Progress Report of the Fiscal & Economic Reconstruction of Puerto Rico

Government Development Bank for Puerto Rico

Investor Presentation

October 2, 2009

Agenda

1.	We have made substantial progress and remain committed to the objectives of the Fiscal & Economic Reconstruction Plan
2.	The local economy is expected to stabilize with the Federal and Local Stimuli and the New Strategic Economic Model is a solid blueprint for medium and long-term growth
3.	Concluding Remarks

We are committed to the reconstruction objectives despite the challenging situation

We found an Unprecedented Fiscal and Economic Situation

- We found a declining economy in need of effective stimulus and long-term strategic investment
- We uncovered a fiscal deficit that reached $3.2 billion or ~40% of net General Fund revenues
- We found inappropriate financial management practices such as payment retention to suppliers and high account payables to Public Corporations
- We have been challenged by a deteriorated Human Resources management system in the process of reducing expenses and improving productivity

We are committed to the Reconstruction Objectives

1. **To stabilize the fiscal situation**
2. **To save Puerto Rico's credit**
3. **To rebuild the economy**

Net revenues are on target with budget estimates…

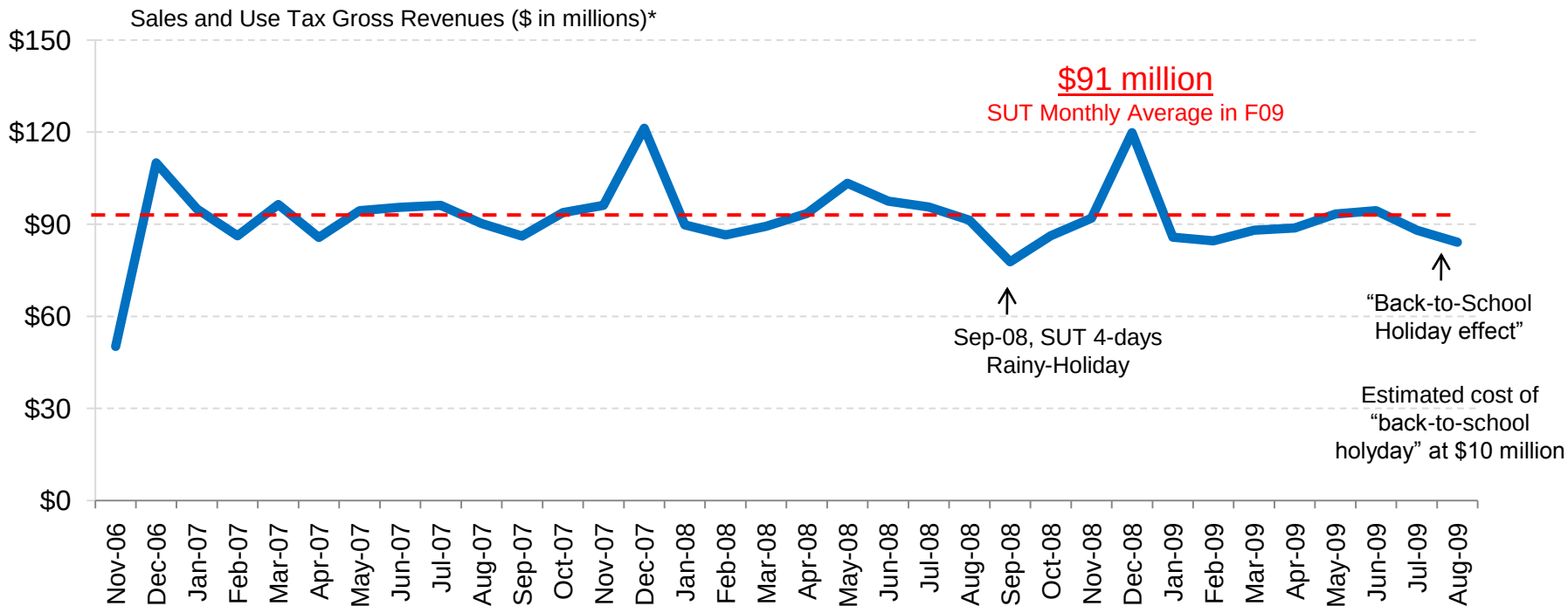
Revenue Categories ($ millions)	Actual July - August 2009	Actual July - August 2010	$ Change	Estimate 2010	Actual vs. Estimate
Individuals	$381	$354	($27)	$363	($8)
Corporations	$228	$245	$17	$212	$33
Non-Resident Withholdings	$163	$142	($22)	$135	$7
Sales and Use Tax	$0	$0	$0	$0	$0
Motor Vehicles	$54	$48	($6)	$57	($9)
Alcoholic Beverages	$38	$39	$1	$39	($0)
Off-Shore Shipments of Rum	$52	$68	$16	$66	$2
Other	$131	$142	$11	$129	$14
Total	**$1,047**	**$1,038**	**($10)**	**$999**	**$39**

Revenues are slightly below previous year...

