



General Exposition of the FY 2010 Recommended Budget

Legislative Joint Committee on Treasury
May 3, 2009

Carlos M. García
President



1. Economic and Fiscal Challenge

2. Reconstruction Plan and Multi-Year Vision

3. Confirmed Deficit for Fiscal Year 2009

4. FY 2010 Recommended Budget and Fiscal Stabilization



Puerto Rico faces important challenges that have placed our credit at risk

Two main perils loom over Puerto Rico's credit

An Economy in Need for Investment

- We have experienced five consecutive years of economic slowdown.
- We are facing the third year of recession.
- We need to create jobs and make strategic investments.
- We are experiencing a gradual slide in global competitiveness.
- The financial sector is devalued and in crisis.

Fiscal Deficit

- Overestimations of the economy and revenue have caused deficits.
- Government unable to take on visionary projects.
- Puerto Rico, at risk of losing its credit.

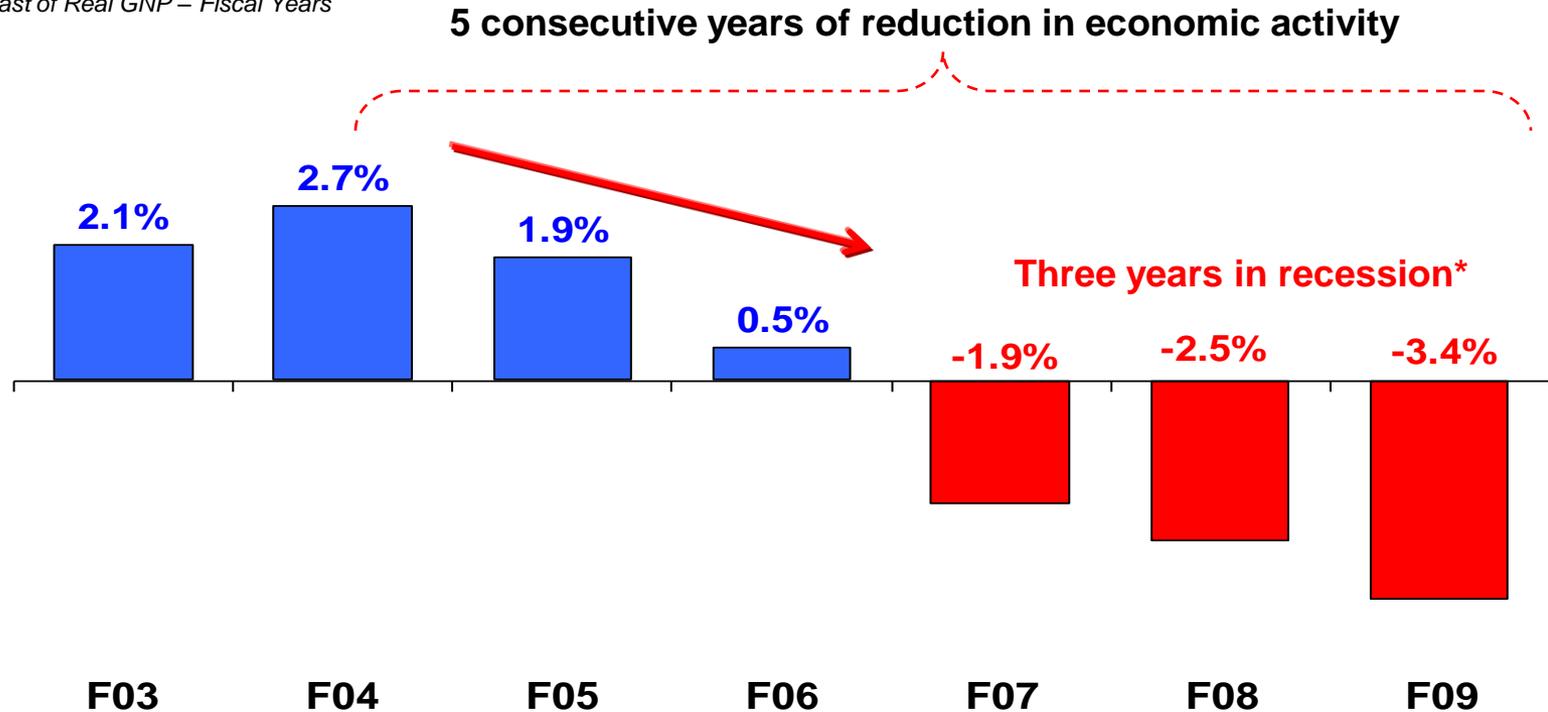
CREDIT WEAKENED AND AT POTENTIAL RISK



Our economy requires immediate attention through stimulus and strategic investment that will allow growth

We must turn back this trend and turn it into sustainable recovery

Forecast of Real GNP – Fiscal Years

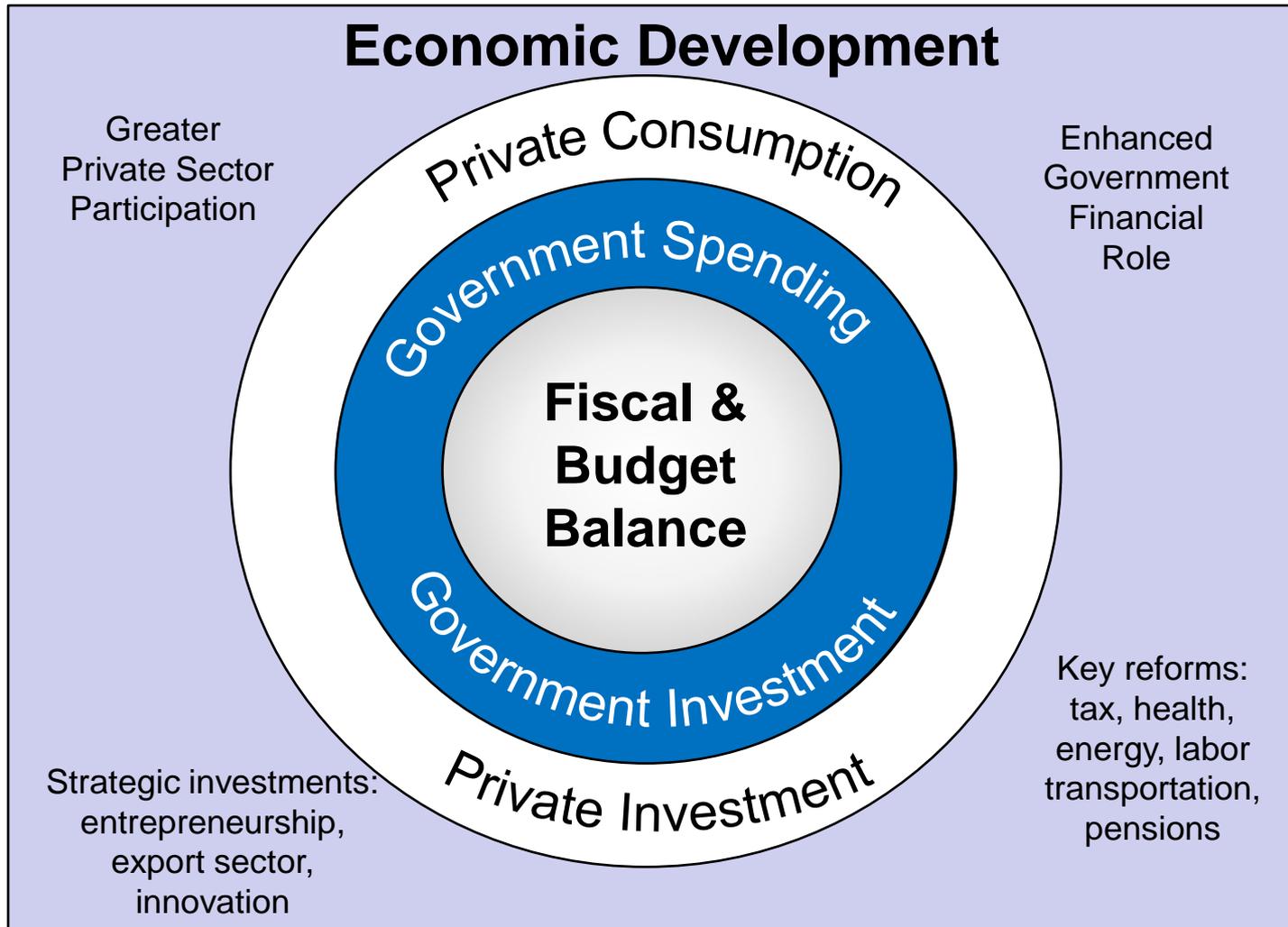


Source: Puerto Rico Planning Board.

