GOVERNMENT OF BELIZE

Ministry of Finance and Economic Development

Belmopan City, Belize

MEMORANDUM

To: Holders of Belize's U.S. Dollar Step-Up Bond due 2029

From: Ministry of Finance and Economic Development

Date: 29 November 2012

Subject: Update on the proposed restructuring of the above-captioned instrument

---

Recent Developments

Since the publication of its Indicative Restructuring Scenarios in August 2012 (the August Indicative Scenarios), the Government of Belize (GoB) has been engaged in discussions with holders of its U.S. Dollar Step-Up Bond due 2029, also known as the 'Superbond', over the proposed restructuring of this instrument.

Discussions have been held bilaterally with individual bondholders, as well with a coordinating committee (the Committee) representing four large bondholders. In parallel, the GoB has periodically published additional information of relevance to the process on the website of the Central Bank of Belize (CBB), which can be found at https://www.centralbank.org.bz.

In early October, the GoB entered into a limited non-disclosure agreement (NDA) with the Committee. This arrangement placed a temporary bar on trading by Committee members, and was intended to facilitate an open dialogue on appropriate restructuring terms for the Superbond. No material non-public information was made available to the Committee during the period covered by the NDA, which has now expired.

Discussions with the Committee and with other bondholders have focused primarily on the following key areas: (i) the macroeconomic assumptions used in the medium-term projections underpinning the August Indicative Scenarios; and (ii) the appropriate treatment within these projections of certain other liabilities of the country not yet captured in the recorded public debt stock (also known as the Additional Liabilities). The Committee has also sought further clarification from the Government regarding the prospects for new oil discoveries in Belize.

At the end of October, a mission from the International Monetary Fund (IMF) arrived in Belize for its annual 'Article IV' consultation. Discussions between the

GoB and IMF Staff were cordial and constructive, and during the two-week visit it was confirmed that the growth outlook for 2012 had improved on account of a stronger-than expected recovery in commodity exports after last year's weather-related damage, as well as other factors.

In view of ongoing discussions between Belize and its bondholders over the restructuring of the Superbond, IMF Staff concluded that further discussions between the GoB and the IMF would be required before the Article IV review could be completed. An end-of-mission statement from the IMF can be found at http://www.imf.org/external/np/sec/pr/2012/pr12443.htm.

Committee Counter-Proposal

On 21 November 2012 the GoB received a counter-proposal from the Committee. This proposal comprises three alternative scenarios, all of which are based on par structures. The scenarios combine, in different measure, temporary reductions in the current coupon rate with modest extensions in average life. All of them involve a return to the current 8.5% coupon upon the expiry of the reduced coupon period. In addition, the counter-proposal specifies a series of 'Required Terms' as an accompaniment to the three scenarios. These include the issuance of GDP warrants/oil recovery certificates, the inclusion of net present value 'reinstatement' clauses, and the payment of consent fees to participating creditors, among others.

Although details of the Required Terms are insufficient to carry out a full valuation, the GoB estimates that the Committee's counter-proposal is designed to be no worse than NPV neutral once the combined effect of the Required Terms is factored in.

While acknowledging that the Committee's counter-proposal provides a degree of short-term cash flow relief, the GoB considers it to be wholly incompatible with its objective of placing the country's debt burden on a sustainable footing – a goal that the Committee itself has indicated it is committed to at various stages. The GoB believes that the counter-proposal ignores Belize's high overall debt levels, and that it amounts to little more than a short-term fix not dissimilar to the 2007 exercise.

The GoB views the recently-submitted scenarios as unsustainable, and is disappointed that a counter-proposal of this nature has come five months after discussions with the Committee began.

Adjustments Recently Made to the GoB's Medium-Term Projections

In the weeks leading up to the submission of the Committee's counter-proposal, the GoB made certain important adjustments to its medium-term projections. Some of these adjustments were made in response to suggestions made by bondholders during the course of the consultations, whereas others stem from discussions with the IMF in the context of the 'Article IV' consultation that recently got underway. These adjustments are described below:

GDP Growth

As indicated above, during the IMF's recent visit, the CBB, GoB and IMF Staff established that growth in 2012 is likely to be better than what had been previously anticipated, largely as a result of one-off factors such as a stronger-than-expected recovery in agricultural production after last year's weather-related damage. Consequently, real GDP growth in 2012 and 2013 is now expected to reach 3.3% and 2.3%, respectively. On the back of this revision, and of an updated analysis of global growth prospects, the GoB has made an upward adjustment to its medium-term growth outlook, taking the real GDP growth assumption used in its medium-term projections from 2.0% to 2.5%.

The GoB believes that the risks associated with the new assumption are skewed on the downside in view of the ongoing fragility of the global economic environment, and of the specific growth challenges faced by the Caribbean region. Consequently, it does not anticipate making further upward adjustments to the growth forecast in the foreseeable future.

