



General Report on Public Debt

December 2010



Agenda

1 Public Debt Summary

2 COFINA Issues

3 Conclusion



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The public debt mechanism plays a key role in economic development

Public debt objective:

- The State should use the debt issuance mechanism to provide resources for the development of permanent public improvements for the general benefit and to spur economic expansion.

It is public policy to:

1. Fully comply with the payment of public debt
2. Keep public debt at reasonable levels within the Constitutional allocation and within Puerto Rico's capacity
3. Identify debt refinancing and repayment opportunities that are favorable for the Government of Puerto Rico
4. Maintain and enhance Puerto Rico's credit rating to ensure continued access to financing



Public debt has five main components:

Central Government Debt

- Constitutional debt and extra-constitutional debt that is paid from the general fund

COFINA

- Mainly debt from accumulated deficits

Public Corporations

- Financing of operations and capital improvements

Municipalities

- Financing of operations and capital improvements

Debt that is not supported by the general fund

- Other debt not involving state tax funds



The Central Government's public debt has been reduced by 10.2% since December 2008

| Item | December 08 | December 09 | December 10 | \$ Difference (2010-2008) |
|---|-----------------|-----------------|-----------------|------------------------------|
| Constitutional | 9,006 | 9,511 | 9,193 | \$187 |
| TRANS and TRABs | 2,500 | 900 | 900 | (1,600) |
| Extra-constitutional | 2,721 | 2,797 | 2,689 | (32) |
| Central Government Total | 14,228 | 13,208 | 12,782 | (1,446) |
| COFINA (net) | 6,306 | 11,544 | 14,218 | 7,912 |
| PRASA | 2,827 | 3,144 | 3,473 | 646 |
| PREPA | 6,031 | 5,858 | 7,781 | 1,750 |
| PRHTA | 6,344 | 6,240 | 6,120 | (224) |
| PRPBA | 3,124 | 3,300 | 3,324 | 200 |
| PRIFA | 1,853 | 1,828 | 1,798 | (55) |
| PRPA | 59 | 56 | 46 | (13) |
| Other and Debts with GDB and Private | 6,358 | 6,932 | 5,653 | (705) |
| Public Corporations Total | 26,596 | 27,358 | 28,195 | 1,599 |
| Municipalities | 2,838 | 3,139 | 3,331 | 493 |
| Debt not supported by General Fund | 6,489 | 5,407 | 5,358 | (1,131) |
| Debt, Grand Total | \$56,455 | \$60,656 | \$63,884 | \$7,429 |



