

PUERTO RICO RECOVERY PLAN: ECONOMIC DEVELOPMENT PROPOSALS

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Economic Environment

Our economy is one that . . .

- Everything is solved through the 'cracks'
- Coffers are plunder: excessive dependence on debt issuances
- Inefficient government bureaucracy expects that you work for them
- For some, corruption and lack of ethics is a "business model"

Opportunities for Economic Development:

- Solidarity (solidaria)
 - Sustainable (sustentable)
 - Responsible (sostenible)
- Endogenous Growth***



How to measure the economy

Economics 101: Identity Equation of the Gross Product
[from the expenditure/demand perspective]

$$Y = C + G + I + (X-M)$$

Y = GNP = nominal value (\$) of production

C = private consumption (-)

G = Government expenditures (-)

I = Private Investment (+)

(X-M) = net exports (+)

Then... what would trigger economy growth?
Revamping the real economy,
not private consumption!



Local threats:

- “*Secular Stagnation*”: Minimum capital accumulation and innovation, aging population
- Growth remains slow, inflation remains weak and thousands of middle-age people are no longer working
- Note to policy makers: “You failed. There are better ways of jump-starting slow economic growth. Stop. You’re making things worse.”
- PROMESA as it is, cannot be considered a REAL tool for economic development
- So long as the political class thinks it has no responsibility in this problem, nothing is going to get done



Financial conundrum:

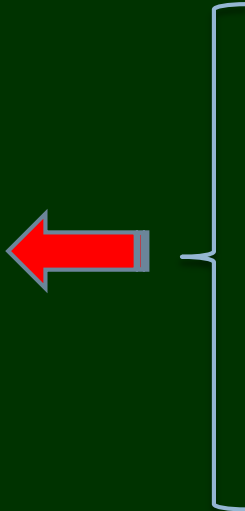
1. ***Slow by habit and by nature*** – always a buck short and a day late!
2. ***Poor business management*** – Underutilizing it's monopsonic market power
3. ***Terms chiseler*** – always looking for the laxity or inconsistencies in terms agreed upon turns “*future business is not desired*”
4. “***Moral Persuasion***” – patriotic call to “arms” on false “people first” argument making a mockery of the Constitution they are sworn to obey



Financial conundrum:

In his book *Effective Loan Management*, Ed Morsman suggests that when a loan gets to “workout” there are five zones:

1. The salvage zone
2. The greater fool zone
3. The twilight zone
4. The cab fare zone
5. The Titanic zone



The Cab Fare zone is a liquidation zone. If a workout is still possible, then by definition, the credit is in an earlier stage of deterioration. In the cab fare zone, if voluntary liquidation occurs, the bank will get paid and the borrower will recover at least "cab fare" from the collateral.



The Cab fare Zone:

- During early stages of the cab fare zone, the borrower stands to recover significant amounts of the investment. During the later stages, he or she is down to cab fare and little else. When a workout is not working, the credit has entered the cab fare zone, and the biggest favor for the bank can do the borrower is to convince him or her of the logic of that a voluntary liquidation. ***Continuing a workout that is not working and letting it reaches the titanic zone is pure folly and is in no one's best interest.***
- By determining that the credit has entered the cab fares own, and by convincing the bar were that it is time to liquidate the business, the bank does the bar were a huge favor: *it keeps him or her from losing the entire investment*. If the bank has handled the workout correctly and is communicating well with the borrower, ***the borrower should assume responsibility*** for the relation to minimize his or her losses. If the bank has to do the liquidation, neither the bank nor the power will get paid in full.



Debt in an elevator:

1. The debt is payable but needs to be restructured
2. Not all debt is equal:
 - a) General Fund/Constitutional guarantee (GO's, PBA, PRASA, UPR, etc)
 - b) COFINA + COFIM
 - c) Public Corporations and others
3. A restructuring does **NOT** imply write-off of principal or interest:
 - a) Multiples issuers with multiples levels of liens (*pari passu*)
 - b) Special Law of Fiscal and Operational Sustainability /Executive Orders 2016-010, 2016-046 and 2016-049



Composition of Puerto Rico's Public Sector Debt

As of June 30, 2015

Puerto Rico: General Government Debt	Dollars in millions
Issued or guaranteed by the Commonwealth	
Full faith and credit bonds and notes issued by the Commonwealth	13,061
Bonds and notes guaranteed by the Commonwealth	<u>5,547</u>
Total	18,608
Supported by the Commonwealth	
Debt supported by Commonwealth appropriations or taxes ^a	8,076
Tax and revenue anticipation notes	300
Bonds and notes payable from sales and use tax revenue (COFINA)	15,224
Pension funding bonds (payable from employer contributions to ERS)	2,948
Other limited obligation debt and non-recourse debt	<u>1,987</u>
Total	28,535
Total issued, guaranteed or supported by the Commonwealth	47,143
Supported by subdivisions and instrumentalities	
Debt issued by public corporations and other instrumentalities	19,848
Debt issued by municipalities	<u>4,126</u>
Total	23,974
Total public sector debt	71,117