* Economic forecasts based on base scenarios.

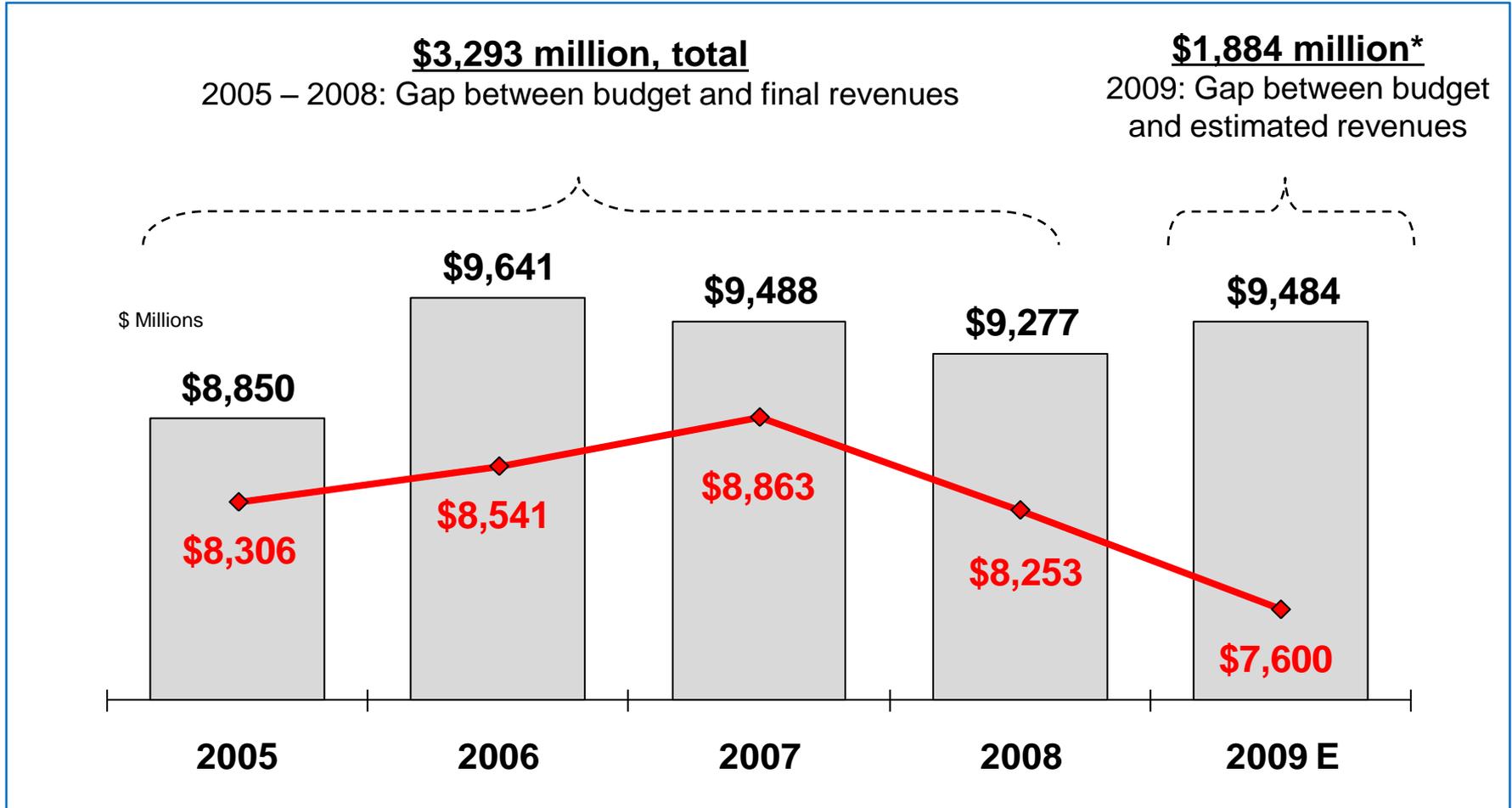


Solving the fiscal problem is key to being able to provide our economy with the sustained stimulus support and investment it needs and to get out of the recession





Revenue overestimations allowed for inflated budgets and caused a continuous fiscal imbalance



Source: Puerto Rico Budgets, Office of Management and Budget and PR Treasury Dept.

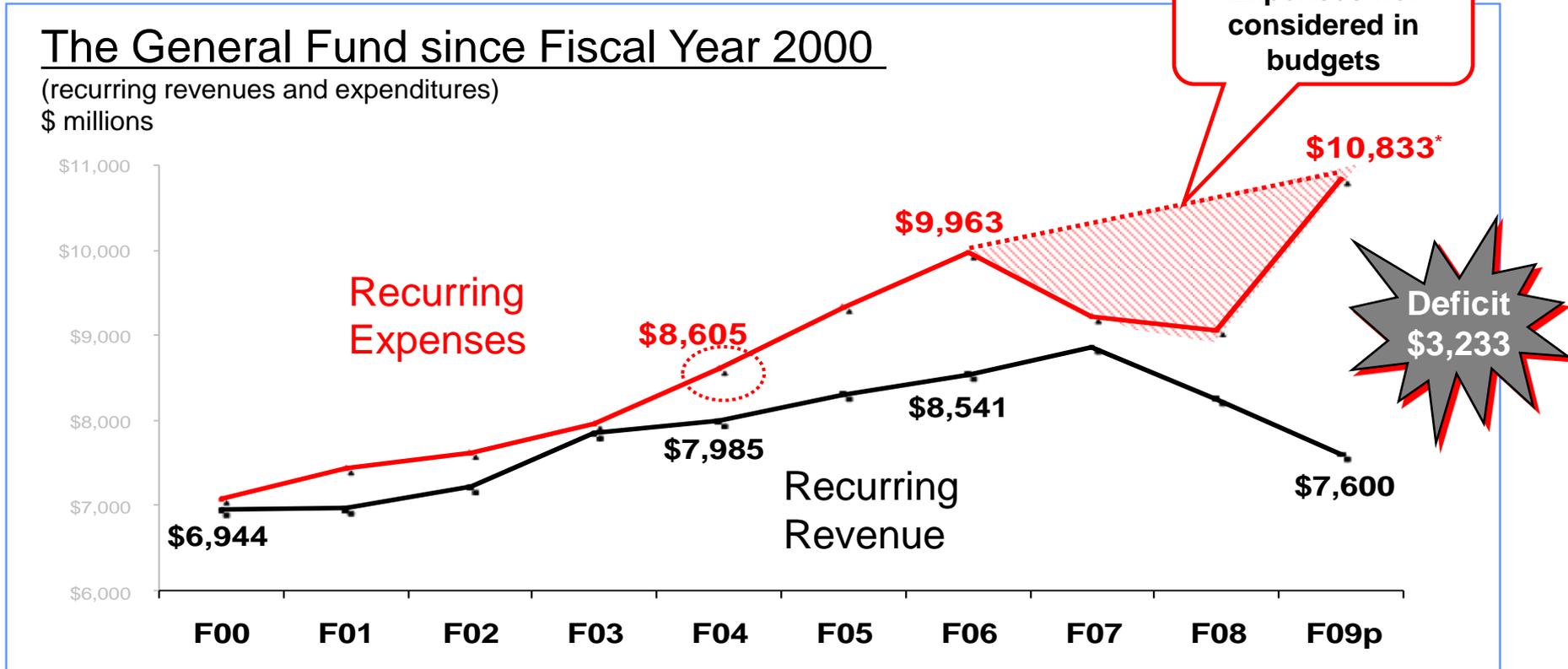
* FY 2009 proposed budget included the sale of \$1.0 billion of accounts receivables from the Treasury Department. Adverse market conditions have not allowed for the sale of such account payables portfolio.

