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for Puerto Rico

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GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO STATEMENT IN RESPONSE TO PROPOSAL RELEASED BY G25 CREDIT UNION GROUP

San Juan, P.R. – The Government Development Bank for Puerto Rico (GDB) released the following statement on a proposal issued yesterday by Puerto Rico credit unions, referred to collectively as the G25 credit union group:

"From the beginning, the Commonwealth has welcomed constructive dialogue to arrive at a balanced, comprehensive restructuring plan that offers a sustainable solution for the Island. However, the proposal made by the G25 credit union group does not prescribe the way to get there.

"This proposal unfortunately draws faulty conclusions from misconstrued data and offers unfounded promises that will not get us the debt relief we need. While the G25 plan purports to meet our shared goal of a 15% maximum debt service-to-revenue ratio for the Commonwealth, the plan arrives at that ratio by excluding the billions of dollars to be paid to COFINA bondholders. If COFINA debt service were to be included, the resulting annual debt service would be approximately $2.8 billion per year, drastically above the $1.85 billion target set by the Working Group. As a result, the G25 plan would in actuality raise the total revenue dedicated to debt service to over 20% of the Commonwealth's annual revenues – an unsustainable level that is well above the 5%-to-6% mean among U.S. states,[1] meaning that the Commonwealth would not be able to make the necessary investments in our economy in the coming years.

"The proposal's headline number of debt relief also relies on the assumption that 100% of bondholders will participate in their plan—but the G25 plan opposes the use of federal restructuring legislation that is critical to ensure 100% participation. If the proposal included a more realistic participation percentage, the annual debt service required by the Commonwealth would balloon to even more unsustainable levels. The G25 plan also incorporates their 'entry point' restructuring method, which, although appearing to provide principles for debt relief that achieve the laudable goal of

[1] See Moody's report titled "State Debt Medians 2016, Medians – Total Debt Remains Static in 2016," dated May 6, 2016, as well as the Moody's report titled "State Debt Medians 2015, Total Debt Falls for First Time in Almost 30 Years," dated June 24, 2015.

protecting local holders, ultimately falters on the several legal and practical issues that make its implementation unrealistic.

"These problems come on top of the proposal's several factual inaccuracies and misrepresentations of the nature of the FEGP and the Commonwealth's restructuring proposals – for example, stating that the FEGP excludes revenues from PRIDCO, COFINA, PBA and UPR, when the exact opposite is the case, as the Working Group has clearly stated in its multiple public releases on the FEGP. While we have always been open to approaches to reduce principal or interest to hit workable debt service levels, this proposal regrettably arrives at those levels by changing and ignoring critical assumptions about the Island's debt and the mechanisms needed to solve the severe and real challenges the Commonwealth faces.

"It is unfortunate that the G25 group released their proposal publically without discussing it first with the Commonwealth or its advisors. We regret that the G25 group did not take the opportunity to present their plan to the Commonwealth so that we could provide useful feedback and correct errors and mistaken assumptions in their proposal.

"As GDB and the Commonwealth of Puerto Rico have repeatedly said, the government recognizes the key role the *cooperativas* play in promoting social and economic development on the Island and is committed to working with the *cooperativas* system to ensure its viability. This commitment was reaffirmed through the efforts undertaken by GDB and the government to exchange certain GDB notes owned by *cooperativas* over the past month. We have been engaged in constructive dialogue with the G25 credit union group regarding potential solutions for the Commonwealth's fiscal and economic challenges that address the *cooperativas*' unique needs. While the proposal released yesterday does not provide that solution, we look forward to continuing our dialogue with the G25 group towards a workable proposal for a restructuring of the Island's debts."

