

Highlights of the Puerto Rico Fiscal Plan Certified by PROMESA Oversight Board

ATTORNEYS

- Arturo J. García-Solá
- Sila M. González-Calderón
- Samuel T. Céspedes Jr.
- Rubén Méndez-Benabe
- Isis Carballo-Irigoyen
- Yamary I. González-Berríos
- Xenia Vélez
- Antonio A. Arias-Larcada
- Nayuan Zouairabani-Trinidad

PRACTICE AREAS

- Government Affairs
- PROMESA Task Force

An McV Government Affairs Alert

March 22, 2017

On March 13, 2017, the PROMESA Fiscal Oversight Board (the “[Oversight Board](#)”) certified an amended Fiscal Plan for Puerto Rico submitted by the Puerto Rico Fiscal Agency and Financial Advisory Authority (the “[FAFAA](#)”) (the “[Fiscal Plan](#)”). The Fiscal Plan was approved subject to amendments introduced by the Oversight Board on that same date.

The Fiscal Plan outlines the Government of Puerto Rico’s current fiscal situation and provides insights on the measures it will implement in order to address the Island’s public debt crisis. The following are the main highlights of the Fiscal Plan:

Financial Projections

The Fiscal Plan estimates the Government’s total outstanding bond debt to be around \$69.24 billion. Of this amount, the outstanding bond debt covered by the Fiscal Plan is \$51.91 billion, with an average annual debt service of around \$3.3 billion for the next ten fiscal years. The Fiscal Plan excludes PREPA, PRASA, Housing Financing Authority, and other minor bond issuers.

According to the Fiscal Plan, the Government will implement a 10-year plan with revenue and expense measures that will reduce the projected \$31.7 billion fiscal gap by \$39.6 billion and provide a cash flow surplus of \$7.9 billion available for debt service for the 10-year period. The Fiscal Plan estimates an average of around \$787 million in annual cash flow available for debt service after revenue and expense measures are put in place.

Fiscal Reform Measures

In order to reduce the 10-year fiscal gap by \$39.6 billion the Government will implement certain fiscal measures aimed at enhancing revenues, right-sizing the government, reducing healthcare spending, and realizing pension reforms.

[Revenue Enhancement Measures:](#)

Highlights of the Puerto Rico Fiscal Plan Certified by PROMESA Oversight Board

- Corporate Tax Reform: taking advantage of the recent 10-year extension of the 4% excise tax under Act 154, the Government seeks to develop a more stable and consistent tax policy with a broader base and fewer exemptions. The target date for this reform is January 2019.
- Tax Compliance: reduce tax revenue leakage by increasing electronic collection of sale and use tax (SUT) at the point of sale and on internet sales. Improve revenue collection by, among other measures, conducting targeted interventions.
- Adjusting Taxes and Fees: (i) increase excise taxes on tobacco-related products, (ii) implement a new property tax regime, and (iii) revise fees on licenses, traffic fines, insurance fees, and service charges.

Government Right-Sizing Measures:

- Labor Related: (i) freeze payroll increases for fiscal years 2018 to 2020, (ii) improve employee mobilization across government, (iii) uniform fringe benefits, and (iv) eliminate vacation and sick day liquidations to produce higher attrition rates or other payroll-related savings.
- Non-Labor Related (i) freeze operational cost increases for fiscal years 2018 to 2020, (ii) reduce non-core expenses, (iii) externalize services to private entities, (iv) centralize services to eliminate duplicity, and (v) achieve procurement savings or other cost-cutting measures.
- Reduction of Subsidies: gradual reduction of subsidies to University of Puerto Rico, municipalities, and private sector in a manner that mitigates the economic development impact of the subsidy removal.

Reduction in Healthcare Spending:

- Pay for Value: (i) establish uniform fee schedules and limit reimbursement rates for providers, and (ii) replace current profit sharing arrangements with Managed Care Organizations (MCOs) with a Medical Loss Ratio.
- Improve Payment Integrity: (i) establish partnerships to increase the scrutiny of premium payments for beneficiaries that have left the system or have another health insurance plan, (ii) establish a Medical Fraud Control Unit, and (iii) implement the Medicaid Management Information System to reduce waste, fraud and abuse.
- Reduce Drug Costs: (i) reduce drug spending by increasing pharmacy discounts on branded drugs; (ii) enforce mandatory dispensing of generic

Highlights of the Puerto Rico Fiscal Plan Certified by PROMESA Oversight Board

drugs; (iii) update the preferred formulary; and (iv) establish shared-savings initiatives.