Source: Bloomberg, public offering statement documentation available on the Government Development Bank's website and the Puerto Rico Fiscal and Economic Growth Plan, Working Group for the Fiscal and Economic Recovery of Puerto Rico, Sept. 9, 2015, p. 75.

^a Includes \$4 billion in highway authority bonds and notes.



Composition of the debt

ISSUER		OUTSTANDING PRINCIPAL	2017
COMMONWEALTH OF PUERTO RICO	COMMONWEALTH	12,877,457,043.00	1,126,803,569.25
PUERTO RICO ELECTRIC POWER AUTHORITY	PREPA	8,322,405,000.00	640,918,690.29
PUERTO RICO SALES TAX FINANCING CORPORATION	COFINA	15,223,820,615.80	708,540,059.25
PUERTO RICO AQUEDUCT AND SEWER AUTHORITY	PRASA	4,046,815,466.80	272,850,879.32
PUERTO RICO MUNICIPAL FINANCE AGENCY	MFA	781,220,000.00	112,590,947.50
PUERTO RICO PUBLIC BUILDINGS AUTHORITY	PBA	4,144,138,666.60	273,881,253.14
PUERTO RICO PUBLIC FINANCE CORPORATION	PFC	1,090,740,000.00	85,781,613.13
PUERTO RICO PORTS AUTHORITY	PUERTOS	155,410,000.00	9,733,030.00
PUERTO RICO INFRASTRUCTURE FINANCING AUTHORITY	AFI	1,660,622,916.15	112,998,162.50
PUERTO RICO INFRASTRUCTURE FINANCING AUTHORITY	AFI (PORT AUTHORITY)	192,830,000.00	12,245,687.50
PUERTO RICO INFRASTRUCTURE FINANCING AUTHORITY	AFI (ASSMCA)	37,100,000.00	3,047,750.00
THE CHILDREN'S TRUST FUND	CHILDREN TRUST	897,765,000.00	49,282,700.00
PUERTO RICO HIGHWAY & TRANSPORTATION AUTHORITY	HIGHWAY	4,717,126,807.25	347,187,831.66
PUERTO RICO HIGHWAY & TRANSPORTATION AUTHORITY	HIGHWAY (T. M. BRIDGE)	136,057,270.45	13,998,190.00
EMPLOYEES RETIREMENT SYSTEM OF PUERTO RICO	RETIRO	2,947,648,342.65	166,518,989.96
PUERTO RICO CONVENTION CENTER DISTRICT AUTHORITY	CENTRO CONVENCIONES	408,530,000.00	30,336,312.50
PUERTO RICO INDUSTRIAL DEVELOPMENT COMPANY	PRIDCO	176,895,159.20	18,148,665.00
UNIVERSITY OF PUERTO RICO	UPR	470,775,000.00	42,554,500.00
UNIVERSITY OF PUERTO RICO	UPR (PLAZA UNIV.)	68,675,000.00	5,701,937.50
Total		\$ 58,356,032,287.90	\$ 4,033,120,768.50



Issuing Costs of the debt

Sample: date of issuance between Jan. 1/2000 to Dec. 31/2014

City	# of CUSIPs	Average TIC
San Juan	285	5.467%
Phoenix	24	5.160%
Miami	419	4.974%
DC	17	4.658%
Atlanta	113	4.521%
San Diego	19	4.321%
Los Angeles	48	3.993%
San Francisco	258	3.849%
Chicago	10	3.747%
Dallas	326	3.572%
Boston	126	3.270%
New York	242	3.113%
Denver	21	2.964%
Houston	15	2.500%
Total	1923	4.208%

- Access to credit is the lifeblood of economic growth
- Higher TIC's must reflect either higher risk (if capital markets are working efficiently)
- Can we claim a causal link?

Investopedia defines True Interest Costs as: "The real cost of taking out a loan. True interest cost includes **all ancillary fees and costs**, such as finance charges, possible late fees, discount points and prepaid interest, along with factors related to the time value of money. It can also refer to the actual cost of issuing a bond."



