



Commonwealth of Puerto Rico

FY 2014 Budget and Other Recent Developments

July 12, 2013

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Agenda

1 Six Months in Review

2 Budget for FY-2014

3 Highways and Transportation Authority

4 Concluding Remarks

In only six months, we have tackled several key challenges faced by Puerto Rico for decades to protect our investment grade ratings

Main fiscal challenges identified by this Administration and publicly discussed upon taking office:

1

**Retirement System's
Unfunded Liability**

2

**General Fund
Budget Deficit**

3

**Strained
Public Corporations**

1. We faced a virtually insolvent retirement system which was shaping up to be a significant burden on the General Fund for years to come,
2. A General Fund budget deficit of approximately \$2.2 billion,
3. Several fiscally strained public corporations such as the Ports Authority, Aqueduct and Sewer Authority (PRASA), and the Highways and Transportation Authority (HTA), and
4. A market perception that the new Administration was unwilling to take the necessary steps to address these challenges and continue on a fiscally responsible path.

We have moved swiftly to correct the problems that were weakening our credit rating and restraining Puerto Rico from sustainable economic growth.

1

Puerto Rico has delivered on its long-standing promise of enacting meaningful and comprehensive pension reform

The reform eliminates the projected need for pay-as-you-go contributions from the General Fund and allows the System to pay all pension benefits as they become due.

Puerto Rico Supreme Court ratified constitutionality of pension reform

“We conclude that the retirement system reform is constitutional because, despite substantial undermining of the contractual obligations at hand, the measures adopted are reasonable and necessary to save the actuarial solvency of the System”

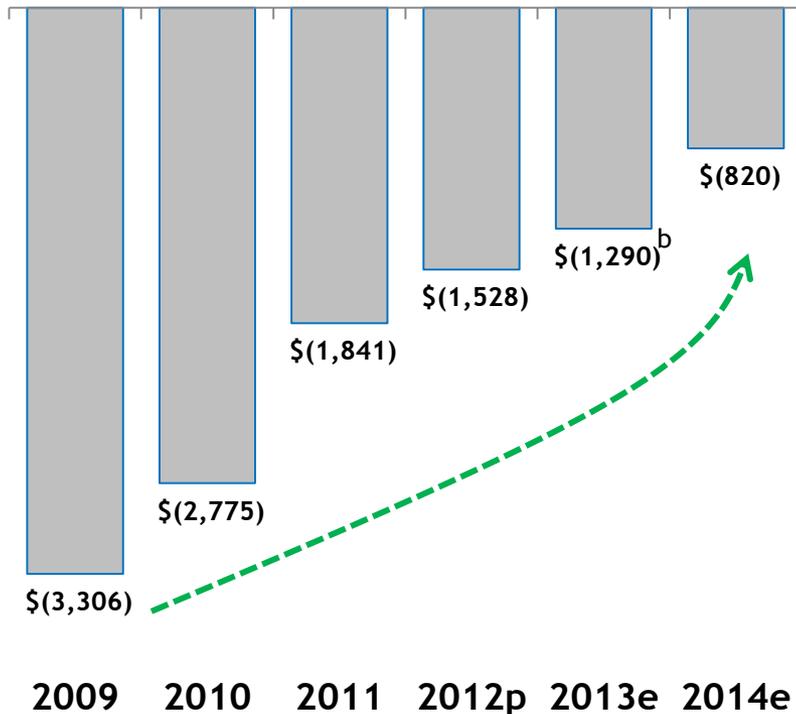
“There aren’t any less onerous measures available to meet that end”

Supreme Court of Puerto Rico - Majority Decision

- Monday, June 24, 2013

2 We have approved a budget for fiscal year 2014 that significantly reduces our General Fund deficit

Historical and projected deficit ^a (in millions)



Decisive actions taken to address budgetary deficit:

1. Act 154 excise tax was increased and fixed to its original level of 4% for five years commencing on July 1, 2013. Tax at 2.75% until June 30, 2013. Given past experience, the tax at 4% is expected to raise approximately \$600 million in additional annual revenues.
2. Enhanced our revenue base by eliminating certain Sales and Use Tax (SUT) exemptions and other revenue increasing measures.
3. Reduced our recent reliance on debt service restructurings.
4. Improved fiscal oversight tools in order to tackle tax evasion and enforce tax compliance (particularly for SUT tax evasion).

(a) Results from FY 2009 through FY 2012 as disclosed in the Commonwealth of Puerto Rico - Financial Information and Operating Data Report, dated May 17, 2013 (the "Commonwealth Report"). Deficit for fiscal year 2013 is preliminary and subject to change.

(b) After implementation of corrective measures by current Administration, deficit for FY 2013 was initially revised from \$2.213 billion as of January 31, 2012 to \$1.602 billion as of April 30, 2013, and again revised to \$1.29 billion as of June 30, 2013.

P: Preliminary unaudited numbers.

E: Estimated; preliminary and subject to change.

3 We have begun restructuring our main public corporations; goal is to make them self-sufficient

Restructuring aimed at improving services at reasonable prices and promoting economic growth



- On July 15, 2013, PRASA will implement a 60% rate increase (on average) that will provide additional revenues to cover operational expenses.
- This increase will allow PRASA to become a financially independent entity that does not rely on Commonwealth or GDB contributions.



- Acts 30 and 31 of 2013 were signed into law on June 25, 2013. These measures will increase HTA's recurring annual revenues by approximately \$270 million, and by \$10 million for the Metropolitan Bus Authority (MBA)—as substitute for loss of revenue due to diesel tax reduction.
- These new revenue measures will allow HTA to repay lines of credit outstanding with GDB and improve the bank's liquidity position.



- On February 27, 2013, Puerto Rico finalized the P3 transaction involving the Luis Muñoz Marín International Airport.
- This transaction strengthened the Ports Authority's fiscal position and enhanced GDB's liquidity and reduced its risk position.

