Peruvian Agrarian Debt Bonds HR D (G)

Bond Class A, B & C

Sovereign Debt
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Ratings

Agrarian Debt Bonds	HR D (G)

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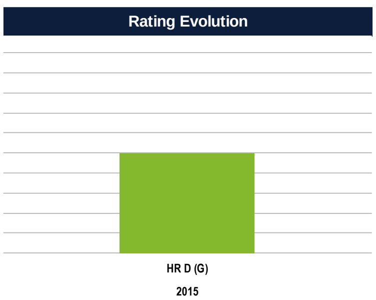

Source: HR Ratings

Definition

The rating of HR D (G) indicates that the issue with this rating has the lowest rating on the global scale. The issue or issuer is susceptible to falling into default in the short term.

HR Ratings has assigned a rating of HR D (G) to the Peruvian Agrarian Debt Bonds, classes A, B & C, issued by Peru.

The rating assigned by HR Ratings is the result of the Peruvian government's failure to make payments on the Bonds in accordance with the original terms of the Bonds. In addition to not making the stipulated formal payments due on the Bonds, hyperinflation has substantially reduced the underlying value of the Bonds as reflected in two changes in the national currency, such that the currency in which the Bonds were originally denominated no longer exists: the first change from "soles de oro" to "intis" in 1985 and then from intis to "nuevo soles" (new soles) in 1991. Furthermore, the current restructuring being offered by the Peruvian government's Ministry of Economy and Finance (MEF) is not committed to making formal payment on all of the outstanding Bonds until two years after the end of the five year registration program and the MEF's proposed compensation formulas eliminate virtually the entire value of the Bonds. **It is important to mention that the analysis performed by HR Ratings centers on the financial performance and payment behavior of the Bonds. Thus, no analysis has been made by HR Ratings regarding the legal validity of the decrees issued by the Peruvian government or the legal actions or consequences of the ongoing process between the Peruvian government and the bondholders.**

The Bonds were originally issued in order to finance the 1969 Agrarian Reform. In the 1980's the Peruvian Government defaulted on the Bonds. However in 1990 the government showed some disposition to pay the Bonds, albeit only at nominal value. A Peruvian Constitutional Tribunal decision in 2001 declared this to be unconstitutional, eventually forcing the government to establish a program to provide compensation to the bondholders at some adjusted value. The process for this compensation has resulted with the issuance of Decree N° 017-2014-EF and Decree N° 019-2014-EF. Based on these decrees, the Peruvian Ministry of Economy and Finance (MEF) established a formula to update the value of the outstanding Bonds.

Agrarian Bonds' Characteristics

Bond Class	A	B	C
Issuer	Peruvian Government		
Maturity date	20 years	25 years	30 years
Outstanding value	$13,285 million soles oro		
Face value	$2,522 million soles oro		
Cupon payment	Annual		
Principal amortization	Yearly payments in equal amounts depending on the bond class' maturity date		
Rate	6.00%	5.00%	4.00%

Source: HR Ratings with information from the Decree N° 17716

Main Factors Considered

Debt Profile

In June 1969, the government of the Republic of Peru, headed by General Juan Velasco Alvarado, issued Decree N° 17716 authorizing a major agrarian reform program in which land was expropriated and then given to peasant families. As compensation for the expropriation the former landholders were given the following classes of Peruvian Agrarian Debt Bonds:

- Class A: with an interest rate of 6% with a 20 year term
- Class B: with an interest rate of 5% with a 25 year term
- Class C: with an interest rate of 4% with a 30 year term

The last Bonds were issued in 1982. Thus it is important to note that according to the original tenor of the Bonds, final payment should have been made on the full amount of the outstanding debt. The Bonds were issued in Peruvian "soles de oro". At the time S/.38.7 soles de oro were worth approximately $1.00 USD. By 1980, the macroeconomic stress faced by Peru led the government to stop all payment on the Bonds. During the decades of the 80's and 90's, Peru's currency lost its value due to hyperinflation. As a result, the Peruvian government on different occasions was forced to issue new versions of its national currency. According to the Peruvian Central Bank, one "sol de oro" is now equivalent to 0.000000001 "nuevo soles" (new soles), thus making the value of the outstanding Bonds virtually disappear. Moreover, the Peruvian National Institution of Statistics and IT does not offer data for the CPI before 1994. Currently, roughly S/.3.18 new soles equals one USD.

