

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



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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: HTA Fiscal Plan

Dear Governor Rosselló Nevares:

The Board is in receipt of HTA's proposed fiscal plan, dated March 9, 2018 (the "Proposed Plan"), and recognizes the substantial revisions that HTA has made to the existing fiscal plan, certified by the Board on April 28, 2017 (the "Current Plan"), to adjust for the post-Hurricane Maria reality and to account for an organizational transformation. Nonetheless, the Board has determined that the Proposed Plan requires certain revisions before the Board can certify it as compliant with the requirements of PROMESA. The Board looks forward to continuing to discuss the Proposed Plan, and the violations detailed herein, with you and your advisors in the coming weeks. This letter will serve as the notice of violation provided for in Section 201(c)(3)(B)(i) of PROMESA.

PROMESA provides the Government with a powerful tool to restore economic growth and opportunity to the people of Puerto Rico. The Board urges the Government to use this tool to provide for a sustainable fiscal future for HTA, and to create an HTA that provides a multi-modal transportation network that is safe and reliable, that enhances mobility for all users, and that helps promote economic growth and recovery on the Island.

Specifically, the Proposed Plan: (i) leaves no funding for strategic projects, even after accounting for the impact of all fiscal measures; (ii) the baseline rests on several questionable assumptions that must be clarified; (iii) reflects a deterioration in both the impact and the timing of the fiscal measures from the Current Plan; (iv) fails to include clear structural reforms to drive additional revenues and further reduce operating expenses and capital expenses; and (v) does not include the

details of a congestion reduction plan, which is required to help Puerto Rico meet the structural reform targets set forth in the Commonwealth's Fiscal Plan.

Net fiscal impact of Proposed Plan

The Proposed Plan currently leaves no funding for strategic projects, even after accounting for the impact of fiscal measures. The Board will not certify the Proposed Plan until it leaves additional funds for strategic projects. Furthermore, the Proposed Plan has reduced the timing and impact of fiscal measures relative to the Current Plan. The Proposed Plan must also include a credible liquidity plan, as well as a debt sustainability analysis, that creates a plausible path for HTA to exit Title III.¹

Updates to financial projections

- **Baseline:** The Proposed Plan's baseline must be broken down by asset: revenues, operating expenses, capital contributions, and capital expenditures must be broken down between transit and roads. Within those categories, transit should be broken down into Tren Urbano and any feeder buses. Roads should be broken out into toll roads and other roads. The financials of each of the individual toll roads should be broken down separately. Finally, all projections should be made for FY2018 through FY2023.²
- **Revenues:** The Proposed Plan must justify tying toll, transit, and other revenue to GNP despite historic trends, as well as explain why toll fine revenue has jumped from \$10-11 million per year in the Current Plan to \$25-29 million per year in the Proposed Plan.³
- **Operating expenditures:** The Proposed Plan's litigation reserve must be adjusted to reflect the increase in projected capital expenditures. The Proposed Plan must also justify the assumption that PayGo expenses and salaries will be held steady for ten years.⁴
- **Capital contributions:** The Proposed Plan must explain why there is a 0% Federal Highway Administration Emergency Relief ("FHWA ER") cost share in each year where FHWA ER work occurs. The Board also needs clarification on FTA funding flows in the plan; in particular, why the \$20 million in annual funding that HTA claims it is eligible for is not included as a funding source in the baseline.⁵
- **Capital expenditures:** The CIP in the Proposed Plan must be prioritized according to a cost benefit analysis that takes into account the relative economic benefits generated by an asset's state of good repair. Additionally, the Proposed Plan must explain how it will successfully spend the large increase in capital spending called for in the Plan. Since 2013, capital spending has been \$150-200 million per year, yet total construction expenses in the Proposed Plan are projected to climb to \$872 million in FY2019, before stepping down to an average of about \$400 million per year from FY2022 onward. HTA must demonstrate that it has the institutional capacity to successfully implement this large, sustained increase

¹ Section 201(b)(1)(B), (D), (I), (J)

² Section 201(b)(1)(A), (B), (D), (F), (G)

³ Section 201(b)(1)(A), (G), (H)

⁴ Section 201(b)(1)(A), (B), (C), (G)

⁵ Section 201(b)(1)(A), (J)

in capital spending. The Proposed Plan must provide for a list of projects receiving FHWA ER funding, and note any that overlap with projects that are already within its active Statewide Transportation Improvement Plan (“STIP”). Furthermore, the Proposed Plan must explain how third-party estimates of the long-term CIP have been incorporated into the baseline. Finally, a cross-walk of the CIP in the Current Plan and Proposed Plan is required.⁶

