

REVISED FISCAL PLAN FOR PUERTO RICO



AS SUBMITTED TO THE FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR
PUERTO RICO



DISCLAIMER

The Puerto Rico Fiscal Agency and Financial Advisory Authority (“AAFAF”), the Government of Puerto Rico, its instrumentalities and agencies (the “Government”), and each of their respective officers, directors, employees, agents, attorneys, advisors, members, partners or affiliates (collectively, with AAFAF and the Government, the “Parties”) make no representation or warranty, express or implied, to any third party with respect to the information contained herein and all Parties expressly disclaim any such representations or warranties. The Government has had to rely upon preliminary information and unaudited financials for 2017 and 2018 in addition to the inherent complexities resulting from a prolonged period of lack of financial transparency. As such, AAFAF and the Government have made certain assumptions that may materially change once those financial statements are fully audited. The Government published audited financials for 2016 on May 2019.

The Parties do not owe or accept any duty or responsibility to any reader or recipient of this presentation, whether in contract or tort, and shall not be liable for or in respect of any loss, damage (including without limitation consequential damages or lost profits) or expense of whatsoever nature of such third party that may be caused by, or alleged to be caused by, the use of this presentation or that is otherwise consequent upon the gaining of access to this document by such third party. The Parties do not undertake any duty to update the information contained herein.

This document does not constitute an audit conducted in accordance with generally accepted auditing standards, an examination of internal controls or other attestation or review services in accordance with standards established by the American Institute of Certified Public Accountants (CPA) or any other organization. Accordingly, the Parties do not express an opinion or any other form of assurance on the financial statements or any financial or other information or the internal controls of the Government and the information contained herein.

Any statements and assumptions contained in this document, whether forward-looking or historical, are not guarantees of future performance and involve certain risks, uncertainties, estimates and other assumptions made in this document. The economic and financial condition of the Government and its instrumentalities is affected by various legal, financial, social, economic, environmental, governmental and political factors. These factors can be very complex, may vary from one fiscal year to the next and are frequently the result of actions taken or not taken, not only by the Government, but also by Financial Oversight and Management Board for Puerto Rico and other third-party entities such as the government of the United States. Examples of these factors include, but are not limited to:

- Any future actions taken or not taken by the United States government related to Medicaid;
- The amount and timing of receipt of any distributions from the Federal Emergency Management Agency (FEMA), U.S. Department of Housing and Urban Development (HUD)’s Community Block Development Grant-Disaster Recovery Program and private insurance companies to repair damage caused by Hurricanes Irma and Maria (“Hurricanes”);
- The amount and timing of receipt of any additional amounts appropriated by the United States government to address the funding gap described herein;
- The timeline for completion of the work being done by the Puerto Rico Electric Power Authority (“PREPA”) to repair PREPA’s electric system and infrastructure and the impact of any future developments or issues related to PREPA’s electric system and infrastructure on Puerto Rico’s economic growth;
- The impact of the measures described herein on outmigration; and
- The impact of the resolution of any pending litigation in the Title III cases

Because of the uncertainty and unpredictability of these factors, their impact cannot be included in the assumptions contained in this document. Future events and actual results may differ materially from any estimates, projections, or statements contained herein. Nothing in this document should be considered as an express or implied commitment to do or take, or to refrain from taking, any action by AAFAF, the Government, or any government instrumentality in the Government or an admission of any fact or future event. Nothing in this document shall be considered a solicitation, recommendation or advice to any person to participate, pursue or support a particular course of action or transaction, to purchase or sell any security, or to make any investment decision.

By receiving this document, the recipient shall be deemed to have acknowledged and agreed to the terms of these limitations. This document may contain capitalized terms that are not defined herein, or may contain terms that are discussed in other documents or that are commonly understood. You should make no assumptions about the meaning of capitalized terms that are not defined, and you should refer questions to AAFAF (Fiscalplanforpuertorico@aaaf.pr.gov) should clarification be required.

List of Acronyms and Key Terms

AAFAF	Puerto Rico Fiscal Agency and Financial Advisory Authority (Spanish acronym)
ACA	Affordable Care Act
Administration	Administration of Governor Wanda Vázquez
AMT	Alternative Minimum Tax
ASEM	Medical Services Administration
ASES	Puerto Rico Health Insurance Administration (Spanish acronym)
ASG	General Services Administration (Spanish acronym)
BBA	Bipartisan Act of 2018
BLS	Bureau of Labor Statistics
CBO	Congressional Budget Office
CDBG-DR	Community Development Block Grant Disaster Recovery
CHIP	Children's Health Insurance Program
CIT	Corporate Income Tax
CMS	Centers for Medicare and Medicaid Services
COFINA	Puerto Rico Sales Tax Financing Corporation (Spanish acronym)
COR3	Central Office of Recovery, Reconstruction, and Resiliency
CPA	Certified Public Accountant
CPI-U	Consumer Price Index for all Urban Consumers
CPO	Chief Procurement Officer
CRIM	Municipal Revenues Collection Center
CU	Component Unit
DDD	Damage, Description, and Dimension
DDEC	Puerto Rico Department of Economic Development Commerce (Spanish acronym)
DHS	Department of Homeland Security
DOH	Department of Health
DOL	Department of Labor
DPR	Discover Puerto Rico
DRG	Diagnosis-Related Group
DRF	Disaster Relief Fund
DSA	Debt Sustainability Analysis
EITC	Earned Income Tax Credit
ERS	Employee Retirement System
FCE	Fixed Cost Estimate
Federal Government	The U.S. Federal Government
FEMA	Federal Emergency Management Agency
FMAP	Federal Medical Assistance Percentage
FOMB	Financial Oversight and Management Board for Puerto Rico
FQHC	Federally Qualified Health Center
GDB	Government Development Bank for Puerto Rico
GDP	Gross Domestic Product
GHP	Government Health Plan
GNP	Gross National Product
GO	General Obligation
Government	Government of Puerto Rico
Governor	Governor Wanda Vázquez
Hacienda	Puerto Rico Department of Treasury
HUD	U.S. Department of Housing and Urban Development
Hurricanes	Hurricane Irma and Hurricane Maria
IA	Individual Assistance
IPEDs	Integrated Postsecondary Education Data System
IFCU	Independently Forecasted Component Units
IMF	International Monetary Fund
iPR	Invest Puerto Rico
IRS	Internal Revenue Service
Island	Puerto Rico
JRS	Judicial Retirement System
LEA	Local Education Agency
MADS	Maximum Annual Debt Service
March 2017 Fiscal Plan	Fiscal Plan certified by the Financial Oversight and Management Board in March 2017, before Hurricanes Irma and Maria hit the Island
MCOs	Managed Care Organizations
Mi Salud	Medicaid program in Puerto Rico
MOU	Memorandum of Understanding

MTA	Maritime Transportation Authority
NAP	Nutrition Assistance Program (Spanish: Programa de Asistencia Nutricional, PAN)
NOAA	North Oceanic and Atmospheric Administration
NRW	Non-Resident Withholdings
OCFO	Office of the CFO
OATHR	Office of the Administration and Transformation of Human Resources
OMB	Office of Management and Budget
OPEB	Other Post-Employment Benefits
O&M	Operations and Maintenance
P3	Public Private Partnerships
PA	Public Assistance
PAN	Nutritional Assistance Program
Parties	AAFAF and the Government
PayGo	New pensions program by which agencies and instrumentalities are responsible for paying their pensions obligations on an annual basis via a "PayGo Charge"
PBA	Public Building Administration
PDL	Prescription Drug List
PFC	Public Finance Corporation
PIT	Personal Income Tax
Platino	Medicare Advantage program that also provides Medicaid wraparound services equivalent to Mi Salud program
PMGs	Primary Medical Groups
PMPM	Per Member Per Month
POA	Plan of Adjustment
PRPA	Puerto Rico Ports Authority
PRPL	Puerto Rico Poverty Level
PRASA	Puerto Rico Aqueduct and Sewer Authority
PRCCDA (CCDA)	Puerto Rico Convention Center District Authority
PRDE	Puerto Rico Department of Education
PREPA	Puerto Rico Electric and Power Authority
PRHTA (or HTA)	Puerto Rico Highways and Transportation Authority
PRIFA	Puerto Rico Infrastructure Financing Authority
PROMESA	Puerto Rico Oversight, Management and Economic Stability Act
RFQ	Request for Qualifications
SBP	Single Business Portal
SEA	State Educational Agencies
SNAP	Supplemental Nutrition Assistance Program
SPA	State Plan Amendment
SURI	Internal Revenue Unified System
SUT	Sales and Use Tax
STEM	Science, Technology, Engineering and Math
TANF	Temporary Assistance for Needy Families
TIGTA	The Treasury Inspector General for Tax Administration
TRS	Teachers' Retirement System
T&D	Transmission and Distribution
UPR	University of Puerto Rico
USGS	United States Geological Survey
WCF	Working Capital Fund
WIOA	Workforce Innovation and Opportunity Act
WIPR	Puerto Rico Public Broadcasting Corporation
VTP	Voluntary Transition Program
V2A	Vision to Action

Table of Contents

<i>Executive Summary</i>	7
PART I: Enactment of PROMESA	22
<i>Chapter 1. Long-Term Economic Trends</i>	22
<i>Chapter 2. Enactment of PROMESA and Fiscal Plan Process</i>	23
PART II: Natural Disasters and Ensuing Disaster Relief Funding	25
<i>Chapter 3. Natural Disasters</i>	25
3.1 Hurricanes Irma & Maria	25
3.2 Earthquakes	26
<i>Chapter 4. Disaster Relief Funding</i>	28
4.1 Disaster Relief Working Capital Fund.....	33
Part III: Structural Reforms	34
<i>Chapter 5. Summary of Structural Reforms</i>	34
5.1 Human Capital and Welfare Reforms	34
5.2 Ease of Doing Business Reforms	35
5.3 Power Sector Reforms	37
5.4 Infrastructure Reform	37
Part IV: New Government Model	43
<i>Chapter 6. Revenue Enhancements</i>	43
6.1 Tax Reform.....	43
6.2 Tax Compliance and Fees Enhancements	44
<i>Chapter 7. Reinvestment in Puerto Rico to Ensure Prosperity</i>	48
7.1 Uniform Remuneration Plan for Career Government Employees (Excludes At-Will or “Confianza” Employees)	48
7.2 Puerto Rico Police Department Retirement.....	49
7.3 Act 29-2019	49
7.4 Disaster Relief Working Capital Fund.....	50
7.5 Parametric Insurance	50
7.6 Government’s Centralized Procurement Act of 2019 (Act 73-2019)	51
<i>Chapter 8. Fiscal Measures</i>	52
8.1 Agency Efficiencies	53
8.2 Reduction of Appropriations	60
Part V: Fiscal Plan Forecast – Macroeconomic and Financial Outputs	63
<i>Chapter 9. Macroeconomic and Demographic Trajectory Post-Maria</i>	63
9.1 Economic Outlook	64
<i>Chapter 10. Fiscal Plan Financial Projections</i>	67
10.1 Baseline Revenue Forecast	68
10.2 Baseline Expenditure Forecast	72
<i>Chapter 11. Fiscal Risks</i>	80
Part VI: Debt Restructuring Progress, Commonwealth Plan of Adjustment and Debt Sustainability Analysis (DSA)	83
<i>Chapter 12. Debt Sustainability Analysis</i>	83

Part VII: Conclusion..... 89
VIII. Appendix..... 90
 Appendix A. Legislation and Executive Order 90
 Appendix B. Interagency Agreements.....90

EXECUTIVE SUMMARY

Background and Context for Restructuring

The people of Puerto Rico need and deserve plentiful good jobs, a dynamic and prosperous economy, affordable and reliable electricity, and an efficient and responsive public sector. Since 2005, the number of people living under the poverty level has increased, the economy has shrunk, and electricity has remained expensive and unreliable. These problems predate Hurricanes Irma and Maria and the recent earthquakes and will continue to plague Puerto Rico long after it recovers from these natural catastrophes unless the necessary actions are taken.

The 2020 Fiscal Plan updates and builds upon the reforms and fiscal measures presented in prior fiscal plans. The goal of this fiscal plan remains committed to achieving for the US citizens of Puerto Rico an effective and efficient public sector, which will put Puerto Rico on the pathway to achieving fiscal responsibility and regaining access to the capital markets¹.

* * *

For over a decade, Puerto Rico has experienced a severe fiscal and economic crisis. Since 2006, Puerto Rico's real gross national product (GNP) has shrunk by more than 19.0% as of 2019. Over 44.9% of Puerto Rico residents live in poverty, more than double the highest poverty rate of any U.S. state.² Puerto Rico's 8.4% unemployment rate is over 2.4x the national average as of December 2019.³ This has resulted in a historic population outmigration. Over the past decade, more than 500,000 people have left Puerto Rico. The impact of Hurricanes Irma and Maria and the recent earthquakes, albeit to a lesser extent, accelerated this trend, with an additional 80,000 people expected to leave Puerto Rico by fiscal year 2024.

Puerto Rico's unfair and inequitable treatment as an unincorporated territory has been a driving factor causing the Puerto Rico (Island)'s precipitous economic decline. Puerto Rico is treated unequally under key federal programs such as Medicaid compared to U.S. states. For example, the Census Bureau reported in 2014 that Oregon—a relatively prosperous state with a population size similar to Puerto Rico—received over \$29 billion from The U.S. Federal Government ("Federal Government"), whereas Puerto Rico received only \$19 billion for the same year. Puerto Rico's unequal treatment under federal economic assistance programs is also one of the primary causes of the severe income disparity between Puerto Rico and U.S. mainland residents. In 2018, the median household income of Puerto Rico residents was \$20,296, which was approximately 67% less than the U.S. median income of \$61,936⁴. As a result of this disparate treatment, Puerto Rico residents have migrated to the U.S. mainland in unprecedented numbers, leaving Puerto Rico with a diminished workforce.

Indeed, the most important and critical structural reform for Puerto Rico is a permanent solution to its territorial status.

The solution to these inequalities is statehood for Puerto Rico. Although it is the 34th most populated region of the United States, Puerto Rico has no voting representation in Congress. If admitted as a U.S. state, Puerto Rico likely would have two Senators and four Representatives in Congress, similar to states such as Connecticut and Iowa that have comparable populations. As a

¹ Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA)

² US Census Bureau

³ US DOL Bureau Labor of Statistics

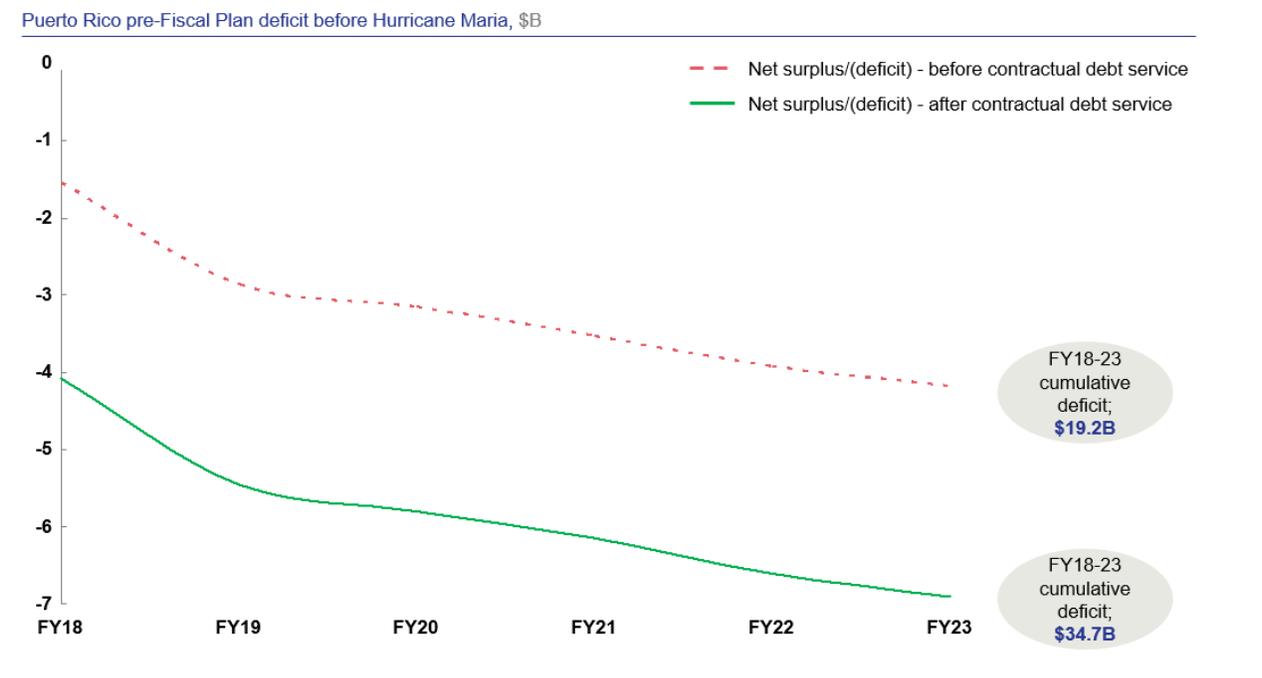
⁴ Data USA (U.S. Government Data Platform)

result, Puerto Rico residents could shape federal legislation and receive equal treatment under federal laws, thereby eliminating the primary benefits of moving to the U.S. mainland. Statehood, therefore, is the best way for Puerto Rico to stop outmigration, increase the on-Island workforce, and grow Puerto Rico’s economy.

These pre-Maria problems are not new and temporary – they are long-standing and structural. For decades, the private sector was overly reliant on now expired Federal tax advantages while having to operate in a difficult business climate with poor infrastructure, especially expensive and unreliable electricity and transit systems, a public sector that is significantly larger than the size of the typical U.S. state yet often has provided poor service.

Puerto Rico has also had structural and fiscal imbalances for years, with actual revenues lower and actual expenses higher than projected, creating a growing general fund deficit (**Exhibit 1**). Puerto Rico has also been in an economic structural decline for over a decade, which has meant an eroding tax base. Therefore, even before Maria, the primary deficit was growing consistently and considerably. To finance these primary deficits, Puerto Rico resorted to issuing debt which steadily became unsustainable.

EXHIBIT 1: PROJECTED PRE-MARIA DEFICIT BEFORE MEASURES AND STRUCTURAL REFORMS (PRE- AND POST- CONTRACTUAL DEBT SERVICE)



It was amidst the protracted demographic, fiscal, and debt crises that Hurricanes Irma and Maria hit the Island. Hurricane Maria has caused unprecedented and catastrophic damage to Puerto Rico, its people, and its businesses. According to current estimates, Hurricane Maria has created over \$80 billion in damages, and has caused a real decline to GNP of 4.7% in FY2018. On the other hand, approximately \$73 billion in Federal dollars and \$8 billion in private insurance proceeds are estimated to be invested to help helping Puerto Rico recover and rebuild from Hurricane Maria. The 2020 Fiscal Plan is prepared assuming this support from the Federal Government, even though there have been substantial and unwarranted delays in receiving this aid. This aid is projected to create temporary fiscal surpluses over the next several years but will not change the underlying structural problems Puerto Rico faces.

While Puerto Rico faces execution risk associated with the implementation of certain measures, the Government continues committed to executing a series of bold actions to improve its fiscal and economic trajectory. These reforms and measures are essential to making the Government more efficient and responsive.

On May 3, 2017, the Oversight Board—at the request of the former Governor—commenced a debt adjustment proceeding for the Commonwealth of Puerto Rico by filing a petition for relief under Title III of PROMESA in the United States District Court for the District of Puerto Rico. Since then, the Oversight Board—at the request of the Governor—has similarly commenced Title III proceedings for five additional Government instrumentalities and public corporations, including the Puerto Rico Sales Tax Financing Corporation (“COFINA”), Puerto Rico Highways and Transportation Authority (HTA), Employee Retirement System (ERS), PREPA, and Public Building Administration (PBA). During the Title III proceedings, the Oversight Board has insisted on imposing cost-saving measures and budgets—including a pension cut that it seeks to implement through a plan of adjustment (POA)—that would under-invest in Puerto Rico’s economy and will not ameliorate its fundamental problems. At every turn, the Government has rejected all pension cut proposals on the basis that reducing pension benefits would unfairly harm a group of Puerto Rico’s most vulnerable citizens—its pensioners—and, therefore, is not in the best interests of the people of Puerto Rico. In addition, the Government and the Oversight Board have been engaged in costly, prolonged litigation with certain creditor groups regarding the validity and scope of their liens, which at times has delayed the progress of the Title III cases generally. In light of the substantial costs, the Government is highly motivated to seek a full and just resolution that will extract Puerto Rico from the Title III process, but will also only accept a resolution based on fundamental fairness and justice for the people and Puerto Rico and its pensioners, who have already endured great suffering as a consequence of recent natural disasters. In addition, the Commonwealth’s cash position upon emergence from Title III will be dictated by the effective date of any confirmed plan of adjustment and, to the maximum extent possible, the Government believes it should utilize any excess available resources after such effective date to reinvest in areas earmarked as the most critical to Puerto Rico’s future economic growth. The Government’s goal is to utilize the Title III process to truly unlock Puerto Rico’s potential and create a robust economy that leaves no one behind.

Unique Opportunity to Restore Prosperity

For over a decade, Puerto Rico has experienced a severe fiscal and economic crisis caused by a multitude of compounding factors. However, the current situation provides Puerto Rico a unique opportunity to return to prosperity through the enactment of PROMESA and receipt of billions of dollars of federal Disaster Relief Funding programs.

Enactment of PROMESA

In 2016, Congress stepped in to address Puerto Rico’s financial crisis by passing the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) in an effort to provide a tool to guide the Government to restructure its debt. PROMESA imposed an automatic stay on Puerto Rico’s debt obligations and created the Financial Oversight and Management Board for Puerto Rico (FOMB or Oversight Board). Puerto Rico continues to benefit from a temporary reprieve from debt service achieved through the automatic stay, which allows the Government additional time and funding to change the underlying economic foundations and prepare for a fiscally responsible future.

Natural Disasters and Ensuing Disaster Relief

On September 6, 2017 and September 20, 2017 – amidst the protracted demographic, fiscal, and economic crises – Hurricanes Irma and Maria struck Puerto Rico. The hurricanes caused unprecedented and catastrophic damage to the Island, its people, and its businesses. According to current estimates, Hurricane Maria has created over \$80 billion in damages, and caused a real decline to GNP of 4.7% in FY2018. It is the largest response in the U.S. history and certainly the most complicated.

Furthermore, on December 28, 2019, the first of many earthquakes shook Puerto Rico and its residents. Since then, there have been more than 400 earthquakes of magnitude 2 or greater, including the most destructive earthquake in a century with a magnitude of 6.4 on the Richter scale. One death was reported, followed by a total of 4,575 refugees, approximately 790 damaged houses, and more than \$460 million preliminary/partial estimates in damages as a result of the earthquakes.

There is no question that these natural disasters have been absolutely devastating to the Island and its people. However, the resulting Federal Funding through the Federal Government's Disaster Relief Programs presents a unique opportunity to properly rebuild the infrastructure of Puerto Rico enabling the Island to return to prosperity. The disaster relief spending will positively impact the economy of Puerto Rico in two ways:

- Short-term impact: there is expected to be a short-term stimulative impact caused by spending on the Island. This stimulus will come in multiple forms, such as construction companies hiring local, unemployed workers, or workers from the mainland U.S. paying local withholding taxes and spending money for food and lodging.
- Long-term impact: If managed effectively, Puerto Rico can utilize the billions of dollars of Federal Funding provided as a result of the natural disasters to not only fix the direct damage caused by the storm, but to restore the Island's diminishing infrastructure to meet high quality standards. Additionally, the funding provides runway for implementing structural reforms and reorganizing the Government to more efficiently provide services to the people of Puerto Rico at a lower cost.

Progress and Ongoing Efforts

Over the last three years, Puerto Rico has made significant progress in the implementation of Structural Reforms, Fiscal Measures and Debt Restructurings. The impact of these Government initiatives is already paying off with improvement in the private sector labor market which is net positive over the last three years.

Structural Reforms

- Achievements to Date:
 - *Human capital and welfare reform*: Private labor reform began in 2017 through the Labor Transformation and Flexibility Act, the most comprehensive change in labor laws in the last 50 years. This Act amended several labor legislations with the intention of improving labor market competitiveness, enhancing the labor participation, and limiting employee turnover. Notable changes aimed at reducing employment-related costs such as: increasing minimum probation period, amending accrual of vacation leave and adjusting Christmas bonus criteria, among others. The Act also facilitates "Flexible Work Schedules" and eliminates "Ley de Cierre" restrictions.

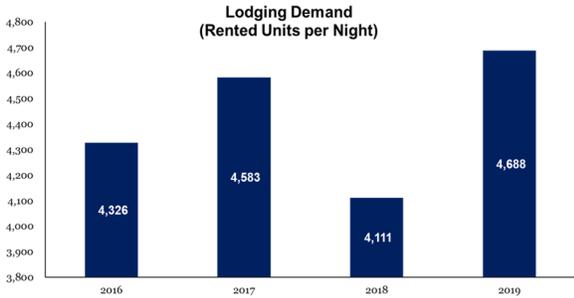
- As part of the Human Capital & Welfare Reform the Government proposed an Earned Income tax Credit (EITC) to facilitate that individuals enter the formal labor force. In order to qualify, the individual must meet certain criteria and file their annual tax return; the EITC reduces the amount of taxes owed and could result in a cash refund if the benefits surpass the taxes owed. The Department of Treasury has already included the EITC Section for the upcoming Tax Season (April 2020), and rolled out an extensive promotional plan on January 1st, 2020 in order to educate the public and promote participation.
 - During Fiscal Year 2019, a Memorandum of Understanding (MOU) was drafted between the Department of Labor (DOL) and Human Resources and the Puerto Rico Department of Economic Development Commerce (DDEC)/PRIDCO to develop apprenticeship programs. A separate MOU was drafted between the University of Puerto Rico (UPR) and DDEC/PRIDCO for continued education programs.
- *Ease of doing business reform:* The Government has ongoing efforts to digitize government services to improve speed and accessibility through the Single Business Portal (SBP) launched in July 2018, which currently includes an online filing system for defined Acts (Acts 14, 20 and 22), but will ultimately consolidate permit requests, filing for incentives and annual reporting on these.
- *Power sector reform:* In January 2018, the Government of Puerto Rico announced its intent to transform and modernize the electric system through private operation or ownership of the assets of the Puerto Rico Electric Power Authority (PREPA). In the context of the proposed transformation, the Puerto Rico Public-Private Partnerships Authority (P3A) is conducting a procurement process to select a private operator under an Operation and Maintenance (O&M) agreement for PREPA's transmission and distribution (T&D) system. The prospective transformation of PREPA-owned generation assets may involve a similar O&M agreement, a sale, lease, concession or other similar structures. The Government has advanced the process of selecting a proponent for the O&M agreement that will be responsible for the operation of the transmission and distribution operation. Selection will be announced by the end of second calendar quarter with a transition period following. A preliminary target date for the completion of the transformation process for the generation assets is by December 2020.
- *Tourism sector revitalization:* Through its initiatives, Discover Puerto Rico (DPR) has accomplished measurable results for Puerto Rico, such as a 115% increase in internet searches for San Juan compared to 2018, the designation as a top travel destination in 22 leading travel and lifestyle publications in 2019, the direct and indirect employment of 80,000 people in Puerto Rico, a 6.5% contribution to the Island's Gross Domestic Product (GDP) from the tourism sector and additional contributions to 17 other sectors of the economy. Additionally, Puerto Rico saw a significant increase in lodging demand and airport arrivals during 2019 achieving

a record performance (**Exhibit 2**). These achievements contribute significantly to the Puerto Rican economy with an estimated \$98 economic impact and \$7 generated tax contribution for every \$1 invested by DPR.

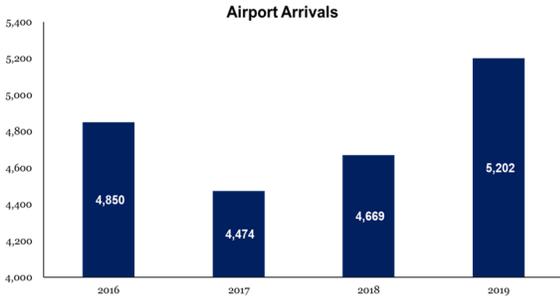
EXHIBIT 2: LODGING DEMAND AND AIRPORT ARRIVALS

Visitor demand, measures in rented unit nights, exceeded 2018 levels by 14%, an all-time record performance.

Airport arrivals increased by 7.3% from 2016 to 2019.