■ General Fund Budget
— Real Net Revenue
(2009, estimated)



FISCAL EMERGENCY: The result is a gap between revenues and expenses

- Expenditure growth accelerates in Fiscal 2004
- Temporary measures to postpone expenditures in FYs 2007 and 2008 explode in 2009
- Reported deficits have been covered with non recurring revenues or measures that have run out

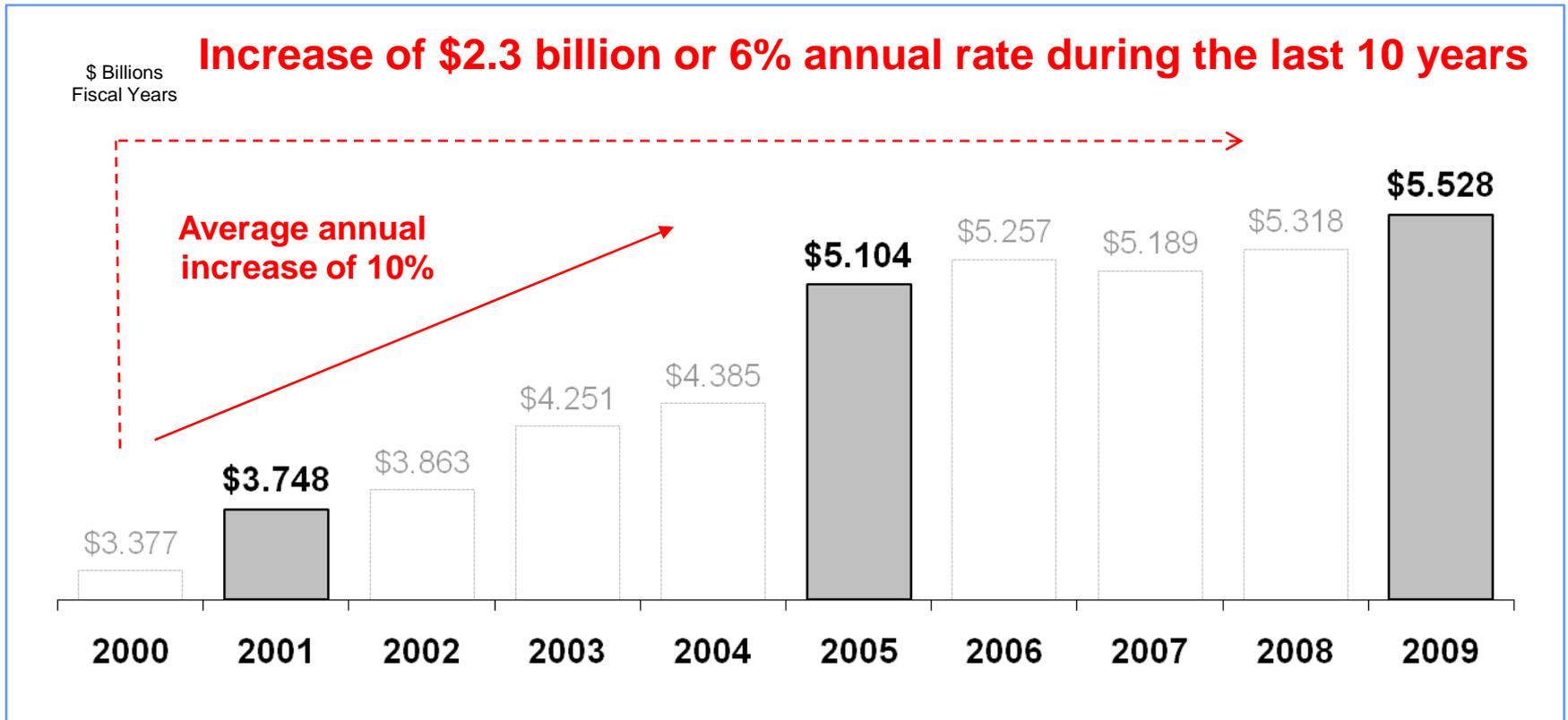


Fuente: PR Planning Board, Government Transition Reports 2008,
* Certified deficit as of Apr-29-09.



The growth in payroll expenses of the Central Government has been disproportionate in relation to revenue growth

- The Government payroll expenses increased at an average annual rate of 6% during the last 10 years, in comparison to 1% in revenue growth.
- Between 2000 and 2005, the payroll grew at 10% annually.

