JANUARY 2019

DEBT ISLAND

Wall Street Closes in on 40 Years of Profit at Puerto Rico's Expense

Debt Island:
Wall Street Closes in on 40 Years of Profit at Puerto Rico's Expense

An important chapter in the story of the Puerto Rican debt crisis is coming to an end this month, as an adjustment plan around sales tax-backed, or COFINA, debt has been voted on by creditors and will likely be approved by the federal court overseeing the restructuring process in mid-January. The agreement will lock in 40 years of payments to Wall Street bondholders, with deep consequences for Puerto Rico.

Hedge fund billionaires are on the verge of pulling off what seemed unthinkable in the wake of Hurricane Maria: a massive payday, at the direct expense of the Puerto Rican people, on debt that was trading for pennies on the dollar in the months following the hurricane. As a result of debt restructuring agreements like the COFINA plan, an island reeling from economic and climate-induced crisis will be paying for billionaire yachts and vacation homes instead of basic necessities and a just recovery.

But more is coming: in 2019, another major adjustment plan concerning the commonwealth's debt will need to be developed by the oversight board and approved by creditors.

This report outlines basic information about the COFINA adjustment plan and where it stands, the next plan to come, the shocking extent to which promised debt service rose as a result of the hurricanes, two of the billionaires profiting – and what is to be done.

The COFINA Plan and Approval Process

The COFINA adjustment plan is a sign of what is to come in the next adjustment plan: indefensibly and unsustainably high debt service payments, over the course of the next 40 years, that will necessarily lead to extreme austerity measures. Mass layoffs, pension cuts, and deep cuts to Medicaid and other essential services are the clear consequences of these plans and their financial terms (not to mention a sales tax rate that will remain sky-high); Puerto Ricans will be forced to pay for Wall Street's profits.

As a result of the plan, COFINA debt principal will be reduced from $17.6 to $11.9 billion, or a 32% reduction – though overall, when interest payments are included, the total debt service will be $32.3 billion over 40 years. This includes a 7% haircut for senior COFINA bonds, and a 46% haircut for subordinated COFINA bonds.

Governor Rossello and the oversight board have hailed this as a victory and as significant debt relief, but vulture funds that bought Puerto Rico's bonds at low prices will be securing massive profits – by our estimates, some hedge funds will be profiting to the tune of hundreds of millions of dollars[1]. The deal has been widely criticized[2] as being far too generous for bondholders, including from some unlikely corners (such as former Obama administration official, banker, and PROMESA architect Antonio Weiss).[3]

The COFINA plan is subject to approval by creditors, who had until January 8 to vote on the plan. On January 16, it will go before Judge Laura Swain for final approval. The voting process surrounding these agreements is yet another illustration of just how anti-democratic the restructuring is: only creditors are allowed to vote.

Some Puerto Ricans will be able to register their dissent in the voting process, since anyone with government claims, such as retired public employees, is able to vote. However, while there will be many, possibly hundreds of thousands, of non-Wall Street voters, hedge funds have the upper hand: the agreements can technically move forward with approval of just one class of voters (such as a class of bondholders) through a process called "cramdown.".

1 https://news.littlesis.org/2018/11/20/the-cofina-agreement-part-2-profits-for-the-few

2 http://cepr.net/blogs/the-americas-blog/puerto-rico-s-crisis-has-been-good-for-many-just-not-the-island-s-residents

3 https://www.bloomberg.com/opinion/articles/2018-10-08/puerto-rico-needs-a-better-debt-deal

The Next Major Plan

The Oversight Board has stated[4] that an adjustment plan for central government debt will be negotiated in the coming months. Commonwealth debt is the second largest slice of the total debt, $13.2 billion, mostly held by general obligations bondholders (GO's). Since the COFINA plan of adjustment established a precedent, the Commonwealth plan will also likely be for 40 years. This plan will be developed by the oversight board and negotiated in a process overseen by federally-appointed mediators.

This agreement will be extremely important because it will determine how much of the General Fund will go to the bondholders. That means future funding for education, health, and housing will be on the negotiating table. The more they take to pay the debt, the less there will be for essential services.

The approval of the Commonwealth's adjustment plan will hinge on another voting process – all creditors, including any person with some kind of claim against the central government, will have a vote. Voters will be divided in groups according to their class of claims. As noted above, the agreement can be forced through via a process called "cramdown" as long as one class of creditors votes to accept the plan.

Hedge funds, who have the biggest portion of the debt, will likely vote yes to the plan, since it will likely promise high bond payments. But active public employees, retirees, government vendors and all persons with claims against the Commonwealth will also get to vote.

Hurricane Recovery Money Padding Vulture Fund Profits

Why is the Oversight Board promising so much money to bondholders? It turns out that hurricane recovery funds are playing a significantly role – not in paying bondholders directly, but in indirectly padding and subsidizing bond payments.

The restructuring should have taken a much different path following the hurricane: debt held by Wall Street vultures should have been canceled in order to free up resources for a just recovery. Instead, the federal recovery money is padding short-term economic and fiscal projections. As a result, the Wall Street-captured Oversight Board has promised much higher payments to bondholders, post-hurricane, than they were offering pre-hurricane.

