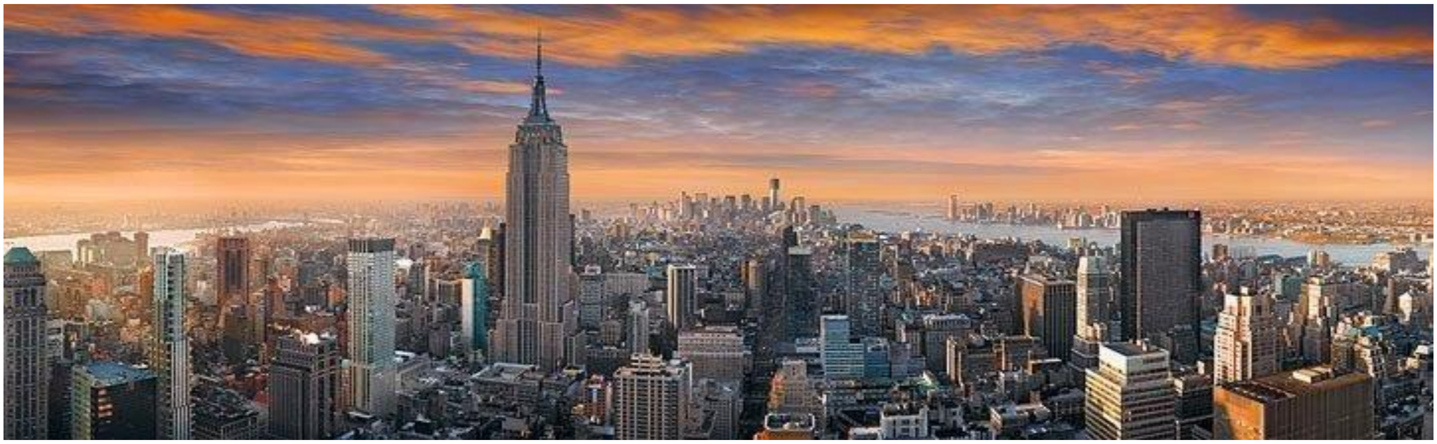

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DEBTORS ANONYMOUS: 12 STEPS TO RECOVERY FOR PUERTO RICO

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In November, 2014, I gave a speech in Puerto Rico outlining 5 things that Puerto Rico needed to do to avoid default & bankruptcy:

1. Implement a multi-year budget plan, instead of merely focusing on the next 365 days;
2. Improve disclosure for all investors, not just privileged large funds and companies with “confidential” access to current financial information (PREPA);
3. Institute regular meetings with bond raters, not merely to discuss what has occurred, but to present an image of where Puerto Rico was going;
4. Establish stronger polices and a clear role for using the Government Development Bank to support stronger financial policies for itself and the Commonwealth; and
5. Mount a strong, positive public relations campaign to improve Puerto Rico’s “tarnished image”, similar to the “I ♥ New York” campaign of the 1970’s.

In a speech in Puerto Rico on June 26, 2015, I stressed 12 financial management policies that could sustain Puerto Rico’s troubled finances, none of which have ever been adopted. In that speech, I again stressed the need for a multi-year financial plan that could compare to one of four stages of financial stress and remedial action:

1. Vitamins to prevent crisis;
2. “Chicken Soup” to deal with fiscal “coughs”;
3. Strong antibiotics to deal with major financial health problems; or
4. Major surgery, because the “patient” may be terminal.

I jokingly said that surgery was prescribed for Puerto Rico's mounting problems, but the patient (Puerto Rico) was seeking a "second opinion". Obviously, Puerto Rico did not seek surgery, because three days later,

Governor Padilla pronounced that Puerto Rico's debt was "unpayable", leading to the first of many bond defaults starting in the summer of 2015.

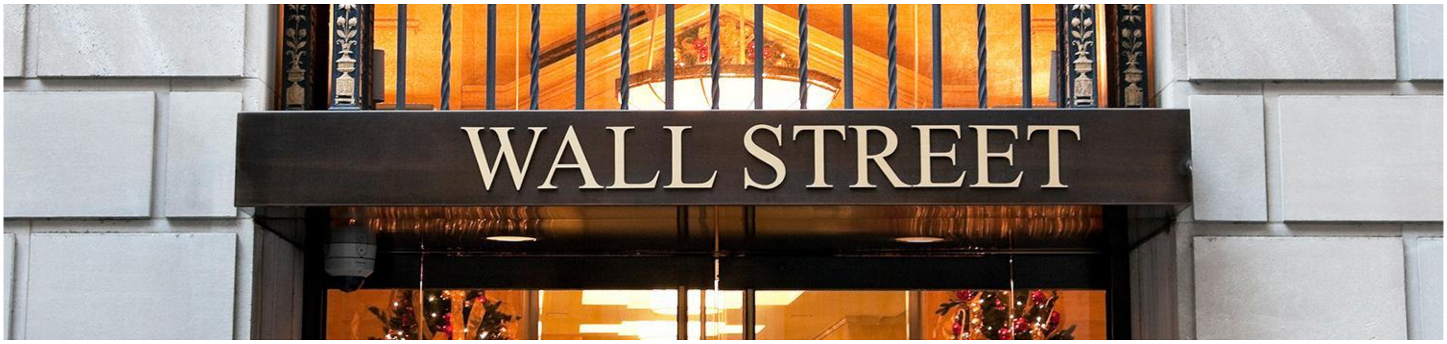
Because of inaction by elected and appointed officials, Puerto Rico now has the unfortunate title of having the largest municipal bond defaults in history. Congress passed a law prescribing an outside financial control board, but we are probably months away from any action. Members of the board have not been selected, and there is no professional staff to give unbiased analysis and opinion on Puerto Rico's financial position and direction.

