Financial Oversight &
Management Board
for Puerto Rico

2023 Transformation Plan for Puerto Rico

Restoring Growth and Prosperity

Volume 1: Transformation plan

As certified by the Financial Oversight and Management Board for Puerto Rico

April 3, 2023

2023 Commonwealth Fiscal Plan pursuant to PROMESA Section 201

DISCLAIMER

The Financial Oversight and Management Board for Puerto Rico (the "FOMB," or "Oversight Board") has formulated this 2023 Fiscal Plan based on, among other things, information obtained from the Commonwealth of Puerto Rico (the "Commonwealth," or the "Government").

This document does not constitute an audit conducted in accordance with generally accepted auditing standards, an examination of internal controls or other attestation or review services in accordance with standards established by the American Institute of Certified Public Accountants or any other organization. Accordingly, the Oversight Board cannot express an opinion or any other form of assurance on the financial statements or any financial or other information or the internal controls of the Government and the information contained herein.

This 2023 Fiscal Plan is directed to the Governor and Legislature of Puerto Rico based on underlying data obtained from the Government. No representations or warranties, express or implied, are made by the Oversight Board with respect to such information.

This 2023 Fiscal Plan is not a Title III plan of adjustment, it does not specify classes of claims and treatments, and it neither discharges debts nor extinguishes liens. For additional historical financial information, parties are referred to the Disclosure Statement approved in the Commonwealth's Title III case. Parties are referred to the Title III plan of adjustment for the Commonwealth that was confirmed by the Title III court, and the Title III court's related orders, with respect to all matters covered by the Title III plan of adjustment.

The 2023 Fiscal Plan may be amended from time to time, as appropriate at the sole discretion of the Oversight Board.

This 2023 Fiscal Plan is based on what the Oversight Board believes is the best information currently available to it. To the extent the Oversight Board becomes aware of additional information after it certifies this 2023 Fiscal Plan that the Oversight Board determines warrants a revision of this 2023 Fiscal Plan, the Oversight Board will so revise it.

For the avoidance of doubt, the Oversight Board does not consider and has not considered anything in the 2023 Fiscal Plan as a "recommendation" pursuant to Section 205(a). However, for those instances of the 2023 Fiscal Plan which specifically prefer to a Section 205(a) letter issued by the Oversight Board, the Oversight Board herby adopts those instances into the 2023 Fiscal Plan pursuant to PROMESA Section 201(b). Nevertheless, to the extent that anything in the 2023 Fiscal Plan is ever deemed by the Governor or Legislature or determined by a court having subject matter jurisdiction to be a "recommendation" pursuant to Section 205(a), the Oversight Board hereby adopts it in the 2023 Fiscal Plan pursuant to PROMESA Section 201(b).

Any statements and assumptions contained in this document, whether forward-looking or historical, are not guarantees of future performance and involve certain risks, uncertainties, estimates, and other assumptions made in this document. The economic and financial condition of the Government and its instrumentalities is affected by various legal, financial, social, economic, environmental, governmental and political factors. These factors can be very complex, may vary from one fiscal year to the next, and are frequently the result of actions taken or not taken, not only by the Government and the Oversight Board, but also by other third-party entities such as the government of the United States. Examples of these factors include, but are not limited to:

- *Any future actions taken or not taken by the United States government related to Medicaid or the Affordable Care Act;*
- *The amount and timing of receipt of any distributions from the Federal Emergency Management Agency and private insurance companies to repair damage caused by the Earthquakes and/or Hurricanes María, Irma, and Fiona;*
- *The amount and timing of receipt of any amounts allocated to Puerto Rico and provided under the Community Disaster Loans Program;*
- *The amount and timing of receipt of any additional amounts appropriated by the United States government to address the funding gap described herein; and*
- *The timeline for completion of the work being done by the Puerto Rico Electric Power Authority ("PREPA") to repair PREPA's electric system and infrastructure and the impact of any future developments or issues related to PREPA's electric system and infrastructure on Puerto Rico's economic growth.*

Because of the uncertainty and unpredictability of these factors, their impact cannot be included in the assumptions contained in this document. Future events and actual results may differ materially from any estimates, projections, or statements contained herein. Nothing in this document should be considered as an express or implied warranty of facts or future events; provided, however, that the Government is required to implement the measures in this 2023 Fiscal Plan and the Oversight Board reserves all its rights to compel compliance. Nothing in this document shall be considered a solicitation, recommendation, or advice to any person to participate, pursue or support a course of action or transaction, to purchase or sell any security, or to make any investment decision.

Table of Contents

1 Guide to the 2023 Commonwealth Fiscal Plan

The 2023 Transformation Plan for Puerto Rico satisfies the requirement of the Commonwealth Fiscal Plan pursuant to PROMESA Section 201. The document contains three parts:

- ***Volume 1: Transformation plan***

  The 2023 Commonwealth Transformation Plan provides an overview of the Government and Oversight Board's achievements under PROMESA, a summary of economic trends and financial projections for the Commonwealth, and highlights priority areas to accelerate economic growth and restore market access for Puerto Rico. In addition, the plan describes areas where the Oversight Board is working with stakeholders to find solutions to priority challenges impacting growth.

- *Volume 2: Economic trends and financial projections – Additional Details*

  These additional details are provided to expand on the economic trends and financial projections introduced in Volume 1.

- *Volume 3: Implementation requirements and plan*

  These supplementary implementation details are provided to guide the Government's implementation of the requirements of this 2023 Fiscal Plan. Additional initiatives from prior fiscal plans remain mandatory and must still be implemented fully.

2 Introduction

In 2016, Puerto Rico was in crisis as a result of chronic financial mismanagement. The crisis was compounded by subsequent natural disasters including Hurricanes Irma and María in 2017, earthquakes in 2020, and a global pandemic resulting in shutdowns through 2022. Today, Puerto Rico is in recovery. Under the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) working with the government of Puerto Rico, massive government budget deficits have given way to government budgets that are aligned with annual revenues sufficient to ensure the funding of essential services and important investments. These investments can be channeled into critical government priorities and the beginnings of reform of Puerto Rico civil service so government can deliver services to residents more effectively.

Most of Puerto Rico's unaffordable debt has been dramatically reduced. The restructuring of the central government debt saved Puerto Rico more than $50 billion in debt payments to creditors. The restructurings of the Puerto Rico Sales Tax Financing Corporation (COFINA) saved about $17.5 billion, the Highways and Transportation Authority (HTA) about $3 billion, and the Puerto Rico Aqueducts and Sewers Authority (PRASA) about $400 million. The savings of more than $70 billion reduced the debt burden on the people of the Island by approximately $24,000 per person in Puerto Rico. This provided critical relief and will allow the government to manage its future finances with more certainty.

Restructuring the debt, however, was only half of PROMESA's mandate. The debt restructuring of the Puerto Rico Electric Power Authority (PREPA) and the Puerto Rico Industrial Company (PRIDCO) are pending. In order to fulfill the mandate of PROMESA, fiscal responsibility still needs to be secured over the long term. Necessary improvements to systems and procedures are underway. However, appropriate spending discipline to preserve and institutionalize the recent success and prevent Puerto Rico from falling back into old habits of overpromising and overspending that resulted in bankruptcy has not been achieved. Strong financial management is critical to long-term fiscal stability and will be required to restore access to the capital markets at reasonable rates.

Puerto Rico has made progress in these areas and many improvements are underway. Continued improvement of the financial management institutions is of paramount importance to ensure Puerto Rico has a strong and stable foundation that supports future growth.

Achieving fiscal responsibility and market access for the Commonwealth and its instrumentalities means more than restructuring and repaying debt. It means generating sufficient revenue to meet the Island's spending needs while also providing for a sustainable economy and restoring opportunity and creating a path to prosperity for the 3.2 million residents of Puerto Rico.

As the Commonwealth of Puerto Rico leaves bankruptcy behind, the Government and Oversight Board's focus will shift toward growing the economy. This revised Fiscal Plan includes urgent and concerted actions to sustain and build momentum toward growth.

The U.S. Government has provided unprecedented recovery and stimulus funds for Puerto Rico. Rarely in its history has Puerto Rico received so much support from the United States government. Puerto Rico needs and deserves this support as a matter of fairness and equity. However, this support comes with expectations – expectations of responsibility, progress, excellence, and performance. Puerto Rico can and must meet those expectations.

Fueled by over $100 billion in recovery and stimulus funds provided by the U.S. Government, Puerto Rico is experiencing a strong economic recovery. The unemployment rate is at a historic low and labor force participation continues to rise. Welcoming this strong recovery and the resilience of

Puerto Ricans, the Governor, and the Legislature must, however, recognize that this surge in federal funds is masking underlying weaknesses in economic fundamentals. Significant work to improve the baseline economy remains to be done, and political decisions that impact the revenues and budgets must be informed by this reality.

Ever since the Government and the Oversight Board together created the Fiscal Plan and the budget it enables under PROMESA, it has been a statement of priorities. This latest Fiscal Plan is a roadmap that prioritizes growth and opportunity. Establishing priorities requires making choices – and sometimes difficult choices – to ensure that necessary investments fit within expected financial resources. Decisions must reflect financial plan impacts over the long-term budget horizon to ensure the recovery and current stability will turn into long-term fiscal responsibility and market access.

The Fiscal Plan also includes critical initiatives to support economic development, including actions to improve the ease of doing business, upgrade infrastructure, prepare the workforce to compete for the jobs of the future, and a roadmap for tax reform.

The Fiscal Plan prioritizes initiatives designed to improve educational opportunities from primary to higher education. It includes a dedication to reengage with stakeholders on how to rebuild the University of Puerto Rico in light of changing trends in demographics and enrollment, with the mission of increasing career opportunity and fueling social mobility.

Reliable and affordable electricity is a prerequisite for any successful economy. While the power sector has failed residents and businesses in the past, its transformation is well underway.

With the certainty provided by the end of the bankruptcy, there is an opportunity to explore improvements to Puerto Rico's tax regime in a way that incentivizes investment and enables economic growth while ensuring sufficient revenues to fund essential services. Puerto Rico's tax regime could be more competitive for investors and more equitable for individuals. Any tax reform must be informed by rigorous evidence-based analysis to ensure that changes result in growth and investments while also providing a sustainable level of funding for government services and obligations.

These economic development initiatives are designed to maximize the impact of an unprecedented influx of federal funds. In response to multiple natural disasters and the COVID-19 pandemic, the federal government has committed over $120 billion in funding to Puerto Rico, equivalent to 150% of the Commonwealth's Gross National Product. These federal funds present an unprecedented opportunity if deployed efficiently and aligned to initiatives that improve long-term growth, resiliency, employment, and prosperity. Decisions on how to deploy these funds must be made with this singular focus in mind, otherwise a once in a lifetime opportunity will be squandered. While the Oversight Board does not directly oversee federal fund expenditures pursuant to a federally authorized or federally delegated program, federal funding has such substantial impact on the economy and its future direction that they must be part of the overall fiscal conversation.

The Fiscal Plan also prioritizes support for a high performing public sector by investing in the people, efficiency, effectiveness, and capacity of the Government to deliver more efficient and higher quality services.

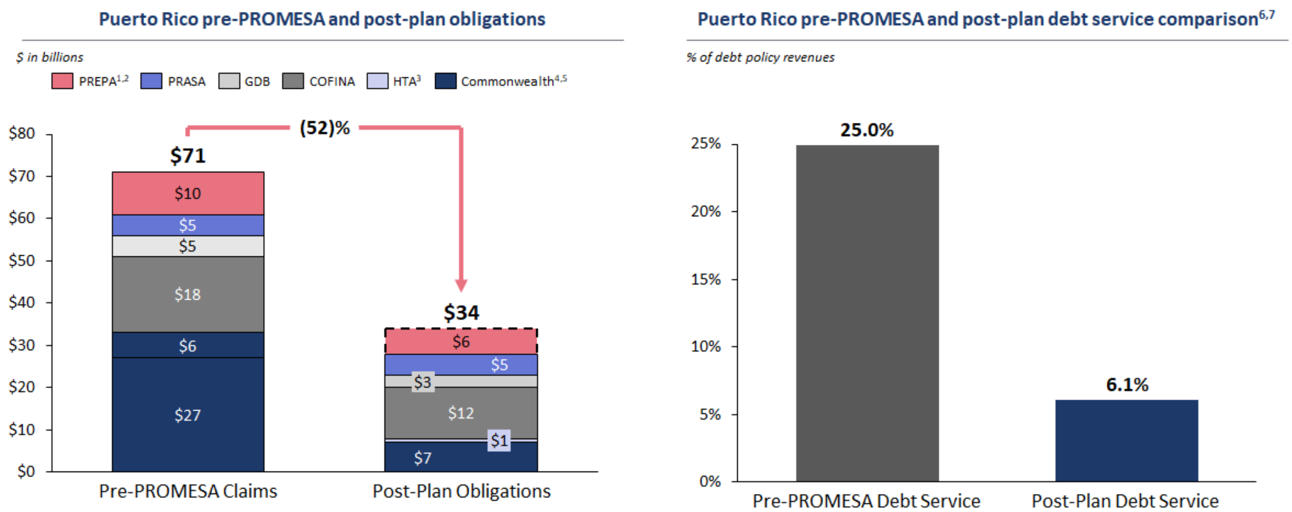
The Fiscal Plan describes a path to investing in economic growth and prosperity, entrenching a legacy of strong fiscal management, and instilling a culture of public-sector excellence. This immediate post-bankruptcy period presents a true inflection point for Puerto Rico. The choices made over the next few years will define the economic future and prosperity of Puerto Rico for future generations.

Achievements under PROMESA

3 Achievements under PROMESA

The Commonwealth's debt has been drastically reduced and made more affordable. Prior to the enactment of PROMESA, the Government accumulated a debt burden of $71 billion, roughly $24,000 per resident of Puerto Rico. Through the concerted efforts of the Oversight Board and the Government described below, the debt is on course to be reduced to $34 billion, as shown in *Exhibit 1*.

EXHIBIT 1: EVOLUTION OF PUERTO RICO'S OBLIGATIONS PRE- AND POST-PROMESA[1]



1) Pre-PROMESA Claims include ~$9 billion of bonded debt and ~$1 million est. GUCs pool per PREPA Title III Amended Disclosure Statement filed on March 3, 2023
2) Post-Plan Obligations of ~$6 billion represents total Series A and Series B Bonds per proposed terms in the pending PREPA Title III Plan of Adjustment filed on December 16, 2022.
3) Post-Plan Obligations of ~$1 billion settles ~$6 billion of CW related claims under the HTA Plan of Adjustment and supported by HTA toll revenues
4) Pre-PROMESA Claims include GO/PBA of ~$19 billion, est. GUCs of ~$3 billion, and ERS of ~$3 billion, as well as ~$2 billion PRIFA and ~$450 million CCDA and MBA (other-clawback entities)
5) Post-Plan Obligations Includes General Obligation claims,; but excludes CVI Claims
6) Pre-PROMESA Debt Service from 2022 Certified Fiscal Plan and Moody's Investor Service "State Government – U.S. Medians," 2020. (Moody's 2015 number was adjusted to exclude HTA debt service).
7) Post-Plan Debt Service represents FY23 Commonwealth debt service, including COFINA, as a percent of own-source revenues.

The lower debt service on the new debt now accounts for nearly 6% of debt policy revenues, compared to roughly 25% before the restructuring.

The reduction in the level of debt has been accomplished through multiple successful restructurings.

- In May 2017, the **Puerto Rico Government and the Government Development Bank** (GDB) signed a Restructuring Support Agreement (RSA) with a significant portion of GDB creditors to restructure GDB's debt under PROMESA's Title VI. The RSA, as amended in April 2018, reduced about $5 billion of debt to about $3 billion, reducing the face value of claims by 45%. The debt payments are secured by GDB cash flow from certain legacy assets without recourse to the Puerto Rico Government. This restructuring also offset loans owed by municipalities to the GDB against the full amount of their deposits at GDB.
- In February 2019, the U.S. District Court approved the Plan of Adjustment for the **Puerto Rico Sales Tax Financing Corporation** (COFINA), the first debt restructuring completed under PROMESA's Title III. It reduced COFINA debt by $6 billion, from $18 billion to $12 billion, and service payments by 32%, saving the people of Puerto Rico roughly $17.5 billion that will now be available to support needs of the Commonwealth.

1 Debt policy revenue refers to adjusted revenue post-measures (excluding federal transfers) plus COFINA debt service

- In August 2019, the **Puerto Rico Aqueduct and Sewer Authority** (PRASA) and the Government of Puerto Rico reached an agreement with the U.S. Environmental Protection Agency (EPA) and U.S. Department of Agriculture (USDA) to a consensual modification under PROMESA Section 207 of about $1 billion of outstanding loans. This agreement lowers PRASA's debt service payments on the U.S. Government program loans by about $380 million over the next 10 years and eliminates approximately $1 billion in guaranty claims against the Puerto Rico Government. It also provides PRASA with access to $400 million in new federal funding through various clean water programs over the next five years to support PRASA's ongoing effort to improve water quality and safety for the people of Puerto Rico.
- On January 18, 2022, Judge Laura Taylor Swain approved an historical debt restructuring by confirming the **Commonwealth Plan of Adjustment (PoA)** restructuring of approximately $35 billion of debt and other claims against the Commonwealth of Puerto Rico, the Public Buildings Authority (PBA), and the Employee Retirement System (ERS), as well as more than $50 billion of unfunded pension liabilities. The Commonwealth Plan of Adjustment went effective on March 15, 2022, a historic day for Puerto Rico. The Plan of Adjustment saves the taxpayers of Puerto Rico more than $50 billion in debt service and reduces outstanding obligations to just over $7 billion down from $33 billion.[2]

The retirement security of government employees is now protected. Historically, government pensions were not sufficiently funded, putting the ability to make pension payments for current and future retirees at risk. The PoA and 2023 Fiscal Plan, together, minimize this risk through a series of pension initiatives. Most importantly, the budget now funds estimated pay-as-you-go (PayGo) payments and the PoA authorizes the establishment of a new Pension Reserve Trust, which allocates surplus funds to support future payments to retirees.[3] The full list of ways the Government has strengthened its ability to meet future commitment to pensioners include:

- Developing the Pension Reserve Trust to strengthen the ability of the Commonwealth to fund future PayGo in the event of a future adverse economic situation in the Commonwealth;
- Enrolling employees in the defined contribution accounts created pursuant to Act 106-2017;
- Automatically enrolling all judges and teachers under the age of 45 in Social Security and allowing those age 45 or over to opt into Social Security on a voluntary basis;
- Segregating approximately $1.5 billion in employee contributions made pursuant to System 2000 and Act 3-2017 to employees' defined contributions;
- Providing $94 million benefiting over 36,000 ERS Act 1-1990 and Act 477-1951 active employees in Act 106 accounts for lost interest in Act 3-2017 accounts; and
- Freezing the defined benefit accumulation for the Teacher and Judicial Retirement Systems (TRS and JRS, respectively).

The 2023 Fiscal Plan reflects full implementation of all pension initiatives required under the PoA. The Government, with the help of the Oversight Board, successfully implemented the key provisions of the PoA related to pensions in a timely fashion. However, the Oversight Board continues to monitor the implementation of key pension initiatives included in the PoA to ensure that processes that were

2 Financial Oversight and Management Board for Puerto Rico, "Modified Eighth Amended Title III Joint Plan of Adjustment of the Commonwealth of Puerto Rico, et al.," 2022

3 Pension Reserve Trust and PayGo accounts for about 10% and 20% of General Fund expenditures in FY2023, respectively

put in place as of the PoA effective date are completed as soon as administratively possible and to ensure the retirement security required by the PoA is ultimately provided to Government employees. In addition, the Oversight Board continues to monitor activity related to the retirement benefits of Commonwealth employees including:

- Monitor compliance with PayGo requirements from Act 106-2017;
- Support establishment of operational capacities of the Pension Reserve Trust;
- Review implementation of enhanced police retirement benefit;
- Collaborate with the Government towards finding a path for partial implementation of Act 80-2020; and
- Monitor funding of Symphonic Orchestra Pension Plan.

Recent federal legislation has boosted Medicaid funding through 2027; however, long-term funding remains uncertain and presents severe risks to outyear budgets and long-term financial planning. H.R. 2617, the "2023 Consolidated Appropriations Act," increases the amount of federal funding available for the Medicaid program for five years. (FY2023-FY2027). As a result, future program costs that were forecasted to be funded using Commonwealth resources are now paid by the Federal Government in the short term. Under the 2023 Consolidated Appropriations Act, Puerto Rico is eligible to receive more than $19 billion in Medicaid funding over FFY2023–FFY2027. This total includes additional enhancements to the base federal allotment subject to certain conditions that Puerto Rico must meet.

Beginning in FY2028, however, the Commonwealth could face a "Medicaid fiscal cliff", where it becomes responsible for a significantly increased share of Medicaid expenses (expenditures that had previously been covered by federal funding since 2011).

The Congressional Budget Office's (CBO) cost analysis of the 2023 Consolidated Appropriations Act estimates that in October 2027 the federal Medicaid funding cap for Puerto Rico will fall from about $4 billion to about $500 million annually. CBO also projects that the roughly $500 million Medicaid federal funding cap will grow each year from FY2028 onwards according to the medical care services component of the Consumer Price Index for All Urban Consumers (CPI-U).[4] In addition, under current law, in October 2027 the Federal Medicaid Assistance Percentage (FMAP) for Puerto Rico would be reduced from what is effectively 76% now to the 55% statutory FMAP for most beneficiaries. However, the Medicaid program for Puerto Rico is subject to a maximum dollar threshold unlike State programs that operate with an FMAP percentage and no spending cap.

The 2023 Fiscal Plan financial projections assume current law and do not assume that future legislation will change Medicaid federal funding for Puerto Rico after FY2028. The 2023 Fiscal Plan assumes the Commonwealth would support Medicaid costs (at current program size) after the Medicaid federal funding reduction scheduled for FY2028 under current law. Periodically since 2010, the Federal government has enacted legislation to provide additional Medicaid funding to the Commonwealth to mitigate a federal funding reduction. Between FFY2011–FFY2022, the Commonwealth received an average of approximately $2 billion in federal Medicaid funding per year. If similar legislation were passed prior to the expiration of the 2023 Consolidated Appropriations Act

4 According to Section 1108(g) of the Social Security Act., from 2011 to 2016, the cap grows by the medical care services component of CPI-U as reported by BLS each year. From FY2011 to FY2016, this growth averaged 2.9%. From FY2012 to FY2022, the growth averaged 3.1%. This inflation rate differs from the health care inflation index for Medicaid and Medicare used elsewhere in the 2023 Fiscal Plan (4.5% to 5.5% from FY2020-FY2022, decreasing to 4.75% in FY2051). Instead, the medical care services component of CPI-U includes other factors that lower the inflation rate by approximately 1-3 percentage points, meaning the increase in the federal funding cap will not keep up with actual increases in expenditures.

funds, the impact of the statutory federal funding shortfall on the people of Puerto Rico could be mitigated. However, the degree and amount of any future legislation is an unknown. The uncertainty of Medicaid federal funding is a major budget risk that is reflected in the outyear financial projections.

