



GOVERNMENT OF PUERTO RICO

Puerto Rico Fiscal Agency and Financial Advisory Authority

BY ELECTRONIC MAIL

March 27, 2019

Natalie A. Jaresko
Executive Director
Financial Oversight & Management Board
P.O. Box 192018
San Juan, PR 00919-2018

Dear Ms. Jaresko:

The Government of Puerto Rico is in receipt of the Board's March 15, 2019 letter (the "Notice of Violation"). The Notice of Violation states that the Commonwealth's Proposed Fiscal Plan as of March 11, 2019 (the "Proposed Plan") "requires certain significant revisions and additional supporting information before the Oversight Board can certify it as compliant with the requirements of PROMESA". The Government disagrees with certain of the Board's assertions and sets forth in detail the Government's position.

In accordance with the Notice of Violation and PROMESA, the Government is submitting herewith a revised plan dated March 27, 2019 (the "Revised Proposed Plan").

The Government has carefully evaluated the Board's comments and observations concerning the Proposed Plan and includes as part of this response background discussion and explanations.

I. Macroeconomic Projections

- **Disaster funding totals:** The Proposed Plan references that FEMA now estimates \$60B in total public assistance funding and discounts that funding by a factor of ~23%. Meanwhile, FEMA's 12-month Report issued October 2018 indicates that funding (excluding Individual Assistance and Administrative categories) will amount to \$65B over the life of the storm. Please revise the Proposed Plan to reflect the full amount of fund that FEMA reports.

Response: The Revised Proposed Plan now includes an incremental \$4.6b of FEMA mission assignments. \$3.6b of mission assignments have been disbursed and it is assumed the remaining \$1.0b of mission assignments are disbursed throughout the remainder of FY19. As explained in the Revised Proposed Plan, there are several factors that warrant that the Government does not include the full amount in the projections.

- **Disaster funding roll-out:** The Proposed Plan shows ~\$3.7B in FEMA funding (excluding Individual Assistance and Administrative categories) across FY18 and FY19. Published data from the government's COR3 office shows that ~\$6.2B has already been disbursed, with several months remaining in FY19. The Government must update the values for FY18 and FY19 to reflect documented obligations and disbursements to date. Further, from FY19 to FY49, the Government

has not adjusted roll out for new information regarding the pace of spend. Please provide documentation and explanation for where roll out estimated are derived. Finally, please provide documentation and explanation for CDBG roll out.

Response: The Revised Proposed Plan has been updated to include \$3.6b of actual FEMA Mission Assignments disbursements made to date. The roll out of FEMA PA is predicated on the actual roll out of FEMA PA monies post Hurricane Katrina as documented in the GAO Report to Congressional Committees – Federal Disaster Assistance dated September 2016. This approach was discussed with the Board’s advisors prior to the submission of the March 11, 2019 Fiscal plan and the GAO report was provided to the Board’s advisors on February 21, 2019.

- **Disaster funding pass-through:** The Proposed Plan includes a pass-through rate of 18% across FEMA Public Assistance, HUD CDBG funding, FEMA Individual Assistance, Other Federal Funding, and Private Insurance. Please justify this one-size-fits-all approach across programs. The Oversight Board’s position is that pass-through rates for disaster funding vary between those which are directed just toward consumption (where a 100% pass-through rate applies), those just toward capital investment (where an 18% or 23.5% pass-through rate applies based on whether investment is in utilities or standard structures), and those that will be directed toward programs, in which funds will be spent both on and off Island (in which a 23.5% pass-through rate applies).

Response: The FOMB characterization of the Government adopting a “one size fits all” approach is incorrect. The Government documents the nature of the spending as immediate disaster relief or investment. The Government includes immediate relief consumption transfers at a 100% pass-through rate. Further differentiation of the pass-through rate is not supported by data. The Government believes the FOMB assumptions are imprecise and do not clearly explain assertions included in the Certified Fiscal Plan, such as the ability to distinguish between the impact of investment in utilities and in other capital expenditure projects. The sizing to 23.5% is unsubstantiated on the basis of the information included in the Certified Fiscal Plan, and includes ad-hoc sizing with incomplete or inadequate documentation.