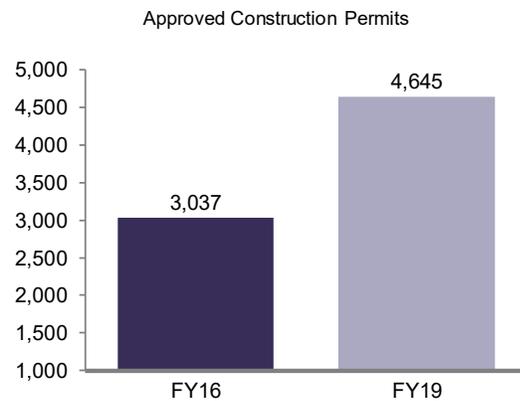
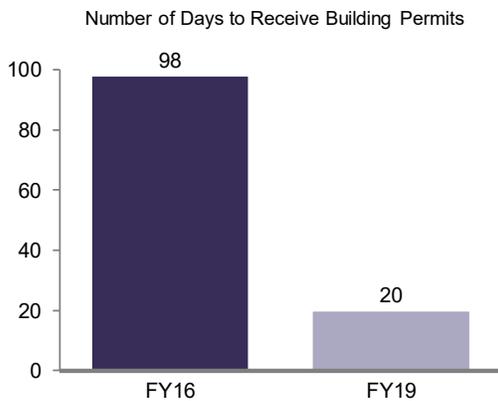
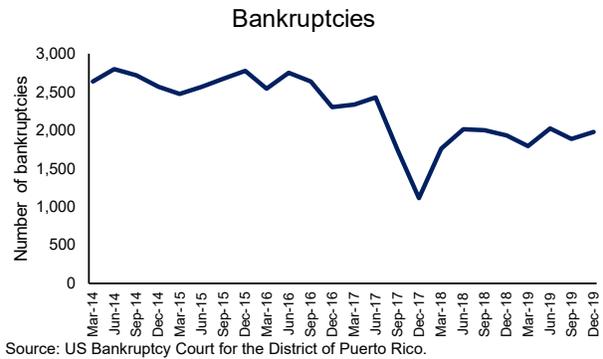
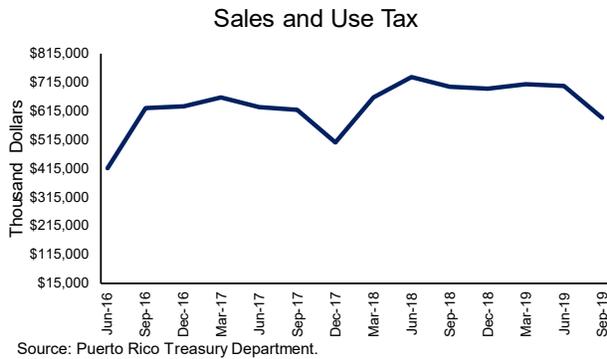
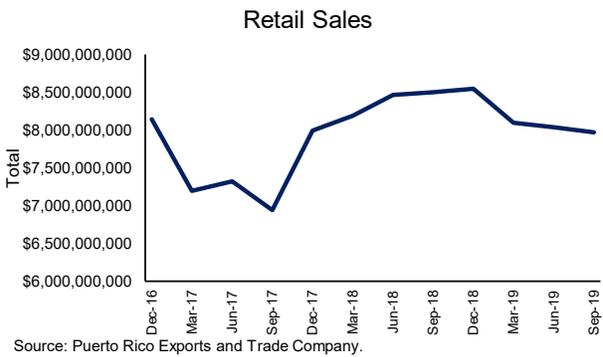
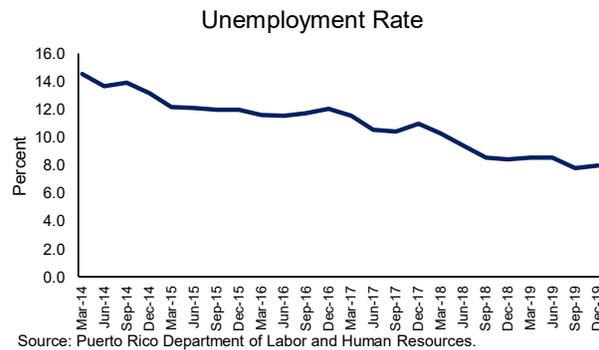
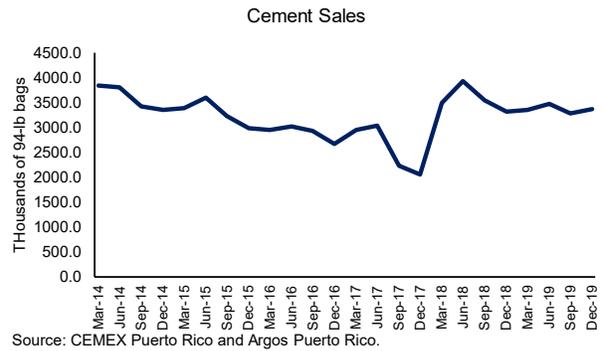
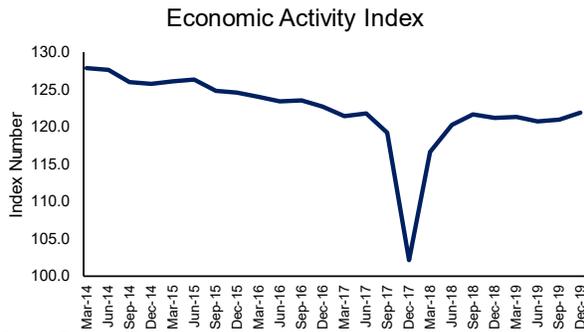
Source: STR, AirDNA



Source: Aerostar, Ports Authority

- *Economic Recovery*: While the hurricanes in late 2017 affected virtually all aspects of the economy sharply and negatively, there are signs of a recovery. Key economic indicators as shown in (**Exhibit 3**) all point to a strengthening economy. Cement sales, an important measure of economic activity, reflects increased activity since late 2017. Unemployment rate has been steadily declining, while retail sales have rebounded. Sales and use tax collections are strong, currently performing above 2016-17 levels, bankruptcies continue a downward trend, and approved construction permits have increased.

EXHIBIT 3: KEY ECONOMIC INDICATORS

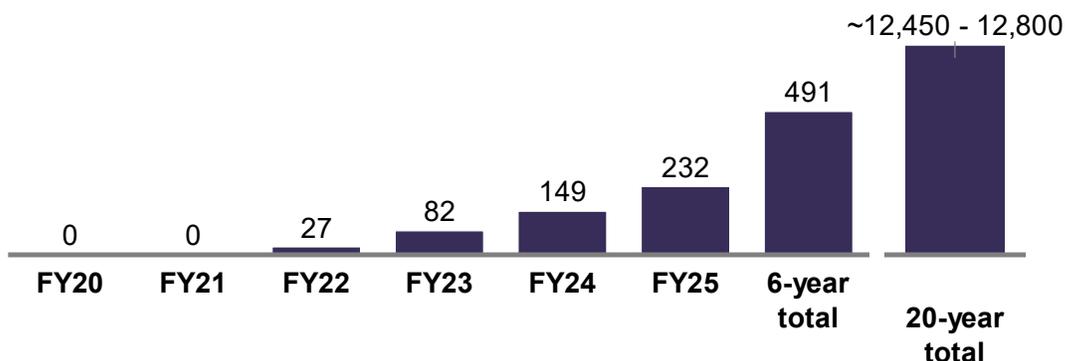


Sources:
 Fortaleza: Number of days to Receive Building Permits
 OGPE SBP Historical Database: Approved Construction Permits

- **Ongoing Efforts:** The 2020 Fiscal Plan maintains the following structural reforms that will improve the economy and drive long term GNP growth by a cumulative 0.85% (**Exhibit 4**):
 - *Human capital and welfare reform:* promoting participation in the formal labor force by creating incentives to work through EITC benefits and welfare reform and providing comprehensive workforce development opportunities. These measures are projected to increase economic growth by 0.15% by FY2025.
 - *Ease of doing business reform:* promoting economic activity and reducing the obstacles to starting and sustaining a business in Puerto Rico through comprehensive reform to improve ease of paying taxes, importing and transporting goods, registering property, and obtaining permits. These reforms are projected to drive a 0.40% uptick in overall growth by FY2025, with annual upticks of 0.20% in FY2022 and FY2023.
 - *Power sector reform:* providing low-cost and reliable energy through the transformation of PREPA and establishment of an independent, expert, and well-funded energy regulator. This is projected to increase growth by 0.30% by FY2025 with incremental annual upticks of 0.10% from FY2022 to FY2024. The Government has advanced the process of selecting a proponent for the O&M agreement that will be responsible for the operation of the transmission and distribution operation. Selection will be announced by the end of first calendar quarter with a transition period following.
 - *Infrastructure reform:* prioritizing economically transformative capital investments with Federal funds and launching maintenance and infrastructure investment policies including utilizing the P3A to deliver projects efficiently and effectively.

EXHIBIT 4: IMPACT OF STRUCTURAL REFORMS

Impact of structural reforms, \$M



Fiscal Measures

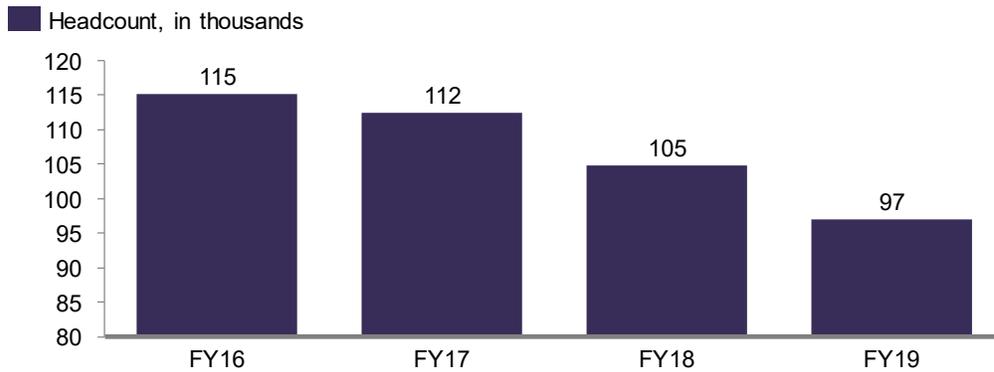
Thanks to sound financial discipline coupled with a clear a set of priorities, the Government has consistently reduced expenses that have allowed to ensure that all pensioners receive their pension payments.

- Achievements to Date:

- *Operating expense reduction:* The Government’s fiscal discipline has resulted in a cumulative headcount reduction of ~ 18,000 employees, the majority of which were non-critical, back-office functions, from FY2016 to FY2019 via natural attrition and early retirement and voluntary transition programs (**Exhibit 5**). This has resulted in a reduction of Payroll expenses of over 19% over this time period. Additionally, non payroll operating expenses have been reduced by over \$1 billion or 20% over the same period (**Exhibit 6**). This has made possible the payment of pension benefits (PayGo) to all retirees reflecting the moral obligation and priority of this Administration to pensioners.

EXHIBIT 5: GOVERNMENT HEADCOUNT REDUCTIONS

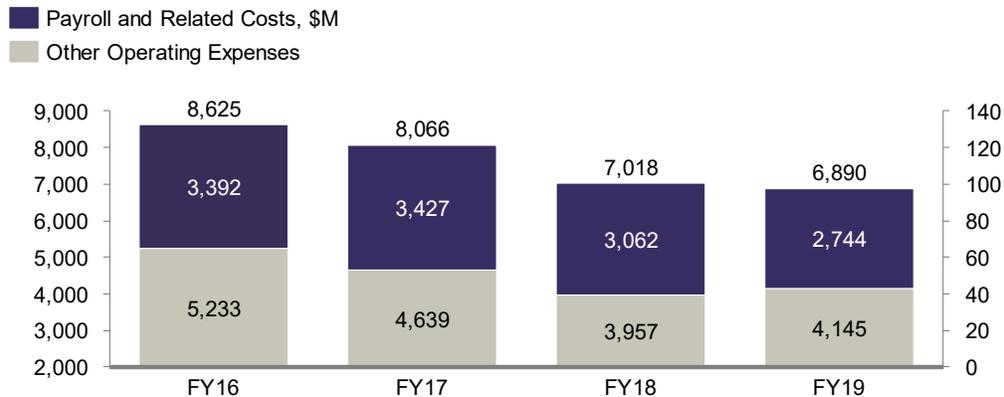
Government Headcount Reduction



Source: OMB

EXHIBIT 6: GENERAL FUND EXPENSES

General Fund Expenses

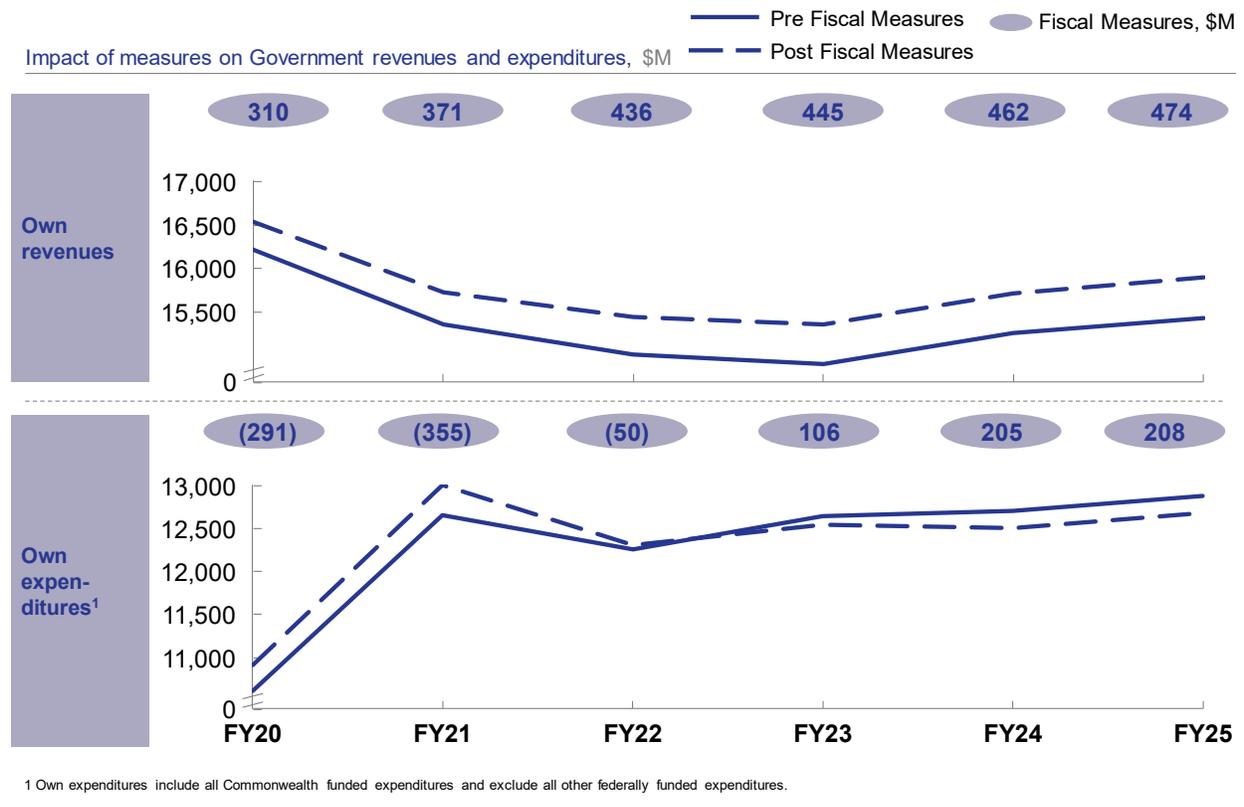


Figures above exclude Paygo Costs and Debt Payments
 FY2019 figures are estimates; FY2020 figures budgeted
 Source: OMB

- *Agency Consolidations:* 10 Reorganization Plans have been passed to date in order to reorganize the Government and reduce public spending while providing similar or better services to the people of Puerto Rico (**Appendix A**).
- *Healthcare reform:* The Government has completed the implementation of initiatives that will help control healthcare cost inflation through the launch of the new managed care model, pharmacy reimbursement reform, lowering prescription drug cost inflation by effectively managing the Prescription Drug List (PDL) and sharing coordination of benefits data with Managed Care Organizations (MCOs). In addition, the Puerto Rico Health Insurance Administration (“ASES”) is continuing the design and implementation of the Diagnosis Related Group (DRG) inpatient hospital payment reform that will establish the foundation for additional value based payment models.
- *Procurement Reform:* The Government is in the process of creating a Centralized Procurement Office to increase the efficiency of its procurement activities in accordance with Act 73-2019, the Government Centralized Procurement Act.
- **Ongoing Efforts:** The 2020 Fiscal Plan includes a set of fiscal measures to reduce expenditures and optimize Government revenues (**Exhibit 7**):
 - *Agency efficiencies:* Consolidating agencies, instituting shared services programs and incorporating best practices to deliver better government services at lower costs including increased buying power through centralization of procurement function across government agencies. Consistent with the methodology assumed with savings targets, the 2020 Fiscal Plan assumes a delay in implementation of incremental measures to afford the Government adequate time to identify additional savings in an efficient and responsible manner. As such, certain consolidations/ reorganizations will occur later than anticipated in the May 9, 2019 Certified Fiscal Plan

- *Reduction of appropriations:* Lowering the fiscal burden on the General Fund by slowly reducing appropriations to municipalities and the University of Puerto Rico.
- *Enhancing tax compliance:* Employing new technology and other innovative practices to broaden the tax base, reduce fraud, and improve fairness to boost overall tax revenues.

EXHIBIT 7: IMPACT OF REVENUE AND EXPENSE MEASURES ON OWN REVENUES AND EXPENDITURES



Natural Disaster Recovery Efforts

The Central Office of Recovery, Reconstruction and Resiliency (“COR3”) achievements have focused on establishing institutional capacity and accelerating the obligation process of permanent work to start the rebuilding process.

- Achievements to Date:
 - Creation of COR3 as centralized oversight authority with sufficient capacity, as required by Presidential Disaster Declaration Post Maria.
 - Engagement of third-party experts on grant management, project formulation, compliance services and data services.
 - Establishment of unprecedented transparency and accountability measures for FEMA disaster relief funding including, without limitation, transparency portal, Fraud-Waste-Abuse Hotline, sub-recipient monitoring, risk-based compliance, and internal controls.

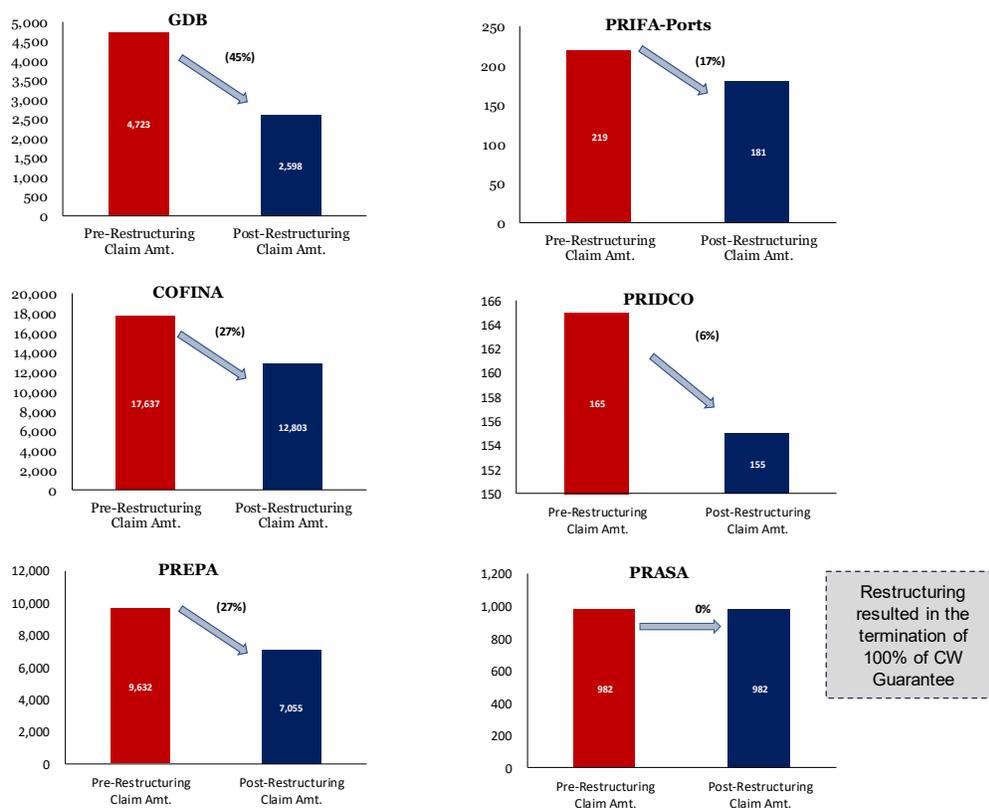
- *Elimination of manual drawdown process:* Continued implementation of controls, accounting and project management procedures at the "Grantee" and Subrecipient levels. These measures demonstrated to the Federal Government that the Government of Puerto Rico is able to assume responsibility and access to federal funds, including the implementation of all phases of the disbursement process. As a result, the manual drawdown process was again removed with Governor Vázquez in power, releasing important projects from additional administrative burdens.
- *Accelerate small projects:* In the past six months we have increased the pace of processing small projects under traditional rules which have reduced the initial administrative burdens and allow small projects to start faster without the restrictions of Section 428. This review has allowed our sub-recipients to start over 5,000 small projects that had stalled because of bureaucratic hurdles.
- *Make section 428 optional:* Consistent with the intent of the Disaster Recovery Reform Act of 2018, when Governor Wanda Vázquez took office, she insisted that the Federal Government lift the requirement for any permanent project to be formulated under the procedures of Section 428 of the Stafford Act. In January 2020, FEMA agreed that any permanent project, except critical facilities, can be done under traditional procedures at the choice of the sub-recipient versus Section 428 of the Stafford Act, thus accelerating the project formulation and obligation of funds for permanent work.
- *State Recovery Account:* On December 26, 2019, the Government of Puerto Rico finalized the establishment of the State Recovery Fund (SRF) account with the availability of \$100 million funds under the supervision of the COR3. The SRF account provides a means of liquidity to eligible sub-recipients, mostly municipalities, to begin their small projects, as defined by FEMA as those with an estimated cost of up to \$123,100.

Debt Restructuring

- *Achievements to Date:* Puerto Rico has made substantial progress in its debt restructuring efforts, having restructured over \$23 billion of existing indebtedness through the various mechanisms available under PROMESA.⁵ Puerto Rico is committed to repaying an affordable and sustainable amount of its outstanding debt. Creditor recoveries are based on a debt sustainability analysis assuming affordable and sustainable amounts of debt after taking into account the legal rights of each class of creditors.
 - *Announced Transactions:* The Government and the FOMB have shown the willingness and ability to reach consensual deals. Completed and announced transactions are shown in **Exhibit 8** below.

⁵ Includes Government Development Bank for Puerto Rico ("GDB"), COFINA Sr./Jr., PRIFA-Ports and PRASA

EXHIBIT 8: COMPLETED AND ANNOUNCED TRANSACTIONS



Fiscal Plan Forecast Update

Summary of Material Updates Relative to May 9, 2019 Certified Fiscal Plan

Relative to the May 9, 2019 Certified Fiscal Plan, the 2020 Fiscal Plan incorporates a number of important updates to reflect the latest outlook for the Commonwealth of Puerto Rico, new information and data, as well as focused investments and fiscal priorities, including:

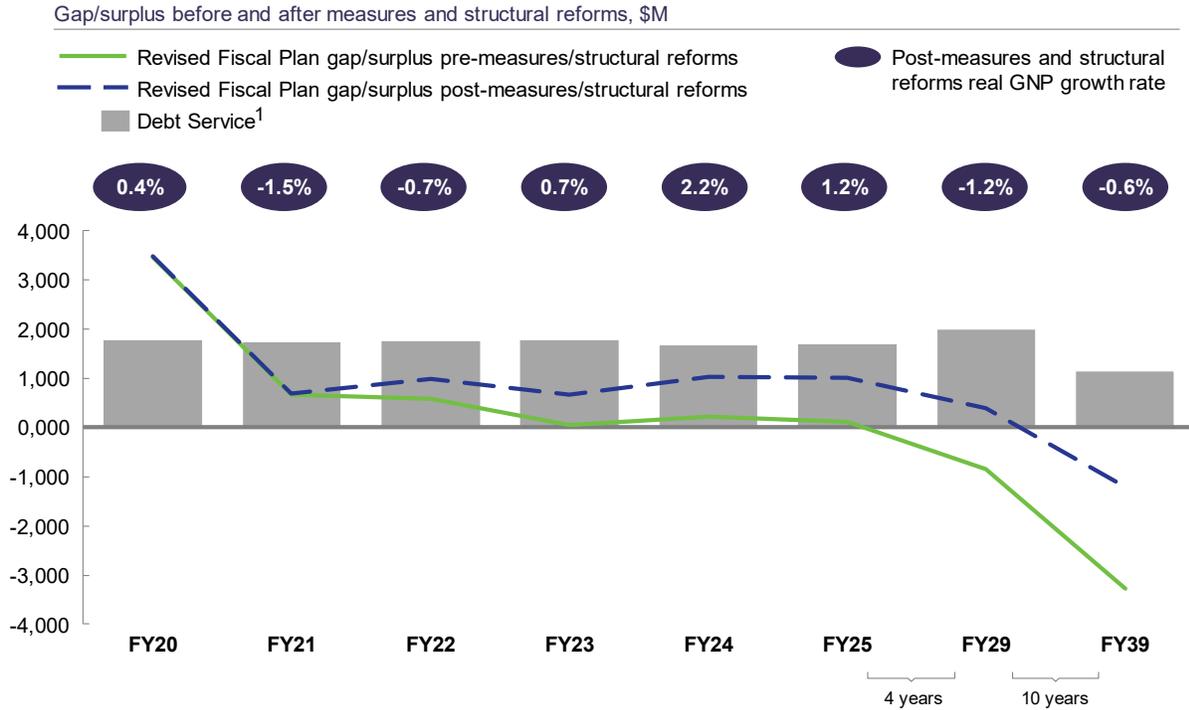
- Forecast Period:** The forecast period has been revised to align with the recently announced new PSA that modifies the September 2019 Plan of Adjustment. As a result, the 2020 Fiscal Plan forecasts revenues and expenditures over a 20-year period, from fiscal year 2020 through fiscal year 2039, to align with the maturity of the new bonds contemplated in the new PSA.
- General Fund Revenues:** General Fund Revenues have been updated for fiscal year 2020 based on material variances observed in the six-months of actual results from July 2019 through December 2019. The prior forecast has been adjusted in the short term for outperformance in Personal Income Taxes (PIT), Corporate Income Taxes (CIT), and Motor Vehicles, which were 9%, 7% and 39% ahead of plan, respectively. The forecast outperformance is then phased out over a five-year period to reflect a realignment of these revenue metrics as a percentage of GNP consistent with historical averages and consistent with the May 9, 2019 Certified Fiscal Plan.

- *Medicaid*: The Medicaid federal funding forecast has been updated to reflect the enactment of the “Further Consolidated Appropriations Act, 2020” which granted the Government of Puerto Rico \$5.3 billion of Medicaid funding in federal FY2020 through FY2021 at a 76% Federal Medical Assistance Percentage (FMAP). Subsequent years have been updated from a capped approach that was used in the May 9, 2019 Certified Fiscal Plan to an assumed 55% flat FMAP.
- *Payroll, Operating Expenses and Associated Measures*: General fund payroll and operating expenses have been updated to reflect the FY2020 budget. As such, measures are included in the baseline forecast in FY2020. FY2021 general fund payroll and operating expenses align with Office of Management and Budget (OMB)’s recommended FY2021 budget. This includes a reinvestment in agency budgets to ensure proper delivery of services that have been affected due to aggressive expense measures imposed by the FOMB. Additional measures are assumed beginning in FY2022.
- *Independently Forecasted Components Units (IFCU)*: IFCU forecasts have been updated to reflect the FY2020 budget and the FY2021 targets, which have been re-aligned with management forecasts. Additionally, two IFCU’s (PRIDCO and Ports Authority) which have outstanding debt and cash flows that will need to be used to fund restructured debt service have been removed from the 2020 Fiscal Plan.
- *Pensions*: It is the public policy of the Government of Puerto Rico that pensions should be honored. In addition, the Government supports the PSA between the FOMB and AFSCME. As such, the PayGo forecast included in the 2020 Fiscal Plan exclude System 2000 benefits. The Government has already taken critical steps toward a more stable pension system through legislation. The Board continues to insist on a reduction to pension benefits across the Government’s retirement systems. The Government opposes these additional pension reduction measures because they impose a disproportionate burden on Government retirees.

Financial Overview

Before measures and structural reforms (“baseline forecast”), there is a pre-contractual debt service surplus through FY2025. The positive surplus is due, in part, to revenues that are bolstered by a positive macroeconomic trajectory resulting from the disaster relief funding stimulus and the incremental Medicaid funding. Over the long term, the baseline forecast surplus decreases as Federal disaster relief funding slows down, Act 154 and Non-Resident Withholding (NRW) revenues decline, and pensions and healthcare expenditures rise. Fiscal measures and structural reforms contained in the 2020 Fiscal Plan mitigate this downward trend. However, even after fiscal measures and structural reforms, the annual pre-contractual debt service surplus decreases to a negative \$1.2 billion forecast by FY2039 (**Exhibit 9**).

EXHIBIT 9: 2020 FISCAL PLAN PROJECTED SURPLUS BEFORE AND AFTER MEASURES AND STRUCTURAL REFORMS MACROECONOMIC AND DEMOGRAPHIC TRAJECTORY POST-MARIA



¹ Contractual debt service does not include COFINA debt service

PART I: Enactment of PROMESA

Chapter 1. LONG-TERM ECONOMIC TRENDS

Before being battered by the most powerful hurricane to strike the Island in almost a century, Puerto Rico's economy had been in an acute structural decline for over a decade, the Government had defaulted on debt exceeding the size of Puerto Rico's annual GNP, and nearly half of Puerto Rican residents lived below the national poverty line. The reasons for these problems are multiple, but the root causes stretch back decades.

On June 25, 1938, Congress legislated to authorize the Puerto Rico Legislature "to create public corporate authorities to undertake slum clearance and projects, to provide dwelling accommodations for families of low income, and to issue bonds therefore."⁶ Bonds issued by public corporations did not constitute debt of the Puerto Rican insular government. This federal legislation permitted Puerto Rico to dramatically increase its debt capacity. By 1947, the Puerto Rico Water Resources Authority (today PREPA) placed the largest debt issuance of any agency or public corporation in the U.S. while Puerto Rico was dramatically poorer than mainland jurisdictions.

In the 1940s and 1950s, led by Operation Bootstrap, Puerto Rico's economy grew rapidly, and productivity increased by 5% per annum as it transitioned from an agricultural-led to a manufacturing-led economy. This transition was anchored to the institutionalist economic policy adopted in Puerto Rico during the governorship of Rexford G. Tugwell. However, as economic performance began to decline in the 1970s, the Federal Government adopted two significant policies to help Puerto Rico shore up its economy.

First, transfer programs increased dramatically, particularly as Puerto Rico started receiving Nutritional Assistance Program (NAP) funding, eventually providing, in aggregate, a portion of residents' personal income that was twice the U.S. mainland average.

Second, in 1976, Section 936 of the Federal tax code was introduced to promote investments by companies that could transfer their "intangible assets" to Puerto Rico, and thereby shift profits to the Island. These Section 936 companies, which were mostly in the pharmaceuticals and life sciences industries, became a pillar of Puerto Rico's economy, creating valuable local supply chains, increasing local banking deposits, and contributing substantial tax revenue.

In 1996, Congress decided to end Section 936, gradually phasing it out by 2006. In the face of an anemic local private sector, the Government also expanded its employment to the point that by 2000, 30% of Puerto Rico's jobs were in Government. Large sectors like water, electricity and ports are still run by public corporations, and have consistently crowded out private investment. This crowding out is partly the result of the institutionalist policies instituted long ago. There is also pervasive cross-subsidization between the Government and public corporations and other parts of the public sector that obfuscates financial management and accountability. As a result, today Puerto Rico underperforms on all important measures of a modern economy, including educational attainment, cost of electricity, quality of water, tax compliance, and labor market participation.

⁶ U.S. Statute at Large, 75th Cong. 3rd Session, Ch. 703, June 25, 1938, 52 Stat., p. 1203.

To promote the private sector, the Government undertook a broad tax incentives policy.

Government revenues suffered and became increasingly hard to forecast. To make up for this recurring and growing budgetary shortfall, Puerto Rico turned to debt markets. As investor appetite began to wane, the Government turned to securing new debt by pledging various revenue streams. The result was a highly complex financial structure that limited transparency and financial accountability and management.

When the Great Recession hit in 2008, Puerto Rico's economy was already in a fragile fiscal and financial position. Since then, the economy has continued to worsen – Puerto Rico has seen its GNP shrink by 20%, and the Island's population has fallen by 10%. As a result, Puerto Rico is much poorer today relative to the U.S. than it was in 1970.

Chapter 2. ENACTMENT OF PROMESA AND FISCAL PLAN PROCESS

By 2016, Puerto Rico was facing an imminent default. Because Puerto Rico and its public corporations cannot take advantage of Chapter 9 of the U.S. Bankruptcy Code, and an attempt to create a territorial bankruptcy law was struck down by the U.S. Supreme Court, Congress stepped in to address Puerto Rico's financial crisis by passing the Puerto Rico Oversight, Management, and Economic Stability Act. PROMESA imposed an automatic stay on Puerto Rico's debt obligations and created the Financial Oversight and Management Board for Puerto Rico.

As required by PROMESA, the duly elected Government of Puerto Rico began drafting a fiscal plan that would help the Government achieve fiscal responsibility and regain access to the capital markets. The outcome of this work was the Commonwealth Fiscal Plan that the Oversight Board certified on March 13, 2017 (the "March 2017 Certified Fiscal Plan"). A few months later, the Oversight Board filed for Title III for the Commonwealth, COFINA, HTA, ERS, and PREPA.