Agenda

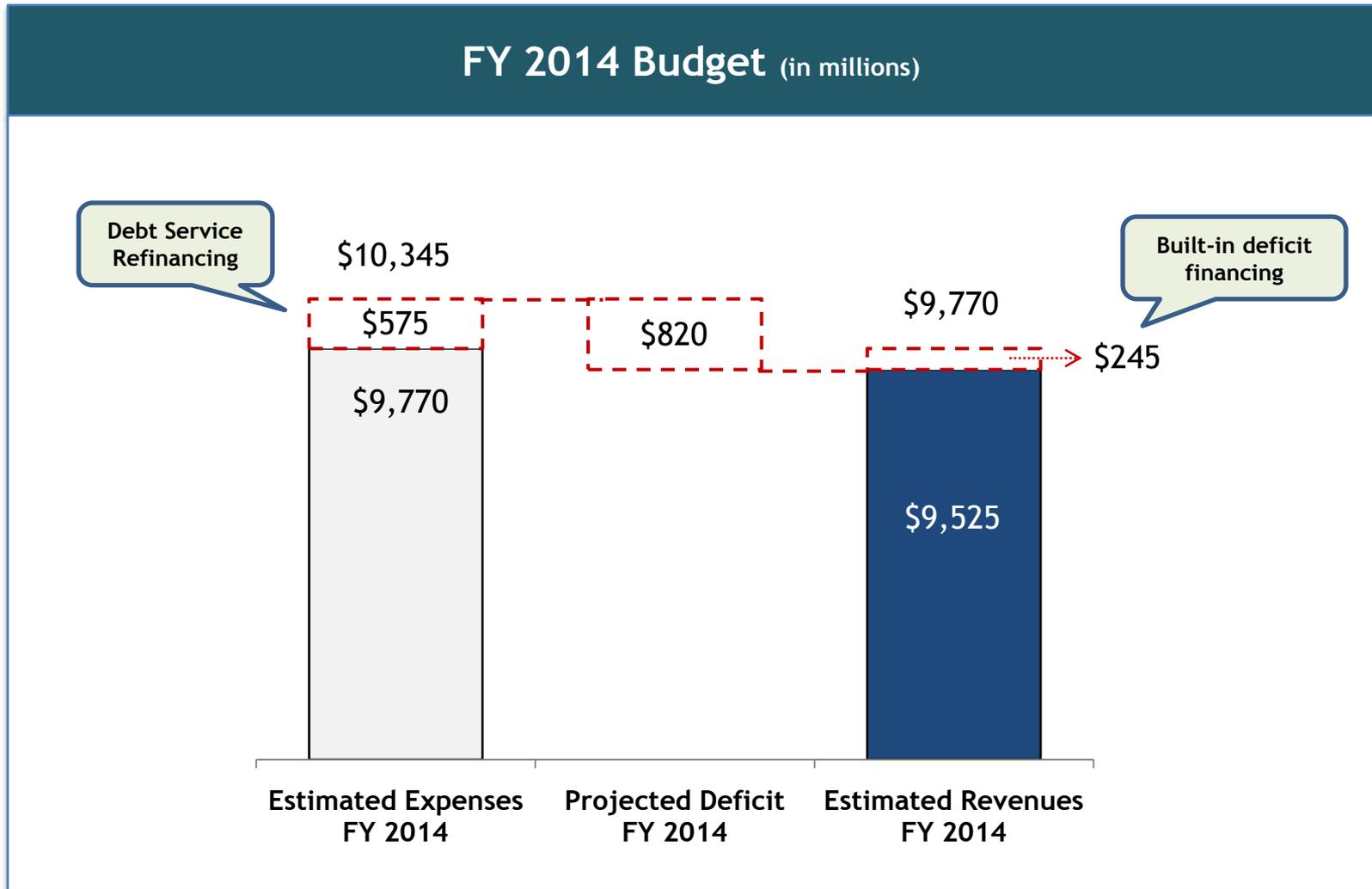
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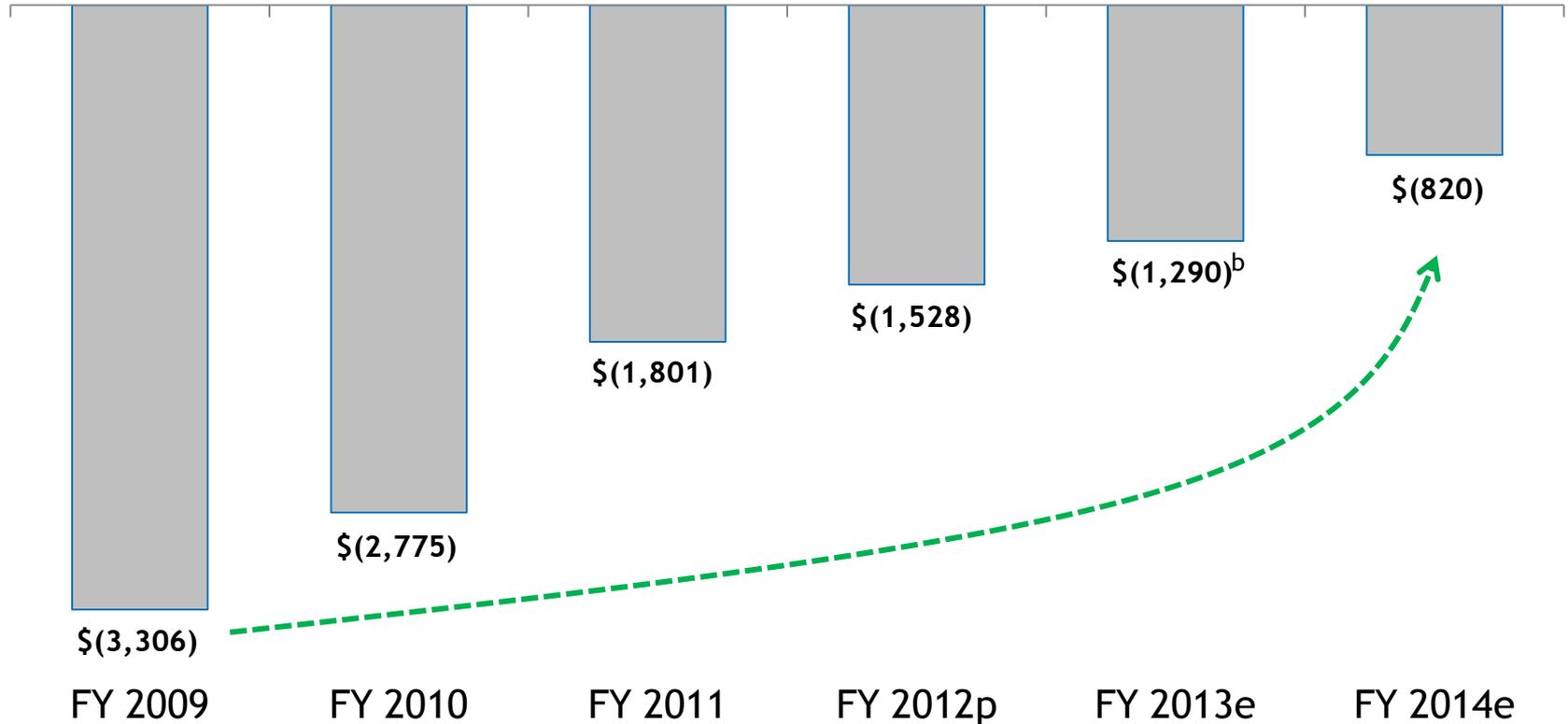
4 Concluding Remarks

