TESTIMONY OF
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FINANCIAL OVERSIGHT & MANAGEMENT BOARD FOR PUERTO RICO

before the Indian, Insular and Alaska Native Affairs Subcommittee
of the House Committee on Natural Resources, at the oversight hearing on
***"The Status of the Puerto Rico Electric Power Authority Restructuring Support Agreement"***
Wednesday, March 22, 2017, 10:00 a.m.
Room 1324, Longworth House Office Building

Good morning. My name is Ana Matosantos. I am a Member of the Financial Oversight and Management Board for Puerto Rico.

Thank you, Chairman LaMalfa for your leadership in holding this oversight hearing on *"The Status of the Puerto Rico Electric Power Authority Restructuring Support Agreement"*. Thanks also to Ranking Member Torres, Vice Chair González-Colón and, indeed, all the members of this Subcommittee for your interest in and attention to this matter.

Before addressing the specific subject of this hearing, I would like to add my voice in support of Chairman Carrión's statement regarding the important progress the Board has made since our appointment last year.

For the last six-and-a-half months, we have worked to understand the facts on the ground, the options available to the government, and the implications of different approaches to addressing the financial and economic crisis facing the Island. Throughout, we have sought to partner with the Government of Puerto Rico and to use the tools made available under PROMESA to help provide a better future for the people of Puerto Rico, not just for today, but for our children and future generations. Our people love their home and they deserve to be able to build a future on it, not forced to move away to support their families and their dreams.

The Board provided guidance and proposed actions on many fronts to ensure there is sufficient cash to fund essential services on the Island, to put the budget on a path to structural balance, and to restore economic growth. The Rosselló administration incorporated the Board's guidance, as well as its own initiatives, in a Fiscal Plan that the Board was able to certify in compliance with PROMESA. With that Fiscal Plan now in place, over the course of the next few years, we aim to partner with the Government of Puerto Rico to balance the budget, restructure long-term debt obligations, and take the decisive action necessary to restore economic growth and opportunity for the people of Puerto Rico.

With respect to PREPA, I would like to state at the outset that the Fiscal Plan that the Oversight Board certified on March 13, 2017 is entirely premised on ending the more than a decade-long economic decline Puerto Rico has experienced and on restoring economic growth by no later than fiscal year 2022.

In that regard, I echo Chairman Carrión's statement that the Board's approach to PREPA's Restructuring Support Agreement ("RSA") must focus on its potential impact on economic growth.

The Governor's determination to review and negotiate amendments to PREPA's RSA is reasonable and supported by the Oversight Board's initial review of the draft Fiscal Plan PREPA's management has submitted to the Board.

We believe that the two main goals of PREPA's Fiscal Plan should be: (1) comprehensive transformation of PREPA's business model, including the substitution of old, inefficient and unreliable transmission and distribution (T&D) and generation infrastructure; and (2) implementing operating efficiencies and other changes that can lower energy costs for the People of Puerto Rico and our businesses.

The Board has done a preliminary review of the draft PREPA Fiscal Plan submitted to the Board on February 21, 2017 and has the following observations:

(a) The draft Fiscal Plan does not provide for the comprehensive transformation of PREPA necessary to lower electricity costs for the People of Puerto Rico.

(b) It does not sufficiently address the need for institutional change in processes and procedures, outdated systems and information technology.

(c) It does not capture enough operating expense savings.

(d) It does not contain an ambitious plan to change its business model, and replace inefficient legacy assets with new assets, especially regarding power generation via Public-Private Partnerships ("P3s") or privately sponsored projects.

(e) The capital expenditures plan seems to be concentrated in legacy assets and their maintenance.

In our view, it is not enough to maintain that although the resultant energy cost under the RSA will increase, it will still compare favorably to energy costs in some other jurisdictions. Energy costs in Puerto Rico are high when compared to the mainland, to the Dominican Republic and others. Costly and at times unreliable energy is a major drag on Puerto Rico's economic growth. The RSA increases the cost of electricity, thereby increasing the cost of living and doing business in Puerto Rico. That only makes it more difficult to reverse the negative economic growth trajectory that largely drove Puerto Rico's budgetary crisis and threatens the well-being of the Island's residents.

Further, in respect to the PREPA RSA, it is important to note what PROMESA requires the Oversight Board to do and not to do. For most consensual deals, PROMESA requires the Oversight Board to make three decisions. But for the PREPA RSA, the Board only makes two decisions.

PROMESA section 104(i) generally requires the Oversight Board to decide whether a Restructuring Support Agreement is consistent with the borrower's debt sustainability, and its certified fiscal plan, if it has one. But the PREPA RSA was entered into prior to May 18, 2016. Therefore, under PROMESA section 104(i) (3), the PREPA RSA is deemed to be consistent with PREPA's debt sustainability and the Oversight Board has no power to say otherwise.