Fiscal measures

- **Operating contracts re-bid optimization:** The Proposed Plan must include a list of the contracts subject to this measure along with a description for each that includes the total amount, date of expiry, and factors that are driving HTA’s ability to capture the projected savings.⁷
- **Outsourcing and workforce rightsizing:** The Proposed Plan must describe a clear two-step approach to this measure. For each year, in the first step, HTA must enumerate the number of net positions it is eliminating, and in the second step it must describe the number of positions it is eliminating, and then replacing, with outsourced FTEs. For the first step, in line with the methodology applied in the Commonwealth Fiscal Plan, the Board expects reduction to back-office FTEs in the range of at least 15-20%, and a corresponding 20% reduction in associated non-personnel procurement costs. The Board also needs to understand the specific business case assumptions that drive any front office FTE reductions, and how they were applied in the right-sizing measure. Once these positions have been eliminated, HTA must state how many positions have been outsourced, detailing which positions they are, the rationale for outsourcing those positions (as opposed to eliminating them, or keeping them in-house) and all costs and savings associated with replacing that FTE with an outsourced FTE. Furthermore, additional detail must be provided around how the program will function (such as amount of time for extending the offer, ways to retain star performers, methods used to increase uptake of voluntary buy-out package, resourcing available to assist employees with decision making, and transition planning).⁸
- **Early exit program:** The Proposed Plan must clarify if this is a completed or an ongoing program. If this initiative has already been completed, its impact should be reflected in the baseline, and not as a fiscal measure.⁹
- **Toll optimization:** The Proposed Plan must break down both the expenses and opportunities for this measure, broken down by each toll road, with a description of where the open road tolling gantries, or similar devices, will be installed.¹⁰
- **Bus Rapid Transit implementation:** The Proposed Plan must provide an analysis of how this measure will impact Tren Urbano ridership, specifically noting how it will affect Tren Urbano’s cost recovery ratio. Further detail is required on how the ridership assumptions

⁶ Section 201(b)(1)(A), (J)

⁷ Section 201(b)(1)(D), (G)

⁸ Section 201(b)(1)(D), (G)

⁹ Section 201(b)(1)(A), (D), (G)

¹⁰ Section 201(b)(1)(D), (G)

were reached, and the assumptions that support the proposed BRT line achieving a farebox recovery ratio of 75%. HTA must also explain how the initiative relates to the unsolicited bid to the P3 Authority to create and operate a BRT along a similar route, and whether this measure overlaps with that effort.¹¹

Structural reforms

- **Overall:** These structural reforms must be accompanied by a detailed implementation plan, specifying clear milestones and deadlines for accomplishing each structural reform and element of the transformation plan.¹²
- **Revenues:** The Proposed Plan must provide a detailed evaluation of the opportunity, socioeconomic impact, and go-forward plan for both raising tolls on existing tolled roads, as well as instituting tolls on currently un-tolled roads. HTA must also develop a comprehensive plan for capturing ancillary revenues, such as advertising and asset disposition, including an annual target and implementation plan. Finally, HTA must include a credible strategy for capturing a greater share of discretionary federal grant funding with sample projects, and key deadlines.¹³
- **Operating expenses:** The Proposed Plan must produce specific targets for reducing operating expenses and a specific cost recovery ratio target for Tren Urbano (in the range of 35-60% to match mainland systems).¹⁴
- **Capital expenditures:** The Proposed Plan must set specific savings targets for reducing the baseline CIP through project delivery reforms.¹⁵
- **Organization:** The Proposed Plan must set clear outcome based KPIs in safety, mobility, economic growth, resiliency, delivery, environmental sustainability, operations and management efficiency and debt sustainability, to instill a culture of performance management within the organization. HTA must also provide a detailed transition plan for adopting a holistic concession model.¹⁶

Congestion management

The Proposed Plan must include a detailed congestion management plan that specifies capital and operating improvements that HTA will make to its road and transit assets to decrease congestion. This decrease in congestion must be measurable, and tied directly to the GNP outcomes in the Commonwealth Fiscal Plan, producing an increase in the growth rate of GNP by 0.25% per year beginning in FY2021.¹⁷

¹¹ Section 201(b)(1) (D), (G)

¹² Section 201(b)(1)(D)

¹³ Section 201(b)(1)(B), (D), (G)

¹⁴ Section 201(b)(1)(B), (D), (G)

¹⁵ Section 201(b)(1)(B), (D), (G)

¹⁶ Section 201(b)(1)(F), (G)

¹⁷ Section 201(b)(1)(D), (G)

Data sources and materials

Additionally, in order to properly stress test the submission, we will need access to the following data sources and materials:

- Complete Excel-based, or other dynamic modelling program, used to create all financial and other estimates included in the submission. This includes all models, including, but not limited to, all modelling efforts used to create the estimates for the “Outsourcing and Workforce Rightsizing” fiscal measure (including, without limitation, all back-up data, calculations, and assumptions).
- Current version of Dr. Jorge Freyre’s report, used to derive the revenue, and any other figures, in the submission.
- Current version of the output developed by SDG, indicating any financial or socioeconomic impact from changing tolling rates, or tolling currently un-tolled roads.
- PowerPoint copy of the current submission, dated March 23, 2018.

Conclusion

The Board recognizes the difficulties implicit in these policy decisions, as well as the long path to return HTA to fiscal stability. Reaching this goal will take time, enormous effort and the full commitment of HTA’s and the Government’s leadership, but done properly and in a sustained manner it will put HTA on the path to a better future. The Board requires that HTA submit a revised version of the Proposed 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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