This is evident in the oversight board's fiscal plans. From its March 2017 fiscal plan[5] (pre-Maria) to its October 2018 fiscal plan[6] (post-Maria), the fiscal board doubled debt service payments, apparently based on projections bolstered by hurricane recovery money (Oversight Board member Andrew Biggs described this as "economic feedback"[7] in an October 2018 tweet).

Rather than leveraging these resources to strengthen essential services and infrastructure, the oversight board is promising it to Wall Street.

4 https://www.elnuevodia.com/noticias/locales/nota/lajuntadesupervisionfiscalponderaajustealosbonistas-2466563/

5 https://drive.google.com/file/d/1H7ucE-d_dyV0TR0JIsJakOiBfbIAI4gv/view

6 https://drive.google.com/file/d/17ca0ALe7vpYn0jEzTz3RfykpsFSM0ujK/view

7 https://twitter.com/biggsag/status/1055487342171979776

The Billionaires Profiting

What is devastating for the vast majority of Puerto Ricans means huge profits for vulture funds. They are managed by billionaires who are the principal winners in these restructuring agreements. Who are they?

Seth Klarman is the billionaire CEO of the Baupost Group, a Boston based hedge fund founded in 1982 known for its investments in distressed assets. It owns[8] more than $900 million in COFINA bonds. It invested big in Puerto Rico's debt in the second half of 2015, when it incorporated ten companies in Delaware called Decagon Holdings with the purpose of hiding its identity.

Baupost investors include some of the wealthiest universities in the world, including Ivy League universities like Harvard, Yale, and Princeton, some of the wealthiest universities in the world which will be making significant profits at the expense of Puerto Rico.

Another profiteer that recently has been very aggressive in its investments is Steve Tananbaum from GoldenTree Asset Management. GoldenTree now ranks in the top three Puerto Rico bondholders with more than $2 billion in COFINA and general obligation bonds. Taking advantage of the chaos caused by hurricane Maria, GoldenTree invested more than $400 million in COFINA subordinated debt between October 2017[9] and April 2018[10]. With the COFINA deal as it is, GoldenTree can expect profits of around $160 million from these investments alone.

GoldenTree has a wide array of investors, including public and private universities from the US like Miami University[11] and the University of Maine System[12]. It also manages money for some public pension fund systems (including Los Angeles County, Boston, New York State, and Texas).

Tilden Park Capital Management is another hedge fund that has been investing big lately in Puerto Rico's debt. It was founded and is directed by **Josh Birnbaum**, former managing director at Goldman Sachs who left the bank to found Tilden in 2009. Birnbaum is known for being one of the traders that devised Goldman Sachs investment strategy that took advantage of the 2007-2008 financial crisis. Betting against the mortgage market, he made $17 million[13] in compensation.

Tilden Park has more than $950 million[14] in COFINA bonds.[15] It also took advantage of the plummeting prices following Hurricane Maria, scooping up around $282 million in COFINA subordinated debt between October 2017[16] and April 2018[17]. From these investments Tilden Park can expect profits around $110 million.

Tilden Park Capital Management manages the investments for some retirement systems also, such as the Teachers Retirement System of the State of Illinois and the New York State and Local Retirement System.

8 https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=ODk5ODcw&id2=0
9 https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=NzExNDA2&id2=0
10 https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=NzMxNTUx&id2=0
11 https://miamioh.edu/_files/documents/about-miami/president/bot/2017/FA_12-07-17.pdf
12 http://staticweb.maine.edu/wp-content/uploads/2014/02/Meeting-Materials78.pdf?0d0f03
13 https://www.lacera.com/about_lacera/boi/meetings/2018-08-08-boi_agnd.pdf
14 https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=ODk5ODcw&id2=0
15 https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=ODk5ODcw&id2=0
16 https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=NzExNDA2&id2=0
17 https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=NzMxNTUx&id2=0

What Is To Be Done?

As the approval process for the next adjustment plan unfolds, some Puerto Ricans with claims against the government, such as retirees, will have the opportunity to vote no. While rejection by these voters will not override a bondholder yes vote, it will put pressure on the process. Also, as shown in the debt restructuring process of the Government Development Bank and COFINA, the Puerto Rican legislature can play a role and vote against the enabling legislation for yet another disastrous adjustment plan. Even though the Fiscal Board's authority has significantly undermined the legislature's power, it will need its consent to pursue a major restructuring in the Commonwealth's plan of adjustment.

Beyond that, those who cannot vote can say no in the informal corridors of power, on the streets and in the airwaves – no to money for Wall Street at the expense of basic services and necessary infrastructure, no to 40 years of creditor control, no to a corrupt process that prioritizes the value of payments to bondholders over the value of human life.

This, ultimately, is the only thing standing in the way of Wall Street's takeover of the next 40 years of Puerto Rico's future: a rejection by the Puerto Rican people of these adjustment plans. Significant public pressure could force the oversight board, the federal judge, and her appointed mediators to stop working for Wall Street; it could keep the Puerto Rican legislature from passing any legislation necessary to put the plans into effect; and it could ultimately force Wall Street creditors to accept less profitable terms that do not clear the way for deep austerity and corporate control.