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Title: Puerto Rico Oversight Board includes arbitrary Act 154 assumptions in fiscal plan.

Authors: Tucker, Robert S.

Source: Bond Buyer. 12/5/2018, Vol. 390 Issue 35022, pN.PAG-N.PAG. 1p.

Document Type: Article

Abstract: The Oversight Board's pessimistic assumptions add unnecessary confusion and complexity to achieving consensual negotiations with the island's creditors. [ABSTRACT FROM AUTHOR]

ISSN: 0732-0469

Accession Number: 133391511

Database: Business Source Complete

Puerto Rico Oversight Board includes arbitrary Act 154 assumptions in fiscal plan

The Oversight Board's pessimistic assumptions add unnecessary confusion and complexity to achieving consensual negotiations with the island's creditors.

On Oct. 23, the Financial Oversight & Management Board for Puerto Rico certified another fiscal plan for Puerto Rico. In multiple critical areas, the Oversight Board set forth overly dire financial projections, ignoring historical norms and averages and using seemingly arbitrary figures. Instead of using the most probable assumptions based on actual past results, the Oversight Board relied on untested assumptions which in combination arrive at extremely low expected revenue numbers for its projections.

This outcome-driven approach towards aggressively conservative forecasts is presumably intended to ensure future outperformance against projections, while providing leverage for the government parties in debt negotiations. The real impact however, is to keep the island mired in litigation, with no foreseeable access to the capital markets which are necessary to fund infrastructure and support future economic growth.

In the plan, the Oversight Board did this most egregiously with Medicaid funding projections after fiscal year 2020, assuming a Medicaid "fiscal cliff" that drops from a current federal reimbursement level of over 80%, to 10% levels. (A link to a recent analysis of the Medicaid assumptions in the fiscal plan can be found here). The Oversight Board is employing similar logic to Act 154 excise taxes to forecast a steep decline in revenue. Act 154 excise taxes are paid by multinationals operating on the island and credited by the U.S.

Treasury against certain federal taxes.

Importantly, Act 154 collections for 2Q '18 and 3Q '18 were actually 6% and 10% *higher* year over year, notwithstanding the impact of Hurricane Maria and the passage of last year's tax cuts, which lowered corporate taxes on the mainland. Yet, the Oversight Board directly asserts without supporting evidence that Act 154 revenues will *decline* and in fact have, in their words, "proven to be less resilient than other types of revenues after the hurricane."

Such a statement is simply contradicted by actual post-hurricane collection data and certainly raises doubt about the validity of Oversight Board projections that Act 154 revenues will decline at an astounding 37% from fiscal year 2018 to fiscal year 2022. Furthermore, the fiscal plan offers no rationale for assuming precisely the same number, $1,199 million, for fiscal years 2022 and 2023.Here are the facts:

- The major multinationals operating on the island show no signs of imminent departure, and there has been no major breaking news of large multinationals announcing future plans to depart the island.

- Nevertheless, based on the slightest degree of uncertainty, the Oversight Board chooses to lower the financial projections from historically based levels to exaggerated, overly conservative scenarios, and projects a revenue decrease of $700 million for both Fiscal Years 2022 and 2023, when compared to Fiscal Year 2018.

- This is a poor basis for accurate planning, and if it is intended to support a negotiating strategy, its unreasonableness will result in its rejection.

The bottom line: Projections should be clearly based on supportable and objective study, careful analysis and reasonable assumptions.Puerto Rico remains an attractive place for multinational corporations to invest. The Oversight Board's pessimistic assumptions, like the unrealistically low estimates for Federal Medicaid reimbursements it projects, add unnecessary confusion and complexity to achieving consensual negotiations with the island's creditors.

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By Robert S. Tucker

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