewhat match those of the United States in 2025, but in prior years (2021-24), Puerto Rico is forecasted to have much lower growth.

Over the next decade, Puerto Rico is expected to receive approximately $110 billion in support from the United States, but a portion of that funding will go directly to some mainland firms and contractors. It is also estimated that, despite a shrinking population, labor participation will increase due to expected changes in labor laws. These changes are being made with the intent of loosening employment law restrictions and increasing labor protection, therefore encouraging labor participation.

In terms of what is currently happening in Puerto Rico, recent tax collections are exceeding initial predictions, proving to be stronger than expected for the last half of 2020. Economic development, however, could be challenged by federal tax law changes that could address the treatment of IP laws and corporate taxation. As of right now, approximately 1/5 of the Commonwealth's revenue comes from Act 154 taxes on transactions between multinational corporation subsidiaries.

When compared to heavily indebted mainland states, Puerto Rico's per capita income levels are substantially lower. If the newly introduced proposals are approved, Puerto Rico's public debt will be reduced significantly.

c. Congressional & Political Issues

As the restructuring plan takes shape and awaits approval from creditors and the court, policy issues are surfacing for the island, debts, creditors, and the wider municipal finance market. It is important that oversight and legislative actions are not ignored and thoroughly considered alongside the wider markets surrounding Puerto Rico as the restructuring process unfolds.

Puerto Rico's debt currently represents 2% of all municipal debt with investors holding this debt through mutual funds, bought at or near par value. As a result, these investors suffered large realized losses when the mutual funds sold off their holdings. The costs of litigation and the time it has taken to craft the restructuring plan have both been incredibly high, arguably too high, and exceeded projections.

When considering federalism and the municipal debt markets, it is important to understand that modifying the federal tax exemption requirements or limiting the amount of certain types of bonds could lead to serious fiscal risks. This was seen when Puerto Rico was still issuing bonds, their lack of federal tax exemption proved to cause serious losses.

In terms of procedures with the disclosure statement, by clarifying requirements, Congress could protect the interests of a much wider scale of investors. This could make the approval of the disclosure statement more efficient. COFINA's bond restructuring initially raised concerns that hedge funds and institutional investors were being treated more favorably than individual investors so, by reducing the excess gains of insiders, the agreement will be more attractive to smaller investors.

The final item to consider is that of constitutional restraints. It is noted that these constitutional restraints may be ineffective when substituted for advisable budgeting. Economists have called for imposing constitutional restrictions on government finances. The current Puerto Rican constitution includes a budget requirement and constraints on public debt; however, those constraints did not seem to be effective when considering the level of indebtedness Puerto Rico was experiencing. It is possible that sound fiscal policies may be the key to providing stringer protection against defaults.

The Recovery of Puerto Rico

Based on extensive research and multiple plans to restructure Puerto Rico it can be found that the island of Puerto Rico will likely recovery from their incredibly high amount of accumulated debt. While a final version of the disclosure statement awaits approval from Judge

Swain, creditors, the Oversight Management Board, and residents of Puerto Rico alike are hopeful that the country will recover within the next few years.

As of the latest hearing to approve the disclosure statement which occurred on July 14, 2021, a final decision from the court to approve the revised statement has been delayed until July 27, 2021 when creditors will have the ability to vote on the statement. Judge Swain stated that, at the time of the hearing, there were no objections that showed that the plan was flawed enough to constitute it not being able to be sent out for vote. The plan, however, did need additional information for financial clarity and Judge Swain recommended the Oversight Board prepare for discovery for plan objectors so the case would be on track for confirmation.

The confirmation hearing will take place in November 2021, pending the hopeful approval of the revised statement on July 27, 2021. If all stays on track, it is possible that Puerto Rico will exit bankruptcy in 2022 if projections are accurate and everything stays on a timely track for what has been outlined.

I believe that if the proposed disclosure statement and plan of adjustment meet the requirements outlined by Judge Swain during the July 13th and 14th hearing, the plan will be approved seeing as though no objections proved to be flawed to the extent that would constitute major changes to be made and a new hearing all together. Judging based on the efforts of the Oversight Board to address as many presented issues as possible during the July 13th and 14th hearing, I feel the revised statement and plan of adjustment will be approved by November.

A General Overview of the Debt Restructuring Process

In June 2016, PROMESA was signed into law by former President, Barack Obama. The enactment of this plan was to allow Puerto Rico to be able to restructure $74 billion dollars of public debt. This act led to the establishment of the Oversight Board whose responsibility was to assist the government of Puerto Rico and its instrumentalities in managing their finances.

The debt of Puerto Rico can be broken up as follows:

- $72 billion of debt was issued by more than a dozen entities from the central government of Puerto Rico to individual public corporations
- $2.7 billion in debt payments was set aside by the government to creditors which eventually turned into $4.2 billion
- $55 billion of additional Puerto Rican debt can be attributed to public pension liabilities.

The general overview of the debt of Puerto Rico can be broken up into different entities when looking at how Puerto Rico plans to restructure the debt. While many entities led the island to their accumulated amount of debt, the restructuring plan for the 5 that hold the majority of the debt is as follows:

- The Commonwealth of Puerto Rico plans to restructure $37 billion of net tax supported debt and other liabilities to $7 billion
- COFINA senior bonds are planning on the restructure of $18 billion to $12 billion
- Puerto Rico Aqueduct and Sewer Authority (PRASA) has no current plan to restructure over $1 billion of their debt of $5 billion
- The Governmental Development Bank plans on restructuring $5 billion of debt to $3 billion
- The Puerto Rican Electric Power Authority (PREPA) plans on the restructuring of $10 billion to $7 billion

Puerto Rico has already completed the recovery of $28 billion in debt and they are in the process of recovering $45 billion more of, mainly Commonwealth and PREPA, debt.

COFINA debt is Puerto Rican sales tax financing debt. COFINA debt is primarily restructured under Title III of PROMESA and $18 billion of COFINA debt is being restructured to be only $12 billion.

The Governmental Development Bank signed a restructuring support agreement with a large portion of GDB creditors to restructure the GDB debt under Title VI PROMESA. The restructuring agreement was amended in 2016 and reduced debt from $5 billion to $3 billion. Debt payments were secured by the GDB cash flow from certain legacy assets without recourse to the Puerto Rican government. The restructuring of GDB bonds cushions municipalities by offsetting the loans they owed to the GDB by the dull amount of their deposits.

The Puerto Rican Aqueduct and Sewer Authority and the Puerto Rican Government reached an agreement to modify about $1 billion of outstanding loans. PRASA debt service payments on the United States government program loans by $380 million over the next decade. This agreement gives PRASA access to approximately $400 million in new federal funding through clean water programs.

The debt of the Commonwealth has been undergoing restructuring in a series of events from September of 2019 to March of 2021. In September 2019, the Oversight Board filed a proposed plan of adjustment to restructure $35 billion of debt and other claims against the Commonwealth of Puerto Rico, the Public Building Authority, and the Employee Retirement System, and about $50 billion in public pension liabilities. This plan was amended in February of 2020. In March of 2020, the Oversight Board asked the United States district court to hold off on the processing of the plan of adjustment for the effects of the COVID 19 pandemic to be properly assessed and understood. In October of 2020, the Oversight Board resumed debt adjustment negotiations with creditors and proposed a plan of adjustment the accurately reflected the effects of the pandemic on the economy. In March 2021, the Oversight Board filed an amended plan of adjustment which provided the path to exit bankruptcy as early as this calendar year and was able to create a foundation for Puerto Rican recovery and long-term economic growth.