


Commonwealth of Puerto Rico
Office of the Comptroller




Puerto Rico Fiscal Distress

*National Intergovernmental Audit Forum
Washington D.C.
October 21, 2015*

Yesmín M. Valdivieso
Comptroller


Puerto Rico at a Glance



| | |
|------------------------------|--|
| Territory of the U.S. | Spanish-American War in 1898 |
| Geography | Island in the Caribbean: 100 mi x 35 mi |
| Population | 3.5 million |
| Language | Mostly Spanish speaking |
| Political Status | Commonwealth |

2 Puerto Rico Fiscal Distress

Office of the Comptroller of Puerto Rico



Cont. Puerto Rico at a Glance

| | |
|-----------------------------------|--------------------------------|
| Consolidated Budget 2016* | \$28.8 billion |
| General Fund Budget | \$9.8 billion |
| From taxes, licenses, etc. | \$4.2 billion |
| Public Debt** | \$72.6 billion |
| Debt Service | Almost tripled in last 3 years |
| Financial Statements | 2013 |
| Unemployment rate 2010 | 16.4% |
| Participation rate | 40% |



*Budget for 2016 was approved with a note that it would be reviewed in a quarterly basis.
 ** Does not include retirement system.

Per Capita (per year)

| | |
|-----------------------------|----------|
| District of Columbia | \$76,532 |
| U.S.A. | \$46,129 |
| Mississippi | \$34,333 |
| Puerto Rico | \$17,855 |



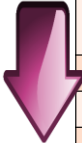
Source: U.S Bureau of Economic Analysis and Puerto Rico Planning Board

Cont. Puerto Rico at a Glance

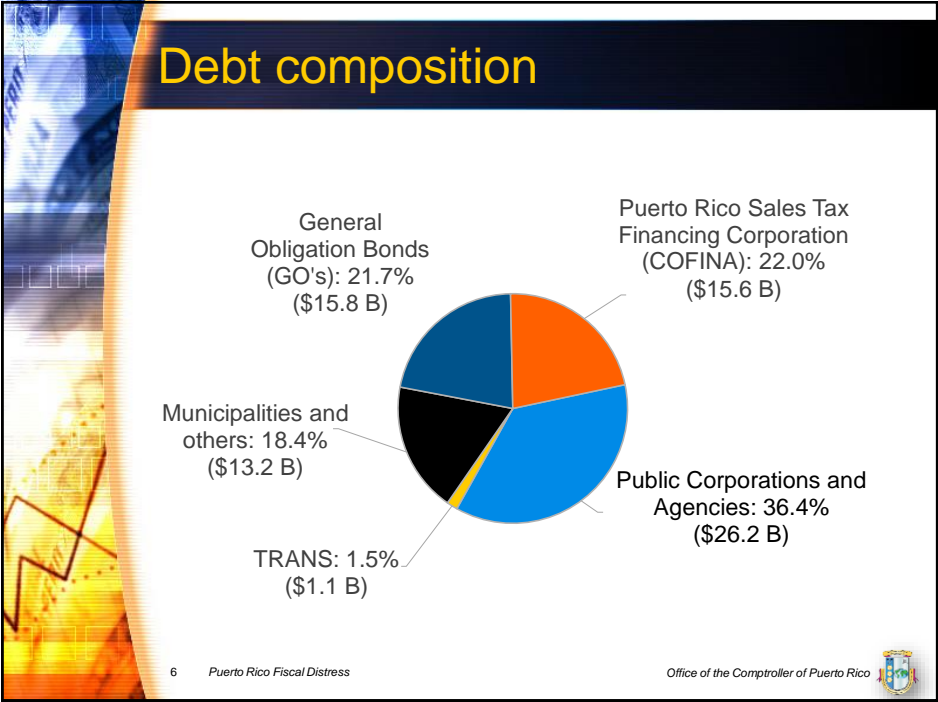
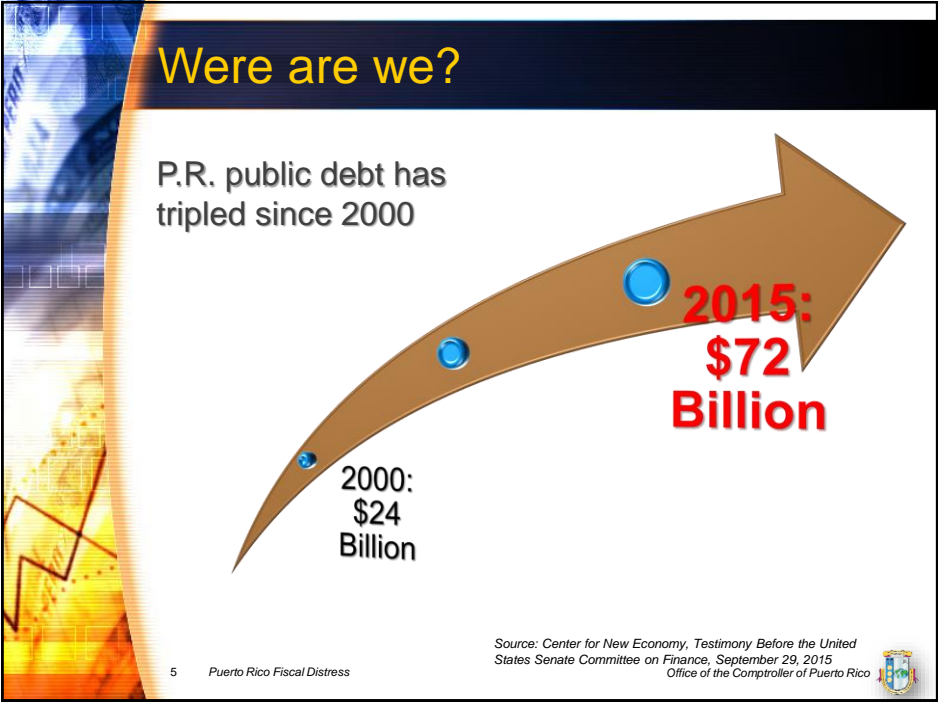
| YEAR | BANK ASSETS (IN BILLIONS) |
|------|---------------------------|
| 2004 | \$74,342 |
| 2007 | \$87,918 |
| 2013 | \$61,276 |