The Government has provided a rationalization for disaster recovery expenditure reflecting pass-through to the local economy at a rate of 18% on page 22 of the March 11, 2019 Proposed Plan.

- **FY18 & FY19 GNP growth rates:** Please provide support for the FY18 & FY19 GNP estimates used in the Proposed Plan, including sources of assumptions and modeling methodology.

Response: The GNP forecast methodology is unchanged relative to previous versions of the Plan. The Proposed Plan includes updates to data (as detailed in the Proposed Plan text) and assumptions but relies on the same economic model as previous fiscal plan submissions. The change in FY2018 GNP growth rate principally reflects differences in disaster spending assumptions, particularly an increase in the amount of disaster relief spending allocated to consumption/immediate relief in FY2018. Sources indicate that individual assistance is largely spent on immediate relief or consumption spending, which impacts at a 100% pass-through rate.¹

¹ (<https://www.fema.gov/news-release/2018/03/07/22-billion-federal-aid-approved-puerto-rico-households-and-businesses>,

These results are consistent with indicators of economic activity in the Commonwealth (the EDB-EAI) and conversations with the Puerto Rico Planning Board regarding economic activity in FY2018.

The changes in FY2019 reflect only updates to input data and disaster funding totals.

- **Projections for mainland US growth and inflation rates:** The Proposed Plan uses up- to-date U.S. mainland GDP growth rate and inflation rate estimates from the CBO projections. The Proposed Plan should use CBO fiscal year projections (which are closer to Puerto Rico’s fiscal year) instead of calendar year projections.

Response: The statistical model is based on calendar year US GDP data. The coefficient therefore describes the relationship between calendar year US GDP and fiscal year Puerto Rico GNP. It is inconsistent to use US fiscal year (October – September) GNP as basis for the projections. DevTech and FOMB economist Andrew Wolf agreed on March 20, 2019 that the Commonwealth will continue to use calendar year US GDP as the basis for projections.

- **Population:** Population figures in the Proposed Plan do not appear to have been updated in line with the macroeconomic projections contained in the model. Please update accordingly.

Response: The Commonwealth requested and received updated population figures from Lyman Stone on March 5, 2019 based on the current economic growth projections. While there were subsequently minor updates to real GNP, these changes were very small (see chart).



The Revised Proposed Plan will include another update based on changes made since March 11, 2019 as has been our practice in each submission.

<https://www.fema.gov/news-release/2018/09/10/fact-sheet-obligated-funding-puerto-rico>

- **Damage assessment:** The Proposed Plan still uses the original damage assessment from the Planning Board (based on data from October 2017). Please share the Planning Board's methodology for reaching this assessment figure.

Response: As was discussed in meetings between Government advisors, FOMB advisors, and the Planning Board on September 4, 2018 and March 6, 2019, there is no update to the damage assessment published by any official source. The Planning Board is no longer publishing hurricane recovery updates. Note that the Planning Board has referred to the FEMA Hazus² estimate in publications but did not perform the Hazus estimate.

The Government will continue to use the FEMA Hazus estimate. The Hazus estimate is based on GIS data and meteorological inputs, which have not changed since the model was run in November 2017. Hazus is a nationally applicable standardized methodology containing models for estimating losses from hurricanes, using GIS technology to estimate physical, economic, and social impacts of disasters.

According to FEMA, potential loss estimates analyzed in Hazus include:

- Physical damage to residential and commercial buildings, schools, critical facilities, and infrastructure;
 - Economic loss, including lost jobs, business interruptions, repair, and reconstruction costs;
 - Social impacts, including estimates of shelter requirements, displaced households, and population exposed to scenario floods, earthquakes, and hurricanes, and tsunamis
- **Power & water rates:** Please provide additional information and an explanation for the power and water rates used in the Proposed Plan, including sources of assumption.