FY 2014 General Fund Budget - Deficit Forecast



Puerto Rico has made significant progress to reduce the structural deficit

Historical and Projected Deficit ^a (in millions)



(a) Results from FY 2009 through FY 2012 as disclosed in the Commonwealth Report. Deficit for fiscal year 2013 is preliminary and subject to change.

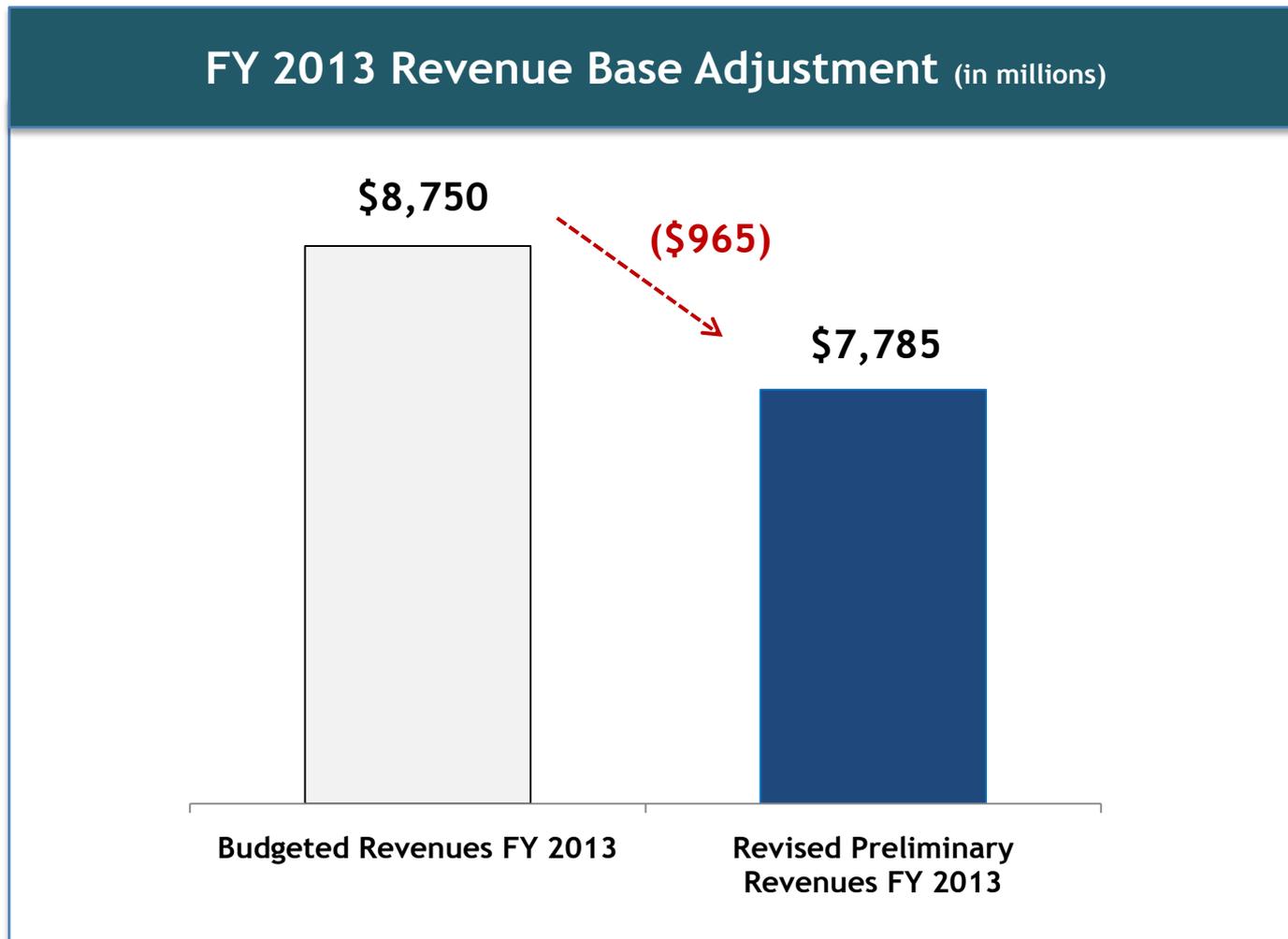
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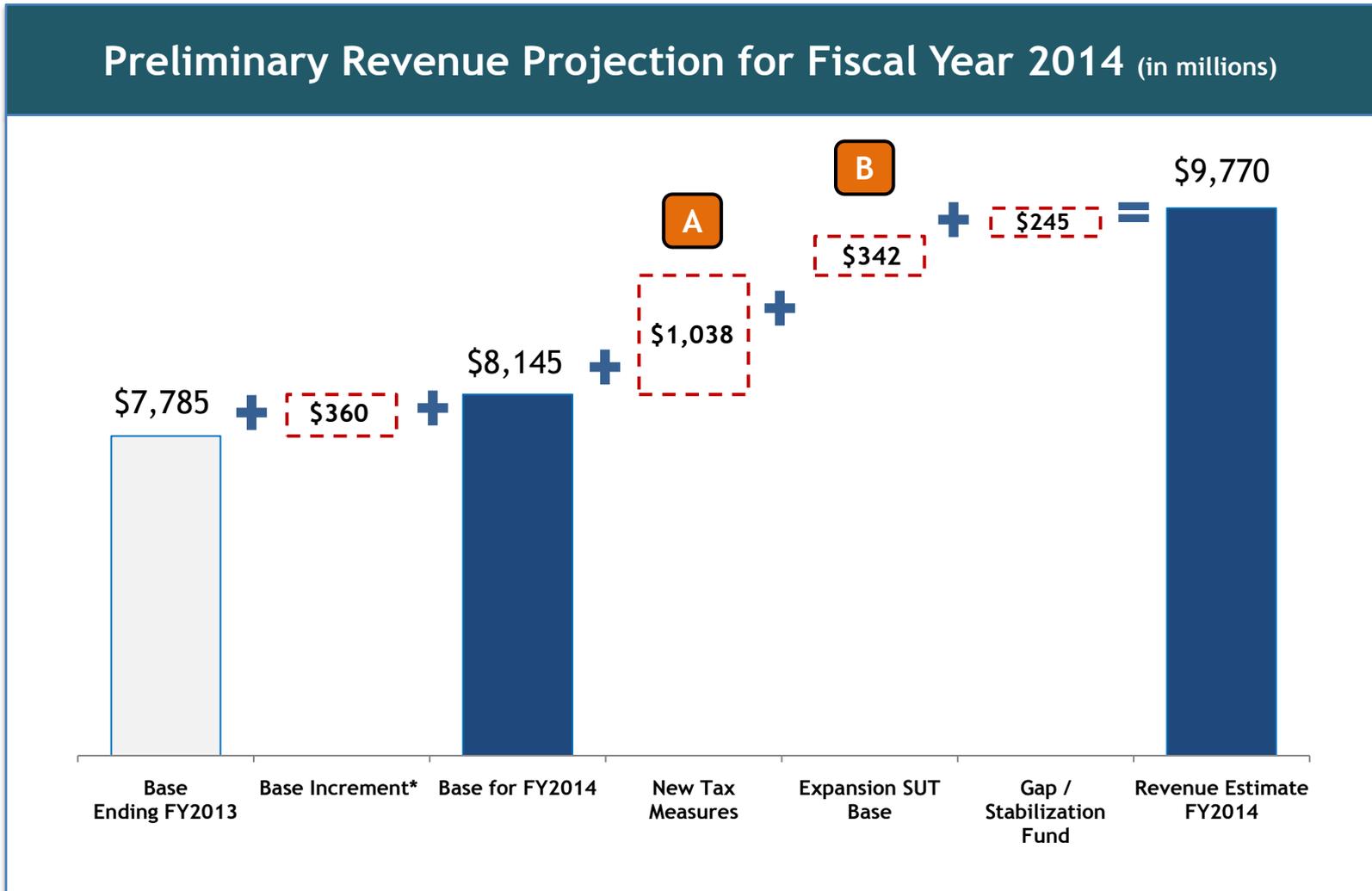
FY 2014 PROJECTED GENERAL FUND REVENUES