Unquestionably, Puerto Rico's financial management is out of control, and its addiction to debt is not unlike an abuser of alcohol or drugs. Perhaps it is time for Puerto Rico to undertake a Twelve Step Program, aided by the new PROMESA financial control board. It could look like this:

1. *Admit the Commonwealth is Powerless Over Debt Addiction, and Work with a Power That is Greater Than Itself, by taking Inventory of Government's Failures, and Acknowledging Them.* The time for finger-pointing is over; there are many to blame. The simple fact is that Puerto Rico's officials have spent more than they can pay for, over years, if not decades. The time is also past for fighting against a control board. Instead, opponents should work in conjunction with the PROMESA board to discard past practice and politics, and change the future. This, in a nutshell, will challenge the PROMESA Financial Control Board once it is formed.

2. *Establish the Magnitude of Puerto Rico's Financial Position.* Puerto Rico cannot solve its financial problems until a true, current and accurate financial statement can be done, and disseminated to all parties of interest. Or in simple terms: Submit a current audited financial statement, the last one being three years old. And supplement that with quarterly financial reporting. This may mean that funds will be necessary to overhaul Puerto Rico's archaic financial management systems and reporting, as was the case in NYC in 1975.

3. *Restore the Efficacy of the Government Development Bank, or Eliminate it.* In decades past, the GDB was an efficient and respected go-between for the Government and investors. Now, it is merely another troubled Puerto Rico agency, whose operations are opaque. Someone needs to take charge of material information for investors. Currently, there is no one in Government or the GDB that will regain the public's and investors' trust.



4. *Consolidate the Multitude of Debt Issuing Authorities into One or Two Umbrella Issuers.* The Public Building Authority, Puerto Rico Infrastructure Authority, the Government Development Bank, the Employees Retirement System, the Public Finance Corporation, the Puerto Rico Municipal Finance Corporation, The Public Finance Corporation, the Highway Authority, the Sales Tax Corporation (COFINA) and the Government's General Obligation authority all borrow for general government purposes, regardless of the legal construct that governs repayment. Since the Debt Moratorium, they are almost all in default based on unilateral actions of the Governor and his finance department. It no longer makes sense to have one authority pitted against another in a battle for funds to repay debt. It is time, perhaps, to revisit Puerto Rico's debt issuance authority, even if it means an amendment to the Constitution.
5. *Develop a Multi-Year Financial Plan, Preferably at Least 4 Years.* The annual budget can count as the first year of the plan, but the subsequent three years must project the consequences of any of the current's budget commitments, adjusted for inflation, employee bargaining, and the consequential operating costs of any capital projects undertaken by the Commonwealth, especially those that are funded from bonds.
6. *The Annual Budget (and the Four Year Plan) Ought to be Published Both in Spanish and English.* It is estimated that at least two-thirds of bonds are held by mainland investors that are not fluent in Spanish (which is the only way that current budgets are published).
7. *Put Off any Consideration of a Value Added Tax as a Substitute for Income and/or Sales Taxes Until a Reasonable Four Year Financial Plan Can Be Adopted.* Undertaking such a radical change in taxation would only muddy the waters, both for the elected officials required to adopt and implement, as well as investors and citizens affected by such a large financial decision. Much more analysis and accurate forecasting is necessary for a value added tax, especially when Puerto Rico's financial managers have been consistently short year after year.
8. *Abandon Any Serious Discussion of Changing Puerto Rico's Political Situation (Commonwealth, Statehood or Independence) Until the Island Can Prove Itself Capable of Managing Its Own Financial Affairs Without Outsider Control Boards.* As long as Puerto Rico is in a state of financial turmoil, any discussion of statehood is academic: I highly doubt that Congress would seriously consider a "bankrupt" Puerto Rico as the Fifty-First State
9. *Do a True Governmental Cash Flow Analysis to Determine What Puerto Rico's Seasonal Cash Flow Needs Are for its General Fund, at Least Annually.* One of the main reasons for the large bond defaults in July 2016 is because the general fund's expenditures are not in line with the timing of its revenue collection. This is the case for many states, which they address by issuing one year revenue anticipation notes (commonly termed RANs). However, Puerto Rico used to be able to finance the shortfall by borrowing temporarily from the Government Development Bank. Puerto Rico's inability to pay off that borrowing by the end of last fiscal year contributed to the bank failure of the GDB. The PROMESA control board will be hard pressed to find a solution to Puerto Rico's operating liquidity shortfalls early in the budget year. It would appear that there are no viable lenders in light of PR's massive defaults.

