



COMMONWEALTH OF
PUERTO RICO
GOVERNOR

ALEJANDRO J. GARCÍA-PADILLA

February 22, 2016

VIA HAND DELIVERY

The Honorable Speaker Paul Ryan
Speaker of the House of Representatives
U.S. House of Representatives
H-232 U.S. Capitol Building
Washington, DC 20515-6501

RE: WORKING DRAFT OF THE FINANCIAL STATEMENTS OF THE COMMONWEALTH OF PUERTO RICO (THE "COMMONWEALTH")

Dear Mr. Speaker:

On February 16, 2016, the Commonwealth made publicly available a working draft of its Basic Financial Statements and Required Supplementary Information for the fiscal year ended June 30, 2014 (the "Working Draft").¹ The Commonwealth is making the Working Draft available prior to the completion of its audit - in addition to an unparalleled amount of verifiable financial information that has been released in recent months - to provide you with further information that could be useful in evaluating the Commonwealth's financial condition and new federal restructuring legislation needed to comprehensively address the Commonwealth's immediate debt crisis. A courtesy copy of the Working Draft is enclosed.

The Working Draft is subject to completion and audit. It includes, however, audited financial information for all of its close to 70 component units and fiduciary funds, except for the Government Development Bank for Puerto Rico ("GDB"), the Employees Retirement System ("ERS") and the Retirement System for the Judiciary ("JRS"). Subject to the limitations described in the disclaimer to the Working Draft, in the opinion of the responsible officers of the Puerto Rico Department of the Treasury, the unaudited financial information included in the Working Draft is a fair statement of the results for the periods reported. The issuance of the audited financial statements is expected to be completed by April 2016. However, there may be additional issues that arise during such period that require an adjustment to such timetable. The delay in completing the financial statements is due precisely to the complexities posed by our current fiscal crisis. I can assure you that we are diligently working to complete the financial statements as soon as possible.

As the Working Draft makes clear, the Commonwealth currently faces a severe fiscal and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession that began in 2006, high unemployment, record outmigration and high levels of debt and pension obligations.

¹ Puerto Rico Department of Treasury, Basic Financial Statements and Required Supplementary Information (Unaudited), Feb. 16, 2016, available at http://www.hacienda.pr.gov/sites/default/files/draft_unaudited_financial_statements_dated_2_16_2016_0.pdf.

The preliminary results for fiscal year 2014 in the Working Draft also show that the Commonwealth's "Primary Government" (as such term is defined in the Working Draft) reported an increase in its net deficit position of \$2.5 billion, from \$46.7 billion to \$49.2 billion during fiscal year 2014, notwithstanding an increase of \$1.7 billion in revenues and a reduction of \$915 million in expenses. The aggregate net position of the Commonwealth's "Discretely Presented Component Units" (as such term is defined in the Draft) also decreased by approximately \$1.7 billion during the same period, denoting a further erosion in the financial condition of the Commonwealth's public corporations. The increase in the net deficit position of the Primary Government and the decrease in the net position of the Discretely Presented Component Units are the result of higher operating expenses than operating revenues and an increase in such entities' liabilities, such as bonds and notes, net pension obligations, and legal claims, among other. These results reflect the continuation of a negative trend in the Commonwealth's financial condition: the Commonwealth's audited financial statements have reported increases in the net deficit position of the Primary Government of approximately \$5.4 billion, \$5.4 billion, \$3.2 billion, \$3.9 billion and \$3.7 billion for fiscal years 2013, 2012, 2011, 2010 and 2009, respectively.

Furthermore, preliminary results in the Working Draft for the Commonwealth's "Governmental Funds" financial statements, which focus on near-term inflows and outflows of expendable resources and are thus useful in evaluating the government's near-term financing requirements, report a deficit (before financing sources) of approximately \$4.1 billion. This deficit was financed through the issuance in March 2014 of \$3.5 billion in general obligation bonds (sold in its entirety to hedge funds) and other financing sources. This continues a decade long trend of Governmental Funds deficits (before financing sources) that according to the Commonwealth's audited financial statements for the previous five fiscal years reached approximately \$3.6 billion, \$5.2 billion, \$3.8 billion, \$4.3 billion and \$3.5 billion for fiscal years 2013, 2012, 2011, 2010 and 2009, respectively.

