

**FINANCIAL OVERSIGHT AND MANAGEMENT BOARD
FOR PUERTO RICO**



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Executive Director

BY ELECTRONIC MAIL

March 28, 2018

The Honorable Ricardo A. Rosselló Nevares
Governor of Puerto Rico
La Fortaleza
P.O. Box 9020082
San Juan, PR 00902-0082

RE: PREPA Fiscal Plan

Dear Governor Rosselló Nevares:

Since the Board sent its Notice of Violation for the Proposed Fiscal Plan for PREPA, dated February 5, 2018, we have worked cooperatively and collaboratively with you and your advisors to address the violations detailed therein, as well as additional requirements that we have outlined in correspondence, oral and written, with you and your advisors. After carefully reviewing the most recent proposed Fiscal Plan for PREPA, dated March 23, 2018 (the “Latest Fiscal Plan”), the Board has concluded that the following issues must be addressed through revisions to the Latest Fiscal Plan before the Board can certify that the Latest Fiscal Plan satisfies the requirements set forth in Section 201(b)(1) of PROMESA. The Board is also sending, under separate cover, a technical appendix that provide additional details on these issues.

Additions to the Latest Fiscal Plan

- **Aspirational rate projections that fall below 20 c/kWh by FY2023:** The Latest Fiscal Plan must include rate projections, inclusive of all legacy obligations, that can meet this target and outline a path to achieving it from lower fuel and purchased power costs, lower non-fuel operational costs, savings from CILT reform, and a modernized grid funded by both private investment and the federal government. Further, the Latest Fiscal Plan must show a year-over-year decline from current prices to FY2023.
- **Rate design principles:** The rate structure section of the Latest Fiscal Plan must include an affirmative statement that PREPA commits to low-cost and reliable power as the primary goal of its rate design, that rate design and implementation support economic

growth and competitiveness, and that any new rate design include fair and equitable cost allocation across the customer base.

- **Specific targets for grid reliability and resiliency:** The Latest Fiscal Plan must commit to improving reliability metrics relative to median U.S. mainland utility performance, and must incorporate specific resiliency targets to demonstrate that commitment.
- **Financial statements for steady state financial projections:** The Latest Fiscal Plan must include a detailed revenue requirement statement and show the impact of planned operational initiatives in the steady state financial projections.
- **Post-certification reporting requirements:** In the interest of providing increased transparency on the recovery and transformation of PREPA detailed in the Latest Fiscal Plan, the Latest Fiscal Plan must include plans for implementing and/or reporting on: all contracts under Title III, CILT reform, results of the Workplan 180 initiative, and procurement for limited new utility-scale distributed renewables generation.
- **Cash management reporting requirements:** The Latest Fiscal Plan must include plans for implementing and/or reporting on cash management and liquidity measures against its stated goal of achieving cash neutrality by the first quarter of 2019.

Updates to financial projections

- **Pension reform:** Consistent with the Board's requirement for the Commonwealth's Fiscal Plan, the Board requires that the Latest Fiscal Plan include the following pension savings measures and reflect them in the financial projections: benefit accruals are frozen and all employees are enrolled in defined contribution plans with segregated, self-directed accounts, and benefits are reduced progressively so that on average the reduction is roughly 10% for the entire group of retirement system members but there is no reduction for those with combined retirement plan and Social Security benefits below the poverty level of \$1,000 per month.
- **Pension underfunding:** The Board requires that PREPA provide, within 30 days of receipt of this letter, an estimate of the underfunded pension liability under a range of rate of return scenarios, in collaboration with the Board's actuarial consultant. This estimate should use an updated report from the pension system if available, and existing information if not available, noting downside risks. Given that a current estimate is not available at this time, the financial projections in the Latest Fiscal Plan should not assume payment of outstanding pension obligations to address underfunding
- **Recalculate financial projections using the Board's macroeconomic variables:** The financial projections in the Latest Fiscal Plan must be adjusted to be consistent with the Board's macroeconomic projections.
- **Additional updates to financial projections:** In addition, the steady state financial projections must be updated to remove the impact of behind the meter revenue enhancement, and reduce income from PREPA NET given its assumed sale in FY2020.

Additional updates

- **Subsidiaries:** The Latest Fiscal Plan must include in the steady state financial projections all subsidiaries and affiliates, which, to the Board's knowledge, are: PREPA Holdings, LLC; Interamerican Energy Sources, LLC; Employees Retirement System; PREPA Networks, LLC; and PREPA Networks. Moreover, the Latest Fiscal Plan must include a plan to privatize PREPA NET by FY2020.
- **Debt sustainability:** The Board has not made any determination about the size of a transition charge as part of a debt restructuring. Accordingly, the debt sustainability analysis in the Latest Fiscal Plan may show various scenarios for various transition charges, but should not select just one.
- **Regulator:** The Latest Fiscal Plan should not include any discussion of the energy sector regulator, other than a brief summary of what is in the Commonwealth Fiscal Plan, because it is the Commonwealth that will address the new energy regulator, not PREPA as the regulated entity.
- **Transaction:** The Latest Fiscal Plan must clarify the role of the FOMB, PREPA, and Government in the Transaction. However, the Latest Fiscal Plan should not detail the structure or criteria for the Transaction given that this will be determined through engagement with the market and the public.
- **IRP:** The targets for the IRP will be consistent with the transformational scenario in the Latest Fiscal Plan.

The Board requires that PREPA submit a revised version of the Latest Fiscal Plan, in .pdf and .ppt, that addresses the foregoing issues, along with accompanying financial models, debt sustainability analysis, and all supporting materials, by April 5, 2018 at 5:00 p.m. AST.

Sincerely,



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