… but revenues are $39 million above the budget …

Sales & Use Tax revenues continue to show resiliency…

SUT monthly trend remains steady in spite of the recession



Source: P.R. Dept. of the Treasury
* Gross revenues without excluding the assignment to COFINA.

The implementation of expense reduction measures continues to follow a strict calendar

OBJECTIVE 1: STABILIZE THE FISCAL SITUATION

Progress in 2nd half of FY09	Enactment of Act No. 7 and effective day of Phase III; Creation of Fiscal Restructuring & Stabilization Board (FRSB)	**Mar-09-09: Completed**	✓
	Release of Circular Letter with details on Expense Reduction Pgm	**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 Notification of first round of Phase II	**May-29-09: Completed**	✓
	Voluntary Workday Reduction becomes Effective	**Jun-01-09: Completed**	✓
Measures taken in 1st half of FY10	First round of Phase II is effective	**Jul-10-09: Completed**	✓
	Executive Order # 34: 15% Savings on Professional Contracts and Leases	**Sep-21-09: Completed**	✓
	Notification of 2nd Round of Phase II	**Sep-25-09: Completed**	✓
	2nd Round of Phase II is effective	**Nov-06-09***	

The FRSB has executed significant savings in just 7 months after the enactment of Act No. 7

* Except for certain positions required to sustain services whose effective date will be laddered.

Phase II work plan focuses on three main areas

OBJECTIVE 1: STABILIZE THE FISCAL SITUATION

Stabilization Phase

- Reducing expenses
- Minimizing impact on operations and services to citizens
- Accumulating knowledge about the workings of agencies as basis for transformation

Stabilization

Transformation

Transformation Phase

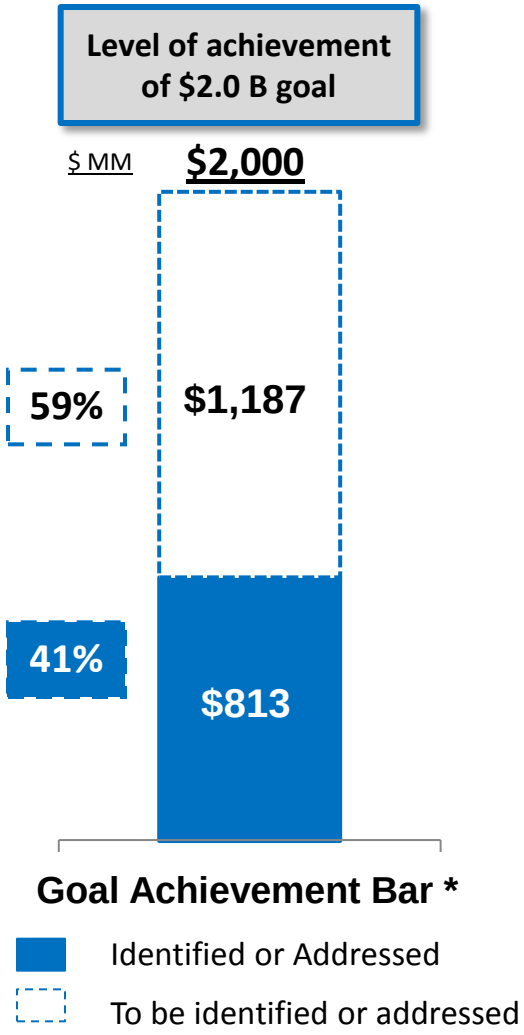
- Achieving efficiency and better service to people
- Reducing duplicity and unnecessary operational expenses by merging and/or eliminating agencies
- Meet budget goals

Transition Support for Employees

- Re-integrating affected employees back into the labor force as soon as possible
- Supporting the employee and his/her family during the transition

41% of the $2 billion savings goal have been identified or implemented prior to September 25th

OBJECTIVE 1: STABILIZE THE FISCAL SITUATION



Progress of various measures as up to Sept-25-09*

	$ Millions
• Payroll savings, Act 7 up to now**:	$291.20
• Reduction in operational expenses:	150.00
• Natural payroll reduction (*attrition*):	45.10
• Reduction in service contracts and leases:	42.00
• Government Health Plan savings:	35.00
• Government Re-organization:	250.00
TOTAL PROJECTED SAVINGS :	**$813.30**

*Subject to periodic revision. Includes estimated data.
**Included: Incentivized Resignations Program, Salary Moratorium, Working Hours Reduction, 1st Round of Phase II Layoffs.