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Supplemental Information

The G25 credit union group plan (the "G25 Proposal") relies on several inaccuracies and incorrect assumptions to arrive at its debt restructuring proposal. The following is intended to serve as background to highlight the G25 Proposal's deficiencies and inaccuracies:

1. **The G25 Proposal purports to achieve debt service relief in line with the parameters outlined by the Commonwealth, including a 15% maximum debt-service-to-revenue ratio and the associated annual cap of $1.85 billion in debt service.[2]**

   - **This is incorrect because when the G25 claims it is abiding by the 15% debt-service-to-revenue ratio and the $1.85 billion annual cap it is *excluding* COFINA debt service.** Once the COFINA debt service suggested by the G25 Proposal is included, the total annual debt service burden for the Commonwealth grows to approximately $2.8 billion,[3] which is greater than the 20% of the Working Group's forecast for revenues.[4] The Working Group's last restructuring proposal in which the $1.85 billion target debt service number was set explicitly included restructured COFINA debt service.[5] Indeed, on page 7 of the Working Group's April 11, 2016 counterproposal, graphs are included showing every element of the $1.85 billion of annual debt service, and included in those graphs is a red box clearly labeled "COFINA."

2. **The G25 Proposal claims that the Working Group excludes the revenues of**

[2] See the G25 Proposal on page 10 claiming total debt service "would be limited to the goal set by the Commonwealth's Working Group and its advisors of $1,.[sic]850MM)."

[3] Precise COFINA debt service under the G25 Proposal was not provided. The $2.8 billion represents the sum of the $1.85 billion explicitly allocated to the GO debt and the "Related Issuers" (as that term is defined in the G25 Proposal) as well as an assumed $952 million of annual COFINA debt service. The $952 million of annual COFINA debt service is in turn calculated using the product of 4.25 points of sales and use tax ("SUT"), which the G25 Proposal suggests will be allocated to COFINA, and $224 million, which the G25 Proposal states is the dollar amount associated with each point of sales tax.

[4] Revenues refer to "Adjusted Revenues" as that term was defined in the Working Group's February 1, 2016 presentation entitled "Puerto Rico Restructuring Proposal" (see page 13 for a definition of "Adjusted Revenues"). For additional details see the Working Group's January 18, 2016 publication entitled "Puerto Rico Fiscal and Economic Growth Plan Update Presentation" (see pages 6 and 29-30) as well as the Working Group's April 11, 2016, publication entitled "Puerto Rico Restructuring Counterproposal" (see, for example, pages 4 and 7).

[5] See the Working Group's April 11, 2016 publication entitled "Puerto Rico Restructuring Counterproposal." As but one example, on page 7 of this publication the debt service under the Working Group's proposal is shown explicitly including COFINA debt service. Page 14 also explicitly shows the consideration offered to COFINA under the proposal.

UPR, PBA, PRIDCO, PRHTA and COFINA in calculating the 15% debt service-to-revenue ratio.[6]

- **This critique is simply incorrect, as would be shown by a quick review of multiple presentations made by the Commonwealth**.
    i. For example, page 29 of the Working Group's January 18, 2016 publication entitled, "Puerto Rico Fiscal and Economic Growth Plan Update Presentation," shows each component of "Total Revenues" and explicitly includes revenues of COFINA, PRIDCO, PRHTA, and UPR. This same page also explicitly shows that the Working Group includes the Commonwealth's General Fund revenues when arriving at total revenues. PBA derives virtually the entirety of its annual revenues through payments from General Fund revenues and therefore, indirectly, PBA revenues are also included. To show PBA revenues in addition to the General Fund revenues would result in counting them twice. There is no doubt that every revenue source the G25 Proposal claims is excluded by the Working Group is actually included.
    ii. In addition, wherever the Working Group has explained its 15% debt service-to-revenue ratio, it explicitly stated that the revenues used in deriving the ratio represent total revenues projected in the Fiscal and Economic Growth Plan after certain adjustments. These adjustments are specifically enumerated in documents that the Commonwealth has made public.[7] None of these adjustments is to remove any of the revenue streams that the G25 Proposal appears to consider excluded. The G25 group seems to believe that, in arriving at its calculation of 15% of annual revenues, the Working Group only used General Fund revenues and excluded all others.[8] The G25 appears to ignore the approach that underpins the Fiscal and Economic Growth Plan, which considers all of the Commonwealth's tax-supported revenue in determining its ability to support debt service. Such a conclusion does not rely on complicated calculations, as simply taking the total debt service

[6] See the G25 Proposal on page 2.