Response: The Government has assumed the same power utility rates and rate escalation as in the October 23, 2018 Certified Fiscal Plan. No further changes were made to these assumptions.

II. Baseline Revenue Projections

- **Recovery revenue methodology:** The Proposed Plan forecasts above-trend revenue collections attributable to disaster-related spending by tying such funds to the rate of roll out of funding directed towards capital. Please align these funds to the rate of roll out to all disaster funding given their potential impact on revenues.

Response: The Government submission followed the same methodology as the October 23, 2018 Certified Fiscal Plan. The Government is now updating the methodology for the rate of disaster recovery funding roll out to be consistent with the FOMB's amended view.

- **Impact of changes to the tax law of Puerto Rico:** The Proposed Plan must incorporate the effects of the recent changes in tax law by showing the expected offsetting changes to CIT, PIT, and SUT.

² <https://www.fema.gov/hazus>

The Proposed Plan must also not include incremental revenues from the tax law changes, per previous Oversight Board guidance around implementation risk.

Response: The Government submission included a tab labeled "tax reform" that included the requested detail regarding impact of tax reform on specific revenue concepts. In order to provide additional clarity, a summary schedule has been included on the same tab. The Government has eliminated the revenues associated with implementation risk to make the tax reform revenue neutral.

III. Baseline Expenditure Projections

- **Medicaid: The Proposed Plan contains substantive updates to Medicaid expenditures which require further information.**
 - **Federal funding:** The Government assumes that it will receive unlegislated sources of federal funds in the amount of \$1B annually starting in FY21, in addition to the ~\$400M federal matching funds (allotted under Social Security Act Section 1108 and federal CHIP program). Please amend the Proposed Plan to exclude this funding assumption given it does not match current law.

Response: Consistent with the March 11, 2019 Government submission, it is assumed that Puerto Rico receives incremental federal funding consistent with a recent request by the Government to the Federal Government for annual support of approximately \$1.6 billion. This funding begins in FY2020.

- **Medicaid enrollment:** The Proposed Plan projects significant drops in Medicaid and Platino enrollment numbers starting in FY20. Please provide an explanation to justify the projected trend for both enrollment categories.

Response: The drop in enrollment figures are the result of the expiration of the auto-recertification of eligibility that was in force since hurricane María through FY2018, as well as the general population trends under current economic conditions.

- **Medicaid long-term projections:** The Proposed Plan contains a long-term healthcare inflation rate that is higher than the Certified Fiscal Plan. Part of this difference relates to the Proposed Plan's population assumptions for the Island as a whole; however, there are also updates to the per capita healthcare inflation rate (i.e., PMPM expense growth). Please provide any new documentation to support this assumption.

Response: The long term PMPM inflation rate is consistent with the September 7, 2018 Government submission and all documentation related to that assumption has already been provided to FOMB advisors.

- **Medicaid modeling methodology:** It appears that the baseline (pre-measure) PMPMs in the ASES expenditure build may already include the effect of the proposed measure

reduction, leading to a double counting when measure totals are later applied to total expenditures. Please confirm and revise.

Response: The measures are not double counted. The measures build includes a compensating amount that removes what is already implicit in the FY2019 baseline.

- **Pensions:** Baseline pension expenses in the Proposed Plan are \$1.4B lower than in the Current Fiscal Plan, without sufficient explanation. Please provide census data to support this change.

Response: The baseline pension expense included in the Revised Proposed Plan included updated pension expense for the Teachers Retirement System. The update was based on more recent information including (i) Department of Education 2018 Voluntary Transition Program, which is expected to result in high refund of contributions activity in Fiscal Year 2019-2020, and (ii) 2016 census data. As requested, the 2016 census data for Teachers Retirement System has been provided to FOMB advisors.