The damage inflicted on Puerto Rico by Hurricanes Irma and Maria required that the March 2017 Certified Fiscal Plan be revised. On October 31, 2017, in light of the devastating effects of these historic storms, the Oversight Board requested the Government submit a fiscal plan to replace the March 2017 Certified Fiscal Plan. After several months of intense negotiations between the Governor and Oversight Board, the Government submitted revised Commonwealth fiscal plans to the Oversight Board on January 24, 2018, February 12, 2018, March 23, 2018, and April 5, 2018. On April 19, 2018, the Oversight Board instead certified its own fiscal plan, which was subsequently amended and recertified on May 30, 2018 and June 29, 2018 (the "June 29, 2018 Certified Fiscal Plan").

The prior administration had several fundamental disagreements with the Oversight Board regarding certain legislation and pension reform as prescribed in the Oversight Board's March 2017 Certified Fiscal Plan (and as revised and updated in subsequent fiscal plans for the Commonwealth and other instrumentalities). Although the new administration also disagrees with the Oversight Board's approach to certain issues—particularly, the treatment of pension claims and future retiree benefits—it has made substantial efforts to collaborate with the Board where possible and alleviate prior tensions so that despite their differences the Government and Board can engage in effective communication to move the Title III cases forward.

On August 1, 2018, the Oversight Board requested the Government submit a revised fiscal plan to replace the June 29, 2018 Certified Fiscal Plan in light of new information including, among other

things, fiscal year 2018 financial information, revised federal disaster spending estimates, and updated demographic projections.

On August 20, 2018 the Government submitted a revised fiscal plan. On August 30, 2018 the Oversight Board issued a Notice of Violation. On September 7, 2018 the Government resubmitted the Fiscal Plan. On October 23, 2018 the Oversight Board certified its own plan. On January 18, 2019 the Oversight Board requested the Government submit another revised fiscal plan, (the “Revised Fiscal Plan”). On March 11, 2018 the Government submitted the Revised Fiscal Plan. On March 15, 2019, the Oversight Board issued a Notice of Violation. On March 27, 2019 the Government resubmitted the Fiscal Plan. On May 9, 2019 the Oversight Board certified its own plan (the “May 9, 2019 Certified Fiscal Plan”).

On July 24, 2019, then-Governor Ricardo Rosselló Nevares announced his resignation as Governor of Puerto Rico effective August 2, 2019 at 5:00 p.m. Atlantic Standard Time. Before his resignation became effective, then-Governor Rosselló appointed former resident commissioner Pedro Pierluisi as Secretary of State. After being confirmed by the House of Representatives (but not the Senate), Mr. Pierluisi was sworn in as acting Governor. On August 7, 2019, the Puerto Rico Supreme Court unanimously determined that Mr. Pierluisi was illegally sworn into office as Governor. As a result, Justice Secretary Wanda Vázquez was sworn in as Governor on August 7, 2019 to complete former Governor Rosselló’s term through 2020 and currently serves as the Governor of Puerto Rico. Despite the political crisis that led to the Island’s new administration, the Government’s position in terms of right-sizing measures and efforts to implement economic reforms remain fundamentally unchanged.

On December 12, 2019, the Oversight Board requested the Government to submit a revised fiscal plan (the “2020 Fiscal Plan”).

PART II: Natural Disasters and Ensuing Disaster Relief Funding

Chapter 3. NATURAL DISASTERS

3.1 Hurricanes Irma & Maria

On September 6, 2017 and September 20, 2017, Hurricanes Irma and Maria struck Puerto Rico, caused unprecedented humanitarian, economic, and infrastructure-related damages and upended the daily lives of Puerto Rico's over 3 million residents. Thousands of residents were left homeless, basic utilities were completely shut down, and schools, hospitals, and businesses were destroyed. Tens of thousands of Puerto Ricans fled the Island. The Federal Government's response has become one of the largest and most complex disaster recovery efforts in U.S. history.

On December 7, 2019, as part of the Government's firm commitment to ensure the transparent and effective use of the federal investment for the recovery, Governor Wanda Vázquez signed executive order OE-2019-062. This order ensures a consistent, coordinated, oversight and assistance across all government agencies for recovery projects. Specifically, this order gives AAFAF the authority to establish a rigorous fiscal supervision structure and compliance mechanisms to guarantee the correct use of taxpayer federal moneys. This order also provides for AAFAF to create or modify management and organizational structures of any governmental agency, particularly those impacting critical infrastructure areas such as: roads, energy, ports, water, education, housing and health. In order to accelerate the recovery process, AAFAF can delegate to COR3, FEMA recipient, and the PR Department of Housing, HUD grantee, to assist and supervise agencies in the recovery project's implementation.

Strengthening the working relationship with FEMA and Puerto Rico has served to expedite the pace of recovery. Over the past six months, COR3 worked collaboratively with FEMA to move forward several initiatives that have slowed the pace of recovery and have reached agreement on:

- **Use of industry standards:** FEMA agreed on the ability to use industry standards and consensus based codes in project formulation so investments in these projects are informed by evidence based research and best practices.
- **Processing of Small Projects:** FEMA has permitted the Government to begin processing small projects under traditional rules which has jumpstarted permanent work on small projects. Additionally, since September 2019, FEMA allowed COR3 to take the lead on the formulation of all small projects.
- **Sub-Recipients' Use of Outside Consultants for the development of Fixed Cost Estimates (FCE):** Sub-recipients can now use their own consultants to produce their application packages. In these cases, COR3's participation is limited to a review of the subrecipients' small project in order to ensure the level of quality required by FEMA. This was also done in order to prevent duplication of funding, for the same purpose, to subrecipients and COR3 ensuring the best use of federal taxpayer money.

- **Fixed Cost Estimate Extension:** COR3 and FEMA agreed that an extension of the October 11th, 2019 deadline for the Fixed Cost Estimation of all projects was deemed necessary. This was a result of an analysis performed jointly on a sector by sector basis that helped create milestones aimed to improve the operations towards the obligation of projects.

During the past six months, COR3 has been able to define five priority projects that FEMA has adopted and greatly supported. The emphasis is on improving the operational aspects of the Public Assistance program at various levels:

- 1) setting milestones to work more efficiently with the 428 alternative procedures, particularly during those phases of which COR3 is responsible;
- 2) increasing the disbursement of the non-permanent completed projects already obligated;
- 3) formulating of small projects for permanent work;
- 4) working closely with FEMA and the local stakeholders on a set of large projects from the water and energy sectors, having weekly meetings and daily phone calls to ensure progress;
- 5) working closely with U.S. Department of Housing and Urban Development, White House Office of Management, and other federal officials to swiftly release disaster relief aid amid delays and setbacks from the Trump Administration; and
- 6) developing a data driven process to guide the 404 Hazard Mitigation Grant Program.

Thanks to effective leadership and collaboration, Puerto Rico's recovery has made considerable progress in the past few months. All that has been accomplished will ease the way into the upcoming works. Despite the many challenges, Puerto Rico is optimistic, determined, and full of potential.⁷

3.2 Earthquakes

3.2.1 Overview of Recent Earthquakes

On December 28, 2019, the first of many earthquakes shook Puerto Rico and its people. On January 8, 2020 President Trump issued an Emergency Declaration for Puerto Rico, wherein Direct Federal Assistance was granted to aid Puerto Rico in the Preliminary Damage Assessments, a day after being struck by a magnitude 5.8 earthquake, Puerto Rico was hit by the most destructive earthquake in a century with a magnitude of 6.4 on the Richter scale. This increase in seismic activity collapsed homes and schools, and knocked out power. Since then, there have been more than 400 earthquakes of magnitude 2 or greater, primarily in the southern region. Thousands have been forced into "refugee camps" as they are afraid to sleep in homes that could collapse in an aftershock.

The disaster declaration was issued on January 16, 2020, wherein 6 municipalities were approved for the Individual Assistance (IA) Program (Guánica, Guayanilla, Peñuelas, Ponce, Utuado and Yauco) and 6 municipalities were approved for the Public Assistance Program, for Category A and Category B work (Guánica, Guayanilla, Peñuelas, Ponce, San Germán and Yauco). Since that time,

⁷ January 29, 2020 Third Congressional Status Report on the Economic Disaster Recovery Plan.

9 municipalities have been added to the Individual Assistance Program and 8 municipalities to the Public Assistance Program.

The aftershocks are not expected to stop any time soon. According to a January 29, 2020 report⁸ published by the United States Geological Survey (USGS), there is a high likelihood of continued, material aftershocks and while there will be fewer over time, Puerto Rico is at risk of many potentially catastrophic earthquakes in the near term. Specifically, the USGS reported the current and future probabilities for additional aftershocks for the following magnitudes:

- **Magnitude 3+** - Earthquakes will occur daily for months and weekly for years.
- **Magnitude 5+** - Currently > 99% chance and will remain over 50% for 3 to 10 years.
- **Magnitude 6+** - Currently 50% and will stay over 25% for 3 months to 3 years.
- **Magnitude 7+** - Currently 8%, will stay over 5% for 1 month to 10 months and will stay over 1% for 2 years to 10 years.

3.2.2 Impact of Earthquakes on Financial and Macro Economic Projections

The damages caused by the January 7th earthquake and subsequent aftershocks are already estimated to be near \$500 million dollars, but the figure is certain to increase as inspections continue in the most affected municipalities. Currently, the estimated damages are relatively small as a percentage of real GNP (0.1%) and the capital stock (1.3%), and as a result the *structural* damage will have a minimal impact on the 2020 Fiscal Plan forecast. However, the *psychological* impact of an additional and ongoing wave of natural disasters while Puerto Rico is still in the preliminary stages of rebuilding from Hurricanes Irma and Maria cannot be understated, yet it is too early to quantify the psychological impact on outmigration. Due to the disasters mentioned above, outmigration above what is forecast in the 2020 Fiscal Plan remains a major risk to recovery that Puerto Rico faces.

Another unknown is the eventual cost and time of repairing power-generating equipment at PREPA's Costa Sur plant, which was significantly damaged as a result of the earthquake. With Costa Sur out of service, Puerto Rico would need to rely on its other power plants to operate almost at full capacity in order to meet demand. This is in addition to PREPA still struggling to recover from the severe damage to the power grid caused by the hurricanes.

3.2.3 Earthquake-Related Disaster Recovery and Federal Funding

While the damages are not as extensive as those caused by Hurricanes Irma and Maria two years ago, it will require Federal disaster recovery funds and a post-earthquake recovery program will have to be implemented alongside the post-Maria reconstruction plan. This has presented the Government with the additional challenge of running two overlapping disaster recovery programs simultaneously over the next several years.

After the earthquake, and under public pressure in addition to the Government, HUD proceeded to issue guidelines for Community Development Block Grant Disaster Recovery (CDBG-DR) funding adding a list of restrictions on the use of funds and reiterating their concern about alleged mismanagement of assistance money by Puerto Rico's government. HUD also appointed a monitor for the CDBG-DR program on the Island. One of the restrictions included as part of the

⁸ 2020 Southwest Puerto Rico Earthquake Sequence (Jan 29, 2020) (<https://www.usgs.gov/media/images/2020-southwest-puerto-rico-earthquake-sequence-jan-29-2020>)

Federal CDBG-DR funding guidelines is a requirement that CDBG-DR funded projects must be authorized by the FOMB.

On February 2, 2020, President Donald Trump appointed Coast Guard Rear Admiral Peter J. Brown as the Administration's liaison to the Government of Puerto Rico for natural disaster recovery efforts on the Island. Brown previously served as Homeland Security advisor to President Trump and also headed the Coast Guard operations in the southeast region of the United States and the Caribbean basin as 7th District Commander. The Government expects the appointment of such Federal Coordinator will help the Island expedite its reconstruction efforts after Hurricanes Irma and Maria, as well as the recent earthquakes.

Governor Wanda Vázquez issued an executive order on February 3, 2020 creating an advisory council for the oversight of CDBG disaster recovery funds authorized for Puerto Rico. Their task is to work with the Puerto Rico Housing Department to create an integrated work plan for the efficient, transparent and correct use of these funds. The council is an important step in Puerto Rico's ongoing efforts to combat corruption in government contracting and restore the Government of Puerto Rico's credibility before the Federal Government. Since Hurricanes Irma and Maria, \$20 billion in CDBG disaster recovery funds have been allocated or obligated to Puerto Rico, while just \$1.5 billion have been released.

Chapter 4. DISASTER RELIEF FUNDING

In response to Hurricanes Irma and Maria, the United States Congress approved nearly \$20 billion in emergency relief funds to assist in Puerto Rico's rebuilding efforts. However, due to concerns regarding the Government's control mechanisms for appropriately managing funds, the Trump administration placed a hold on releasing much of Puerto Rico's allocation. In January 2020, the Trump administration announced that it would end a months-long hold on more than \$8.2 billion of Puerto Rico relief administered by the Department of Housing and Urban Development. Despite providing some relief, the Trump administration recently expressed that it "strongly opposes" a new bill that would provide an additional \$4.7 billion in disaster relief to Puerto Rico in response to the earthquakes that have impacted the island throughout 2020, noting the administration's concerns that the bill's restrictive provisions would "prevent the Administration from ensuring these funds are well-spent." However, after a recent review of the Government's recovery operations, Coast Guard Admiral Peter J. Brown—the Trump administration's liaison to the Government for natural disaster recovery efforts—reported on February 26, 2020 that the pace of recovery efforts has "accelerated dramatically" and that Puerto Rico's "reputation seems to lag the reality" because the Government has implemented "very strong internal control mechanisms to counter any attempts at corruption or diversion of funds." Admiral Brown further indicated that, after reporting his findings to President Trump, he hopes the administration will be convinced that federal money is being spent wisely in Puerto Rico and that the federal government and Puerto Rico government have established a new atmosphere of cooperation and trust.

Notwithstanding the release of existing federal emergency funds or the future appropriation of additional federal funds, Admiral Brown emphasized that "private investment is very important to the long-term sustainability of Puerto Rico." Eventually, federal disaster and recovery aid will run out, and when it does Puerto Rico's fragile economy alone may not be sufficient for long-term viability. In part, private investment in Puerto Rico's aging infrastructure will be crucial to sustainability. For example, in January 2020, a group of congressional democrats sent a letter to the Oversight Board urging it to "prioritize the restoration of critical infrastructure and services

at affordable rates over channeling available cash flow” to debt service payments. Consistent with these views, to the extent additional resources exist become available in the future, the Government believes that its first priority must be to reinvest in areas most critical to Puerto Rico’s future economic growth.

Disaster spending has a short-term stimulative effect on an economy post-crisis. While the fiscal impact of the spending is short-lived, disaster relief funds are to rebuild the Island’s productive capital and its long-term productive capacity.⁹ The level of public and private disaster relief spending is anticipated to be significant when compared to the overall size of the economy. Public and private disaster relief spending will impact the economy in two ways in the short term:

- **Short-term stimulative impact caused by spending on the Island:** This stimulus will come in multiple forms, such as construction companies hiring local, unemployed workers, or workers from the mainland U.S. paying local withholding taxes and spending money for food and lodging.
- **Expected refurbishment of the capital stock on the Island:** The 2020 Fiscal Plan factors in significant damage to the Island’s capital stock that is repaired, rebuilt, and augmented in large part, by this significant infusion of federal and private monies, contributing to increase in long-term trend growth by rebuilding destroyed capital and contribution to long-term productive capacity.

The 2020 Fiscal Plan projects that ~\$81 billion of disaster relief funding, including federal and private sources, will be disbursed in the reconstruction effort. It will be used for a mix of individual assistance (e.g., reconstruction of houses, personal expenditures related to the hurricane such as clothing and supplies), public assistance (e.g., reconstruction of major infrastructure, roads, and schools), and in the case of CDBG-DR funds, to cover part of the Government’s share of the cost of disaster relief funding under the FEMA Public Assistance program (recipients often must match some portion of federal public assistance funds).

Of that, ~\$47 billion is estimated to come from FEMA’s Disaster Relief Fund (DRF) for public assistance, hazard mitigation, mission assignments, and individual assistance. An estimated \$8.4 billion will come from private and business insurance payouts, and \$6 billion is related to other federal funding. The 2020 Fiscal Plan includes ~\$20 billion from the CDBG-DR.

A total of \$3.9 billion in CDBG funding from fiscal years 2020 – 2032 is estimated to be allocated to offset the Government’s and its entities’ expected cost-share requirements under federal programs. This portion of CDBG funding will go towards covering the ~10% cost share burden on expenditures attributable to the Government between fiscal year 2020 and fiscal year 2032, and the ~10% cost share burden attributable to PREPA, PRASA, and HTA between fiscal year 2020 and fiscal year 2032. While current statute calls for CDBG funds to be spent over a seven year period, HUD has historically extended the expenditure deadlines for countless CDBG-DR recipients including: Texas after Hurricane Ike, Louisiana after Hurricane Katrina, and Mississippi after Hurricane Katrina. Given the magnitude of the devastation experienced in Puerto Rico on account of both Hurricanes Irma and Maria, it is assumed that Puerto Rico will receive an extension to the 7-year CDBG expenditure deadline.

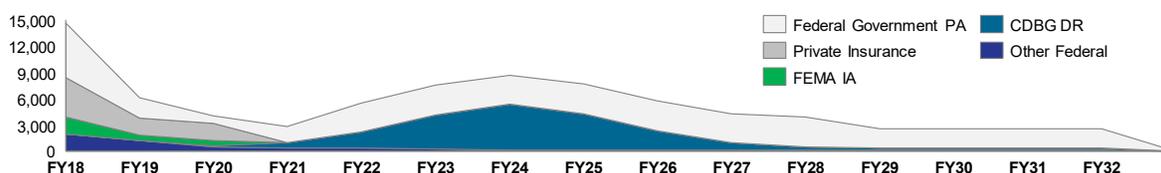
The estimated ~10% cost share comes from a weighted average of all categories of FEMA Public Assistance funding expected to be received by Puerto Rico and is informed by specific FEMA cost share guidelines (**Exhibit 10**).

⁹ Relief aid after the Haitian Earthquake represented nearly 200% of overall GDP, providing a major economic “cushion” after the disaster. In Grenada, disaster aid after Hurricane Ivan (2005) equaled about two-thirds of GDP at the time, and after declines in growth immediately following the hurricane, Grenada’s economy grew at a faster rate than any year since 1985, at a clip of 12.5%. However, revenues returned to pre-storm levels after about two fiscal quarters.

EXHIBIT 10: PROJECTED PRIVATE AND PUBLIC DISASTER RELIEF FUNDING AND ROLL OUT

	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32 +	Total	Total
	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	%
Federal Public Assistance 	\$6,190	\$2,370	\$959	\$1,836	\$3,359	\$3,359	\$3,359	\$3,359	\$3,359	\$3,359	\$3,359	\$2,217	\$2,217	\$2,217	\$2,217	\$43,736	53.8%
	14.2%	5.4%	2.2%	4.2%	7.7%	7.7%	7.7%	7.7%	7.7%	7.7%	7.7%	5.1%	5.1%	5.1%	5.1%		
CDBG-DR 	\$0	\$0.81	\$87	\$514	\$1,817	\$3,946	\$5,145	\$4,145	\$2,162	\$764	\$375	\$248	\$248	\$248	\$248	\$19,946	24.5%
	0.0%	0.0%	0.4%	2.6%	9.1%	19.8%	25.8%	20.8%	10.8%	3.8%	1.9%	1.2%	1.2%	1.2%	1.2%		
FEMA Individual Assistance 	\$1,996	\$604	\$604	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$3,204	3.9%
	62.3%	18.9%	18.9%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%		
Private Insurance 	\$4,512	\$1,942	\$1,942	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$8,397	10.3%
	53.7%	23.1%	23.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%		
Other Federal Funding 	\$1,933	\$1,238	\$493	\$423	\$342	\$205	\$190	\$190	\$190	\$190	\$181	\$120	\$120	\$120	\$120	\$6,051	7.4%
	31.9%	20.5%	8.1%	7.0%	5.7%	3.4%	3.1%	3.1%	3.1%	3.1%	3.0%	2.0%	2.0%	2.0%	2.0%		
Total	\$14,631	\$6,155	\$4,085	\$2,773	\$5,519	\$7,510	\$8,694	\$7,694	\$5,711	\$4,313	\$3,916	\$2,584	\$2,584	\$2,584	\$2,584	\$81,335	100.0%
Spending as a % of GNP	21.5%	8.8%	5.8%	3.9%	7.7%	10.3%	11.5%	9.9%	7.3%	5.4%	4.9%	3.2%	3.2%	3.1%	3.1%		
CDBG cost share	\$0	\$0	\$56	\$205	\$375	\$375	\$375	\$375	\$375	\$375	\$375	\$248	\$248	\$248	\$248		

Disaster aid by source of funding, \$M



- Based on more recent information, estimates of federal fund disbursements have been revised. FEMA-PA actuals have been updated for the latest information provided by COR3¹⁰, while CDBG actuals are sourced from the Department of Housing Puerto Rico¹¹. Curves have flattened due to the historical federal funding receipts and future uncertainties tied to bureaucratic complications. The major sources of disaster relief funding are detailed below:
 - **FEMA Disaster Relief Fund:** FEMA provides Individual Assistance to individuals and families who have sustained uncovered losses due to disasters. FEMA also provides Public Assistance for infrastructure projects and other permanent improvements.¹² Relative to the May 9, 2019 Certified Fiscal Plan, the FEMA-PA spend curve included herein is flatter with lower spend upfront and a less significant decline in the latter years. FEMA’s Hazard mitigation funds projects to reduce or eliminate long-term risks. FEMA’s Mission Assignments provide emergency work and debris removal services primarily in the immediate aftermath of the disaster.
 - **HUD Community Development Block Grant-Disaster Recovery:** Based on a housing recovery plan, HUD provides CDBG-DR funding that can be used for assistance to individuals (e.g., housing repair), for public assistance (e.g., infrastructure development), and for covering disaster relief funding match among other things. To date, two action plans have been approved, leading to the approval of ~\$9.7 billion in CDBG federal relief funding. The first action plan was approved on July 29, 2018 and outlined

¹⁰ <https://recovery.pr/en/financial-analysis/table-view>

¹¹ <https://www.cdbg-dr.pr.gov/en/projections/>

¹² The 2020 Fiscal Plan does not account for Operations and Administration funding, which only flows to federal agencies. Rather, it looks at funds that are spent for reconstruction on-Island, though those funds could flow to firms that are local or external.

the uses of the approximately \$1.5 billion in CDBG-DR made available by Congress on February 1, 2018. The allocation focused primarily on addressing urgent housing and socioeconomic needs and laying the foundation for the next phase of the long-term recovery. The foundational approaches included: planning, housing, economy, and infrastructure. An amended action plan was approved on March 1, 2019 and incorporated an additional ~\$8.2 billion in CDBG-DR funding. This substantial amendment amended the program scope and budget in some of the original 19 programs from the initial Action Plan and included eight additional programs for unmet needs. The 2020 Fiscal Plan also assumes that \$3.9 billion in CDBG funding will be used to cover cost share for the Government of Puerto Rico and its instrumentalities from fiscal year 2020 on.

- **Private insurance funding:** Large personal property and casualty losses have been incurred in the aftermath of Hurricane Maria. Early analysis of data from the Office of the Insurance Commissioner of Puerto Rico, adjusted for self-insured and other types of coverage, was used to determine the total amount that will be paid out to individuals and businesses for major damages.
- **Other supplemental federal funding:** Additional federal funding has been allocated to various agencies and projects in Puerto Rico following the hurricane. This money is directed at a wide range of recovery efforts, from reconstruction of damaged buildings (for example, funding to repair damage to Job Corps centers in Puerto Rico) to funding for health programs and environmental management (for example, North Oceanic and Atmospheric Administration (NOAA) coastal habitat restoration funding).

In prior Government Fiscal Plan submissions and Certified Fiscal Plans, disaster roll out for FEMA public assistance funds have been projected in line with historical spending on other major disaster events, particularly Hurricane Katrina in Louisiana.

The 2020 Fiscal Plan assumes a more conservative approach on FEMA public assistance disaster roll out given the delay in funds since the Island suffered two critical blows from Hurricanes Irma and Maria. Based on data from the Federal Emergency Management Agency's website¹³, only \$5.9 billion of FEMA public assistance funds have been obligated over the last 27 months (September 2017 – November 2020). In addition, over that same timeframe, only \$3.8 billion of FEMA public assistance funds have been outlaid, the overwhelming majority of which were for category A (debris removal) & category B (protective measures), which occurred immediately post storms.

The extended spend curve is rooted in a number of issues specifically relating to: 1.) actual federal funding consistently falling short of expectations, and 2.) more federal funding constraints being considered in Washington. COR3 has been working closely with FEMA to address these areas of concern and Governor Vázquez recently announced that FEMA has agreed to allow Puerto Rico to use the standard section 406 procedure under the Stafford Act for non-critical infrastructure projects. Because this route does not require fixed cost estimates, projects under section 406 can get underway more quickly. The roll out of FEMA public assistance has been updated from the May 9, 2019 Certified Fiscal Plan for FY2019 actuals, assumes minimal funding in FY2020 given the year-to-date pace of funding and assumes a relatively flat level of funding from FY2021 through FY2035.

An extension past the current seven-year roll out per the statute is assumed for CDBG expenditures. CDBG roll out assumptions are derived from revised HUD projections for the \$1.5

¹³ <https://recovery.fema.gov/state-profiles>

billion action plan¹⁴. The same rollout assumptions are assumed for the 2nd action plan and future additional CDBG funding on a one-year and two-year delay, beginning in fiscal year 2021 and 2022, respectively. Additional funding is assumed to cover the FEMA public assistance cost share requirements post FY2025 as a portion of CDBG funding will be used to fund the FEMA public assistance cost share. Individual assistance and private insurance are assumed to have been spent in the immediate aftermath of the storm.

Historically, as funding is predominantly done on a reimbursement basis, liquidity constrains limit the ability for recipients and sub-recipients to spend disaster recovery money at an accelerated rate, particularly when they don't have money, but neither access to credit. Therefore, the 2020 Fiscal Plan assumes a \$1 billion working capital fund (WCF) to address the liquidity constraints associated with disaster relief funding reimbursements in order to promote economic recovery activity.

As stated before, disaster relief funds will impact the economy in a number of ways: building the capital stock of the Island by constructing, repairing, or replacing damage to buildings, utilities, or other physical goods, directly through consumption of goods and services on the Island, or funding programs and services on the Island. The Plan estimates the rate of pass-through to the economy for these different types of funding as follows:¹⁵

- A 100% pass-through rate is assumed for funding that is used directly and in full to replace income or stimulate spending on goods and services originating on the Island. Hence, this corresponds to the final consumption expenditure that are spent on the Island for immediate disaster relief needs, and that are financed by transfer payments from Federal Disaster Relief Spending funds. This kind of current expenditure or final consumption expenditure on relief goods and services does not contribute to the capital stock on the Island, and therefore does not contribute to long-term growth. A 100% pass-through rate is assumed for funding that is used directly and in full to replace income or stimulate spending on goods and services originating on the Island. This kind of spending does not contribute to the capital stock on the Island, and therefore does not contribute to long-term growth.
- An 18% pass-through rate is assumed for all other funding, including funding used to construct, repair, and replace buildings, utilities, and other physical goods, or funding directed toward programs and services on the Island. The pass-through of 18% consists of a base pass-through rate of 12.5% estimated using a weighted average of FEMA and non-FEMA individual and public assistance based on study of historical reconstruction spending contracts. It is increased by a 5.5% addition for on-cost logistics for a total pass-through rate of 18%. The 18% represents the portion of funding spent on-Island for labor and on-Island services. The remaining 82% corresponds to capital expenditures or fixed capital formation, and consists of spending on goods and services intended to create future benefits such as infrastructure investment in transport, health, communication, education, etc.¹⁶.

¹⁴ <https://www.cdbg-dr.pr.gov/en/projections/>

¹⁵ Estimated using local contracts for PREPA, residential construction and school construction. These contracts were estimated to have between 10% and 18% pass-through on the economy, respectively, which was then augmented by 5.5% average spend on transportation and logistics on construction projects, which rely on 100% domestic labor. Historical FEMA spending and the percentage of DHS contracts awarded to local Puerto Rican firms supported this figure.

¹⁶ The Government recognizes all capital formation related expenditure consistent with the above definition as yielding an increase in Puerto Rico's capital stock. This recognition drives a material difference with the FOMB plan, which excludes a category of capital expenditures defined as funding that is directed towards programs and services (e.g., private insurance payments to

4.1 Disaster Relief Working Capital Fund

The FEMA public assistance program requires the Government have access to working capital funding that covers the entirety of project costs in order to initiate and complete Permanent Recovery Projects. These recovery projects are essential to Puerto Rico's reconstruction efforts and present opportunities to impact the Island's future economic success. The disaster relief working capital fund will ensure the Government has access to the capital necessary to initiate the reimbursement processes associated with Federal funding. The capital will be used to cover the estimated cash flow and liquidity needs for eligible Subrecipients, which can be Puerto Rico agencies, municipalities or local non profit organizations, to jumpstart the recovery process. The 2020 Fiscal Plan assumes a \$1 billion working capital fund to address the liquidity constraints associated with the reimbursement nature of disaster relief programs. The fund will be set up in FY2021 and will allow to get reconstruction work off the ground.

While the Federal awards provide for most of the recovery needs, the unique nature of the economic situation in Puerto Rico requires additional measures for successful project completion. When executing Federally funded projects there can be a time lag between the need to pay contractors and the availability of Federal funds. This is generally caused by the reimbursable nature of FEMA and the Department of Housing and Urban Development programs and could lead to work stoppages and increased costs to account for the potential of delayed payment. To assist with these potential issues, the disaster relief working capital fund would be a COR3 account used to finance working capital advances to provide the liquidity needed to initially fund permanent recovery projects, which will be replenished through collection of other sources of funding (e.g., reimbursements) as they become available. The fund, will assist with the following five (5) objectives:

- 1) Provide a faster means of liquidity to begin Permanent Recovery Projects;
- 2) Allow for the segregation and availability of funds for Puerto Rico's recovery;
- 3) Assist with disaster recovery and reconstruction cash flow;
- 4) Assist with Subrecipient cash flow concerns; and
- 5) Determine funds are available for project continuity.

reimburse personal auto expenditures). The Government views programs and services that lead to increases in the capital stock, such as new auto expenditures, as on-Island fixed capital formation that increases the capital stock. The FOMB excludes these from the capital stock.

Part III: Structural Reforms

A sustainable fiscal and economic turnaround depends largely on comprehensive structural reforms to the economy of Puerto Rico. Only such reforms can drive growth in the economy, reversing the negative growth trend over the last ~10 years and enabling the Island to become a vibrant and productive economy going forward. To reverse the negative economic trends, the Government will pursue the reforms outlined below. The impact and timing of these reforms has been adjusted to reflect delay caused by various forces, but the Government continues to believe on these reforms due to their potential economic impact.