| YEAR | MORTGAGES (IN BILLIONS) |
|------|-------------------------|
| 2004 | \$10,976 |
| 2007 | \$5,917 |
| 2013 | \$1,736 |



*Source: Office of the Commissioner of Financial Institutions



PR Constitution

Art. VI, Section 8

“In case the available revenues including surplus for any fiscal year are insufficient to meet the appropriations made for that year, interest on the public debt and amortization thereof shall first be paid, and other disbursements shall thereafter be made in accordance with the order of priorities established by law”.



Pay public debt?

Pay services?



Responding to Fiscal Distress

Responding to fiscal distress

- **Act 103-2006:** Fiscal Reform
- **Act 7 – 2009:** Declared a Fiscal Emergency
- **Act 70 – 2010:** Incentivated retirement plan
- **Act 3 – 2013:** Restructuration of Pension Plans for public servants
- **Act 66-2015:** Sustainability Law



Responding to fiscal distress

Puerto Rico, A Way Forward – Report by
Anne O. Krueger, Ranjit Teja and Andrew Wolfe, -
June 29, 2015

- Reduction in minimum wage
- More flexibility in labor laws
- Welfare reform
- Reduction in energy costs
- Reform public corporations such as:
the energy, water and the State
Insurance Fund



Responding to fiscal distress

Creation of the **Working Group for the Fiscal and Economic Recovery of Puerto Rico (WG)** - Executive Order 2015-022 - June 29, 2015

- Puerto Rico Fiscal and Economic Growth Plan – prepared by the WG - September 9, 2015

Summary

- The cumulative financing gap for the Commonwealth is projected to be \$27.8 billion from fiscal year 2016 to FY 2020 absent corrective action.
- Proposes the implementation of a control board and new budgetary regulations, pursuant to proposed legislation known as the Fiscal Responsibility and Economic Revitalization Act (“FRERA”).



Working Group for the Fiscal and Economic Recovery of Puerto Rico

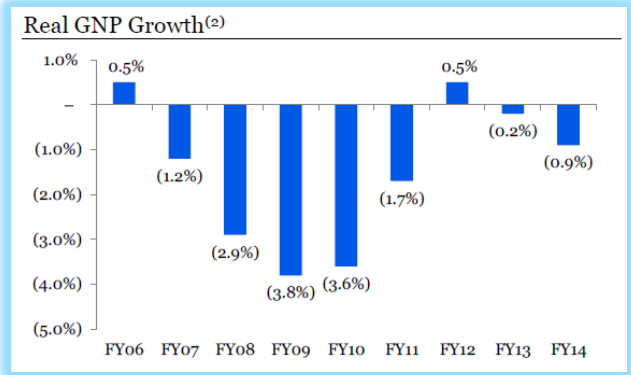
Cont. Summary

- Meaningful changes to US federal policies are critical for the Commonwealth to meet its debt service.
- Public Debt is not sustainable. Paying debt service is currently scheduled in the face of significant financing gaps could severely impair the Commonwealth’s ability to provide essential services to its residents
- There is an absence of an effective federal or Commonwealth public debt restructuring legal framework.
- A consensual compromise of the creditors’ completing claims to the Commonwealth’s revenues to support debt service will be required in order to avoid a disorderly default.

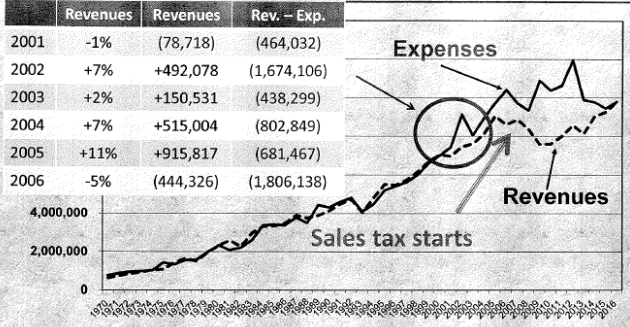


How did we get here?