On September 25, the Fiscal Restructuring and Stabilization Board announced the second round of layoffs related to Phase II

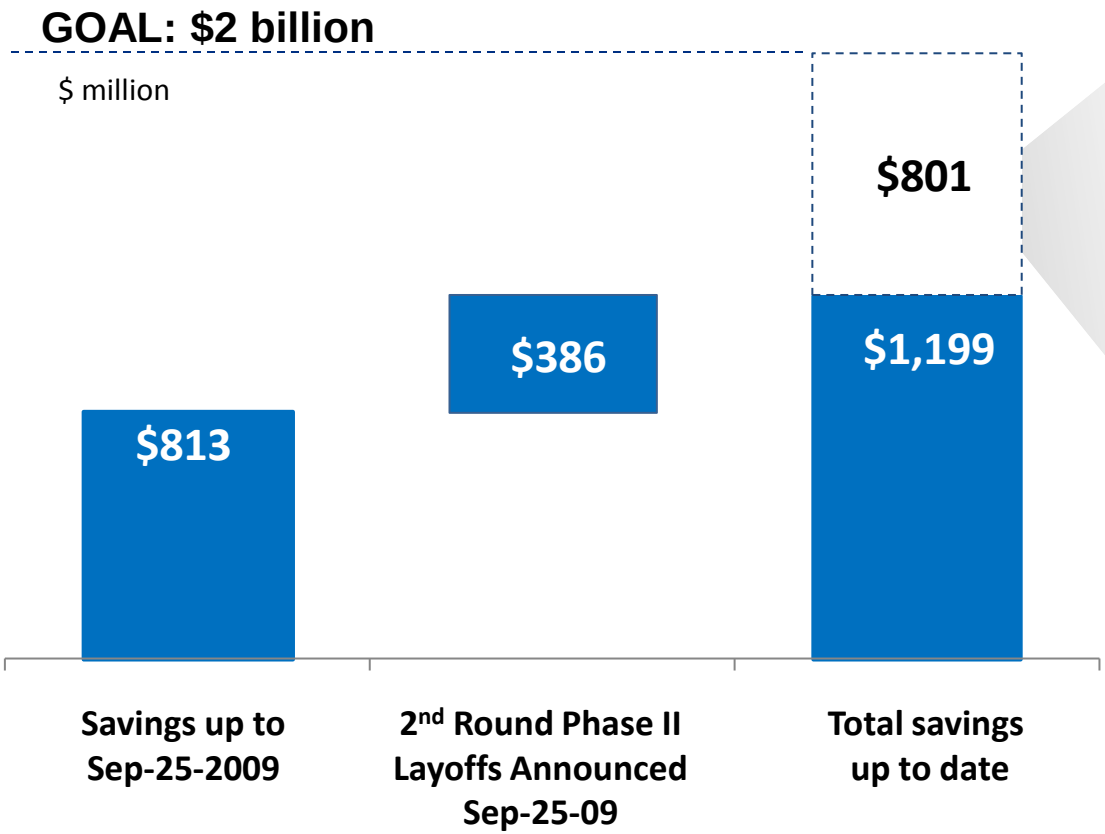
OBJECTIVE 1: STABILIZE THE FISCAL SITUATION

	Payroll Reduction	Effective Date	#
Payroll measures up to Sept-25-09	Phase I: Incentivized Resignations	May-29-09	2,555
	Phase II: Irregular / Transitory Employees	Jul-10-09	1,751
	Phase II: Career Employees	Jul-10-09	531
Announcement Sept-25-09	**Phase II: 2nd Round of Layoffs**	**Nov-06-09***	**16,970**
	Total Layoffs Notified		21,807

This additional step represents projected annual savings of $386 million

* Except for certain positions required to sustain services whose effective date will be laddered.

