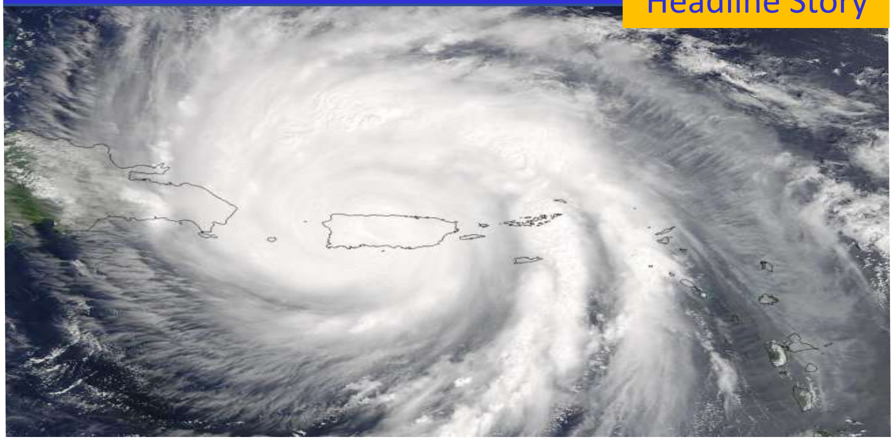
Puerto Rico: Two Years After Hurricane María

Headline Story



FEMA considering extending Puerto Rico's deadline for Project Estimates

Puerto Rico's FOMB to approve Plan of Adjustment for about $19 billion of central government bonds

Government's Tax Revenue exceeds projections, reaching $1.05 Billion in July

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Puerto Rico's challenges in the Second Anniversary of María

Two years ago, in September of 2017, Hurricane María caused extensive damage throughout Puerto Rico. Hurricane María, a Category 4 hurricane, with 140 MPH winds and major flooding was the most intense hurricane to make landfall in Puerto Rico since 1928, causing major destruction in the U.S. territory, affecting power and communications lines, and affecting the already crippled infrastructure in the island, among other things.

Even before Hurricane María, the territory was in a dire financial position, with a bankrupt government and with $70 billion in debt. The local government estimates that around $132 billion will be needed to repair and rebuild the island's infrastructure and to restore services.

The Federal Emergency Management Agency ("FEMA") is the lead federal agency responsible for assisting Puerto Rico in the recovery process. FEMA administers the Public Assistance program in partnership with the government of Puerto Rico to provide funds to rebuild damaged infrastructure and restore critically-needed services. FEMA obligated almost $4 billion in Public Assistance grant funding, about $3.63 billion for emergency work such as debris removal and generators, and about $151 million for permanent work to repair and replace public infrastructure.

Congress has provided over $35 billion in supplemental appropriations to the Department of Housing and Urban Development ("HUD") for Community Development Block Grant Disaster Recovery ("CDBG-DR") funds to help affected communities recover, of which HUD has awarded approximately $19.9 billion to Puerto Rico.

Communities are allowed to use their CDBG-DR grants to address a wide range of unmet recovery needs such as, losses not met with insurance or other forms of assistance, including federal disaster assistance, related to housing, infrastructure, and economic revitalization.

Two years after María, an estimated 30,000 people don't have permanent roofs, and still have blue tarps provided by FEMA over their houses. Washed-out roads, particularly in the central part of the island, still need extensive repair and the island's electrical grid is still vulnerable to a storm or a hurricane.

There have been many challenges with FEMA's Public Assistance program, including concerns about FEMA staff turnover and lack of knowledge about how the alternative procedures are to be applied in Puerto Rico There are also concerns with the municipalities not been fully reimbursed for work already completed in the immediate aftermath of the hurricane, causing financial hardship to the municipalities.

As for the CDBG-DR funds, just $1.5 billion of the almost $20 billion awarded to Puerto Rico has been made available. HUD's complicated regulations, combined with staffing shortages at the federal agency and local offices, has made it a challenge to release grant money.

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FEMA considering extending Puerto Rico's deadline for Project Estimates

Several state government agencies and municipalities have requested the Federal Emergency Management Agency ("FEMA") for an extension to the October 11 deadline to complete cost estimates for repairs and permanent work projects at hurricane-damaged properties in Puerto Rico.

FEMA has stated that around 50 thousand sites in Puerto Rico that were damaged by hurricanes Irma and María are being evaluated for repairs and permanent work projects as of August of this year. That number was around 90 thousand as of February, according to then-director of the Central Office of Recovery, Reconstruction and Resiliency ("COR3"), Omar Marrero. Of the 50 thousand damaged sited, around 30 thousand are owned by the state government or its dependencies, around 17 thousand are owned by municipalities, and around 3 thousand belong to private non-profit entities.

The October 11 deadline for finalizing fixed-cost estimates in Puerto Rico was set as part of FEMA's alternative procedure for large-project funding under its Public Assistance program for permanent works. Section 428 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act ("Stafford Act"), authorizes FEMA to award public assistance funding based on fixed estimates.