[7] See, for example, page 13 of the Working Group's February 1, 2016, publication entitled "Puerto Rico Restructuring Proposal" ("Adjusted Revenues represent revenues shown in the updated FEGP projections, excluding federal transfers and GDB loan inflows, and includes the estimated cost of the Earned Income Tax Credit") and page 4 of the Working Group's April 11, 2016, publication entitled "Puerto Rico Restructuring Counterproposal" (stating the same). Adjusted Revenues are used so as to provide a direct comparison to Moody's calculations of the debt-service-to-revenue ratios of the 50 states. See page 13 of the Working Group's February 1, 2016 publication entitled "Puerto Rico Restructuring Proposal."

[8] See the G25 Proposal on page 2 claiming that the Working Group and it advisors "have stated that PR assigns 36% of the General Funds Internal Revenues to debt service." (emphasis added)

proposed by the Working Group of $1.85 billion and dividing by 15% would have shown that the G25 Proposal's approach is erroneous, because it does not come close to the General Fund revenues explicitly projected by the Commonwealth. Nonetheless, we note that the G25 advisors have long had full access to the underlying numbers and mathematical models used by the Working Group, including the calculation of revenues used in the debt service-to revenue ratio.

3. **The debt relief offered by the G25 plan appears to assume that 100% of bondholders will participate in its voluntary exchange. However, the G25 group also states that the use of federal restructuring legislation is not necessary.**

    - **This is a faulty assumption.** As an initial problem and practical matter, it is **virtually impossible to reach levels of 100% participation**, across the Island's many issuers and dozens of bond issuances, on a purely voluntary basis. As a comparison point, voluntary exchanges of a single series of bonds at most corporate issuers are viewed as highly successful if they achieve participation levels of 90 or 95%. With this level of complexity, and high number and varied nature of holders, the Commonwealth's advisors estimate that voluntary participation at levels of even 65 or 70% would be on the high end of realistic participation.
    - **Without 100% participation** of holders in the exchange, **the levels of debt relief offered by the G25 Proposal evaporate and the amount of debt service burden on the Commonwealth increases significantly**.
    - The clear difficulty of achieving the necessary participation levels on a purely voluntary basis is one of the core reasons why **federal restructuring legislation is critical to helping Puerto Rico solve its debt overload**.

4. **The G25 plan also relies on an unrealistic "entry point" restructuring method, whereby holders would only be permitted to recover a maximum of 20% of their original investment, limiting the recovery of speculative investors.**
    - **We believe the entry point method is unrealistic** for several legal and practical issues. First, we do not believe that it provides a solution for 100% of holders to participate, which, as noted above, appears to be an assumption of the G25 plan. At the very least, some of the most visible investors in Puerto Rico today are speculative investors, and we do not believe they would agree to participate in a restructuring that limited their recovery.

- We also have identified several legal deficiencies in the proposed "entry point" method, which we do not believe is a permissible method of restructuring debt under bankruptcy law principles, as those principles require similar treatment to be offered to similar bondholders. These very principles underlie the bankruptcy provisions of PROMESA, and therefore would bar the implementation of an "entry point" restructuring under the proposed federal statute.
- While **GDB and the Commonwealth fully support a restructuring that takes into account the many local and retail holders that are creditors of the Island,** we do not believe the "entry point" method provides a workable solution for such holders.

5. **The G25 plan appears to offer all exchanging holders either new GO or GO-Guaranteed bonds under the Puerto Rico Constitution**
    - **The Commonwealth has reason to believe this solution has serious legal considerations that may render it unconstitutional**. The Commonwealth's constitution creates limitations on the future issuance of GOs and GO-Guaranteed debt. We believe that the proposal, which offers billions in new GO-Guaranteed debt without specifying a payment source for that debt, may be constitutionally impermissible.

6. **The G25 plan purports to promise the "avoidance of defaults, moratoriums and uncertain litigation."**
    - **We believe this assumption is incorrect**. Because the plan only provides for a voluntary exchange, it does not solve the risk of holdouts, which we believe is very high in Puerto Rico regardless of the terms of the exchange.
    - However, the G25 plan also appears to assume that no debt service is paid to holdouts—otherwise, the new debt service offered by the plan would be much higher, significantly raising the annual debt service of the Commonwealth under the G25 Proposal beyond the already unsustainable level of $2.7 billion.
    - **If no debt service is paid to holdouts, and no legal basis (such as a moratorium) is in place to support the Commonwealth's non-payment of the holdouts — as the G25 Proposal appears to assume — our assumption is that the Commonwealth will descend into a morass of litigation** by holdouts as well as participating bondholders, as all creditors seek to preserve their recovery.