Disbursements

The projections underpinning the August Indicative Scenarios assumed that annual disbursements from official sector lenders would average US$45 million per annum over the medium term. This assumption is much higher than actual commitments for the coming years, and does not take into account the ailing appetite among Belize's multilateral partners for lending to small middle-income countries with high levels of indebtedness.

Some bondholders have nevertheless indicated a preference for the GoB to employ a more aggressive stance with respect to this variable, and in response to this request the GoB is now expanding its original US$45 million assumption at annual rate of 2.0% beginning in 2013.

Additional Liabilities

The medium-term projections published by the GoB in June 2012 assumed, for analytical purposes only, that the compensation outstanding to the former shareholders of the nationalized utilities (making up the bulk of the Additional Liabilities) would be paid out over the constitutionally-mandated five-year period on the basis of settlements reached at the 'mid-point' between the GoB's valuations (undertaken by NERA Economic Consulting) and those put forward by the former shareholders. The August Indicative Scenarios then assumed that these settlements would be restructured on the same terms as those to be agreed with bondholders with respect to the Superbond.

The objectives of this analytical approach were (a) to provide bondholders with an indication of the likely impact on overall debt dynamics of settlements with the former shareholders at different valuation points; and (b) to signal the GoB's view that, in the interest of inter-creditor equity, the Superbond and the Additional Liabilities should be placed on the same footing in the context of efforts to address the large financing shortfalls facing the country.

Although some dialogue did take place with the two sets of former shareholders early on in the process, it ceased shortly after the parties involved indicated to the GoB that their aspirations for compensation went well beyond what was implied in the GoB's approach as described above. The GoB's position is that higher levels of compensation are not warranted given the fundamentals of the two nationalized entities at the point of nationalization, and would in any case result in an unreasonable drain on the resources that are expected to be available for servicing other categories of the public debt going forward.

During parallel discussions with the Committee regarding the appropriate treatment of the Additional Liabilities within the GoB's macroeconomic projections, the Committee proposed an approach that would entail the 'ring-fencing' by the GoB of future dividend flows from the two nationalized entities, so as to create a 'compensation reserve' to fund a future settlement with the former shareholders.

The GoB's initial response to this proposal was to remind the Committee that the compensation levels being sought by the former shareholders are many multiples of the dividend flow that can be expected from the two nationalized entities over the medium- to long-term, and that a significant degree of risk would therefore be inherent in any medium-term projections based on the proposed approach.

Nevertheless, the GoB concurs with the view expressed by the Committee and other bondholders that compensation to be paid to the former shareholders should be broadly in line with what would have been their share of the present value of future dividend flow, and has therefore agreed to adopt the suggested approach.

In terms of its medium-term projections, the GoB has stripped out the debt service that had been factored in on account of the outstanding compensation due to the former shareholders of the nationalized utilities, and has instead ring-fenced the equivalent of approximately 0.35% of GDP each year from projected fiscal inflows. This assumption for the combined dividend flow from the two nationalized utilities is in line with the valuations that have been previously undertaken on behalf of the GoB.

Revised Indicative Restructuring Scenarios

In the context of the GoB's macroeconomic projections, the combined effect of the adjustments described above is to free up material levels of additional fiscal resources to be directed to the servicing of the public debt over the medium-term.

As part of its ongoing dialogue with the broader bondholder community, the GoB is now applying these additional resources to the framework underpinning the August Indicative Scenarios. The impact of this step is illustrated in the scenarios summarized below (the Revised Indicative Scenarios):

Table: Revised Indicative Restructuring Scenarios

	Revised		Previous	
TYPE	*Par*	*Discount*	*Par (Scenario A)*	*Discount (Scenario C)*
PRINCIPAL REDUCTION	0%	33%	0%	45%
REPAYMENT STYLE	Mortgage	Mortgage	Amortizing	Mortgage
PRINCIPAL GRACE PERIOD	10 years	5 years	15 years	5 years
FINAL TENOR	40 years	30 years	50 years	30 years
COUPON	• 2.75% for 5 yrs; • 4.5% thereafter	• 4.5% for 5 yrs; • 6.75% thereafter	2.0%	3.5%

Next Steps

The GoB will seek feedback on the Revised Indicative Scenarios from bondholders and will remain open to discussing alternative structures that yield comparable levels of debt relief.

The GoB remains determined to place Belize's debt burden firmly and decisively on a sustainable footing, and considers that in order to be sustainable a restructuring of the Superbond must:

- be built upon realistic medium-term macroeconomic projections; and
- close the resulting financing gaps in a manner that is conducive to steadily improving debt dynamics over time.

Further updates on the process will be published periodically on the CBB's website.

Any queries relating to the contents of this Memorandum should be directed to Joseph Waight, Financial Secretary, on +501 822 0367 or at financial.secretary@mof.gov.bz.

Any bondholders who may have acquired the Superbond after the GoB's identification process was undertaken in the second quarter of this year are invited to identify themselves now, either directly to the GoB using the contact details above, or to DF King, the GoB's information agent at belize@dfking.com.