Public Assistance program funds are categorized as either "emergency work" or "permanent work". Within those broad categories, there are separate sub-categories: (i) Category A: Debris Removal; (ii) Category B: Emergency Protective Measures; (iii) Category C: Roads and Bridges; (iv) Category D: Water Control Facilities; (v) Category E: Buildings and Equipment; (vi) Category F: Utilities; (vii) Category G: Parks, recreational, and other; and (viii) Category Z: Managements Costs, which represents indirect costs, administrative expenses and other expenses a recipient or subrecipient incurs in administering and managing projects.

In Puerto Rico, the Public Assistance program is administered through a partnership between FEMA and the state government, which provides funding to eligible subrecipients. Unlike the standard Public Assistance program where FEMA will fund the actual cost of a project, the Public Assistance alternative procedures allow awards for permanent work projects to be made on the basis of fixed cost estimates to provide financial incentives for the timely and cost-

effective completion of work. The alternative procedures process has been used in 30 states but on a project-by-project basis. Puerto Rico is the first U.S. jurisdiction to use the alternative procedures process for all large permanent work projects resulting from a single catastrophic event.

FOMB to approve Plan of Adjustment for about $19 billion of government debt

The Puerto Rico Federal Oversight Management Board ("FOMB") will approve a plan of adjustment for Puerto Rico's central government debt, outlining the level of repayment for as much as $19 billion of central government bonds.

The U.S. territory of Puerto Rico entered bankruptcy in May of 2017 to restructure $120 billion of debt and pension obligations, $74 billion in bond debt and $49 billion in unfunded pension obligations, pursuant to Title III of the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA") allowing the territory and its covered instrumentalities to work with its creditors in a bankruptcy-like proceeding to adjust its debts. Certain sections of the United States Bankruptcy Code are incorporated and made applicable under Title III of PROMESA. It was the first time in history that a U.S. territory or state had taken the extraordinary measure.

In April of this year, the FOMB had signaled that it could file a plan of adjustment covering roughly $13 billion of general obligation debt and almost $50 billion of unfunded pension obligations. The FOMB also asked the Court to void more than $6 billion of general obligation ("GO") bonds issued in 2012 and 2014 and sued certain bondholders to recoup debt service payments and investment banks and firms that participated in debt issuances. Judge Swain ordered mediation that could extend into November over the validity of Puerto Rico's GOs and other bonds.

In June, the FOMB announced deals with some creditors over recovery rates for certain bonds and for a pension restructuring. Puerto Rico's government has won court approval for restructurings of debt from GDB and COFINA.

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Government's Tax Revenue Collections exceed projections

Puerto Rico Treasury Department's tax revenue for July of 2019 exceeded estimates and reached historical levels, according to Puerto Rico's Treasury Secretary, Francisco Parés.

General fund net income during July of 2019, the first month of Puerto Rico's government fiscal year 2020, totaled $1.05 billion, around $305.5 million or 41.2% more than on July of 2018, exceeding estimates by $159.9 million. The Treasury Secretary attributed July's record breaking revenue mostly to income tax collections resulting from economic activity by corporations. Corporations on the island paid $255.7 million in income taxes, nearly 3 times the $89.5 million paid during the same month last year. July's corporate income tax revenue exceeded projections by $101.9 million, or 66.3%.

Furthermore, Act 154's 4% excise tax that stateside companies pay on their purchases from Puerto Rico-based subsidiaries generated $383.4 million in July, a 53% increase compared with the $250.1 million collected on July of 2018, $35.9 million above what was projected. Individual income tax collections totaled $143.3 million in July, which represents $13 million or 10% more than in July of last year, exceeding estimates by $8 million.

Nevertheless, there were declines in other revenue categories such as the sales and use tax ("IVU", by its Spanish acronym), which totaled $91.6 million in July, a decrease of $10.8 million or 11%, compared to July of last year, $9 million below estimates. Treasury Secretary stated that starting in July 2019, the method used to record IVU payments was modified in light of the Sales Tax Financing Corp. ("COFINA", by its Spanish acronym) Plan of Adjustment. Under the new methodology, payments received will be recorded at the time the return is filed. Therefore, some payments made in July were reflected after August 20, the due date to file the monthly IVU return.

Motor vehicle excise tax collections also had a decrease when compared to the same period last year, with a decrease of $9.7 million., as well as excise tax collections on alcoholic beverages, which had a $1.7 million decline versus the same period last year. Motor vehicle excise tax collections and alcoholic beverages excise tax collections were however, $10.5 million above estimates, respectively.

Meanwhile, preliminary net revenues to the General Fund for the government fiscal year 2019 totaled $11.3 billion according to the Treasury Secretary, a new record number for revenue collections. On a year-over-year comparison, revenues increased by $2.06 billion or 22%. The Treasury Secretary predicted that the Treasury Department will once again meet revenue goals in the fiscal year 2020.