The Earned Income Tax Credit Program (EITC) supports low income working families and has boosted workforce participation, though its costs are far exceeding local funding allocated.

Puerto Rico's labor force participation rate is significantly lower than that in the mainland U.S. This divergence is especially pronounced among workers under age 24 years and over age 45. Structural challenges in Puerto Rico, including limited access to child and elder care, regional inequities in the availability of jobs, and the average time to complete advanced degrees all may contribute to this gap. Measures to increase overall labor force participation will be instrumental in rebuilding Puerto Rico's economy.

The EITC is one of the most effective tools to increase formal sector labor force participation and to reduce poverty. The EITC increases hourly take-home wages for low-income workers and has been shown to encourage workers to enter the labor force in the United States.[5] Puerto Rico's government greatly expanded the local EITC program starting in tax year 2021. Since the adoption of the expanded EITC, Puerto Rico's non-farm employment level increased by over 83,000 from about 845,000 in January 2021 to 928,000 in September 2022.[6] Puerto Rico's labor force also increased by about 100,000 over this same period and the participation rate (the size of the labor force relative to the size of the working age population) increased from around 40.6% in 2020 (1.1 million workers) to 43.8% in 2022 (1.2 million workers). More recent data is not available on demographics but the labor force participation rate of 45 and older females, likely beneficiaries of the expanded EITC, also grew from 2019. [7]

The American Rescue Plan (ARP) Act included permanent additional funds to incentivize Puerto Rico to expand the local EITC program put in place for tax year 2019. The ARP Act permanently provides for an annual grant of up to three times local spending, capped at $600 million (indexed to US inflation). The Government, with the Oversight Board's assistance, successfully amended the existing Puerto Rico EITC program to qualify for the additional federal funding provided in the ARP Act.

The total cost of the EITC in its first year, tax year 2021, exceed initial projections. The total EITC benefits (the sum of the non-refundable and refundable portions of the EITC) amounted to $1.05 billion, received by nearly 640,000 tax filers, representing nearly half of the 1.3 million tax returns filed for tax year 2021 with an average benefit of about $1,600. Given the size of the program, the Commonwealth spent roughly $450 million of local funds on the EITC program, significantly more than $200 million budgeted for the credit. Initial filing trends indicate the total size of Puerto Rico's EITC claims for 2023 may significantly exceed those of 2022, meaning that the locally funded costs for the program may be substantially greater than the roughly $450 million in local costs in 2022. If the estimated program size meets current projections, the Commonwealth contribution for the EITC could exceed $600 million, representing a more than 50% cost share and nearly three times the initial estimate.

Given the rapid increase in locally funded costs above the level originally forecast, Puerto Rico will need to reevaluate the EITC forecast assumptions and closely monitor whether the benefits are being

5 Eissa, Nada, and Jeffrey B. Liebman. "Labor supply response to the earned income tax credit." The quarterly journal of economics 111.2 (1996): 605-637.

6 Bureau of Labor Statistics, Quarterly Census of Employment and Wages.

7 Bureau of Labor Statistics: Puerto Rico Economy at a Glance

accurately and equitably deployed, particularly to self-employed individuals and those claiming dependents.

The EITC has numerous benefits, including its ability to help lower poverty, increase labor supply, and encourage employment in the formal sector. It is, however, important that only those who qualify receive the credit. In the U.S. mainland, the IRS estimates 21% to 26% of EITC funds are paid in error. In Puerto Rico, independent reports have suggested that 24% of filers (accounting for 24% of the value of the credit paid) received the EITC even though they may not have met the qualification requirements.[8] The Government must evaluate potential fraud, waste, and abuse of the EITC program to ensure the funding goes only to those who qualify. If strong compliance measures are not enforced, the Government may need to adjust the size of the benefit to reduce the program's overall costs.

To maximize the ability to improve labor force participation, Puerto Rico should consider alleviating other obstacles as well. For instance, the EITC could be supported by a labor regulatory environment that is supportive of hiring in the formal sector.

The Labor Transformation and Flexibility Act, or Act 4-2017, eased some restrictions on labor hiring by eliminating some elements of Act 80 of 1976, also known as the Unjust Dismissal Act. While some stakeholders have called for the repeal of Act 4-2017, its elimination would likely reestablish onerous provisions related to probationary periods, overtime, and bonuses, which would all make the hiring environment more costly in the formal sector. Its repeal would discourage new hiring and reduce the labor market flexibility, thus limiting the effectiveness of the EITC expansion in promoting labor force participation, economic growth, and the revenues associated with that growth. Therefore, the Government must refrain from repealing Act 4-2017 or enacting new legislation that negatively impacts labor market flexibility, including currently proposed legislation that is similar to Act 41-2022.

On June 20, 2022, the Government enacted Act 41-2022, formerly known as House Bill 1244 (HB 1244). Notwithstanding the Oversight Board's resolution directing the Senate not to pass and the Governor not to sign HB 1244 and its resolution finding HB 1244 would impair and/or defeat PROMESA's purposes[9] the Legislature and Governor enacted and implemented Act 41-2022. In contravention of the 2022 Fiscal Plan, Act 41-2022 sought to repeal elements of Act 4-2017 and reestablish many burdensome labor restrictions. The Oversight Board filed an adversary proceeding seeking declaratory and injunctive relief pursuant to PROMESA to nullify and enjoin Act 41-2022.[10] On March 3, 2023, the Title III Court granted in part the Oversight Board's motion for summary judgment, declared Act 41 null and void ab initio, and enjoined the Government from taking any acts to help private parties implement or enforce Act 41-2022.[11] The Governor and the Speaker have filed an appeal of the injunction before the United States Court of Appeals for the First Circuit.[12] For additional details, see Volume 3.

According to a 2021 World Bank report, labor market reforms that result in greater labor market flexibility and efficiency have been associated with significant declines in informal economic

8 Alvarez, Wilmari de Jesus. Espacios Abiertos, "Our Dollars and Their Data: A Look at the 2021 Earned Income Tax Credit and Child Tax Credit," 2022

9 PROMESA § 108(a)(2).

10 Adv. Proc. No. 22-00063, ECF No. 1.

11 Adv. Proc. No. 22-00063, ECF No. 90.

12 Case No. 23-1267 and Case No. 23-1268.

activity.[13] Clearly then, the elimination of Act 4- 2017 or other actions taken that are detrimental to a labor regulatory environment supportive of hiring labor in the formal sector would put at risk the benefits of increasing the labor force participation.

13 Ohnsorge, Franziska, and Shu Yu (2021). The Long Shadow of Informality: Challenges and Policies. Advance Edition

Economic trends and financial projections

4 Economic trends and financial projections

A strong post-COVID recovery fueled by federal stimulus funding has generated near-term economic outperformance in Puerto Rico and across U.S. states. However, federal funds have an outsized and temporary impact that may mask underlying structural weaknesses. Across key economic indicators, Puerto Rico has shown strong performance as shown in *Exhibit 2*.

EXHIBIT 2: CHANGES IN KEY ECONOMIC INDICATORS IN PUERTO RICO

Indicator	Key Findings	Metrics	2010	2022	Change
Macro-economic	Puerto Rico GNP has increased in nominal terms since 2010, but real GNP is continuing to decline. This is in part due to a shrinking and aging population. High inflation in Puerto Rico and across the globe is reducing nominal gains in per capita income	Gross National Product (2010-2021, $ billions)	$64.3	$73.6	14%
		Real Gross National Product (2010-2021, $2021 billions)	$84.0	$73.6	-12%
		Economic Activity Index	138.8	124.2	-10%
		Population (2010-2021, millions)	3.7	3.3	-11%
		Population under 5 (2010-2021, 1000s)	223	104	-53%
		Population over 65 (2010-2021, 1000s)	547	740	35%
		Per Capita Income (2010-2021)	$18,791	$21,967	17%
		Inflation rate (percent)	2.5%	6.1%	3.6%
Labor force	Though having rebounded to or past 2010 levels, PR labor force participation and unemployment rate still lags even the lowest performing US state	Total Nonfarm Employment (1,000s)	932	923	-1%
		Labor Force Participation Rate	43.5%	43.8%	0.3%
		Unemployment Rate	16.4%	6.0%	-10.4%
		Manufacturing Jobs (2010-2021, 1,000s, BLS)	87	78	-10%
Fiscal	Puerto Rico successfully restructured debt obligations, which declined by 52%. General Fund revenue increased, in part due to the transference of Special Revenue Funds to the General Fund	Total Debt ($ billions, pre-PROMESA and post-plan)[1,2,3,4,5]	$71	$34	-52%
		General Fund Net Revenues ($ billions)	$9.2	$12.8	39%
		Bank deposits (2013 - 2021, $ billions)	$45.4	$81.4	79%
		Commercial Bank Lending (2013 - 2021, $ billions)	$43.5	$32.6	-25%
		Commercial Bankruptcies	10,221	3,811	-63%
		Industrial Lending (2013 - 2021, $ billions)	$8.2	$3.6	-56%
Other	School enrollment has declined along with the population. Mortgage originations, delinquencies and foreclosures have all started to decline as well	K-12 school enrollment (1000s)	493	276	-44%
		NAEP test math score[6]	218	216	-1%
		NAEP test math score points below national average	-64	-57	-11%
		Mortgage Originations (1,000s)	16	13	-19%
		Mortgage 90+ day delinquencies (Dec 2012-Dec 2022 -1,000s)	36	19	-47%
		Foreclosures (2012 - 2021 - 1,000s)	4	3	-21%

1 Pre-PROMESA Claims include $9 billion of bonded debt and —$1 million est. GUCs pool per PREPA Title III Amended Disclosure Statement filed on March 3, 2023
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5 Post-Plan Obligations Includes General Obligation claims, but excludes CVI claims
6 2011 and 2022 8th grade math scores were used as proxies for 2010 and 2021 respectively

Note: Green indicates positive effect and red indicates negative effect

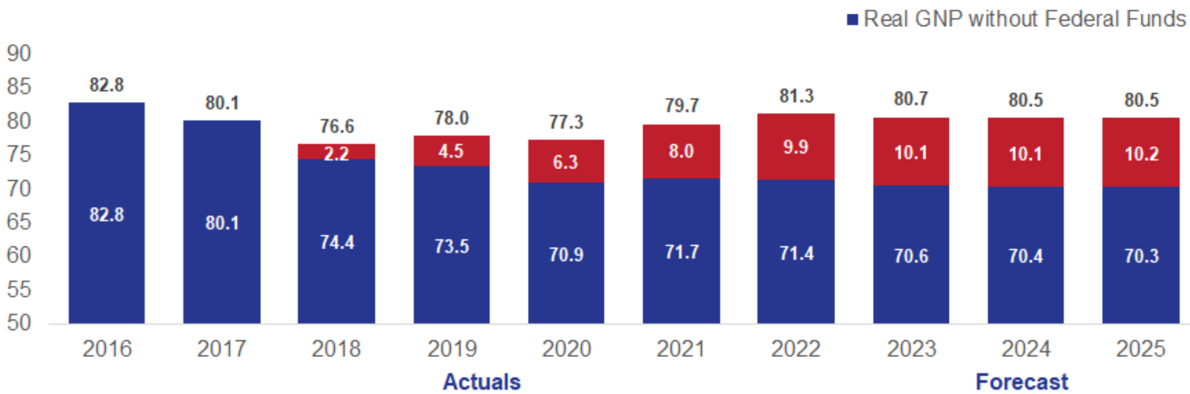
Sources: Puerto Rico Development Bank, Bureau of Labor Statistics, Puerto Rico Planning Board, Puerto Rico Department of Labor and Human Resources, Puerto Rico Office of Commissioner of Financial Resources, Instituto Estadistica de Puerto Rico, PRDE M1C data (2021), NAEP Report Card, Puerto Rico Community Survey

Near term, unprecedented inflows of federal funds are waning, and may be masking underlying weakness in the economy. The economy of Puerto Rico is sensitive to changes in the level of federal funding since federal funds have historically comprised approximately a quarter of personal income. In recent years, Puerto Rico has received an unprecedented infusion of federal funds in the form of Disaster Relief Funding and COVID-19 stimulus that has helped the economic recovery. Through successive federal stimulus and recovery packages, Puerto Rico received approximately $120 billion in federal funds, equivalent to over 150% of 2022 GNP. Comparable levels of federal support for major U.S. states would be equivalent to New York state receiving over $2 trillion or California receiving nearly $4 trillion in relief funds. Most of these COVID-related funds, such as enhanced unemployment benefits, Paycheck Protection Program (PPP) loans, and economic impact payments were one-time infusions that temporarily boosted output. This major influx of one-time federal funds has strengthened the economy during the pandemic, but even at this level of support Puerto Rico GNP has not yet returned to FY2016 levels, as shown in *Exhibit 3*.

EXHIBIT 3: PUERTO RICO GNP WITH AND WITHOUT FEDERAL RELIEF SPENDING FROM 2016 - 2025[14]

Puerto Rico real GNP, with and without federal relief spending

Fiscal Year, in billions of constant 2023 dollars



	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Nominal GNP growth, %	-1.3%	-2.1%	4.7%	-0.4%	4.4%	6.9%	2.5%	1.8%	1.4%
Real GNP growth, %	-3.2%	-4.4%	1.8%	-0.9%	3.1%	2.0%	-0.7%	-0.2%	-0.0%
Real GNP growth w/o federal funds, %	-3.2%	-7.1%	-1.3%	-3.4%	1.0%	-0.4%	-1.2%	-0.2%	-0.1%
US real GDP growth, %	2.3%	3.0%	2.2%	-2.8%	5.9%	1.9%	0.3%	1.8%	2.7%

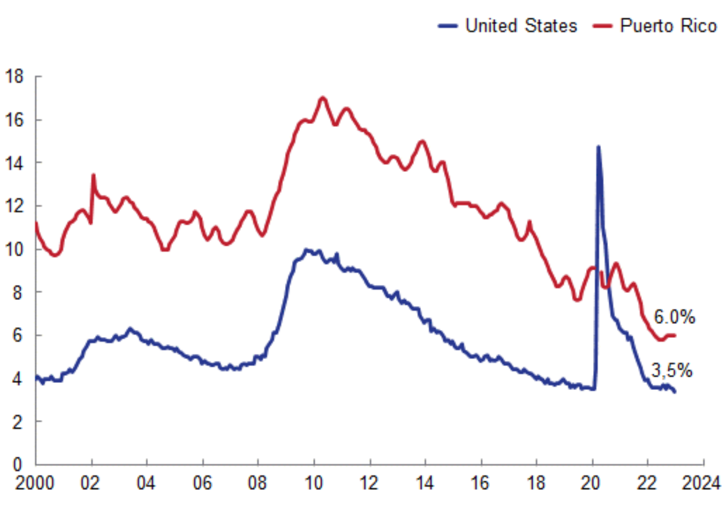
Note: The stimulus estimates for FY2018 through FY2025 were calculated as the difference between the actual or projected level of real GNP less the level of real GNP that would have occurred if there were no federal DRF, COVID-19, federal benefits, or infrastructure funds (primarily IIJA). The implicit GNP deflator was used to convert nominal values to constant 2023 dollars. Numbers in figures may not add up to totals because of rounding. Puerto Rico real GNP growth in 2020-2021 is adjusted for the impact of direct income transfers as part of COVID-19 federal relief packages. US real GDP forecast is for calendar years and sourced from the February 2023 CBO Budget and Economic Outlook.

Labor force participation is up, and unemployment is at historically low levels. As Puerto Rico continues to emerge from the COVID-19 pandemic, the unemployment rate continues to decline in a trend started in 2010 reaching a historic low of 5.8% in August 2022. While unemployment is still relatively high compared to the mainland, Puerto Rico has narrowed the gap to just over 2 percentage points. In addition, labor force participation, despite being below other U.S. states, continues to rise. This increase is likely related in part to the recent expansion of the EITC program in 2021.

14 The stimulus estimates for FY2018 through FY2025 were calculated as the difference between the actual or projected level of real GNP less the level of real GNP that would have occurred if there were no federal DRF, COVID-19, federal benefits, or infrastructure funds (primarily IIJA). The implicit GNP deflator was used to convert nominal values to constant 2023 dollars. Numbers in figures may not add up to totals because of rounding.

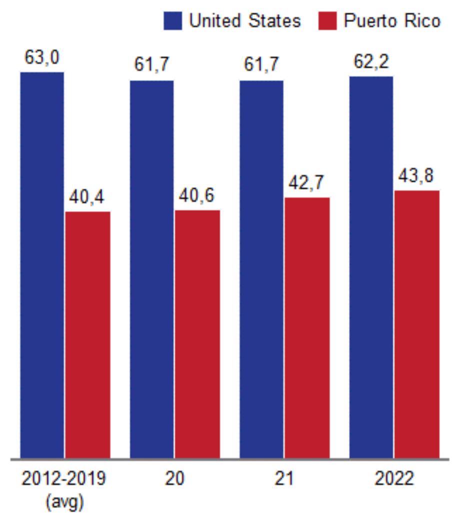
EXHIBIT 4: PR AND U.S. UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES

Unemployment rate, %



Note: While Puerto Rico's labor force participation appears much lower than US average, Puerto Rico has a large informal sector. The formal + informal labor force participation is estimated to be 62%-79%.
Source: PRDOL and Bureau of Labor Statistics

Formal labor force participation rate, %

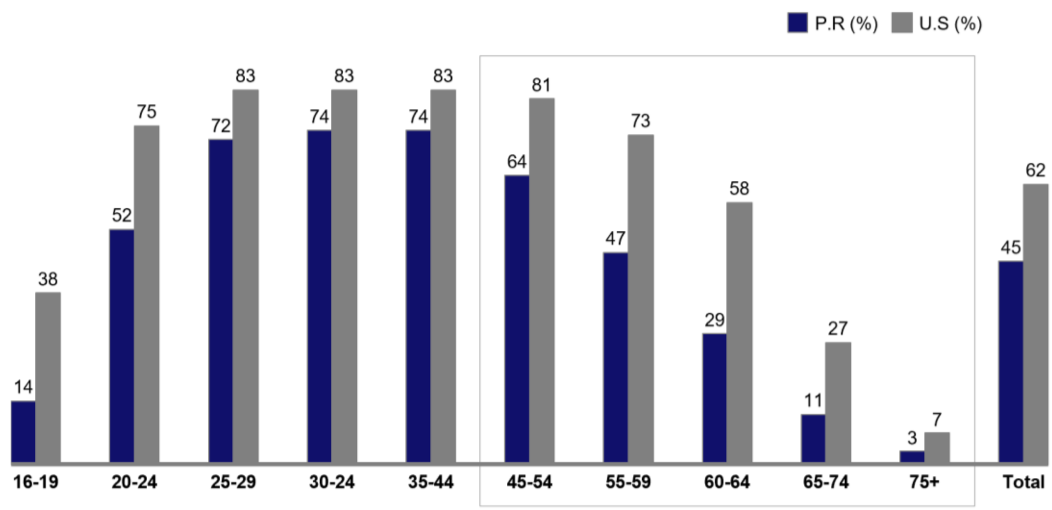


Note: Puerto Rico does not show a positive spike at start of COVID-19 pandemic because: (1) Survey was not conducted in March and April of 2020 and thus the data is missing for there two months; (2) PRDOL did not include those employed but working 0 hours as part of the unemployed.
Source: Bureau of Labor Statistics

While overall labor force participation is relatively low compared to the mainland, the gap is particularly stark among those over age 45. Given the large share of that group in the total population, their low labor force participation significantly affects the average.

EXHIBIT 5: LABOR FORCE PARTICIPATION BY AGE GROUP

Puerto Rico and U.S. Labor Force, by age cohort, %

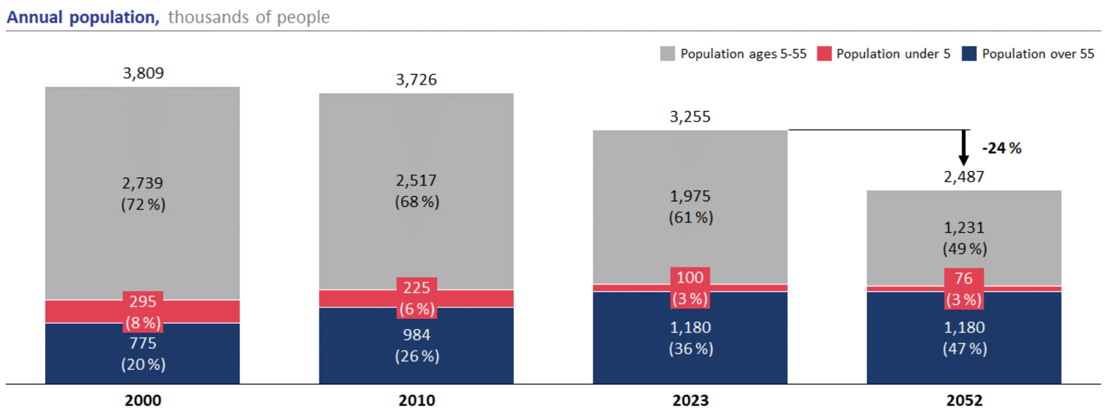


PR Pop # 2021	171K	227K	224K	195K	404K	430K	221K	221K	378K	326K	2.8M
PR Pop % 2021	5%	7%	7%	6%	12%	13%	7%	7%	11%	10%	84%
US Pop % 2021	5%	7%	7%	7%	13%	13%	7%	6%	10%	6%	80%

*Totals are derived from BLS and PRDOL and represent values for December 2022 while age disaggregation is derived from Census
SOURCE: Bureau of Labor Statistics; Puerto Rico Department of Labor; Census ACS 2021 5-year estimates

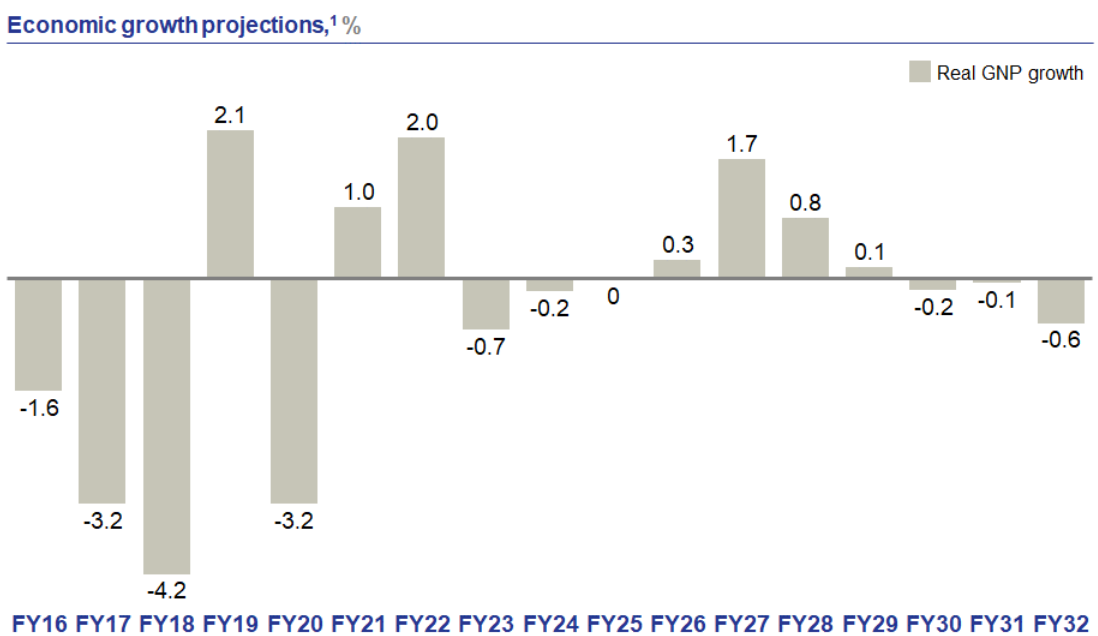
The population is projected to decline due to the demographic composition of Puerto Rico's residents. In 2016, Puerto Rico began to experience negative natural population change (a higher number of deaths than births). This negative natural change has continued unabated into 2023. Natural population decline is exacerbated by outmigration. While the updated population forecast in the 2023 Fiscal Plan shows higher population projection relative to the 2022 Fiscal Plan due to updates from the 2020 federal census, the declining population trend remains.