PROMESA section 601(e) provides that the Oversight Board must determine whether to authorize an entity to invoke Title VI to implement an RSA. Because Title VI does not deal with the restructuring of anything other than bond debt, other obligations cannot be restructured in Title VI. If PREPA requires relief of other contractual obligations, the Oversight Board's use of Title VI would be inadequate. The Board could approve the implementation of the PREPA RSA, as amended, in a Title III case, making it possible for PREPA to address other contractual obligations driving significant costs.

Finally, PROMESA section 207 provides the Oversight Board must authorize the issuance of new debt, and the PREPA RSA includes issuance of new debt.

To date, the Board has not had the RSA before it for approval as the prior government did not present it for review and now Governor Rosselló has expressed an interest in modifications. The Board stands ready to review the PREPA RSA upon its submission for the Board's consideration. The Board has already advised the Governor that it would approve an RSA amended to reflect improved economic terms, including lower transition costs, as the Governor is requesting in negotiations.

It is important to note that because the PREPA RSA was grandfathered to some extent by PROMESA, PREPA creditors do not bear under the RSA anything remotely comparable to the losses to be borne by creditors of other Commonwealth entities.

To avoid overlooking the obvious, I will just mention briefly that while the uninsured PREPA bondholders agreed to take a 15% discount on their principal claims, the insured bondholders retain their claims to 100% of their principal. The monoline insurers, who were paid premiums in exchange for their promises to make all debt service payments that PREPA does not make, will not be making any debt service payments of principal once the deal is implemented and they have not shown us any interest payments they will make. Instead, they are posting some surety bonds that are returned to them as cash reserves are built up. Additionally, hundreds of millions of other debts are not experiencing any discounts.

The sacrifices the implementation of Puerto Rico's certified Fiscal Plan will require from the people of Puerto Rico and other Commonwealth creditors are far greater than anything being asked of PREPA's creditors.

It is important to understand how other Commonwealth creditors are likely to fare under the recently certified Fiscal Plan. To accomplish PROMESA's mandate that Puerto Rico balance its budget, fund essential services and pensions, as well as work to restore access to capital markets at cost-effective rates, the Oversight Board worked to understand Puerto Rico's actual financial condition and operating deficits.

Between 2009 and 2014, Puerto Rico's annual deficit averaged $3.9 billion. With a deficit of that magnitude and lack of access to capital markets, this year, Puerto Rico funded essential services by defaulting on much of its debt, delaying payments to vendors and delaying the issuance of refunds to taxpayers. Next year, Puerto Rico's fiscal situation will worsen.

Most all pension funding will be exhausted in fiscal year 2018, necessitating general fund expenditures starting at $989 million per year. Likewise, Affordable Care Act funding from the federal government of $800 million per year will cease during fiscal year 2018.

Against that background, the Oversight Board had to evaluate the prior Governor's proposed fiscal plan for the Commonwealth, and determined it contained many violations of the terms of PROMESA section 201(b).

The prior Governor declined to revise his proposed fiscal plan, leaving it to the new Governor who was not inaugurated until January 2, 2017.

Understandably, the new Governor requested more time to propose a fiscal plan and the Oversight Board provided him until February 28, 2017, so that the Board could certify the Governor's plan or its own plan by March 15, 2017.

Further, an analysis of initial spending projection included in the Government's Fiscal plan conducted by Ernst & Young at the Board's request, concluded that spending in fiscal year 2017 was potentially understated by a range between $360 million and $810 million.

The Board acknowledged that the Governor revised his proposed plan to accommodate the best available spending, revenue and economic projections. The revised plan also includes substantial increases in the depth of reductions being made to balance the budget including hundreds of millions of dollars in reductions to health care programs, to the University of Puerto Rico and to public employment. The Fiscal Plan, as certified, provides funds for less than 25 percent of contractual debt service due between now and 2026.

In addition to the Governor's changes, the Oversight Board inserted two amendments requiring (i) higher pension cuts averaging 10 percent, to be implemented in a progressive manner, and (ii) to the extent necessary, cancellation of the Christmas bonus for public employees and a public employee furlough program of up to four days per month.

These additional measures are acutely painful, but their implementation may be necessary for liquidity, achieving structural balance, funding essential services and pensions, as well as providing some funding for debt service.

As stated before, on March 13, 2017, the Oversight Board certified the Governor's fiscal plan for the Commonwealth, with the two amendments I just described, and provided the Government until April 30, 2017 to submit its proposed budget in accordance with the certified Fiscal Plan.

In conclusion, the Oversight Board stands ready to review the PREPA RSA upon its submission for the Board's consideration. The Board supports efforts to lower energy costs and ameliorate projected electricity rate hikes to avoid exacerbating the prevailing negative economic growth trend.

Thank you, Mr. Chairman. And thanks to all the members for your interest in and attention to this matter.