- **Restoration of federal funds held at GDB:** The Proposed Plan assumes the Commonwealth will have to pay to the federal government \$105M to restore federal funds that were held at GDB to avoid the risk of offsets under the US Treasury Offset Program. Part of this \$105M balance reflects certain amounts related to entities outside of the Commonwealth Fiscal Plan. Please provide detailed support and documentation for this amount, especially as it relates to amounts outside of the Commonwealth Fiscal Plan.

Response: The assumption that the Government would restore the remaining \$105 million in federal funds held at GDB has existed since the Fourth Amendment to the GDB Restructuring Support Agreement, dated as of April 6, 2018, which included a list of all federal funds held at GDB.

The Proposed Plan simply includes those funds that have yet to be disbursed by the Commonwealth. The restoration of such federal funds to Government Entities (as such term is defined in Act 109-2017, as amended, known as the GDB Restructuring Act)³ is aligned with several documents that formed part of the GDB Qualifying Modification and to which the FOMB was either a party to, or certified during the course of the Title VI process. The restoration of federal funds held at GDB was also provided for in Judge Swain's order approving the Qualifying Modification.

More detailed information has been provided to FOMB advisors.

- **Payroll & non-payroll expenditures:** The Proposed plan uses FY19 as the baseline year and includes some FY19 measures in this baseline (e.g., payroll baseline appears to include measures but operational expenditure measures do not appear to be included). This reduces transparency in government reform needed, implementation progress, and results in the macroeconomic model inadequately representing fiscal reform. The Government should adjust the Proposed Plan

³ The GDB Restructuring Act defines the term "Government Entity" as any agency, department, office, public corporation, trust, fund, system, instrumentality, political subdivision, taxing authority or municipality of the Government.

to show the baseline separate from the measures. The baseline year for the Fiscal Plan is FY18 and should continue to be FY18.

Response: The Commonwealth is operating under a Certified Budget that includes the FY2019 measures. The Commonwealth is also reporting budget to actual results against the Certified Budget. By including the Certified Budget with operational adjustments and apportionment activity, the Government is being fully transparent by reflecting the actual budget that it is operating under and that results are being reported against.

- **Utilities:** The Proposed Plan includes the outstanding historical Commonwealth utility payments to PREPA and PRASA; however, it assumes the Commonwealth will have to pay \$0.1B less in utilities between FY19 and FY23 than in the Current Fiscal Plan. Please provide an explanation for why there is a discrepancy in this amount.

Response: There is no discrepancy. The “difference” in comparison to the Current Fiscal Plan results from FY2019 savings being incorporated in the FY2019 baseline for utilities. The decrease in utility expense measure is consistent with the decrease in utilities.

- **Disaster recovery cost match:** The Proposed Plan assumes that CDBG funds will be used for cost share beyond the CDBG roll-out period stipulated in the latest published Action Plan. This likely misstates the time period within which CDBG can be used, and how it will be used. Please provide detailed support and an explanation for how the Government can use CDBG funds after Action Plans have expired.

Response: Historically HUD has 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 Hurricane Maria and Hurricane Irma, it is more than reasonable to assume that Puerto Rico would receive an extension to the 7-year expenditure deadline.

IV. Structural Reforms

- **Labor reform scoring:** The Proposed Plan maintains the 0.15% uptick in GNP in FY21 due to labor reform. However, that scoring was dependent on full and timely implementation of EITC and the NAP work requirement, which the Proposed Plan does not commit to and which current implementation reports indicate that the Commonwealth will not be able to do. As such, this uptick should be delayed until FY25, a year after the Commonwealth has recently proposed it will have full implementation of the NAP program with the three-month transition time.

Response: The Government has maintained its stand in a phase-in of the work requirement for NAP. Including a phase-in of the work requirement over a four-year period (Government proposal) versus launching a full work requirement (with a 3-month transition time) is critical due to Puerto Rico’s economic and social welfare framework. High unemployment (lack of supply of jobs) and high volume for training and re-training (lack of skilled professionals) represents a challenge that could negatively impact

the current benefits provided by the NAP Program. Different from other states, Puerto Rico receives the NAP Programs Benefits as a block grant and cannot redistribute funds immediately in order to mitigate this potential economic impact to over 150,000 citizens that would potentially qualify for work requirements. A phase-in option is the correct policy decision, and also, what has been communicated to the Food and Nutrition Service Agency (“FNS”).