EXHIBIT 6: POPULATION GROWTH RATE OF SELECTED AGE GROUPS



As COVID stimulus funds dwindle, the growth outlook for the next several years is anemic. Households in Puerto Rico and across the U.S. have been buoyed by COVID relief funds. As those funds are drawn down, a drag on the economy may be expected as the pace of consumption and economic activity slows. These economic forecasts are critical to the revenue projections and for informing the budgeting capacity to fund government service delivery.

EXHIBIT 7: PUERTO RICO REAL GNP GROWTH RATE



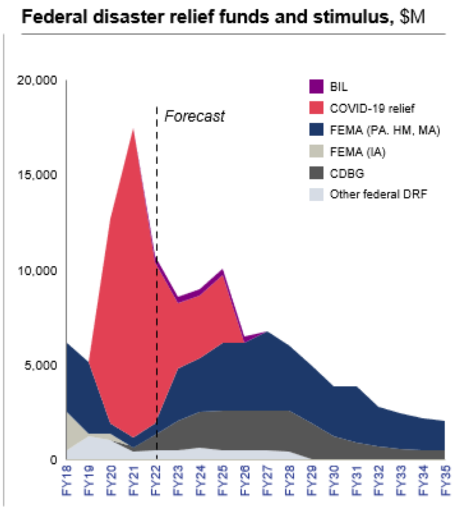
1 FY2016-FY2021 actuals sourced from the 2021 Statistical Appendix to the Economic Report to the Governor; FY2022 and beyond are 2023 Fiscal Plan model estimates and projections

Future growth is highly dependent on Puerto Rico's ability to deploy federal reconstruction funds. The 2023 Fiscal Plan assumes full deployment of disaster relief funds by 2035 (*Exhibit 8*). Less than full deployment is a risk that would substantially lower GNP growth. For example, a scenario with 50% deployment of relief funds would result in a 1.9 percentage point decrease in average GNP growth between FY2023 and FY2027, and a scenario with no further federal reconstruction fund deployments would decrease growth by 3.1 percentage points per year over the same period. (*Exhibit 9*)

EXHIBIT 8: FEDERAL RELIEF FUNDS BY SOURCE OF FUNDING

Federal disaster relief funds by category, $M

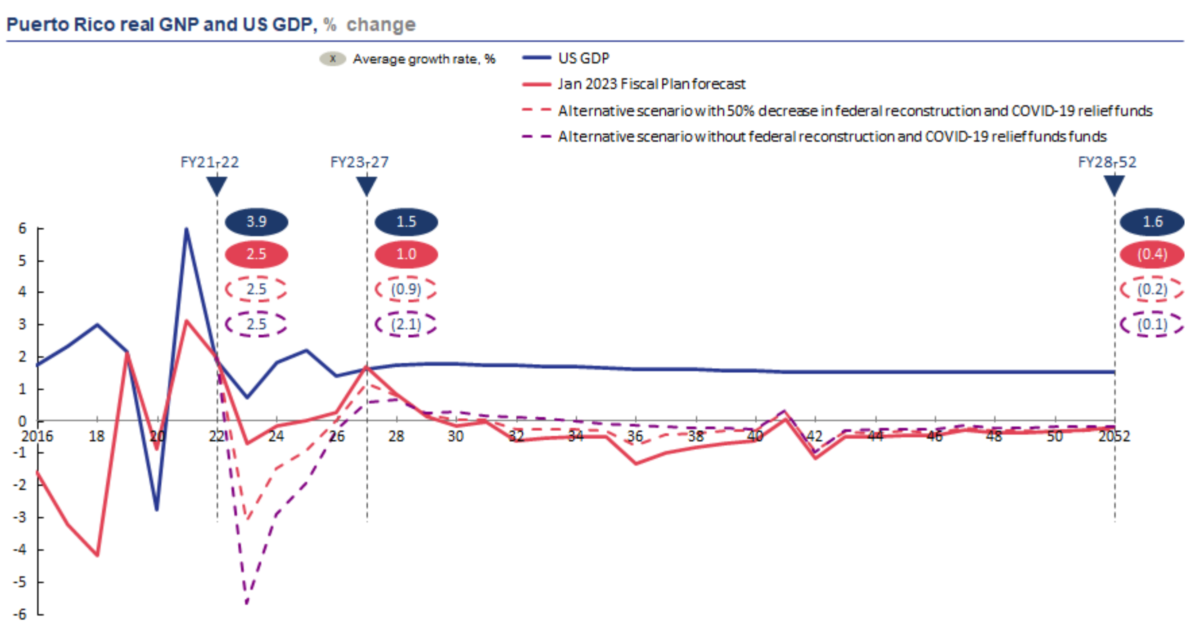
Federal funds	FY18, $M, %	FY19, $M, %	FY20, $M, %	FY21, $M, %	FY22, $M, %	FY23, $M, %	FY24, $M, %	FY25, $M, %	FY26-35, $M, %	Total, $M
Total federal disaster relief programs	6,167	5,139	1,942	1,196	1,915	4,783	5,350	6,146	41,144	73,780
	8%	7%	3%	2%	3%	6%	7%	8%	56%	
FEMA Public Assistance, Hazard Mitigation, Mission Assignments[1]	3,607	3,772	544	585	596	2,708	2,845	3,578	26,992	45,226
	8%	8%	1%	1%	1%	6%	6%	8%	60%	
FEMA Individual Assistance[1]	2,050	130	317	(70)	10	4	0	0	-	2,442
	84%	5%	13%	-3%	0%	0%	0%	0%	0%	
CDBG	-	-	66	257	787	1,532	1,858	2,054	12,643	19,198
	0%	0%	0%	1%	4%	8%	10%	11%	66%	
Other federal disaster relief funding	509	1,237	1,014	426	522	539	646	513	1,509	6,915
	7%	18%	15%	6%	8%	8%	9%	7%	22%	
COVID-19 relief programs[2]	-	-	10,764	16,275	8,465	3,465	3,276	2,583	-	44,828
	-	-	24%	36%	19%	8%	7%	6%	-	
Bipartisan Infrastructure Law	-	-	-	-	322	323	324	325	326	1,620
	-	-	-	-	20%	20%	20%	20%	20%	
Total	6,167	5,139	12,706	17,471	10,702	8,571	8,950	9,053	41,470	120,228



1.Includes federal assistance for 2019/2020 earthquakes

2.Includes CARES Act, CRRSA Act, ARPA, Preparedness and Response Supplemental Appropriations Act, Families First Coronavirus Aid Package, CW stimulus package

EXHIBIT 9: GNP GROWTH SCENARIOS



Note: Fiscal Plan model forecast for PR GNP is adjusted for income effects of direct federal transfers as part of COVID-19 relief programs

The near-term economic performance and trends have translated into revenue outperformance. Puerto Rico had stronger than forecasted revenue performance in FY2022, which has continued into FY2023. The 2023 Fiscal Plan raises the forecast of full year FY2023 General Fund revenues by approximately 11%. This trend is consistent with U.S. states, where 33 of 41 states reported FY2023 revenue collections above-forecast revenue collections largely driven by federal stimulus and COVID-19 rebound.[15] The 2023 Fiscal Plan projects that the lingering effects of historically unprecedented federal stimulus money will carry over through FY2024, while returning to long-term trend by FY2025. Separate from the current economic cycle, and consistent with prior fiscal plans, the Commonwealth revenue forecast attributes long-term improved collections of core sales and income taxes to improved tax administration processes. For example, Hacienda has expanded its sales and use tax (SUT) internet sales collections through regulations enabled by the passage of Act 40-2020, which allowed the Government to reach tax-collection agreements with remote sellers and marketplace facilitators.

The Puerto Rico Department of Treasury (Hacienda) is committed to implementing initiatives with the potential of increasing collections and has already successfully implemented an integrated tax system paired with increased information reporting to improve tax compliance. Hacienda is driving improvements in its culture and organization to boost enforcement capabilities and digitize the process of filing taxes to lighten the burden of compliance on taxpayers. In addition, the 2023 Fiscal Plan suggests that Hacienda evaluate strategic investment opportunities in tax compliance programs. Previous studies of large-scale investments in tax compliance programs show at least an overall return of two times the investment, potentially more if the investments are made in areas of high compliance risk.[16]

The 2023 Fiscal Plan incorporates the effects of the newly enacted Act 52-2022, signed into law on June 30, 2022. The law builds a framework for companies to voluntarily transition out from the Act 154 excise tax, and into a regime that taxes industrial development income and royalties. The new Act 52 sets the statutory tax rate at 10.5% potentially increasing to 15% if the U.S. enacts a qualifying 15% or higher minimum tax on corporate income. The tax rate is then reduced by a series of adjustments based on the tier a decree holder falls into, resulting in a net tax liability as low as 1.6%.

As described in its correspondence with Hacienda, the Oversight Board remains uncertain about Act 52's long-term effect, given that the tax is highly concentrated in a handful of multinational entities. Considering this, the 2023 Fiscal Plan does not budget incremental revenue relative to the projections in the 2022 Fiscal Plan related to Act 154 revenues. As required in the 2023 Fiscal Plan, the Government set aside a $250 million reserve out of FY2022 revenue surpluses to fund any potential Act 52 near-term revenue shortfall. The $250 million reserve must be retained until at least December 31, 2025, to allow an adequate assessment of Act 52's FY2023 revenue, after which the Act's revenue implications will be re-examined by the Oversight Board. In the interim, actual receipts under Act 52 will be closely monitored and the 2023 Fiscal Plan forecast will be updated as appropriate based on actual performance.

Longer-term, the changes to Federal funding for the Medicaid program create uncertainty. Changes included in the federal 2023 Consolidated Appropriations Act provided a near term boost in funding for the Commonwealth but does not provide additional Medicaid federal funds beyond FFY2027. The Commonwealth could face a "Medicaid fiscal cliff," where it becomes responsible for a significantly increased share of Medicaid expenses (expenditures that had

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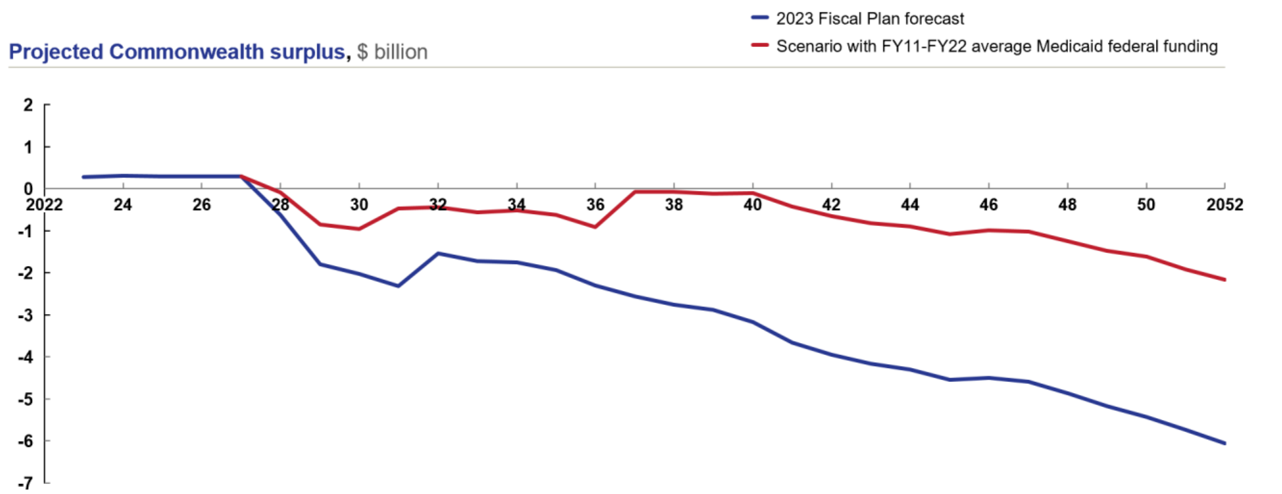
15 Data from 41 reporting states. National Association of State Budget Officers (NASBO), The Fiscal Survey of States; Fall 2022

16 Congressional Budget Office, "The Effects of Increased Funding for the IRS", September 2021: Government Accountability Office, "Tax Gap: IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources", December 2012

previously been covered by federal funding since 2011). The updated financial forecast reflects current federal law, while the alternative forecast shows for illustrative purposes what the forecast would look like if Puerto Rico were to receive Medicaid funding at the level of the average over the past 10 years.

EXHIBIT 10: COMMONWEALTH PROJECTED BUDGET GAPS/SURPLUS



Priority initiatives to restore market access and accelerate growth

2023 Commonwealth Fiscal Plan pursuant to PROMESA Section 201

5 Priority initiatives to restore market access and accelerate economic growth

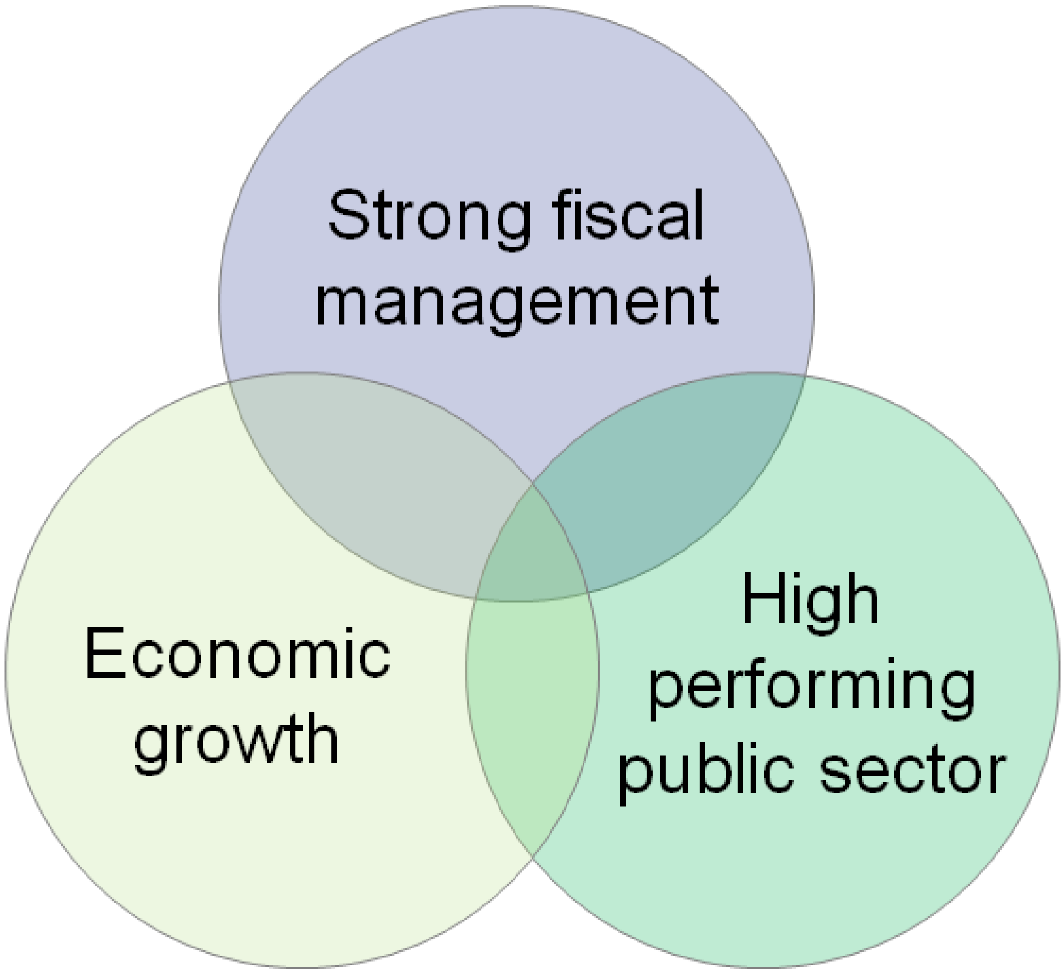
To thrive and grow, Puerto Rico needs access to capital markets at reasonable rates. All governments need the financial flexibility to invest for the future, which requires access to capital markets to finance long-term investments across economic cycles. As part of the long road to recovery post-bankruptcy, Puerto Rico will have to demonstrate to investors and the public that its financial management capabilities are strong, and its mistakes are in the past. The Government will also have to show a serious commitment to improving the delivery of government services while reforming its civil service to better serve the people.

The 2023 Fiscal Plan prioritizes resource allocation across three major pillars. These are designed to cascade throughout the Government of Puerto Rico and serve as an overarching guide for allocating the resources needed to achieve the Commonwealth long-term economic, fiscal, and social outcomes.

- **Entrenching a legacy of strong financial management:** The Government must implement a comprehensive Financial Management Agenda (Agenda), as outlined in this Fiscal Plan. The Agenda calls for timely financial audits, transparent financial reporting, improved resource management, and implementation of long-term planning objectives. Furthermore, the Agenda includes implementation of initiatives such as an improved real property registry, enhanced time and attendance reporting, debt management policy, and budget best practices. A new comprehensive Enterprise Resource Planning (ERP) system will be instrumental in supporting financial data recording, reconciliations, and timely interim and year-end financial reporting, as well as timely preparation and audit of its financial statements.
- **Instilling a culture of public-sector performance and excellence:** The Government must cultivate a high performing public sector to deliver quality public services. This would allow the Commonwealth to bolster the Government's capacity to address 21st-century challenges and fulfill the most fundamental and emerging needs of the residents of Puerto Rico. The cornerstone of these efforts is the continued investment in the Civil Service Reform (CSR) originally established in the 2021 Fiscal Plan. Having completed the CSR Pilot Program, in 2023 CSR will be scaled up government-wide with further optimization in its recruitment processes, evaluation, and organizational restructuring. The 2023 Fiscal Plan also introduces a second phase to the salary adjustment process to implement the Uniform Classification and Remuneration Plan (URP), where the Government can keep its commitment to pay market competitive salary rates while also cementing the program's sustainability.
- **Investing for economic growth:** One of the basic expectations for Government is the effective delivery of services to the people. Providing these services requires revenues sufficient to fund the level of services required. Puerto Rico's economy must generate enough revenues to support the need. The economy must grow over time and thus increase revenues available to fund the government. The fiscal and economic turnaround of Puerto Rico cannot be accomplished without the implementation of structural economic reforms that promote sustainable economic development. If implemented quickly and widely, structural reforms are projected to drive real economic growth, reversing decades-long economic challenges and enabling the economy to flourish. These reforms include power/energy sector reform to improve availability, reliability, and affordability of energy, K-12 and higher education reform to expand opportunity and improve

outcomes, and infrastructure reform to improve the efficiency of the economy and facilitate investment.

EXHIBIT 11: 2023 FISCAL PLAN RESOURCE ALLOCATION PRIORITIES



Additionally, the 2023 Fiscal Plan continues to support investments from previous fiscal plans to support frontline services and agency operations. These include continued funding to bolster healthcare infrastructure and services (e.g., through capital and IT investments at public hospitals) and funding for supporting critical Government operations (e.g., Enterprise Resource Planning implementation, additional staff to finalize centralized procurement initiatives). The 2023 Fiscal Plan also continues to support efforts to improve public safety given its impact on the quality of life of Puerto Ricans and its potentially catalytic effect on economic development. The Oversight Board and the Government are committed to redoubling their efforts to improve public safety by continuing previous investments in the workforce (e.g., salary increases, police equipment and capital) and maximizing the impact of those investments (e.g., by allocating as many sworn officers to the field as possible and improving the efficiency and effectiveness of procurement).

5.1 Strong Financial Management

The Financial Management Agenda included in this Plan was designed to implement and institutionalize the reforms necessary for Puerto Rico to achieve fiscal responsibility and economic renewal and is a critical precondition for balanced budgeting over the long-term and restoring market access. Improving financial management through the Agenda will have direct and positive impacts on the lives of the people of Puerto Rico. It will ensure federal disaster aid is used to rebuild critical infrastructure and provide aid to families and businesses. Finally, it seeks to prevent misuse of taxpayer dollars. The Financial Management Agenda includes 12 initiatives described in *Exhibit 12*.

EXHIBIT 12: INITIATIVES TO ACHIEVE STRONG FISCAL MANAGEMENT

Financial Management Agenda initiatives

Foundational initiatives – lay the foundation for sound, sustained financial management	**Office of the Chief Financial Officer (OCFO)**	Aligns financial management functions across the Government under singular leadership, enabling consistent policies and procedures
	A Civil Service Reform (CSR)	Will result in more competitive compensation and better recruiting, training, and performance management for public service employees
Central initiatives – essential for meeting the conditions for terminating the Oversight Board	**Timely Audited Financial Statements**	Fulfil a prerequisite for issuing bonds at reasonable interest rates, and debt management policy implementation
	Debt Management Policy	Is necessary to assure investors, safeguard against future over borrowing, and ensure future market access
	Budgeting Best Practices	Budget best practices and federal funds management work together to help the Gov. more accurately forecast available revenue, prepare, and adhere to responsible spending plans, and maximize the use of federal funding to supplement local revenue sources
	Federal Funds Management	
Supporting initiatives – support other aspects of financial management improvement	**Automated time and attendance**	Will ensure that only active employees who are working get paid
	Cash & bank account monitoring	Will close idle government bank accounts and reduce erroneous bank account activity and inaccurate cash reporting
	Procurement best practices	Will make Gov. purchases transparent to the public, reduce non-competitive contract awards, and standardize procurement rules
	Non-partisan legislative scoring	Will ensure that the fiscal impact of legislative actions is accurately estimated and that budgets are based on revenue forecasts
	Real estate best practices	Will ensure that all Gov.-owned property is accounted for, properly maintained, and delivers the maximum value to the people of PR
	Real property registry	Will streamline the land registration process, verify ownership of all land on the Island, and assist with tax compliance and distribution of DRF

The initiatives in the Agenda were carefully chosen to lay a foundation for success, build on progress that has already been made, and achieve milestones that are most critical for restoring Puerto Rico's financial responsibility. Overall, the Agenda requires the Government's commitment to achieve immediate, concrete, and measurable results. The Agenda focuses on remedies to serious problems and requires the Government to implement the initiatives fully. The Agenda is being undertaken in coordination with, not instead of, other needed management improvements.