Expiration of Section 936 of the US Internal Revenue Code in 2006



General Fund: Revenues vs. Expenses (In \$ thousands.)



Sources: Comprehensive Annual Financial Report (CAFR) of the Government of Puerto Rico.



Municipalities



- 50 municipalities operate with deficit
- 43 have negative balances in their General Fund
- 22 spend more than 20% of its revenues in debt repayment
- In 40 municipalities over 40% of its revenues come from the Central Government.

Another Government strategy is to delegate certain responsibilities to municipalities.



Significant Fiscal Responsibility Measures

The Commonwealth has repeatedly taken difficult measures to reduce its consolidated financing gaps

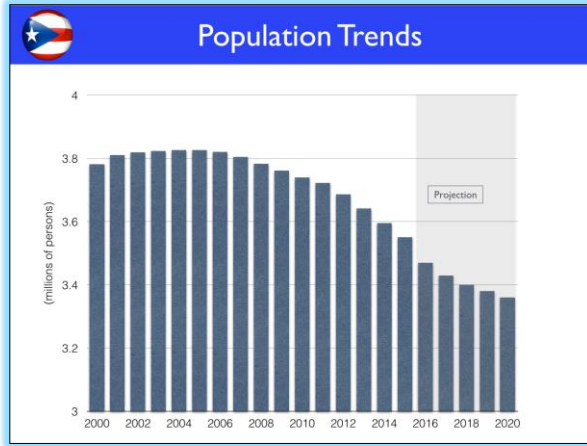
- The following chart represents a select subset of the various measures that the Commonwealth has taken since the onset of the economic crisis

| Revenues | Expenditures | Other Fiscal Responsibility Measures |
|---|---|--|
| 2007: 7% Sales and Use Tax ("SUT") implemented ~\$1.1bn per year | 2010: Voluntary resignation and work-day reduction programs ~\$91mm | 2011: Gradually increase employer contribution to ERS from 9.275% to 20.525% |
| 2011: Act 154-2011 institutes annually declining 4% excise tax on multinationals operating in Puerto Rico ~\$1.9bn per year | 2010: Temporary suspension of certain laws, collective bargaining agreements and other contractual agreements ~\$107mm | 2011: Gradually increase employer contribution to TRS from 8.5% to 19.75% per employee |
| 2011: UPR ⁽¹⁾ stabilization fee ~\$40mm per year (later repealed) | 2011: Involuntary layoffs ~\$367mm | 2011: Complete public-private partnership ("P3") of PR-22 |
| 2013: Act 154 excise tax reset at 4% rate | 2013: Eliminate subsidies to PRASA ⁽²⁾ (due to PRASA rate increase) ~\$340mm | 2013: Complete P3 of LMM International Airport |
| 2013: Petroleum products tax increase from \$3.00 to \$9.25 per barrel ~\$190mm per year | 2014: Reduction in non-salary benefits ~\$51mm (prohibited December bonus above \$600 and liquidations of unused vacation or sick leave); government merit bonuses eliminated | 2013: Increase employee contribution to ERS ⁽³⁾ from 8% to 10%; eliminate special law benefits to ERS retirees; increase retirement age |
| 2014: Gross profits tax on corporations ~\$300mm per year | 2014: Judicial and legislative budget reductions ~\$45mm | 2013: Increase employee contribution to TRS ⁽⁴⁾ from 9% to ~13%; eliminate special law benefits to TRS retirees; increase retirement age (ruled unconstitutional in part) |
| 2014: SUT charged at point of entry ~\$70mm per year | 2014: UPR, Judicial and Municipality appropriation levels frozen from 2015-2017; CBA salary increases frozen | 2013: Eliminate "scoop and toss" ⁽⁵⁾ of PBA ⁽⁶⁾ debt service (\$175mm in FY 2013) |
| 2015: Petroleum products tax raised from \$9.25 to \$15.50 per barrel, providing an incremental ~\$170mm per year | 2015: School transportation cost reductions and school consolidations ~\$110mm | 2014: Eliminate "scoop and toss" ⁽⁵⁾ of GO ⁽⁷⁾ debt service (\$975mm in FY 2014) |
| 2016: SUT increased from 7% to 11.5% and VAT ⁽⁸⁾ instituted; projected ~\$1.1-\$1.3bn per year | 2013-2015: 3% annual payroll reduction | 2014: Prohibit deficit financings by GDB |

(1) University of Puerto Rico ("UPR")
 (2) Puerto Rico Aqueduct and Sewer Authority ("PRASA")
 (3) Employee Retirement System ("ERS")
 (4) Teachers Retirement System ("TRS")

(5) "Scoop and Toss" generally refers to the elimination of annual debt principal and interest through a refinancing with delayed payment dates.
 (6) Public Buildings Authority ("PBA")
 (7) General Obligation "GO"
 (8) Value Added Tax ("VAT")

Effect on population



Source: Puerto Rico – A Way Forward – Anne O. Krueger, Ranjit Teja and Andrew Wolfe, June 29, 2015



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