Chapter 5. SUMMARY OF STRUCTURAL REFORMS

5.1 Human Capital and Welfare Reforms

- These reforms will improve workforce participation and the well-being and self-sufficiency of welfare recipients, resulting in a cumulative GNP impact of 0.15% by FY2025. The impact is enhanced in the long-term as K-12 education reforms begin adding an additional 0.01% GNP impact per year, resulting in an additional 0.07% by FY2039.
 - *Earned Income Tax Credit*: The EITC is a benefit for working people with low to moderate income. The EITC reduces the amount of taxes owed and may result in a cash refund if the benefit is higher than owed taxes. From 2006 to 2014, Puerto Rico had a Worker's Tax Credit, which was later discontinued due to its ineffective application. This prior Worker's Tax Credit applied to 45% of all tax filers at a cost of \$152 million in its last year of implementation. It was smaller than federal EITC programs (\$150 to \$450 versus ~\$2,000 average credit) and did not eliminate high implicit tax rates on low-income employees or do enough to incentivize formal employment¹⁷. The EITC program would cost approximately \$205 million per year, but the program will raise formal labor force participation significantly, providing a positive return on the investment.
 - *NAP Work Requirements*: NAP (or PAN for its Spanish acronym), Puerto Rico's largest welfare program, is similar to the mainland SNAP, but is funded and administered separately and does not include a work requirement nor specific budget allocations to administer such requirements. As part of the human capital and welfare reform package, the Government will institute work requirements with a 4-year phase-in period starting July 1, 2021 for able-bodied adults without dependents in order to qualify for PAN benefits. Like mainland SNAP, this work requirement must become effective after the individual has collected NAP benefits for three months. The work requirement may be satisfied with 80 hours per month of paid work, volunteer work, and/or qualified training and education. General exceptions would include those under age 18 or over age 60, parents with dependents under age 18, as well as those who are medically certified as physically or mentally unfit for employment. Children, even if their parents do not work, will continue to receive the benefit. The phase-in is the most viable approach because high unemployment rate (lack of supply of jobs) and high volume for training and

¹⁷ New York Federal Reserve Bank, 2014

re-training (lack of skilled professionals) has become a stumbling block that could endanger the current benefits provided by the NAP Program. Contrary to other U.S. jurisdictions, Puerto Rico receives the NAP Programs benefits as a block grant. Puerto Rico cannot redistribute funds immediately in order to mitigate the economic impact to over 150,000 citizens that would qualify for work requirements. To support the efforts for this program, in the FY2020 General Fund budget, the Oversight Board included a \$4.7 million increase within the Department of Families grouping to hire case workers and supervisors for the NAP program.

- *Workforce Innovation and Opportunity Act (WIOA)*: The Government has already updated the WIOA State Plan to focus its programs and incentives on high-priority sectors and capabilities (e.g., aerospace, software development, and creative services). WIOA is the primary way in which the Federal Government invests in adult education and workforce development, and it is designed to help jobseekers access employment, education, and support services to succeed in the labor market, and to match employers with the skilled workers they need. The Government will broaden the list of core industries that qualify under WIOA and focus on high impact economic sectors to provide a skilled workforce that meets the needs of employers in each specific region. It will integrate this WIOA program with the broader promotional efforts of the Department of Economic Development and Commerce.

5.2 Ease of Doing Business Reforms

- These reforms will improve conditions for economic activity, job creation, and business vitality, resulting in a cumulative GNP impact of 0.40% by FY2025.
 - *Improve Ease of Doing Business World Ranking*: One of the best ways to increase economic growth is to attract additional investment and create new jobs. The competitive environment in Puerto Rico requires improvement if it is to compete with other investment destinations, specifically by reducing a variety of inefficiencies related to building, expanding and attracting businesses. Easier-to-navigate regulations, less complex and faster investment and permitting mechanisms, and streamlined tax administration systems can encourage new businesses to hire employees and invest in growth. These outcomes can be achieved by making necessary administrative and legislative changes and by investing in digitization. To quantify a jurisdiction's overall effectiveness in this regard, the World Bank created the Doing Business Index, which ranks 190 countries and entities worldwide on several core indicators. Countries and territories that have been able to meaningfully improve their ranking have shown real growth. For example, when the Republic of Georgia improved its ranking from #98 in 2006 to #8 by 2014, output per capita increased by 66% and business density tripled. Meanwhile, ease of doing business remains an area in which Puerto Rico has much room for improvement. Puerto Rico will achieve a best-in-class business environment by taking targeted steps to improve rankings in key identified Doing Business Index indicators by FY2023, with the goal of closing the gap with the mainland U.S. by at least 50% from its 2019 rankings:

- **Overall:** Move from 64 (65 in 2020) to at least 57¹⁸
- **Construction Permits:** Move from 138 (143 in 2020) to at least 87
- **Registering Property:** Move from 153 (161 in 2020) to at least 95
- **Paying Taxes:** Move from 161 (163 in 2020) to at least 99
- **Getting Electricity:** Move from 69 (92 in 2020) to at least 59

The 2020 Fiscal Plan re-iterates the **need for urgent action, particularly in light of no progress in Puerto Rico’s ranking in the categories of Ease of Doing Business that have proven most important to stimulating growth in other jurisdictions.** The Oversight Board acknowledges recent initiatives announced by the Government to streamline the permitting process and expects committed actions to ensure that this results in meaningful change during the next fiscal year.

- *Single Business Portal:* The April Certified Fiscal Plan required that the Government target 100% integration into SBP by end of 2018 for the following metrics: Licenses integrated into SBP; cases filed in SBP; cases issued in SBP; concerned entities integrated into SBP; and autonomous municipalities integrated into SBP. The Government has moved forms online to the extent possible, including decoupling all non-related procedures from permitting, centralizing and digitizing permits. The SBP receives constant upgrades in order to keep it running at its highest capacity, and help it integrate new features as required by the 2019 Certified Fiscal Plan.
- *Reduce occupational licensing:* Reducing occupational licensing requirements can encourage activity in the formal labor market. The Government has taken an inventory of all occupational licensing requirements and has begun developing reforms to reduce unnecessary regulations, creating a more open labor market. It will also consider joining U.S. mainland agreements to recognize licenses obtained in other states, such as the Compact for the Temporary Licensure of Professionals. Such an agreement enables professionals with licenses from other states to enter the Puerto Rican labor market without undue barriers.
- *Improve ease of registering property:* The Government has improved the process for business permitting and registrations through a digitized one-stop-shop system for business processes, expanding on work initiated under Act 19. A revised property registration (with improved geographic coverage and transparency of information) must be integrated into the SBP and all permitting requirements must be carried out within the SBP. The SBP should contain clear and coherent rules for permitting, as well as transparency and access to regulations.
- *Improve ease of paying taxes:* The Government will develop a one-stop tax registration and payment portal linked to the SBP (or directly within the SBP) in order to reduce time taken to file corporate and sales tax. Puerto Rico Department of Treasury (“Hacienda”) has made some progress to date on automating internal systems, but this work must be completed and fully integrated with SBP – to date it has not been possible to e-file and returns have been slow to process. These efforts can focus on reducing the core measures of performance, which include

¹⁸ In line with the top ranked Latin American country in 2018.

number of payments per year, the hours required per year, and the burden of the tax system after the tax filing.

- *Invest Puerto Rico*: iPR has created an internal platform to track data (both inputs and outcomes) that has begun developing benchmarks for project ROI. Further, iPR has already published its first annual report and is currently developing a template for quarterly reports, these reports address key metrics and performance results and track/course-correct projects on an ongoing basis, including feedback from investors and data trends.
- *Discover Puerto Rico*: DPR has completed an analysis comparing tourism statistics in Puerto Rico versus tourism industries worldwide.¹⁹ After such analysis DPR has created a promotional plan to target specific markets that can bring the most return to the Island. In addition DPR is currently trying to take over the duties of visitor surveys from the Puerto Rico Planning Board. Further, DPR has developed an annual report addressing key metrics and performance results as well as update on targets.

5.3 Power Sector Reforms

- For decades, Puerto Rico has suffered the burden of unreliable and costly electric power, a result of an aging infrastructure with insufficient investment, poor operating performance and high and volatile fuel prices. Devastation in 2017 caused by Hurricanes Irma and Maria resulted in significant damage to an already aged T&D system.
 - *Outsourcing T&D*: Hiring a third-party T&D system operator creates significant benefits to Puerto Rico ratepayers including modernizing and hardening the grid to ensure long term resiliency, improving safety and security and improving affordability and customer experience. The transformation of PREPA-owned generation will allow for increased competition of fuels and technology stabilizing electric rates impacting Puerto Rican ratepayers and driving local and foreign investment in Puerto Rico and ultimately promoting economic development across the Island.
- These reforms will improve availability and affordability of energy for families and businesses, resulting in 0.30% cumulative GNP impact by FY2025.

5.4 Infrastructure Reform

- These reforms, along with capital investment, will improve the flow of goods, services, information, and people across the Island. It has not been scored to provide a specific GNP uptick, but will likely contribute a consequential uptick in the Island's long-term development.
 - *Infrastructure and Reconstruction Efforts*: The Government created COR3 to lead the coordination, development and execution of long-term recovery and reconstruction efforts, and facilitate federal funding and private capital to promote a more rapid economic turnaround. The Public Private Partnerships (P3) Authority could serve as counter-party, introducing exclusivity provisions to lower

¹⁹ For example, utilizing the Tourism Satellite Account tool leveraging economic tourism data

the risk for private capital, and subordinating government-provided capital. The P3 Authority would further seek to leverage the skills and assets of the public and private sectors to service the people of Puerto Rico in delivering prioritized projects efficiently and effectively. Puerto Rico's proven P3 framework and record in executing landmark projects such as Toll Roads PR-22 / PR-5 and LMM International airport highlight the potential for an Island-wide team to develop and deliver technical, financial and legal expertise for P3 projects. Further investing in these entities can enable their ability to facilitate needed improvements in infrastructure, knowledge services, and other strategically important sectors to improve the fiscal situation in Puerto Rico and spark economic growth and environmental compliance. Additional funding that becomes available for the COR3/P3 Authority could also go towards improving governance and execution. Additional investment in infrastructure projects and recovery efforts through the Puerto Rico Infrastructure Authority (PRIFA) will promote further economic growth and reduce the risk of reform implementation. To avoid the potential for wasteful spending, these investments must adhere to the following principles:

- Set clear priorities using cost-benefit analysis to guide investment
- Accelerate the pre-construction process
- Build sustainable funding models and financing strategies focused on full lifecycle costs of any capital investments
- Promote procurement and project delivery best practices to lower costs
- Build infrastructure of tomorrow

5.4.1 Current State of Infrastructure and Capital Investment

Infrastructure investment as a percentage of GDP decreased from 3.3% in 2000 to 1.2% in 2018²⁰, in part as a result of the fiscal crisis, but the capital investments enabled by federal disaster recovery funding offer a unique opportunity to make transformational investments that support economic development.

There are several critical elements that Puerto Rico will include to capitalize on the transformational opportunity afforded by historic federal capital funding:

- **Build organizational structures and capabilities** in the Government to prioritize and deliver projects faster and at lower cost;
- **Prioritize projects with the highest long-term benefit-cost ratios** taking account a variety of monetizable and non-monetizable benefits; and
- **Systematically leverage private sector capabilities** to improve overall public outcomes

²⁰ American Society of Civil Engineers 2019 Infrastructure Report Card.

5.4.2 Organizational Structures and Capabilities

When creating a reconstruction plan, it is imperative to build a central capability with the skills and mandate to design an overall recovery portfolio and oversee efficient project delivery. To address this, the Government created COR3 as a Division of the P3 Authority to lead the coordination, development, and execution of long-term recovery and reconstruction efforts. The COR3 has been created based on leading practices used in many jurisdictions, including New Jersey, Louisiana, New York and New Zealand, to ensure higher accountability, transparency and coordination of disaster recovery efforts.

COR3 will aggressively pursue next level resiliency activities with federal dollars, to ensure that Puerto Rico's critical assets are sufficiently protected from future hazards.

Specific COR3 activities will include:

- Developing, presenting and administering recovery action plans
- Financing, executing and effecting infrastructure projects related to recovery efforts
- Monitoring contracting for compliance and effectiveness purposes
- Implementing and enforce checks and balances for procurement and approval of contracts and payments
- Coordinating and channeling all efforts and activities of the Government related to recovery efforts
- Monitoring capital project delivery, focused on major projects, to ensure on-time, on-budget delivery, highlight risks of cost overrun or delay, and create transparency for overall capital program delivery, including recovery spending led by COR3 or another Government entity with capital delivery expertise

5.4.3 Prioritization and Delivery

The Government will employ infrastructure delivery best practices (e.g., prioritization of projects for economic impact, fast-track permitting, procurement reform). These best practices improve efficiency and transparency and should be applied to all areas of infrastructure expenditure of the Government including reconstruction, construction and maintenance of government owned assets, and procurement of infrastructure through public corporations and Public-Private Partnerships.

The Government will pursue five sub-strategies:

1) Set Government infrastructure priorities to guide investment

- Set target outcomes to guide prioritization of projects
- Develop clear, systematic cost-benefit analysis and quantitative scoring to prioritize projects based on return on public investment and the ability to implement

2) Accelerate the pre-construction process

- Identify opportunities for local review and permitting, for as many projects as possible, to avoid federal delays

- For projects requiring local review, revisit existing process to reduce hurdles, and ease of meeting them, wherever possible
- Where federal approval is needed, focus on: clarifying decision rights and confirming processes with all major stakeholders; harmonizing local processes to match federal processes and seeking waivers where applicable; ensuring transparency and clarity from Federal Government on where projects are in the pipeline; and utilizing Title V of PROMESA

3) Build sustainable funding models and financing strategies

- Leverage external capital, by expanding P3's and access to federal credit (e.g., TIFIA) and grant (e.g., INFRA) programs
- Increase bankability, and eligibility for participation in P3's by deploying monetary and non-monetary incentives (e.g., recyclability of proceeds from asset monetization, including monetization of Government-owned real estate to support the revenue models for P3's)
- Provide support to de-risk greenfield investment (e.g., reduction of early stage demand risk)

4) Promote procurement and delivery best practices

- For projects that receive Government funding, ensure such projects:
- Develop an aligned owner organization with streamlined processes (e.g., early procurement involvement, accountable owner team oversight)
- Build an effective contracting strategy (e.g., tailored bidding process and pricing models, change order management tools)
- Utilize advanced procurement tools and approaches (e.g., rigorous clean sheet models, quantified view of Total Cost of Ownership drivers)
- Implement lean construction and digital techniques

5) Build the infrastructure of tomorrow

- Identify innovative technologies (e.g., automotive transformations, drones, new tunnel creation methods, the Internet of Things) and develop a strategy to actively promote them (e.g., AV pilot test zones), or at least find a way to not stifle their development (e.g., job trainings for displaced workers)
- Critically evaluate major new investments against future trends, to avoid disruption by innovation (e.g., avoid the buildout of excessive parking given increase in shared mobility and growth of autonomous vehicles)

The 2020 Fiscal Plan assumes the growth from these reforms will reach 0.85% in the short term and does not fully occur until FY2025. These reforms equal approximately \$12.8 billion in increased Government revenues over FY2020-2039. In the long term, education reforms are projected to add an additional cumulative 0.07% to GNP growth, making total impact 0.92% by FY2039.

5.4.4 Puerto Rico Public-Private Partnerships

Through P3s, the Government seeks to leverage the skills and assets of the public and private sectors to deliver better services to the people of Puerto Rico, as well as building and/or operating high priority facilities or projects of the Government.

- The prioritized projects will serve one of the following goals:
 - Long-term and sustainable increase in overall productivity.
 - Respond to emergencies to protect life, public health and safety.
 - Carry out extraordinary repairs and renovations to extend useful life of critical public assets.
 - Significantly reduce operational costs and/or increase revenues.
 - Attract significant private investment in critical sectors (e.g. highway, water, and waste management).
- **PREPA T&D P3:** The PREPA Certified Fiscal Plan contemplates the complete transformation of PREPA to become a customer-centric and financially sustainable utility that provides affordable, reliable and resilient services to the people of Puerto Rico. To achieve this transformation, an RFP process is being conducted by the P3A with the purpose of awarding a long-term public-private partnership agreement. Qualified respondents were invited to submit proposals to manage, operate, maintain, rehabilitate, repair, refurbish, replace, improve, expand and finance PREPA's T&D system.
- **PRASA Meter and Customer Service P3:** The Puerto Rico Aqueduct and Sewer Authority (PRASA) and P3A are establishing a 15 to 20 year public-private partnership that consists of the design, build, finance, maintenance and operations of a series of infrastructure and technological improvements to reduce the amount of non-revenue water produced by the utility while improving water conservation and customer service operations. These advanced technologies include, but are not limited to, remote smart meter reading technology and geo-referencing of customer accounts. PRASA aims to increase revenues by reducing meter error, establishing new connections of inactive accounts and reducing theft.
- **MTA P3:** The Puerto Rico Maritime Transportation Authority (MTA) desires to have a private operator invest and participate in the operation and maintenance of MTA's ferry system, including the vessels and facilities, and engage in other ancillary commercial activities to increase revenue and improve services and customer experience. The P3A is leading a public-private partnership process between a private operator and MTA that will require the private operator to maintain specific performance standard to ensure the safety, reliability and efficiency of ferry services. The Government will allocate the necessary resources so that the people of Vieques and Culebra have reliable transportation services.
- **PRPA P3:** The P3A is currently evaluating a transaction that contemplates the concession of Piers 1 through 4, Piers 11 through 14 and Pan American Piers 1 and 2 in the San Juan Bay to a private operator. Piers 11 through 14 are currently closed by the US Coast Guard due to poor structural conditions and the remaining piers could face similar risks. In exchange for the concession, Puerto Rico Ports Authority (PRPA) expects the operator to

invest in significant capital improvements that will bring the existing piers to adequate standards to accommodate larger cruise ships and allow for additional growth in cruise ship passenger volumes. Additionally, PRPA is expected to receive an upfront payment from a preferred proponent and participate in a revenue share agreement. In addition, the P3A is currently evaluating a project that would result in the engagement of a private entity to operate and maintain nine regional airports under a single O&M contract in accordance with performance standards and applicable laws. Through this initiative, operations of regional airport operations would be optimized with improved services, increased revenues and reduced costs. The private operator will be responsible for performing routine and preventive maintenance of the airport facilities, providing administrative functions, advising PRPA on recommended capital improvements and issuing alerts to aircraft pilots of potential hazards.

Part IV: New Government Model

Chapter 6. REVENUE ENHANCEMENTS

6.1 Tax Reform

Future Vision for Tax Environment

The 2020 Fiscal Plan includes a revenue neutral tax model that provides significant relief to individuals and businesses and helps drive economic development as described below:

- Reduces by 5% the total regular tax responsibility for individuals
- New thresholds for Alternative Basic Tax rates that range from 1% to 24%
- Earned Income Tax Credit ranging from \$300 dollars to \$2,000 dollars, will be granted to qualifying Puerto Rico resident taxpayers with earned income
- Reduces the corporate base tax from 20% to 18.5%, and the top rate from 39% to 37.5%
- The Alternative Minimum Tax (AMT) rate is reduced to 18.5% for certain small and medium enterprises, and 23% to those corporations with volume of business of \$3 million or more
- Reduction of the cost of compliance to taxpayers through offering Optional Contribution option for self-employed individuals and corporations that have income derived primarily from services. This provides the option for taxpayers to pay fixed tax rates of up to 20% as long as income is subject to withholding tax or estimated payments
- Use of greater controls in deductions to provide a greater degree of certainty and discourage tax evasion
- Increased use of technology and digitization of information that will allow simplification of interaction with the Department of the Treasury, increased efficiency in making tax administration decisions, improve operational aspects of the Department of Treasury, and reduce the complexity using a unified and integrated system
- Eliminates the requirement of collect B2B tax for 77% of merchants registered in Internal Revenue Unified System (SURI)
- Reduces the tax rate on prepared foods transactions (e.g., at restaurants) from 11.5% to 7%

The projected value of tax reductions and offsets are shown below (**Exhibit 11**).

EXHIBIT 11: DETAILED TAX REFORM INITIATIVES AND OFFSETS

	FY19	FY20	FY21	FY22	FY23	FY24	Total
Tax cuts / revenue reductions							
Individual nonrefundable credit 5%	(41)	(101)	(103)	(105)	(106)	(106)	(562)
Corporate income tax reductions to 37.5%	(15)	(36)	(37)	(37)	(37)	(37)	(199)
Phase out of B2B tax	(6)	(17)	(18)	(18)	(18)	(18)	(95)
Reduction of SUT on prepared foods	0	(68)	(91)	(91)	(91)	(91)	(432)
Subtotal	(\$62)	(\$222)	(\$249)	(\$251)	(\$252)	(\$252)	(\$1,289)
Tax initiative offsets							
Miscellaneous changes in Sales and Use Tax Regime	1	3	3	3	3	3	15
Tax credits	0	0	0	0	0	0	0
Cash grants	0	0	0	0	0	0	0
Corporate AMT & Flat Tax Potential Revenue	103	248	254	257	257	257	1,376
Individual AMT & Flat Tax Potential Revenue	20	49	50	50	51	51	271
Individual Cafeteria Plans - Technical Adjustments	58	59	61	62	63	63	365
Other Measures	8	0	0	0	0	0	8
Subtotal	190	358	367	372	374	374	2,034
Subtotal Total Net Impact Before Implementation Risks	128	136	118	121	121	121	745
Implementation Risk Adjustments							
Corporate AMT behavioral adjustment discount	(17)	(42)	(43)	(43)	(43)	(50)	(238)
Corporate AMT economic adjustment discount	(4)	(10)	(10)	(10)	(10)	(14)	(59)
Individual AMT behavioral adjustment discount	(3)	(8)	(8)	(8)	(8)	(11)	(48)
Individual AMT economic adjustment discount	(1)	(2)	(2)	(2)	(2)	(3)	(12)
Other measures behavioral adjustment discount	(8)	(5)	(5)	(5)	(6)	(8)	(37)
Additional Reduction of SUT on prepared foods	(8)	(17)	(20)	(22)	(22)	(26)	(115)
Elimination B2B ONLY on businesses of \$200k or less in Sales Behavioral Change	(2)	(3)	(3)	(3)	(3)	(5)	(20)
Additional Adjustment Requested by the FOMB	38	27	0	0	0	0	65
Total Net Impact After Implementation Risk Adjustments	\$123	\$76	\$26	\$27	\$27	\$4	\$282
Unallocated implementation risk	(123)	(76)	(26)	(27)	(27)	(4)	(282)
Unallocated implementation risk	0	0	0	0	0	0	0

6.2 Tax Compliance and Fees Enhancements

6.2.1 Current state and future vision for tax revenue collection

Puerto Rico has suffered from low tax compliance due to an unevenness in who pays taxes and lack of fear among violators, leading to limited downside for non-compliance and high upside for tax avoidance. **Due to its compliance and collections issues, the Government has not been able to drive as many revenues from taxes as it should each year.**

In response to these challenges, the Government has already started implementing compliance-related changes. It is driving improvements in its culture and organization to boost enforcement capabilities, streamlining the process of filing taxes and reducing complexity in the system to lighten the burden of compliance on taxpayers. These efforts have already resulted in some success: in 2012, Sales and Use Tax (SUT) compliance stood at 56%, and by 2016 had improved by 12 percentage points, to 68% compliance.²¹

6.2.2 Administrative tax initiatives to increase revenue collections

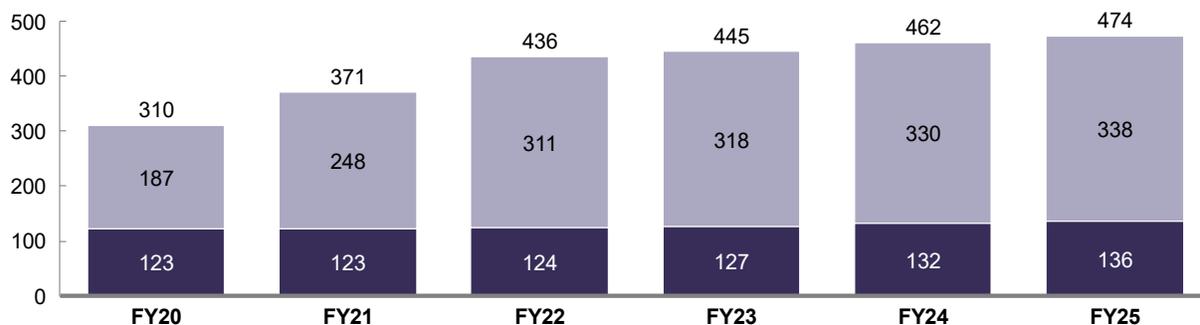
By driving administrative reform, the Government of Puerto Rico will increase revenues by approximately \$2.5 billion over six years, as shown below (**Exhibit 12**).

²¹ Departamento de Hacienda, November 2016.

EXHIBIT 12: TAX COMPLIANCE AND FEE ENHANCEMENTS SUMMARY OF IMPACT

Summary of tax compliance and fees enhancement measures impact, \$M

■ Improve compliance rate ■ Right-rate other taxes and fees



6.2.3 Improve compliance rate

Given the progress to date in improving compliance rates and the ongoing gap to reach mainland performance, the Government is targeting a 5% net increase in revenues due to enhanced compliance by FY2022 – inclusive of implementation costs from reinvestment described in the “Office of the CFO (OCFO)” – across the major tax lines (PIT, CIT, and SUT). Such an improvement would also be in line with improvements seen in other tax transformations.²²

Recent compliance efforts have largely focused on collections outreach activities, obtaining one-time back taxes owed through a collection call center, flexible payment plans, and a large corporate taxpayer-focused team (with a longer-term goal of establishing a permanent separate unit). In the future, emphasis will shift towards initiatives that promote a culture of compliance to boost voluntary payment. The goal will be to reduce the cost of compliance while simultaneously raising the cost of non-compliance, through a combination of increased detection rate of tax delinquency and more effective and enforceable penalties.²³

- **Use new systems and processes to identify and remediate non-payment.** Hacienda will create a “premium return system” for individual and corporate taxpayers that enables taxpayers to claim certain deductions and exemptions only if their return is prepared by a certified public accountant following agreed upon procedures; the CPA’s review and certification of the return and supporting documentation as compliant with Puerto Rico’s tax laws would functionally serve as a “pre-audit,” reducing the likelihood of tax evasion and the need for a fuller review by Hacienda.
- **Create a new culture internally and externally** that shifts from the agency existing to serve the public (“*Hacienda para servirle*”) towards emphasis on Hacienda making sure everyone pays their taxes, but with as little friction as possible for the taxpayer and the agency.

²² Analogous case studies include Panama, Jamaica, and Spain, which saw 1.0 to 2.5 percentage point increases in tax ratio relative to GDP through their comprehensive tax overhauls. Puerto Rico achieving a 5% uplift from compliance, along with the other measures on corporate tax reform and increased fees, would produce a 2.25 percentage point increase in tax ratio relative to GDP, in line with these case studies.

²³ Ms. Xenia Velez presentation to the Oversight Board (Nov. 30, 2017).

- **Reduce the complexity of the tax system and process of filing taxes** to make it easier for individuals and businesses to pay their taxes correctly. Hacienda reports it plans to introduce pre-filled tax returns and fully digitize the tax filing system onto the SURI platform that will enable easier filing, communication, and levying of penalties for late payment or non-payment. It must also ease the process of paying for licenses, stamps, and fees by shifting from a system of 64 agency payment centers to instead partner with retail banks, enabling taxpayers to pay their fees at any of 200 private sector locations in various communities (and within four years, 1,000 locations).
- **Institute advanced analytics and broad-reach, low-touch correspondence audits.** Small and medium taxpayers account for a significant share of the unpaid and underpaid taxes, but only a tiny fraction of these taxpayers receive full-scale audits due to the significant time and cost investment needed. While a traditional Internal Revenue Service (IRS) audit costs an average of \$2,278 per case, automated notices or letters can be executed for \$52 to \$274 per case.²⁴ Hacienda had begun a correspondence audit program prior to Hurricanes Irma and Maria, receiving such a strong response to the first batch of 1,000 letters that it overwhelmed the call center. This program helped contribute to \$7.1 million of collections outreach revenues in the first 2 months of FY2018 (against a \$1.4 million target),²⁵ with half of those responding to the letters agreeing to pay the proposed penalty amount.²⁶ Fully implementing data-driven tiered audits will enable Puerto Rico to reach a significantly larger share of nonpayers.
- **Collecting SUT on Internet sales.** Nationally, the percent of taxpayers voluntarily reporting and paying use tax on their income tax forms ranges from 0.2% to 10.2%,²⁷ while nearly 80% of Americans shop online.²⁸ Pursuant to the recently published United States Supreme Court decision on *South Dakota vs. Wayfair*, U.S. S.Ct., Dkt. No. 147-494 (June 21, 2018), the Supreme Court overruled the judicially created physical presence requirement to the imposition of SUT collection responsibility on remote retailers (or internet retailers) and validated the economic nexus standard implemented by South Dakota. The Supreme Court ruled that the correct standard is “whether the tax applies to an activity with a substantial nexus with the taxing State”. In holding that the substantial nexus requirement was met, the Supreme Court noted that the sellers in *South Dakota vs. Wayfair* “maintain an extensive virtual presence”.²⁹ Through legislation combining click-through nexus, affiliate nexus, and economic nexus following the standards of *South Dakota vs. Wayfair*, as well as voluntary agreements with major online retailers, the Government should be able to capture SUT on a much larger share of Internet sales.³⁰ In

²⁴ IRS Enforcement Results, TIGTA Filing Season Audit, IRS Taxpayer Advocate, Team Analysis, GAO.

²⁵ Hacienda, Fiscal Reforms August 2017 reporting.

²⁶ Conversation with Hacienda, Dec 13, 2017.

²⁷ <http://www.house.leg.state.mn.us/hrd/pubs/usetax.pdf>.

²⁸ Tech Crunch, 2016.

²⁹ The economic nexus standard in *South Dakota vs. Wayfair*, U.S. S.Ct., Dkt. No. 147-494 (June 21, 2018) imposing SUT collection and remittance responsibility on out-of-state sellers applies to retailers that deliver more than \$100,000 of goods or services to South Dakota or engage in 200 or more separate transactions for the delivery of goods or services to South Dakota. In upholding the South Dakota’s economic nexus law, the Supreme Court held that the standard met the constitutional requirements of the Commerce Clause because: (i) “the Act applies a safe harbor to those who transact only limited business in South Dakota”, (ii) “the Act ensures that no obligation to remit sales tax may be applied retroactively”, and (iii) “South Dakota is one of the more than 20 States that have adopted the Streamlined Sales and Use Tax Agreement”.

³⁰ Click Through refers to a nexus between an out of state seller and the state, which enables them jurisdiction to collect taxes, created via an affiliate in the state that links to another “out-of-state” business via an affiliate program (i.e., they send sales your way, you give them a small cut of the profits). Economic nexus refers to the dollar amount spent by a consumer at a business, which provides sufficient local economic activity for the state to be able to collect taxes from that out-of-state seller. Affiliate nexus refers to out-of-state sellers with ties to local sellers, such as through parent or subsidiary arrangements, or local order fulfillment,

fact, the Government has approved several amendments to the Puerto Rico Internal Revenue Code of 2011, as amended, that incorporate these nexus standards and impose certain notice and reporting obligations on out of state retailers that don't meet the nexus requirements.³¹ For example, out of state sellers classified as non-withholding agents for SUT are required to: (i) include with their invoice a notice to every Puerto Rico customer of their obligation to pay the SUT and (ii) file a quarterly report with Hacienda to report sales made to Puerto Rico residents.³² Additionally, Hacienda has already announced an agreement with a large online retailer to charge Puerto Rico sales tax on sales of goods.³³ With Internet sales growing at ~15% annually, Internet sales tax presents an even more important opportunity going forward.