A strong financial architecture is essential to effective financial management across the Commonwealth. The Commonwealth will need to centralize all financial management functions with the intent of providing a uniform and coordinated structure to support fiscal governance and transparency. A robust financial management architecture will be instrumental in implementing the new comprehensive ERP system that will support financial data recording, reconciliations, and timely interim and year-end financial reporting, as well as timely preparation and audit of its financial statements.

Additional core financial management goals should include centralizing treasury and liquidity management, enhancing the budget development process, driving the standardization and integration of the Government's financial information technology (IT) systems, ensuring compliance with procurement, contract, pension, and human resource management policies, strengthening oversight of Special Revenue Funds (SRF) , improving the timeliness of the Government's annual audited report and financial reporting, centralizing and validating the management of Government funds, debts, and other financial transactions, overseeing the implementation of the 2023 Certified Fiscal Plan, and ensuring robust management of federal funds.

There are several important steps the Government has already undertaken to support the implementation of the Agenda. For example, the Government created detailed implementation plans for several initiatives, with definitive timelines, milestones, action steps, budgets, and responsibilities. The Government issued the FY2019 and FY2020 audited financial statements and established a comprehensive debt management policy, which was approved by the Oversight Board. The Governor and the Legislature also enacted Act 1-2023, which creates the Budget Office of the Legislative Assembly (OPAL, for its Spanish acronym).

Annual Comprehensive Financial Reports (ACFRs) provide markets and the public with financial transparency; the Government is making progress toward the goal of providing ACFRs within 6 months after the end of the fiscal year. The Oversight Board has continuously encouraged the Government to finalize and publish its past due audited financial statements, including spending time at two public board meetings on the topic and providing increased funding for required personnel at Hacienda. The Commonwealth published fiscal year 2017 audited financial statements on August 31, 2020, taking more than 1,158 days (about 38 months) to issue. The Commonwealth published fiscal year 2018 audited financial statements on June 30, 2021, taking more than 1,096 days (about 36 months) to issue. These intervals are too long and must be shortened. By comparison, according to a study by the Governmental Accounting Standards Board (GASB), state governments issued their annual audited financial reports (AAFRs) on average 189 days after fiscal year-end during 2012-2014 and 199 days during 2015-2017.[17] Best practice calls for ACFRs to be made public approximately 180 days or 6 months after the close of the fiscal year. Some states, like Michigan, have taken less than 100 days to release their ACFRs. The Government has made initial progress in closing this gap, publishing the FY2019 statements on April 8, 2022, and the FY2020 statements on September 30, 2022.

To continue progress toward timely financial reporting the Government must, among other things, provide a detailed timeline and implementation plan, positioning Hacienda to successfully oversee the publication of the ACFRs, and signing a multi-year master audit contract. Perhaps most importantly, the Government must transition to implementing monthly closing procedures over its books and records and implement strict monitoring over the process with consequences for agencies that fall behind. Without implementing these changes, ACFR issuance will continue to be delayed and unpredictable.

The Commonwealth has adopted a comprehensive written Debt Management Policy to help protect against unsustainable borrowing practices. The Policy lays the foundation for fiscal responsibility critical for future fiscal stability and sustainable economic growth. Specifically, the Debt Management Policy includes several controls on the current and future indebtedness of the

17 Financial Oversight and Management Board for Puerto Rico, "Internal Research and Public Policy Department Reporting", 2022

Commonwealth. For example, it defines Debt Policy Revenue[18], sets a maximum annual net-tax supported debt service limit to 7.94% of the average Debt Policy Revenues for two prior fiscal years, limits new long-term borrowing to capital improvements only, mandates the periodic release of Debt Affordability Report, and sets newly issued debt to begin amortizing within two to five years of issuance and have a maximum maturity of 30 years or less. In the fiscal year 2024, the 2023 Fiscal Plan projects net-tax supported debt service to be 6.2% of debt policy revenues, in accordance with the Policy ratio. In addition, the Government has adopted a separate policy to govern the use of derivatives and structured products by Government entities. Fifty-seven percent of all Commonwealth agencies have identified their capital leases and lease-purchase transactions and submitted the information to AAFAF. In February 2023, Government representatives met with officials from the three principal credit rating agencies to commence efforts towards a future credit rating for the Government obligations.

The implementation of the Time & Attendance (T&A) project has already resulted in multiple benefits and savings. In September 2020, the Puerto Rico Department of Education (PRDE) identified almost 700 employees registered as inactive but still receiving payments. This, along with an estimated $80 million in unlawful payroll payments made in previous years, prompted the T&A initiative. Most Government agencies and public corporations have some form of electronic system for employee attendance registration in place, however, these attendance registration systems are not integrated with payroll systems. The project seeks to automatically link time and attendance systems to payroll systems, which ensures both systems have the same employee data. Such automation ensures only active employees who are working get paid, and thus prevents incorrect payroll payments being disbursed to employees across Government agencies, as well as, preventing errors in reporting and/or miscalculation of employee balances. Upon completion, which is expected to occur in the summer of 2024, 87 agencies will have been impacted. The fully automated T&A infrastructure has, to date, been implemented in four agencies and approximately 53% of total employees across the 87 agencies have been given access to register and utilize the system to monitor their attendance. Automated processes have been implemented that deliver continuous savings each pay period as payroll / leave discounts are reflected in a timely manner. For example, T&A has led to the following additional benefits in the Department of Education: increased school staffing levels, reduction by 77% in the number of employees who had not registered their time and attendance between November 2020 (project initiation) and February 2021 (project launch). Since the last Fiscal Plan, expansion T&A milestones have been completed across additional agencies: Department of Justice, Department of Health, and Medical Services Administration of Puerto Rico. The Government is working in conjunction with the Oversight Board in the implementation of the T&A project. A substantial number of agencies remain in the pipeline for completion. However, agencies with larger headcounts and more complex structures have been addressed first. Critical learnings garnered through those implementations are facilitating a ramp up in the implementation processes.

For detailed description of the Agenda, implementation plans, and progress to date, please refer to Volume 3.

The Plan of Adjustment allows the Government to demonstrate its ability to deliver balanced budgets. Before PROMESA, Puerto Rico had a history of overstating revenues and understating, misstating, or not stating all its expenditures in a given year. This lack of budgetary

[18] Debt Policy Revenues include revenues derived from taxes, fees, permits, licenses, fines, or other charges authorized by the Legislative Assembly of the Commonwealth, including COFINA, and all additional revenues or monies deposited in the General Fund or any debt service or other governmental fund of the Government, and the revenues generated by any of the entities identified in Exhibit A of the Debt Management Policy (DMP). It excludes revenues from the entities identified in Exhibit B of the DMP, owned by any municipality of the Commonwealth, proceeds from the issuance of Debt (including from a refinancing transaction), transfers from the federal government, and proceeds from claims on property or casualty insurance policies. See DMP for a comprehensive definition.

control enabled budgets which appeared to be balanced consistent with the Puerto Rico Constitution's requirements, yet resulted in deficits, forced additional borrowing, and led to dire financial situation that existed before PROMESA.

There are numerous benefits of transitioning from cash accounting to modified accrual accounting. A modified accrual accounting method is more conservative since it requires recognition of revenues when measurable and promised payments when liabilities are incurred. Consequently, the books and records will present a more realistic picture of spending, help Puerto Rico avoid overspending, and present an accurate financial picture to Government managers, taxpayers, other stakeholders, and capital markets. Furthermore, it would eliminate many one-time maneuvers and lead to genuinely balanced budgets once all the debt restructurings are consummated. The transition to modified accrual budgeting was one element that led to New York City's financial recovery in the 1970's, helping to establish stricter budgetary discipline within the city.

To fully implement modified accrual budgeting, the Government must adopt policies and train employees to record expenses, make sure adjusting entries are communicated and coordinated across agencies, and shift to having accruals and interagency reconciliations automated. Furthermore, revenues and expenditures must be periodically reviewed against the forecast to respond to changes and there must be detailed resolution certifications and expense system registration. Additionally, payroll must be adequately tracked, controlled, and integrated. Accounts payable must be automated and follow clear procedures. Purchase orders and other encumbrances must be booked for the entire year, at the beginning of the year, and as many special revenue funds as possible must be eliminated.

The Government needs to ensure that it fully funds all known liabilities and maintains sufficient rainy-day funds and reserves. As the Government seeks to regain access to capital markets, rainy-day funds and cash reserves become critically important. Investors and ratings agencies pay close attention to the level of reserves that governments maintain, and their behaviors in accumulating and spending them. For example, ratings analysts often look for governments to tie rainy-day fund contributions to revenue volatility. According to a Pew Charitable Trust report on state financial management, "credit rating analysts from all three agencies agree that well-managed states administer rainy-day funds in a way that reinforces structural balance, or a budget that is financially sustainable over several years."[19] The 2023 Fiscal Plan adopts these practices by prioritizing the allocation of revenue outperformance to rainy day funds or reserves against pre-existing obligations.

The Oversight Board and the Government can more frequently communicate to the public and the markets about the financial performance of the Commonwealth. Since its establishment, the Oversight Board typically updates the fiscal plan annually, with a handful of exceptions. This annual update includes an updated revenue and expenditure forecast, with in-year public updates provided of actual performance relative to budget for TSA revenues and agencies. Moving forward, the Oversight Board will work with the Government to move toward periodic updates to forecasts, in addition to updates on actuals vs budget (e.g., quarterly). This will allow the Oversight Board and Government to communicate transparently about changes to the outlook and get ahead of potential changes needed as conditions evolve. Note that in evaluating potential changes on a more frequent basis, the Oversight Board and Government may decide that no update is warranted (e.g., if the outlook is uncertain, or if the changes are not material).

Strong financial management is a precondition for termination of the Oversight Board. The Oversight Board was designed to have a finite life, defined objectives, and defined tools and authorities to achieve those objectives. Every action taken by the Oversight Board over the past six

19 Pew Charitable Trusts, Rainy Day Funds and State Credit Ratings, May 2017

years has been dedicated specifically and exclusively to completing its mission as stated in the law as soon as possible. The Oversight Board seeks to complete its work under PROMESA as soon as the conditions are met, so that fiscal controls, fiscal sustainability, and economic prosperity and growth can return to Puerto Rico.

PROMESA is specific in terms of how and when the Oversight Board can be terminated. The two requirements found in Section 209 of PROMESA were designed to ensure that Puerto Rico's financial outlook is stabilized, and better financial management processes are institutionalized before the Board's oversight can be terminated. Now that the Commonwealth debt restructuring is completed and restructured debt service is included in Annual Budgets, in the coming months, the Oversight Board intends to provide more guidance on the performance standards and metrics by which the Section 209 requirements will be measured. In any case, while the Oversight Board must certify that these requirements have been satisfied, the Commonwealth Government bears the responsibility for completing the work necessary to meet the Section 209 termination requirements.

Section 209 of PROMESA (Termination of the Oversight Board) states the following:

An Oversight Board shall terminate upon certification by the Oversight Board that:

1) *the applicable territorial government has adequate access to short-term and long-term credit markets at reasonable interest rates to meet the borrowing needs of the territorial government; and*
2) *for at least 4 consecutive fiscal years--*
   A. *the territorial government has developed its Budgets in accordance with modified accrual accounting standards; and*
   B. *the expenditures made by the territorial government during each fiscal year did not exceed the revenues of the territorial government during that year, as determined in accordance with modified accrual accounting standards.*

5.2 Instilling a culture of public-sector excellence

The Government and the Oversight Board have been working collaboratively to change the way government manages its human resources for generations to come, by co-designing and implementing a comprehensive and integrated Civil Service Reform (CSR).[20] The objective of the CSR is to build a more efficient, effective, and accountable government through the creation of an improved work experience and an enhanced employee value proposition for public sector employees. Civil servants are under increasing pressure to deliver important public services in an environment that demands more of them to build a high-performing government. The Government requires CSR to equip civil servants with the appropriate skills, structure, and support to tackle current and future needs effectively and to empower the workforce to carry on professional duties with competence and excellence.

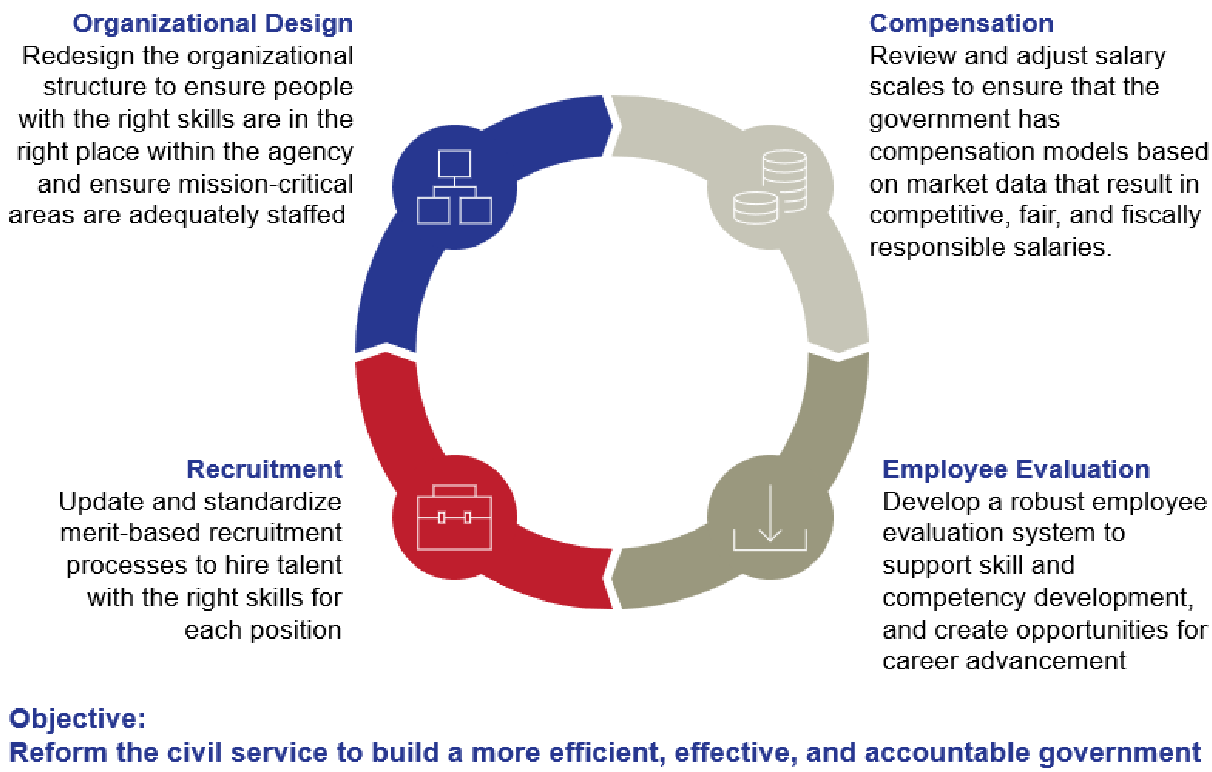
The Civil Service Reform seeks to meet this objective by:

- Revamping disjointed and outdated organizational structures across government, ensuring people with the right skills are at the right place within the organization, and mission-critical functions are adequately staffed (Organizational Design)

20 For more on the origins, approaches, and methods of the reform, refer to the CSR Pilot Essay Vol. 1 titled "Planning and Implementation of the Civil Service Reform of the Government of Puerto Rico: Methods and Practices"

- Reviewing and adjusting compensation structures and ensuring the government has data-driven and market-based compensation models that lead to competitive, fair, and fiscally responsible salaries (Compensation)
- Building a robust employee evaluation system to support the continuous development of core, technical, and leadership skills and developing clear paths to career advancement to promote greater motivation, engagement, and retention (Employee Evaluation and Development)
- Enabling tech-driven and streamlined recruitment processes to recruit the right talent for each role (Recruitment)

EXHIBIT 13: COMPONENTS OF CIVIL SERVICE REFORM



The four strategic components of the CSR are intimately intertwined and are essential to achieve lasting change in human resource management in the Government of Puerto Rico. Framing and addressing the perennial problems faced by the public workforce solely from a remunerative perspective will not result in the necessary transformation of human resources management in the government. While adopting a compensation system and philosophy that ensures competitive, equitable, and justifiable salaries in the Government is a crucial pillar of good human resource management, other important areas such as operating in an up-to-date organizational structure with clear lines of supervision and roles, having a transparent, merit-based recruitment process, and an employee-centric evaluation system centered around professional development, are also vitally important to transforming the public service.

The CSR effort has made significant progress through the initial pilot phase. The organizational design component of the pilot included an organizational review and restructuring of several critical areas within Hacienda and OGP to provide future state organizational design and workforce investment recommendations focused on enabling more effective financial management and reporting.

In the case of Hacienda, sections and divisions were consolidated to make work areas more efficient, with clearer lines of supervision throughout the organization. The Financial Statements Office was restructured and strengthened with new principal and senior accountant positions, a new Customer Service Center was created to consolidate administrative and transactional activities to streamline internal and external consultations, and an Operational Center of Excellence (CoE) was established focused on carrying out continuous improvement and optimization studies of operational areas within Hacienda through process reengineering, data analysis and visualization, and the development of digital solutions.

The organizational component of the pilot program also brought about important changes in OGP including a new Center for Government Excellence replacing the Public Management Area. This new center was equipped with resources to be able to lead the transformation of the government and the development of more specialized work divisions in the Budget Directorate to achieve greater focus and effectiveness in budget management activities.

When the new organizational structures were established in Hacienda and OGP, the job classification system was revised to ensure that the positions were aligned with the future-state structures outlined in new designed organizational charts with revised roles and functions. Furthermore, one of the top recommendations at the pilot agencies was the recruitment of new positions to close skills gaps in critical areas leveraging external talent pools. After the development of the new structures, the positions for new recruitment in each functional area of the pilot were identified. In total, the recruitment of 112 new positions was recommended in both agencies, 85 in Hacienda and 27 in OGP. Positions vary between areas including accounting, data science, project management, and technology.

A core component of the CSR Pilot is conducting a compensation benchmarking analysis for in scope job classes to ensure their pay is closely aligned with market competitive rates of public- and private-sector peers. Pay or compensation benchmarking is a process of collecting data on the compensation for comparable jobs in the public and private sectors to establish their market rate; in other words, it is a gap analysis of what a current employee makes relative to a similar employee in the wider market.

Employee salaries were compared to market salaries for each job classification to determine the number of employees below the minimum of the market's competitive range. The analysis revealed that the salary of most of the employees participating in the pilot were below the minimum of the competitive range. Specifically, 80% of the OGP employees were below the competitive range, 73% for Hacienda. Pilot employees who were paid below the minimum of the competitive range (90% of the median) within their new job classification received a salary adjustment, while employees who were above the minimum of the competitive range did not receive an adjustment. With the application of this methodology, no employee who participated in the Pilot has a salary below the market-based competitive salary.

The 2023 Fiscal Plan requires the Government to continue the full government-wide rollout. To do so, the Government's milestones in the 2023 Fiscal Plan include:

- Implementing Phase 2 of the two-phase salary adjustment for the Uniform Classification and Renumeration Plan
- Recruiting 500 mission-critical positions across the government

The Puerto Rico Department of Education (PRDE) and other public agencies are undergoing broad Civil Service Reform to become financially and operationally sustainable and to build capacity among personnel, beginning with finance and accounting functions. The CSR efforts they are undergoing include implementing best practices in procurement, staff and financial management, and performance tracking and reporting.

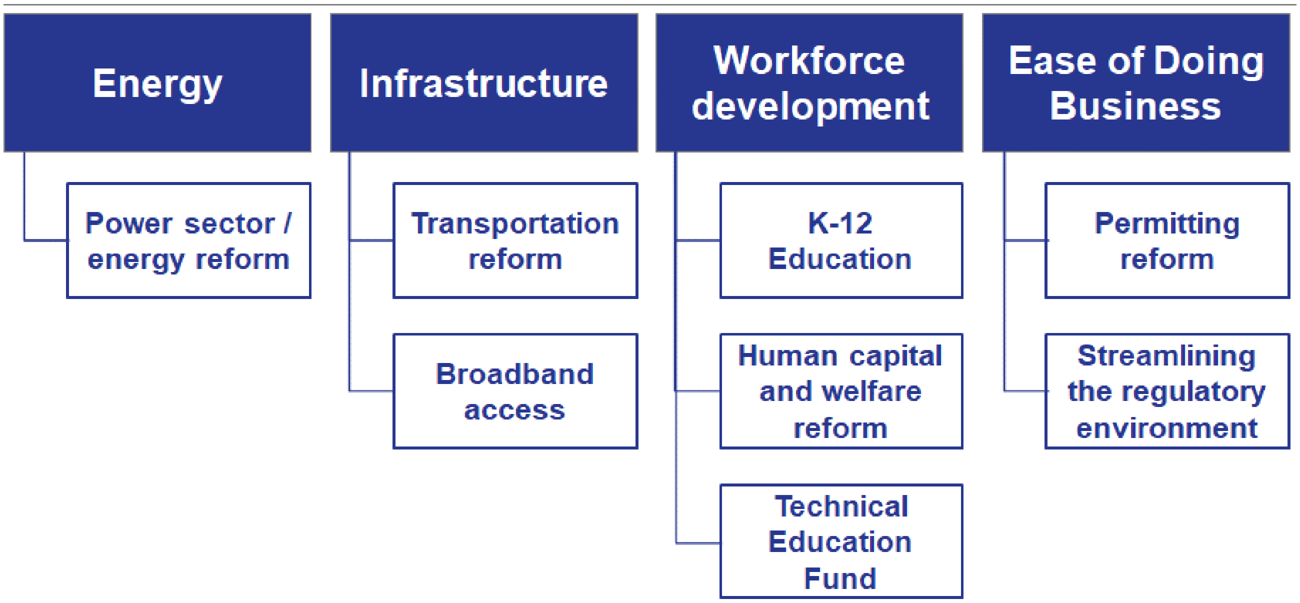
For a detailed description of public agencies' CSR initiatives, implementation plans, and progress to date, please refer to Volume 3.

5.3 Investing for economic growth

As Puerto Rico emerges from bankruptcy and the pandemic, it is more important than ever that the Government focus on a comprehensive approach to economic development. The economy of Puerto Rico is buoyed by federal funding that is temporary in nature. Without urgent actions to improve the conditions for growth and development, the economic outlook over the medium term is anemic. Realizing economic growth will require a proactive, prioritized, and coordinated effort. Large scale investments require careful definition and prioritization to execute and maximize the impact federal and local funds. Rigorous prioritization of investments based on long-term benefits is essential to ensuring the maximum benefits for residents.

The Oversight Board is eager to collaborate with the Commonwealth and Island-wide stakeholders to refine priorities with a focus on identifying near-term actions that can be taken to accelerate progress against economic development priorities. While the Oversight Board recognizes the role of the private sector in driving economic development, the 2023 Fiscal Plan has identified the following strategic areas that can significantly contribute to improving economic outcomes on the Island.