- Modify Benefits Packages: evaluate services that could be capped and/or eliminated from the current benefit package without adversely affecting access for “Mi Salud” beneficiaries.
- New Healthcare Model: develop a new healthcare model in which the Government pays for basic and less costly benefits while the patient pays for premium services selected.

Pension Reform:

- Contribution Segregation and New Benefit Plans: (i) switch to a pay-as-you-go model, (ii) segregate prospective employee contributions, (iii) facilitate Social Security enrollment for police and teachers, and (iv) improve investment alternatives.
- Adjust Retirement Benefits: (i) protect benefits for lowest pension income earners, and (ii) implement a progressive strategy to reduce retirement benefit costs including other post-employment benefits.

Structural Reforms

The Fiscal Plan also provides measures aimed at increasing economic growth by aiding business activity, improving capital efficiency, implementing energy reforms, and promoting economic development.

Measures to Aid Business Activities:

- Increase Labor Participation: (i) institute public policy measures aimed at attracting new businesses, create new employment opportunities, and foster private sector employment growth to increase labor demand, and (ii) change welfare and labor incentives to encourage greater sector participation.
- Reform the Permit Process: improve and expedite the permitting processes.
- Tax Reform: (i) lower marginal tax rates, (ii) broaden the tax base, and (iii) simplify the existing tax code, and (iv) reduce unnecessary regulatory burdens on the private sector.

Improvement of Capital Efficiency:

- Infrastructure Reform: investing in critical infrastructure projects.

Highlights of the Puerto Rico Fiscal Plan Certified by PROMESA Oversight Board

- Public Private Partnerships: optimizing the quality of public infrastructure and services through public private partnerships. The initial stage of the public private partnership program includes around \$5 billion in projects for fiscal years 2017 through 2019.
- Critical Projects: expedite the permitting processes to develop critical projects.

Energy Reform:

- Private Sector Investment: facilitate expedited private sector investment in modern, cost-efficient and environmentally sound energy projects.
- PREPA Reform: reform PREPA operations and services to clients.
- Competition: allow for greater competition in energy generation.

Promote Economic Development:

- Enterprise Puerto Rico: use Enterprise Puerto Rico (Enterprise PR) to attract foreign direct investment and incentivize investments in technology in collaboration with private sector. Enterprise PR is a recent statutorily-created not-for-profit corporation to promote the economic development of Puerto Rico with the collaboration of the Puerto Rico Department of Economic Development and Commerce.
- Destination Marketing Organization: promote Puerto Rico's tourism industry through the soon to be created Destination Marketing Organization, governed by a board of directors to be composed of private and public sector members with the objective of marketing Puerto Rico as a tourism brand and a worldwide tourism destination.

Amendments Introduced by Oversight Board

Amendment No.1

- Furlough program to commence July 1, 2017, unless Government submits a proposed budget by April 30 that includes right-sizing measures and a liquidity plan capable of generating an additional \$200MM cash reserve by June 30, 2017. The furloughs would commence on September 1, 2017. If the Oversight Board determines that the Government submits an implementation plan with right-sizing personnel measures capable of generating sufficient savings, there will be no furloughs.

Highlights of the Puerto Rico Fiscal Plan Certified by PROMESA Oversight Board

- Elimination of all Christmas bonuses starting FY 2018 unless before September 30, 2017, the Oversight Board determines that as of September 1, 2017, the right-sizing measures result in a trend of labor costs sufficient to produce savings which could have the effect of a partial reduction or no elimination of the bonus.

Amendment No. 2

- Pension outlays must be reduced by 10% by 2020, requiring public pension systems to be overhauled guided by the following principles:
 1. Fund existing pension obligations on a “paygo” basis
 2. Liquidate certain assets to help fund benefits
 3. Using general fund revenues to pay benefits owed under previous plans
- Enroll all active members in defined contribution plans that segregate funds and protect their contributions.

Beginning in 2020, enroll all newly-hired teachers and public safety workers in Social Security, and to the extent practicable existing employees under age 40.

The content of this McV Alert has been prepared for information purposes only. It is not intended as, and does not constitute, either legal advice or solicitation of any prospective client. An attorney-client relationship with McConnell Valdés LLC cannot be formed by reading or responding to this McV Alert. Such a relationship may be formed only by express agreement with McConnell Valdés LLC.