60% of the savings have been identified or implemented in the first 9 months of the present calendar year

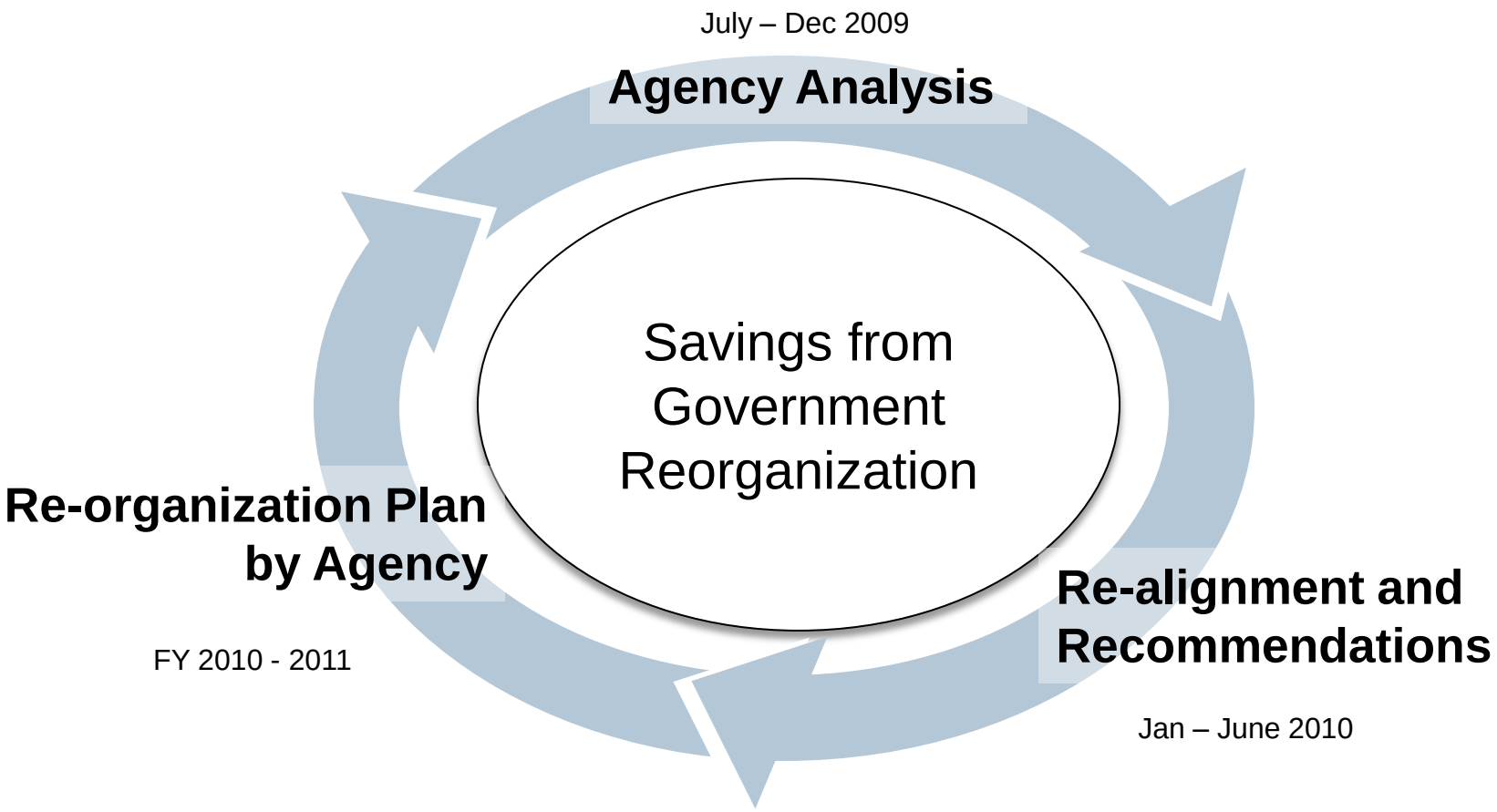


Additional savings will come from a combination of measures that include expense and revenue initiatives

The remaining savings are targeted through a combination of initiatives

Initiative	Description
Additional reduction in contracts and improvement in procurement processes	• There is potential savings in contracts related to direct purchases of goods and services
Additional Govt. Health Program Savings	• Renegotiation and optimization of health program could yield significant savings
Additional Savings from Government Reorganization	• Further opportunities to achieve savings by consolidating offices and eliminating redundancies in agencies where services are not essential
Fiscal Oversight of Central Government Agencies	• Greater expense control achieved through MOUs with largest Central Government Agencies and revision of the procurement process
Additional revenues from stronger tax oversight & compliance efforts	• Large opportunity to increase collections through tax compliance

