FINANCIAL OVERSIGHT AND MANAGEMENT BOARD
FOR PUERTO RICO

BY ELECTRONIC MAIL

June 22, 2017

Honorable Tom Cotton
United States Senator
United States Senate
124 Russell Senate Office Building
Washington, DC 20510

Dear Senator Cotton:

I appreciate this opportunity to respond to your letter received June 13, 2017, and the questions it asks.

Your letter interpreted my letter dated April 25, 2017 to mean that because PROMESA section 201(b)(1)(N) provides a fiscal plan should "respect" relative lawful priorities and lawful liens, the Oversight Board has flexibility "to decide which legal obligations to meet." I apologize that my letter created that inference. In fact, consistent with the priority in the Puerto Rico Constitution of General Obligation bonds over other Commonwealth debt, the certified fiscal plan includes in the funds available for debt service, the tax revenues otherwise channeled to other public entities, thereby rendering the funds available to be allocated to debt service on the General Obligation bonds to the maximum extent they are property of the Commonwealth and not of COFINA. The actual allocation would be done in a Title III plan of adjustment, as contemplated by PROMESA.

The "flexibility" mentioned in my April 25 letter referred to the fact that PROMESA's instruction to respect relative priorities in section 201(b)(1) is one of many instructions, including instructions to ensure funding of essential services, to provide adequate funding for public pension systems, and to provide for capital expenditures and investments. Therefore, the revenues must be allocated among all PROMESA's requirements and that requires flexibility.

Your letter asks whether the Oversight Board anticipated that its interpretation of respecting lawful priorities would hurt the appeal of municipal debt and potentially raise its cost. We believe that under the orderly process provided by PROMESA, with a fiscal plan that maximizes available funds for debt service while ensuring the overall economic recovery of the island, the municipal bond market actually will suffer less than it otherwise would given the disastrous level of debt and incapacity to pay faced by Puerto Rico. The Oversight Board required a fiscal plan configured to maximize debt service payments over time. We completely recognize and acknowledge that the amount available for debt service is far from payment in full. It creates losses showing investors that Puerto Rico was over-leveraged, and the old interest rates may have been insufficient to compensate for the risk that arose from situations PROMESA is eliminating.

That said, the fiscal plan is still better for creditors than any alternative the Oversight Board had. The Oversight Board retained highly skilled experts and consultants in economics, municipal efficiencies, finance, and accounting. The bottom line is that if the fiscal plan allocated materially more revenues to pay debt service today, the Commonwealth's decade-old negative economic growth would not turn around because the money must come from somewhere. If we take even more money away from public services (whether creditors consider them essential or nonessential) so we can pay more debt, we will only accelerate the out-migration of population to the United States, increasing costs to the States and to the federal government. That would propel the downward spiral, and over time, creditors would receive much less. Put differently, the Oversight Board did not have a universe of potential solutions that included higher payment of debt and a successful turnaround. Therefore, the best solution was the least-worst solution.

Your letter inquires whether the Oversight Board's opinion is that servicing lawful debt is a non-essential expense. As explained above, the Oversight Board believes the certified fiscal plan will maximize debt repayment, because additional material cuts to other expenses are counterproductive. As explained above, the Oversight Board views debt service as being entitled to lawful priorities. In that sense, it is an essential expense. The Oversight Board also believes there can be no revenue available for debt service if the other expenses in the fiscal plan are not paid, which includes essential services and the other categories of expenses required by PROMESA section 201(b).

Sincerely,

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