Moreover, as the explanatory notes to the Working Draft explain, the Commonwealth's management has concluded that there is substantial doubt about the ability of the Commonwealth's Primary Government and a significant number of its Component Units and Fiduciary Funds to continue as a going concern in accordance with GASB Statement Number 56. To underscore the nature of the crisis, note that the entities subject to going concern qualifications include the Commonwealth central government itself, which provides essential services such as safety and primary and secondary education, the Puerto Rico Electric Power Authority, the sole provider of electricity on the island, the Puerto Rico Highways and Transportation Authority, which operates the island's major roads and highways, the Puerto Rico Metropolitan Bus Authority, which provides mass transit services in the San Juan metropolitan area, the Puerto Rico Medical Services Administration, which runs the Commonwealth's main hospital and trauma center, and the Puerto Rico Health Insurance Administration ("PRHIA"), which oversees the island's Medicaid-funded MiSalud program that provides health insurance coverage to approximately 1.6 million low income persons.

The notes to the Working Draft also state that there is substantial doubt about of the ability of GDB to continue as a going concern and stress that GDB projects its liquidity may be insufficient to meet all of its financial obligations in the fourth quarter of fiscal year 2016 (April to June 2016). As the entity responsible for holding government deposits and offering short-term liquidity, managing the Commonwealth's finances and clearing payments, GDB plays an essential role in Puerto Rico's financial system. Consequently, the Commonwealth may be required to enact emergency legislation that could include a moratorium on the payment of debt service with respect to outstanding GDB indebtedness or other remedies that affect the rights of creditors.

Lastly, I want to address the misconception about the lack of reliable and up-to-date financial information regarding the Commonwealth's debt crisis. Over the last year the Commonwealth has published:

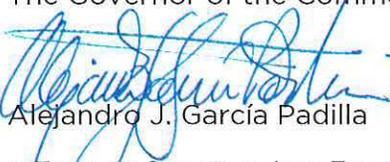
- (i) A comprehensive debt sustainability analysis prepared by Dr. Anne Krueger and other former IMF economists known as the "Krueger Report" and dated June 29, 2015;²
- (ii) A detailed liquidity analysis prepared at the request of creditors by Conway MacKenzie dated August 25, 2015 (the "Conway Report");³
- (iii) The Puerto Rico Fiscal and Economic Growth Plan, dated September 9, 2015, as updated on January 18, 2016, which contains detailed 10 year revenue and expenditure projections for the Commonwealth and its instrumentalities and the Commonwealth's plan to stabilize its finances and grow its economy;⁴ and
- (iv) The Commonwealth of Puerto Rico Financial Information and Operating Data Report dated November 6, 2015, which provides a general overview of the Commonwealth' financial condition, its outstanding debt service obligations and recent material developments.⁵

The depth of our debt crisis has been extensively disclosed. Our debt is unsustainable and a broad restructuring of our debt is inevitable. The issue is whether the restructuring will occur under a broad legal framework and in an orderly manner or without any legal guardrails and chaotic. Failure to enact a broad restructuring framework will cause years of legal challenges - against the Commonwealth and among creditors - that will harm the government's ability to provide essential services, accelerate outmigration to the U.S. mainland, further contract the Puerto Rican economy and severely impair creditors' ability to recover on their claims. Without the rule of law, 3.5 million American citizens in Puerto Rico face an ever more uncertain future.

I will continue to update you as we move forward with the completion of the Commonwealth's financial statements. I assure you that we are working together with KPMG with all deliberate speed to complete the audit. The Commonwealth's Secretary of the Treasury is also available at your convenience to discuss any questions your Committee may have concerning this matter.

Cordially,

The Governor of the Commonwealth of Puerto Rico,



Alejandro J. García Padilla

c Treasury Secretary Juan Zaragoza

Enclosure

² Anne O. Krueger, Ranjit Teja and Andrew Wolfe, Puerto Rico - A Way Forward, Jun. 29, 2015 (as updated on Jul. 13, 2015), available at <http://www.bgfpr.com/documents/FinalUpdatedReport7-13-15.pdf>.

³ Conway MacKenzie, Liquidity Update, Aug. 25, 2015, available at <http://www.bgfpr.com/documents/150825ConwayMacKenzieLiquidityUpdateReport.pdf>.

⁴ Working Group for the Fiscal and Economic Recovery of Puerto Rico, Puerto Rico Fiscal and Economic Growth Plan, Sept. 9, 2015, available at <http://www.bgfpr.com/documents/PuertoRicoFiscalandEconomicGrowthPlan9.9.15.pdf>; Jan. 18, 2016 update, available at <http://www.bgfpr.com/documents/PRFEGPUpdatePresentation1.18.16-2.pdf>.

⁵ Commonwealth of Puerto Rico, Financial Information and Operating Data Report, Nov. 6 2015, available at <http://www.bgfpr.com/documents/CommonwealthReport11-06-15.pdf>.