EXHIBIT 14: KEY STRATEGIC AREAS TO DRIVE ONG-TERM ECONOMIC GROWTH ON THE ISLAND



5.3.1 Power sector / energy reform

Customer-centric, affordable, reliable, sustainable, and resilient electric power service is essential for Puerto Rico's economic growth and development. As an important element of household and business activity, electricity is also a critical factor for attracting and maintaining investment in Puerto Rico. The Puerto Rico Electric and Power Authority (PREPA), which until recently was Puerto Rico's sole energy provider, has been encumbered by numerous financial and operational issues, including underinvestment in the grid and poor maintenance practices. [21] Politicized management and volatile fuel prices, exacerbated by declining energy demand and an economic contraction, have resulted in PREPA's inability to service its debt, and ultimately resulted in PREPA seeking PROMESA Title III protection in July 2017.[22]

Puerto Rico has almost twice as many forced outages as the U.S. industry average.[23] Following Hurricane Fiona, the Puerto Rico electric grid is operating in a condition of heightened risk of load shed due to generation issues. Prior to Hurricane Fiona, customers were 88 times more likely to have a load shed event, when compared to the average mainland electric customer (8.8 days a year versus 0.1 days a year). They are now approximately 500 times more likely to have a load shed event when compared to the average mainland electric customer (50 days a year versus 0.1 a year). On November 15th, 2022, the Governor of Puerto Rico and FEMA, announced that FEMA's power stabilization initiative aimed to install between 600 to 700 MW of temporary emergency generation capacity through the mobilization of power generation maritime barges and temporary land-based generator. As a result, on March 17, 2023, the first electric generator arrived. This will add 150 MWs to the system and help stabilize it, particularly during hurricane season.

PREPA has historically also significantly underperformed against mainland utilities in its elevated carbon dioxide emissions, high reliance on fossil fuels, lack of capital investments in a new generation asset, and notably, its struggle to maintain a very high reserve margin.[24] Although historically, PREPA had maintained a very high reserve margin with double the capacity needed to serve demand, most of its reserve margin is currently out of service and has been in a precarious state in recent years, consistently falling below best practices.[25] This problem was exacerbated by Hurricane Fiona.

To achieve Puerto Rico's energy system transformation, a change in PREPA's historical roles and responsibilities and their reassignment through multiple entities is imperative. Much progress has been achieved so far to begin this reorganization, but more work remains to be done.

The focus in the coming months will be to: (i) create the Puerto Rico Energy Bureau (PREB) approved subsidiaries (PREPA GenCo, PREPA GridCo, PREPA HydroCo, and PREPA PropertyCo); and (ii) assign separate PREPA assets, roles, and responsibilities into each of the subsidiaries.[26][27]

GridCo comprises transmission and distribution, customer service and administrative functions, operated and maintained by LUMA Energy, LLC and LUMA Energy ServCo, LLC (together, "LUMA"),

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21 For more information, refer to the 2022 Certified Fiscal Plan.

22 "Puerto Rico's Power Authority Effectively Files for Bankruptcy", New York Times, 2 July 2017

23 PREPA reported 417 forced outages during 2020; U.S. Energy Information Administration (EIA), Independent Statistic & Analysis, Major Disturbances and Unusual Occurrences, Year-to-Date 2020

24 See PREB Docket Number NEPR-MI-2022-0003.

25 See PREB Docket Number NEPR-MI-2022-0003.

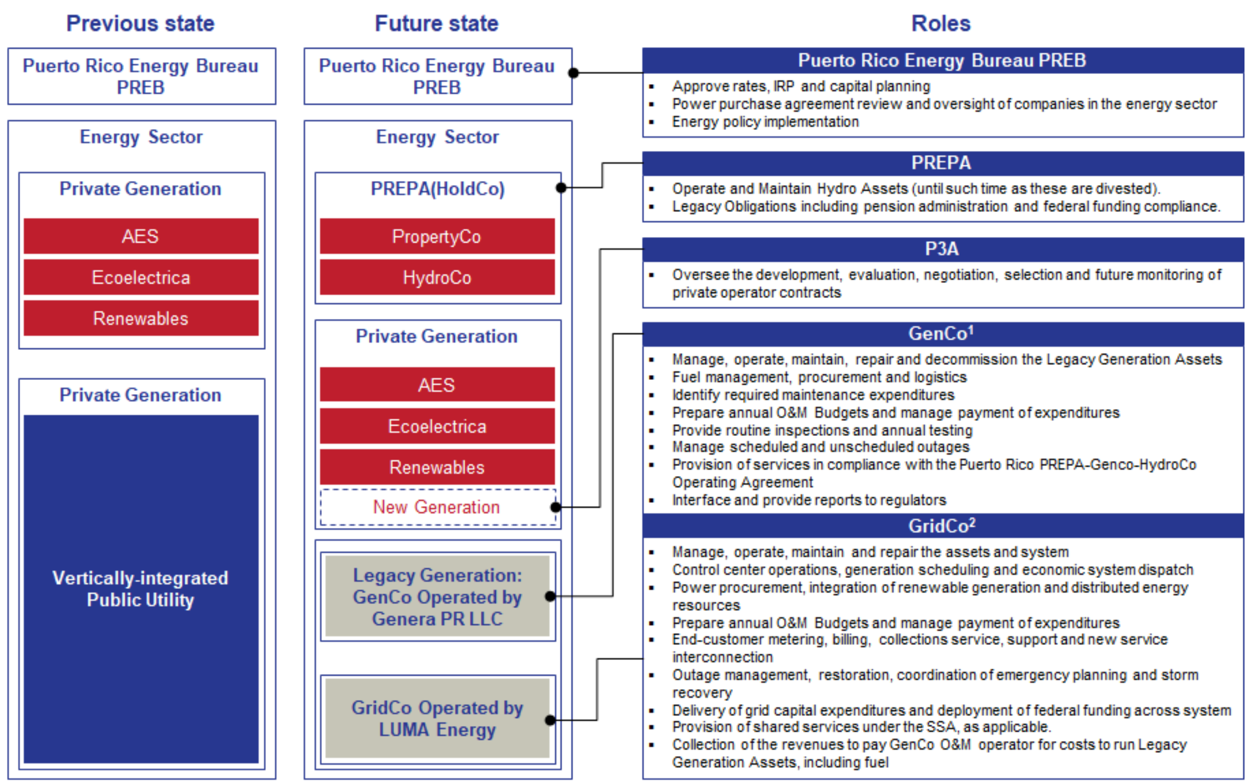
26 We note that GridCo is a subsidiary that has not yet been approved by the PREB but will instead be a "de facto" entity whilst the assets remain under the PREPA HoldCo entity. All other entities listed herein were approved pursuant to PREB's Resolution and Order issued on December 29, 2022, under PREB Docket No. CEPR-CT-2016-0018.

27 See PREPA's 2022 Certified Fiscal Plan for subsidiaries description.

GenCo comprises existing PREPA-owned thermal generation resources that are to be operated and maintained by the newly selected private operator, Genera PRs LLC ("Genera"), until their retirement, as mandated by PREPA's approved Integrated Resource Plan.[28] Genera will be responsible for, among other activities, the operation and maintenance of existing PREPA-owned generation resources, environmental compliance, safety, and eventual plant retirement and decommissioning. Moreover, Genera will be responsible for working closely with LUMA to ensure appropriate short, mid, and long-term system planning and timely and efficient execution of system-wide capital improvements.

Finally, PREPA's existing day-to-day roles and responsibilities over the operation of the energy system, deployment of federally and non-federally funded capital investments, short, medium, and long-term system planning, and energy sector oversight are expected to be reduced in the near future as such roles and responsibilities are taken up by relevant Government agencies and private operators.[29]

EXHIBIT 15: ENERGY SECTOR TRANSFORMATION – PREVIOUS AND FUTURE STATE



1. GenCo refers to the wholly-owned subsidiary of PREPA who would obtain ownership of the Legacy Generation after a potential reorganization of PREPA
2. GridCo refers to PREPA, in its capacity as owner of the T&D assets

28 See Section 1.8 of the Puerto Rico Energy Public Policy Act; Act 17-2019

29 See Section 1.7 of Act 17-2019, which states that "the Government of Puerto Rico, by itself or through the Authority or another public corporation affiliated to the Authority, shall maintain ownership of the transmission and distribution assets and may maintain ownership of the legacy power generation assets." See Section 1.8(b) of Act 17-2019 which also provides that PREPA shall only "retain personnel as are necessary to fulfill its responsibility as a Partnering Government Entity, as such term is defined in Act No. 29-2009, of assisting the Public-Private Partnership Authority in overseeing the Contractor's performance of the Partnership Contract and compliance with the performance-based metrics set forth therein." Pursuant to the LUMA agreement, PREPA delegated any duties with respect to overseeing LUMA's performance to the P3A

PREB plays a critical role in promoting an efficient, reliable, resilient, and customer-responsive energy system. PREB has been operational since its creation by Act 57-2014. PREB has the responsibility to "regulate, monitor, and enforce the energy public policy of the Commonwealth of Puerto Rico." In a transformed energy system state (after transitioning operations to private parties and emerging from Title III), PREB's responsibilities will include (i) rate setting, (ii) Integrated Resource Plan (IRP) approval and compliance oversight, (iii) protecting customers, (iv) ensuring workforce safety, and (v) renewable procurement oversight (now run through the appointed independent coordinator (Accion Group LLC)).

PREB must "review and approve and, if applicable, modify the rates or fees charged by electric power service companies in Puerto Rico."[30] In doing so, PREB must ensure rates and rate structure are rational and predictable, minimize risk and "rate shock", and create incentives to support equitability and economic development. PREB should set a clear, transparent, and efficient process for rate cases. All rate adjustments and revisions, other than those approved under the plan of adjustment, must be approved by PREB before enactment.

To ensure PREB becomes a best-in-class regulator, several structural changes are required. There are five key structural elements that will ensure PREB is a best-in-class regulatory agency[31]:

- **Governance:** It is imperative that PREB's governance structure enable independent, quick, and robust decision-making. Commissioners serving staggered terms should be supported in their oversight role by professional civil servant staff that has utility expertise.
- **Independent ratepayer advocate:** All commission decisions in adjudicatory proceedings must comply with applicable requirements of administrative procedure. Separate from the regulator, there shall be an independent ratepayer advocate, a role currently filled by the Oficina Independiente de Protección al Consumidor (OIPC).
- **Employee Structure:** PREB must comply with the career employee structure required by Act 17-2019, as described in detail in the 2022 Certified Fiscal Plan.
- **Transparency:** PREB must ensure proactive transparency, while being diligent in excluding confidential information such as customer data and operational details that would increase cyber or risk vulnerabilities. Transparency practices may include making information publicly accessible, maintaining quick and efficient decision-making, and holding public events when appropriate to consider public opinion.
- **Budget:** PREB's substantive independence must be supported by financial independence. Neither the Executive nor the Legislative branches should have authority to modify PREB's budget or reapportion any of PREB's funds without PREB's prior consent. Under current law, PREB's yearly budget is set at $20 million and collected through charges assessed on certified energy companies. To provide for a steady and predictable funding source, PREB's enabling act must be amended by the Governor and the Legislature to provide that PREB's budget shall be funded entirely through rates, as part of the revenue requirement used to determine energy rates. PREB's funds are then collected by the T&D operator through customer bills and periodically remitted to PREB. Providing for an independent and unencumbered source of income for PREB helps create the conditions to protect ratepayer interests, increase transparency, and reduce

30 Puerto Rico Energy Bureau, "About the Puerto Rico Energy Bureau," 2021

31 Refer to the 2022 Certified Fiscal Plan for the full details on the five structural elements required to ensure PREB is a best-in-class regulatory agency

system costs. PREB is subject to periodic reviews from relevant authorities regarding its use of public funds, which is consistent with all other Government agencies in Puerto Rico.

Finally, the Oversight Board is working closely with the Government to restructure PREPA's legacy debt obligations to regain access to capital markets at reasonable rates.

The Oversight Board has the authority to approve a yearly budget and restructure PREPA's existing debt through a Plan of Adjustment and oversee liquidity management. At the same time, the Oversight Board approves any private operator that engages with PREPA, and after the operator has been installed, ensures compliance with PROMESA and the energy sector transformation objectives.

On December 16, 2022, the Oversight Board filed its proposed Plan of Adjustment to restructure approximately $9.9 billion of debt and other claims against PREPA, which prior to the PREPA Title III filing would have represented an unsustainable repayment schedule; PREPA would have had to repay approximately $4.5 billion of debt service obligations between FY2019 and FY2023.

The filed PREPA Plan of Adjustment reduces PREPA's legacy financial and general unsecured debt by approximately 40%.[32] The Plan contemplates the issuance of $5.68 billion in New Bonds that will be exchanged for the discharge of about $8.4 billion in bond debt, $700 million in "Fuel Line Loans", and general unsecured claims estimated at $800 million. The New Bonds will be paid from revenues generated by a "Legacy Charge", which consists of a fixed and volumetric charge on customers' bills that will vary based on category of customer and level of usage. To protect the most vulnerable, an exempted residential class will be established to protect lower-income residential customers. The Legacy Charge is expected to generate sufficient revenue to pay down the New Bonds in 35 years based on the projections in PREPA's 2022 certified fiscal plan. For pensions, the Plan provides PREPA's pension system with treatment substantially similar to the treatment of pensions at the Commonwealth. The PREPA plan closes the pension system to new entrants, preserves the benefits of current retirees, eliminates any future cost of living adjustments (COLAs), and ensures all benefits accrued to date by active participants are protected. Pension costs on a "pay as you go" (PayGo) basis will be paid through reimbursements of pension costs paid by the PREPA ERS, to be funded by PREPA through a new separate trust and paid as an operating expense of PREPA that will require sufficient rates to ensure pensions are covered and paid.

The Plan is supported by settlements with three separate creditor classes: (i) PREPA's prepetition fuel line lenders, (ii) National Public Finance Guarantee Corporation, and (iii) Vitol. Recoveries to general unsecured creditors and PREPA's bondholders and monoline insurers who did not elect to settle under the Plan will "toggle" based on the final outcome of pending litigation with PREPA's bondholders regarding the scope of the security interest and recourse claim of the bond trustee against PREPA. Pursuant to a ruling issued by the Title III Court on March 22, 2023, the security interest of the bond trustee is limited to a relatively small amount of funds in certain bank accounts. The court also ruled the bond trustee has an unsecured claim against PREPA in an amount yet to be determined. Depending on the amount of the unsecured claim of the bond trustee ultimately allowed by the court, recoveries to most of PREPA's creditors could be as high as 100%. If the claim of the bond trustee is allowed at a higher amount, recoveries will be allocated on a pro rata basis to general unsecured creditors and non-settling bond parties and could be less than 100%."

Under the PoA, the Legacy Charge's fixed monthly fee for general residential customers is $13, whereas the volumetric charge is 0.75 c/kWh for the first monthly 500 kWh consumed, and 3 c/kWh for all monthly kWh consumed above that amount. Moreover, because the PREPA Plan contemplates payment of pensions costs as general operating expenses, PREPA Employee Retirement System

32 PREPA's legacy financial and unsecured debt totals about $9.9 billion.

pensions are to be funded through a rate increase of an estimated 2.40 c/kWh.[33] This cost will come down over time because of the freeze of pension benefits and elimination of COLAs.

Small commercial customers, on the other hand, will pay a Legacy Charge consisting of a $16.25 fixed monthly fee and a volumetric charge of 1.50 c/kWh for the first monthly 500 kWh consumed, and 3 c/kWh for all monthly kWh consumed above 500. As described above, small commercial customers would also pay the same pension charge of 2.40 c/kWh.

The Title III plan confirmation process is underway, confirmation hearing is set for mid-July 2023 and the plan is expected to go effective in Q2 FY2024.

For detailed description of the power sector / energy reform, implementation plans, and progress to date, please refer to Volume 3.

5.3.2 Infrastructure reform: Transportation sector

The transportation sector is essential for both economic and social development in Puerto Rico, given its critical role in facilitating the movement of goods and people. A well-performing transportation system can increase access to jobs and business opportunity, unlocking the productive potential of residents and firms. In turn, a transportation system can increase economic output and invite further private investment. Meanwhile, a poorly performing system can mire its residents in wasted time, inequitable access to jobs and opportunities, fractured communities, and productivity losses. Puerto Rico is currently suffering from several of these factors.

Puerto Rico's transportation sector currently underperforms across a range of outcomes, including congestion, safety, and road quality. In 2020, the Highways and Transportation Authority (HTA) reported to the Federal Highway Administration (FHWA) that 12% of Puerto Rico's lane miles are in "poor" condition. Federal law mandates that no more than 5% of lane miles may be in a "poor" state for pavement conditions on the Interstate System.[34] [35] The state of public transit infrastructure and management in Puerto Rico deserves special focus given its many challenges. Congestion is increasing in many metropolitan areas, creating additional delays for commuting and transportation of goods. High congestion is due in part to the minimal use of mass transit; the San Juan metro area has 37,000 more households commuting by private vehicle than would be expected if mass-transit usage matched the U.S. average.[36] As a result of the extra vehicle journeys, San Juan experiences two additional weeks of low air-quality days per year, compared to the U.S. average.[37] Worse yet, NOx and PM2.5 emissions from vehicles are statistically associated with higher mortality rates in the local population.[38]

While HTA has made some improvements over the past few years, including the addition of a new dynamic toll lane to alleviate congestion, the current transit system suffers from limited efficiency, route coordination, operational cohesiveness, and accessibility. These issues result in higher congestion and reduced mobility, particularly for low-income residents who experience long commutes or are forced to bear the costs of owning a private vehicle.

33 Illustrative pension charge assuming $388 million annual PREPA pension PayGo.

34 As defined by 23 USC 103(c)

35 23 USC 119(f)(1) and 23 CFR 490.315

36 22% of San Juan metro area residents commute via carpool, walking, bicycling, or public transit, compared to 27% for the U.S.

37 Low air quality defined as AQI > 100; PR has 19 days per year to U.S. median of 4, as per the Department of Natural and Environmental Resources website

38 EPA estimates excess deaths per ton of emissions at 0.002 for NOx and 0.1 for PM 2.5.

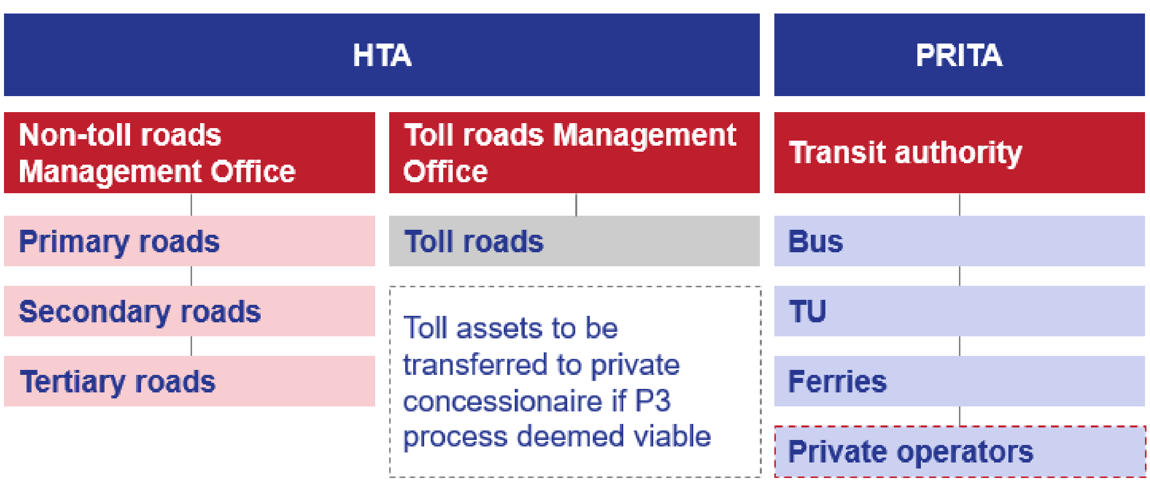
To address these issues, a comprehensive reform of the transportation sector is required. HTA, being the manager of critical assets across different transport modes, should be a key driver of that reform. To achieve this reform, the Government must:

- Reorganize Puerto Rico's transportation assets into transportation mode-specific entities to integrate all transit assets under PRITA, internally segregate HTA responsibilities into toll and non-toll assets, and create a Toll Roads Management Office
- Create an overarching transportation policy board to guide multi-modal transportation strategy
- Develop and use objective frameworks for project selection to optimize capital expenses
- Improve performance management through integration in public systems, performance-based contracts, and better supervision
- Maximize the Commonwealth's funding envelope through a more aggressive federal grants strategy and by improving grant management to attract private capital

In addition, the Oversight Board and the Government will explore the use of traffic enforcement technologies that are in use in other jurisdictions to improve safety and traffic conditions.

The cornerstone of the Transportation Sector Reform (TSR) should be the rationalization of asset ownership, with the creation of mode-specific transport entities. To achieve that, HTA would need to transfer all transit assets to the Puerto Rico Integrated Transit Authority (PRITA), establish an internal separation ("ringfence") between its toll and non-toll operations and pursue a public-private partnership for further structural independence of toll assets.

EXHIBIT 16: PROPOSED ALIGNMENT OF ASSET TYPES TO ENTITIES



The HTA Plan of Adjustment (PoA), confirmed on October 12, 2022, enables HTA to make the necessary investments to improve and maintain Puerto Rico's roads and other transportation infrastructure. The PoA became effective on December 6, 2022, marking an important milestone towards the future of Puerto Rico's transportation sector. Through the PoA, HTA is required to implement this comprehensive reorganization, enabling HTA to optimize decisions on toll pricing policy and enhance its financial position to accommodate investments that support economic growth priorities. Furthermore, it will enable HTA to deploy funds more effectively, thus reducing the proportion of pavement in poor condition and making the roads of Puerto Rico safer. Moreover, during FY2023, HTA has implemented the first two toll fare increases since 2005, a critical measure in advancing its internal restructuring.

The rationalization of asset ownership must be accompanied by a series of other structural measures and rolled out as a holistic reform package. The October 2022 HTA Fiscal Plan establishes how the HTA, Department of Transportation and Public Works (DTOP), PRITA, the Fiscal Agency, and Financial Advisory Authority (AAFAF), and other Government agencies must support the implementation of this reform, in line with the PROMESA section 205(a) letter sent to the Government on January 29th, 2021.

The Government must create an overarching transportation policy board to guide multi-modal transportation strategy. The Transportation Policy Board (TPB) must control a common transportation fund and suggest projects for funding across all transportation modes based on their potential to advance the overall transportation strategy. These projects must be proposed by a variety of transportation stakeholders, including metropolitan planning organizations, local governments, and local transit agencies. The TPB must facilitate coordination between the agencies to ensure ease of multi-modal transportation for its users.

