PUERTO RICO POTENTIAL RESTRUCTURING
JULY 2015

In a weekend interview published in the New York Times[1], Puerto Rico Governor Padilla made it clear that a broad-based restructuring of the Commonwealth's debt is inevitable, as the island has racked up almost $72 billion in leverage. The Governor was clear that the cost to service that debt is overly burdensome and that creditors should expect some form of a restructuring, including possible payment deferrals, reduced payments, or an extension of maturities. Market participants have long believed that a restructuring of Puerto Rico's Electric Power Authority was on the horizon, as well as a number of other public corporations, but Governor Padilla's comments now put the Commonwealth's General Obligation bonds and sales tax-backed COFINA bonds on the table.

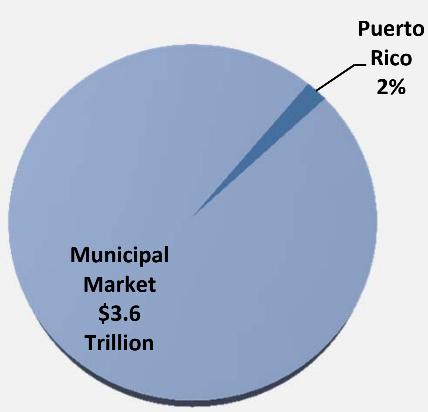
Given the vast number of entities, structures, and stakeholders involved, we believe its safe to assume that no one, even the Governor himself, knows how this will ultimately play out. The volatility that has accompanied an investment in Puerto Rico bonds over the last few years will most certainly experience the same or heightened pressure going forward. We also note that the players involved now include a number of institutional investors with deep knowledge and experience in distressed events, creating a very different environment compared to other municipal restructurings.

The developing situation in Puerto Rico does not reflect broader fundamental factors for the rest of the municipal market. State and local governments broadly have seen improving credit trends driven by recovering housing and labor markets, stable growth in tax revenues, and relative deleveraging. Puerto Rico's economy has been mired in recession for a number of years, and growing liabilities associated with pensions and debt have magnified weak financial performance. Therefore, Puerto Rico's fundamental problems are unique and significantly different than the rest of the municipal market.

Contagion from a technical standpoint would require investors to extrapolate problems in Puerto Rico as a signal of widespread municipal credit stress, resulting in asset flows out of the municipal market. While we believe this to be unlikely, the potential for a modest reaction does exist.

[1] http://www.nytimes.com/2015/06/29/business/dealbook/puerto-ricos-governor-says-islands-debts-are-not-payable.html

PUERTO RICO REMAINS A SMALL PORTION OF THE MUNI MARKET



PUERTO RICO'S DEBT IS SPLIT AMONG MANY ISSUERS

ISSUER	PAR ($MMS)	SHARE
COFINA (Sr & Sub)	16,082	22%
GO & Public Buildings	13,706	19%
PREPA	9,067	12%
GDB	8,353	11%
Highways (1998)	4,333	6%
Public Buildings	4,255	6%
PRASA	3,677	5%
Other	14,265	19%
Total	**73,738**	

Source: U.S. Federal Reserve Flow of Funds and Bloomberg