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August 14, 2017

<u>By Email</u>

Members of the Financial Oversight and
Management Board for Puerto Rico

c/o
Martin J. Bienenstock
Proskauer Rose LLP
Eleven Times Square
New York, NY 10036

<u>Re: Commonwealth's Financial Disclosures</u>

Dear Chairman Carrión and Members of the Board:

I write on behalf of the Ad Hoc Group of General Obligation Bondholders[1] concerning the Commonwealth's recent financial disclosures and the Board's statements about them. Despite mounting evidence that the Commonwealth's finances are robust,

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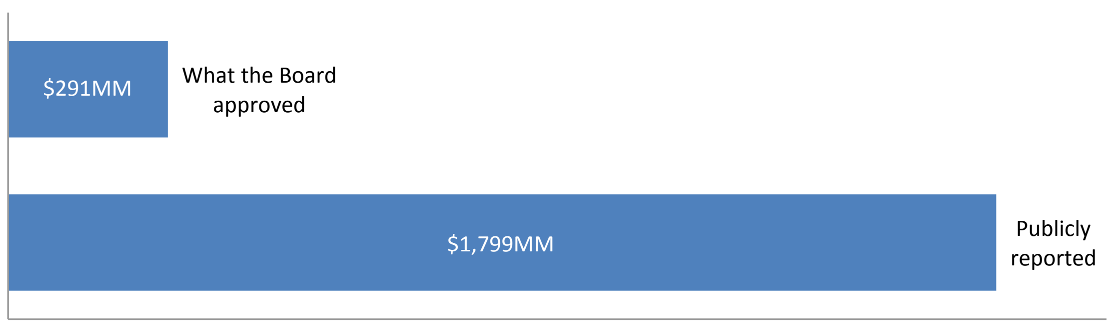
1 Members of the Ad Hoc Group of General Obligation Bondholders submit this letter exclusively on their own behalves and do not assume any fiduciary or other duties to any other creditor or person.

the Board has refused to correct the financial projections in its Fiscal Plan for the Commonwealth. In fact, disclosures of the Commonwealth's dramatic revenue overperformance and rapidly expanding cash position both contradict the financial picture portrayed by the Board and put to rest its claims that the Commonwealth cannot afford to abide by its constitutional obligation to pay its first-lien and first-priority Constitutional Debtholders. Rather than paying the Constitutional Debt with available resources, the Board's budget subterfuge has enabled the Commonwealth to *increase* non-debt general fund expenditures, in clear violation of PROMESA and Puerto Rico's Constitution.

Given the current state of the Commonwealth's financial overperformance and its current cash positions, we request immediate action by the Board on the following: First, the Board and the Commonwealth should disclose the data and projections behind the Commonwealth's Fiscal Plan, which are irreconcilable with the Commonwealth's recent disclosures, and which the Board itself has now called into question. Second, we request that the Commonwealth resume payments of interest on its Constitutional Debt.

The Commonwealth Is Stronger Financially Than The Board Long Has Claimed

Facts undermine the Board's repeated claims that there is simply no money to pay the island's senior-most creditors. The Commonwealth has reported that, as of June 30, 2017, it had cash on hand of approximately $1.8 billion. Just months ago, by contrast, the Commonwealth's Fiscal Plan projected that, by the same date, the same number would be $291 million. The difference is so striking that, during its last meeting, the Board itself has called for the "appointment of a Central Commonwealth Treasury Manager to oversee the implementation" of "mechanisms to ensure the effective (i) monitoring, (ii) oversight, (iii) transparency, (iv) reporting and (v) controls" relating to the Commonwealth's liquidity position and performance against budget. *See* FOMB Resolution #4 (adopted Aug. 4, 2017). And it is not hard to see why:



The Commonwealth did not build this cash position by skimping on expenses. Not only has the Commonwealth continued to fund all non-debt expenditures without any attempt to separate essential services from non-essential ones, it has also reported that it has reduced outstanding third-party accounts payable by $1.2 billion in the preceding fiscal year. Together, these facts represent a **$2.7 billion** net improvement in the Commonwealth's finances in fiscal year 2017 alone.