Considering the post-hurricane limitations, additional compliance activities should be implemented throughout FY2019, and are expected to cause revenue impacts growing throughout FY2020 and beyond. The impact would phase-in over the course of 4 years given the need for training and movement of workers into Hacienda through the Single Employer Act (Act 8-2017), establishment of new offices and processes, and gradual shift in public perception and voluntary compliance as a result of enforcement activities.

6.2.4 Right-rate other taxes and fees

Prior to Hurricane Maria, the Government had already developed a plan to right-rate the following taxes and fees. These original plans, as well as any adjustments mutually agreed upon between the Government and the Oversight Board during implementation of the March 2017 Fiscal Plan, have been largely included in this 2020 Fiscal Plan, except where explicitly noted below.

- **Gaming tax:** Legislation passed in 2017 that increased licenses and fees on mechanical and electronic gaming machines to \$3,000 from \$100. This was originally estimated to generate \$~71 million in incremental revenues.³⁴ Part of this calculation involved assumptions of improved enforcement improvements, as the Government has previously estimated it is losing approximately \$170 million per year due to illegal machines that are not paying licensing fees. However, when factoring in the potential that a 2,900% increase in taxes on the machines could decrease total revenues from gaming – a change from 2017 forecasting – run-rate, incremental revenue from the gaming tax has now been reduced to approximately ~\$52 million by FY2024.
- **Licenses and other fees:** Act 28-2017 legislation enabled fee increases in miscellaneous categories. A committee composed of AAFAF, Hacienda and OMB will determine which exact fees are to be increased to meet these minimum thresholds, achieving an overall revenue of ~\$65 million by FY2024.³⁵ Categories that will be considered are: Charges for services; Fines; Insurance; Licenses; Permits; Rent; Royalties; Stamps; Other.
- **Tobacco taxes:** Legislation was passed in 2017 to increase specific tobacco taxes, including taxes on cigarettes, cigars, rolling tobacco, cigarette paper and tubes, chewing

which creates sufficient local ties to subject the out of state seller to local taxes. Voluntary agreements occur when corporations agree through individual negotiations with states to collect and remit sales tax directly to the state.

³¹ Sections 4010.01(h), 4020.08 and 4041.03 of the Puerto Rico Internal Revenue Code of 2011, as amended (the "PR Code").

³² Sections 4020.08 and 4041.03 of the PR Code.

³³ Caribbean Business, "Amazon to charge Puerto Rico sales tax".

³⁴ Based on an assumption of 23,000 gaming machines on which Hacienda is able to collect fees (<http://www.oslpr.org/2017-2020/leyes/pdf/ley-108-23-Ago-2017.pdf>).

³⁵ Assumes an 80% capture rate on the \$73 million potential to account for potential elasticities in demand based on fee increases.

tobacco, snuff, electronic cigarettes, nicotine cartridges, and vaporizers. A new tax is included in the baseline to account for one-time declines in use due to price-related elasticities after the new fees went into place.³⁶

- **Medical marijuana tax:** The Government has passed legislation to tax medical marijuana. Based on an estimated 29,000 patients, the Government can be expected to collect approximately ~\$15 million per year in additional revenue through this initiative.³⁷
- **Airbnb & Short-term Rental Tax:** The Government has passed a law to apply a 7% hotel room tax to Airbnb and all other short-term rentals, resulting in a projected ~\$4 million of annual revenue increases, based on annualization of the actual Airbnb tax receipts from before the hurricanes.³⁸

Chapter 7. REINVESTMENT IN PUERTO RICO TO ENSURE PROSPERITY

As part of the 2020 Fiscal Plan, the Governor has developed six initiatives to improve the standard of living of American citizens living in Puerto Rico. These initiatives, as outlined below, are focused on protecting some of the most critical career public servants.

7.1 Uniform Remuneration Plan for Career Government Employees (Excludes At-Will or “Confianza” Employees)

The Governor’s Uniform Remuneration Plan is an initiative that is being carried out by the Office of the Administration and Transformation of Human Resources (OATHR). The legal framework for the Uniform Remuneration Plan has been established through Law No. 8-2017³⁹ and Executive Order No. OE-2017-026⁴⁰. The ultimate goal of the Uniform Remuneration Plan is to optimize the administration of government career employee functions and improve the quality of life of career public service employees. To achieve its goal, the initiative has been divided in two parts, the “Classification Plan” which aims to standardize roles and compensation structures across all agencies, and the “Compensation Plan” which aims to increase compensation to government career employees (Excludes At-Will or “Confianza” Employees).

- **Classification Plan:** The Classification Plan standardizes government functions for career employees across agencies to facilitate the administration of human resources processes, preparation of training plans, and improvement of utilization of services offered by government employees. To achieve this, a series of uniform criteria were developed for classes of functions, position titles, and minimum academic and work experience requirements. Prior to this initiative, an overwhelming amount of different job titles existed for career employees who perform similar functions across government agencies. By consolidating these job titles into standardized roles, government career employees could more efficiently transfer between agencies and were provided

³⁶ Based on an 18% decline, per Hacienda (April 5, 2017 calculations).

³⁷ \$15 million projected receipts, minus \$1.5 million of dedicated revenues for the medical marijuana council established in 2017-Act 42 and controlled substances monitoring in 2017-Act 70.

³⁸ Hacienda August 2017 Revenue Scorecard, submitted Sept 15, 2017.

³⁹ Law No. 8-2017, as amended, known as “Law for the Administration and Transformation of Human Resources in the Puerto Rico Government”.

⁴⁰ Executive Order No. OE-2017-026, “Executive Order from the Governor of Puerto Rico to Increase the Minimum Wage in the Public Service and Government Construction Contracts”.

transparency around responsibilities and compensation as compared to their peers. This initiative has been successful to date, having already reduced the amount of job positions and titles across government agencies by 94%.

- **Compensation Plan:** The Compensation Plan addresses the need to determine a clear and reasonable way to pay the new groups of career employees outlined in the Classification Plan. The Compensation Plan accomplishes this goal by dividing government career employees into two categories: Career Union Employees and Career Administrative Employees. Each of these categories has three standardized compensation structures, which will be maintained real time such that they are representative of the economic reality, fiscal capacity and cost of living in Puerto Rico. In creating these uniform pay structures, a variety of aspects are being carefully considered, including complexity of the functions performed, grade of responsibility and authority related to the position, and employment conditions. These new compensation groups will receive increased salaries in accordance with the aforementioned criteria, which are not only transparent but will also allow government employees to live an improved standard of life.

The 2020 Fiscal Plan projects this initiative will cost approximately \$146 million in FY2021, growing to \$155 million by FY2025.

7.2 Puerto Rico Police Department Retirement

Up until 2013, police officers with 30 years of service received 75% of average compensation when retiring at age 55, or 65% when retiring before the age of 55. However, Law 3-2013⁴¹ drastically decreased these benefits for police officers. As a result, the average pension benefits are currently 41% of base salary for police officers hired under Law 447 and 26% for those hired under Law 1⁴². This initiative increases the average pension benefit to 50% of base salaries for all police officers. The 2020 Fiscal Plan projects this initiative will cost approximately \$25 million in FY2021 and growing with inflation through the 20-year forecast period.

7.3 Act 29-2019⁴³

Municipalities deliver accessible and affordable public services such as health, sanitation and emergency services. In recent years, many municipalities have been facing financial distress due to unforeseen disaster relief spending, payment of PayGo liabilities on account of Act 106-2017 and debt service payments. Such distress burdens the municipalities' day-to-day functions, which has a resulting negative impact on the critical services that they provide. The 2020 Fiscal Plan includes Act 29 which is meant to alleviate municipalities' financial distress via the payment of Municipality PayGo and Medicaid by the General Fund. On July 3, 2019, the Oversight Board initiated an adversary proceeding against the Governor and AAFAF seeking, among other things, to prevent the implementation and enforcement of Act 29. According to the Board, Act 29 violated the May 9, 2019 Certified Fiscal Plan and Board budgets for fiscal years 2019 and 2020 because the Board relied on the assumption that municipalities would continue paying the PayGo

⁴¹ Law 3-2013, an amendment to Law 447 "Commonwealth Employee Retirement System Law", altered the defined contribution structure of pension benefits for police officers who started working for the Government before January 1, 2000.

⁴² Law 447 is used to determine pension benefits for police officers that started working before April 1, 1990; Law 1: used to determine pension benefits for officers hired between April 1, 1990 and December 31, 1999.

⁴³ Act 29 is the subject of litigation between the Oversight Board and the Government. The outcome of that litigation could impact the expenditures assumed herein.

fee to the Government under Act 106-2017. On August 22, 2019, the Title III Court denied the Government's motion to dismiss the complaint and the Board subsequently filed a motion for summary judgment, which is currently scheduled to be heard on March 4, 2020. The cost to the central government related to this initiative is \$334.0 million in FY2021. The impact of Act-29 on the municipalities is significant and real. Based on an analysis prepared by the Municipal Revenues Collection Center ("CRIM"), 28 municipalities receive more than 70% of their FY20 estimated income from Act-29 and Lottery funds. An additional 16 municipalities receive between 50% and 70% of their FY20 estimated income from Act-29 and Lottery funds. The nullification of Act-29 could render at least 28 municipalities insolvent which would result in the reduction or elimination of the essential services they provide. In addition, the nullification would very likely trigger defaults on the various municipal credit obligations that could result in a domino effect across the local financial industry.

7.4 Disaster Relief Working Capital Fund

The 2020 Fiscal Plan assumes a \$1 billion working capital fund to address the liquidity constraints associated with the reimbursement nature of disaster relief programs. The WCF will be set up in FY2021 and will accelerate the rebuilding process, particularly permanent projects. There will be a one-time budgetary impact with substantially all funds returning to the general fund upon completion of the program.

7.5 Parametric Insurance

Following steps already taken by some mainland states, such as Louisiana and Utah, and considering the aftermath of the 2017 natural disasters, the Government plans to acquire a Parametric Insurance Program, which is a proven and viable alternative to traditional Property Insurance Policies, for said types of natural disasters, including earthquakes. The proposed Program would cover both Central Government Agencies and key Component Units (CU) (in terms of services offered). Unlike traditional insurance policies, parametric insurance policies are not subject to legal interpretation (there is no claims adjusting process involved). These programs do not indemnify the pure loss, but rather provides an *ex-ante* payment upon occurrence and certification of pre-determined and pre specified natural events, subject to a series of pre-defined triggers. The benefits of parametric insurance are three-fold:

- **Liquidity:** In the event of the occurrence of a predetermined and specified event, the Government would not be left cash-strapped since there is no adjusting process involved, provided the predetermined event triggers are met. Hence, liquidity would be readily available to the Government, much faster than with a traditional Property Insurance Policy; this liquidity will allow the Government to restore services in a more expedient manner.
- **FEMA Recovery Policy Compliance:** According to the Stafford Act, Pub. Law 100-707 (1988), as amended, "(w)hen FEMA provides an applicant assistance for permanent work...the applicant must insure that facility against future loss...". The annual cost of this Program is estimated at \$82 million, while the Limit of Liability would be \$1.5 billion and will reduce the current "uninsured gap" from \$2.3 billion to \$800 million. Pursuant to applicable federal regulations, this \$800 gap could be justified as acceptable after certification by the Office of the Insurance Commissioner, and acceptance by FEMA, that this approach is a commercially reasonable alternative to protect against future losses. On March 19, 2019, FEMA issued a letter to the Government stating that they are evaluating

if the Parametric Insurance approach is an acceptable approach to cover the current “uninsured gap”.

- **Gradual reduction of insurance costs:** Currently, the Government and key Component Units, spend around \$150 million in annual premiums for traditional Property & Casualty Insurance Programs (excluding Municipalities); the Government intends to gradually reduce this spending during the next 3-4 fiscal years, once the Parametric Program is in place and said program matures moving forward.

7.6 Government’s Centralized Procurement Act of 2019 (Act 73-2019)

The Government is in the process of transforming the General Services Administration (or ASG for its Spanish acronym) into a Centralized Procurement Office to increase the efficiency of its procurement activities. This change is being implemented in accordance with the Government’s Centralized Procurement Act of 2019 (Act 73-2019). Beginning in FY2021, ASG will be funded through the General Fund and no longer charge fees for the vast majority of the services that it offers to other Government Agencies⁴⁴. This integration is beneficial to Puerto Rico in a multitude of ways, including the following:

- **Increased Visibility & Transparency:** by appropriating General Fund monies to ASG, the Central Government will have a direct line of vision over ASG’s budgetary structure which creates increased visibility & transparency. Previously, a relatively complex structure existed whereby the Office of Management and Budget appropriated General Funds monies for each of the individual agencies, and ASG charged each of these agencies a fee for their services. Act 73-2019 simplifies this process by providing one General Fund appropriation to ASG, thereby eliminating the need for ASG to charge each of the agencies a fee for their services. The result is a single, transparent budget related to procurement services which can be managed by the Central Government.
- **Additional Oversight:** as part of the creation of the Centralized Procurement Office, a variety of additional oversight positions and boards will be established to ensure an efficient process:
 - Chief Procurement Officer (CPO)⁴⁵: created to oversee all procurement activities at ASG. This position exists across the majority of the United States; 41 of the 48 states, that have a procurement office, have a single CPO that is in charge of overseeing activities.
 - New Management Team⁴⁶: in addition to a CPO, Act 73-2019 creates a new management structure to drive the success of procurement reform, including a new Administrator and Deputy Administrator.

⁴⁴ Following this change, ASG will continue to offer fuel consumption to Government Agencies for a fee. Additionally, ASG will have a second source of income from charging government suppliers a yearly registration fee from the RUL platform.

⁴⁵ Mandated by Article 9 of Act 73-2019.

⁴⁶ Mandated by Articles 7 and Article 9 of Act 73-2019.

- Centralized Auction Board⁴⁷: created to evaluate all auctions, which will eliminate the need to have independent auction boards at each individual government entity level.
- Centralized Revisory Board⁴⁸: created to handle all requests for reviews, reconsiderations and protests resulting from decisions made by ASG.

The 2020 Fiscal Plan projects this initiative will cost approximately \$5 million annually beginning in FY2021 to ensure the procurement savings included in the 2020 fiscal plan are achieved.

Chapter 8. FISCAL MEASURES

In addition to structural reforms, the Government has been implementing fiscal measures to create a sustainable fiscal future for Puerto Rico. Fiscal reforms will reduce costs while maintaining or improving the quality of services. There are a wide range of government efficiency initiatives which target an increase in revenues through new and more efficient collections activities and decrease government expenditures by ensuring reasonable and responsible usage of resources. The 2020 Fiscal Plan does not go into the granular detail of defining savings by measure/agency which will be clearly defined as part of the budgeting process. The measures include the following:

- **Agency Efficiencies:** A new model for government operations “right-sizes” the Government through agency consolidation, stand-alone reorganizations and privatizations/externalizations. It includes comprehensive reform initiatives in the Departments of Education, Health, Public Broadcasting Corporation (WIPR), as well as reductions across other agencies. Agency efficiency measures will result in \$1,516 million in run-rate savings by FY2024 (inclusive of savings embedded in the baseline).
- **Healthcare Reform:** Healthcare measures implemented by the Government have reduced the rate of healthcare cost inflation through the launch of the new managed care model, pharmacy reimbursement reform, lowering prescription drug cost by effectively managing the PDL and sharing coordination of benefits data with MCOs.
- **Tax Reform:** Puerto Rico has reduced income tax rates as well as other taxes such as business to business sales and use tax and prepared foods sales and use tax while broadening the tax base and technology and other innovative practices. This has been done on a revenue neutral basis.
- **Tax Compliance and Fees Enhancement:** Tax compliance initiatives involve employing technology and other innovative practices, to capture revenue from under-leveraged sources. These initiatives will increase run-rate revenues by \$474 million by FY2025.
- **Reduction of Appropriations:** The central Government will decrease appropriations granted to municipalities and UPR, which will result in \$499 million in run-rate savings by FY2024 (inclusive of savings embedded in FY2019 baseline).

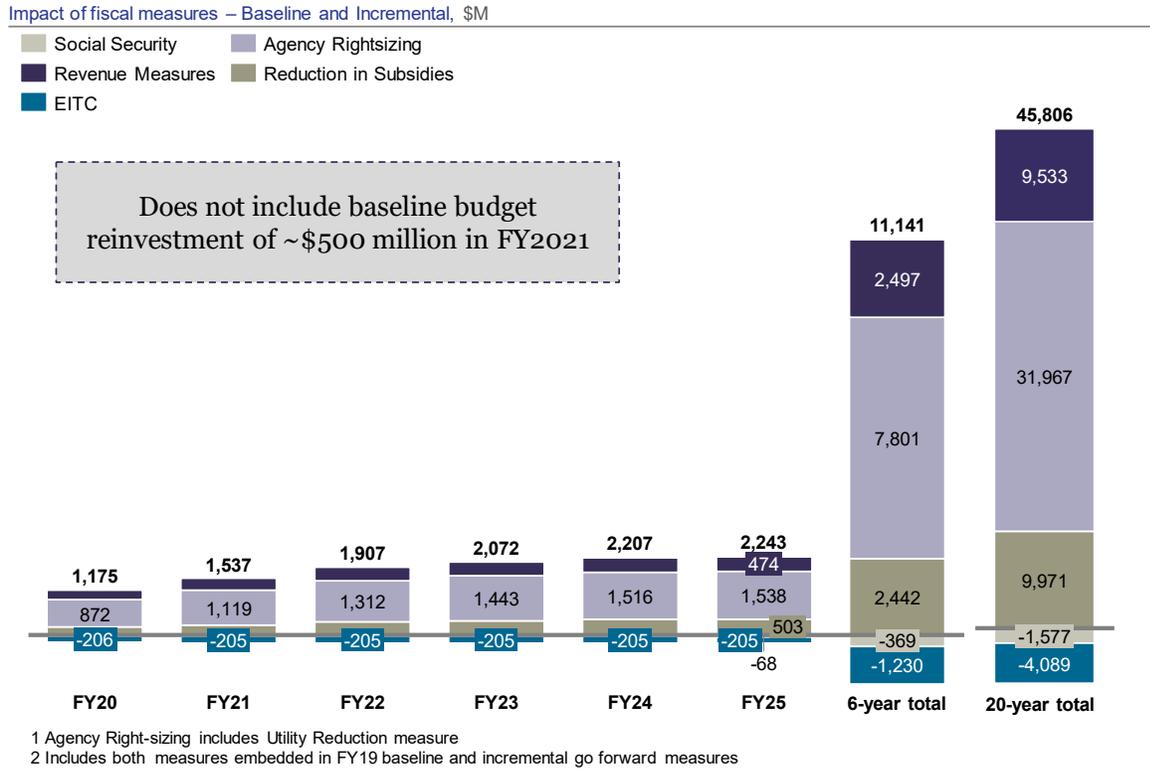
⁴⁷ Mandated by Article 47 of Act 73-2019.

⁴⁸ Mandated by Article 55 of Act 73-2019.

- **Social Security:** Social security contributions to enroll police officers in social security program will result in ~\$301 million contributions through FY2024.

Together, these measures are crucial to the structural balance of Puerto Rico’s economy, and are projected to result in over \$11.1 billion in the next six years and over \$45.8 billion over the next 20 years (**Exhibit 13**).

EXHIBIT 13: IMPACT OF FISCAL MEASURES SAVINGS AND REVENUES⁴⁹



8.1 Agency Efficiencies

The right-sized Government of the future will wherever possible reflect mainland U.S. benchmarks in terms of both number of agencies and size of agencies themselves to deliver services in as efficient a manner as possible. As part of the new Government model, the Government will consolidate agencies into groupings, close/externalize other agencies and reduce expenditures across a number of stand-alone agencies. In some cases, the groupings will be designed to better focus the competing efforts of multiple agencies. In other cases, the consolidations will serve to move services closer to citizens, such as Healthcare which will consolidate access points to important services like Medicaid. Furthermore, in cases where agencies will be left independent, measures will be applied to improve the quality of the underlying services, especially in the case of the Puerto Rico Department of Education (PRDE).

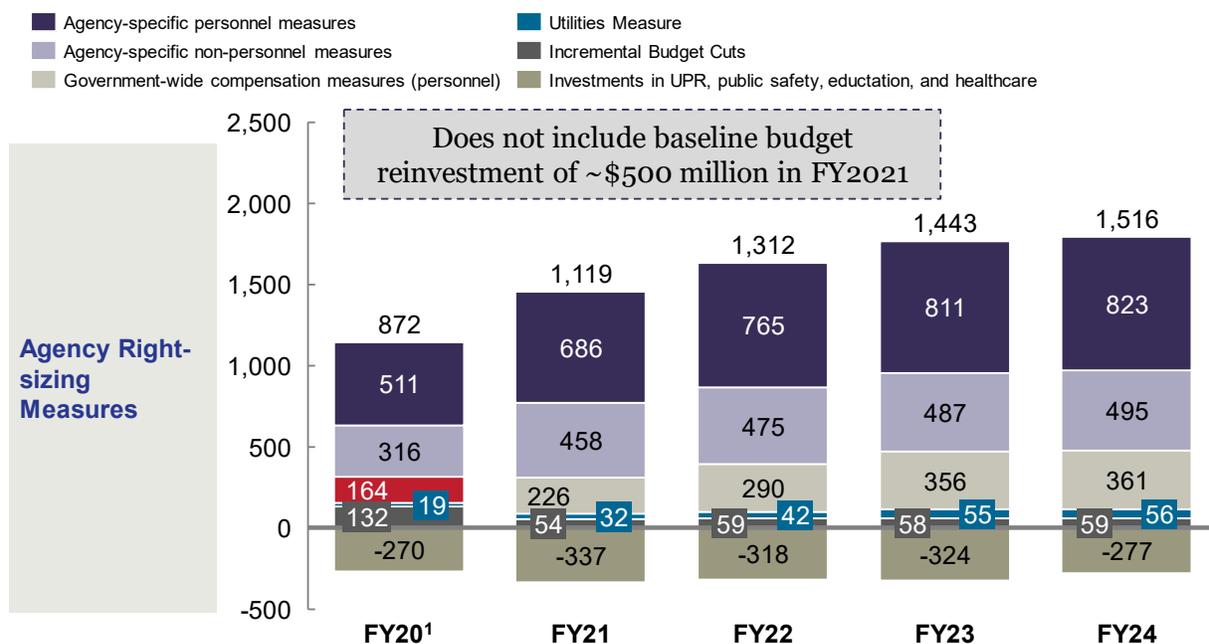
⁴⁹ Totals do not include Medicaid counter measure.

8.1.1 New Government Model Savings Targets

Aggregate savings targets (prior to reinvestments) for the Government included in this 2020 Fiscal Plan are consistent with aggregate savings targets as outlined in the May 9, 2019 Certified Fiscal Plan. The reinvestments contemplated in the FY2021 proposed budget are meant to ensure continuity of Government services and programs for the American citizens living in Puerto Rico. The incremental budget will also provide agencies with the additional time to identify and implement incremental measures in the most efficient way possible. The identification of measures, sizing of measures and ultimate enforcement of measures is more efficiently managed by the Office of Management and Budget as part of the budgeting process. Leveraging the budget process simplifies the iterative nature of aligning budgets with the 2020 Fiscal Plan as the Office of Management and Budget can efficiently allocate budget dollars based on their intimate knowledge of the needs and operations of each of the Government agencies and public corporations. Below is an aggregate build of savings by personnel and non-personnel and year included in the 2020 Fiscal Plan (**Exhibit 14**):

EXHIBIT 14: AGENCY RIGHT-SIZING SAVINGS INCLUDING FY19 BASELINE AND INCREMENTAL

Agency Right-sizing Savings – Baseline & Incremental, \$M



¹ FY19 Savings from previous fiscal plan are embedded in the FY19 baseline

8.1.2 Example of Agency Efficiency Stand-Alone Re-Organization Plans - Department of Education

8.1.2.1 CURRENT STATE AND FUTURE VISION FOR THE DEPARTMENT OF EDUCATION

Throughout the last decade, PRDE has encountered longstanding challenges which have affected academic performance. These include bureaucratic hurdles associated with operating as a single local education agency (LEA), inability to execute professional evaluations tied to student outcomes in the classroom, lack of a cohesive strategy for academic improvement, and most recently the devastation suffered from natural disasters of hurricanes and earthquakes.

Student enrollment declined considerably over the past few decades (over 50% decline since its peak in 1980, and by about 33% in the past decade alone); with an expected additional student decline of ~15% over the coming years, PRDE has room to right-size its education system relative to student enrollment. Optimization will help give PRDE the flexibility and funding to focus on improving the quality of education provided.

To improve the capabilities and capacity of the Puerto Rican population, the Government has set high goals. PRDE aims to improve student academic achievement over the coming years by reducing the achievement gap by 5% annually on Puerto Rico proficiency tests until achieving 80% proficiency in Spanish, 73% in Mathematics, and 77% in English, and improving the graduation rate to 90%. This rate of proficiency achievement is not easy but significant progress can be made through application of efficiency measures as well as targeted reinvestment in student and teacher outcomes.

8.1.2.2 PRDE EFFICIENCY MEASURES

Cumulative with prior years' savings, PRDE must achieve a total of \$266 million in personnel savings and \$119 million in non-personnel savings by the end of FY2021, exclusive of the FY21 Fiscal Plan investments of \$79 million. This level of savings necessitates a cultural shift to evaluating each dollar spent in terms of cost/benefit analysis and seeing each dollar spent as a tradeoff for another goal. For example, how many textbooks could be purchased for the amount spent on printer paper and what other options exist?

Non-personnel efficiencies

- **Consolidate buildings:** Reduction in building space through consolidating partially used office spaces and terminating leases on unused space is necessary for the Department to reach their savings goal and operate efficiently. Central office space has a generous layout across several buildings in San Juan with a driving service to assist employees who need to attend meetings or tasks in the various buildings. With planning, central office could be significantly consolidated reducing overall building cost as well as time employees spend commuting between buildings. Additionally, it is estimated that over 300 closed school buildings are not in use and could have leases terminated (or buildings repurposed), reducing cost and liabilities associated with vacant buildings such as public utilities.
- **Procurement reform:** Independent of, but accelerated through, consolidations, PRDE procured spend should be reduced by approximately 10-15% through centralized procurement policies including strategic purchasing and demand controls.
- **Process and system optimization:** Modernization and automation of processes and systems will reduce time and cost of current operations and lead to long-term savings for the Department. By methodically cataloging, documenting, and redesigning processes to leverage technology, in time will result in less processing time, reduce errors, reduce reliance on paper, and significantly reduce costs. Back office operations including Finance, Human Resources, and Technology are best positioned to gain these efficiencies with potential savings estimated as high as 24% of the overall cost for these departments.

Personnel efficiencies

Per current student enrollment, staffing should slightly decrease and moreover should be optimized by moving personnel to fill positions in understaffed areas as well as hold personnel

accountable to attendance policies. In time, with the predicted declines in student enrollment, staffing should naturally decrease through attrition proportionally to any actual decrease in student enrollment. Furthermore, administrative personnel in Central, Regional, and School offices should also decline with implementation of process and system optimization. Lastly, reducing use of Trust employees will further stabilize operations and better enable lasting improvements by reducing leadership turnover and insulating the department from political influences.

Food service and maintenance staffing is dictated by union agreements as depicted in the table below and is not in scope for reduction or optimization:

Food service	1 employee per 75 meals, per day, per school (<i>2 employees working 4-hours each over lunch</i>)
Maintenance	1 janitor for every 13 "units" (<i>1 unit = 3 bathrooms, or 1 classroom, or 3 offices</i>)

- **Investments in the children of Puerto Rico:** The education of the children of Puerto Rico, and their successful entrance into the workforce or college is a core goal of PRDE. Investment in education has also been shown to drive long-term economic growth – and in the case of Puerto Rico is projected to add 0.17% increase in GNP growth by FY2049 and keep growing thereafter. As a result, it is important that investments be made in four major areas:
 - 1) Teacher development and retention
 - 2) Director salary increases
 - 3) New educational materials (such as textbooks)
 - 4) Curriculum reform

- **Teacher development and retention:** Teachers are considered one of the most determinative factors in student success in the classroom and standard of living beyond the classroom. For example, a 2011 National Bureau of Economic Research study found that U.S. classes with an average-quality teacher had a lifetime income of \$266,000 higher than classes with a poor-quality teacher in each year. Improved education through enhanced teacher quality is critical to the long-term success of the children of Puerto Rico and will help to lift a new generation of Puerto Rican residents out of poverty. Recognizing this, PRDE has committed to transforming system practices related to attracting, retaining, and developing teachers and administrators:
 - 1) **Providing increased opportunities for and higher quality of training for teachers** (e.g., in-class; through leadership academies; STEM development through collaboration with universities; etc.)
 - 2) **Creating opportunities for targeted skill development** (e.g., instituting mentorship programs to enable coaching by experienced and high-performing teachers as a cost-neutral, and often high impact, initiative)
 - 3) **Investing in teacher salaries to improve competitiveness** (i.e., provide all positions *requiring* a teaching license or certificate a \$500 raise)

- **Director salary increases:** School directors are critical to achieving the continued goals of the 2020 Fiscal Plan. They drive the dual push for increasing quality of instruction while making more efficient use of resources. Their leadership is critical through emergency management as well as day to day stability for students and staff. Finally, as administration maintains a leaner model, directors are relied on to work closely with students and staff to drive educational change. In accordance with previous fiscal years, PRDE plans to continue annual raises of \$500 per year for all school directors.
- **New educational materials:** Teachers are limited in their ability to provide the best educational opportunities because of limited resources available, including up-to-date textbooks. Therefore, ~\$70 per student (for FY19-FY21) has been invested in procuring new textbooks, or \$21-24 million each year as one-time costs. Relevant textbooks have a profound impact on student achievement scores and are most effective when they are sourced from the same publisher as the standardized tests. This ensures the content students are being tested on are being covered in the materials provided to the students for their studies.
- **Curriculum reform:** The Department must continue with efforts to refresh and align curriculum to modern standards in STEM as well as other academic areas of Spanish, English, and History, by age and academic levels, in order to raise student performance on standardized tests and improve graduation rates. The Department has implemented significant improvements in school specific reporting and metrics enabling all levels of the Department to respond to struggling schools. With continued efforts targeting the most at risk students and leveraging expert resources available from universities and professional services, the curriculum reforms are expected to show significant improvement in FY21.

8.1.2.3 IMPLEMENTATION OF REFORMS

The Department has made *significant* progress implementing reforms in fiscal years 2019 and 2020 but significant transformation work remains to improve education of students while reducing overall cost. The biggest opportunities to reduce waste for the Department are in the elimination of unused or unoptimized space, procurement transformation, process optimization, and system modernization. While labor costs remain high, staffing levels are close to other state's Departments of Education and significant reductions from current overall staffing levels would destabilize transformation efforts and impact students. The Department should instead optimize staffing and shift current staff to areas most critical for student achievement and efficiency transformation efforts.

Perhaps most critical is the improvement of education through teacher development and retention, investment in educational materials, investment in directors, and curriculum reforms. These are the changes leadership at all levels must support with laser focus to ensure the children of Puerto Rico are prepared to lead the future.