The Government must maximize federal funding flowing into its transportation network. By establishing a holistic federal funding strategy, attracting more private investment, and increasing ancillary revenue, HTA, alongside other agencies, can improve the transportation sector's financial health and invest more in service delivery and capital projects for public transportation users. To obtain Puerto Rico's proportional share of federal funds, transportation entities should have a proactive strategy to identify, apply for and pursue additional discretionary federal funding. Similarly, P3s and ancillary revenue are effective strategies to attract private investment into the transportation network. The importance of these efforts has been magnified with the passage of the Bipartisan Infrastructure Law, which increases the available pool of discretionary grant funding for which HTA can compete. If HTA were to get its "fair share" (i.e., 1%, comparable to Puerto Rico's share of the U.S. population), discretionary grant programs would add an additional $90 million per year for capital investments. Similarly, P3s and ancillary revenue are effective strategies to attract private investment into the transportation network.

For detailed description of the transportation sector reform, implementation plans, and progress to date, please refer to Volume 3.

5.3.3 Infrastructure reform: Broadband access and affordability

The 2012 Puerto Rico Broadband Strategic Plan (written by Connect Puerto Rico, in conjunction with the Puerto Rico Telecommunications Regulatory Board and the Puerto Rico Broadband Taskforce) established a vision of a Puerto Rico with fast, robust, redundant, and ubiquitous broadband access. Broadband provides numerous socio-economic benefits to communities and individuals, including improving labor market outcomes by enabling remote education and increasing business productivity through better connectivity, providing access to better health care through telemedicine for those in rural areas, and enhancing civic participation through better access to information.

During and post-COVID-19 pandemic, internet access has become even more important to residents' livelihoods. Across the U.S., telemedicine is becoming more widespread to deliver health services safely. As public and private school systems alike move to distance learning models, students who do not have access to reliable, high-speed internet are unable to participate – and therefore fall farther behind. Finally, many employers have shifted to remote or hybrid working models, meaning participation in the formal sector requires stable broadband access.

Unfortunately, within Puerto Rico, while there was some growth in broadband deployment in 2011-2014 (driven by an aggressive capacity upgrade of cable networks, as well as the deployment of fiber by other broadband providers), critical broadband infrastructure gaps still exist, particularly across rural areas. As of 2014 (the most recent year for which data is available), while roughly 99% of urban households across Puerto Rico had access to speeds of at least 10 Mbps download and 1.5 Mbps upload, this was true for only about 66% of rural households.[39] Broadband adoption figures across Puerto Rico also reveal a persistent gap among certain demographic groups. Broadband non-adopters in Puerto Rico are generally low-income groups, senior residents, people with disabilities, and / or individuals with less education, which mirrors demographic trends related to broadband adoption on the U.S. mainland. These gaps have possibly widened since Hurricanes Irma and María, particularly in the mountainous region of Puerto Rico, where topography has hindered replacement of damaged infrastructure.

Addressing the digital divide is critical to ensuring that all residents of Puerto Rico can take advantage of the many well-documented socio-economic benefits afforded by Internet connections. These benefits are most evident when people have access to the Internet at speeds fast enough to be considered broadband since these speeds are required to facilitate full interaction with advanced online platforms.

Governor Pierluisi issued Executive Order 2022-040 which creates the Puerto Rico Broadband Program (PRBP) under the Puerto Rico Office of Management and Budget and created an Executive and an Advisory Committee to oversee and advise the execution of projects and disbursement of funds. PRBP is responsible for coordination across local and federally funded broadband programs across multiple entities that provide funding (FCC, NTIA, Treasury). Through the competitive process held by AAFAF in 2021, Tilson Technologies was selected and contracted to not only serve as Grant Manager and Grant Creator, but also to advise the Executive Committee on the rollout of a comprehensive 5-year broadband execution plan, known as the Smart Island Initiative. The plan is being jointly developed by OMB, the office of the Governor and Tilson Technologies. This 5-year plan will serve as requisite for the different Federal Programs and will serve as a detailed map for Puerto Rico's Broadband infrastructure and Digital Inclusion projects. Broadband infrastructure projects cannot be effectively implemented without a Digital Inclusion plan to guide their deployment.

The 2023 Fiscal Plan continues the prior investment of $400 million (to be used over three years) to complement federal funding, accelerate growth in broadband access, expand resident adoption and use of online resources, develop necessary and reliable data through an assessment of broadband availability, incentivize private sector investments in broadband build-out, and improve access to faster speed offerings in underserved areas (the "Broadband Infrastructure Fund"). This emulates the approach taken by several states such as Illinois, Minnesota, California, and Kentucky. While the overarching goal of all these sources of funding is aligned with that of federal programs, their focus, scope, granting and eligibility criteria, and disbursement timeline are different and complementary.

39 Puerto Rico Broadband Taskforce, "Puerto Rico Broadband Strategic Assessment," 2015

5.3.4 Workforce development: K-12 education reform

A high-quality education is the cornerstone for creating economic opportunities for the residents of Puerto Rico—especially after years of devastating natural disasters and the unprecedented impacts of the COVID-19 crisis. Educational attainment is a key factor in strong economic growth and on conceptualizing and visualizing a 21st-century workforce development and employment system. Indeed, improvements in education will bring prosperity and growth to individuals and the Island as a whole. It also sets the groundwork for the workforce preparation pipeline that ensures people have equitable access to opportunities for acquiring in-demand skills over the course of their working lives. Across occupations, there is greater demand for so-called 21st-century skills that go beyond routine cognitive skills and stock academic knowledge to capture competencies in such areas as information synthesis, creativity, problem-solving, communication, and teamwork. However, in survey after survey, employers report that they cannot find the workers they need and that skilled positions go unfilled[40]. Despite these changes, education and training institutions in Puerto Rico, in many cases, still follow a 20th-century linear pipeline.

The Puerto Rico Department of Education (PRDE) is the largest government agency in the Commonwealth with a FY2023 General Fund budget of approximately $2.4 billion and $4.6 billion in federal funds available; its roughly 45,000 employees are charged with providing high quality education for approximately 245,000 K-12 students in about 860 schools. PRDE has been under a Third-Party Fiduciary Agreement since April 2021, as mandated by the United States Department of Education (USDE) for the receipt of USDE grant funds. Unfortunately, educational progress has been slow. PRDE trails mainland counterparts on measures of academic achievement, and natural disasters, and the COVID-19 pandemic has exacerbated the challenges PRDE faces. In 2022, PRDE students scored the lowest in the U.S. on the math NAEP exam, more than 57 points below the national average. Only 10% of 4th graders and 6% of 8th graders at PRDE met basic math understanding and no PRDE students scored proficient. Furthermore, despite technological change, globalization, and important demographic changes, PRDE has been preparing students for jobs using essentially the same set of strategies they've been relying on for decades. In other words, learning models and curricula are appropriate for the world of work 20 or 30 years ago and have been slow to adapt to the need to prepare children and youth to be lifelong learners.

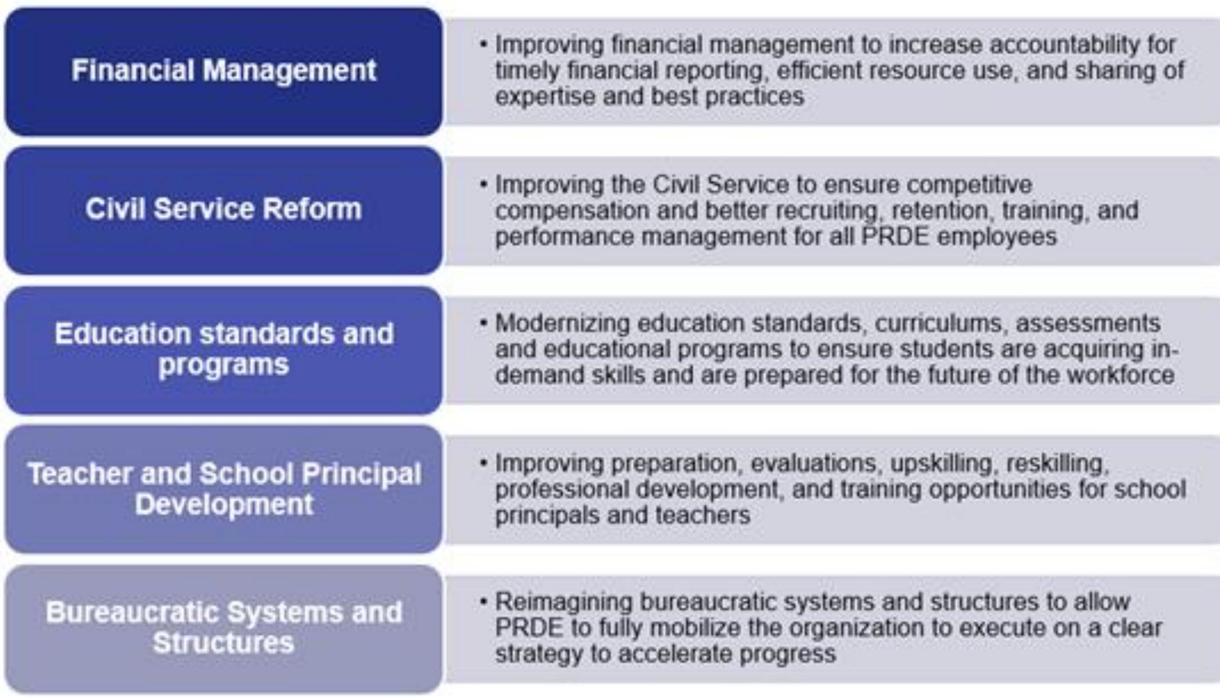
Notwithstanding some recent strides, PRDE has not yet developed the internal capacity, or led with commitment to a clear plan to manage the complex educational dynamics in Puerto Rico to align financial resources to students' needs. A significant factor driving PRDE's subpar outcomes is a set of underlying bureaucratic systems and structures that are ineffective and inefficient. Rather than operating in more strategic ways while aiming to fulfill its core function of driving a more efficient and cost-effective educational delivery model, PRDE has relied on actions that enable near-term savings but hurt its ability to provide optimal services in a sustainable way in the long term. A recent examination of the existing human resources management structure at PRDE conducted by the Oversight Board revealed many deficiencies in areas such as strategic human capital planning, recruitment, selection, talent management, performance management and evaluations, and succession planning. Lastly, despite its importance, PRDE currently lacks a standardized approach to teacher and school principal professional development. Effective teachers are better equipped to develop strong lesson plans, understand their curricula, and support their students. Similarly, school

40 A 2015 survey by the Manufacturing Institute—consistent with earlier surveys in 2001, 2005, and 2011—showed that six out of ten manufacturing companies had open skilled production positions that were unfilled because of a talent shortage. The 2018 survey suggests the skills gap has continued to grow. See Manufacturing Institute and Deloitte Insights, 2018 Deloitte and the Manufacturing Institute Skills Gap in Manufacturing, 2018.

directors are better equipped to improve school operations, implement reforms, and oversee the development of teachers when they receive robust training on how to do so[41].

To improve the capabilities and capacity of the Puerto Rican population, PRDE will need to set high aspirations and redouble efforts. This involves both immediate actions while also driving the operational and management improvements to provide better services for the children of Puerto Rico. Successful education reforms require a strategic and operational foundation to succeed. This will demand strong leadership, accountability, continuity, and willingness to work with a broad range of entities, both within the government and non-governmental organizations (NGOs). The first step is developing the right framework with different reform dimensions, and each dimension has goals to influence policy and practice. A framework is intended to recognize the strategies that are needed for making changes in the various components of the educational system. These reform dimensions are carefully chosen to lay a foundation for success, build on progress that has already been made, and achieve milestones that are most critical for reforming K-12 education in Puerto Rico.

EXHIBIT 17: K-12 EDUCATION REFORM FRAMEWORK



Stakeholder engagement is critically important for the success of any reform initiative. Stakeholders consist of the entire community involved: those in leadership positions within the school, educators, principals, counselors, administrators, NGOs and all the other members of a school district that students may or may not come face to face with. To drive effective education reform efforts and effective learning environments, all stakeholders need to come together in a meaningful way, through collaboration and therefore connection. Over the next fiscal year, in partnership with public and private stakeholders, PRDE should institute a new Panel of Education Reform Advisors comprised of nonprofits, government agencies, and school community leaders to inform policy, identify further areas for support, and monitor results to assess, evaluate, and map various opportunities for

41 Investigators found that a one standard deviation increase in teacher quality in a single grade raises annual earnings by 1% on average. Moreover, researchers linked the replacement of a low (bottom 5%) value-added teacher with an average value-added teacher to a $267,000 increase in students' average lifetime incomes per classroom taught; see Chetty, et. al, "The Long-Term Impacts of Teachers: Teacher Value-Added and Student Outcomes in Adulthood," 2011.

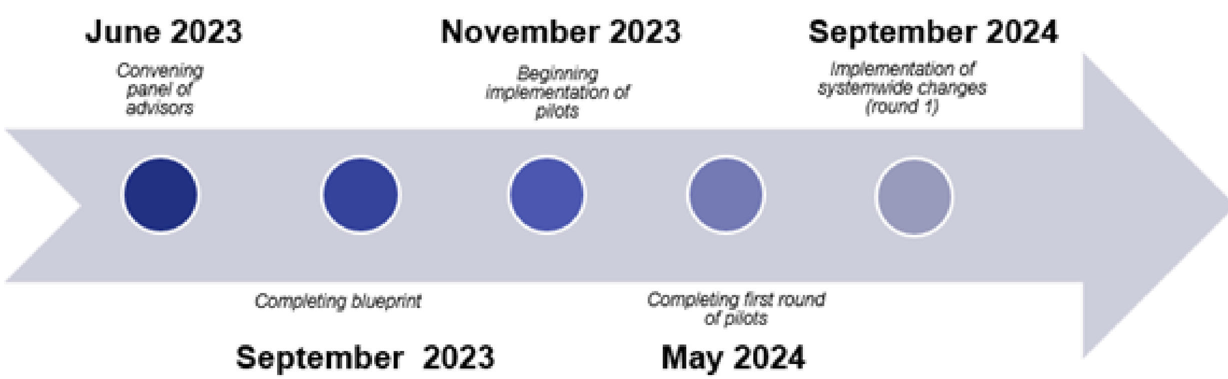
improving education outcomes on the Island. This new advisory council will develop an **Education Development Blueprint** to enable a better understanding of the main challenges, including underserved populations, as well as prioritize future investments to improve education outcomes. This Education Development Blueprint should contain an ambitious set of initiatives to improve educational outcomes and deliver better labor market results on the Island. This Blueprint should require PRDE's commitment to achieve immediate, concrete, and measurable results, focused on remedies to serious problems and commitments to implement them fully. Once the Education Development Blueprint is completed, PRDE will work with the Oversight Board to ensure all initiatives, actions and projects are properly planned and funded through various sources (including federal funds). The Blueprint should be goal oriented, innovative, and accountable and should incorporate:

- **Project charters** that establish the goals and structures of measures, identify risks and obstacles, and establish metrics and KPIs for each initiative, action or project.
- **Implementation plans** with detailed layouts of each activity required for accomplishing sub-measures, risks / mitigants for each activity, clear leaders and owners for each activity, and metrics and KPIs.

This new Blueprint will allow the Commonwealth to reprioritize spending based on initiatives that are essential to having a high-quality education system on the Island.

Given the amount of administrative and political challenges with reform in Puerto Rico, a gradual and more narrowed approach, focused on actionable and concrete initiatives might be more practical. Adopting a pilot-then-scale implementation approach will enable government leadership to see reforms in action and allow for policy changes and new programs to be adapted and tweaked as required prior to a larger-scale implementation and roll out. It also allows leadership to get a more concrete and accurate idea of the operational and financial challenges that might be faced in the implementation of reforms across the education system. As such, the Oversight Board and PRDE will work with the Panel of Education Reform Advisors on designing pilot projects derived from the list of actionable initiatives on the Education Reform Blueprint. Pilots can be designed to be implemented within an educational region, a school, or a municipality. The Oversight Board will allocate $10 million for pilot projects for fiscal year 2024.

EXHIBIT 18: TIMELINE FOR NEW EDUCATION REFORM INITIATIVES



5.3.5 Workforce development: Human capital and welfare reform

Historically Puerto Rico's economy has suffered from low labor force participation. Increasing the productivity of Puerto Rico's labor force is essential to creating growth. There are several structural reasons why Puerto Rico is lagging its potential, and they each must be addressed with tailored actions. Despite recent improvement, levels of productivity have much room to grow. In 2022, Puerto Rico's formal labor force participation rate was on average 43.8% (slight increase from 2020s 40.2%), among the lowest in the world and far below U.S. and Caribbean averages.[42] There are several factors that contribute to this low rate, which include suboptimal eligibility criteria for welfare programs and underperforming human capital development systems influencing behavior. Additionally, relative to U.S. states, Puerto Rico lacks some features of the social safety net that may hold back labor participation. Specifically, certain nursing facility and home health services covered by Medicaid on the mainland are not covered in Puerto Rico, which may increase elder care responsibilities faced by working age residents.

According to the Congressional Budget Office, labor force participation is an important component of economic growth, since it allows firms to expand employment and increase production and has an important impact on fiscal and budget trends.[43] Puerto Rico has an opportunity to increase this rate and must aspire to reach at least the rate of the lowest U.S. state (West Virginia, with 54.7%), to provide its economy with the dynamism it requires to foster growth.[44] Puerto Rico must continue to build on this progress in 2023 if it continues to implement human capital and welfare reforms.

Changes to welfare program rules are needed to address disincentives to working in the formal economy while ensuring sufficient nutritional support, housing, and health care.[45] For instance, current welfare eligibility guidelines sharply phase-out beneficiaries as their income rises, informally taxing workers for seeking work within the formal economy.[46] This phenomenon is particularly pronounced in the case of recipients of public housing assistance: even securing a part-time minimum wage job can render a beneficiary ineligible for public housing, potentially forcing some beneficiaries to choose between formal sector work and keeping their homes.[47] Working with the Federal Government to revise eligibility guidelines and other policies that encourage residents to work could help resolve these issues.

In addition, the 2023 Fiscal Plan requires the Government to introduce a work / volunteer requirement for select adult NAP beneficiaries, with full implementation by the beginning of FY2024.

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42 For comparison, the U.S. has a 61% labor force participation rate. In the Caribbean, the Dominican Republic's labor force participation rate was 62% in 2020. Jamaica and Haiti's rates were even higher (64% and 65%, respectively). See the World Bank Group via International Labor Organization, "Labor force participation rate, total (% of total population ages 15+)," 2020; and Departamento del Trabajo y Recursos Humanos, "Empleo y Desempleo en Puerto Rico," Diciembre 2020

43 Congressional Budget Office, "Factors Affecting the Labor Force Participation of People Ages 25 to 54," 2018

44 U.S. Bureau of Labor Statistics, "Employment status of the civilian noninstitutional population 16 years of age and over by region, division, and state, 2019-2020 annual averages," 2020

45 Cordero-Guzmán, "The production and reproduction of poverty in Puerto Rico," in Nazario, ed. Poverty in Puerto Rico: A Socioeconomic and Demographic Analysis with data from the Puerto Rico Community Survey (2014), 2016

46 For example, a single parent with two dependents and an annual income below $4,900 was eligible to receive up to $4,229 dollars in annual Nutritional Assistance Program (NAP) benefits in 2016. But should this parent work 35 hours per week at minimum wage—generating approximately $12,180 in annual earnings, they would become ineligible for NAP benefits. Net of taxes on their earning, full-time formal sector work would increase household income by only $7,002—the equivalent of a $3.86 effective hourly wage. Effective hourly wage income equals income received from formal sector work minus income lost from loss of benefits.

47 The U.S. Department of Housing and Urban Development (HUD) sets income limits that determine the eligibility of applicants for assisted housing programs. For U.S. states, the limit to be considered an "extremely low-income family" is determined by HUD using the Department of Health and Human Services (HHS) poverty guidelines. However, an alternative formula is used to define an extremely low-income family for Puerto Rico—30% of the median family income for an area or lower—which results in lower income limits. The current HUD income limits are so low that, in many cases, entering the formal labor market in a part time job at the minimum wage would result in losing eligibility for housing assistance. Thus, the existing income limits directly disincentivize formal employment and hinder economic mobility in Puerto Rico.

NAP is Puerto Rico's largest Government assistance program and provides nutritional assistance. Unlike mainland Supplemental Nutritional Assistance Program (SNAP) benefits, NAP does not include a work / volunteer requirement. The Federal Government requires that all able-bodied adult beneficiaries without dependent children work, volunteer, or be enrolled in worker training classes for at least 20 hours per week to receive SNAP benefits.[48] When well-designed, including such requirements in similar programs has led to increases in labor force participation.[49] The implementation of a NAP work / volunteer requirement will contribute to increasing labor market participation and achieve the potential growth anticipated from human capital and welfare reforms. The 2023 Fiscal Plan requires the Government to implement a NAP work / volunteer requirement.

The 2020 Fiscal Plan provided design parameters and specific milestones for the implementation of a NAP work / volunteer requirement. The Government committed to a 2-year implementation timeline beginning in July 2021. Reaching full and timely implementation requires urgent and nimble action from the Government. While the Administration of the Socio-Economic Development of the Family (ADSEF, by its Spanish acronym) began to review the NAP caseload to identify eligible NAP participants, progress has been delayed due to Hurricane Fiona. As such, the Government has yet to meet any major milestones in the implementation of this reform.

In August 2021, the Food and Nutrition Service at the U.S. Department of Agriculture announced an update to the Thrifty Food Plan, which is an important part of determining benefit amounts for NAP and other federal nutrition assistance programs. Due to this change, the funds available for benefit payments in Puerto Rico are projected to increase in future years.[50] These additional funds could help further incentivize labor force participation if a work / volunteer requirement is successfully implemented.

Worker training programs in Puerto Rico can be better coordinated across 15 local workforce boards. DDEC may focus on creating partnerships with private and social sector organizations to strengthen worker training and conduct regular analyses to understand private sector labor market needs. DDEC can also create a holistic strategic plan that outlines how different workforce development efforts blend in a cohesive way across programs and the 15 local boards.

Investments in the health care workforce are needed to support high-quality primary care as the foundation of the health care system. Primary care provides continuous, person-centered, relationship-based care that considers the needs and preferences of individuals, families, and communities. Creating economic opportunities, including job trainings and workforce development will address academic and social impacts. Anecdotal evidence suggests that the health sector in Puerto Rico is facing a shortage in medical personnel. Currently, Puerto Rico does not have a system in place to track data regarding the number of working health care professionals. Many professionals may continue to renew their membership with a professional association; however, this does not mean they are actively practicing in Puerto Rico. In addition, there is no data regarding the number of residents that graduate and remain working in Puerto Rico. Hence, the Oversight Board in collaboration with the Department of Health (DOH) and AAFAF will conduct a health care workforce analysis to understand the current health care workforce environment in Puerto Rico. The goal is to particularly understand the health care workforce supply and demand imbalance of today

48 NAP also differs from SNAP in that the former is funded as a block grant and is administered separately from the latter; see Center on Budget and Policy Priorities, "How Does Household Food Assistance in Puerto Rico Compare to the Rest of the United States?" 2020

49 For example, when the Federal Government first introduced a work / volunteer requirement for recipients of Temporary Assistance for Needy Families (TANF) benefits in the 1970's, the labor force participation rates of single mothers rose while poverty rates among single mothers and children both fell substantially. See Gitis, "A Menu of Options to Grow the Labor Force," 2017, and Gitis and Arndt, "The 20th Anniversary of Welfare Reform," 2016

50 USDA FNS, "USDA Thrifty Food Plan Increase Means More Nutrition Assistance Funding for Puerto Rico," 2021

and tomorrow, as well as understand the drivers of the supply and demand. The results gathered will be used to identify and help address the most acute health care workforce shortages in the Commonwealth. By determining the key drivers for the lack of health care workers, targeted ideas may be identified to continue supporting the health care system. At present, an initial kick-off meeting was held between the participating project sponsors, a list of potential stakeholders has been identified, and a draft survey has been prepared with the expectation to begin distribution of such survey during FY2023.