10. *Make Amends to Repay Current Bondholders as Much as Possible, if the Commonwealth Ever Hopes to Get Access to Borrowed Funds from the Inexpensive Municipal Bond Market.* The only alternative will be that Puerto Rico will have to pay the equivalent of "loan shark" interest rates and terms. Pitting one set of bondholders against another serves no purpose except to further harm Puerto Rico's credit reputation.
11. *Pension Obligations and Municipal Bond Obligations Should Be Merged; Perhaps Pensioners Could be Paid with Negotiable Debt Instruments Under the Same Restructured Terms That Investors Will Get.* Some might say that is not a solution because it will just add more debt to Puerto Rico's balance sheet. That is not true; the unfunded pension liability is as large or larger than outstanding indebtedness. By aligning pensions with debt repayment would give Puerto Rico a better incentive to straighten out its financial affairs. Both pensioners and investors should have the same goal: work with the Commonwealth to achieve financial self-sufficiency.
12. *In Addition to a Reckoning of What Puerto Rico's Financial Affairs Should Be, a Substantial Investment in a "Facelift" of Puerto Rico's Image Must Occur.* Puerto Rico needs to mount a massive public relations effort to repair its attractiveness to tourists and businesses. Ever since the August 2013 Barrons front page article "Puerto Rico in Trouble", the media has painted a picture of management ineptitude, couple with irreversible economic decline. Overhauling fiscal management will undoubtedly help the island's image. Reform and renewal in Puerto Rico must be demonstrated on all fronts and carried out in all of the island's affairs. Band-aids will not cure Puerto Rico's ills; major surgery is called for in a total makeover of how the island is seen outside of its borders.

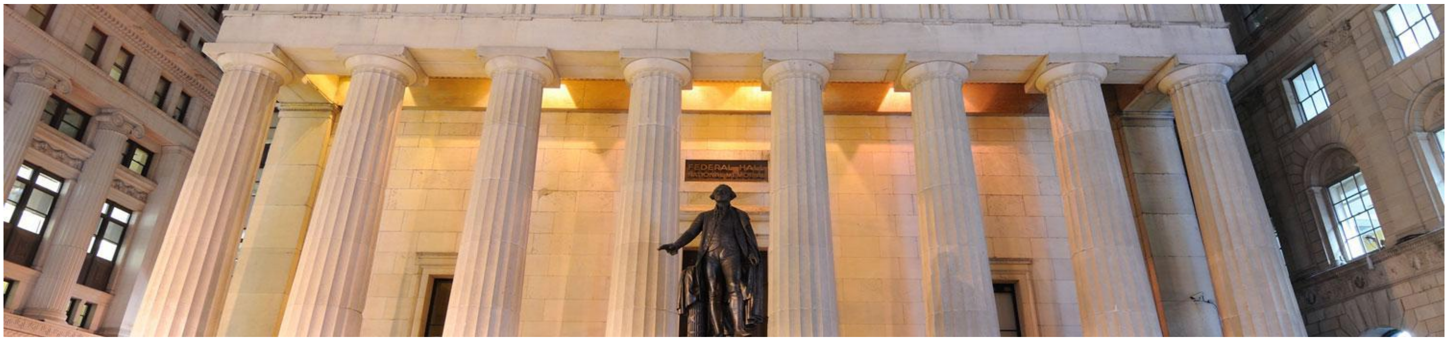
Puerto Rico's debt and financial crises are of historical proportions. I hope that current & future elected officials, as well as the new PROMESA Control Board, will prove that they are up to the task.

About the Author

RICHARD P. LARKIN, Stoever Glass & Co., Inc.

Richard Larkin, a recognized 40 year industry veteran, has joined SG & Co. as Director of Municipal Credit Analysis. Mr. Larkin began his career in credit rating analysis at Standard & Poor's in 1975. After rising through the ranks in various analytical and management positions, Dick left S&P as its Chief Municipal Rating Officer, responsible for municipal rating policy, practices, governance and criteria. In 1998, Mr. Larkin joined Fitch Ratings as Chairman of its Public Finance Criteria Committee. He ultimately left to take leading roles in municipal hi-yield analysis at firms JB Hanauer & HJ Sims.

"Dick will be a unique resource to Stoever Glass' municipal clients. His knowledge in specific issues and areas of the municipal bond industry will aid our representatives and their clients in making educated decisions, in a sector where this type of research is unique," said Roland Stoever of Stoever Glass.



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