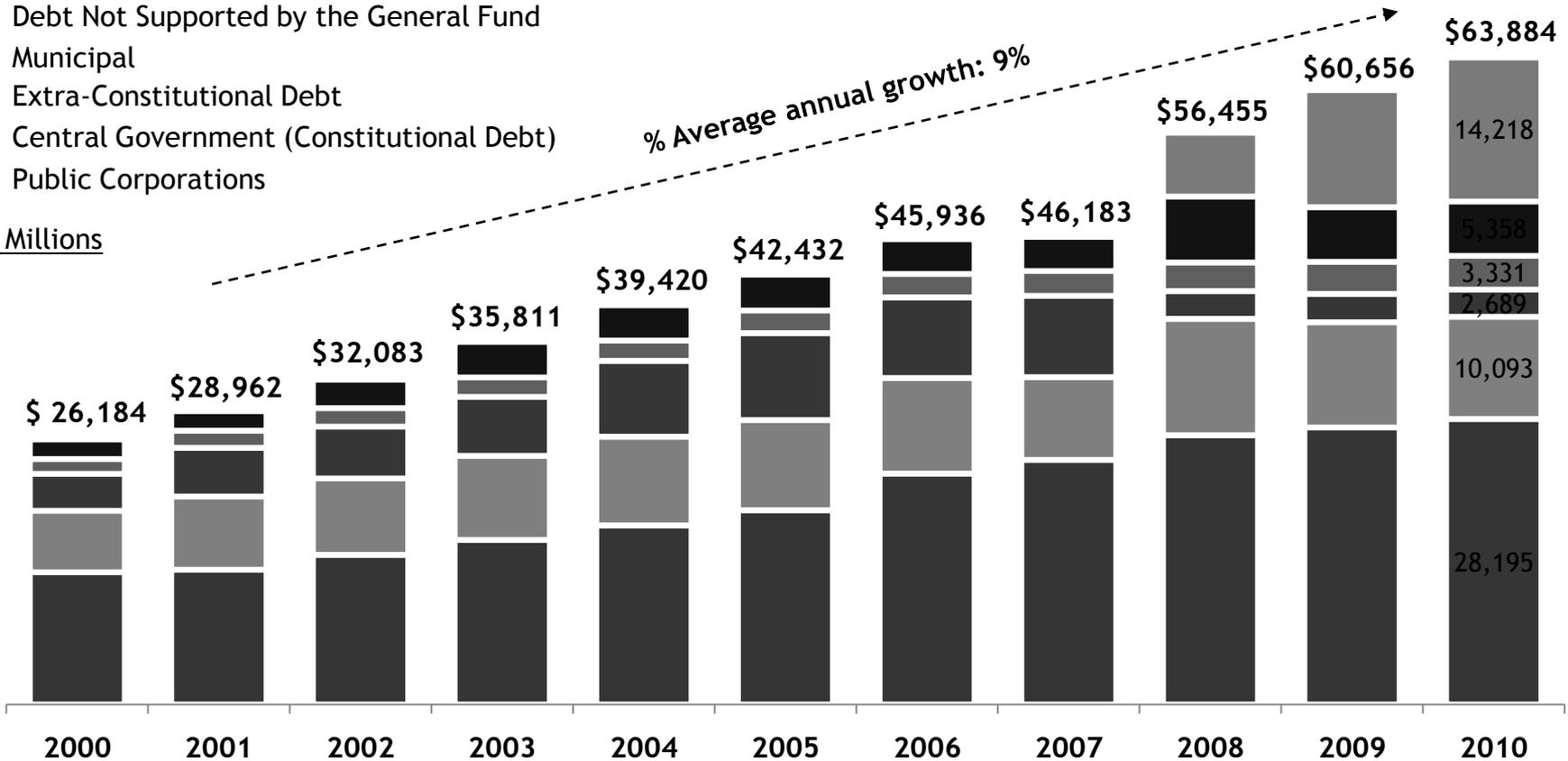
Snapshot of Puerto Rico's Public Debt

The total outstanding public debt reached \$63,884 million as of Dec 10 *

- COFINA
- Debt Not Supported by the General Fund
- Municipal
- Extra-Constitutional Debt
- Central Government (Constitutional Debt)
- Public Corporations

% Average annual growth: 9%

\$ Millions



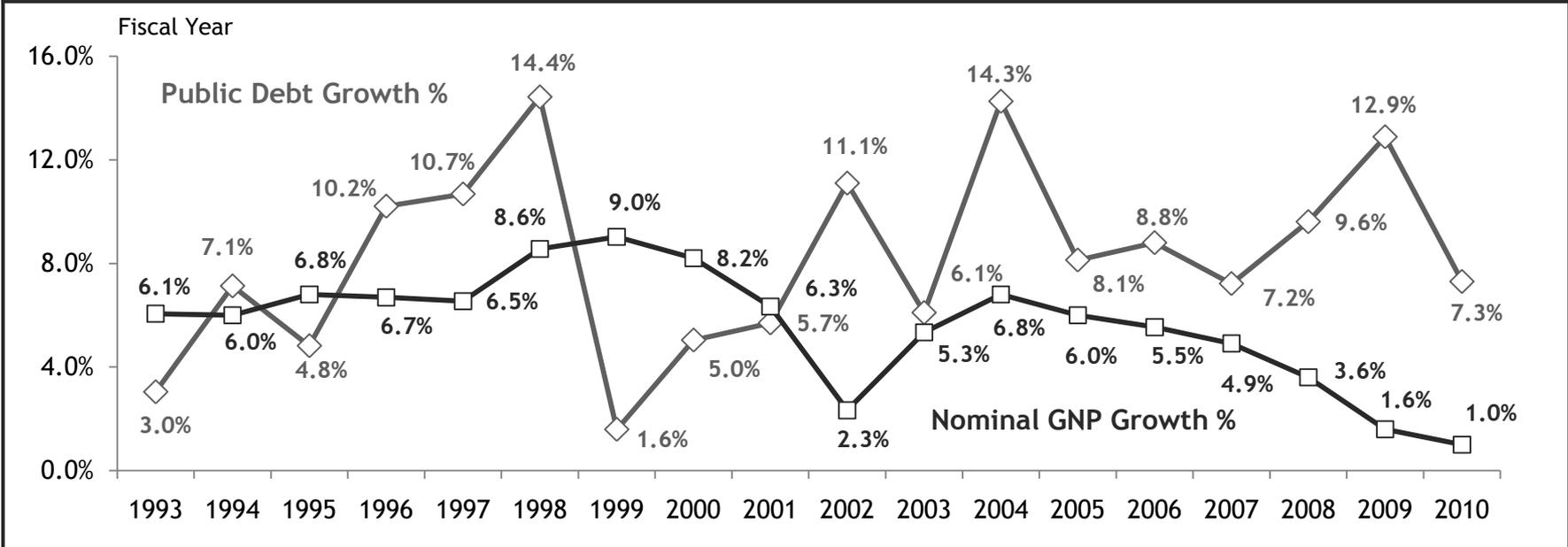
Source: Government Development Bank for Puerto Rico

* Includes total outstanding debt, including debt that is not supported by the general fund at the end of the calendar year.



