



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
REGION 2
290 BROADWAY
NEW YORK, NY 10007-1866

JUN 22 2017

MEMORANDUM

SUBJECT: Response to the Office of Inspector General Draft Report No. 17-P-0186
"Over \$774 Million of Puerto Rico State Revolving Funds at Risk," dated April
26, 2017

FROM: Catherine McCabe *Catherine R. McCabe*
Acting Regional Administrator

TO: Arthur A. Elkins, Jr.
Inspector General

Thank you for the opportunity to respond to the issues and recommendation in the subject audit report. Following is a summary of Region 2's overall position, along with our position on the report recommendation. Region 2 agrees with the recommendation, and we have set forth high-level intended corrective actions and estimated completion dates. For your consideration, we have also included a more detailed summary of "Actions Already Taken and Next Steps" to supplement this response.

REGION 2'S OVERALL POSITION

Region 2 agrees with the OIG report and the importance of ensuring that critical Puerto Rico Aqueduct and Sewer Authority (PRASA) projects resume to achieve and/or maintain compliance with the requirements of the Clean Water and Safe Drinking Water Acts. These projects are critical in avoiding additional violations as well as serious threats to public health and the environment. Although we recognize the complexity and the numerous challenges the Government of Puerto Rico is facing, we are committed to finding an effective path forward to revitalize the Clean Water and Drinking Water State Revolving Fund (SRF) programs.

The Region has been working continuously with all of the relevant Puerto Rico Managing Agencies (Department of Health (DOH), Environmental Quality Board (EQB) and Infrastructure Financing Authority (Financing Authority)), as well as the Puerto Rico Aqueduct and Sewer Authority (PRASA), to resolve the issues and ensure that federal funds are protected. The Financing Authority has established new revolving fund trust accounts at a commercial bank (Banco Popular), revised Operating Agreements (OAs) and Memoranda of Understanding (MOU) have been executed, and EPA has incorporated grant conditions into the active agreements to ensure compliance with the state match requirement.

It is important to note that there has been progress by the Government of Puerto Rico in addressing the ongoing fiscal crisis. The Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) Board certified the Commonwealth's fiscal plan in March 2017, with

a revised liquidity and implementation plan due for certification by April 30, 2017. On May 2, 2017, the Governor announced that the Commonwealth had requested that the PROMESA Board file, on its behalf, a Title III Proceeding due to its inability to reach an agreement with debt holders by the April 30, 2017 deadline. Executive agencies, such as PRASA and the Puerto Rico Electric Power Authority (PREPA), would have to request separate filings; however, the PROMESA Board and the Commonwealth agency leaders have indicated no intent to do so at this time. PRASA's fiscal plan was certified on April 28, 2017, and the implementation plan was certified on May 31, 2017. As a direct result of the fiscal plans' certification, PRASA, the primary recipient of SRF loans, has provided additional financial information to EQB and DOH addressing its outstanding debt to the SRFs. The Office of Water and Region 2 together presented EQB and DOH with recommendations for another forbearance period and options for restructuring PRASA's existing debt, in order to ensure that PRASA resumes payments to the SRFs as soon as possible. It is our position that PRASA's resumption of payments to the SRFs is critical to restoring the viability of the funds, but that another brief forbearance period would be beneficial so as to ensure that the loans are restructured in accordance with the programs' legal requirements.

REGION 2's RESPONSE TO REPORT RECOMMENDATION

No.	Recommendation	High-Level Intended Corrective Action(s)	Estimated Completion by Quarter and FY
1	Evaluate options to restore the viability of Puerto Rico's Clean Water and Drinking Water State Revolving Funds or implement strategies better suited to the financial, programmatic, public health and environmental needs of the government of Puerto Rico.	<p>Continue to work with the PR Managing Agencies and PRASA to complete the restructuring of PRASA's existing debts.</p> <p>Resume the flow of grant funds by awarding the FY 2016 Clean Water and Drinking Water capitalization grants to EQB and DOH, respectively.</p> <p>Incorporate additional conditions in the capitalization grants to ensure all new loan agreements will undergo a financial capability review by the Puerto Rico Fiscal Agency and Financial Advisory Authority (PRFAFAA).</p> <p>Revise EPA's 12/30/16 OAs with EQB and DOH,</p>	<p>1st Quarter FY 2018</p> <p>4th Quarter FY 2017</p> <p>4th Quarter FY 2017</p> <p>1st Quarter FY 2018</p>

		<p>respectively, and provide assistance to EQB and DOH to revise their MOUs with PRIFA to incorporate the new role of PRFAFAA.</p> <p>Consider future approaches to grant funding, including, but not limited to, future federal fund allocations and assessing the effectiveness and potential of transitioning the program to a direct grant program.</p>	<p>4th Quarter FY 2018</p>
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CONTACT INFORMATION

If you have any questions regarding this response, please let me know or have your staff contact Region 2's Audit Coordinator, John Svec, at (212) 637-3699.