In all submitted Fiscal Plans and Implementation Plans the Government has presented the work requirements as a phase-in, and the date of effectiveness to be October 2019, after FNS approval. Puerto Rico has already submitted a work requirement language in its FY2019 Annual State Plan to the FNS. During FY2019 the Government will continue developing, alongside FNS, the work requirement program policies, parameters, operational guidelines and compliance oversight that will be included in its FY2020 Annual State Plan submission.

- **Energy reform scoring:** The Proposed Plan includes an uptick of 0.30% for the transformation of PREPA and the energy sector on the Island. Given the status of the PREPA transformation and implementation of its measures, this uptick will likely take place over several years (e.g., 0.10% uptick in FY21, FY22, and FY23) instead of all at once. Please update the Proposed Plan accordingly.

Response: The Government has updated the Revised Proposed Plan to reflect the Board’s assessment.

- **Ease of Doing Business reform scoring:** The Proposed Plan includes a 0.25% uptick in FY20 and FY21 for Ease of Doing Business reforms. However, it excludes crucial metrics for Discover Puerto Rico and Invest Puerto Rico, and current reports indicate that there is no substantial change in the ease of doing business milestones (e.g., permitting continues to be a major barrier despite the new website due to minimal additional changes in the process design). As such, the upticks should be delayed to FY21 and FY22 accordingly.

Response: During regular monthly meetings with the FOMB, the Government has presented its progress towards achieving Ease of Doing Business Reforms, including: the full capacity and integration of the permit platform (“SUI”), deregulation of the Condominium Law (already submitted to the Legislature), reduction in occupation licensing efforts through the widespread Dale Tijera Initiative, and the efforts of the already fully operational Discover Puerto Rico and Invest Puerto Rico.

Specifically, for the Permit Reform the Government has presented to the FOMB the achievements and project plans of the new Permit Reform and has invited the FOMB for a physical meeting in OGPE offices to demonstrate the advancements of the system and processes. The Government is targeting a 100% integration into SUI by end of FY2019 for the following metrics: Licenses integrated into SUI; cases filed in SUI; cases issued in SUI; concerned entities integrated into SUI; and autonomous municipalities integrated into SUI.

- **Detail in structural reform initiatives:** The Proposed Plan drastically reduces the detail on how structural reform initiatives will be accomplished, including major milestones that must be achieved to drive growth. The Proposed Plan must maintain the detail included in the Current Certified Plan and restore all implementation plans and milestones.

Response: This information is routinely communicated with the FOMB through implementation progress reports and ongoing Government support of implementation efforts.

V. Fiscal Measures

- **Agency efficiencies:** The Proposed Plan includes a number of deviations within the agency efficiency measures from the Certified Fiscal Plan. The Proposed Plan reduces total savings to be achieved via agency efficiencies by \$1.1 billion through additional spending in FY19- 23.

Response: Although the assumptions and projections contained in the Revised Proposed Plan have detailed support and backup, the Revised Proposed Plan does not delve into the minutiae of every governance and spending detail. The Government believes that it is ill-advised for the Fiscal Plan to include detailed financial allocations among each of the Government's more than 110 agencies, as the Board has required in prior fiscal plans. In the Government's view, this level of detail at the fiscal plan stage causes a disconnect between the fiscal plan and the budgeting process and is among the primary reasons why the fiscal plans have been revised so frequently and unnecessarily in the past (other than with respect to natural disasters). For instance, since certifying the initial Commonwealth fiscal plan on March 13, 2017, the Board has required recertification of the Commonwealth fiscal plan five times. On average, each certified fiscal plan has only been in effect for about four months before the Board has requested a revised fiscal plan submission from the Government. Each time the Government is required to prepare a new fiscal plan, it must divert its attention and resources to this same issue rather than moving on to other important restructuring tasks. For example, the frequent fiscal plan recertifications have disrupted the Commonwealth's Title III plan of adjustment process because each time the fiscal plan is recertified creditors demand additional diligence regarding any changed financial assumptions, which stalls plan negotiations. To avoid this result, the Government is willing to work with the Board to develop detailed revenue and expense measures in the context of a budget, which we believe is the appropriate forum to do so. Additionally, the plan includes costs required for the successful implementation of both fiscal measures and structural reforms including both implementation costs and economic development initiatives. These costs generate a significant return on investment via ensuring the successful transformation of the Government of Puerto Rico.