Opportunities:

- “Destrabatología”: Across the board consolidation on the 3 branches of government
- Debt restructuring
- Credit channeling for “CapEx” and not consumption in order to achieve desired innovation in high value added sectors:
 1. Information technologies
 2. Renewable energy
 3. Agriculture
 4. Financial services export



Key drivers:

- Strong statistical gathering capabilities to enhance economic intelligence and feed policy makers
- Economy will not grow just because . . . the monetary part is important but what is key is the real productive economy (fix the structural/restrictive labor regulations appropriately)
- Tax reform: perfect storm \neq laissez-faire. Say no to “trickle down” fiscal and economic incentives . . . ***They’ve been proven not to work!***
- We have relied on low interest rates to encourage increased spending by businesses and consumers even as government spending has remained relatively austere. This experiment has reached its limits. The economy is not run like a casino



Weaknesses:

- Puerto Rico is not bankrupt, the Government is
- Lack of fiduciary duties compliance
- “Perverse” fiscal incentives geared toward consumption and almost none to investment
- Political investing (\$72MM with average returns of “0%”)



Weaknesses:

- Demography – 1940 to 2013: at this rate, by 2050, PR will be the largest elderly home in LatAm



Sources: Puerto Rico Planning Board, Bureau of Social Statistics, Puerto Rican Migrants, a Socio-economic study, San Juan, Puerto Rico 1972. Junta de Planificación, Oficina del Gobernador, Gobierno de Puerto Rico, Informe económico al gobernador 1995, San Juan, Puerto Rico 1996. Instituto de Estadísticas.



Final considerations:

1. Capital Works Programs must be funded by the “minus expenditure” of the forbearance/debt loss mitigation
 - provide for capital expenditures and investments necessary to promote economic growth (PROMESA Title II Sec. 201 (b)(1)(J))

PROMESA may affect you



Final considerations:

2. Idle capacity in place



Final considerations:

3. Political investing

Years	Total donations	Credit as invertment to capital fund	All IRA acct contributions
2008	\$13,467,887	\$249,433	\$12,202,000
2009	\$3,194,676	\$120,000	\$12,472,000
2010	\$5,450,130	\$0	\$11,831,000
2011	\$7,896,496	\$0	\$10,400,000
2012	\$21,023,592	\$0	\$9,664,000
2013	\$4,218,532	\$94,500	\$9,190,000
2014	\$5,628,273	\$865,000	\$8,110,000
2015	\$7,092,702	<u>N/D</u>	<u>N/D</u>
2016	<u>\$4,667,309</u>	<u>N/D</u>	<u>N/D</u>
	\$72,639,598	\$1,328,933	\$73,870,000

source: OCE y DH



Final considerations:

Sample: date of issuance between Jan. 1/2000 to Dec. 31/2014

4. Fiscal audit of the Debt

Investment Barker	Comm. Charged
CITIGROUP	\$95,091
GOLDMAN SACHS & COMPANY	21,267
SANTANDER	18,297
BofA_ML	18,080
LEHMAN BROTHERS	12,628
UBS SECURITIES LLC	11,839
BANC OF AMERICA SEC LLC	11,510
UBS FINANCIAL SERVICES	11,111
MORGAN STANLEY	5,712
BARCLAYS	3,295
JP MORGAN	2,711
MERRILL LYNCH & COMPANY	2,529
SAMUEL RAMIREZ	1,165
	\$215,235

source: Bloomberg



Final considerations:

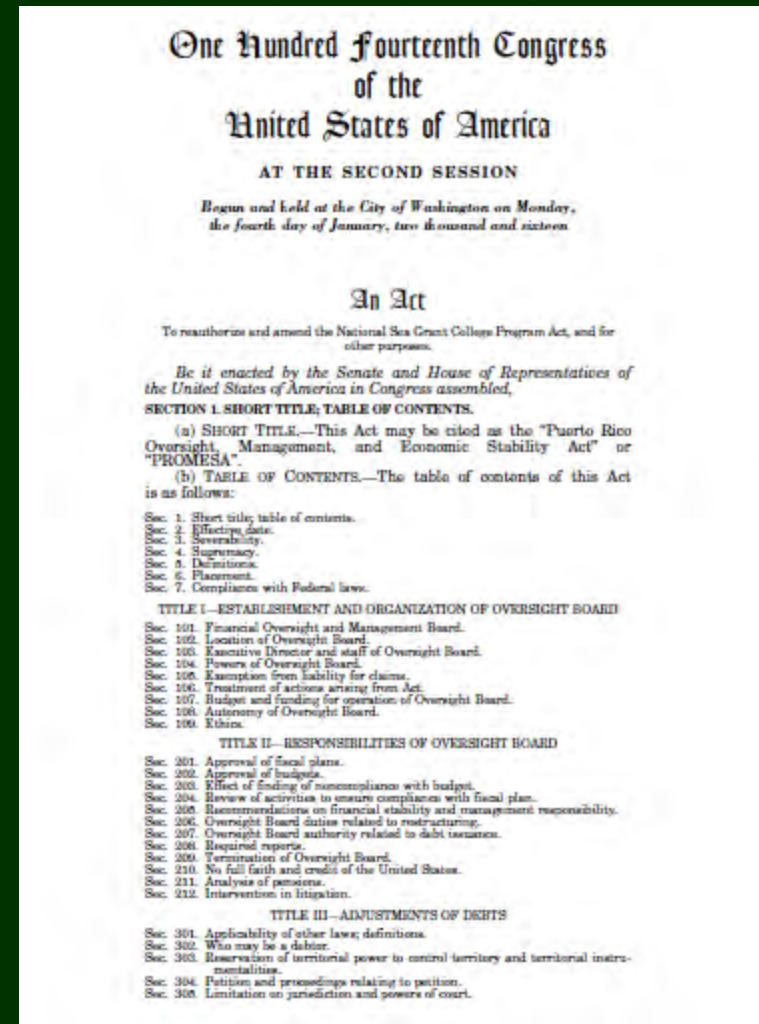
5. PROMESA, though, is not limited to restructuring and enforcement of debt obligations or securities. If you lent money or extended other forms of credit, or provided goods or services, to Puerto Rico or any of its instrumentalities, PROMESA may affect you



Demystifying PROMESA

What PROMESA does:

- Budget is compliant with the applicable Fiscal Plan
- Debt sustainability analysis
- Provide for capital expenditures and investments necessary to promote economic growth
- Bring to solvency to PR to ensure the island regains access to capital markets
- Certify voluntary agreements with holders of PR's debt obligations with PR or its covered instrumentalities



Demystifying PROMESA

What PROMESA will not do:

- Straighten up the political class
- Build a foundation for future growth (whoever said this must have failed ECON 101)
- Political investment
- Audit the debt
- Terminate public welfare
- File criminal charges against those who failed their fiduciary duties or prevarication

One Hundred Fourteenth Congress
of the
United States of America

AT THE SECOND SESSION

*Began and held at the City of Washington on Monday,
the fourth day of January, two thousand and sixteen*

An Act

To reauthorize and amend the National Sex Grant College Program Act, and for
other purposes.

*Be it enacted by the Senate and House of Representatives of
the United States of America in Congress assembled,*

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the “Puerto Rico
Oversight, Management, and Economic Stability Act” or
“PROMESA”.

(b) TABLE OF CONTENTS.—The table of contents of this Act
is as follows:

Sec. 1. Short title; table of contents.
Sec. 2. Effective date.
Sec. 3. Severability.
Sec. 4. Supremacy.
Sec. 5. Definitions.
Sec. 6. Placement.
Sec. 7. Compliance with Federal laws.

TITLE I—ESTABLISHMENT AND ORGANIZATION OF OVERSIGHT BOARD

Sec. 101. Financial Oversight and Management Board.
Sec. 102. Location of Oversight Board.
Sec. 103. Executive Director and staff of Oversight Board.
Sec. 104. Powers of Oversight Board.
Sec. 105. Exemption from liability for claims.
Sec. 106. Treatment of actions arising from Act.
Sec. 107. Budget and funding for operation of Oversight Board.
Sec. 108. Autonomy of Oversight Board.
Sec. 109. Ethics.

TITLE II—RESPONSIBILITIES OF OVERSIGHT BOARD

Sec. 201. Approval of fiscal plans.
Sec. 202. Approval of budgets.
Sec. 203. Effect of finding of noncompliance with budget.
Sec. 204. Review of activities to ensure compliance with fiscal plan.
Sec. 205. Recommendations on financial stability and management responsibility.
Sec. 206. Oversight Board duties related to restructuring.
Sec. 207. Oversight Board authority related to debt issuance.
Sec. 208. Required reports.
Sec. 209. Termination of Oversight Board.
Sec. 210. No full faith and credit of the United States.
Sec. 211. Analysis of pensions.
Sec. 212. Intervention in litigation.

TITLE III—ADJUSTMENTS OF DEBTS

Sec. 301. Applicability of other laws; definitions.
Sec. 302. Who may be a debtor.
Sec. 303. Reservation of territorial power to control territory and territorial insti-
tutionalities.
Sec. 304. Petitions and proceedings relating to petition.
Sec. 305. Limitation on jurisdiction and powers of court.