How has the Commonwealth managed to achieve this $2.7 billion improvement? While the Board claims to be unsure, the answer is clear: by refusing to pay Constitutional Debtholders while continuing to collect record tax revenues. To date, the Commonwealth has failed to pay Constitutional Debtholders over $2.4 billion.

PROMESA was not enacted so that the Commonwealth could build massive cash reserves and pay down lower-priority creditors on the backs of bondholders. The Board, however, has promoted exactly that result, in willful violation of PROMESA and Puerto Rico law.

The Board Should Disclose The Data Behind The Commonwealth's Fiscal Plan

On June 2, 2017, we requested that the Commonwealth and the Board disclose the data behind the Fiscal Plan. You refused to provide it, based upon the pretextual assertion that "Congress expressly barred challenges to all certification determinations." The Commonwealth's latest disclosures further amplify the need for the Board to disclose the data behind the Commonwealth's Fiscal Plan. As the Governor himself recently stated, "[t]he baseline assumptions and forecasts in the Fiscal Plan work hand-in-hand with the Budget" and are "the foundation of the Government's finances." Letter from Governor Ricardo A. Rosselló Nevares to President Donald J. Trump *et al.* (Aug. 4, 2017). Projections as far from reality as the Fiscal Plan's have proven serve no legitimate purpose and hinder the ability of the Commonwealth and its instrumentalities to emerge from Title III. It is in the interests of the Commonwealth and all its stakeholders for sophisticated parties to critically examine the projections with an eye to making them more realistic. This cannot happen if the Board continues to hide the data.

The Board itself has recognized the need for greater transparency. After the Commonwealth's disclosures, the Board questioned the Commonwealth's data. Ms. Jaresko acknowledged at the August 4 meeting, for example, that "the significant variance to prior expectations highlights the need for more to be done to ensure transparency, timeliness, and accuracy of the cash forecasting and reporting." Yet that data is, of necessity, the basis for the Commonwealth's Fiscal Plan. Like the Board, creditors need not and will not accept projections based on opaque and demonstrably unreliable data.

We are confident that greater transparency will reveal that the Fiscal Plan's debt-service projections are a policy preference, not a fact based in reality. The Board has clung to its debt-service projections despite mounting evidence to the contrary. The Commonwealth's disclosures make that untenable, as Mr. Sobrino acknowledged on August 4: "[T]he number was surpassed by $1.6 billion [sic] . . . This places Puerto Rico in a better position to face the grave fiscal challenges ahead tha[n] we have publicly recognized." Even if the Board sees things differently, there is no conceivable justification for continuing to hide the data from creditors.

The Commonwealth Should Resume Interest Payments On Its Constitutional Debt

The Commonwealth's disclosures belie any remaining argument that the Commonwealth's illegal moratorium on Constitutional Debt payments should continue. It is entirely feasible—and would benefit the Commonwealth—to resume interest payments on the Constitutional Debt now.

The law is clear that the Commonwealth should be paying interest on its Constitutional Debt. The Commonwealth's Constitution obligates it to appropriate funds sufficient to pay Constitutional Debt; indeed, non-compliant budgets are expressly overridden, as debt service is the sole mandatory appropriation. P.R. Const. art. VI, § 6. If revenues fall short of appropriations, Constitutional Debt "shall first be paid." *Id.* § 8. PROMESA expressly requires the Fiscal Plan to "respect the[se] lawful priorities." § 201(b)(1)(N); *see also, e.g.*, § 314(b)(6). And Congress did not suspend these obligations until a plan is confirmed. For example, PROMESA provides that, "to the extent the Oversight Board, in its sole discretion, determines it is feasible," the Commonwealth "shall make interest payments on outstanding indebtedness when such payments become due during the length of the stay" it imposes. § 405(*l*).