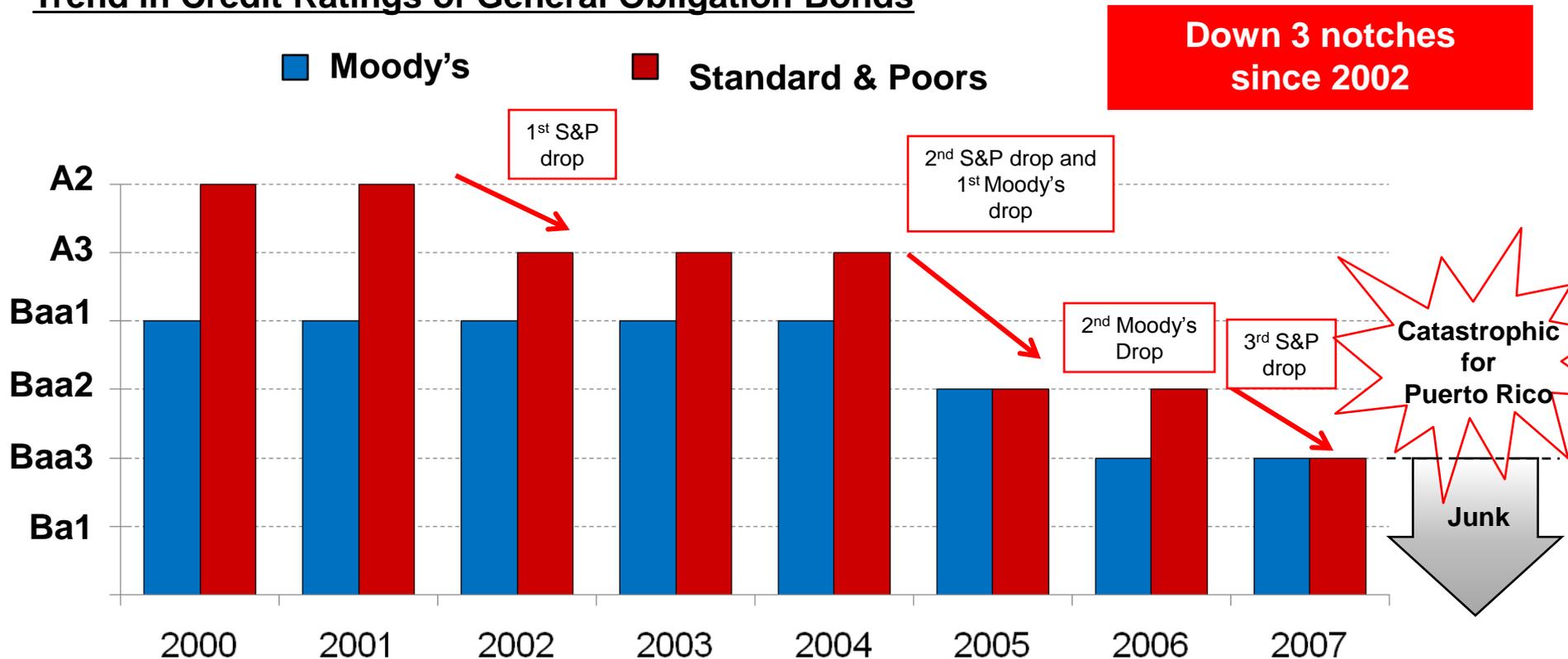




Protecting and strengthening our credit is critical, given our weakened economy

- Puerto Rico's credit has been downgraded regularly during recent years, to the point that it is close to "junk".
- A balanced budget together with fiscal discipline and an economic growth program are the only factors that can stop this negative trend.

Trend in Credit Ratings of General Obligation Bonds





The approval of the Reconstruction Plan has been seen as a favorable step by the credit rating agencies

Moody's Investors Service, March 2009:

These measures... support plans to reestablish fiscal solvency for the commonwealth... it [is] a significant achievement that the administration and legislature have worked together to quickly produce a plan for recovery...

E. Raimés, E. Behr and B. Kurtter

Standard & Poor's (en Bloomberg News), March 9, 2009:

Puerto Rico is taking the right steps to preserve its investment-grade credit rating with a deficit-reduction plan...

Horacio Aldrete



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Coordinated effort ensured the approval of the Reconstruction Plan and allowed us to begin its implementation

Goals of the Reconstruction Plan

1. Stabilizing Puerto Rico's fiscal situation
2. Protecting and strengthening the credit rating
3. Rebuilding the economy

1 Legislation Approved on 14-Jan-09

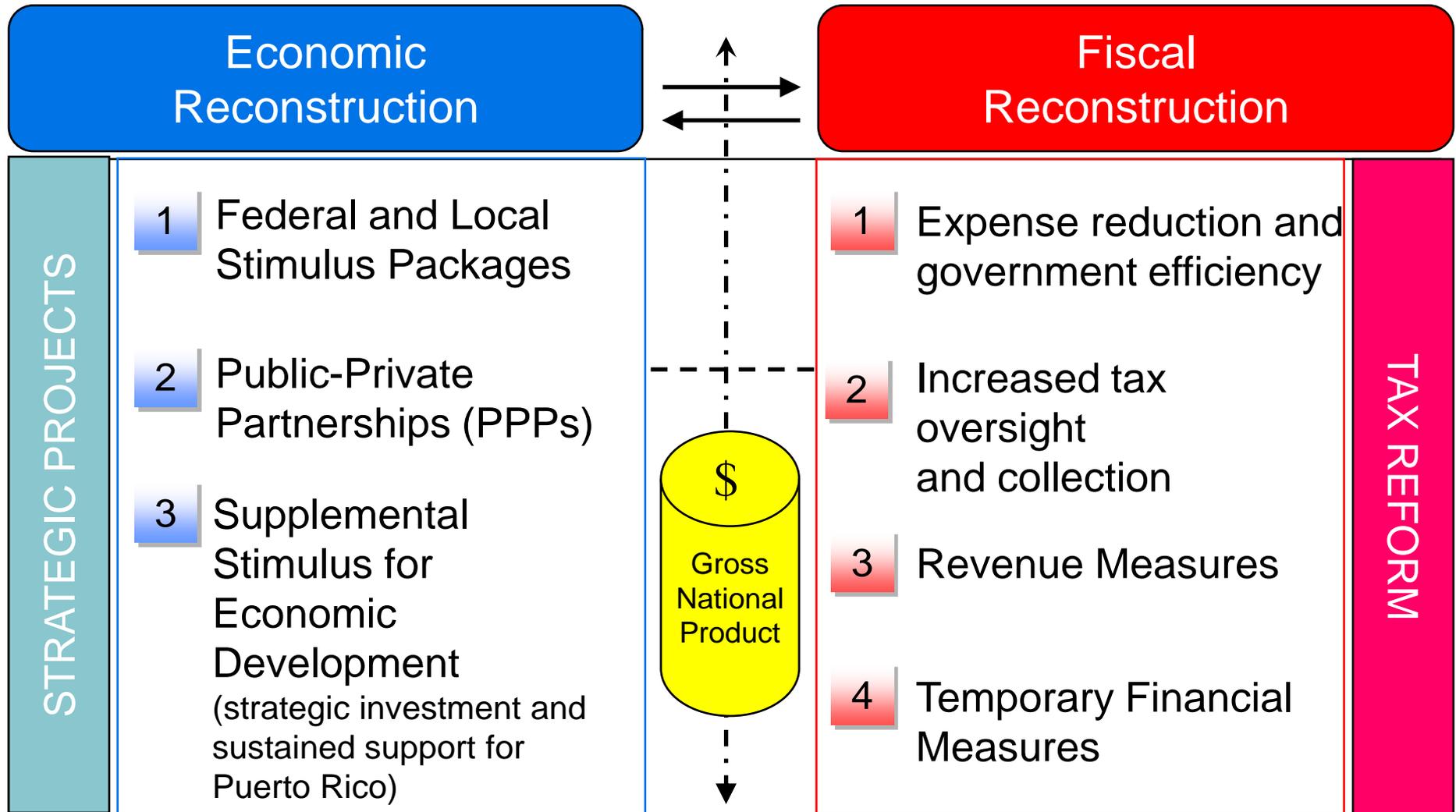
- Act # 1: 1% additional allocation to COFINA
- Act # 2: Temporary use of deficit financing
- Act # 3: Restructuring of PRIFA's *Corpus Account*
- Act # 4: Temporary increase to loan limits from GDB

2 Legislation Approved on 09-mar-09

- Act # 7: Fiscal Emergency Act
- Act # 8: PRIFA to administer ARRA * funds
- Act # 9: Local Stimulus Plan

Puerto Rico Reconstruction Plan

Goals: Stabilizing the fiscal situation, protecting and strengthening the credit, rebuilding the economy.