8.1.3 *Example of Agency Efficiency Consolidation Re-Organization Plans - Department of Health (DOH)*

8.1.3.1 CURRENT STATE AND FUTURE VISION FOR THE DEPARTMENT OF HEALTH

Currently, the Government has several health-related agencies, including: three public corporations, three public hospitals, seven sub-secretaries, six regional offices, and eight program offices administering 64 federally funded programs. Each agency provides their own human capital management, procurement, and financial support.

The Board has proposed that the DOH centralize the following agencies' aforementioned support functions under the DOH umbrella: **(Exhibit 15)**.

EXHIBIT 15: AGENCIES INCLUDED IN FUTURE STATE DEPARTMENT OF HEALTH GROUPING

1 Department of Health	5 Center for Research, Education, and Medical Services for Diabetes
2 Health Insurance Administration (ASES)	6 Mental Health and Addiction Services Administration
3 Medical Services Administration (ASEM)	7 University of Puerto Rico Comprehensive Cancer Center ¹
4 Puerto Rico and the Caribbean Cardiovascular Center Corporation	

¹ Current Consolidation plan may leave this agency as a separate entity

Efficiency measures for the Department of Health

The DOH agrees with and supports the proposed consolidated structure, which should enable efficiencies while maintaining high quality public health. Centralizing administrative functions and support services should provide opportunity for rightsizing, improved management and oversight as well as centralizing and optimizing procurement to provide savings and efficiency. Still, as previously articulated to the Board, implementing a wide-scale consolidation requires implementation costs and external support that has been consistently ignored by the Board. Additional fiscal year 2021 budget requests have been sent to the FOMB, in part to receive the necessary runway to properly execute the consolidation efforts in an efficient and responsible manner and realize savings contemplated by the Board.

Additionally, the DOH is currently working on a Roster Reconciliation Phase I, and a Capacity Plan Phase II as part of the Human Resources Process Optimization Project. Phase I, roster reconciliation, is the process of comparing the human resources master list with current employees' positions in order to ensure accuracy and validity of employees' functions and job descriptions. Phase II, capacity plan, is the process of determining the employees' productivity capacity needed by the agency in order to meet demand and services. In an effort to realize additional savings, as part of the Capacity Plan, the DOH will revise and analyze the necessary positions in order to provide direct and necessary services efficiently.

Non- personnel efficiencies

- **Medical supply chain management:** Due to the high cost of medical supplies, there is a significant opportunity to improve procurement efficiency through best practice supply and demand management. This effort includes category and item standardization, physician preference item optimization, vendor consolidation, Group Purchasing Organization (GPO) evaluation, volume discounts, and should reflect any synergies available through ASG.
- **Hospital management transformation:** In addition to procurement, investments in technology infrastructure, optimization of clinical workflow within the DOH hospitals, and enhanced governance and coordination with the University of Puerto Rico School of Medicine and social service agencies should be closely evaluated. Efforts should be undertaken to evaluate potential consolidation of underutilized facilities, patient referral programs and strategies with other public and private hospitals, and providing the DOH hospitals with the systems and data necessary to better support negotiations with commercial payers.

Holistic hospital transformation efforts should also reduce payroll spend through clinical labor optimization, which is captured in the "personnel optimization" measure. For example, wages should be optimized to fair market value to reduce turnover and therefore

temporary/overtime spend; and role/responsibilities should be optimized to skill level and wage rate.

Restructuring ASEM and Revenue Cycle Management

The Medical Services Administration (“ASEM”) is a public corporation originally created to serve as a central procurement office for government hospitals to create economies of scale for medical supplies, devices, and services. Throughout the years, rates, salaries, and services have increased at a higher rate than within the broader industry, and procurement processes have decentralized across the hospitals ASEM was created to serve.

The focus areas of this measure include:

- Establishing a centralized Medical Center including ASEM, University, Pediatric and Cardiovascular hospitals,
- Identifying and establishing key hospitals across the Island,
- Designing and implementing a referral system among key hospitals and clinics,
- Establishing an expanded physician network, and
- Operational improvements to organizational structures, processes, and technology.

On June 17, 2018, ASEM issued a request for proposal to procure services to provide ASEM and Hospital Universitario de Adultos (“UDH”) comprehensive hospital revenue cycle management services for the following operations:

- Clinical Services Patient Registration
- Billing of clinical services
- Collections
- Health Care Utilization Management
- Patient Discharge Management

To date, a vendor has been selected. The current timeline is to send the contract to CCS on March 1, 2020 for their approval, and start the government review and approval process the following week. Implementation is projected to begin on April 1, 2020.

Effective revenue cycle management is key to reforming the overall balance sheet of the DOH health system. To begin this effort, ASEM should complete its revenue cycle management outsourcing overhaul and set in motion a plan to consolidate revenue cycle management across other DOH hospitals.

Obtaining Medicare Certification for the General Psychiatric Hospital

Despite the intention of the 2019 Fiscal Plan to invest \$12 million over FY2020 and FY2021 (\$6 million each year) to enable the General Psychiatric Hospital to receive Medicare certification, these funds have not been properly allocated to the Mental Health and Addiction Services Administration (ASSMCA). The lack of allocated funds has led to ASSMCA not having the resources necessary to improve the General Psychiatric Hospital and receive Medicare certification, thus preventing it from being able to receive reimbursement from Medicare for services it provides to qualified patients. The Board should reinstate and properly allocate these

funds as a full \$12 million net addition to the FY2021 budget, so the improvements can be made and Medicare certification obtained, which will lead to a multiple per annum in reimbursements.

8.1.4 Example of Agency Efficiency Privatization Re-Organization Plans - WIPR

8.1.4.1 CURRENT STATE AND FUTURE VISION FOR WIPR

On January 11, 2019, the Oversight Board sent the Executive Branch and Legislature a recommendation, pursuant to Section 205(a), that the Government transfer ownership of the Public Broadcasting Corporation to a private non-profit. On April 11, 2019, the Executive Branch responded to this recommendation, pursuant to Section 205(b), accepting in principle the Oversight Board's recommendation, expecting that it be implemented on or before June 30, 2020. Moreover, the Executive Branch asserted that appropriations to the Public Broadcasting Corporation should continue at a sustainable level after ownership has been transferred to a private non-profit.

The Public Broadcasting Corporation will be transferred from Government ownership by June 30, 2021. Therefore, the Public Broadcasting Corporation will be provided with funding to operate through June 30, 2021 and will receive its appropriations from the Government through that time, when ownership has been transferred to a private non-profit. This will create annual savings of ~\$12.9 million starting in FY2022.

8.2 Reduction of Appropriations

8.2.1 Current state and vision for Government appropriations

The central Government provides a range of appropriations to three main groups of recipients: The University of Puerto Rico, Puerto Rico's 78 municipalities, and "other" recipients (typically private industry or non-profit institutions).

Currently, UPR is 46.7% subsidized (~\$560 million in annual appropriations) by state and local funds, compared to 25% average level of state/local subsidization of U.S. public universities.⁵⁰ UPR's tuition is less than one-third of the U.S. public average even after adjusting for per-capita income, and UPR spends ~10% more per student on operational spend than the average public university.

A reduction of the appropriation for UPR was determined in 2017 through a shared process with the Oversight Board to identify reasonable, sustainable reductions to the UPR appropriation that brought UPR closer to U.S. public university tuition and cost benchmarks. This reduction was included in the original March 2017 Fiscal Plan.

Municipalities receive ~\$132 million (FY2020) in annual appropriations from the Government, but despite this aid many municipalities are operating significant deficits.⁵¹ With additional reductions on the horizon, municipalities must undergo substantial operating model changes, or else risk increasing their annual operating deficits. In addition to reducing the appropriations to municipalities to drive fiscal discipline, the Government can support consolidations of municipal services to encourage efficiencies, such as through service provision collectives or streamlining the legal framework to remove barriers to collaboration.

⁵⁰ UPR, Integrated Postsecondary Education Data System (IPEDs), College Board.

⁵¹ Draft Report prepared by V2A November 2016.

In total, the central Government will have decreased appropriations granted to municipalities and UPR by a total of \$496 million including prior reductions to appropriations and incremental reductions through FY2024.

8.2.2 Reduce UPR appropriations to levels in line with funding of other U.S. public universities

The 2020 Fiscal Plan has maintained the March 2017 Fiscal Plan and May 9, 2019 Certified Fiscal Plan measures, less reductions to the appropriations that have already been factored into the FY2018 baseline, as well as reductions in addressable spend.

Targeted measures to increase revenues and reduce expenditures will allow UPR to operate sustainably under a reduced subsidy. On the revenue side, these include modestly raising tuition using a means-based approach (e.g., creating a means-based scholarship fund in parallel), applying more aggressively for Federal grants (seeking to achieve funding equal to the level of 25th percentile of U.S. public universities), charging more dues and fees to students, applying for patents and other intellectual property, and continuing to provide trainings to the PRDE and the Government more broadly.

On the expense reduction side, measures include implementing hub structures, optimizing HR through reducing temporary and trust positions, improving procurement, reducing the cost of medical insurance, and reducing tuition exemptions and special scholarships. These include identifying campuses and programs for consolidations based on performance metrics, tying personnel savings to roles specifically consolidated with campus consolidations and service reductions and increasing tuition in future years to be roughly equivalent to Federal Pell grant less cost of living.

These efforts to improve the operations of UPR will in turn allow the University to renew its operating model to provide the best outcomes for its students. These outcomes will include reduced time to degree, improved job placement, and higher standardized test scores, among others. A re-envisioned University, which focuses on areas of strengths and on improving outcomes for students, will ultimately prove to be a critical source of renewal for the Island, as it is a cornerstone of human capital development to propel growth in the economy.

The Government will afford the UPR with additional flexibility with its appropriations. Currently, UPR receives a \$20 million appropriation for Central Government training related services and Seminars. UPR has historically used ~ \$5 million of this appropriation and currently has \$60 million in cash earmarked for these purposes. The Central Government will continue to provide this appropriation but allow UPR to use the appropriation for other operational needs. The Central Government will also provide capital expenditure support to UPR to free up Special Revenue Fund Capital Expenditure dollars for operational needs.

Currently, UPR's total aggregate amount of outstanding bond debt is approximately \$451 million, which requires approximately \$48 million of debt service payments annually. UPR currently has in effect a forbearance agreement with its bondholders to reduce the amount of debt service it is currently required to pay. However, the forbearance agreement is a temporary solution and a long-term restructuring process for UPR's debt may be required in the future.

8.2.2.1 ESTABLISH INDEPENDENT SCHOLARSHIP FUND FOR UPR

Prior Fiscal Plans established a means-based scholarship fund for the benefit of UPR students, which will be initially supported through reductions to the budgets of the Oversight Board, the

General Court of Justice, the Legislative Assembly, and AAFAF. These reductions will generate between ~ \$35 million and ~ \$50 million annually during 5 fiscal years, for a total of ~ \$124 million. This will help build up the endowment fund which will be managed by Hacienda & the OCFO through an external private entity.

Consequently, on November 7, 2019, the Government issued a request for qualifications (RFQ) for scholarship fund management & investment management services, a process which successfully closed on December 6, 2019. An intragovernmental committee was established by the Government to evaluate submitted qualifications and formally begin the qualification process and subsequent selection process.

8.2.3 Reduce municipal appropriations

Already in FY2020, the total municipal appropriations were reduced, bringing the new baseline appropriations to ~\$132 million per year. Going forward from this current baseline the 2020 Fiscal Plan provides municipalities a one year delay in additional reductions to afford them adequate time to address the fiscal crisis they face.

Due to Puerto Rico's financial situation, the Government has no choice but to continue to gradually reduce the current level of municipal appropriations before ultimately phasing out all subsidies in FY2024. This, together with the same economic and fiscal challenges that the central government is facing, could cause significant financial stress for municipalities over the coming years.

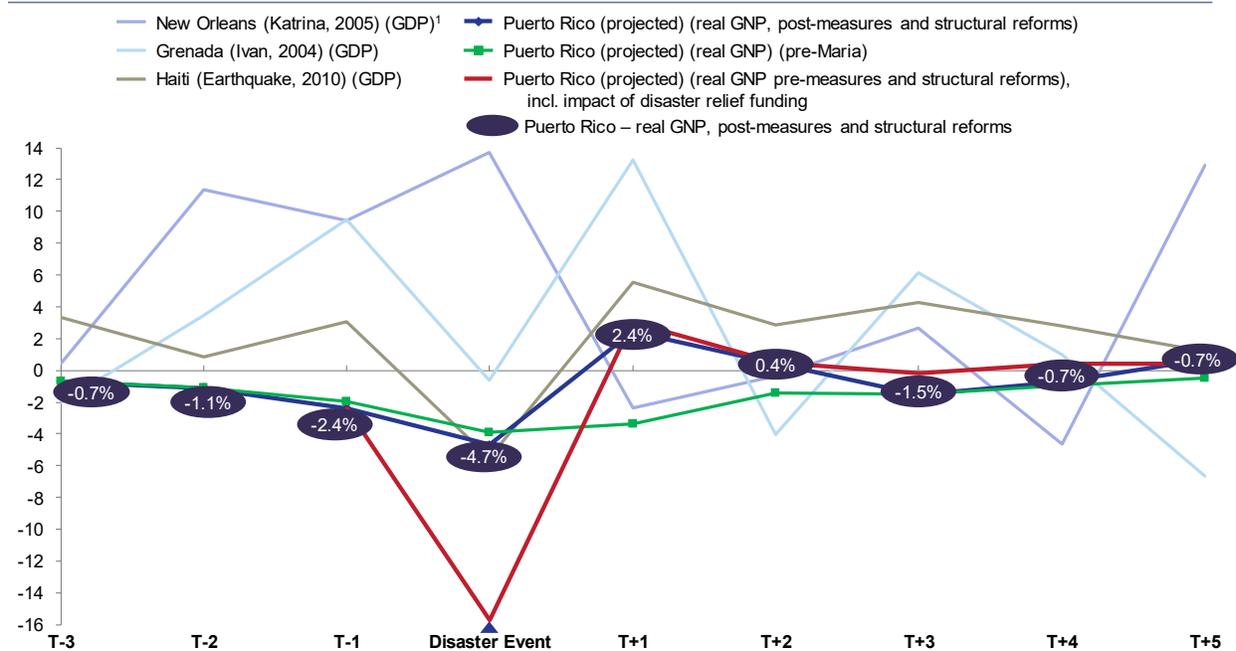
Part V: Fiscal Plan Forecast – Macroeconomic and Financial Outputs

Chapter 9. MACROECONOMIC AND DEMOGRAPHIC TRAJECTORY POST-MARIA

Hurricanes Irma and Maria have created a new economic reality for Puerto Rico, drastically impacting the years to come. Given this context, the 2020 Fiscal Plan projects there will be macroeconomic volatility in the wake of the storms. FY2018 saw a decline in real GNP of 4.7%, reflecting economic devastation in the wake of Hurricanes Irma and Maria, which struck the Island in the first quarter of the fiscal year. There was a bounce-back in FY2019 of 2.4%, fueled by disaster relief funding. The recovery will continue as more federal reconstruction funding is disbursed and rebuilding of the Island’s damaged infrastructure progresses. While fiscal measures will have a temporary contractionary effect on the economy, structural reforms will have a permanent positive impact on economic growth. In the medium term, structural reforms will drive economic growth back to slightly above the trendline. This trendline has similarities to the growth trendline faced by other jurisdictions that have suffered from major natural disasters (**Exhibit 16**).

EXHIBIT 16: PUERTO RICO’S PROJECTED GROWTH TRAJECTORY COMPARED TO OTHER JURISDICTIONS AFTER NATURAL DISASTERS

Puerto Rico’s projections track with other areas suffering from natural disasters, T = year of shock; constant local currency units (LCU) unless otherwise stated; year on year change



¹ Katrina figures not adjusted for inflation

SOURCE: World Bank, Bureau of Economic Analysis, and ECCB

The 2020 Fiscal Plan economic outlook model estimates the pre-hurricane trend growth of Puerto Rico as well as the economic impact of hurricanes based on a comprehensive data set of official Puerto Rican economic data from 1965 to 2017. The data set includes both variables that collectively describe the Puerto Rican economy (e.g. growth, federal transfers, capital investment, etc.) and data on damage from past natural disasters. Reflecting the close relationship of Puerto Rico to the U.S. mainland economy and the rest of the world, the model also includes external economic data: U.S. mainland GDP growth and inflation and world price conditions also influence economic conditions in Puerto Rico and are included in the model. The model uses statistical regression techniques to estimate and describe the impact of each economic driver on Puerto Rican growth from 1965 to 2017. This analysis forms the basis for the economic projections from 2019 to 2048: by combining the estimated effects with projections of the stimulative impact of disaster relief assistance and its impact on the growth of the capital stock and future policy changes such as the proposed fiscal measures and structural, the model produces a forecast of economic growth for the Government.

The economic forecast includes a reduction in productive capital caused by the earthquakes that have struck the southern coast in January 2020. The Government has estimated damage at \$460 million. Given the USGS estimates the probability of an earthquake of magnitude 5 or higher is 91% and 6 or higher is 26%⁵² within the next year, it is probable that additional earthquake inflicted damage will occur. This damage affects the economy in the same way as damage to capital caused by hurricanes.

Projected inflation rates serve as a proxy for the GNP deflator for calculating nominal GNP growth (**Exhibit 17**).

EXHIBIT 17: ANNUAL INFLATION RATE

Annual inflation rate, %



The January macroeconomic forecast reflects updates made to source data. New editions of the Congressional Budget Office Economic Outlook and IMF World Economic Outlook have been released since the May 9, 2019 Certified Fiscal Plan was developed, most recently in August 2019 (CBO) and October 2019 (IMF).

9.1 Economic Outlook

9.1.1 Impact of fiscal measures and structural reforms

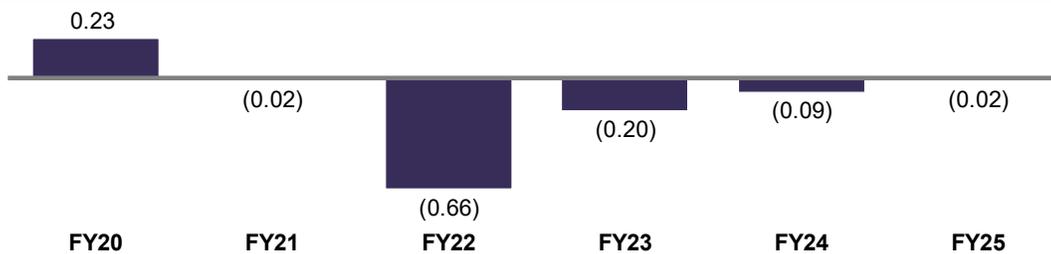
By optimizing revenue collection and reducing government-wide expenditures, fiscal measures seek to streamline and transform the Government of Puerto Rico to a size appropriate for its

⁵² USGS 2/25 Aftershock Forecast

population. Such policy actions will generate a contractionary impact on the economy in the short term, but are necessary to drive fiscal sustainability in the long term. The net effect of these two forces is still significantly positive from a fiscal savings perspective. In addition, the economic contraction estimated from cost-saving measures is limited in the long-term, while such measures are critical for providing long-term financial stability. The macroeconomic impact of the measures is summarized in **(Exhibit 18)** below.

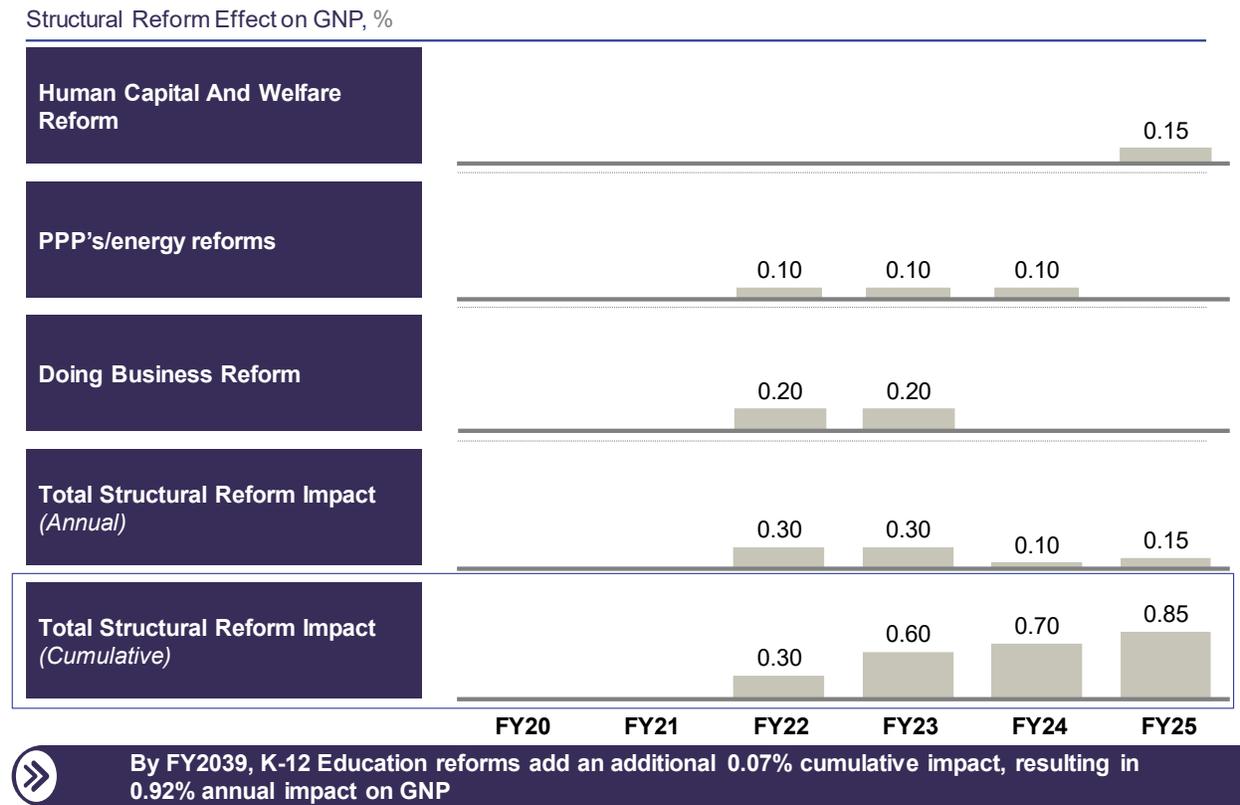
EXHIBIT 18: MACROECONOMIC IMPACT OF FISCAL MEASURES, INCLUSIVE OF DISASTER RELIEF SPENDING

Fiscal Measures Effect on Real GNP, %



The timing and impact of structural reforms are based on work done by the IMF on similar reforms implemented in Europe (e.g., Spain and Estonia), South America (e.g., Peru and Colombia), among other jurisdictions, utilities reform in Latin America, and broadly accepted metrics for measuring improvement in the World Bank’s Ease of Doing Business Rankings. Structural reform benchmarks generally come from nations or jurisdictions without monetary policy options and large informal labor markets, like Puerto Rico. Labor, energy, and doing business reforms are projected to increase GNP by 0.85% by FY2025 **(Exhibit 19)**. K-12 education reforms add an additional 0.01% annual impact beginning in FY2033, resulting in a total annual GNP increase from structural reforms of 0.92% by FY2039.

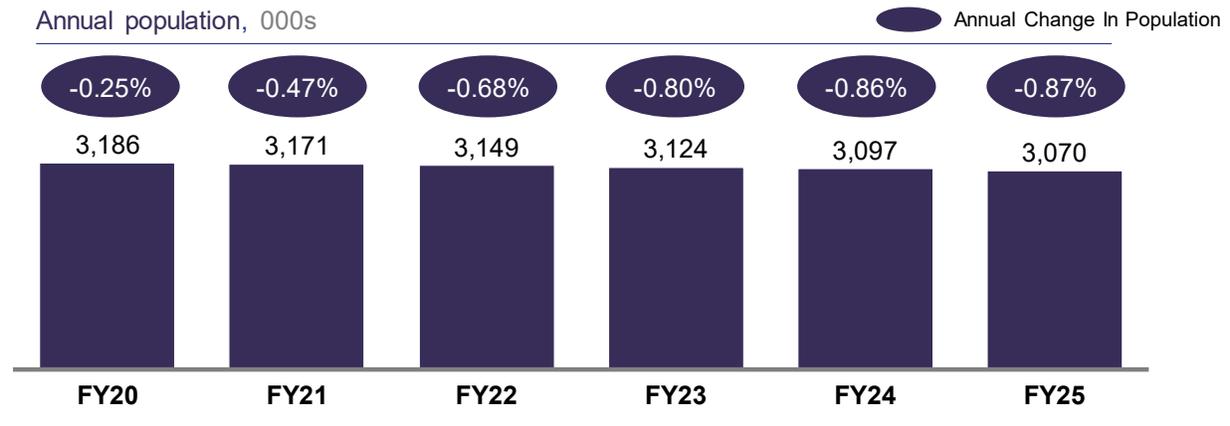
EXHIBIT 19: MACROECONOMIC IMPACT OF STRUCTURAL REFORMS



9.1.2 Population projections

In December 2019, the United States Census Bureau released its official estimates of population growth for the year beginning July 1, 2018 (FY2019), showing a population increase of 340 persons (0.0%) over FY2018. This ends a near decade and a half long streak of annual population declines as Puerto Ricans left the Island to seek opportunities elsewhere, and birth rates declined. Despite the growth in FY2019, the downward trend is expected to resume over the Fiscal Plan forecast period, returning to -0.87% by FY2025, similar to the trend over the past decade (**Exhibit 20**).

EXHIBIT 20: PROJECTED POPULATION CHANGE



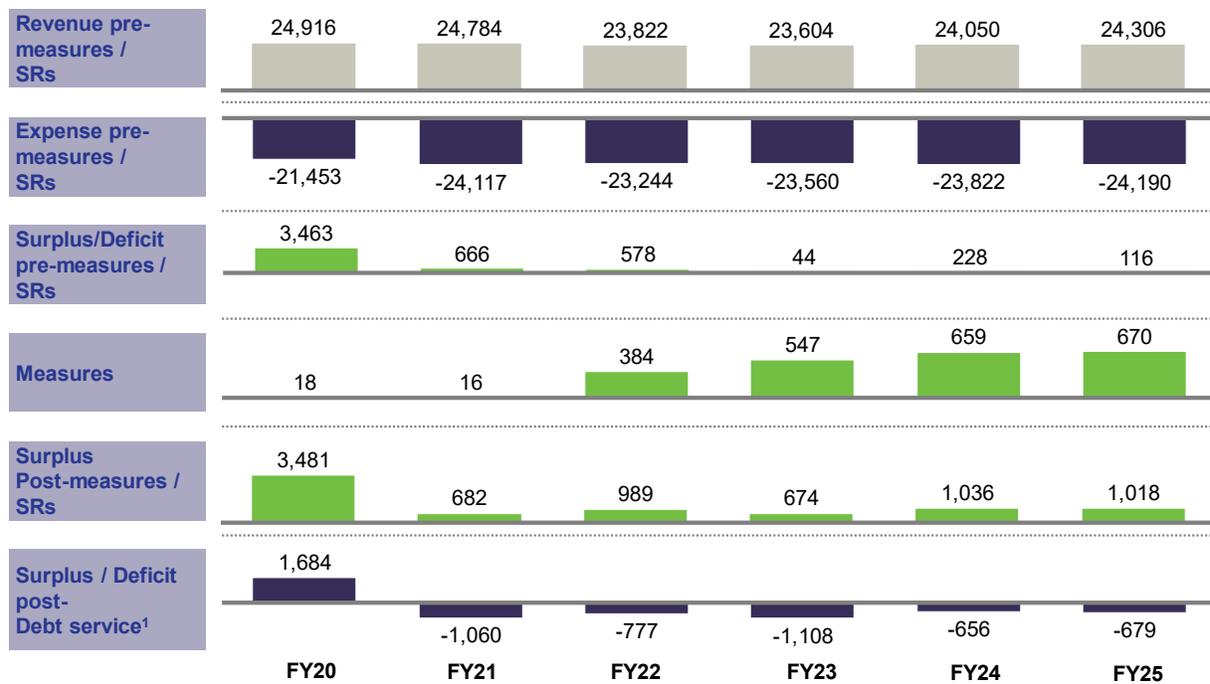
The Fiscal Plan economic outlook model estimates population growth jointly with GNP based on official data since 1965. The population data set includes variables that influence migration decisions, including Puerto Rican GNP growth, U.S. mainland GDP growth, net federal transfers, the effects of storms and recent earthquakes, as well as taking into account trends in population growth.

Chapter 10. FISCAL PLAN FINANCIAL PROJECTIONS

Before measures and structural reforms (“baseline forecast”), there is a pre-contractual debt service surplus through FY2026. The surplus is due, in part, to revenues that are bolstered by a positive macroeconomic trajectory resulting from the disaster relief funding stimulus. Additionally, the surplus is in part due to the New Medicaid Funding Bill which granted Puerto Rico \$5.3 billion of Medicaid funding in federal fiscal years 2020 through 2021 at a 76% FMAP. Over the long term, the baseline forecast surplus is not sustainable as Federal disaster relief funding slows down, Act 154 and Non-Resident Withholding revenues decline, and pensions and healthcare expenditures rise. Even after fiscal measures and structural reforms, there is an annual pre-contractual debt service deficit reflected in the projection starting in FY2031. The financial projections contained in this fiscal plan do not take into account potential delays in confirming a plan of adjustment for the Commonwealth beyond the effective date anticipated in the Board’s plan support agreement with the Commonwealth’s general obligation (GO) bondholders.

EXHIBIT 21: PROJECTED DEFICIT / SURPLUS PRE- AND POST-MEASURES AND STRUCTURAL REFORMS

Projected deficit / surplus pre- and post- measures and structural reforms (“SRs”), \$M



¹ Contractual debt service does not include COFINA debt service

10.1 Baseline Revenue Forecast

Major revenue streams (**Exhibit 22**) include non-export sector General Fund revenues (including individual, corporate, and sales and use taxes) and export sector revenues (including Act 154 excise taxes paid by multinationals operating on the Island, and Non-Resident Withholdings), as well as federal funding.

EXHIBIT 22: MAJOR REVENUE CATEGORIES PRE-MEASURES AND STRUCTURAL REFORMS

Key Baseline Revenue Drivers, Pre-measures and structural reforms, \$M



10.1.1 Non-export sector General Fund revenue projections

In the midst of a decline in economic activity from FY2017 to FY2018, income tax collections proved more resilient than the economy as a whole. Recovery related activities in FY2019 continued to support strong individual income tax collections. The forecast for FY2020 and beyond attempts to segregate these recovery-related revenues from revenues driven by recurring on-Island economic activity.

Individual income taxes: Individual income taxes are highly concentrated, with 78.2% of revenues coming from the 8.7% of returns reporting income above \$60,000.⁵³ Post-Maria revenues have been impacted by mainland corporations ramping up activity to support disaster recovery related projects. Recent out-performance relative to forecast, continued disaster recovery spend, and baseline Island economic activity have been considered in the near-term forecast while the longer term forecast is more aligned with Puerto Rico nominal GNP and year-to-year changes in Puerto Rico nominal GNP.

Corporate income taxes: There is also concentration in tax receipts among the largest corporations operating in Puerto Rico (e.g., ~29% of corporate income taxes are paid by 20 corporate taxpayers).⁵⁴ Corporate activity spurred by reconstruction funding, mainland-based firms entering the Island economy, and Puerto Rican firms receiving new business have contributed to strong revenues post-Maria. Similar to PIT, recent out-performance (excluding

⁵³ Hacienda historical reports as of April 2018.