Projected revenue base for FY 2013 has been reduced by \$965 million to account for non-recurring revenue measures



Continuing our responsible budgetary practices, reduced base revenues for FY 2014 will account for lower economic projections and non-recurring revenues in FY 2013 budget

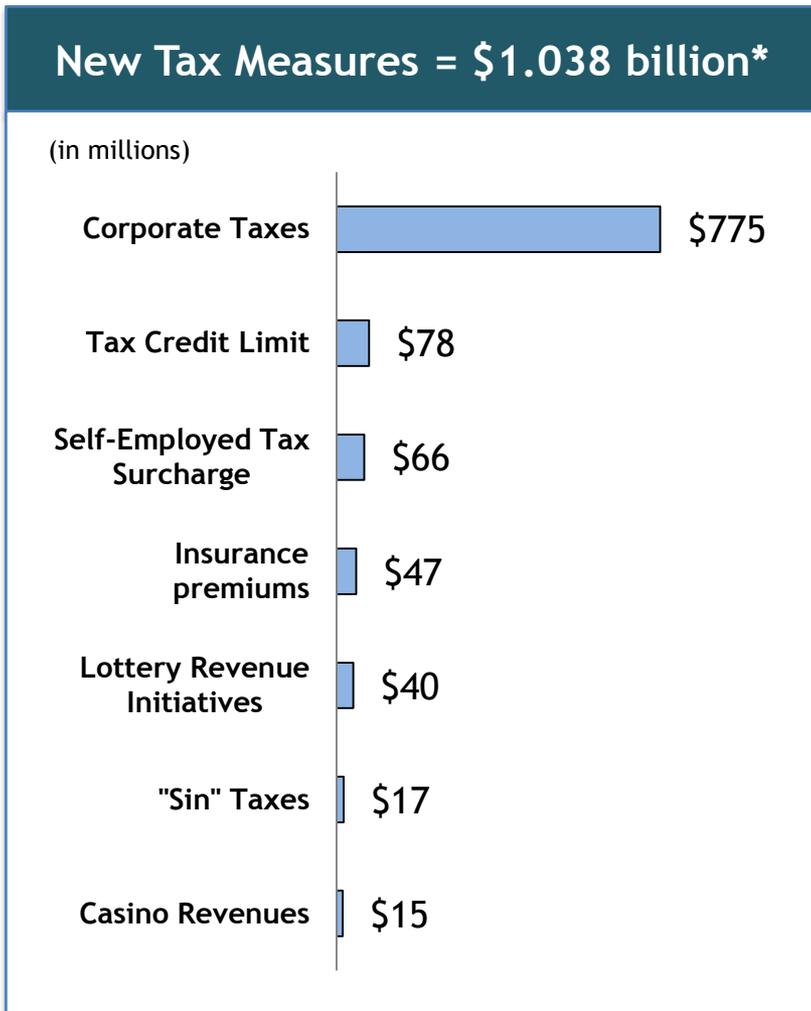
1 FY 2014 Adopted General Fund - Projected Revenues



* Base increment is principally as a result of the amendment to Act 154 minus reduction of royalty pre-payments received in 2012-13 as part of deferral of amendments to Act 154 and reduction of \$62 million of vehicle license fees transferred to PR Highways. Also, economic growth projections reflect most recent revision by the PR Planning Board for FY 2014 (+0.2%).