Investments are being deployed to support doctors who serve the residents of Puerto Rico. The 2020 Fiscal Plan allocated a total of $30 million over two fiscal years to be used to establish an independently managed loan forgiveness program to incentivize doctors to practice in underserved areas in Puerto Rico. Under this program, each medical student or resident would be eligible for up to $25,000 of loan forgiveness per year of service – up to four years – in underserved areas and the program would be administered by an independent third party. On June 24, 2022, AAFAF officially published the request for proposal (RFP) to identify the third-party vendor for the Medical Student Loan Forgiveness Program (MSLFP) and provided the proponents until July 22, 2022, to submit the proposals. After further evaluation no proponents were received, and an updated RFP will be published during FY2023.

The Government can invest to close core skill gaps and ensure the people of Puerto Rico can compete in a global economy. Creating an aligned, 21st century workforce that prepares residents of Puerto Rico to thrive is the central challenge to maintaining economic competitiveness over the next decade.

As the pace of technological change has accelerated, one core skill gap in Puerto Rico is around technical capabilities. To close the gap for people who are already in the workforce, Puerto Rico must take a learner-centric approach to make it easier to access targeted technical education.

Meanwhile, as businesses look for new skillsets, they are often willing to look beyond college graduates to fill open roles – especially for technical skills. According to a recent 2019 survey by Future Workforce, 90% of employers would hire candidates who validate their knowledge using a certification, digital badge, or coursework in lieu of a college degree.[51] In addition, 55% of employers often offer jobs to people who have not finished college. Today, the number of both traditional and non-degree credentials is rising. There are now 315,067 unique credential programs from non-academic organizations, with the largest categories being digital badges and online course completion certificates. Coding bootcamps, which have appeared recently, were responsible for over 1,000 unique credentials.

The University of Puerto also has important role to play in adapting offerings to meet 21st century workforce in line with Puerto Rico's economic development strategy. For additional details, please refer to Section 6.1.

5.3.6 Workforce development: 21st Century Technical Education Fund

Prior fiscal plans allocated $50 million for a 21st century Technical and Business Education Fund. Given that DDEC has talent and workforce development as one of their priorities in their economic development framework, PRopósito, and they are the recipients of funds under the Workforce Innovation and Opportunity Act (WIOA), the Oversight Board has agreed to make DDEC the owner of this initiative. DDEC's vision is for Puerto Rico to become a top 10 state/territory for 21st Century talent by generating about 50,000 additional skilled workers over the next 10 years. To

51 Future Workplace and Wiley Education Services, "Closing the Skills Gap," 2019

achieve this vision, DDEC has identified the following five key initiatives to launch and begin delivering impact:

- **PR 21st Century Skills Stacked Credentials:** developing a common, aligned framework fully adopted by employers and educational institutions to ensure the roughly 45% of students who only gain partial college credits have a recognized credential
- **PR 21st Century Talent Accelerator (Skilling Platform):** building a cadre of 'digital athletes' via immersive skill building in project-based, short-form programs with deep employer integration
- **12 Career Connection Lighthouses:** driving earlier exposure and awareness to 21st century skills and career paths
- **Scaling 21st Century Credentials (with existing providers and employers):** unlocking the expansion of proven models through capacity-building grants
- **PR QuickStart:** providing a one-stop shop to deliver talent pipeline and upskilling/reskilling solutions to employers

To ensure success, clear targets have been identified for each initiative that includes robust strategic oversight, program management and executional support, Teams/partners to build, launch and begin to scale on both PR 21st Century Skilling Platform and PR QuickStart, Resources driving rigorous grant lifecycle support from design to dissemination to selection to compliance and impact tracking. To support these efforts, DDEC must establish an engagement mechanism with stakeholders (e.g., a private sector taskforce), publish the results of initiatives, create, and put in place a regular monitoring and evaluation process.

5.3.7 Ease of doing business reform

The last issued World Bank report in 2020 rated Puerto Rico the 65th most business-friendly economy.[52] **By comparison, the U.S. mainland ranked 6th in that same year.** While future publications of the Doing Business report were suspended due to data irregularities, the metrics are still relevant to track business friendliness. Puerto Rico's lowest rankings are in construction permitting, property registration, electricity, and the ease of paying taxes (for more information, please refer to the 2022 Fiscal Plan). Given heightened levels of competition in the global marketplace, Puerto Rico needs to further address the needs of the Puerto Rico business community and urgently improve its business friendliness through implementation of ease of doing business reforms to support economic growth.

Empirical studies (cited in the 2022 Fiscal Plan) have shown that, because of business environment reforms, countries have seen increases in firm creation, business activity, investment, and economic growth, after controlling for other relevant variables, such as overall governance and macroeconomic conditions.

The Government can improve the conditions for growth and opportunity by taking concrete action to:

- Improve the availability, cost, and reliability of electricity

52 The World Bank suspended the publication of future reports due to irregularities found in the data in the Doing Business 2018 and 2020 reports. Nevertheless, the data and benchmarking contained in the last published report continues to be a good resource to compare Puerto Rico's doing business regulatory environment to best-in-class economies and top reformers.

- Streamline approvals and make permits more easily accessible to enable business activity and public safety
- Overhaul property registration to facilitate financial transactions and promote disaster-preparedness
- Simplify paying taxes to spur economic activity
- Reduce occupational licensing requirements to facilitate labor force participation
- Minimize the negative effect of inefficient on-Island freight regulations
- Strengthen offshore investment attraction efforts
- Prime tourism attraction efforts for success

There has been some progress in improving important elements of the business climate, including:

- **Reducing the amount of time required to register a property**. Department of Justice – Public Registry (DOJ-PR) has consolidated 29 sections into 12 offices as of September 2022 and is expected to consolidate down to 9 offices by the end of 2023. The digitization efforts for property registrations may also have boosted productivity at the DOJ-PR by roughly 2%, enabling the registry to process 4,500 more applications than it receives per month.[53]
- **Increasing investment attraction**. Invest Puerto Rico (IPR) exceeded some of its internal targets in FY2022 related to new leads, new businesses, new investment committed, and average payroll. IPR has also identified areas of growth and targets for the FY2023 in its IPR Strategy and Workplan, including 2,000 qualified prospect opportunities, $320 million in new investment committed, and $45,000 on average payroll.
- **Encouraging strategic development projects**. The Naval Station Roosevelt Roads (NSRR), located in eastern Puerto Rico in the municipality of Ceiba, was closed on March 31, 2004, as part of the Base Realignment and Closure (BRAC) process. Like many other former military installations, NSRR can be redeveloped into a multi-purpose destination with housing, retail, educational institutions, and recreational opportunities. Projects include a magnet secondary residential high school, a commercial beach and marina, several businesses related to eco-tourism, a multi-tenant shipyard facility and a ship dismantling and materials recovery operation. Additionally, PR Conservation Trust signed a contract to establish a visitor center at NSRR and a research and education center in the natural and social sciences which would also include archeological excursions, an information center, an incubator for community enterprises, and an archaeological repository. Most recently in 2020, the LoopLand Hotel broke ground at Roosevelt Roads, making it the first hotel on the property.
- **Growing the tourism sector**. According to third-party travel data, Puerto Rico was moving the needle of growth in this sector before the onset of the COVID-19 pandemic, and it has had a strong recovery since. In 2022, approximately $8.9 billion in revenue was generated by travel and tourism in Puerto Rico, representing a 39% increase over the previous high in 2019. Puerto Rico also reported peaks in incoming travelers and a record level of local tourism employees. One

53 Puerto Rico Department of Justice-Property Registry, performance data shared with Oversight Board, 2019; The World Bank Group, “Ease of Doing Business Report 2020”, 2019.

market insights and research firm with a focus on travel and tourism found that likelihood of visiting Puerto Rico in the next 12 months has grown to 22%, as of late 2022.[54]

There is significantly more work to be done to accelerate progress on improving ease of doing business and improve growth and opportunity. Building on initial efforts, the Government will need to redouble its efforts to meaningfully move the needle on key ease of doing business processes. Specifically, the Government must focus on:

- **Streamlining the permits and approvals processes**. Adopting a Joint Regulation will reduce regulatory uncertainty and provide a common set of rules for agencies to move forward. Successful adoption of a new regulation will require considerable effort on the part of multiple agencies. The Puerto Rico Planning Board (PRPB) must continue to engage in close communication with these agencies to monitor the progress and quickly resolve roadblocks to implementation of the regulations. To improve efficiency in permitting processes and reduce bottlenecks in the system, roles and responsibilities need to be rebalanced among OGPe and other entities. The Government should implement training programs, enhanced processes for internal communications, and a tool for centralized knowledge sharing to ensure standard procedures are implemented and followed throughout various permitting offices. Also, PRPB should coordinate with municipalities to complete territorial planning, including updating existing plans, since not having territorial plans up to date can cause significant delays in the permitting process. In addition, the Government must simplify the overall permitting process, establishing thresholds for smaller, less complex projects with reduced application requirements. Finally, the Single Business Portal (SBP) should also be overhauled to have expanded capacity to handle more users and provide a better customer interface.
- **Accelerating Invest Puerto Rico's implementation of its strategic plan to compete with U.S. mainland states and other economies for investments that arise as companies move to shift their supply chains to the U.S. to minimize risk**. IPR should also continue to partner with DDEC to implement a strategic plan to promote Puerto Rico as a cold-chain sensitive materials logistics center. Puerto Rico's historical strength in the pharmaceutical manufacturing industry and the established concentration of companies and accompanying infrastructure make it an ideal regional hub for products that require true end-to-end refrigeration.
- **Maximizing federal funds available to boost the tourism sector**. In FY2023, Discover Puerto Rico (DPR) has a plan to optimize its core budget that comes as part of contract with the Puerto Rico Tourism Company (PRTC) to cover 25 destinations in the east of the U.S. and leveraging ARP funds to cover the Midwest and invest in 6-7 international destinations. The overall return on investment (ROI) for 2022 was $54 million in influenced visitor spending for every $1 of the Destination Marketing Organization's (DMO) nearly $65 million budget for the year. The ARP funds generated an additional $375 million in influenced visitor spending in new markets to DPR. The ROI for these new markets was $16 dollars for every $1 dollar invested. DPR's American Rescue Plan (ARP) Investment Strategy includes a description of how funds will be used to achieve strategic priorities.[55]

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54 PR Newswire, "Puerto Rico Reflects on 2022 as Strongest Year in Tourism History, this National Plan for Vacation Day," 2023.

55 American Rescue Plan Investment Strategy developed by DPR.

- **Fully deploying FEMA grants set to expire in 2024**. The $2.3 billion FEMA Hazard Mitigation grant funds include resources that have been critical to staffing and equipping a properly sized and functioning permitting office. These funds have been used to hire staff, purchase technology, and provide training to support the permitting activity, all of which provide the critical foundation to support the economic development efforts of the Commonwealth. Although there has been significant progress made on satisfying the requirements of the FEMA Hazard Mitigation Grant program, additional work in streamlining the processes remains. For instance, 73% of additional personnel have been hired, but only $30 million of the $144 million grant resources associated with the permitting efforts have been spent. The grant program is set to expire as of January 2024, and PRPB is planning to apply for an extension of the grant in June 2023. Furthermore, the grant program is designed so that the Commonwealth cost share obligation increases annually. In past years, this amount was relatively small and was covered by the agency's expenditures on existing personnel. As expenditures from the grant program continue, the cost share obligation will increase substantially. Currently, the agency has not been successful in identifying a source of funds to cover the cost share obligation. The Oversight Board will continue to work with PRPB to implement initiatives to streamline the permitting processes, improve the user-interface of the SBP, and develop consistent training and documentation materials with the aim of reducing processing time and errors. The Oversight Board will also continue to work with PRPB to develop a sustainable staffing level which is able to process permits according to the statutory mandates and to identify funds to satisfy the cost share obligation.
- **Reducing occupational licensing to facilitate labor force participation**. At least 129 professions are licensed by autonomous boards and supervised mainly by the Department of Health (DOH), the Department of State (DOS), the Puerto Rico Tourism Company (PRTC), the Sports and Recreation Department (DRD, by its Spanish acronym), and eleven other agencies. Workers must meet application requirements set by licensing boards. Applications are then processed by their respective boards and issued by DOH, DOS, PRTC, and DRD. Processing times vary substantially and can range anywhere from 30 days to 3 years. While there has been some analysis done to identify the occupational licenses and their requirement and processes in the Commonwealth vs. other states, further analysis should be done to assess the need for these licenses in Puerto Rico given the low extent of licensing in the mainland U.S. and to ensure adherence to requirements which provide consumer, health, and safety protections. The relevant government agencies such as DOS, DOH, PRTC, and others could consider partnering with organizations such as UPR, the Institute of Economic Liberty of PR (Instituto de Libertad Economical or ILE in Spanish) and others to leverage deep knowledge, experience, and eagerness to drive change on this reform.
- **Deregulating on-Island freight**. Puerto Rico is one of only two major U.S. jurisdictions that still regulates land freight prices. The cargo industry has sufficient providers to be able to compete on prices. Regulated freights in other jurisdictions in the past have reportedly decreased the quality of services rendered by carriers and shippers and forced companies to hold additional inventory, all of which have contributed to the increased cost of doing business in Puerto Rico.[56] Tariff rates in Puerto Rico are also more than 2.5 times that of market rates in most states. Higher transportation costs negatively impact businesses and lead to more expensive consumer goods relative to the mainland. The interpretation by the Transportation and Other Public Services

56 Advantage Business Consulting, "Progress Report on Deregulation of Land Freight Rates," 2016

Bureau (NTSP by its Spanish acronym) of the most recently approved regulation on land freight prices extended its applicability to private contracts (while previously only applicable to spot contracts). Even though said regulation on land freight prices was not approved by the Oversight Board, the NTSP is operating in accordance with its provisions as per an agreement with the Government. Such agreement was expected to be valid a period not to exceed 18 months. During this period the NTSP was to develop a new regulatory framework compliant with the Certified Fiscal Plan for the cargo industry. Upon expiration of said agreement, the Government should retract the extension of the tariff setting function of the NTSP to private contracts. Future NTSP economic studies also include a simulation on the economic impact on any tariff increase on consumer prices, economic growth, and tax collections. Moreover, the regulations should be reviewed to ensure they do not place oversized burdens on the trucking industry.

- **Continuously engaging with and getting feedback from stakeholders**. DDEC organized the Red Tape Commission (Comite Timon) which is comprised of private and public sector stakeholders involved in the permitting process, including OGPe, PRPB, DRNA, Health, Bomberos, Tourism, LUMA, and several others. The purpose of the monthly meetings is to exchange information and ideas with the goal of identifying opportunities to streamline required documents while at the same time protecting the health and safety of the residents and the environment. This group provides a forum to introduce and develop initiatives designed to improve the permitting process on the Island. The Oversight Board recommends regular meetings of the Comite Timon. These meetings should be focused on providing solutions that impact processes for the Single Permit (PU) and the Consolidated Construction Permit (PCOC) which are the most common permit applications and will have the most significant impact on supporting economic development activities. The Oversight Board has engaged with this group and will continue to do so in the future to support their initiatives.

5.4 Medicaid Reform

As of January 2023, an estimated 39% of Puerto Rico's population receive their health coverage through the Commonwealth's state-run Medicaid Program ("Plan Vital", formerly known as "Mi Salud"). The percent of residents receiving benefits via Plan Vital increases to 48% when considering the addition of dual-eligible enrollees who are also in one of the Medicare Advantage programs (Platinos). This share of the population enrolled in Medicaid/CHIP-funded health insurance exceeds that of any U.S. state.[57]

Two separate agencies are responsible for the administration and provision of Plan Vital. The Department of Health is the state agency responsible for the administration of Medicaid, via the Puerto Rico Medicaid Program (PRMP). PRMP oversees enrollment and eligibility processes, and it also operates the Medicaid Management Information System (MMIS). Meanwhile, the Puerto Rico Health Insurance Administration (ASES, by its Spanish acronym) is responsible for negotiating, managing, and implementing the provisioning of Medicaid benefits, primarily through contracts with private managed care organizations (MCOs), pharmacy benefit managers (PBMs), and other health services organizations.

Plan Vital consists of four primary eligibility groups: federally-qualified Medicaid recipients; expanded federally-qualified Medicaid recipients; Children's Health Insurance Program (CHIP); and the Commonwealth's self-funded health insurance program, which covers (a) low-income adults who

57 Kaiser Family Foundation, "Medicaid State Fact Sheets: Percent of People Covered by Medicaid/CHIP", 2019

do not qualify for federal programs but qualify under the eligibility criteria established by the local government as well as (b) certain Commonwealth employees and retirees.[58] The first three programs are eligible for federal matching at varying rates, known as the federal medical assistance percentage (FMAP). The Vital program also covers dual-eligible enrollees, which are those who meet the eligibility standards for both federal Medicaid and Medicare. For those dual-eligible who are enrolled in Medicare Advantage plans, the Commonwealth provides an additional "wrap-around" payment.

Because federal-matching funds for Medicaid in U.S. territories are subject to an annual allotment cap, the federal portion of the Vital program revenues functions more like a block grant than a traditional Medicaid reimbursement system. Given the federal funding increases provided in the 2023 Consolidated Appropriations Act, the 2023 Fiscal Plan projects that Puerto Rico will have $3.7 billion federal funds available during FY2023, including traditional Medicaid (non-CHIP), Enhanced Allotment Plan (EAP), and CHIP funds. Even though Puerto Rico has received an increase to the inflow of federal funds, due to the significant portion of the population reliant on Medicaid for health care, it is important that the Commonwealth always be prepared to fund these services in the event that federal legislators reduce the Commonwealth's appropriations of federal Medicaid funds in future years. It is therefore crucial for ASES to put in place required reforms to reduce the long-term growth rate of health care expenditures.

The Fiscal Plan provides investments in Medicaid to address the significant strain in the health care system stemming from hurricanes, earthquakes, and the COVID-19 pandemic. These events amplified provider shortages and created increases in demand for health services, particularly behavioral health care. Given these turbulent circumstances the 2020 and 2021 Fiscal Plans included incremental investments in the health system. Such investments were made possible through additional federal funding made available through legislation such as the 2020 Further Consolidated Appropriations Act and were further supported by the FFY2022 and FFY2023 allotments. These investments included providing Hepatitis C drug coverage, increasing reimbursement rates to specialty and primary care providers and hospitals, and expanding coverage of the Medicaid Program to more than 200,000 local residents by increasing Puerto Rico's Poverty Level, which is the key determinant of Medicaid eligibility.

To ensure the system can continue to support the vulnerable populations who rely on its services, Puerto Rico will need to improve the efficiency and effectiveness of its public health insurance plan by "bending the health care cost curve" on premium inflation, which is reflective of escalating expenditures on health care delivery. There are several categories of actions the Government can take to both curb the growth rate in per capita health care expenditure as well as shift the overall public health system toward higher-value care. None of these actions should result in reduction in service quality for beneficiaries and savings derived from the implementation of Medicaid reform measures can be reinvested back into Puerto Rico's Medicaid Program.

Program integrity initiatives help to ensure that eligibility decisions are made correctly, prospective and enrolled providers meet federal and state participation requirements, services provided to enrollees are medically necessary and appropriate, and provider payments are made in the correct amount and for appropriate services.[59] Puerto Rico has taken meaningful steps towards improving program integrity. These include the integration of ASES data with the MMIS. In FY2021, the Centers for Medicare & Medicaid (CMS) approved the certification of Phase 2 of Puerto Rico's MMIS. On November 1, 2022, the PRMP kicked off Phase 3 of the implementation (to be completed by January

58 As it relates to (b) of the wholly Commonwealth-funded enrollees, Plan Vital coverage for currently retired police offices and active police officers upon their expected retirement was added beginning in FY2022.

59 MACPAC, "Program integrity," 2018

2024), which will set up the financial module of the MMIS and develop the processes necessary to calculate provider payments.

Typical fraud, waste, and abuse reduction programs in other state Medicaid programs and health insurers have been able to achieve 1-3% cost savings. These savings have been reached through (i) pre-payment review (e.g., reviewing claims before payment to identify outliers / issues); (ii) auditing and enforcement units to investigate suspicious behavior; (iii) advanced analytics capabilities to identify inefficient or fraudulent activities in post-payment review, such as identification of "impossible" utilization (e.g., billing for over 24 hours of service in one day) or frequently repeated, high value procedures; and (iv) long-term policy or organizational transformation. Pursuant to federal requirements, ASES has established a contracting reform plan to improve procurement and contracting prices, as well as combat fraudulent, wasteful, and abusive contracts. ASES should begin implementing fraud, waste, and abuse reduction programs, with a goal of achieving 3% cost savings from these programs by FY2025.

In addition, it is imperative for Medicaid programs to deploy robust enrollment verification to ensure that coverage is offered only to eligible individuals. In December 2020, the Office of the Inspector General at the U.S. Department of Health, and Human Services (HHS-OIG) performed a Risk Assessment of Puerto Rico's Medicaid Program and identified the beneficiary eligibility process as a high-risk area. Specifically, the HHS-OIG noted weaknesses related to Puerto Rico's post-eligibility determination process for validating beneficiary eligibility. Outdated, missing, or inaccurate beneficiary eligibility information may limit the effectiveness of the eligibility validation process and increase the risk that ineligible applicants will be enrolled in the Puerto Rico Medicaid Program.[60] Full compliance with Medicaid Eligibility Quality Control (MEQC) requirements and establishment of an asset verification system that utilizes third-party data sources can strengthen enrollment verification.[61] The PRMP must finalize establishment of a robust enrollment verification program in FY2023, with a target of identifying a significant proportion of ineligible beneficiaries (estimated to be roughly 5% of total enrollees) by FY2025.

To further support program integrity, ASES must hire a chief financial officer to accurately and efficiently track cash flow and financial planning, analyze the Medicaid Program's financial health, and develop robust budget to actuals reports to identify and prevent potential cost overruns.

Under value-based care initiatives, providers are reimbursed based on their ability to improve quality of care in a cost-effective manner or to lower costs while maintaining standards of care, rather than on the volume of care they provide.[62] Pursuing value-based improvement initiatives with demonstrated success is required to help the Commonwealth "bend the curve" on health care inflation without jeopardizing outcomes. There are several potential sources of value in Puerto Rico's health care system. These sources of value are opportunities to reduce wasteful health care spending and increase efficiency while improving quality of care and health outcomes. By implementing value-based reforms beginning in FY2023, ASES should aim to achieve 3% in annual cost savings from these reforms by FY2025.