⁵⁴ Hacienda historical reports as of April 2018.

certain non-recurring revenues), continued disaster recovery spend, and baseline Island economic activity drive the near-term forecast, while the longer term forecast is more aligned with Puerto Rico nominal GNP and year-to-year changes in Puerto Rico nominal GNP.

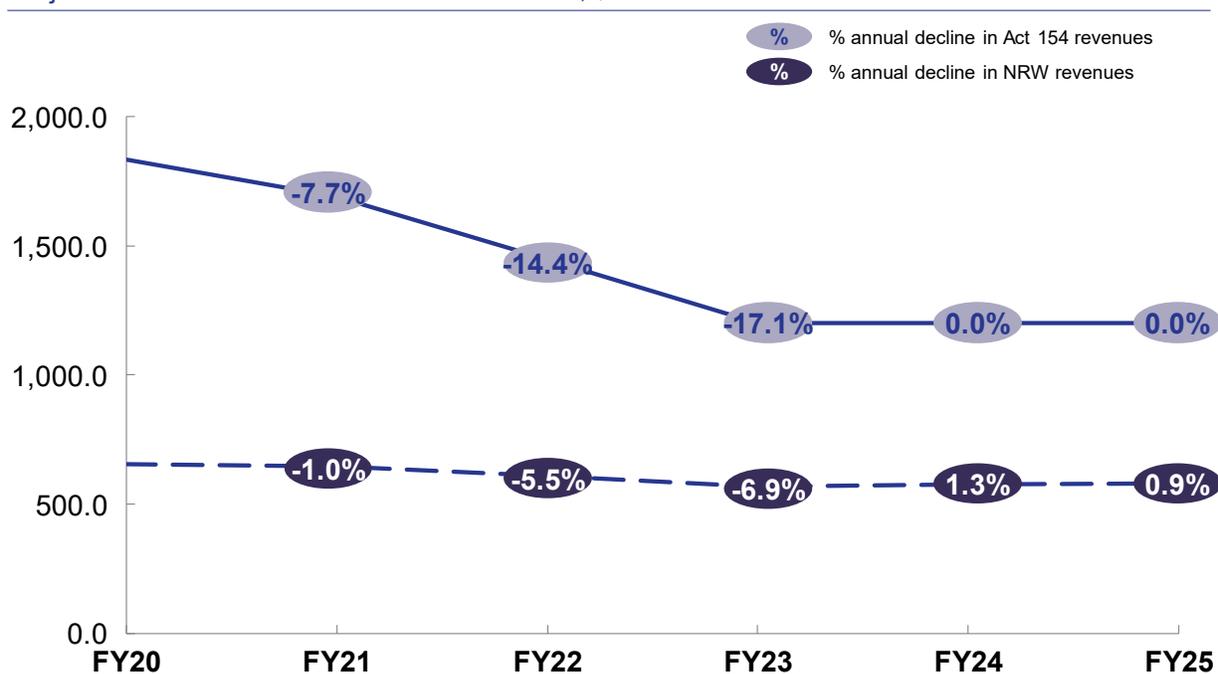
Sales and use taxes: Like corporate and personal income taxes, SUT revenues were likely boosted by the increased economic activity resulting from the post-disaster reconstruction process (including through replacement of lost inventory), as well as enhanced compliance by those firms less impacted by the storm. Near-term SUT collections consider the impacts of continued disaster recovery spend and baseline economic activity, while the longer term forecast is aligned with changes in Puerto Rico nominal GNP.

Motor Vehicles: disaster related spend seemed to have a positive impact on motor vehicle revenue. This is believed to be due to many residents replacing motor vehicles in the wake of the storm and purchases of vehicles to support disaster recovery activities. The observed surge in motor vehicle revenue observed in FY2018 through FY2020 year-to-date is expected to continue through FY2025, after which motor vehicle revenue is expected the return to the originally forecasted amounts, which are then grown at Puerto Rico nominal GNP going forward.

Export sector revenue projections: Act 154 and NRW tax revenues have proven to be less resilient than other types of revenues after the hurricane. Both revenue types are concentrated in a small number of multinational corporations, and the absence of payments from large payers in previous years has had an impact on the overall trendline of these revenues. From FY2020 to FY2025, Hacienda estimates that ~34% of Act 154 and 11% of NRW revenues will erode (**Exhibit 23**) due to the combination of federal tax reform (reducing Puerto Rico’s attractiveness as a low tax jurisdiction for multinationals) and hurricane impacts (creating challenges of restoring manufacturing operations and exporting).

EXHIBIT 23: PROJECTED ACT 154 AND NON-RESIDENT WITHHOLDING REVENUES

Projected annual Act 154 and NRW revenues, \$M



10.1.2 Medicaid funding

Puerto Rico's Government-funded health plan, Vital, covers individuals through four primary funding sources: Federally-matched Medicaid funds, EAP funds, the Children's Health Insurance Program (CHIP), and the Government's self-funded insurance program for low-income adults who do not qualify for federally-matched Medicaid. An additional ~8% of the people of Puerto Rico receive some benefits from the Government as part of the Platino program, which supports Medicare Advantage recipients who also qualify for Medicaid (also known as "dual-eligible").

The Bipartisan Budget Act of 2018 (BBA) provided the Commonwealth temporary relief from raising healthcare costs by expanding the amount of federal reimbursement over an 18-month period. Starting in September 2019, however, the Commonwealth was projected to hit a "Medicaid cliff" whereby it would be responsible for multi-billion-dollar annual healthcare expenditures unseen since the Affordable Care Act (ACA) provided additional federal funding in 2011. In response, in May of 2019, the Government of Puerto Rico lobbied the Federal Government for a continuation of Medicaid benefits to enhance its Medicaid program and ensure the continued support of the most vulnerable population

Due to these efforts, on December 16, 2019 the Federal Government passed the "Further Consolidated Appropriations Act, 2020" and granted Puerto Rico \$5.3 billion of Medicaid funding in federal fiscal years 2020 through 2021 at a 76% FMAP, or federal medical assistance percentage. The Act allows for \$200 million of additional Medicaid funding each year so long as the Secretary certifies that, with respect to such fiscal year, Puerto Rico's state plan establishes a reimbursement floor for physician services that is not less than 70 percent of the Medicare schedule rate and allows an audit of payments to health insurers participating in the Medicaid program.

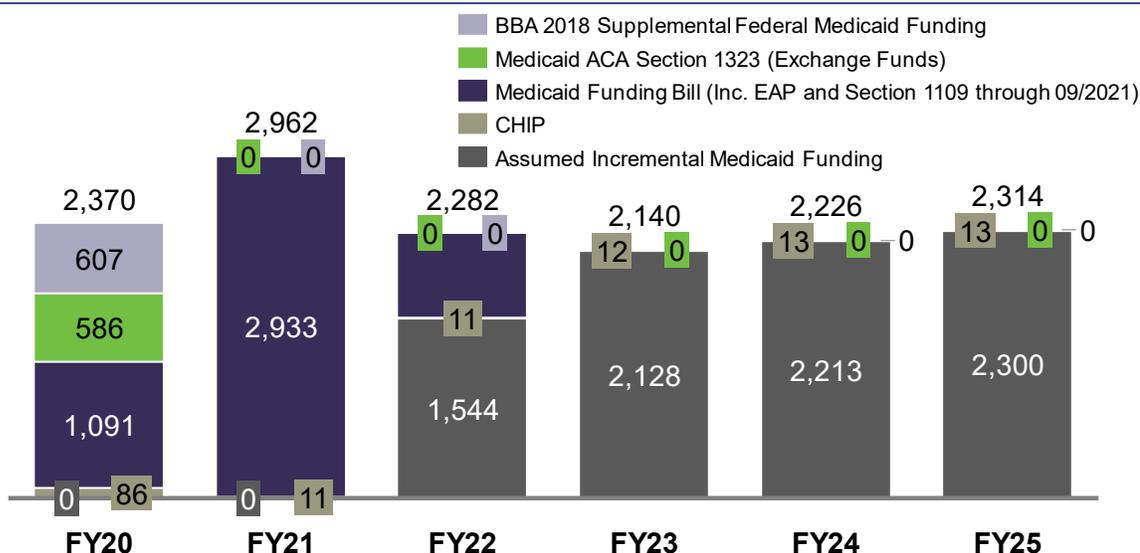
The 2020 Fiscal Plan assumes incremental Medicaid funding from the Federal government to cover approximately 55% of Puerto Rico Medicaid related expenses beginning in Federal Fiscal Year 2022, after the expiration of the Medicaid Bill, and extending over the life of the forecast. This percentage is consistent with the Statutory Rate for the Medicaid population, which represents the largest population of participants in the program. This incremental Medicaid funding covers the Standard Annual Federal Medicaid Funding and EAP Funding.

In addition to these funds, the Commonwealth is assumed to continue to receive CHIP funding which is not subject to a federal cap. Federal matching of CHIP related expenditures is approximately 80% in FY2020, a temporarily inflated FMAP due to the Affordable Care Act. This federal cost share is projected to decrease to a long-term 68.5% FMAP in FY2022. In FY2020, the amount of CHIP funding is projected to be approximately \$85.6 million, decreasing to ~\$13.3 million in FY2025 due to critical sustainability measure.

In February 2018, the BBA allocated a supplemental \$4.8 billion of federal funding to Puerto Rico Medicaid for use between January 2018 and September 2019. Per guidance from the Centers for Medicare and Medicaid Services ("CMS"), this funding is estimated to apply only as a reimbursement for eligible populations (i.e., federally funded Medicaid expenditures). ASES spent as much of the BBA allocation as possible before drawing down any remaining ACA funds, which can resume use from September 30, 2019 until expiration in December 31, 2019. In fiscal year 2020, ASES used \$616 million of BBA funds and \$586 million of ACA funds. It will continue to receive its annual CHIP, FQHC, and DOH Medicaid operations funding. **Exhibit 24** outlines expected Medicaid federal fund receipts.

EXHIBIT 24: MEDICAID EXPECTED FEDERAL FUND RECEIPTS

Medicaid Federal funding sources, \$M



10.1.3 Other federal funding

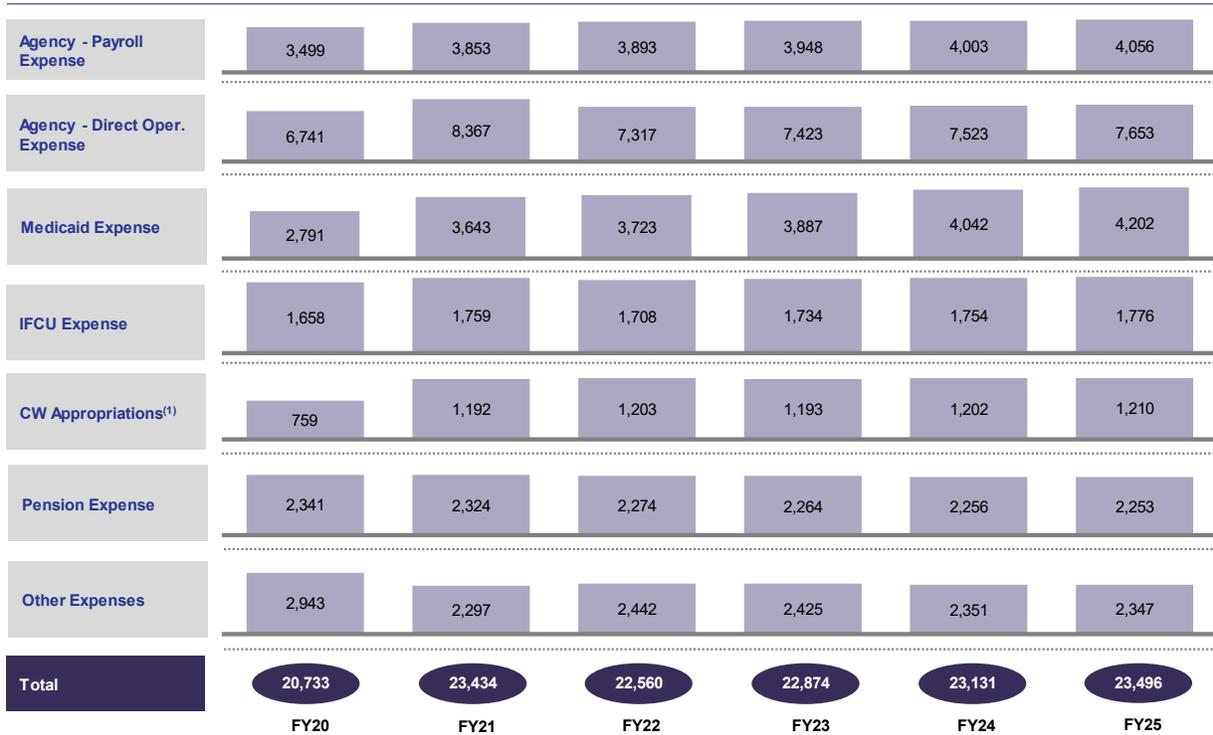
In addition to Medicaid funding, Puerto Rico receives other federal funds on a regular basis. (These are not to be confused with disaster relief funds, which are directly tied to post-storm reconstruction activity.) These funds typically cover both social benefits and operational expenditures. In the 2020 Fiscal Plan, these funds have been modeled based on what types of costs they cover (e.g., benefits or operations) as well as the statutory formula that defines the size of Puerto Rico’s allotment. For example, while Temporary Assistance for Needy Families (TANF) funds are typically pass-through (e.g., none of these funds go to operational costs), some Title I education funds are used for operational purposes (e.g., teachers’ salaries, school supplies for programs for students with special needs, etc.). For the former, federal fund inflows and outflows mirror each other (as benefit needs decline, so do funds). For the latter, though inflows may decline, it does not necessarily mean expenditures decline as well – as expenditures are based on operations, not on benefits formulas. Meanwhile, while Head Start funds are allocated from the Federal Government based on the number of children living in poverty, NAP funds are provided through a block grant that is capped. The former, therefore, should change by population aged 0-4, while the latter should be consistent regardless of population size.

10.2 Baseline Expenditure Forecast

Over the next six years, baseline expenditures are set to increase relative to FY2020 due to inflation and increases in Medicaid costs (Exhibit 25).

EXHIBIT 25: MAJOR EXPENDITURE CATEGORIES PRE-MEASURES AND STRUCTURAL REFORMS

Key Baseline Expense Drivers (pre-measures and structural reforms), \$M



¹ Includes appropriations to HTA, UPR, and municipalities

10.2.1 Payroll expenditures and non-payroll operating expenditures

Payroll and Non-personnel operating expenses: FY2020 payroll and non-personnel operating expenses are expected to be consistent with the FY2020 certified budget, including reapportionments and adjustments that have been approved by the FOMB. FY2021 payroll and operating expenses align with OMB's recommended FY2021 budget. This includes a reinvestment in agency budgets to ensure proper delivery of services that have been affected due to aggressive expense measures imposed by the FOMB. Additional measures are assumed beginning in FY2022.

If not for the proposed reinvestment, the Government would face a critical scenario in which services to the most vulnerable citizens and would be affected. Among these, we can distinguish that the most affected programs and initiatives are:

- Administration of Criminal Institutions and Services to Inmates and Young Offenders
- Comprehensive Educational Services for People with Disabilities
- Medical Services to Injured Workers
- Auxiliary Administrative Services, Labor Insurance Issues and Claims
- Integrity and Government Efficiency
- Administration of the Government Employee Retirement System and the Judiciary
- Family Services with Children
- Administration of the University Adult Hospital
- Criminal Investigation

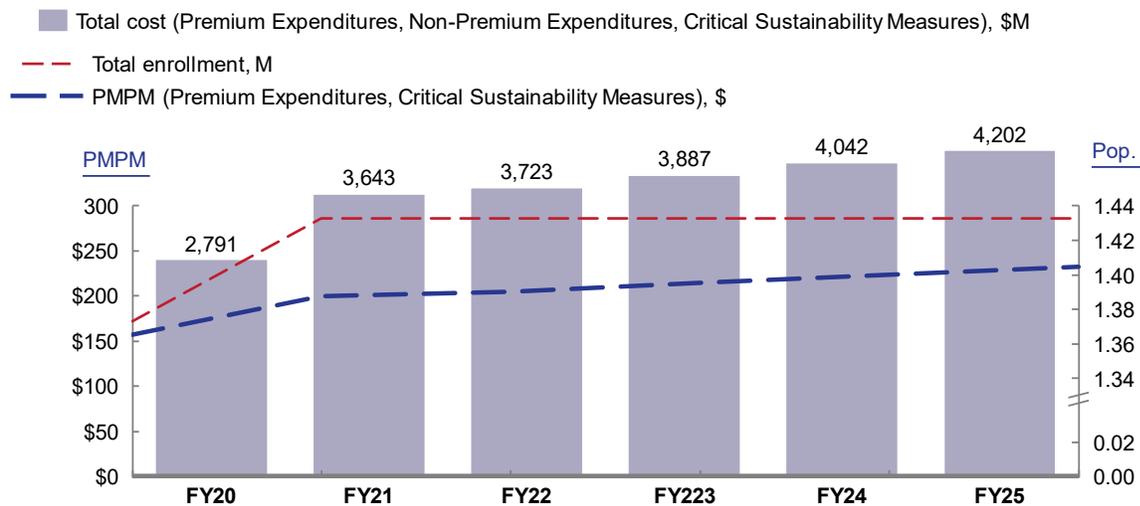
- Planning and Development of Electoral Activities
- Health Services Criminal Population
- Criminal Investigation and Prosecution
- Administration of the Pediatric University Hospital
- Permanent membership boards
- Programming and Production of Television Programs
- Nutrition Assistance for People of Limited Income (PAN)
- Medical Emergency Services
- Health Institutions
- Administration and Supervision of the Ponce Correctional Complex
- Services to the Agricultural Sector
- Land Registry
- Internal Revenue and Collections
- Administration and Supervision of the Bayamon Correctional Complex
- Legal Advice and Representation in Litigation
- Social Services for the Elderly and Adults with limitations
- "Child Care"
- Evaluation and Compliance (Direct Services to Agencies, Municipalities and Corporations)
- Treatment and Rehabilitation Services for Minor Offenders
- Maintenance and Conservation of Roads
- Agribusiness Integrity
- USA Regulation and Supervision of Energy in Puerto Rico
- Collective Land Transportation
- Random Games Supervision
- Administration of Rfo Piedras Psychiatric Hospital
- Evaluation and Award of Cases of the State Insurance Fund
- Research and Processing of Children and Family Affairs
- Corporation of the Symphony of Puerto Rico
- Auxiliary services
- Auxiliary Technical Services
- Environmental Health Regulations

10.2.2 Medicaid costs

Medicaid costs are projected to reach over \$4.2 billion annually by FY2025 (**Exhibit 26**). These costs are primarily driven by the cost per member per month (PMPM), the estimated number of people enrolled in Medicaid, and the implementation of critical sustainability measures. Other categories also include non-premium expenditures.

EXHIBIT 26: PROJECTIONS FOR VITAL BASELINE PMPM AND ENROLLMENT (NOT INCLUDING PLATINO)

Medicaid projected PMPM, enrollment, and expenditures, \$M total cost, M enrollees, \$ PMPM



With the incremental federal money granted through the Further Consolidate Appropriations Act, 2020, the Government will implement several critical sustainability measures that are aimed to stabilize, strengthen, and improve the healthcare system.

The additional Medicaid funding will allow the Government of Puerto Rico to implement the four critical sustainability measures needed to provide essential health services to Puerto Rico's Medicaid recipients. The four critical sustainability measures are as follows: (i) Increase provider reimbursement rates; (ii) Provide coverage for hepatitis C drugs; (iii) Provide Medicaid Part B premium coverage for dual eligible; and (iv) Adjust the Puerto Rico poverty level (PRPL).

- i. **Increase provider reimbursement rates:** Reimbursement rates for Government Health Plan (GHP) providers are particularly low compared to other Medicaid programs in the states and territories. In addition, increases in reimbursement rates have been limited due to budgetary constraints. For example, from July 2016 to July 2017 primary care services were reimbursed at 19% of the Puerto Rico Medicare fee, while these services are reimbursed at 66% of the Medicare fee nationally. Also, maternity services were reimbursed at 50% of the Puerto Rico Medicare fee while these services are reimbursed at 81% of Medicare fee nationally. The low reimbursement rates have caused provider shortages, lack of access to certain specialty services, and lengthy wait times. To address this issue the Puerto Rico government will implement the following measures:

- **Establish a 70% of Medicare reimbursement floor for all outpatient physician services**

ASES wants to establish a 70% of Puerto Rico Medicare fee schedule reimbursement floor for all physician services. The floor will be implemented through a directed payment arrangement that will be submitted for approval by the Centers for Medicare and Medicaid Services. The costs associated with the measure will be included in the Managed Care Organization PMPM capitation rate. In turn, the MCOs will be contractually obligated to reimburse all contracted providers at

the rate of at least 70% of the Puerto Rico Medicare fee schedule, which will ensure that the increase will be transferred to providers. The directed payment arrangement will not apply to services that MCOs sub-capitated.

- **Increase sub-capitation payment to primary care physician (PCP) services**

Almost all primary care services are paid through sub-capitation arrangements where MCOs delegate the risk for these services to Primary Medical Groups (PMGs). The PMGs are reimbursed through a fixed PMPM payment. In order to improve access to primary and preventive services ASES will include a 10% increase in PMPM sub-capitation paid to PMGs for contract year 2020. This will be considered a one-time increase and therefore no trend is applied to subsequent periods. However, the sub-capitation will increase when MCO premiums are revised each contract year.

- **Increase dental reimbursement rates**

Currently, the GHP covers child and adult dental services. Historically, dentists have not received reimbursement rate increases for these services. In Puerto Rico, dental services are being reimbursed at a much lower level when compared to other Medicaid programs. ASES submitted a directed payment arrangement to CMS, which was approved, that will ensure that the increase will be transferred to dental providers which is pending approval.

- **Increase hospital reimbursement rates**

According to the latest available CMS Hospital Cost Reports, over 50% of Puerto Rico hospitals reported net losses. Medicaid, as is the case in most other States, is the payer with the lowest reimbursement rates for hospitals. Puerto Rico hospitals are disproportionately affected by the low reimbursement rates because Medicaid covers almost half of the Island's population. These conditions jeopardize the ability for hospitals to operate and re-invest in their infrastructure. To support the sustainability of hospital services, additional funds are needed to compensate hospitals for losses attributable to Medicaid. The increase will be tied to the new DRG payment system that is currently being designed for the GHP. The payment system will allow reimbursement rates to be tied to acuity, quality, and value of services offered by each facility. ASES will ensure that the increase will be transferred to providers by mandating all MCOs to increase the base rate payment to hospitals by this amount. Subsequent increases to hospital reimbursement rates will be reflected in increases in the DRG base rate.

- ii. **Provide coverage for hepatitis C drugs:** Puerto Rico's Medicaid plan currently does not provide coverage for drugs that cure the Hepatitis-C virus. There are approximately 14,000 Puerto Ricans that are eligible for treatment and could be cured by making these drugs available to them. While the short-term cost is high, however, in the long term it is estimated that savings can be achieved due to the avoidance of costs related to the treatment of Hepatitis-C virus such as decompensated cirrhosis and liver transplants. Puerto Rico is investing in the long-term health and well-being of its population to provide this benefit and negate the need for more serious, more dangerous treatment options in the future.

- iii. Provide Medicaid Part B premium coverage for dual eligible:** There are approximately 282,000 Medicaid and Medicare dual eligibles in Puerto Rico that pay the Medicare Part B premium out-of-pocket. In most cases, the payment is a direct deduction from each individual's Social Security check, which for most recipients is their main or sole source of income. In all States, this premium is required to be paid by Medicaid for dual eligibles - however this does not apply in Puerto Rico. The Government of Puerto Rico recognizes that the high cost of the premium, which could be as high as \$135.50 per month, directly affects the livelihood of these low income and elderly individuals, and may force them to choose between this critical health benefit or other essentials like food, rent, etc. Providing this benefit will ensure that Medicare beneficiaries in Puerto Rico are not unduly harmed by their disparate treatment under Medicare Part B coverage, which is currently affecting the physical, mental and financial health of our most vulnerable citizens.
- iv. Adjust the Puerto Rico poverty level:** Due to the disproportionately low level of federal Medicaid funding for Puerto Rico, the Island has been forced to limit Medicaid eligibility well below the federal poverty level used in the states. As a result, a large portion of low-income and vulnerable families and individuals remain without health coverage even though they would clearly qualify if they moved stateside. Currently, Puerto Rico provides benefits to 120,000 individuals known as the State or Commonwealth population directly from its state funds. However, state funds are insufficient to meet the full needs of this population so additional federal funding is needed to continue to provide essential healthcare services on the Island so that these individuals do not see themselves forced to move stateside in search of adequate health coverage which is bound to be more costly to the federal government. The modification of the Puerto Rico poverty level on which income requirements for Medicaid is based would increase the fairness in eligibility for this population compared to their fellow citizens in the states. The full transparency of this change would be guaranteed through the approval by CMS of a State Plan Amendment (SPA).

PMPM costs, for premium expenditures are projected to grow at an annual growth rate of 5.1% from FY2020 to FY2025. This rate tracks pre-hurricane growth in Puerto Rico after the Island switched to a fully managed care model in 2015. In the long term, costs increase according to an age-mix adjusted PMPM growth rate. Additionally, the poverty level adjustment critical sustainability measure increases the income threshold to be closer to comparable US states, resulting in increased enrollment and provision of other services. This impact is included in the baseline.

Other Government expenditures, which include HIV/PDP, Health Insurance Provider Fee, Air Ambulance, MC21 administrative fee, Super Utilizers, and Pulmonary, among others, are projected to grow at the rate of Puerto Rico inflation. The Health Insurance Provider was eliminated as part of the New Medicaid Funding Bill.

Expenditures for the Platino dual-eligible program were estimated using a consistent \$10 PMPM over FY2020-FY2025, representing payment for wrap-around services supplementing main Medicare coverage. Platino costs are estimated to be approximately annual \$29 million from during the period FY2020 to FY2025.

10.2.3 Other expenditures

Appropriations: Baseline municipal appropriations are projected to be \$88 million in FY2021-FY2025 based on the OMB FY2021 Recommended Budget. The University of Puerto Rico appropriation baseline remains at \$560 million from FY2021-FY2023, and grows by inflation beginning in FY2024.

Pension costs: Projections rely on demographic estimates for ERS, Teachers' Retirement System (TRS), and Judicial Retirement System (JRS) populations and benefit obligations, and include updated data and actuarial projections for regular TRS benefits. From FY2020-FY2025, costs are projected to grow slowly but remain at approximately \$2.3 billion.⁵⁵ Since FY2018, ERS pension benefits have been paid on a pay-as-you-go basis, given that the majority of the liquid assets in the retirement system have been depleted.

The projection of TRS cash flows include updated census data from FY2015 to FY2016 and higher refund contributions (cash out elections from plan participants) from the 2018 voluntary transition program (VTP). The net effect is a positive impact of \$1.5 billion attributable to the Government not having to pay future employer contributions for participants that cashed out.

Capital expenditures: Centrally funded maintenance and capital expenditures of the Government (excluding PREPA, PRASA, HTA self-funded capex and one-time transfers) are expected to grow by inflation from a baseline of \$382 million in FY2020. Of note, FY2021 includes a one-time incremental capital expenditure consistent with the OMB FY2021 Recommended Budget resulting in \$450 million on FY2021 capital expenditures. Of this FY2021 amount, ~\$101 million will be appropriated annually to HTA and UPR, with the remaining ~\$348 million for use by the Government. After the devastation caused by Hurricanes Irma and Maria, Puerto Rico is in a unique position to become a platform for innovation in resiliency and climate change. To this end, the Governor is making a pledge to invest 100% of available capital expenditure resources (except funds needed for UPR and HTA) solely for resiliency and mitigation purposes. These amounts will be assigned to and managed by PRIFA.

HTA's capital expenditure funds will be used to support reconstruction, maintenance, traffic reduction, completion of the strategic network, and P3-related expenditures. UPR's capital expenditure funds will support, among other projects, several floors of the Molecular Sciences building, building restoration at Rio Piedras and Medical Sciences, and the development and restorations of campus buildings at Mayagüez including residential housing (among others).

Disaster relief funding cost share: Federal funds for public assistance typically require a local match from the entity receiving them (anywhere from 10-25% of funds). The 2020 Fiscal Plan projects that the Government will need to cover an estimated 10% of federal public assistance funds, amounting to approximately \$1.7 billion from FY2020-FY2032, and instrumentalities not covered under the 2020 Fiscal Plan will shoulder a further ~\$2.2 billion in total cost match expenditures during the same period, for a total of ~\$3.9 billion. The 2020 Fiscal Plan assumes the cost match expenditures will be covered by CDBG funds. As previously stated, the 2020 fiscal plan forecasts CDBG funds will be accessible past the statutory seven year limit.

PROMESA-related costs: PROMESA-related expenditures for the Government are projected to be \$1.1 billion for FY2020 to FY2024, comprised of professional fees and funding for the Oversight Board. The estimate for professional fees was developed by analyzing FY2018 run-rate billings and soliciting input from certain professionals. Fees were benchmarked versus

⁵⁵ Projections for pension expenditures are provided by Milliman.

comparable restructuring situations that yield an average professional-fee-to-funded-debt ratio of 1.89% relative to 1.72% projected for the Government (**Exhibit 27**).

EXHIBIT 27: PROJECTED PROFESSIONAL FEES RELATIVE TO OTHER MAJOR RESTRUCTURINGS

Professional fees for restructuring				
	Date filed	Outstanding debt, USD	Total fees and expenses, USD	Fees to funded debt, %
City of Detroit, Michigan	Jul. 2013	\$20,000,000,000	\$177,910,000	0.89%
Residential Capital, LLC	May 2012	\$15,000,000,000	\$409,321,308	2.73%
Sabine Oil & Gas Corp.	Jul. 2015	\$2,800,000,000	\$78,553,223	2.81%
Caesars Entertainment Operating Company	Jan. 2015	\$18,000,000,000	\$258,278,005	1.43%
Lehman Brothers Holdings Inc.	Sep. 2008	\$613,000,000,000	\$956,957,469	0.16%
Lyondell Chemical Company	Jan. 2009	\$22,000,000,000	\$205,932,292	0.94%
American Airlines	Nov. 2011	\$11,000,000,000	\$391,637,858	3.56%
Washington Mutual, Inc.	Sep. 2008	\$8,000,000,000	\$271,085,213	3.39%
Edison Mission Energy	Dec. 2012	\$5,000,000,000	\$96,244,628	1.92%
Energy Future Holdings Corp.	Apr. 2014	\$40,000,000,000	\$450,110,233	1.13%
Puerto Rico	2017	\$64,000,000,000	\$1,099,000,000	1.72%

Summary Statistics

Avg.	1.89%
Max	3.56%
Min	0.16%
Med	1.68%

Puerto Rico involves added complexity as the largest public sector restructuring in the history of the United States

Emergency reserve: The Government has established an emergency reserve based on 2.0% of FY18 GNP, which will be funded at \$1.3 billion by 2028. To achieve this, the Government will reserve \$130 million per year for 10 beginning in FY2019. The methodology supporting this reserve is informed by guidance provided to other Caribbean islands by the International Monetary Fund in defining an adequate emergency reserve (2-4% of GNP, accumulated at ½% per year).⁵⁶ Restrictions on the use of this fund will ensure that it is a true emergency reserve.