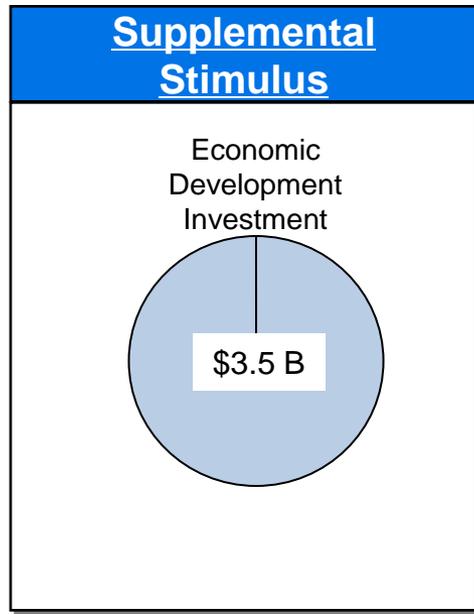
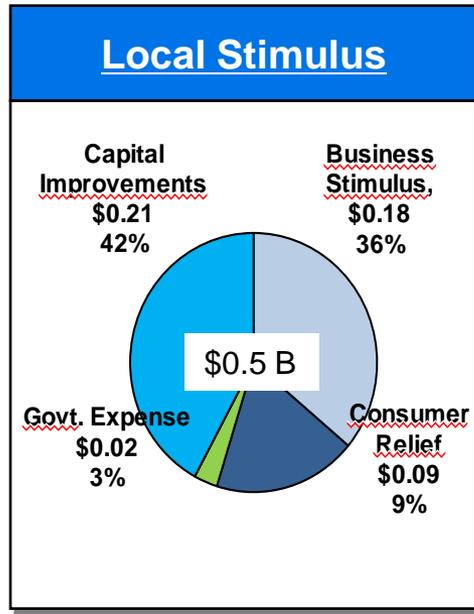
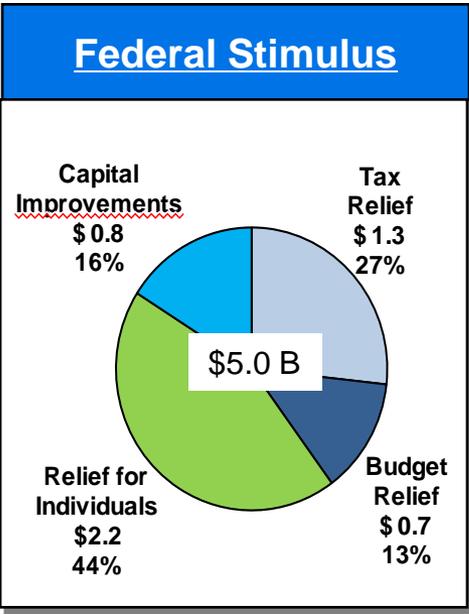
The Economic Reconstruction Plan includes economic stimulus and economic investment

Jun-09 -----> 2011 -----> 2012

(\$ billions)

\$5.0 + **\$0.5** + **\$3.5** ≈ **\$9.0 BN***

PHASE Ia **PHASE Ib** **PHASE II**



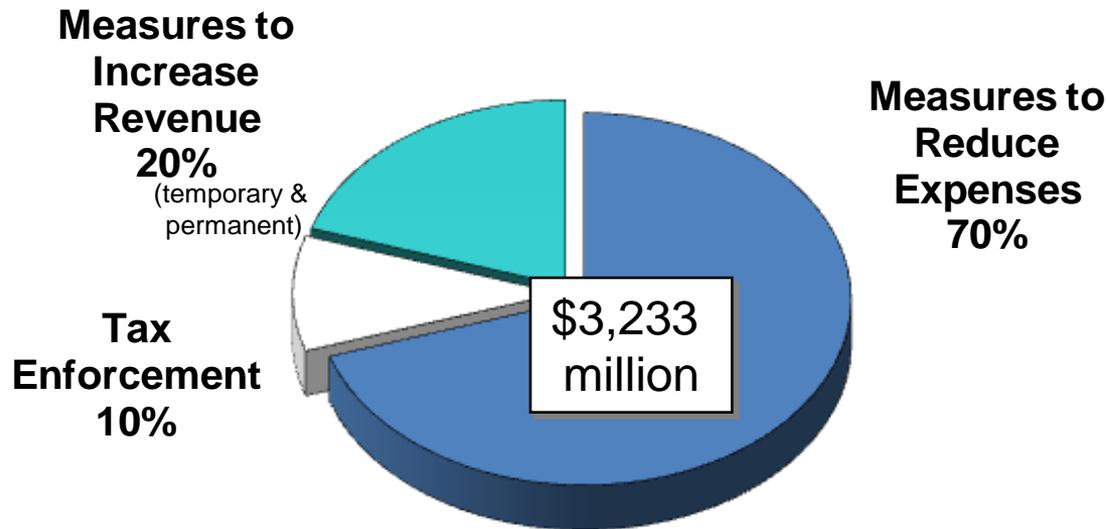
Approx. **4%** of the GNP annually between AF10-AF12

Public-Private Partnerships



The Fiscal Reconstruction Plan includes a combination of measures

Distribution of Fiscal Reconstruction Measures



Financial Stabilization Measures



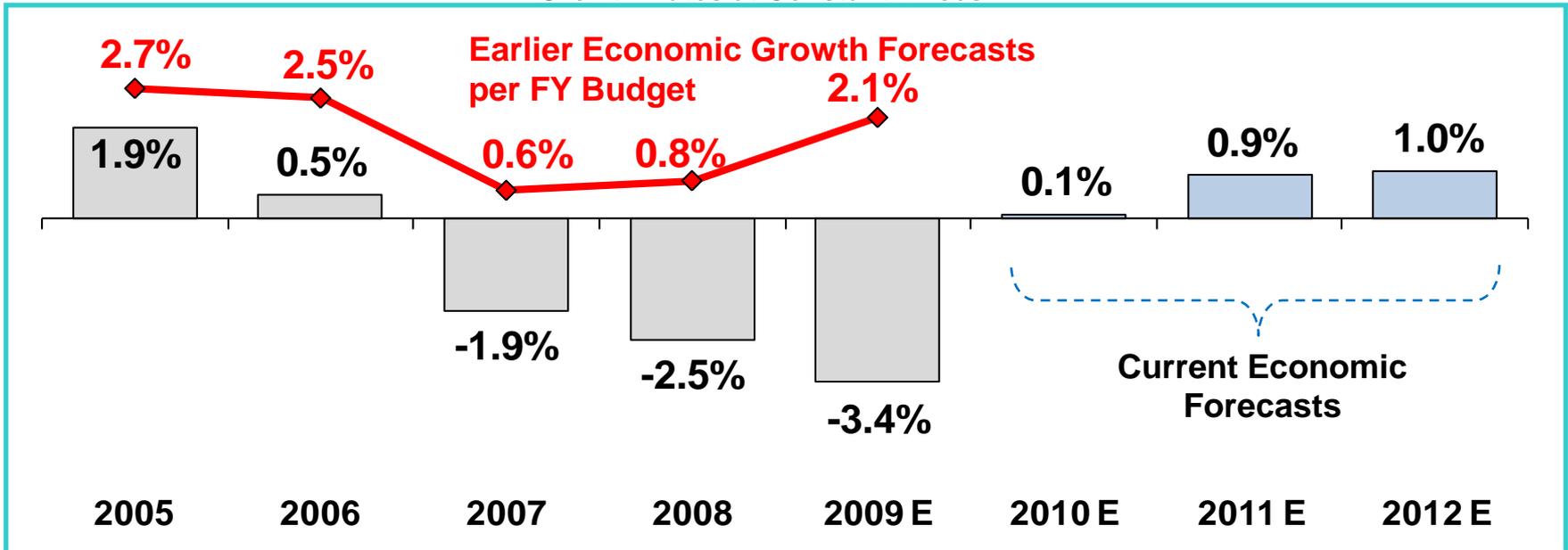
We are following a strict calendar in implementing the expense measures

