ECONOMY

Prepa a Mirror Image of P.R. Government Troubles

THINK STRATEGICALLY:

Who is Leading Puerto Rico in this Complex World?

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Ever since Puerto Rico fell into bankruptcy, I have been waiting to see which of our leaders would rise to the occasion by placing aside voting pressures and temptations to accomplish one specific goal, ending the Puerto Rico Financial Oversight and Management Board's (FOMB) tenure.

We have watched how, once a leader arrives in the La Fortaleza governor's mansion, they become unable to resist the temptations to fight the FOMB. After what it is called, the fiscal board has the job to cure all the years of bad administration, poor financial planning, overspending and lack of discipline when dealing with the island's finances.

I am the first to agree that the FOMB has not been nearly as effective as it should have been, and it has shown a penchant for expenditures without concrete results. Maybe it is the fact that the fiscal board has not taught us what success coming from them looks like and how to recognize it or probably the lack of understanding our culture and knowing what ethnocentrism for Puerto Ricans means.

Our leaders' expectations have been relatively high, but none higher than our governors', Senate presidents', House speakers' or resident commissioners'. Sadly, all have come short.

None of those individuals have taken on the behavioral changes Puerto Rico needs to cure its lack of financial discipline.

There is a specific representation of all of the island's problems in a single corporation, the Puerto Rico Electric Power Authority (Prepa).

Like the government, Prepa is in bankruptcy, with $9 billion in debt, $4 billion in unfunded pension liabilities, excess personnel, political turmoil, and a tribal structure that has sharp similarities to the overall situation of the island.

One of the most recent examples of these failures is the Prepa and LUMA Energy situation that every single Puerto Rican has been living with daily: the lack of electric power service in our homes.

Prepa is perhaps the best example of undue political influence, tribal behavior, constant changes in direction, high turnover rates, and a lack of a capital investment and maintenance program in line with Prepa's complexity.

There are two line items that, when combined, represent 80 percent of what we pay for electricity both in our homes and businesses:

1. The cost of operating the grid
2. The cost of fuel

Therefore, any attempt to transform Prepa must take on those issues head-on to force a dramatic transformation.

We must also remind you that the electricity rate that Prepa charges does not include any debt or bonded debt payments due to the moratorium granted under Title III of the Puerto Rico Oversight, Management and Economic Stability Act (Promesa).

Prepa has been financially unstable since at least fiscal year 2001. As the incentives of the U.S. tax code's section 936 began to be phased out in 1996 and many large industrial clients began to leave, Prepa was left vulnerable. The revenue loss became even worse since Prepa failed to adjust its services, rates, operation and employment levels to face Puerto Rico's economic 15-year decline.

Adding to an already problematic situation for Prepa, Puerto Rico's outmigration reached 522,736, or 13.75 percent, of the population compared with the 2000 census; this dramatically decreased consumption and Prepa's revenue.

Prepa continued charging higher electricity prices; the status quo encouraged a large-scale distribution of rooftop solar panels and other solar thermal collectors, further eroding Prepa's revenues. Since at least 2007, Prepa has had an average annual cash-flow deficit of $330 million. It maintained its debt-coverage ratio of 1.2 by capitalizing interest and using non-cash revenue and cost savings.

As we continue this dialogue, we must note that the world is moving toward changing its energy sources from fossil fuels to a better mix using wind, solar, hydroelectric and waste-to-energy.

For example, by 2018, the United States had reduced its reliance on oil to 36.4 percent and natural gas to 30.7 percent; Prepa still mainly utilizes oil-fired power plants.

Not only is Prepa overburdened with obsolete operational systems, debt and pension liabilities, it is also overstaffed. Because of the militant Irrigation and Electrical Workers Union (Utier by its Spanish acronym), reductions in the labor force were challenging to achieve until recently. Two examples come to mind:

1. Prepa's Human Resources and Labor Relations Department has 250 people. Compared to its peers, it is highly overstaffed, costing Prepa 2.7 percent of total operating expenses, when the industry standard is 0.56 percent.

2. The other is excessive employee compensation; one small example is the lack of a biometric employee clocking could have saved Prepa $30 million annually. However, staunch opposition to the move by the union blocked its implementation.

Finally, failure to diversify its sources of generation, lack of upgrades in power generation and strict control by the labor union led to rising costs, constant faults and outages that leave 700,000 or more customers without power on any given day.

Suppose the proposed debt restructuring agreement allows Prepa to exit bankruptcy. In that case, it will ultimately enable Prepa to begin planning for the future and finally provide the citizens of Puerto Rico with dependable, cost-effective and efficient service.

Prepa is the best example of all the ills that the Government of Puerto Rico has been suffering from, and the critical question is: Who is leading Puerto Rico in this complex world?

Week in Markets: September was the worst month since 2020; market rotation increases

The U.S. stock markets began the month with gains searching for a new path after registering the worst monthly performance in September, living up to its reputation of being the worst month of the year.

The major indices fell during September: the Dow Jones lost 1,516.81 points, the S&P 500 lost 218.14, and the Nasdaq Composite lost 810.66. However, the Birling Capital Puerto Rico Stock index gained 61.05.

Nevertheless, the U.S. stock markets closed with gains, helped by much more robust than projected consumer spending in August, alleviating investor concern over the economic recovery.

Both Republicans and Democrats continued to engage in a dangerous game of inaction on the dire need to raise the debt ceiling to avoid a disastrous default that could unravel the economic growth to date and, with it, the U.S. credibility in global markets. The Senate needs to obtain at least 60 votes to pass the measure, which means that 10 Republican senators must vote.

Treasury Secretary Janet Yellen has informed Congress that she is unsure whether the U.S. government would have the funding to meet obligations and debt payments after Oct. 18.

The Final Word: The Top Issues Impacting Markets

There are several issues at play affecting investors; we consider these the most relevant:

– Worries over rising rates: This impact on the stock market is temporary. What is truly happening is that the market is performing a rotation to better position itself for the future.

– Economic growth and expansions go hand in hand with bull markets. However, it is often true that increased rates pose a threat to market expansions. We do not see it occurring in the near term.

– Probability to increase rates causes market rotations: The threat of rising rates has affected the tech-heavy Nasdaq worse, as investors position their holdings for opportunities.

– We do not see the U.S. government defaulting: No party wants to be the poster child for a U.S. market meltdown; a deal with a more permanent solution will occur before the new deadline.

– Slower but consistent growth ahead: While the economy continues to grow, we should expect corporate earnings to continue rising; however, as soon the Federal Reserve raises its rates, there will be an adjustment period.

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Weekly Market Close Comparison	10/1/21	9/24/21	Return	YTD
Dow Jones Industrial Average	34,326.46	34,798.00	-1.36%	12.15%
Standard & Poor's 500	4,357.04	4,455.48	-2.21%	16.00%
Nasdaq Composite	14,566.70	15,047.70	-3.20%	13.02%
Birling Puerto Rico Stock Index	2,924.13	2,832.82	3.22%	42.99%
U.S. Treasury 10-Year Note	1.48%	1.47%	0.68%	0.50%
U.S. Treasury 2-Year Note	0.27%	0.29%	-6.90%	0.63%