The neglected economic recession encouraged the use of debt to cover the trailing deficit of recent years...

The growth of the public debt has exceeded the growth of the economy *



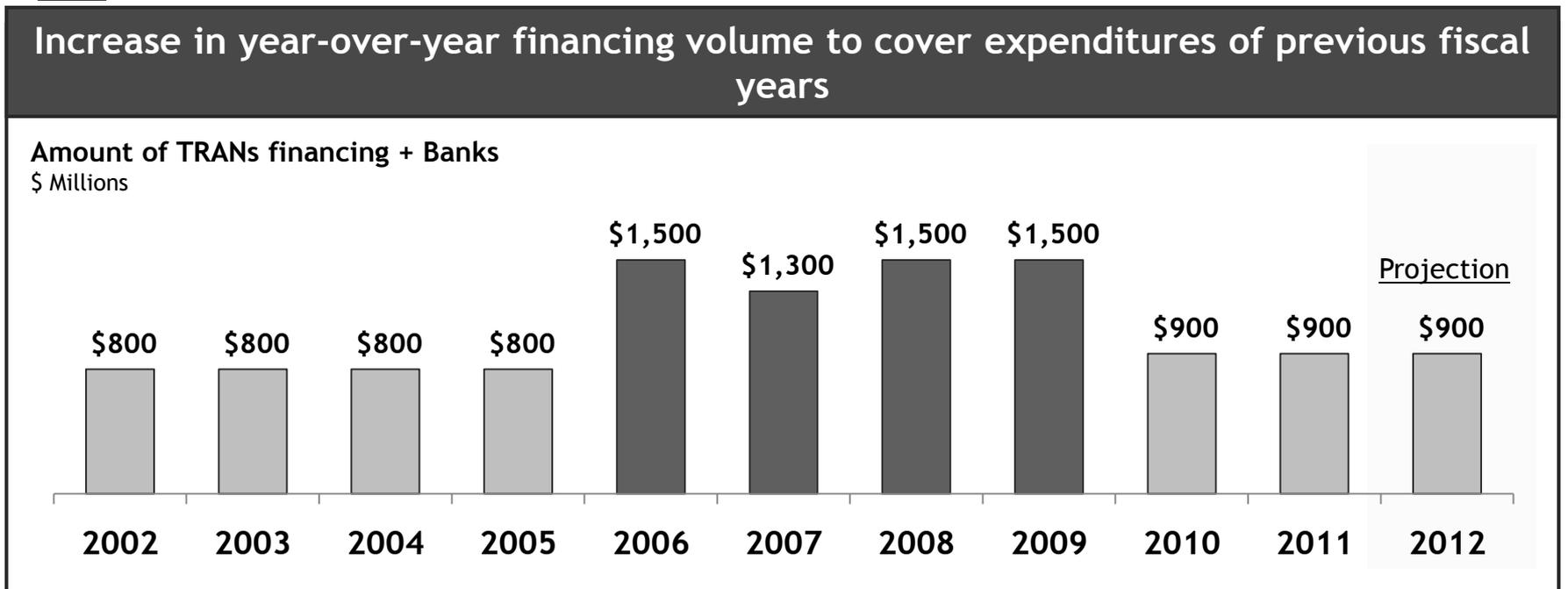
With the exception of FYs 93, 95, 99-01, in the past 17 years, the debt has been growing at a faster rate than the economy. In FY 2010, we are paying the cost of over-dimensioned growth of expenditures and debt incurred in FYs 02-08, which we are forced to pay

Source: Government Development Bank for Puerto Rico and Puerto Rico Planning Board.
* The total public debt, excluding the debt that is not supported by the general fund, was used.



Dramatic increases in year-over-year financings and the practice of increasing the use of these financings early in the fiscal year to pay off withheld payments from previous fiscal year put the government in a delicate position near the end of the fiscal year

- Among these financings, the TRANs represent a very important mechanism available to the government at the beginning of each year in advance of tax collections. The government should have repaid the TRANs at the end of each fiscal year with the proceeds from income taxes.
- TRANs should be used to repay current expenditures with revenues generated during the same fiscal year.



