

Holder of COFINA Senior-Lien Bonds Critical of Settlement Agreement

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The tentative agreement between Puerto Rico's FOMB and COFINA should be rejected by holders of senior lien revenue bonds.

- The proposed recovery differs from what is widely being reported. In my view, the recovery of 93% is based on a pre-petition claim representing par value on outstanding bonds plus accrued interest calculated from February 2017 to the May 2017 Title III petition date. The recovery is based on the date-of-petition figure X 93%. The funds held by the COFINA trustee (BONYM) will be not be used to pay bondholders back interest but instead to meet the recovery claim figure established at petition. Let's assume a \$100,000 bond with a 5% coupon: The bondholder's claim is \$101,250 [\$100,000 par plus the three months of accrued interest before the Title III filing or \$1,250 ($\$5,000 \times 3/12$)]. The proposed recovery is approximately \$94,000 ($\$101,250 \times .93$). To provide for bondholder recovery the FOMB, will use all held BONYM interest plus various exchange bonds issued on a pro rata basis. Members of the municipal bond community who believe that existing holders will receive 93% of par AND 93% of the funds held at BONYM are mistaken, in my view.
- Senior lien bondholders should be emboldened by the recent US Court of Appeals decision on the PR FOMB vs PEAJE Investments, LLC case. Explaining its decision, the court provides one of the clearest definitions and best discussions of what constitutes a statutory lien. While the court affirmed the lower court's ruling that certain Puerto Rico Highway bonds did not have a statutory lien, it nonetheless affirmed indirectly the COFINA structure and enabling legislation.
- General Obligation (GOs) bonds have no basis to challenge the rights of *senior* lien bondholders. GOs continually trumpet their Article VI Section 8 constitutional priority over available resources – and they should. But not in relation to senior COFINAs. Notwithstanding the fact that the COFINA enabling acts and every bond indenture clearly states that COFINA's lien on a portion of the sales tax (SUT) is not considered an available resource, the Puerto Rico constitution itself contradicts the GOs claim. Article II, Section 18 states "Nothing herein contained shall impair the authority of the Legislative Assembly to enact laws to deal with grave emergencies that clearly imperil the public health or safety or essential services." COFINAs enabling legislation states the reason for enactment is to address a grave emergency. Moreover, early on in the COFINA vs Commonwealth case over property rights all parties concluded that a grave emergency existed at the time COFINA was structured. Simply, the GOs have no constitutional standing or priority relative to senior COFINAs.
- The settlement proposal appears to be based on low-ball estimates of SUT collections. Collections for all of fiscal year 2018, ending June 30, and including the economic impact of the September hurricanes, were only 1% lower than the prior year. Additionally, collections over

the last three months are up 17% over 2017 SUT collections. The trend is clearly up. Moreover, the recent Supreme Court ruling (South Dakota vs Wayfair, Inc.) providing a pathway to collect SUT from online sales should be particularly positive for overall SUT collections on a forward basis.

- The settlement offers senior COFINA bondholders nothing they don't already have except the *potential* for much better market acceptance if the COFINA structure is recast as a "true sale" or other mechanism to gain a high investment grade rating. However, this is unlikely. The rating agencies over the last 18 months have significantly raised the bar for rating a dedicated tax bond above the underlying issuer's general obligation bond rating. As part of their terms, COFINA bondholders should require the exchange bonds to carry an A or better rating as a condition of any agreement.
- In the end, I encourage bondholders to reevaluate the proposed settlement agreement and vote no unless significant changes are made.

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