A

Adopted budget for FY 2014 includes new tax measures expected to result in \$1.038 billion of additional revenues



Commentary

Measures include among others:

- Gross Receipts Tax, AMT adjustment and 2010 tax rate code.
- Modified corporate AMT - Adjustment Net Operational Loss and Book-Tax Adjustment

- Tax credits with questionable impact on economic growth legislated over time reduced by 50%

- 2% top-line tax on sole proprietorships and self employed professionals earning over \$200,000
- Limit on mortgage interest deductions

- 1% tax on underwriting premiums

- Lottery revenue from certain initiatives (changes in modality)
- Effect of already repealed UPR scholarship extraction

- Increase excise tax on cigarettes
- Effect calculated net of demand elasticity

- More casino (slot) machines allowed in hotels

* Numbers are preliminary estimates and subject to change.

Detail of FY 2014 new tax measures

Revenue Measures		Amount (\$ in millions)
Tax Measures and Lottery Initiatives		
Corporations		
	Various Adjustments to AMT calculation, among them: <ul style="list-style-type: none"> • Inclusion of New Gross Receipt Tax (corporations and pass-through entities) • 20% tax on intercompany expenses in agreements with holding companies (through a disallowance) • 2% tax on purchases made by PR corporations outside of PR • Reduction of Net Operating Loss (NOL) deduction from 90% to 80% 	475
	Return corporate tax rates to 2010 tax code	270
	Limit of 90% on the use of NOL for regular income tax purposes	10
	Special contribution by government contractors	20
Individuals		
	2% top-line surcharge on self-employed professionals earning over \$200,000	50
	Limit on mortgage interest deductions	16
Tax Credits		
	Tax credits with questionable impact on economic growth reduced by 50%	78
Cigarettes		
	Increase in excise tax on cigarettes (net of HTA transfer of \$30 million)	17
Insurance Agencies		
	1% tax on underwriting premiums	47
Lottery and Casinos		
	Lottery revenue initiatives (changes in modality and elimination of transfer to UPR)	40
	Increase in slot machines revenues by adding new slot machines in casinos	15
Sub-Total Tax Measures and Lottery Initiatives		\$1,038

B

Expansion of Sales and Use Tax (“SUT”) base principally relies on the inclusion of business-to-business services

Elimination of the following exemptions	
1. Business-to-Business services	\$110 M
2. Business telephone services	\$73 M
3. Purchases made by:	
• Credit unions	\$16 M
• Universities	\$7 M
• Hospitals	\$7 M
• Hotels	\$17 M
• Others	\$7 M
4. Resellers’ Exemption Certificate	\$50 M
5. Enforcement measures	\$55 M
Total	\$342 M

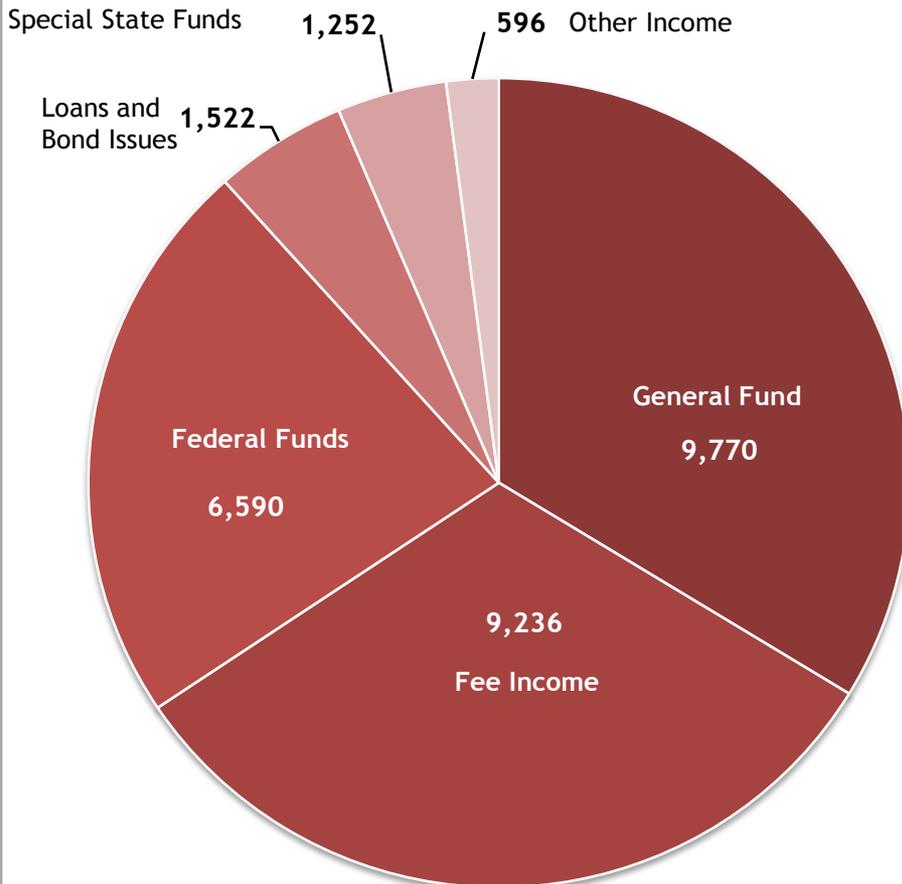
Transportation services: \$21 M
Services bank charges: \$17 M
Collection agencies: \$1 M
Security services: \$23 M
Cleaning services: \$10 M
Car Rental: \$11 M
Parking: \$2 M
Laundry: \$1 M
Auto repair services: \$8 M
Waste management: \$16M
Total: \$110 M

FY 2014 PROJECTED GENERAL FUND EXPENSES

Consolidated Budget for Fiscal Year 2014

Consolidated Budget for Fiscal Year 2014 - \$28,966M

\$ in millions



General Fund

34%

Fee Income

32%

Federal Funds

23%

Loans and Bond Issues

5%

Special State Funds

4%

Other Income

2%

General Fund Budget - Expenses by Use of Funds (Non - Discretionary)

Non Discretionary

- Expenses from appropriations by formula, debt, contribution to the retirement systems, and other pre-legislated or agreed-upon commitments

32%

Total Non Discretionary
\$3,167M

Semi Discretionary

- Contributions or block grants to entities outside the central government (municipalities, legislature, subsidized public corporations)
- Large entitlement programs (health insurance)