- **PRDE Measures:** The Proposed Plan suggests redistributing back office personnel to the front line, which would reduce savings unless an offset is planned elsewhere in Government spending. The Government must provide evidence that this redistribution can be done within the target level of savings put forward in the Certified Fiscal Plan.

Response: The Department of Education's approach of defining rule-based human resource allocation allows for the redistribution of excess employees to ensure all employees are adding maximum value to the system. The Revised Proposed Plan has included language within PRDE's efficiency measures section of the Plan to address the FOMB's comments.

- **DDEC Measures:** The Proposed Plan suggests redistributing back office personnel to the front line, which would reduce savings unless an offset is planned elsewhere in Government spending. The Government must provide evidence that this redistribution can be done within the target level of savings put forward in the Certified Fiscal Plan.

Response: As addressed in monthly implementation meetings, DDEC has been on target in terms of headcount reduction through the VTP program, natural attrition, hiring freeze and eliminating redundant positions. As such, DDEC will be able to redistribute personnel throughout the areas that need strengthening while still achieving the target level of savings as per the Certified Fiscal Plan.

- **Medicaid:** The Proposed Plan has lowered target reductions in premium expenditures, stating that meeting the original targets would require undue hardship to the Medicaid population in the form of service reductions. The Board recognizes the ambitious undertaking involved in achieving the healthcare measures savings in the Certified Fiscal Plan, and therefore requests that the Government propose a plan that achieves an FY23 measure savings of \$671M in healthcare premiums instead of the \$827M FY23 measure savings put forth in the Certified Fiscal Plan. The measure should ramp up across FY20- 23 (\$122 in FY19, \$160 in FY20, \$324 in FY21, \$494 in FY22, \$671M in FY23). The Proposed Plan must also tie projected savings to specific measures in the new Island healthcare model (e.g., improvements in enrollment verification, implementation of value- based payment reform, pharmacy spend reduction).

Response: In early FY2018, ASES began efforts to reduce healthcare costs, including implementation of preliminary enrollment verification efforts with DCR and private insurers; standardization of fee schedules for providers; and prescription drug cost controls such as increased pharmacy discounts on branded drugs, mandatory dispensing of generic drugs, and changes to prescription coverage guidelines.

Vital, the new healthcare model, was launched on November 1, 2018. The new model changes how the Island's managed care organizations (MCOs), are contracted and incentivized as third-party administrators. The new model savings will reach an annual run-rate savings of ~\$156 million by FY2024 (off the FY2022 baseline of approximately \$3.7 billion), a measure run-rate which is then projected to increase as the baseline expenditures increase at long-term healthcare inflation rate of 5.1%.

The proposed additional investment in provider reimbursements included in FY2020 and onward affects the program savings previously projected otherwise. The impact of this policy decision is estimated at \$50 million beginning in FY2020 growing to \$156 million in FY2024 (this is in addition to the \$122 million already implicit in the FY19 baseline). Consequently, the program savings have been adjusted accordingly. Furthermore, the level of accumulated savings included in the Currently Effective Fiscal Plan of \$823 million by FY2023 no longer holds, as indicated by over \$170 million already earmarked for additional provider investments including hospital in FY2020 and FY2021. Said FY2023 savings would have necessarily required the material reduction of most optional benefits as federally defined, including pharmacy benefits. The segment of the Puerto Rico population covered by Vital cannot effectively access healthcare services through any other venue. Therefore, the projection in this Revised Fiscal Plan considers the Administration's policy decision not to reduce or eliminate benefits that would negatively affect the health of the population. It has become patently clear that - absent a dramatic reduction in the

number of lives participating in the program - total program expenditures cannot be reasonably expected to be lower than the revised expenditures indicated in this Revised Fiscal Plan projection.

