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Puerto Rico Update

Government Solicits Votes on New Restructured Bond

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INVITATION FOR SOLICITATION OF VOTES

Following our June 4-2018 update ("GDB Offers Restructuring Terms"), additional information has been made available to creditors by the government of Puerto Rico. On August 9th, the Puerto Rico Fiscal Agency and Financial Advisory ("AAFAF"-Spanish Acronym) and the Government Development Bank (GDB) announced that it would begin the solicitation of votes from creditors / bondholders ***seeking approval for the terms of the new bond*** offered under Title VI of the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA").

The government noted that commencing the voting process was an important milestone towards closing out the restructuring process. According to the ***Puerto Rico Fiscal Agency & Financial Advisory Authority***, the move was lauded because it confirmed that the government and creditors could resolve legacy issues without litigation.

Puerto Rican debt has, what is referred to as a ***Collective Action Clause (CAC)***. This means that once the majority vote to accept the qualifying modification, all participating bond claims, whether the holder of such claims voted in the solicitation to approve, reject or they did not vote, will mandatorily accept the exchange of old bonds for newly discounted bonds. The solicitation and deadline for voting will expire at 5:00 p.m., New York time, on September 12, 2018.

UPDATED DETAILS OF THE NEW BONDS ON OFFER

The new bonds on offer to clients are worth 55% of the value of the old bonds. The new bonds will bear a ***fixed interest rate of 7.5% per annum***, they are ***payable semi-annually*** on February-20 and August-20 each year and the final payment/***maturity date is August-20-2040***.

ANALYST'S OPINION

Puerto Rico has experienced a difficult and ongoing economic and fiscal situation. As noted before the sovereign's ability to pay is a real challenge given the contraction in economic activity over the past decade, the relocation of businesses out of Puerto Rico due to expiration of US-Federal tax holidays and the devastation caused by hurricanes Irma and Maria. Estimates by Moody's indicate that Hurricane Maria alone could cost between US$45 and US$95 billion (almost a year's total economic output on the high end).

Another key point is that the default must give Puerto Rico room to comfortably service/repay its debt. This means that the interest burden (interest payments as a percentage of tax revenue) needs to be manageable. If the default does not create enough fiscal space (manageable interest burden) then Puerto Rico could be placed in a situation where they are contemplating default again in a few years.

The US appointed Federal Oversight & Management Board (FOMB) has recommended tough fiscal measures for Puerto Rico. The FOMB has recommended, on three separate occasions, a 10% cut to all pensions that pay out more than USD1,000 per month. The government however has refused the recommendation on all three occasions and refused the austerity measures overall. Therefore it is likely that the FOMB will be forced to impose a fiscal austerity package on the territory.

The FOMB and the elected government have had verbal clashes with Governor Rossello openly criticizing the Board for subverting the elected government. It is believed however that given the wide powers granted to the FOMB by Congress, the FOMB has the power to implement the fiscal measures. This could lead to protests as issues of sovereignty and a possible referendum could be brought to the people. Consequently Puerto could have ongoing challenges.

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Source: ***Office of the Governor of Puerto Rico (http://prfaa.pr.gov), Puerto Rico Fiscal Agency & Financial Advisory Authority (http://www.aafaf.pr.gov/), Bloomberg, https://businessmonitor.com.***

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APPENDIX

IMPORTANT DISCLOSURES

ABSTRACT—As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation **DEFINITIONS/RECOMMENDATIONS**.

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