12%

Total Semi Discretionary
\$1,168M

Discretionary

- Operating cost of the central government including programs, payroll, and administrative costs
- Special appropriations for program purposes, some of which may be pass-through grants to non-profit or non-public entities

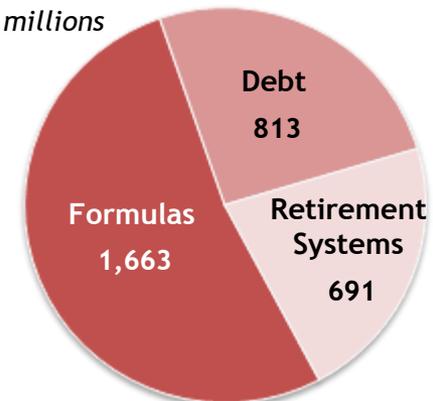
56%

Total Discretionary
\$5,435M

Non Discretionary Expenses - \$3,167M

UPR Formula	\$834M
Retirement System - Special Laws	\$691M
General Obligations and 3 rd Party Debt	\$521M
Municipalities & Legislature Formulas	\$480M
Judicial Branch Formula	\$349M
GDB Debt	\$291M

In \$ millions



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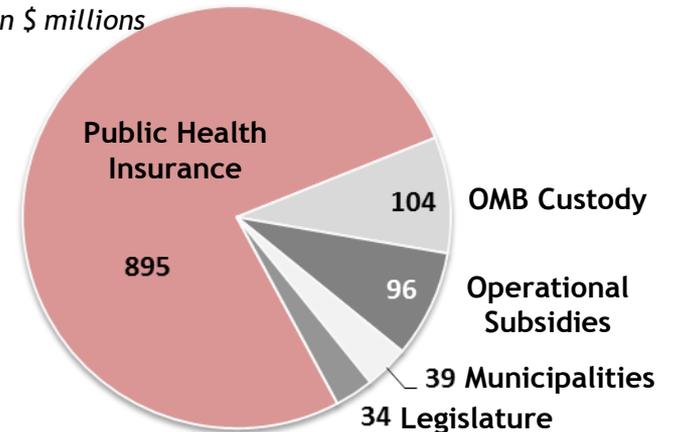
56%

Total Discretionary
\$5,435M

Semi Discretionary Expenses - \$1,168M

Public Health Insurance	\$895M
Special Appropriations - OMB Custody	\$104M
Operational Subsidies	\$96M
Contributions to Municipalities	\$39M
Contributions to Legislature	\$34M

In \$ millions



General Fund Budget - Expenses by Use of Funds (Discretionary)

Non Discretionary

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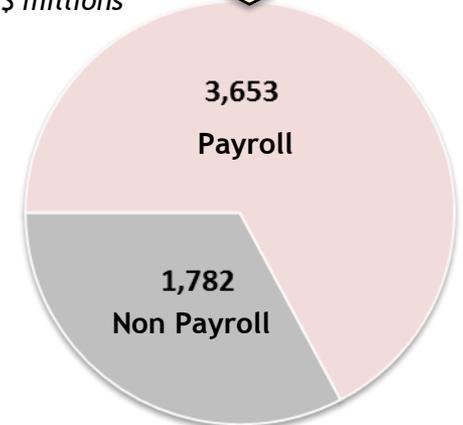
56%

Total Discretionary
\$5,435M

Non Payroll Expenses - \$1,782M

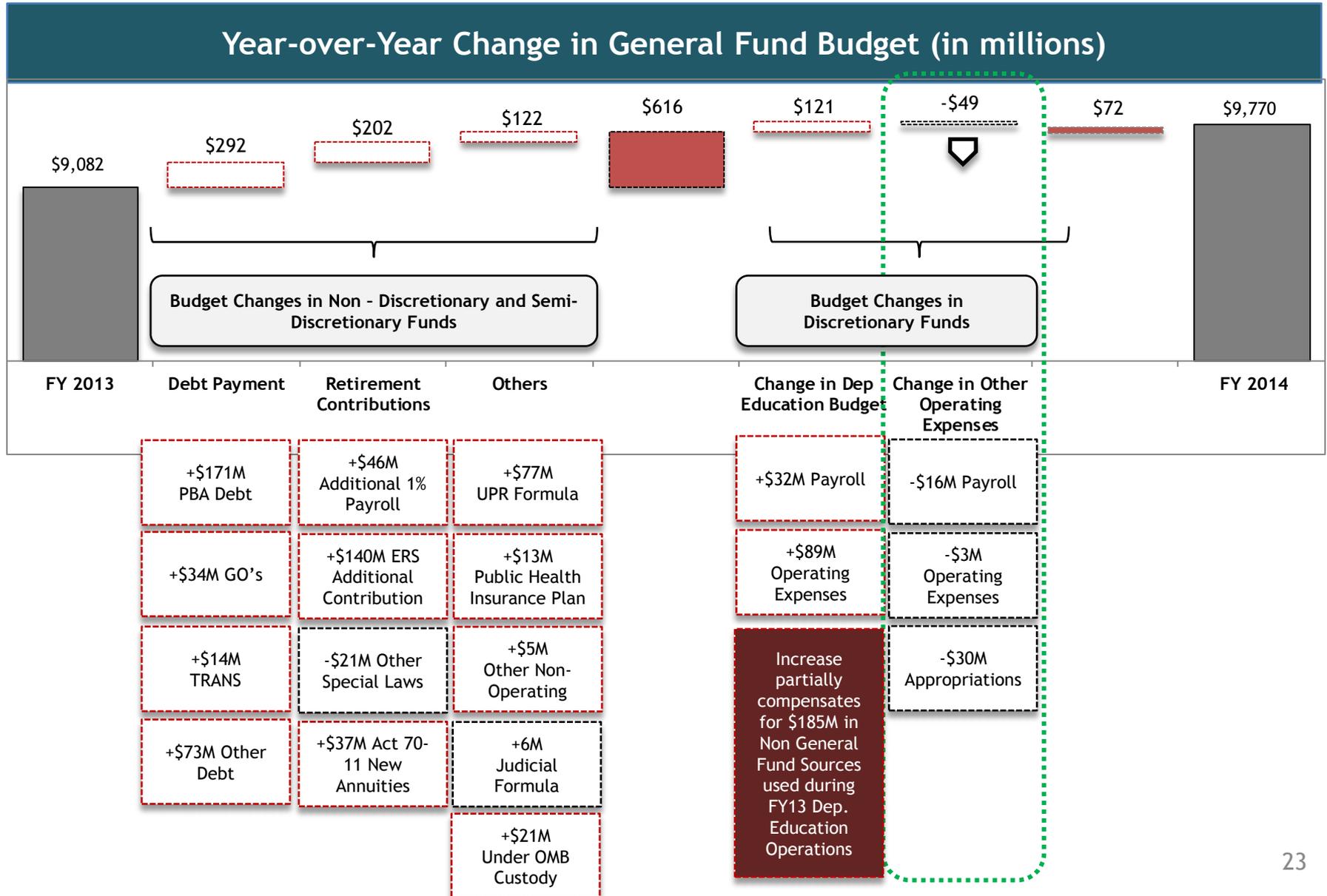
Rent and Utilities	\$532M	Transportation	\$146M
↳ PBA Rent (Excluded Debt)	\$214M	Professional Services	\$106M
↳ PREPA & PRASA	\$149M	Materials	\$90M
Non Distributed Appropriations	\$398M	Others	\$55M
Purchased Services	\$257M	Equipment	\$32M
Subsidies and Incentives	\$151M	Federal Funds Matching	\$15M