7. **The G25 plan includes several factual inaccuracies that undermine its conclusions.**

- **We believe that the debt service calculations underlying the G25 Proposal's offer to bondholders have several critical inaccuracies**, such as the following.
    i. **The G25 Proposal states that total debt outstanding is $52.6 billion,** which it claims is based on the Working Group's fiscal and economic growth plan.[9] However, **the total debt addressed by the Working Group's proposal was clearly set out in multiple presentations as approximately $49.2 billion,[10]** so we assume that the G25 Proposal relies on separate calculations to arrive at a different number. The G25's calculations are not enumerated in their public release, so we cannot isolate all of the differences.
    ii. However, one very significant difference is clear: **while the G25 Proposal claims to include "accreted values of CABs as of 6-30-2016"[11], in reality it appears as if they have mistakenly included CAB values that date much further into the future.** "CABs" refers to capital appreciation bonds, which are bonds that pay no current interest, but instead accrue interest over time before a large, final lump-sum payment at maturity. Some CABs issued by Commonwealth instrumentalities do not mature until 2057, implying that their accrued interest as of "6-30-2016" is much lower than what it will be at maturity. In certain cases the G25 Proposal seems to have relied on the CAB values at maturity, rather the CAB values as of 6-30-2016, as the proposal states. For example, the total debt of ERS used in the Working Group's proposal, including CAB accretion,[12] was $3.1 billion. The G25 shows total debt for ERS of $3.8 billion,[13] which corresponds precisely to the ERS debt if you include all the CABs at their accreted value at final maturity. Consequently, the G25 Proposal has increased the claim of ERS holders by approximately $700 million. It is uncertain why the G25 would have used this much higher number, though it must be noted that the Working Group believes the G25 group holds ERS debt.
    iii. In addition to this error, **the Working Group also believes that the G25 Proposal is mistakenly including debt that is no longer**

[9] See page 2 of the G25 Proposal.

[10] See pages 8, 17 and 19 of the document titled "Puerto Rico Restructuring Counterproposal," dated April 11, 2016.

[11] See page 2 of the G25 Proposal.

[12] Technically the CAB accretion used by the Working Group was to May 2016, not June, as the proposal was made much earlier in the year than the G25 Proposal.

[13] See page 5 of the G25 Proposal.

outstanding. In particular, at PRHTA, the Working Group believes the G25 Proposal includes approximately $388 million of PRHTA "LIBOR Bonds" which were cancelled in November 2015.[14] The Working Group excludes this cancelled indebtedness from its calculations.

- **The plan also erroneously claims that the Commonwealth's previous debt restructuring proposals have exclusively relied on the Superbond and ignored the constitutional priority of the GO debt.** This is incorrect. Every proposal that the Working Group has publically released has explicitly recognized the constitutional priority of the GO bonds, including by consistently offering the most senior and best secured position in any restructuring.[15] As the Working Group and the Commonwealth have stated, the Commonwealth remains open to constructive dialogue regarding the ultimate structure of a debt restructuring, whether through a "Superbond" or other structure.[16] We note that the G25 Proposal itself, in proposing that the "Related Issuers" exchange their various series of debt into a single GO-Guaranteed bond, recognizes some of the considerations that the Working Group has grappled with in formulating a structure that solves the complex inter-creditor issues of the Island. While we do not believe that the G25 Proposal offers a workable solution to those issues, we appreciate their recognition of the need for such comprehensive structure.

[14] See the following link for details on the cancellation of this indebtedness. http://emma.msrb.org/ES743776-ES583062-ES978949.pdf

[15] See pages 7 and 12 of the Working Group's February 1, 2016 publication entitled "Puerto Rico Restructuring Proposal."

[16] See page 4 of the Working Group's April 11, 2016 publication entitled "Puerto Rico Restructuring Counterproposal" stating that "the Counterproposal is agnostic with respect to the structure of the ultimate exchange currency provided to creditors."

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