The Board's apparent conclusion that payment of interest is not feasible is wrong. The Commonwealth has amassed $1.5 billion more than the Board anticipated just months ago. And it has done so while rapidly paying down its non-bond debt. The Fiscal Plan does not appropriate the $1.5 billion for any purpose, so using it to pay Constitutional Debt will not affect the Commonwealth's ability to comply with the Fiscal Plan. The Commonwealth's cash on hand ($1.8 billion in its TSA account alone, which comprises Commonwealth public funds), together with any amount allocated to debt service for fiscal year 2018, greatly exceeds the interest (including interest on overdue interest) owed on Constitutional Debt in fiscal year 2018 ($1.1 billion).

The Board's arguments that payment remains infeasible despite the Commonwealth's cash position are not credible.

First, the Board suggests that the Commonwealth's liquidity at a single moment in time is irrelevant. But the Commonwealth has been surpassing its liquidity estimates for over a year, and it surpassed its revenue estimate in July, the first month of fiscal year 2018. As Mr. Sobrino stated at the August 4 meeting: "[W]e beat the expectations once already, and I can commit that we will beat those expectations again." This is a direct concession by the Commonwealth's representative that the projections are too conservative. Further, the Commonwealth's cash position on June 30, 2017—the last day of fiscal year 2017—is a significant data point, as the Commonwealth just passed a balanced budget for fiscal year 2018.[2]

Second, the Board tries to dismiss the Commonwealth's $1.8 billion in cash by suggesting that the amount is taken out of context. For example, Ms. Jaresko stated on August 4: "[I]t's essential that the government provides a liquidity plan for *all* the cash flow of the Commonwealth. To date, the information that has been provided by the Government has failed to provide a comprehensive picture of the liquidity flows across all Commonwealth entities—not just the TSA," the account containing the $1.8 billion. This statement is misleading at best. The Commonwealth's most recent financial disclosures reveal that the TSA is the "main operational account in which *substantially all* Commonwealth public funds are deposited and from which most expenses are disbursed." Commonwealth of Puerto Rico, *Financial Information and Operating Data Report* 7 (Dec. 18, 2016). If the Commonwealth has changed its liquidity management practices in the last eight months, it should disclose such changes to its creditors and to the public.[3]

These facts aside, continuing the payment moratorium would harm those the Board claims to protect—the people of Puerto Rico. To state the obvious, the Commonwealth's ongoing disregard of its financial obligations harms the credibility of the Commonwealth in the eyes of the capital markets. But even more directly, the Commonwealth would save an immense amount of interest expense by resuming interest payments on the Constitutional Debt, since overdue interest (like overdue principal) is itself accruing interest. Through August 1, 2017, the amount of interest accrued on missed payments of principal and interest was approximately $90 million. And interest will accrue more quickly as more overdue interest accumulates. As required by PROMESA and Puerto Rico's Constitution, such interest on overdue interest, like all other amounts owed the Constitutional Debt, is entitled to a full recovery. The longer the Oversight Board squanders time and money, the greater that cost will be for the Commonwealth.

* * *

We ask the Oversight Board (i) to disclose the data related to the Fiscal Plan that we have requested, and (ii) to require the Commonwealth to resume making interest

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2 Moreover, the budget for fiscal year 2018 provides for an additional $190 million in appropriations to the liquidity reserve. https://juntasupervision.pr.gov/wp-content/uploads/wpfd/50/5969454ae4034.pdf. Likewise, the Fiscal Plan includes an inexplicable "reconciliation adjustment" of $592 million in fiscal year 2018. The Board may authorize use of these funds and existing reserve funds to pay Constitutional Debt.

3 The GO Group reserves all rights to contend that resources not identified as "available" by the Commonwealth are in fact available resources of the Commonwealth.

payments to Constitutional Debtholders. Please provide us the Oversight Board's decision by no later than August 21, 2017. As always, we stand ready to discuss these issues.

Sincerely,

Andrew N. Rosenberg