Source: Government Development Bank for Puerto Rico
* TRANs = Tax Revenue Anticipation Notes.



Agenda

1

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2

COFINA Issues

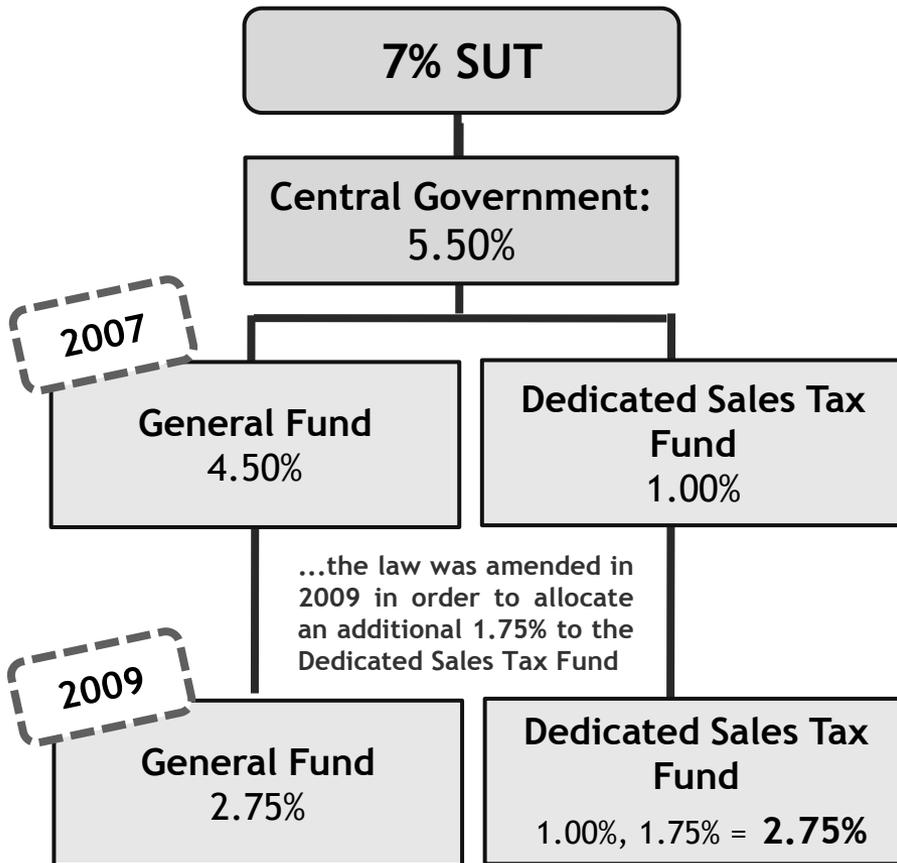
3

Conclusion



Act 117 of July 2006 established a 7% Sales and Use Tax (SUT) throughout the island ...

Tax Structure



Allocation of Funds

1. The first SUT revenues go **directly** to the Sales Tax Fund to repay bonds issued by COFINA up to a Base Amount
2. The proceeds from COFINA issues were used to:
 - Pay extra-constitutional debt
 - Pay the debt of the Secretary of the Treasury with the GDB in the amount of \$1.0 billion, which was used to finance the budget deficit from fiscal year 2008-2009
 - Pay the financings granted to the Secretary by GDB that were payable from future issues of general obligation bonds of the Commonwealth, as well as any debt without a repayment source or payable from legislative budget appropriations of the Government that were in existence as of December 31, 2008
 - Pay accounts payable to Government providers
 - Finance Government operating expenses for Fiscal Years 2009, 2010, 2011 and 2012
 - Provide funds to the Local Economic Stimulus Plan



Since the SUT was implemented, the proceeds from COFINA issues were all used to pay Extra-Constitutional Debt without a repayment source and the trailing deficits left by previous administrations

| Issue | Proceeds | Proceeds used to pay Extra-Constitutional Debt |
|--------------|------------------------|--|
| 2007 A | \$2,594,848,883 | 100% |
| 2007 B | \$1,314,816,191 | 100% |
| 2007 C | \$496,772,146 | 100% |
| 2007 A | \$737,046,992 | 100% |
| Total | \$5,143,484,212 | 100% |

At the time of the first COFINA bond issue in July 2007, the extra-constitutional debt (including loans from the GDB) totaled \$8.029 billion