- | | | |
|--|----------------------|---|
| • Enactment of Act No. 7 and Phase III become effective (temporary freeze of economic conditions) | Mar-09-09: Completed | ✓ |
| • Creation of Fiscal Restructuring & Stabilization Board (FRSB) | Mar-09-09: Completed | ✓ |
| • Release of Circular Letter with details on Expense Reduction Program | Mar-20-09: Completed | ✓ |
| • Public Agencies Notify Employees about Phase I (Voluntary) | Mar-27-09: Completed | ✓ |
| • Orientation about Transition Alternatives to Public Employees | Apr-18-09: Completed | ✓ |
| • Eligible Employees Submit Form for Phase I | Apr-27-09: Completed | ✓ |
| • Voluntary Resignations Effective | May-29-09 | |
| • Notification of first round of Phase II | Jun-01-09 | |
| • Voluntary Workday Reduction becomes Effective | Jul-03-09 | |
| • First round of Phase II is effective | | |



A recovery and a subsequent moderate economic growth is expected

Puerto Rico Economy's Growth ($\Delta\%$ GNP)
Growth Rates at Constant Prices*



- Actual Economic Growth
- Economic Growth Forecasts per FY Budget
- Current Forecasts for Economic Growth

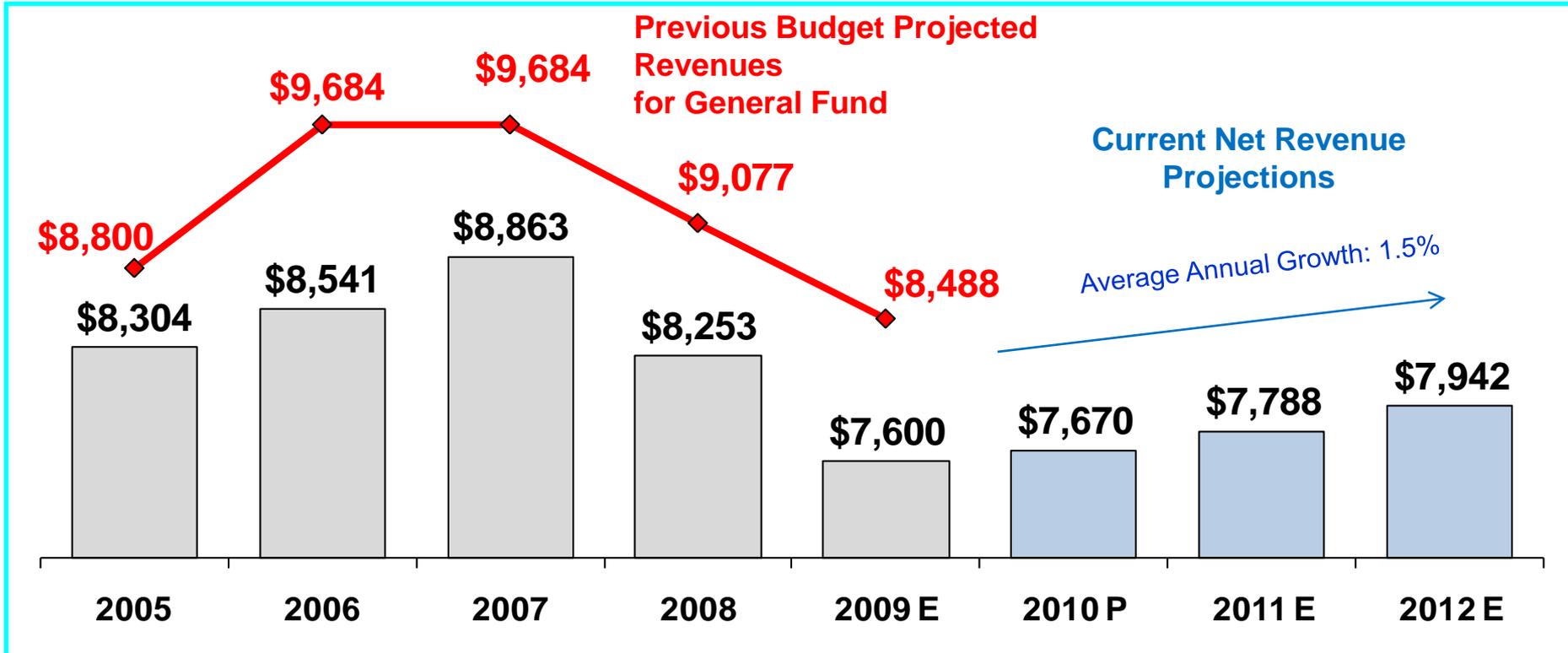
Constant Forecast Revisions:

During the next three years, the economy will experience the effects of many factors. Therefore, the Planning Board will carry out regular revision processes of its projections. This is critical to monitoring the situation.



Revenue forecasts show slight growth, which is consistent with the current environment

\$ in millions



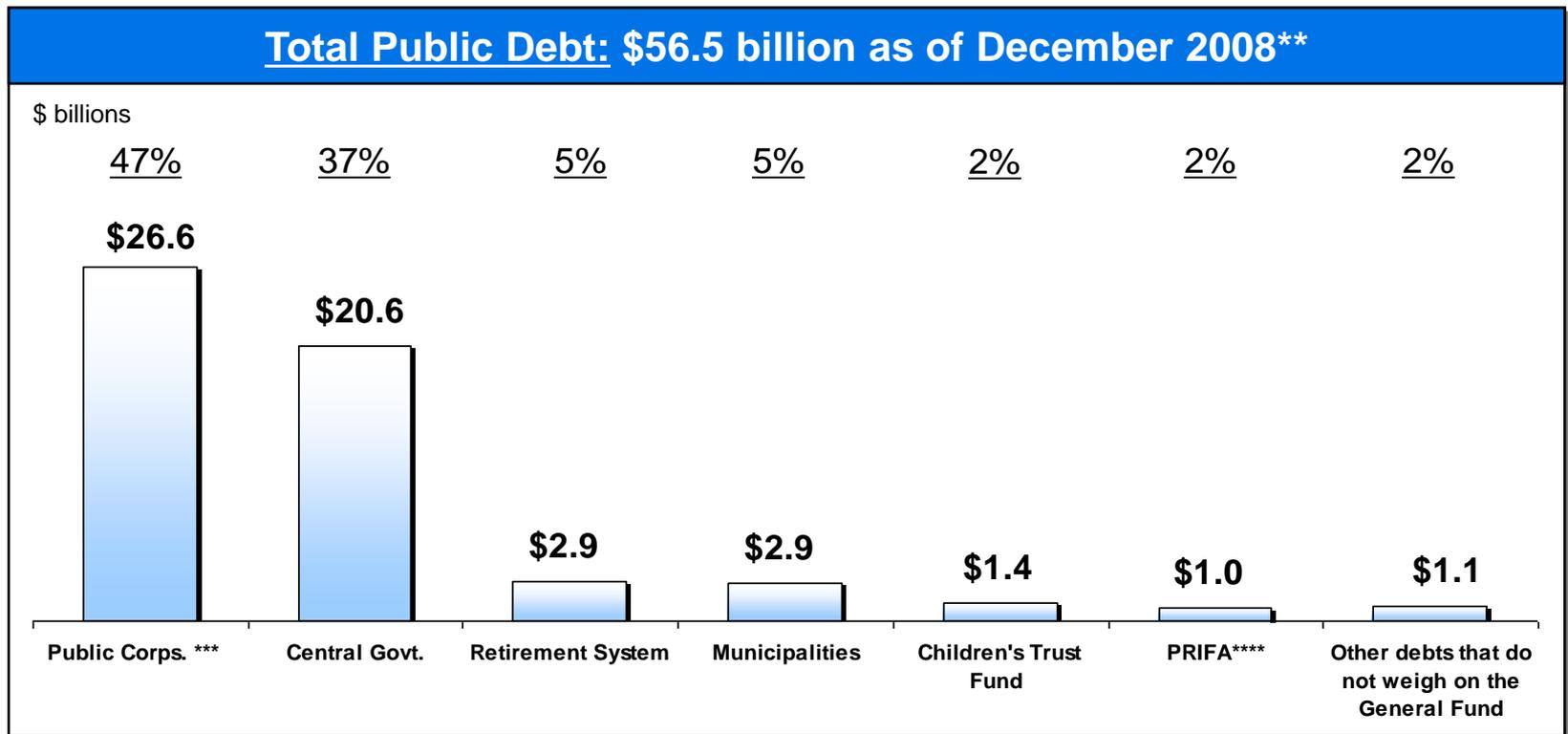
- Actual Revenues for the General Fund
- Budget Projected revenues for the General Fund
- Current Projected Net Revenues for the General Fund

Source: P.R. Department of Treasury.