Federal emergency funds provide only temporary relief for Puerto Rico’s recovery from natural disasters. Eventually, federal emergency funds will run out and Puerto Rico will need to have in place a solution to respond to future natural disasters. The emergency reserve is designed to provide a long-term solution for Puerto Rico’s emergency response to natural disasters. However, even with the emergency reserve, Puerto Rico will need significant private investment to build infrastructure improvements strong enough to withstand such events so that they will have a minimal negative impact on Puerto Rico’s economy.

Other non-recurring expenditures: The Commonwealth 2020 Fiscal Plan includes the following non-recurring expenditures:

- *One-Time Litigation – Case No. KPE2002-1037 in Puerto Rico Court:* in Primary Health Association of Puerto Rico, Inc. and Others vs. Commonwealth of Puerto Rico (GPR) and

⁵⁶ IMF Bahamas Article IV report published March 22, 2018.

Others: forecast \$92 million of one-time litigation expenses in FY'2021, which are required to comply with the Transactional Stipulation of the case. These funds reflect the amounts owed by the GPR to the 330 centers for supplementary wraparound payments related to the claims during the period from January 1, 2001 to June 30, 2006.

- *One-Time Litigation – Case No. 99-1435 in Federal Court: United States of America vs. Commonwealth of Puerto Rico:* forecast \$20 million of one-time litigation expenses in FY'2021, which reflect amounts needed to replenish the surpluses of State Funds not used by the Division of Services to Persons with Intellectual Disabilities, which were returned to the General Fund during fiscal years 2015 to 2019.
- *One-Time Accrued and Unpaid PTO –* forecast \$15 million of one-time accrued and unpaid paid time off (“PTO”) in FY2021.
- *Electoral Expenses –* forecast \$34 million of electoral-related expenditures which are included every fourth year (election years).

Chapter 11. FISCAL RISKS

Risk to Revenue Generation: Revenues could be compromised through lower growth generation than expected by structural reforms, and revenues could be impacted by demographic shifts described below. Additionally, revenue upticks might be shorter than expected, while the creditability of Act 154 revenues is in question.

Economic Downturn: Puerto Rico has faced a profound fiscal and economic crisis, which has affected many of the Island’s municipalities and public instrumentalities. Puerto Rico’s gross national product contracted in real terms in all but one year between fiscal year 2007 and fiscal year 2018. The 2020 Fiscal Plan, which accounts for the impact of Hurricanes Irma and Maria, includes a 4.7% contraction in real gross national product in fiscal year 2018. While economic activity experienced a bounce back in FY2019, factors that may continue to adversely affect the Government’s ability to increase economic activity include the following:

- high cost of energy,
- changes in federal policy,
- the cost of repairs and rebuilding from severe weather events and the recent earthquakes,
- United States and global economic and trade conditions,
- population decline,
- epidemics or pandemics of communicable diseases,
- temporary economic stimulus of disaster relief funds may be shorter than expected,
- delays or withholding of federal funds, particularly disaster relief and Medicaid funding, and
- the Government’s high level of debt and the ongoing debt restructuring proceedings.

Rebuilding efforts, funded by federal disaster recovery assistance, are expected to alleviate the recession and result in positive growth in the short term, but growth is dependent on the disbursement of federal funds and the Island’s economic fundamentals remain weak.

Implementation risk of agency efficiency measures: The implementation of a massive reorganization of Government agencies could be difficult to achieve due to unforeseen obstacles or delays at some point along the way. To date, delays have occurred, and the 2020 Fiscal Plan projects the savings forecast in the May 9, 2019 Certified Fiscal Plan to be delayed by one year.

Population loss: Population decline has had, and may continue to have, an adverse impact on Puerto Rico's economic growth. According to the United States Census Bureau, the Island's population decreased by 2.2% from 2000 to 2010, and by an estimated 14.3% decline from 2010 to 2019. Population decline has been driven primarily by the falling birth rate, a rising death rate, and migration to the United States mainland, with over 500,000 leaving the Island in the past decade. Population decline has accelerated following the disruption caused by Hurricanes Irma and Maria, with a steep decline of 4.0% in fiscal year 2018. Reductions in population, particularly of working-age individuals, are likely to have an adverse effect on tax and other government revenues that will not be entirely offset by reductions in government expenses in the short or medium term. In addition, the average age of the Puerto Rico population is increasing, due mainly to a reduction in the birth rate and the migration of younger people to the United States mainland. This phenomenon is likely to affect every sector of the economy to the extent that the local consumer base is diminished, and the local labor force fails to meet the demand for workers. Moreover, this trend increases the demand for health and other services provided by the Government and its municipalities, and the relative cost to the Government and its municipalities of providing such services.

Federal Government Political Risk: Federal Government policy has a direct impact on the economy of Puerto Rico. With uncertainty surrounding the amount and timing of disaster relief funding that will ultimately be disbursed to Puerto Rico, the Government may need to delay repairs to infrastructure and the funding to those on the Island impacted by Hurricanes Irma and Maria. This could significantly impact the economy's ability to recover.

Medicaid Funding Risk: Puerto Rico's colonial status is an impediment for equal treatment under this vital federal program. Unlike states, Puerto Rico receives capped federal Medicaid funds. While the fiscal plan assumes a stable level of federal Medicaid support after the expiration of the recently passed Medicaid funding bill, there is no certainty that such funding will be made available. The expiration of temporary federal Medicaid funds without legislation to provide additional funds would result in significant funding shortfalls and have severe consequences.

Environmental Risks: The recent earthquakes that struck Puerto Rico highlight the continued environmental risks that the Island faces. In addition to physical damage, these natural disasters contribute to population erosion and will likely remain on the minds of corporations looking to locate or expand in Puerto Rico. Puerto Rico faces significant risk around the compounding impact of past disasters as well as the risk of future natural disasters which could negatively impact the Island's growth trends.

Title III Process Risk: The Oversight Board and the Government are currently engaged in costly, prolonged litigation with certain creditor groups regarding the validity and scope of their liens (among other issues), which at times has delayed the progress of the Title III cases generally. To the extent the parties fail to resolve outstanding issues consensually or the Board's proposed plan of adjustment is not confirmed or cannot be implemented in the near term, there is a substantial risk that Puerto Rico will not benefit from the favorable aspects of the Board's plan of adjustment proposal and, as a consequence, may not be able to comply with all aspects of this fiscal plan.

COVID-19: The novel coronavirus COVID-19 poses a significant risk to the outlook. As of early on February 28, panic has ensued in the U.S. equity markets over the spreading coronavirus, with shares tumbling more than 15 percent from a record high reached prior to the virus, and leaving the major indexes on track for their worst week since the 2008 financial crisis, following equally steep declines in Asia and Europe. The sell-off is fueled by worry that measures to contain the virus would hamper economic growth, and fears that the outbreak could get worse. The selling has dragged stock benchmarks around the world into a correction — a drop of 10 percent or more that is taken as a measure of extreme pessimism — in a matter of days. While stimulus and Federal Reserve rate cuts are a possibility if the coronavirus outbreak morphs into a pandemic, the stock rout and pullback in other assets has tightened financial conditions, impacted consumer confidence, could lead to direct slowing of economic activity (due for example, to school closures, quarantines, tourist cancellations, supply disruptions) and is likely to impact consumer confidence and real U.S. GDP growth.

Negatives for Puerto Rico include emerging risks to federal funding from competing priorities for what is possibly an emerging and immediate economic, political and public health emergency. Direct impact from slowing tourism globally is also a risk. A bias away from international travel could benefit Puerto Rico - to the extent that American tourism to Europe and Asia is impacted, it is possible that a redistribution towards closer destinations such as the Caribbean and Puerto Rico specifically could be beneficial, but much depends on the direct level of impact the virus has in Puerto Rico and the United States. Finally, to the extent that Puerto Rico's bio/pharmaceutical products are responsive to the needs of a federal COVID-19 response, the Island's economy can capitalize on what is likely short-term surges in demand for these products.

Part VI: Debt Restructuring Progress, Commonwealth Plan of Adjustment and Debt Sustainability Analysis (DSA)

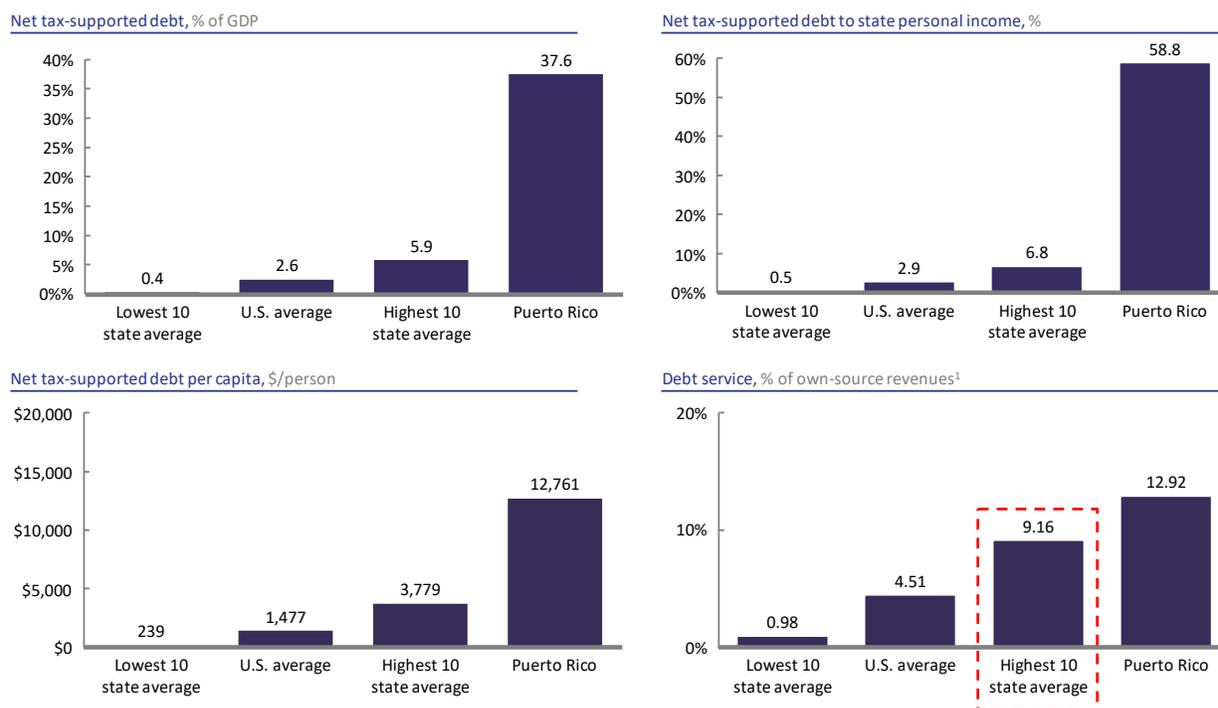
Chapter 12. DEBT SUSTAINABILITY ANALYSIS

Prior to the enactment of PROMESA, Puerto Rico had approximately \$45 billion in tax-supported debt with a declining economy and no guarantee of sustained federal funding. If the Oversight Board's plan of adjustment is confirmed, Puerto Rico's debt will essentially be cut in half to approximately \$25 billion and just under \$1.5 billion a year in debt service. However, the impact of federal disaster and recovery aid eventually tapers off and given Puerto Rico's aging demographic there is reasonable uncertainty as to the amount of debt Puerto Rico's economy can realistically support. Therefore, even if a plan of adjustment is confirmed for the Government, it will be crucial for the Government to seek and obtain private investment and other outside cash resources to enhance Puerto Rico's infrastructure so that it can withstand future natural disasters and better support long-term economic growth to the extent additional cash resources become available above what is presently forecasted, such resources as a matter of first priority and importance to the government have to be dedicated to investment in Puerto Rico's future.

The DSA is intended to provide a framework for assessing the long-term capacity of the Government to pay debt service on its bonded debt. Debt levels post-restructuring need to be sustainable over the long-term and consistent with both a minimal risk of default on the restructured debt and a recovery of market access for future new money capital borrowings for ongoing infrastructure investment. The analysis begins with the 2020 Fiscal Plan and is then informed by the debt sustained by the most appropriate peer group against which to benchmark Puerto Rico. The DSA then applies rating agency metrics for that benchmark group to Puerto Rico to arrive at an assessment of what debt levels are sustainable in light of long-term projections and the peer metrics. Net tax-supported debt is defined as debt payable from statewide taxes and other general resources, net of obligations that are self-supporting from pledged sources other than state taxes or operating resources (such as utility or local government revenues). Post COFINA restructuring, Puerto Rico net tax supported debt outstanding was approximately \$41 billion, comprised of GO, PBA, COFINA, PRIFA, HTA, Puerto Rico Convention Center District Authority (CCDA), ERS, Public Finance Corporation (PFC), and other intergovernmental loans. Net of the restructured COFINA debt, Puerto Rico's other net tax-supported debt outstanding totals approximately \$28 billion.

U.S. states as peer comparables: Like U.S. states, Puerto Rico does not control its own currency, has no access to IMF restructuring support programs or similar international sovereign relief funding packages, and traditionally has been reliant on access to the same long-term municipal bond market used by the U.S. states to finance their capital needs. Puerto Rico's bonds are also rated by the same rating agency analyst groups that assign ratings to U.S. states, not by foreign sovereign bond rating analysts. For these and other reasons, Puerto Rico has more similarities to U.S. states than to sovereign nations. (By virtually any measure tracked by the rating agencies, Puerto Rico's existing debt levels are clear outliers relative to these U.S. state peers (**Exhibit 28**).

EXHIBIT 28: US STATES AS COMPARABLES



¹ Own revenues includes all Commonwealth-collected revenues and excludes all federal transfers.

SOURCE: Moody's investors service, "Medians – State debt continues slow growth trend from April 24, 2018"; Puerto Rico data from Moody's investors service, "Medians – Total State Debt Remains Essentially Flat in 2017 from May 3, 2017"

NOTE: Puerto Rico benchmark metrics per Moody's debt service as % of revenues based on 2016 own-source government revenues, personal income reflects FY18 preliminary estimates from Commonwealth. In Puerto Rico's case, net tax supported debt totals approximately \$46 billion and includes GO, PBA, COFINA, PRIFA, HTA, CCDA, ERS, PFC, and other intergovernmental loans

While some observers note that Puerto Rico residents do not pay federal income taxes, they do pay Social Security and Medicare taxes, and the low per capita income levels would place most Puerto Ricans in a tax bracket where they would otherwise pay little or no federal income tax. Meanwhile, federal reimbursement levels provided to Puerto Rico for the largest Government spending programs (including Medicaid and transportation) are capped at levels well below the FMAP and federal highway reimbursement levels provided to comparably sized and wealthier states. Puerto Rico's residents pay graduated income taxes to Puerto Rico at brackets comparable to the federal income tax rates, thereby providing the funds needed to provide services to the Puerto Rico resident population, which is far poorer than the population of any U.S. state. Yet Puerto Rico receives less federal support.

Metrics for debt sustainability: Viewing U.S. states as the most comparable group for benchmarking Puerto Rico, the DSA uses the debt ratio metrics in the April 24, 2018 Moody's Investors Service (Moody's) report "States – U.S. Medians – State debt continues slow growth trend" and the "Fixed Costs" ratio metrics in Exhibit 20 of the August 27, 2018 Moody's report "States – U.S. Medians – Adjusted net pension liabilities spike in advance of moderate declines" to develop a range of levels for sustainable debt capacity, including maximum annual debt service levels for Puerto Rico on its restructured existing debt. The key debt ratios for the ten lowest indebted states, the ten highest indebted states, and the mean for all U.S. states are shown below (**Exhibit 29**).

EXHIBIT 29: KEY DEBT RATIOS FOR TEN HIGHEST INDEBTED STATES

NTSD as a % of GDP ¹		NTSD as a % of Personal Income ¹		Debt per capita (U.S. dollar) ¹		Debt Service to Revenue ¹		Fixed Cost to Own-Source Revenues ²	
	Low 10 Mean Top 10		Low 10 Mean Top 10		Low 10 Mean Top 10		Low 10 Mean Top 10		Low 10 Mean Top 10
	0.4%		0.5%		\$239		1.0%		3.6%
	2.6%		2.9%		\$1,477		4.5%		10.4%
	5.9%		6.8%		\$3,779		9.2%		20.9%
1	Connecticut 9.0%	1	Hawaii 10.4%	1	Connecticut \$6,544	1	Connecticut 13.8%	1	Connecticut 30.3%
2	Hawaii 8.9%	2	Connecticut 9.5%	2	Massachusetts \$6,085	2	Massachusetts 11.7%	2	Illinois 28.4%
3	Massachusetts 8.3%	3	Massachusetts 9.5%	3	Hawaii \$5,257	3	Hawaii 10.5%	3	Hawaii 24.8%
4	New Jersey 6.7%	4	New Jersey 7.0%	4	New Jersey \$4,281	4	New Jersey 9.4%	4	Kentucky 20.5%
5	Mississippi 5.1%	5	Illinois 5.6%	5	New York \$3,082	5	Illinois 9.2%	5	Massachusetts 19.9%
6	Illinois 4.7%	6	Delaware 5.5%	6	Illinois \$2,919	6	New York 8.1%	6	New Jersey 19.1%
7	Kentucky 4.5%	7	Mississippi 5.2%	7	Washington \$2,662	7	Washington 7.7%	7	Pennsylvania 17.9%
8	Washington 4.1%	8	New York 5.2%	8	Delaware \$2,587	8	Kentucky 7.3%	8	Maryland 17.5%
9	New York 4.1%	9	Kentucky 5.1%	9	California \$2,188	9	Maryland 7.0%	9	West Virginia 16.0%
10	Rhode Island 4.0%	10	Washington 5.0%	10	Rhode Island \$2,188	10	Mississippi 6.9%	10	Utah 14.2%

1 Moody's investors service, "Medians – State debt continues slow growth trend from April 24, 2018"

2 Moody's investors service, "Medians – Adjusted net pension liabilities spike in advance of moderate declines from August 27, 2018"

"Fixed costs" are the FY2017 sum of each state's (1) net tax-supported debt service expense and their (2) actual budgetary contributions to pension expense and retiree health care ("OPEB"), as reported by Moody's

Exhibit 30 uses the long-term 20-year macroeconomic forecast to determine a range of implied debt capacity based on the debt and fixed cost metrics of the *average* U.S. state. The debt capacity ranges shown are based off the following four methodologies: (i) debt to own-source revenues, (ii) debt per capita, (iii) debt to state personal income; (iv) debt to GDP; and (v) fixed costs to own-source revenues. Implied debt capacity and expected growth in debt capacity must be sufficient to cover both restructured debt and debt service on any future new money capital borrowings Puerto Rico needs to maintain its public infrastructure. To the extent new and additional revenues are enacted in the future, including revenues designed to support future capital projects or generated by public-private partnership infrastructure investments, then those initiatives could generate additional debt capacity for Puerto Rico that is not reflected in the current 2020 Fiscal Plan projections. The 5-year average capacity statistics represent the average par amount between the five methodologies of an implied 5% 20-year level debt service structure. Moody's defines "fixed costs" as the sum of a state's annual debt service and its annual budgetary pension and retiree healthcare (i.e. Other Post-Employment Benefits (OPEB)) expenditures. Given that Puerto Rico's public employee pension system is essentially zero percent funded—and that as a consequence the central Government will pay pension expenditures on a fully PayGo basis from budgeted revenues each year—the fixed costs ratio helps capture that burden in comparison to the level of fixed costs as a percentage of Own-Source Revenues for U.S. States.

EXHIBIT 30: IMPLIED NET TAX-SUPPORTED DEBT CAPACITY RANGE BASED ON AVERAGE U.S. STATE (\$M)

Implied debt capacity range based on average US state, \$M

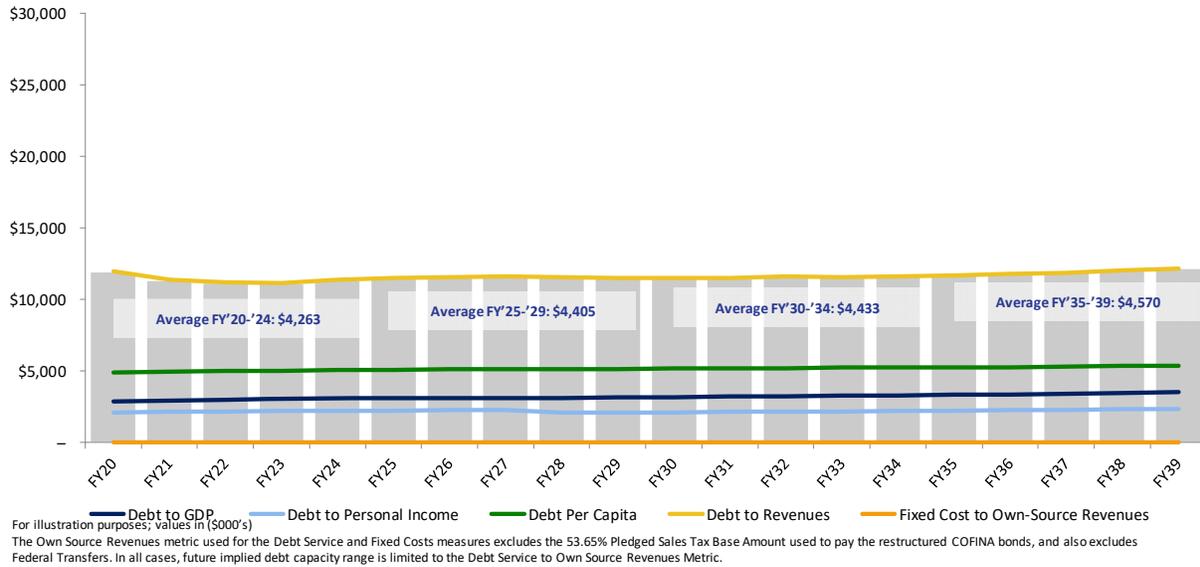
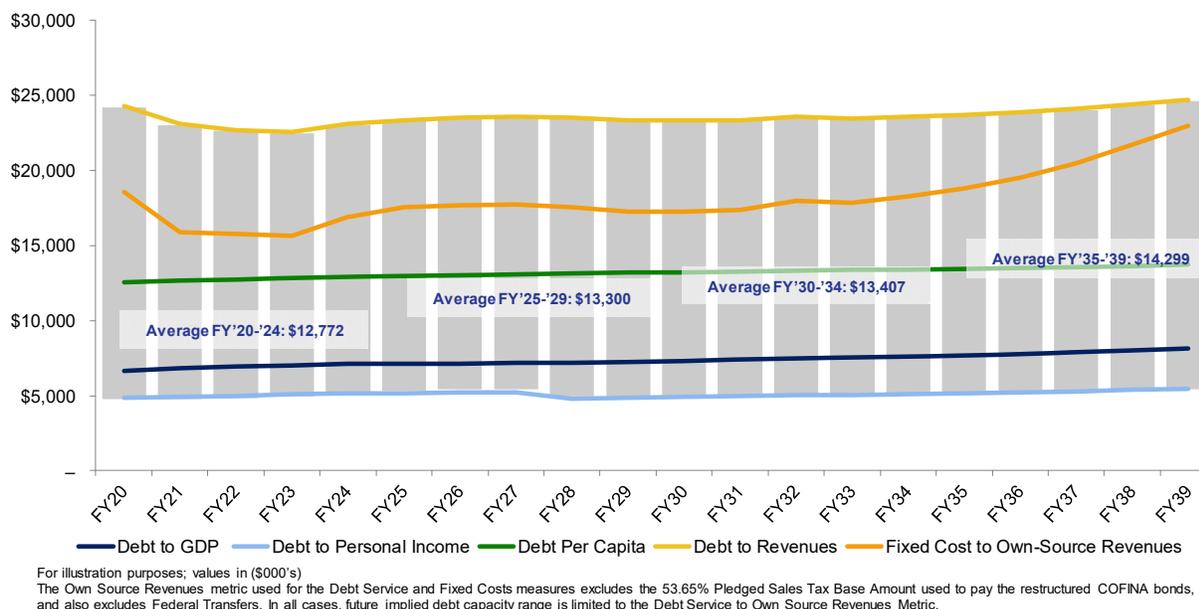


Exhibit 31 uses the long-term 20-year macroeconomic forecast to determine a range of implied debt capacity based on the debt metrics of the *10 highest indebted* U.S. states. The debt capacity ranges shown are based off the following four methodologies: (i) debt service to own source revenues, (ii) debt per capita, (iii) debt to state personal income, (iv) debt to GDP, and (v) fixed costs to own-source revenues. Implied debt capacity and expected growth in debt capacity must be sufficient to cover both restructured debt and future debt issuance. The 5-year average capacity statistics represent the average par amount between the five methodologies of an implied 5.0% 20-year level debt service structure.

EXHIBIT 31: IMPLIED NET TAX-SUPPORTED DEBT CAPACITY RANGE BASED ON TOP-10 HIGHEST INDEBTED U.S. STATE DEBT METRICS (\$M)

Implied debt capacity range based on top-10 highest indebted US state debt metrics, \$M



The illustrative implied levels of the Government’s restructured debt in the previous chart are calculated by applying the Net Tax Supported Debt ratios of the “top ten” U.S. states (in terms of debt load) to Puerto Rico’s future projected GDP, population and Own-Source Revenues. Debt Service to Own Source Revenue and Fixed Costs to Own Source Revenues figures are derived assuming debt service of a long-term level debt service structure, with a 5% average coupon.

Maximum annual debt service cap on restructured fixed payment debt: The implied debt capacity and expected growth in debt capacity must be sufficient to cover both the payments due on the restructured debt and all payments due on future new money borrowings. Accordingly, the aggregate debt service due on all fixed payment debt issued in the restructuring of the Government’s existing tax-supported debt should be capped at a maximum annual debt service (MADS) level. The cap would be derived from the U.S. state rating metrics, and specifically from what Moody’s calls the “Debt Service Ratio.” The Debt Service Ratio is the ratio of total payments due in a year on all existing net tax-supported debt over that state government’s own-source revenues (i.e., excluding federal transfer payments) in that year.

The Moody’s report indicates that the average Debt Service Ratio for the all U.S. states is 4.5%. The Moody’s report indicates that the average Debt Service Ratio for the top 10 most indebted states is 9.16%. To the extent either of these Debt Service Ratios is used to set a MADS cap on the restructured debt and the Primary Surplus is below the MADS level, then the debt service due on fixed payment debt would need to be set at the lower of the amount available for debt service or the MADS limit.

With respect to the Moody’s Fixed Costs Ratio, the August 2018 Moody’s report indicates that the average Fixed Costs Ratio for all U.S. States is 10.4%. The same report indicates that the average Fixed Costs Ratio for the 10 States with the highest Fixed Costs Ratios is 20.9%.

Debt sustainability analysis: Exhibit 32 below calculates implied debt capacity based on a range of interest rates and 2020 Fiscal Plan risk factors under an assumed illustrative 20-year term and level debt service. The risk factor is calculated by reducing the amount of projected cash flow available per year for debt service by a certain percentage. For example, a 20% risk factor case would use only 80% of the projected cash flow available to pay debt service on fixed payment debt.

EXHIBIT 32: IMPLIED DEBT CAPACITY BASED ON RANGE OF INTEREST RATES AND RISK FACTORS (\$M)

Implied debt capacity based on range of interest rates and contingency, \$M

Illustrative Cash Flow Available		Implied Debt Capacity at Cash Flow				
		\$900	\$1,000	\$1,100	\$1,200	\$1,300
Sensitivity Analysis: PV Rate %	4.0%	\$9,785	\$10,872	\$11,959	\$13,047	\$14,134
	5.0%	8,973	9,970	10,967	11,964	12,961
	6.0%	8,258	9,176	10,094	11,011	11,929

Illustrative Cash Flow Available		Implied Debt Capacity at 5% PV Rate				
		\$900	\$1,000	\$1,100	\$1,200	\$1,300
Sensitivity Analysis: % Contingency	10.0%	\$10,094	\$11,216	\$12,338	\$13,459	\$14,581
	20.0%	8,973	9,970	10,967	11,964	12,961
	30.0%	7,851	8,724	9,596	10,468	11,341

Restoration of cost-effective market access: As Puerto Rico seeks to regain cost-effective capital markets access, rating analysts and investors will demand that the Government demonstrate improvement in all four core areas of creditworthiness identified by Moody's: the economy, government finances, governance and "fixed cost" debt service and pension expenditures. The Government will adhere to structurally balanced budgets reflecting ongoing fiscal discipline and return to the timely publication of audited financial statements and related disclosure information. Together, these and other measures outlined in the 2020 Fiscal Plan can chart a path to restoring Puerto Rico's market access.

Part VII: Conclusion

Despite many challenges, the state of the U.S. territory of Puerto Rico is optimistic, determined and full of potential. In the nearly four years since Congress passed PROMESA, Puerto Rico has been challenged by the most damaging hurricanes in U.S. history and the strongest earthquakes in the Caribbean in over a century. These natural disasters have further complicated an already decades-long, island-wide recession marked by significant population loss. As it navigates the island through its litigious Title III cases, the Government will continue to pursue Title III processes and outcomes that are fair and just to all constituents. The Government's goal is to reimagine, revitalize and rebuild Puerto Rico so that it can develop to its full capacity for the benefit of not only Island residents, but for the United States as a whole.

VIII. Appendix

Appendix A. Legislation and Executive Order

- Department of Public Safety (Act 20-2017)
- Office of the Municipal Affairs Commissioner into the Office of Management and Budget (Act 81-2017)
- Model Forest to Nonprofit Trust (Act 131-2018)
- Puerto Rico Education Council into the Department of State (Act 212-2018)
- Environmental Quality Board, Natural Resources Administration, and Solid Waste Authority into the Department of Environmental and Natural Resources (Act 171-2018)
- Puerto Rico Energy Board, Public Services Commission, Independent Bureau of Consumer Protection, and Telecommunications Regulatory Board into the - Public Service Regulatory Board (Act 211-2018)
- Office of the Chief Financial Officer (Executive Order 2018-034)⁵⁷
- Department of Economic Development and Commerce (Act 122-2018)
- Department of Agriculture, the Agricultural Enterprise Development Administration, and the Farm Insurance Corporation into the Agriculture grouping (Executive Order 2018-039)
- Office of the Financial Institutions Commissioner and the Office of the Commissioner of Insurance into the Finance Commission grouping (Executive Order 2018-040)

Appendix B. Interagency Agreements

Another strategy used by the Government to generate savings and efficiencies are interagency agreements signed to leverage shared services by pooling administrative resources such as HR, Accounting and Finance, Legal Services, Technology, and sharing real estate, among other initiatives:

- Agreement between the Department of Agriculture, the Agricultural Enterprise Development Administration, and the Farm Insurance Corporation;
- Agreement between AAFAF and OMB (Executive Order 2018-034)⁵⁸
- Agreement between Office of the Financial Institutions Commissioner and the Office of the Commissioner of Insurance; and
- Agreement between the Fine Arts Center Corporation, the Institute of Puerto Rican Culture, and the Musical Arts and Stagecraft Corporation.

⁵⁷ Pending final signature.

⁵⁸ Pending final signature.