Examples of best practice for value-based payment models include implementing a Diagnosis Related Group (DRG)-based payment model where providers are reimbursed a fixed amount to fully treat a patient with a given medical condition. These models help control medical costs by incentivizing providers to deliver cost-effective care without sacrificing quality, while also improving the effectiveness of Medicaid service delivery by standardizing the measurement of patient acuity across

60 HHS, "Risk Assessment of Puerto Rico Medicaid Program, A-02-20-01011," 2020

61 GAO, "Medicaid Eligibility: Accuracy of Determinations and Efforts to Recoup Federal Funds Due to Errors," 2020

62 CMS, "CMS Issues New Roadmap for States to Accelerate Adoption of Value-Based Care to Improve Quality of Care for Medicaid Beneficiaries," 2020

providers and reducing the administrative burden associated with reimbursement. Another potential source of value lies in reducing emergency room (ER) visits. Successfully shifting unnecessary ER visits to lower-cost settings, such as primary care offices or urgent care, could save tens of millions of dollars annually.

New approaches that emphasize care coordination and align incentives between patients, providers, and payors can produce improvements in health outcomes while lowering costs. Direct pay-for-performance quality bonuses provide special incentives to care for members with high-cost needs like behavioral health. Care coordination models like patient-centered medical homes have been quite effective at improving outcomes for members with chronic conditions by empowering primary care providers to work closely with patients and manage treatment plans across multiple care providers.[63] Given the preponderance of chronic conditions and potential rising behavioral and mental health needs in the wake of recent natural disasters and the pandemic, better access and coordination of care for multiple comorbidities across populations will become increasingly important.[64]

Additional opportunity exists through reduction of both inpatient length of stay and hospital readmissions. Puerto Rico's inpatient length of stay was 1.5 times the U.S. average in 2014,[65] and 35 out of 41 Puerto Rico hospitals show readmission rates above the U.S. average of 15.3%.[66] Hospital readmissions occur when patients are discharged from hospitals but must return for additional treatment for the same condition. This can occur when patients are not adequately prepared to return home due to lack of education, lack of access to follow-up care, or challenges with prescription drugs, among other factors. MCOs can incentivize both reduced hospital readmissions and shorter length of stay through improved discharge planning, as well as by increasing weekend staffing to manage discharges. Similar value-based programs piloted in mainland states have typically saved 2-10% of costs. In Puerto Rico, value-based reforms may result in lower-than-average savings due to the breadth of other simultaneous savings measures being implemented for Vital. Nevertheless, these structural changes to reimbursement and care delivery present the most viable path to long-term sustainability for the program.

For detailed description of the Medicaid reform, implementation plans, and progress to date, please refer to Volume 3.

63 Patient-Centered Primary Care Collaborative, "Benefits of Implementing the Primary Care Medical Home: A Review of Cost & Quality Results," 2012

64 Thomas Huelskoetter (Center for American Progress), "Hurricane Katrina's Health Care Legacy," 2015

65 Estimates exclude Platino beneficiaries; see JEL Consulting, analysis of ASES data and public use microdata from the Puerto Rico Community Survey (as of 2014), 2016

66 V2A Consulting, "The disparity in hospital quality metrics between Puerto Rico and the U.S.," 2019

Working together to find solutions and stakeholder engagement

2023 Commonwealth Fiscal Plan pursuant to PROMESA Section 201

6 Working together to find solutions

As outlined above, the Oversight Board and the Government have a robust agenda of initiatives identified in prior fiscal plans designed to set the stage for fiscal stability and economic growth. The needs are clear, project teams have been created, and implementation is being actively monitored.

At the same time, there are a handful of outstanding issues that are holding back progress and there is no consensus on how to proceed. The Oversight Board has exercised its responsibility to make sure that fiscally sound decisions are made but continues to explore more comprehensive discussions to engage and build consensus with stakeholders on potential solutions for improving outcomes in the following critical areas:

- University of Puerto Rico
- Municipalities
- Tax system
- Title V infrastructure projects

6.1 University of Puerto Rico

The University of Puerto Rico (UPR), founded in 1903, is Puerto Rico's largest and main university system. Its mission is to serve the people of Puerto Rico, contribute to the development and enjoyment of the fundamental values of Puerto Rican culture, and uphold the ideals of a democratic society. UPR has a history of academic excellence and is an important center of research. UPR plays a critical role in providing avenues for social and economic advancement, with Pell Grants covering about 70% of total undergraduate tuition and fees.[67]

The central Government provides a range of appropriations, including to the UPR. In FY2022, UPR was 52% subsidized (roughly $466 million in annual appropriations) by state and local funds, compared to an average 21% state and local subsidization for U.S. public universities.[68] In FY2018, UPR's undergraduate tuition was less than one-third of the U.S. average for public universities, even after adjusting for per-capita income, and more than 40% below the average tuition of private universities in Puerto Rico.[69]

UPR has shown areas of progress and success, such as diversifying its sources of revenue in part by adjusting tuition cost while increasing need-based scholarship expenditure. UPR has also continued to advance its investment in the field of engineering, particularly at the Mayagüez campus. The university has successfully provided students with sought-after technical skills training in STEM ("Science, Technology, Engineering, and Mathematics") fields, as well as the opportunity to engage in research and academic exchanges with industry leaders and peers from other countries positioning the university as a leader in STEM education, both on and off the island of Puerto Rico.

However, UPR has suffered significant setbacks in its academic reputation and standing due to probationary status and in some cases losses of accreditations particularly those in the medical science area. These accreditation bodies repeatedly highlighted a lack of financial planning, identifying and prioritizing needs to effectively appropriate available resources, and having a well-

67 Data from UPR FY2021 Certified Fiscal Plan

68 Data gathered from UPR, IPEDs 2020, and the College Board

69 Represents the average reported in IPEDS across the Ana G. Mendez University system, Inter-American University, Sacred Heart University, and Polytechnic University for SY20-21

defined decision-making process as potentially impacting the system's performance, including student enrollment, student academic performance, research funding and output, infrastructure, faculty composition and labor relations.

The university must take a holistic and proactive approach to address the challenges it faces and invest in strategic initiatives to improve its academic reputation and standing with the understanding that responding to the workforce needs and adapting to technological change, globalization, and important demographic changes is critical to their role in supporting Puerto Rico's economy. The UPR, as a stakeholder, should actively participate and contribute to the activities related to the 21st Century Fund currently led by the DDEC.

To bring UPR closer to U.S. mainland public university tuition and administrative cost benchmarks, UPR appropriations were reduced beginning in 2017 through a collaborative process with the Government to identify reasonable and sustainable efficiency measures, while maintaining (and in many cases improving) the performance of the system. Previous Fiscal Plans provided for Commonwealth appropriations to UPR totaling approximately $442 million by FY2023 (growing with inflation starting FY2024). However, reflecting the approval of Act 53-2021, the 2022 Fiscal Plan increased the UPR appropriation to a constant $500 million annually, starting in FY2023 through FY2027.

While these prudent measures are necessary given the financial pressures on both UPR and the Commonwealth, there has been little consensus on a longer-term economic model that will allow UPR to embrace its role at the center of Puerto Rico's economic growth agenda. The Oversight Board will redouble its efforts to engage with a wide range of UPR stakeholders, along with higher education and economic development leaders in pursuit of options for how to move forward. Through open and transparent consultation, the Oversight Board will strive for a common understanding of the facts and challenges, and ideally, agreement on a vision and plan that can be implemented to anchor the UPR in its vital role to the economic prosperity of the Island.

6.2 Municipal services reform

Similar to the central government, in recent years, Puerto Rico's 78 municipalities have confronted significant fiscal and economic challenges. To respond to this fiscal reality and to incentivize a new operating model between the central and municipal governments, starting in 2015, the Commonwealth government proposed the reduction of certain Commonwealth financial transfers to the municipalities. The Oversight Board subsequently adopted the Central Government's proposal to reduce these financial transfers in the certified fiscal plans.

It is well known, however, that Puerto Rico's municipalities are important providers of critical services to all citizens. In recognition of the important value provided by municipalities, over the past 3 years, the Oversight Board authorized and funded the establishment of multiple new appropriations and investments to offset the decline in intergovernmental transfers. This incremental funding includes, among other funds: the Act 53-2021 Extraordinary Waste Fund to share in POA debt savings, Medicaid relief from additional federal funding to the Commonwealth, $66 million of unutilized Municipal Consolidation Fund appropriations, Emergency Reserve support, school and road maintenance funding, and other one-time economic support.

Beyond those sources of alternate funding, municipalities are also in possession of significant federal funds to supplement their budgets in the near term. Taken together, the funding available to municipalities in the near-term is substantial, including: State Fiscal Recovery Funds, direct fiscal assistance through ARPA, additional COVID-19 emergency aid through the CARES Act, and access to the State Revolving Fund.

To date, despite multiple efforts designed to strengthen Puerto Rico's municipal structure, achieve fiscal discipline, implement critical reforms and boost economic growth, the desired progress to achieve improved outcomes has not been achieved. Municipalities must work with the Executive branch to analyze financial needs for each individual municipality and focus on the necessary enhancements in municipal shared services and other municipal and government initiatives, including: inventory tax reform, permitting reform, improvement in tax filing processes, and restructuring of municipal debt, in addition to initiatives proposed from mayors on broader financial reforms. Starting in FY2024, once established transformational measures and milestones related to these initiatives are achieved, additional funding from the Commonwealth may be made available to municipalities as part of ongoing collaboration to improve fiscal sustainability. The Oversight Board, the Commonwealth, and the municipalities must use the FY2024 budget certification process to agree on specific conditional funding amounts and operational milestones required for disbursement.

6.3 Tax reform

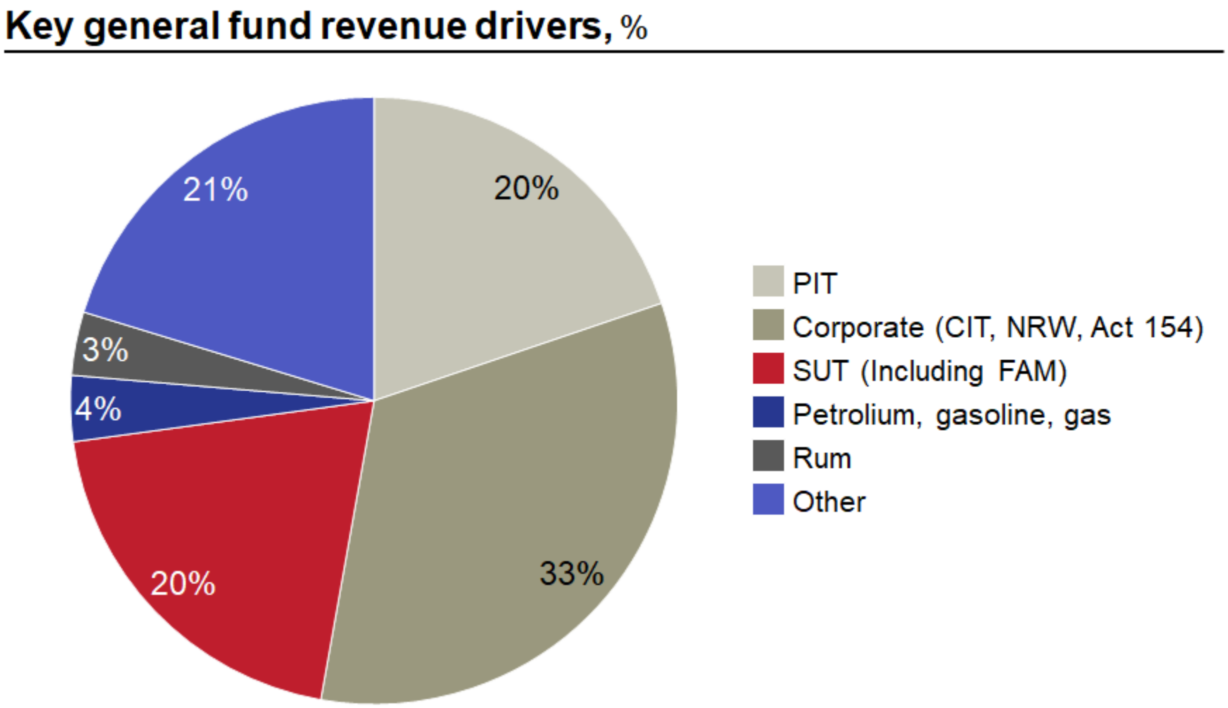
Over the past several years, Puerto Rico's government has improved Puerto Rico's tax system by changing information reporting requirements and improving the organization of tax information and forms, including the digitization of certain processes. Significant reform is still, however, required because Puerto Rico's current tax system has historically suffered from structural complexity, instability, internal inconsistency, inefficient administration, and inadequate enforcement. There have been at least 11 major revisions to Puerto Rico's tax code since 1994, including at least six adjustments since 2013.[70] As a result, the government must continue efforts to reduce the tax system's complexity, enhance equity, increase transparency, reduce tax administrative and compliance costs and maintain, if not enhance, revenue.

Effective revenue systems are based on taxes that generate sufficient revenue to fund needed public expenditures, are simple to administer, are transparent, are perceived as fair and equitable, and encourage economic efficiency and growth. Effective tax systems that have a broad base and low rates generally conform to these precepts. These tax systems generally avoid targeted tax incentives unless those incentives are supported by clearly demonstrated economic or social benefits. Furthermore, a broad base combined with low tax rates reduces the potential gain from tax evasion or avoidance. Promoting compliance is another central feature of properly designed revenue systems. An overly complex and poorly designed tax structure cannot be implemented effectively and, therefore, compliance and enforcement typically fall short. Beyond simplicity, perceptions of fairness are another important factor for promoting compliance and enforcement.

Because revenue can be raised from a variety of different sources, it is important that Puerto Rico's mix of tax sources be carefully considered so that government programs are not excessively reliant on sources that may be uncertain or volatile or to a degree which excessively distorts economic activity or taxpayer choices. This is particularly relevant because Puerto Rico's tax regime disproportionately relies on two tax sources, income taxes and sales and use taxes, which represented roughly 73% of General Fund revenue collections in FY2022.

70 Reforms include: Act 40-2013, the "Tax Burden Redistribution and Adjustment Act;" Act 120-2014, the "Small and Medium Business Job Generation and Retention Act;" Act 72-2015, the "Adjustments to the Internal Revenue Code of 2011;" Administrative Orders 2017-01 and 2017-05; and Act 257-2018, the "2018 Puerto Rico Tax Reform Act."

EXHIBIT 19: GENERAL FUND REVENUE DRIVERS



Source: Hacienda reports, FY2022 General Fund revenue collections

A comprehensive review of Puerto Rico's revenue structure must be completed as part of a tax reform process because Puerto Rico's income tax structure (for both individuals and corporations) is complex and opaque. Unlike the federal tax code, Puerto Rico's tax brackets are fixed and do not adjust for inflation. The tax code also includes numerous targeted deductions, exemptions, credits, and special rates that benefit narrow groups of taxpayers while potentially distorting the allocation of resources and reducing revenue available to fund needed public expenditures. These incentives are often privately issued and are not always disclosed publicly. At the same time businesses faced with paying statutory corporate income taxes face a relatively high tax burden, as Puerto Rico has not followed the global trend of reducing statutory corporate income tax rates over the last 20 years. Similarly, Puerto Rico's 11.5% Sales and Use Tax (SUT), is higher than the rate imposed by other U.S. jurisdictions, though there are multiple reductions and exemptions to the rate.

In addition to reviewing Puerto Rico's revenue structure, a detailed review of tax expenditures must also be considered because Puerto Rico issues more than 400+ tax incentives with total foregone revenue projected to exceed $23 billion in 2023. Any tax reform considered by the government should establish rates, credits, deductions, and other alterations to tax structures firmly in the tax code. It should also limit the use of negotiated rates or incentives. Tax incentives, moreover, should be evaluated based strictly on a return-on-investment criteria and those that that do not provide a significant positive return should be eliminated or reduced.

The Oversight Board has long advocated for a truly comprehensive tax reform that can contribute to Puerto Rico's competitiveness and contribute to economic growth. Having now exited the restructuring process, it is finally time to evaluate opportunities for broad-based, holistic tax reform. At the same time, any potential reform must be fiscally responsible, meaning it cannot lose revenues in the process. Therefore, any tax reform or tax law initiative that the Government undertakes or pursues during a year within the 2023 Fiscal Plan period must be revenue neutral. That is, all tax reductions must be accompanied by specific, offsetting revenue measures of at least the same amount that are identified in the enabling legislation. Each tax measure must also include confidence building elements, such as behavioral adjustments and reasonable capture rates. To ensure revenue neutrality, the implementation of any tax law initiative must occur sequentially, with the Government ensuring that initiatives are paid for before rates are reduced. Enforcement mechanisms that yield additional revenues must be part of any tax initiative package that results in a tax revenue decrease to prevent a scenario where tax reductions are not accompanied by sufficient offsetting revenue measures identified in the enabling legislation. Any potential tax reform should also be inextricably linked to the economic development strategy while preserving resources needed to fund essential services. The Oversight Board, Government, and Legislature have not yet been able to agree on far-reaching proposals that meet this criterion. Nevertheless, the Oversight Board is committed to pursuing fair and competitive solutions that can improve the tax climate for individuals and business while also maintaining fiscal stability.

When assessing comprehensive tax reform opportunities, there are several design features that can be explored in future discussions with the government. Reforms, for example, could be phased in over time, and could be designed such that progressive phases are only triggered if the performance of the reform is in line with expectations. This would provide local businesses with the certainty and stability they require to make long-term investments. Similarly, exemptions and tax incentives could be explored broadly to determine whether reductions could help to offset reductions in tax rates or the one-time recalibration of tax brackets. The Government could also evaluate ways in which digitization of economic activity impacts the nexus and identification of economic activity and impacts tax administration (valuation, audit, collection). There are numerous other design choices that could be explored to stimulate economic growth and make Puerto Rico more competitive. All of this can and should be done in the context of Puerto Rico's overall spending priorities. By evaluating the Government's spending needs now that there is more clarity on the resources required to cover the remaining debt and pension obligation, the ability to reshape and reform the tax system to contribute to making the Island more competitive will become clearer. The Oversight Board looks forward to engaging with the Government and a broad group of stakeholders to identify creative solutions that meet Puerto Rico's long-term needs.

6.4 Title V infrastructure projects

In order to accelerate growth and opportunity, there will need to be renewed focus on revitalizing Puerto Rico's infrastructure. Congress included Title V in PROMESA to facilitate and expedite private investment in infrastructure, Title V created the Revitalization Coordinator position to review private infrastructure projects for consideration as Critical Projects. Per the statute, if the Oversight Board agrees with the Revitalization Coordinator that a project is a Critical Project, it is entitled to expedited local permitting.

The Title V process has been under-utilized since the enactment for a variety of reasons. Recently, the Oversight Board has redoubled its efforts to expand use of this process for critical infrastructure and development investments. The Board hopes to use the Title V process more expansively to support critical energy and economic development projects. To ensure the Oversight Board is prepared to manage the renewed demand, the Board is currently in the process of hiring a full-time Revitalization Coordinator.

Conclusion

Conclusion

The 2023 Fiscal Plan is the result of six years of intensive working sessions, dialogue, stakeholder engagement, and hands on work to establish the conditions for economic recovery and growth for the benefit of residents of Puerto Rico. Across these activities, the Oversight Board and the Government have collaborated to create a deep and rich fact base to underpin their work and have remained focused on creating an integrated approach to restoring fiscal sustainability and economic opportunity for future generations of residents.

Puerto Rico must entrench a legacy of strong fiscal management to prevent a recurrence of past challenges and secure a stable base for future prosperity. To do so, it must prioritize implementing the Financial Management Agenda, while also tracking federal fund spending, strengthening tax revenue collection, and encouraging the efficient use of public resources. The Government must take advantage of this unique time following bankruptcy to build key fiscal controls and a general financial prudence into its fiscal policy. This foundation of proper fiscal management is crucial to ensuring that any initiative outlined in this plan will have a sustained, long-term impact.

Puerto Rico must instill a culture of public-sector excellence to improve the delivery and efficacy of government services. The 2023 Fiscal Plan includes investments aimed at improving the operational capacity of the government, cultivating a high-performing public workforce, enhancing frontline services, improving healthcare, and fulfilling public pensions. However, the cornerstone of this cultural change is the continuation and expansion of the CSR, which empowers civil servants by strengthening their skills, performance management, and offering more attractive incentives for hiring.

In addition, Puerto Rico must establish conditions for economic prosperity to improve the livelihood of residents and cultivate an environment conducive to economic development. Although COVID-19 federal relief and disaster relief-related spending will provide economic buoyancy in the coming years, the fiscal and economic turnaround of Puerto Rico cannot be accomplished without the implementation of structural economic reforms and other initiatives that promote sustainable economic development. Specifically, it must prioritize power sector reforms, education reforms and support, ease of doing business reforms, transportation reforms, and technology reforms. The 2023 Fiscal Plan lays out a series of practical and proven growth-oriented structural reforms and investments, which, when coupled with the federal funds, can restore long-term opportunity to the people of Puerto Rico.

The Government has the unique and historic opportunity to capitalize on substantial federal funding support without the blanket of bankruptcy-related uncertainty to transform the future of Puerto Rico. Focusing on the proposed three pillars of entrenching a legacy of strong fiscal management, establishing conditions for economic prosperity, and instilling a culture of public-sector excellence will make enduring change possible for the everyday residents of Puerto Rico. **The Oversight Board stands ready to work in partnership with the Government to fulfill the detailed action steps outlined in this Fiscal Plan and achieve long-term financial success.**

Since certifying the first Fiscal Plan in 2017, and notwithstanding multiple natural disasters and the global pandemic, the Oversight Board has worked with the Government to create the conditions for long term fiscal stability and economic growth. This has resulted in the ability of the Government to increase expenditures in times of crisis and uncertainty, while ensuring total expenditure levels remain within total available revenues. There is a new level of transparency and control over government spending, including controls over the reapportionment of funding between concepts of spend to eliminate the defunding of accrued liabilities and d regular reporting on revenues and expenses. Moreover, the Fiscal Year FY2020-2023 budgets were built at a granular “concept code” level (e.g., differentiating between spend on professional IT services versus advisory services). The Oversight Board has exercised authority over government contracts to avoid overspending, and the Government has been held accountable to its implementation requirements via public hearings, such as those held on education, public safety, corrections, and economic development.

The Oversight Board is working diligently to complete its statutory obligations under PROMESA and meet the criteria for termination and devolution of its responsibilities to the Government of Puerto Rico. While the Plan of Adjustment and end of the Commonwealth’s bankruptcy proceeding is a significant enabling milestone, significant work remains to meet other criteria under the law, including four consecutive fiscal years of balanced budgets and restoration of adequate access to credit markets at reasonable interest rates. The Oversight Board is working diligently with the Government to take the steps necessary to achieve these milestones in the years ahead and conclude its responsibilities on behalf of the people of Puerto Rico.