Snapshot of Puerto Rico's Public Debt

- Total public debt represents approximately 61% of the economy.*
- Establishing a fiscal balance will ensure that we keep access to the credit market, which is important in order to channel resources for the Government of Puerto Rico.



Source: GDB (preliminary figures) and Planning Board.

* Estimate based on GDP in nominal terms for fiscal 2008 and public debt figures from GDB as of Dec-31-08.

** Estimated figures and subject to change.

*** Includes loans from GDB and private sector.

**** Puerto Rico Infrastructure Financing Authority.



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FY 2009 Confirmed Structural Deficit reaffirms earlier estimates

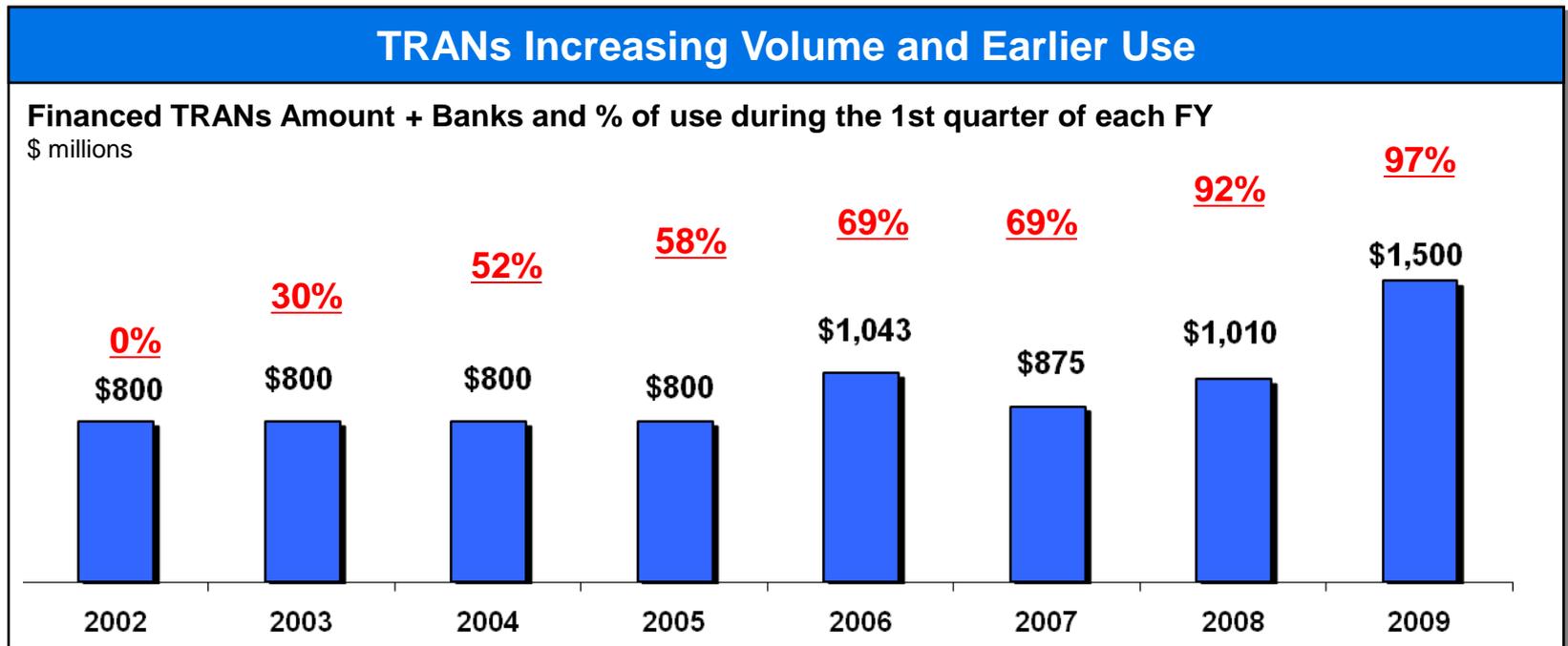
(Confirmed deficit as of April 29, 2009 – see deficit confirmation letter)

Concept	Quantity (\$ Millions)*	Description
Individuals	\$2,555	Shows reduction due to a recession and high unemployment
Corporations	\$1,412	Marked drop due to losses in the banking and other sectors
SUT (IVU)	\$911	Reduction due to recession and Sept. 2008 exemption
Others	\$2,722	Decrease in other areas
TOTAL INTERNAL REVENUE	\$7,600	A drop of 8% is estimated (as of Apr-29-2009)
(1) Base budget	\$9,484	Budgeted expenses for F09
(2) Env. Quality Board Retirement Plan	\$15	Act 244 approved retirement pgm. without a repayment source
(3) Health Reform and Education Deficit	\$500	Estimated excess expenditures in Health Reform, Education Dept.
(4) Rent (Not budgeted)	\$145	Rents not budgeted, owed to the Public Buildings Authority
(5) Utilities (Not budgeted)	\$60	Payments to PREPA and PRASA, not budgeted.
(6) Central Govt. agencies' deficits	\$88	Medical Emergencies, Health Dept., ADFAN, ASDA and others.
(7) Debt service payment (Not budgeted)	\$174	Debt service payment for loans from GDB. Not budgeted.
(8) FMP, debt service payment	\$175	Debt service payment, not budgeted, for the Permanent Improvement Funds (FMP, for its initials in Spanish)
(9) Interest on \$1.0 billion credit line	\$27	Interest on line of credit to the P.R. Treasury Dept. (Not budgeted)
(10) Financial expenses (<i>Swaps</i>)	\$111	Collateral expenses for financial transactions.
(11) Financial expenses, TRAns	\$54	TRAns expenses, not budgeted.
TOTAL EXPENDITURES	\$10,833	Confirmed Total Expenditures, as of Apr-29-09
ESTIMATED DEFICIT	(\$3,233)	



Dramatic increases in volume of TRANs and the practice of using the TRANs earlier in the fiscal year has placed the government in a delicate position toward the end of the fiscal year

- TRANs are an important financing mechanism available to the government at the beginning of each fiscal year as an advance on tax revenues. The government must repay TRANs at the end of each fiscal year with its tax revenues.
- The graph below shows that TRANs have increased in terms of volume and that they have been used earlier in the fiscal year each time, which complicates the government's financial situation for the rest of the months of the year.



Source: GDB.

* TRANs = Tax Revenue Anticipation Notes.

Urgent measures have been taken to interrupt the growth of this deficit, and they have produced results

Measures	Description and Results Update
Act # 1 of January 14, 2009	<ul style="list-style-type: none">• COFINA's financing capacity derives from an additional 1% allocation from SUT and it is estimated at approximately \$3,850 millions.• Up to now, GDB has structured \$1 billion advances through the private banking sector and its own resources as allowed by this Act. The money has been used to pay government suppliers (\$750 million) and to provide funds for the Local Stimulus Plan (\$250 million).• In addition, COFINA will provide \$1 billion as source or payment of the debt subscribed by the former Treasury Secretary, following the failed attempt to sell Treasury's accounts receivable which was considered an extraordinary revenue in the current budget.• COFINA's remaining capacity will be used to close part of the budgetary gap of the current fiscal year, to provide the other \$250 million for the Local Stimulus Package Plan and to assign a repayment source to the rest of the outstanding extra-constitutional debt assumed before fiscal year 2006 and not covered by the previous COFINA issuance.