Attachment

ATTACHMENT
Actions Already Taken and Next Steps

Steps taken since the OIG conducted its review in October:

- Region 2 and Headquarters Office of Water have continued to work with the Puerto Rico Managing Agencies to find a path forward to revitalize the SRFs.
- Payments were stopped on existing grant agreements with EQB and DOH for costs related to PRASA loans. Payments associated with costs incurred for administrative costs and Non-PRASA Financial Assistance Agreements resumed in January 2017 and require approvals from the Grants and Audit Management Branch and Caribbean Environmental Protection Division.
- Notices of Noncompliance were issued on October 3, 2016, to EQB, DOH, the Financing Authority and the Government Development Bank for Puerto Rico (GDB).
- New bank accounts for the Clean Water and Drinking Water State Revolving Funds have been set up at Banco Popular and are Trust Accounts to add additional protections
- The MOU and OAs were revised to remove the role of GDB. The agreements were executed at the end of December 2016 and January 2017, as noted in the report.
- Grant conditions have been incorporated into existing grant agreements to require proof of the state match on deposit at Banco Popular when submitting payment requests to EPA.
- Puerto Rico's new Administration took office in January 2017, and new Department Heads were appointed in February 2017.
- Puerto Rico Fiscal Agency and Financial Advisory Authority (PRFAFAA) will be overseeing the implementation of the Commonwealth's fiscal plan on an ongoing basis.
- The Commonwealth's Fiscal Plan was certified by the PROMESA Board in March 2017, with a revised liquidity and implementation plan due by April 30, 2017. On May 2, 2017, the Governor announced that the Commonwealth had requested that the PROMESA Board file, on its behalf, a Title III (similar to bankruptcy) Proceeding to restructure the current debt. Executive Agencies are required to file independently. PROMESA has announced it does not intend to file a Title III Proceeding on PRASA's behalf.
- GDB's and PRASA's fiscal plans were certified by PROMESA Board on April 28, 2017, and the implementation plans were certified on May 31, 2017.
 - GDB will be winding down operations and liquidating assets
 - Approximately \$190 million is "owed" to the SRF Repayment account; it is unclear at this time how much, if any, will be recovered, and when it would be transferred to the accounts in Banco Popular
- EPA participated in a joint meeting with USDA, May 2-5, 2017, and met with representatives from PREQB, PRDOH, PRIFA, PRFAAFA, PRASA, PROMESA, Citi, Rothschild, and USDA to discuss PRASA's financial situation, future cash needs and recovery plan, and its ability to comply with the Consent Decree and Federal Regulations under the respective federal programs.
- EPA has presented its recommendations to PREQB and PRDOH for terms for an additional forbearance period. An additional forbearance period would allow adequate time to restructure PRASA's individual loan agreements under both programs.

- EPA is currently working with EQB, DOH, PRIFA, and PRASA to ensure that terms for restructuring PRASA loans will result in resumption of repayments to the Funds and maintain the Funds in perpetuity.

Next Steps - Options/strategies to restore the viability of the Puerto Rico SRFs

EPA is working with EQB, DOH, and PRASA to identify means for PRASA to resume payment on existing debt and terms for restructuring existing debt, other than a decrease in interest rates and extension of loan terms. A framework for the discussions between the PR and Federal Agencies on debt restructuring is anticipated to be achieved by June 30, 2017; an actual agreement as to restructuring of the debt is anticipated by December 31, 2017. The SRF Team, comprised of the HQ Office of Water's, Office of Wastewater Management and Office of Groundwater and Drinking Water, and Region 2's Caribbean Environmental Protection Division will lead the effort, in conjunction with the Managing Puerto Rico Agencies, to evaluate the individual loan agreements and implement appropriate restructuring terms. PRASA currently has an outstanding debt of \$580 million in loans owed to the PR SRF. The initial proposal, as set forth by EPA in May, would achieve an estimated savings of \$45 million to PRASA and a 22% reduction in overall debt. According to PRASA's fiscal plan, its annual debt service on SRF loans is approximately \$30 million. Resumption of repayment on existing debts is a critical component of the SRF program, so as to ensure the Fund meets the perpetuity requirement. The expected date of completion for restructuring all loans is December 31, 2017, if not sooner. EPA has presented to EQB and DOH its recommendation of terms for another six-month forbearance period for PRASA. This brief forbearance period would allow sufficient time to ensure all of the loan agreements are properly restructured. Beginning in January 2017, PRFAAFA was officially charged with the task of implementing the Commonwealth's fiscal plan and ensuring Executive Agencies are managing their fiscal activities with the PROMESA Board priorities and approval. It is anticipated that any financial restructuring agreements would also be subjected to PRFAAFA and PROMESA approvals.

EPA is also considering options for future grant awards. Currently, the allotments for FY 16 funds will be awarded to both DOH and EQB by the end of the 4th quarter of FY 17, and allotments for FY 17 funds have yet to be awarded. Region 2, in consultation with HQ OW, is working with the PR grant recipients to ensure that federal funds are implemented in a way that meets the PR communities' water infrastructure needs and considers the impacts of consent decree projects. PRASA is the primary beneficiary of Clean Water SRF and Drinking Water SRF funds, providing 55% of the population with wastewater treatment services and 96% of the population with clean drinking water. EPA has crafted grant conditions that have been incorporated into its existing grant agreements that ensure state match is on deposit at the time a request for payment is submitted to EPA. Additionally, new grant conditions have been developed to ensure that any funds which could potentially be used for PRASA loans are subject to additional scrutiny, undergo a financial capacity review by PRFAAFA, and meet the terms of any agreement related to PRASA's existing debt restructuring.

EPA is also considering the potential benefit of recommending transitioning the PR SRF program into a direct grant program. Pursuit of a program change of this magnitude would require a legislative mandate. At this time, EPA does not have a recommendation.