In \$ millions

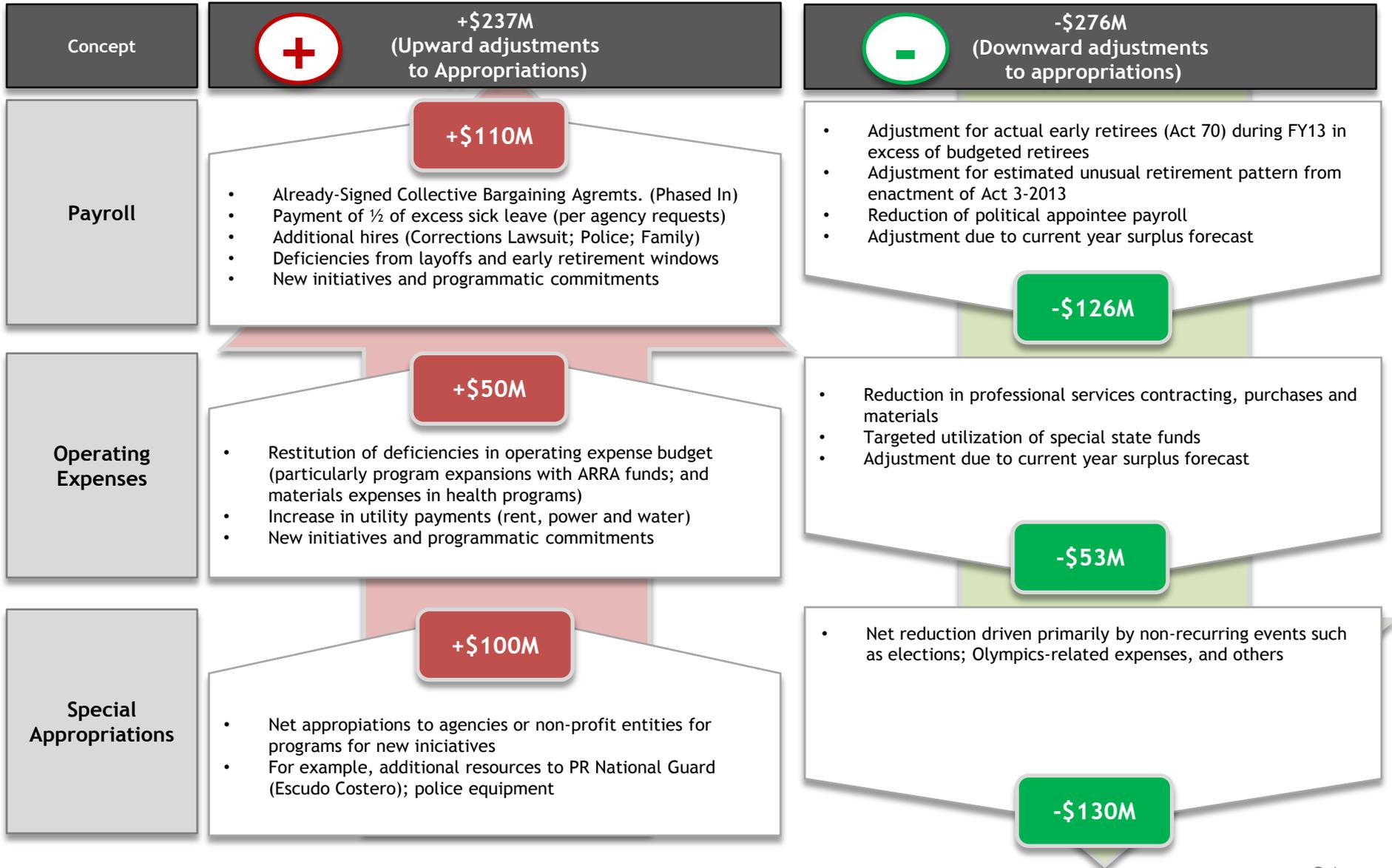


*Reconciliation with Joint Resolution for Operating Expenses: Discretionary Expenses of \$5,435M plus (i) add-back \$171M in PBA Rent that were reclassified as Non Discretionary - Debt Service; (ii) add-back of Legislature budget of \$119M that were reclassified as Non-Discretionary - Legislature; and (iii) subtract Special Appropriations (\$351M) which are substantially Discretionary in nature but not included in the Joint Resolution for Operating Expenses. This reconciles with the \$5,375M in Joint Resolution total appropriations.

Increases in budget expenses are mostly related to responsible measures to address our retirement system and payment of our GO debt



Detail on Further Adjustments to Other Operating Expenses (Net: -\$49M)*



* Adjustments are based on estimates. Amount of adjustments may reflect or assume further management actions, with respect to FY 2013 operations, for cost containment, re-hiring restrictions, payroll control, and other austerity or efficiency measures. Adjustments may be grouped or rounded for simplification purposes.