- **Pensions:** The Proposed Plan does not include the pension reforms required in the Certified Fiscal Plan. A freeze on benefit accruals and a net reduction to applicable pension benefits must be incorporated. In addition, the Proposed Plan only includes Social Security contributions for police and does not propose including Social Security for teachers. Furthermore, this benefit is offered to all police officers, even those that are unlikely to ultimately meet the eligibility benefit requirement to receive Social Security payments once they retire because of their age and years of service. As a consequence, after having paid into the system for several years, they may not ultimately be entitled to receive any benefits. It also appears to include expenses related to employee contributions, which are not included in the Certified Fiscal Plan. The Oversight Board's position on pension reform remains the same. The Proposed Plan must restore the pension reforms included in the Certified Fiscal Plan, teachers must receive access to social security, and the employee contributions for Social Security must be made by employees, not the Government.

Response: The Board continues to insist on a reduction to pension benefits across the Government's retirement systems. However, any changes to pension benefits require legislative action. The Government opposes these additional pension reduction measures because they impose a disproportionate burden on Puerto Rico's workers and retirees. Implementing any pension reform in the Proposed Plan would require both legislative and executive support, and the Board can be assured it would receive neither. Furthermore, as the Government has expressed to the Board in multiple occasions, including pension cuts in the Proposed Plan is inappropriate because there are significant legal impediments to implementing such cuts through a Title III plan of adjustment. As for implementation of social security for police officers, it is the Government's public policy to ensure police officers adequate retirement benefits. Enrolling police officers in Social Security will provide them with diversified sources of income in retirement, and Social Security's progressive benefit formula will provide a stronger safety net for lower-paid employees. With respect to social security for Policemen, the Government intends to include Policemen in social security and pay the employer portion of social security tax and also increase Police officer salaries to ensure the net impact to the employees will be zero. In addition, considering the Government is not including the freeze on the benefit accruals for Teachers, there is no need to include the Teachers in social security.

- **Office of the CFO:** Within the chapter on the OCFO, the Proposed Plan requires the OCFO to increase investment in revenue-generating Special Revenue Fund opportunities. This requirement may increase Special Revenue Funds, further reducing transparency in sources and uses of government funds and will also drive an increase in expenditures. The Government must revise the Proposed Plan to remove this requirement and any mention of increasing Special Revenue Funds, and instead should include language on the proper controls on SRF funds. In addition, the Proposed Plan removes the requirement to publish the Tax Expenditure Report. The revision must restore this. While OMB oversees the building of a Fiscal Plan compliant budget, the Fiscal Plan is the only basis for the agency spend reform measures and reinvestments on the grouping and individual measure level. The Oversight Board certifies and enforces the Fiscal Plan and Budget. Thus, the inaccurate language regarding OMB's role in establishing the measures and

reinvestments must be removed and the language should be amended to reflect a more accurate view of the role of OMB in the budget process.

Response: The issue of transparency is irrelevant as the FOMB continues to retain oversight over all Special Revenue Funds. Any increases in Special Revenue Funds must be approved by OCFO and FOMB as part of the annual budget process (for which the FOMB establishes Revenue Targets) and throughout the year as part of the reappropriation requests (also approved by the FOMB and OMB).

The Government included the publication of the Tax Expenditure Report as part of section 9.1 (G) of the Proposed Plan submitted on March 11, 2019.