Urgent measures have been taken to interrupt the growth of this deficit, and they have produced results – (cont.)

Measures	Description and Results Update
<p>Act # 3 of January 14, 2009</p>	<ul style="list-style-type: none"> • Law that authorized the restructuring of the securities in the Corpus account of the P.R. Infrastructure Financing Authority (PRIFA) and the payment of the bonds issuance. • On January 29, 2009, \$169.4 million were transferred to the Treasury Secretary's account and \$84.7 million were transferred to GDB as a result of this transaction. The funds for the early payment of \$1,141 million in PRIFA bonds and the \$300 million to invest in PRIFA's Corpus Account were deposited at GDB. • Final negotiations with the U.S. Internal Revenue Service are in progress and could result in an additional surplus to distribute as required by law.
<p>Act # 4 of January 14, 2009</p>	<ul style="list-style-type: none"> • This Act increases the amount in loans that GDB can grant to the General Fund, based on future budget allocations, from \$100 million to \$200 million. • So far, no money has been borrowed under this law.

Urgent measures have been taken to interrupt the growth of this deficit, and they have produced results – (cont.)

Measures	Description and Results Update
Act # 7 of March 9, 2009	<ul style="list-style-type: none">• This law prescribes the combined reduction of operational and payroll expenses up to the goal of \$2 billion, as well as certain revenue and financial measures to cover budgetary needs while the revenue and expense measures take effect and to finance the government employees' transition.• This law allocated an additional 0.75% from the SUT to COFINA, which provides it with approximately \$2.9 billion in financing capacity. Of these resources available for COFINA, \$1 billion will be assigned to pay for the cost of the payroll reduction and public employee alternatives programs, and the rest will be available as bridge to finance the structural deficit to achieve fiscal balance.

The fiscal landscape includes a set of debts with no source of payment, which weakens the government's fiscal capacity

- Certain debts with no source of payment have been identified, as well as the accumulation of Central Government accounts payable to other government entities, which add up to \$5.4 billion.

Identified Debts with No Definite Source of Payment (As of 30-jun-09)

Millions

	<u>Debts payable from the General Fund</u>
\$ 2,020	Loans related to the General Fund's Public Improvement Fund
\$ 356	Other loans with no source of payment
\$ 463	Central Government debts to other government entities
\$ 2,839	Payable from the General Fund, Subtotal
	<u>Other Debts</u>
\$ 1,027	Treasury Dept.'s loan with accounts receivable collateral
\$ 1,112	Extra-constitutional debt from before FY 2006, and not covered by COFINA
\$ 260	Special Health Fund (Act No. 249 of 2006)
\$ 2,399	Other Debts Subtotal
\$ 5,238	TOTAL
\$ 150	Loan paid off by payment in kind with real estate from the Lands Adm.
\$ 5,388	GRAND TOTAL



Forecast of the debt service for the next few years that affects the General Fund

\$ in millions

Debt Service	Outstanding Balance	FY 2009	FY 2010	FY 2011	FY 2012
General Obligation (GO)	\$9,006	\$414	\$763	\$761	\$767
Contractual payments					
1.03% of Real Estate Property		(\$125)	(\$122)	(\$122)	(\$122)
Debt Restructuring			(\$121)	(\$183)	\$31
GO Debt Service		\$289	\$521	\$456	\$676
TRANS' Interest Payments	\$1,750		\$98	\$98	\$98
Annual debt from Legislative appropriations	See Budget	\$126	\$133	\$133	\$133
Public Improvements Fund Debt	\$2,020		\$163	\$163	\$163
Payments owed to Public Corporations	\$463		\$108	\$108	\$108
Other loans with no source of repayment	\$356		\$64	\$64	\$64
Total		\$415	\$1,087	\$1,022	\$1,242



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Resources Available for FY 2010: General Fund + Stabilization Fund

\$ in millions



- General Fund (GF) = Internal revenues from Treasury Secretary
- Stabilization Fund (SF) = Provisional resources provided through an additional SUT allocation to the P.R. Sales Tax Financing Corporation (COFINA, for its initials in Spanish)



- \$1,000 million in costs for the reduction in payroll and the program for alternatives for the public employee of fiscal year 2009-2010.
- \$1,000 million in expense reduction, an annual saving that will not take place in FY 2009-10, but in the next fiscal year

\$500 Structural Deficit



Comparative Budgetary Analysis for 2009 and 2010

Concept <small>(\$ in millions)</small>	Budget	Budget	Difference
	2009	2010	
Internal Budgeted Revenue	\$9,484		
Forecast of lower revenue	(1,884)		
RECURRING REVENUE	\$7,600	\$7,670	\$70
Budgeted Expenses (General Fund)	\$9,484	\$7,670	(\$1,814)
Expenses Beyond Budgeted Amounts	1,349	0	(1,349)
Stabilization Fund (savings in operational expenses)	0	1,500	1,500
Operational Expenses	\$10,833	\$9,170	(\$1,663)
Stabilization Fund (Benefits for public employees)	0	1,000	1,000
TOTAL EXPENSES	\$10,833	\$10,170	(\$663)
REVENUE DEFICIENCIES– EXPENSES	(\$3,233)	(\$2,500)	(\$5,733)
Loan backed by tax debts	1,000		1,000
Effort to reduce expenses and COFINA financing	1,963		1,963
Funds liberated from the PRIFA Corpus Account	270		270
COFINA Financing		2,500	2,500
DEFICIENCY	\$0	\$0	\$0



Multi-Annual Forecast of the General Fund + Stabilization Fund: FY 2009 – FY 2012

\$ In millions

	2009 E	2010 P	2011 E	2012 E
Internal Revenue – General Fund	\$ 7,600	\$ 7,670	\$ 7,788	\$ 7,942
Expenses – General Fund + Stabilization	(10,833)	(10,170)	(8,247)	(8,095)
Internal Revenue <i>versus</i> Expenses	(3,233)	(2,500)	(459)	(153)
Transitory Expenses				
Cost of payroll reduction		1,000		
Act #7 Expense Reduction not recognized in FY10		1,000		
Government Re-organization and Efficiency			200	153
STRUCTURAL DEFICIT	\$ (3,233)	\$ (500)	\$ (259)	-



Final Summary



Summary

1

Puerto Rico faces an acute recession and a general fiscal emergency. Repairing public finances is key to being able to address Puerto Rico's economic growth in a sustained and vigorous manner.

2

Initial steps have been taken and validated as appropriate in order to avoid further downgrade of the Island's credit and to ensure constant access to financing.

3

A deficit of as much as \$3,233 million has been confirmed and the existence of \$5,388 in debt with no source of payment. Fifty-eight percent (58%) of the deficit is ascribed to the overestimation of revenue and 42% to excessive spending over budgeted amounts.

4

It is necessary to bring expenses to a level consistent with revenues given that revenues are forecasted to be the lowest since 2002.

5

The recommended budget addresses the problem of expenditures and integrates stabilization components that provide a financial buffer in order to achieve budget balance and the conditions necessary for the government to push the economy to face the future.

6

The Stabilization Plan would increase public debt at a pace slower than usual for recent years and would assign a source of payment to the extra-constitutional debt.



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