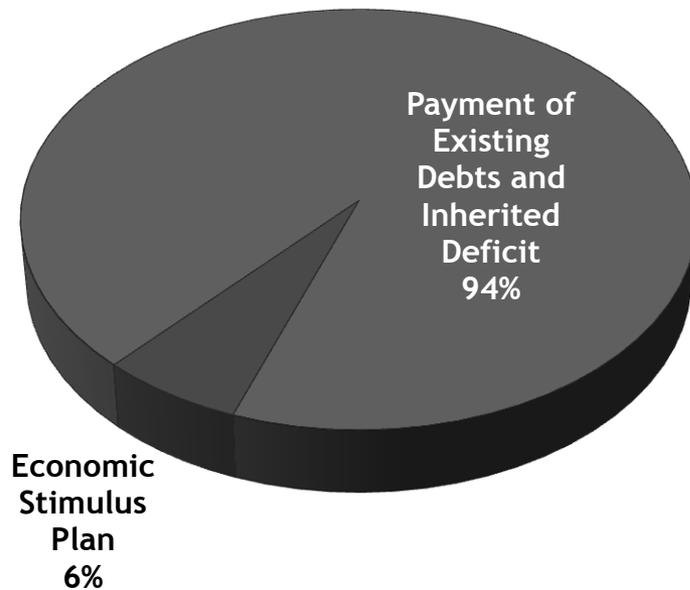
94% of the proceeds from the 2009 and 2010 issues was used to pay existing debts and tackle the inherited deficit

| Sources of Funds: | Total |
|--|------------------------|
| Series 2009A, 2009B, 2010A, 2010C, 2010D, & 2010E | |
| Net Proceeds | \$7,935,377,388 |
| Uses: | |
| Repayment of GDB loan collateralized by Treasury delinquent accounts (used for FY2009 operating expenses) | \$1,000,000,000 |
| Repayment of interim loans used to cover fiscal year 2008-2009 deficit incurred by the past administration | 1,302,156,725 |
| Debt service, GDB loans without repayment source incurred by the previous administration | 635,550,963 |
| Payment to suppliers (insufficient funds checks, FY 2009) | 756,315,969 |
| Stabilization Fund FY 2010 | 2,500,000,000 |
| Stabilization Fund FY 2011 | 1,000,000,000 |
| Local Economic Stimulus Plan | 500,000,000 |
| Other | 241,353,731 |
| Total | \$7,935,377,388 |

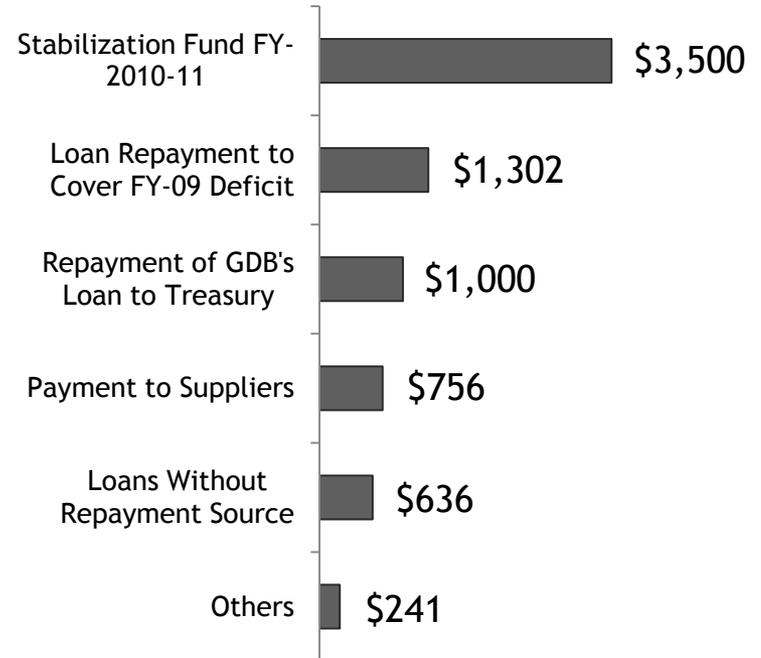


Following the inherited fiscal disaster and deficit, only 6% of the proceeds from 2009 and 2010 issues were used to incentivize the economy

Use of COFINA Funds



Distribution - Payment of existing debts and inherited deficit (\$ Millions)





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1

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2

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3

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Concluding Remarks

- The public debt mechanism plays a key role in economic development
- The unattended economic recession encouraged the use of debt to cover the trailing deficit of recent years
- However, the Central Government's public debt has been reduced by 10.2% since December 2008 as a result of prudent public debt management
- 94% of the proceeds from the 2009 and 2010 COFINA issues was used to pay existing debts and tackle the inherited deficit
- Only 6% of the proceeds from the issues was used to incentivize the economy



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