www.cadtm.org/The-COFINA-Agreement-Part-1-The-First-40-Year-Plan

Puerto Rico

The COFINA Agreement, Part 1: The First 40 Year Plan

by Abner Dennis , Kevin Connor

3 December 2018

> This is the first installment of a two-part series on the COFINA debt restructuring agreement for Puerto Rico.

A major deal around the restructuring of the largest portion of Puerto Rico's debt cleared an important legislative hurdle this month. As it stands, the deal will bestow massive profits on vultu funds at the direct expense of Puerto Ricans.

By our estimates, the small group of hedge funds driving the deal will make over $1 billion in pro Puerto Ricans, meanwhile, continue to suffer deteriorating living conditions, with hundreds of pul schools having been closed and thousands of families in danger of seen their mortgages foreclosed.

This series of two articles offers background on the debt restructuring agreement, including how it will play out for speculators on the debt.

The agreement came through the Puerto Rico legislature's recent approval of House Bill 1837, which facilitates the restructuring of the debt of the Sales Tax Financing Corporation (commonly known as COFINA, by its Spanish acronym). The bill was passed without any public hearings or discussion; it is another step in the process of certifying the COFINA Adjustment Plan, the first debt restructuring achieved through Title III of PROMESA (the Puerto Rico Oversight, Management, and Economic Stability Act, the federal law that created Puerto Rico's Fiscal Oversight Board), and the second restructuring achieved after the Government Development Bank.

This agreement will restructure around $17.5 billion – or about 23.8% – of the total debt. This is the largest slice of all the debts of the government of Puerto Rico.

What is COFINA?

COFINA was created in 2006, during the administration of Governor Aníbal Acevedo Vilá, and under a legislature dominated by the New Progressive Party. It is a public corporation whose sole purpose was to issue bonds to refinance the so-called extra-constitutional debt.

The source of repayment for the bonds that COFINA issued is the sales and use tax (SUT), which started at 7% but gradually increased to 11.5%, the highest sales tax in the entire United States. COFINA's original objective was also amended to include financing the operational expenses of the various government agencies.

The arrangement generated needed revenue for Puerto Rico as it first entered its ongoing economic crisis – but it did so by expanding unsustainable lending arrangements that would ultimately prove disastrous. Wall Street banks such as Santander – and revolving door government officials tied to these banks – encouraged the creation and expansion of this debt, enriching themselves through bond commissions and sales.

What is the restructuring?

COFINA is one of the five entities that the Fiscal Board entered into the bankruptcy process through Title III of PROMESA – the others were PREPA (the public electric utility), the Retirement System, the Highway Authority and the Central Government (the Commonwealth). A restructuring consists of an agreement with creditors that establishes a new payment structure for the debt. The last step to exit a bankruptcy process is the approval of an adjustment plan, which finalizes the new agreement.

The basis of the COFINA adjustment plan is the division of the collections generated by the SUT (again, the sales and use tax).

Of the 11.5% tax, 5.5% belonged to COFINA. From the start of the bankruptcy process in federa court, different groups of creditors and vulture funds have battled over who gets to extract this money.

The General Obligation (GO, or Commonwealth) bondholders and the Unsecured Creditors Committee (the committee representing all unsecured creditors of the government, like unions and businesses) have attacked the constitutionality of COFINA, claiming that they are owed its share of the SUT. Section 8 of Article VI of the Commonwealth Constitution states:

"In case the **available revenues** including surplus for any fiscal year are insufficient to meet the appropriations made for that year, interest on the public debt and amortization thereof shall first be paid, and other disbursements shall thereafter be made in accordance with the order of priorities established by law." (emphasis added)

Does "available revenues" include the proceeds from the SUT that are passed on to COFINA? This question has never been answered by a court in Puerto Rico. Cutting COFINA's payments to its bondholders would mean more money to both the Commonwealth (for example, to finance essential services for the population) and its creditors.

The Fiscal Board and Judge Laura Taylor Swain, who is presiding over the Title III process in federal court, avoided deciding on this matter, preferring to open a mediation process that culminated in the following agreement that forms the basis of the newly approved adjustment plan: From the 5.5% portion of the SUT belonging to COFINA, 53.65% will be preserved for the bondholders of COFINA and the rest will be for the central government.

Through the recently approved restructuring law, the government of Puerto Rico renounces its right to challenge the constitutionality of COFINA in the future.

The adjustment plan of COFINA will be effective for the next 40 years. Once approved, neither the legislature nor the governor can eliminate the SUT during that period, unless they fulfill some very restrictive conditions established in the agreement. (See the "Substitution of Collateral" conditions on page 286 of the disclosure statement for the adjustment.)

The Financial Control Board established by PROMESA and the administration of Governor Ricardo Rosselló are selling the plan as a victory and step toward restoring the country's access to credit markets. In particular, the cuts to the bonds' face value ("haircuts") made through the agreement stand out, from approximately $17.6 billion to $11.9 billion, or a reduction of 32%. The question is, are these cuts enough?

To understand the cuts, it is necessary to understand the hierarchy of COFINA bonds. On the one hand, there are senior bonds, those whose debt is more secured, and which are the first in line to collect. Then there are the subordinates or juniors, which are next in line. Senior bonds total $7.7 billion (44% of the total debt), while juniors total $9.8 billion (56%). (See page 138 of the COFINA fiscal plan.)

Senior bonds were only cut by 7%; that is, they will be able to recover 93% of the nominal value of the bonds, while the juniors were cut by 46.1%, enabling a recovery of only 53.9% of the bonds' nominal value. Obviously, the weight of the cuts fell on the owners of junior bonds. It should be noted that Puerto Rican investors own a larger portion of these subordinated bonds.

The sustainability of this adjustment plan is questionable. After all, Puerto Rico has been in an economic depression since 2005. Not only does the economy continue to contract, as recognize by the fiscal plans of the Fiscal Board, but the emigration of Puerto Ricans to the United States, mainly to Florida, will continue in the coming years, according to the same projections. The only growth expected will come from the impact of billions of dollars in federal money, primarily throug Federal Emergency Management Agency (FEMA) and Community Development Block Grant (CDBG) funds. Once those funds end, the economy will likely again falter.

In an economy that has been shrinking for the past 13 years, how can an agreement that will increase debt payments annually and govern the country for the next 40 years be approved?

Examining the first restructuring plan to emerge from PROMESA leaves no doubt that the Fiscal Board is at the service of vulture funds and other large investors whose profits are directly related to the hollowing out of public services and the decline in the quality of life of the majority of the people of Puerto Rico. As the government fails, corporate interests step in to profit. What represents a disaster for the island is a bonanza for Wall Street.

View online : Eyes on the Ties

Abner Dennis

Kevin Connor