During 1991, the Peruvian executive branch issued the Legislative Decree N° 653 requiring that bondholders be compensated based on the market value of their former lands and in cash. This Legislative Decree was later repealed by Law N° 26207 in 1993. In 1996 Decree N° 26597, established that the outstanding Agrarian Bonds be paid in its nominal value plus accrued interest in accordance with the terms of each class of Bonds. This prompted the Peruvian College of Engineers to petition Peru's Constitutional Tribunal to rule the decree unconstitutional. The Constitutional Tribunal ruled in favor of the Peruvian College of Engineers in March 2001. In 2013 the Constitutional Tribunal issued an enforceability declaration in favor of its 2001 ruling. The Constitutional Tribunal also stated that the outstanding value of the Bonds must be indexed to the United States dollar, along with accumulated interest tied to the interest rate on Treasury Bonds. This dollarization methodology conflicts with the Constitutional Tribunal's earlier 2001 ruling and earlier decisions of the Peruvian Supreme Court relating to the Bonds.

In 2006, the Agrarian Commission of the Peruvian Congress estimated that the MEF had placed over $13,285 million "soles de oro" in Agrarian Bonds. The Agrarian Commission also stated that $10,763 million of "soles de oro" had been amortized, representing 81.0% of the issued Bonds.

In January 2014, the MEF issued decrees N° 017-2014-EF and N° 019-2014-EF in which the remaining bondholders were offered a formula to update the value of the outstanding Bonds. These decrees do not adequately provide payment in accordance with the original terms of the bonds or compensate for the degradation of the currency.

This is reflected in the fact that the decrees have met considerable opposition from the bondholders who claim the formula provides an expected payment that accounts for only 0.5% of the current value of the outstanding debt. For example, Peru issued a 1,000,000 Soles Oro Class A Bond on 1970 with a 6% coupon rate and 20 year maturity. We understand that on the basis of the traditional CPI methodology used in Peru, the amount owed under one of these Bonds would now be 16,041,031 Nuevo Soles. However, under the MEF's formulas, the amount would only be 26,662 Nuevo Soles, approximately 0.17% of the amount owed under the alternative CPI methodology.

Furthermore, Supreme Decree N° 017-2014-EF also established a payment priority for holders of the Bonds, which priority was not incorporated into the Bonds as originally issued. The priorities are as follows: first, natural persons who are the original bondholders (or heirs) and are 65 years old or older; second, natural persons who are the original bondholders (or heirs) and are younger than 65 years old; third, natural personas who are not the original bondholders and are 65 years old or older; fourth, natural persons who are not the original bondholders and are younger than 65 years old; fifth, legal entities that are original bondholders; sixth, legal entities that are not original bondholders and who have acquired the Bonds as payment obligations; and seventh, legal entities that are not original bondholders and acquired the debt for speculative purposes.

According to another limitation, in order to participate in the program the bondholder must relinquish all rights to seek recovery pursuant to judicial proceedings. In addition, the MEF reserves the right to determine the method and timing of payment as well as making the payment conditional upon the achievement of deficit objectives. These decrees also established that the bondholders have up to five years to register their bonds to participate in the program and to have their authenticity determined by the MEF. Upon authentication, the MEF has 2 years to pay the value estimated by the formula.

All the above imply that the total outstanding debt remains unpaid or has not been restructured and places in doubt whether the outstanding balance will be paid in accordance with the original terms and with a reasonable adjustment for inflation; hence, justifying the rating of HR D (G) assigned by HR Ratings.

Payment Analysis

As of this moment, the total of the principal and interest corresponding to the Peruvian Agrarian Debt Bonds has not been paid completely, thus effectively making the credit quality of the Bonds as "default". This is based on the fact that for HR Ratings, a default is a failure to meet prescribed obligations on a timely basis and in the manner to which the parties had originally agreed. Thus, as full payment has not been made as of this time, the Bonds are in default.

It is important to mention that the analysis performed by HR Ratings centers on the financial performance and payment behavior of the Bonds. Thus, no analysis has been made by HR Ratings regarding the legal validity of the decrees issued by the Peruvian government or the legal actions or consequences of the ongoing process between the Peruvian government and the bondholders.

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General Methodology Criteria, July 2015
Sovereign Debt Methodology, September 2012

For more information with respect to this (these) methodology (ies), please consult the website:
www.hrratings.com/en/methodology

Complementary information in accordance with section V, paragraph A) of Annex 1 of the General Provisions applicable to Credit Rating Agencies.	
Previous Rating	N.A.
Date of the last Rating Action	N.A.
Period of the financial information used by HR Ratings for the assignment of the current rating.	N.A.
Main sources of information used, including third parties	Information contained in bonosagrarios.pe
Ratings assigned by other rating agencies that were used by HR Ratings (if so).	N.A.
HR Ratings considered at the moment of assigning or reviewing the rating, the existence of mechanisms designed to align the incentives between the originator, servicer and guarantor and the possible buyers of the rated instrument (where it applies)	N.A.

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