

1Q2019 Review: Puerto Rico

The quarter proved to be a meaningful one for the Commonwealth of Puerto Rico, with the Puerto Rico Sales Tax Financing Corporation (COFINA) finalizing the restructuring of its \$17-plus billion in outstanding debt.

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Market Commentary



This stands as the most significant development we have seen in Puerto Rico's years-long journey, with COFINA representing approximately 24% of the island's public sector debt. Existing uninsured debt obligations were swapped for new senior lien securities in a process that was messy, complicated, and confusing for many. Bonds insured by Assured Guaranty were accelerated, paying par plus accrued interest to the plan of adjustment's effective date. As Puerto Rico puts COFINA in its rearview mirror, it now moves on to bigger challenges and unanswered questions.

Next on the agenda for the Federal Oversight and Management Board (FOMB) is the restructuring of the Commonwealth's general-obligation debt. The FOMB stated in court that it expects to have a plan of adjustment filed by the end of

April. It is hard to imagine any proposal being taken seriously by creditors without questions surrounding the validity of debt issued after 2011 being answered. We have written previously about the attempted invalidation of general-obligation debt and the possible implications for the broader municipal market. See <http://www.cumber.com/buyer-beware/>. It remains to be seen whether this is a strong-arm negotiating tactic or if questions surrounding the debt's validity will actually get answered in court. Whatever the rationale, the attempted invalidation is something we question, considering that one of the FOMB's mandates is to regain capital market access. Who will be left willing to buy the island's debt at a reasonable yield if the FOMB is ultimately successful? We do expect this to be a contentious fight, with the outcome shaping not just Puerto Rico's future but the whole of the municipal market as well.

Overhanging ongoing negotiations are questions regarding the constitutionality of board member appointments to the FOMB. Judge Swain's prior ruling that board member were properly appointed was overturned February 15th by the US Court of Appeals for the First Circuit. It found that board members were federal officials and thereby not appointed in accordance with the US Constitution's Appointments Clause. Thankfully, the court chose not to invalidate prior actions by the board or dismiss the Commonwealth's current Title III proceedings. Although some creditors desired that outcome, the results of such a decision would have been chaotic and meant more time, money, and financial losses for both the Commonwealth and creditors. The federal government now has 90 days to appoint board members legally. The FOMB has chosen to take the question to the Supreme Court, and any action by the federal government before that happens is unlikely.

Assuming the Supreme Court chooses to take the case on, what side it takes remains questionable. If the court sides with

the FOMB and determines its members are territorial officials, then things move forward with only a small delay. If the court decides they are federal officials, it makes thing far more complicated. The federal government would have very little time to either confirm existing members or appoint new ones. Considering the high degree of dysfunction at which our elected officials operate, we don't expect anything to be done until the eleventh hour. Hopefully Washington proves us wrong, but we're not holding our breath.

We still believe carefully selected insured paper can offer tremendous value for clients and continue to take advantage of the space. However, with the acceleration of insured COFINA debt, we are being cautious as we put money to work. We do not recommend blindly buying insured paper without doing the necessary research into each issue and authority.

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Cumberland Advisors invites you to our third annual Financial Literacy Day, to be held April 11, 2019, from 8:30 AM to 4 PM at the Selby Auditorium of the University of South Florida Sarasota-Manatee.

Our focus is "**Financial Markets and the Economy**," featuring:

Panels –

- The Stock Market
- Health Hunger and Philanthropy
- How the World Looks to Me – A Global Economic Outlook

Special Presentations –

- A Conversation with Susan Harper, Canada's Consul Gen in Fla, on Trade/World Affairs
- Keynote by Gretchen Morgenson, Senior Special Writer in the Investigations Unit at The Wall Street Journal and Former Business and Financial Editor for the New York Times.

We welcome and encourage the participation of our friends, colleagues, and clients. The cost is only \$50 to register, and

includes coffee, pastries, catered lunch, and a light reception with Gretchen Morgenson. Please reserve your spot soon – we expect a full auditorium. Learn more: <https://www.cumber.com/financial-literacy-day/>