Other Non-General Fund State Appropriations

1 Budgetary Support Fund

Uses: \$96.5M

- Claims and Lawsuits \$53.0M
- Non Recurring Programs or Equipment \$16.1M
- Recurring Programs \$15.3M
- Improvements and Works \$12.1M

Sources: \$96.5M

- Printed material fund \$1.0M
- Real estate licensing board funds \$3.0M
- Medical licensing fund \$3.2M
- Post secondary fee collections fund \$3.5M
- Compensation funds for victims of crime \$4.8M
- Licensing and promoting use of weapons fund \$6.0M
- Casinos licensing fund \$15.0M
- Department of Education fund \$20.0M
- Contribution of State Insurance Fund \$40.0M

- Match as best as possible non-recurring uses, lawsuit payments, improvements, and one time projects - to extraction of excess balances. In FY12 and FY13 structural lawsuits were covered by GDB \$150M LOC.

- Largest appropriations are payment of Health Department primary care centers (recurring); Police Department Re-Engineering per DOJ lawsuit; incentive program for affordable housing acquisition; and payment of past due overtime as part of Corrections federal lawsuit.

- Special State Funds with history of profitability and low turnover were selected.

- Where possible, also pair programmatic aims, for example, weapons fund with equipment purchases.

- Fund distribution was revised from initial proposal by the Commonwealth Legislative Assembly

2 Science and Technology Fund

Uses: \$100.0M

- Development of priority infrastructure projects of science and technology, including Comprehensive Cancer Center: \$62.2M
- Municipal Development Fund (Infrastructure): \$20.0M
- Technology; Improvements and Works: \$17.8M

Sources: \$100.0M

- Special tax of 50% on extraordinary dividend payable by Joint Subscription Association (mandatory car insurance)
- Sample appropriations include flood control in rivers or bodies of water, dredging of PRPA docking areas, digitalization of the Property Registry, centralized mapping and GPS initiative, and improved financial intelligence platform.

3 Public Improvements Fund

Uses: \$100.0M

- Non - Distributed: \$69.7M
- Improvements and Works: \$22.8M
- Capital Equipment: \$7.6M

Sources: \$100.0M

- GO Debt Issuance - when market conditions allow.

- Amount smaller than lower-than-usual recent public improvement funds bond issuances in the ~\$300M range (FY11 and FY12).

General Fund Budget for FY2014

 Much of the budget is pre-committed to debt service, retirement contributions, appropriation formulas, and other non-discretionary or semi-discretionary expenses.

 The great majority of the General Fund budget increase is due to increases in debt service, contributions to retirement systems, restitution of the UPR formula basis, and restoration of carry-forward non-GF reserves that were funding FY13 expenses for the Department of Education.

 The rest of the General Fund budget registers a slight decrease. Essentially, pre-existing labor commitments, especially collective bargaining agreements and sick leave liquidations, are budgeted to be funded by austerity cuts in services, and by diminishing headcount from early retirees.

 OMB is committed, not just to short-term follow up and transactional review, but also to long term improvements in government efficiency, technology, and funds management. After recent rapid headcount reductions, the focus in the medium term has to be in an efficient, smart and effective government.

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During the last four years, the Highways and Transportation Authority (HTA) has relied on GDB to maintain its operations and capital improvements' program. As a result, GDB's loan exposure to HTA represented approximately 24% of the bank's loans as of March 31, 2013.

Consistent with our commitment to fiscal responsibility, the Administration has passed legislation to raise additional annual revenues for HTA and repay its outstanding loans with GDB.

On June 25, 2013, Puerto Rico passed Acts 30 and 31 of 2013 that will provide approximately \$271* million in additional annual revenues to HTA

1

License Fees

- Transfer to HTA of vehicle license fee revenues currently received by the Treasury Department, which amount to approximately \$62.5 million in additional annual revenues to HTA.

2

Petroleum Product Tax

- Increase in the petroleum products tax from \$3.00 per barrel to \$9.25 per barrel, which is estimated to result in approximately \$189 million in additional annual revenues to HTA.
- This tax will be subject to an adjustment for inflation, every four years beginning 2017, based on the accumulated compounded yearly increase in the USA CPI Index plus a margin of 1.5%.

3

Cigarette Tax

- Transfer to HTA and the Metropolitan Bus Authority (MBA) of the first \$30 million in annual cigarette tax revenues currently collected by the Treasury Department.
- First \$20 million will be collected by HTA and the next \$10 million will be assigned to MBA to pay outstanding debt service.

These measures are an essential step on HTA's road to financial stability and will allow the HTA to repay its loans with GDB.

These new measures represent increases to three of the main sources of revenues for HTA and add a new source of revenue

	HTA's Revenues	FY 2012*	New Revenues	Pro-Forma FY 2014
1	Gas tax	\$159.7M	--	\$159.7M
2	Tolls	\$137.1M	\$5.0M**	\$142.1M
3	Vehicle License fees	\$32.7M	\$62.5M	\$95.2M
4	Petroleum product tax	\$90.6M	\$188.8M	\$279.4M
5	Diesel & Oil gas tax	\$9.5M	--	\$9.5M
New	Cigarette Tax	n/a	\$20.0M	\$20.0M***
Total		\$429.6M	\$276.3M	\$705.9M

Given the new measures, HTA's annual revenues are expected to increase 64% to \$705.9 million

*According to audited financial statements.

** Not a new toll increase. Consists in the elimination of the Rapid Pass (Auto-Expreso) discount that does not require legislation for its implementation.

*** First \$20 million of cigarette tax will be collected by HTA. Next \$10 million will be assigned to finance MBA's operations.

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We have delivered significant positive results in only six months

Major accomplishments to address long-standing fiscal challenges have been effected:

- ✓ Act 154 excise tax has been increased and fixed at 4% after multiple conversations with relevant stakeholders.
- ✓ Finalized the P3 transaction involving the Luis Muñoz Marín International Airport.
- ✓ Enacted comprehensive ERS pension reform; legality validated by the Puerto Rico Supreme Court.
- ✓ PRASA rate increase approved by its Board; effective July 15, 2013.
- ✓ Enacted legislation to address HTA/GDB situation.
- ✓ Responsible budget for FY 2014 has been approved; on our way to achieve structural balance of our General Fund with real recurring revenues and expenses.

Next steps:

- Enact legislation to reform our Teacher's pension plan in next legislative session starting in August 2013
- Continue efforts to transform our public corporations and reduce our reliance on GO debt service restructurings