The Government does not see the specific language referenced by the FOMB. It is possible the FOMB is referring to language in section 9.1.1 that reads, “This step reflects a primary milestone to consolidate, establish clear authority, and permanently align two of the key OCFO responsibilities over finance and budget.” The Government has made the following revision, “This step reflects a primary milestone to consolidate, establish clear authority within the executive branch, and permanently align two of the key OCFO responsibilities over finance and budget, subject to the requirements of PROMESA.”

- **Revenue measures:** The Government assumes a slower ramp-up of the revenue collection measure for PIT and CIT, which results in a \$73M cumulative revenue shortfall by FY20. The Proposed Plan must restore the ramp-up schedule included in the Certified Fiscal Plan. The Proposed Plan also fails to mention the need to undertake tax incentives code reform. The Government should restore the corresponding section from the Certified Fiscal Plan.

Response: The Government is still planning to achieve the full compliance measure by FY2023. The delayed ramp up of the PIT and CIT compliance measures reflects the updated timeline for implementing the SURI system, which is essential for driving increased compliance.

- **Forecasting:** The Proposed Plan does not appropriately forecast measures. The current methodology grows measures by inflation and population whereas expenditures are only grown by inflation. The Government should adjust the methodology to forecast growth using inflation alone.

Response: As discussed with the FOMB advisors, this comment is in reference to IFCU measures which were forecast to grow at both inflation and population growth. This approach was consistent with the approach used by the Oversight Board in the October 23, 2018 Certified Fiscal Plan. The Revised Proposed Plan now adopts the Boards revised approach and grows IFCU measures at inflation only.

VI. Other

- **Implementation and fiscal controls/reporting:** The Proposed Plan removed all implementation plan exhibits and detail, as well as details surrounding the enforcement of the budget and required fiscal controls and reporting milestones. The next submission must reinstate the Implementation Chapter including the budget enforcement language.

Response: This information is routinely communicated with the FOMB through implementation progress reports and ongoing Government support of implementation efforts.

- **Debt Sustainability Analysis:** The Proposed Plan removes reference to correcting the long-term structural deficit. Please restore the language regarding this commitment in the Certified Fiscal Plan.

Response: The Government is whole heartily committed to long-term structural balance and the return to the capital markets.

- **Statehood:** The Proposed Plan includes references to Puerto Rico's statehood and unequal treatment in receiving federal funding. The Oversight Board cannot certify a fiscal plan with such references as it is not a political entity.

Response: Puerto Rico's current situation, as the Board openly acknowledges, is a result of a myriad of issues that are structural in nature and require significant reforms, which the Government is already in process of implementing. The most important and significant of these reforms is statehood. A simple example of this is the discriminatory way Puerto Rico is treated for purposes of Medicaid funding. The Government will continue advocating that statehood is an integral part of any permanent, equitable solution to Puerto Rico's problems. Furthermore, failure on the part of the Oversight Board to publicly recognize and acknowledge the structural impediment represented by Puerto Rico's territorial and colonial status does not reflect that the Oversight Board is not a political entity, rather purposeful ignorance.

- **Baby Bonds:** The Proposed Plan includes reference to Baby Bonds that will create an additional ~\$25-29M in annual expenditures not currently in the Certified Fiscal Plan. If the Government wants to implement this program it must be accounted for through equivalent reductions in Government spend elsewhere.

Response: The Government believes this will be an important program to Puerto Rico's long-term economic growth and will continue to include it in the Revised Proposed Plan. The Oversight Board has expressed in various budget communications its willingness to reallocate funding for certain items towards educational programs. We look forward to working with the Oversight Board in identifying the same to implement such an important program.

The Government looks forward to continuing to discuss the Revised Proposed Plan with the Oversight Board in the coming weeks and sincerely hopes the Oversight Board will avoid committing some of its recent mistakes regarding such an important document for Puerto Rico.

Sincerely,

Christian Sobrino Vega

Ms. Natalie Jaresko

March 27, 2019

Page 14

CEO and President of AAFAF

Governor's Representative to the FOMB