Further potential savings can be obtained through Government Reorganization

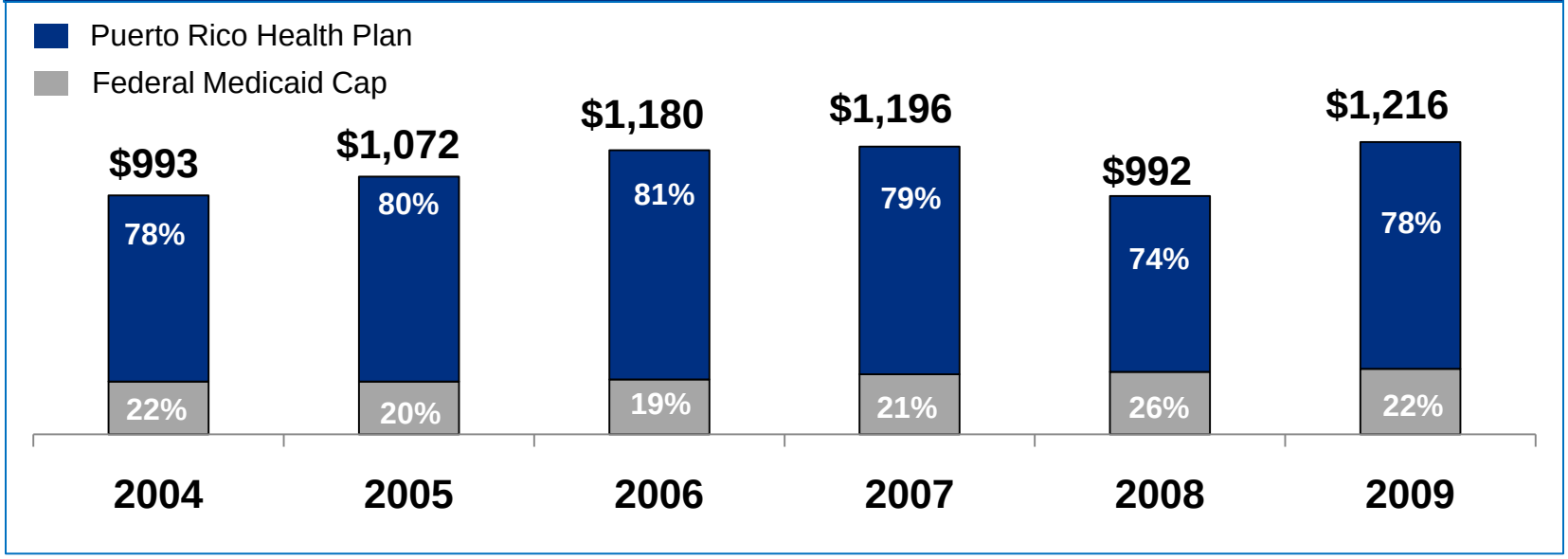


Reorganization is focused on consolidating agencies and streamlining processes in order to provide better service to the people

Puerto Rico's fiscal crisis has been aggravated by a 22% federal Medicaid funding versus a federal contribution close to 83% in states with similar demographics

- **In 1993, P.R. legislated a comprehensive government health care program that presently covers over 1.5 million of citizens that did not have private insurance coverage**
- **As a result, Puerto Rico is shouldering far higher Medicaid expenses than any other State**

Total Cost of PR Health System and Distribution ($ in millions)



- **Opportunity to reduce operating cost of the Puerto Rico Health Care Program**

Establishing measures to improve collection and tax enforcement strategies

OBJECTIVE 1: STABILIZE THE FISCAL SITUATION

Current assessment:

- **Limited collection strategies- No centralized collection strategies**
- **Understaffing/ Wrong allocation of staff**
- **Not enough resources to handle collection of outstanding debt**
- **Limited training**

- **Former senior IRS executives advising Treasury Department on establishing innovative and effective collection and enforcement strategies**
- **Reorganizing Department to focus on collections and compliance**

New hires - 500 former government employees

• Auditors	100
• Internal revenue agents	100
• Tax evasion specialists	25
• Collection agents	225
• Support	50
	500

- **Supplement collections efforts by outsourcing certain collection functions. Contracted firms will be required to recruit an additional collection force of 500 former government employees. Selected firms will be eligible to participate in government sponsored wage subsidy program.**
- **Establishment of 2 call centers (inbound and outbound) with extended operation hours from 8 a.m. – 8 p.m.**
- **Changes in legislation and procedures to allow Treasury to:**
  - **Waive surcharges**
  - **Streamline payment plan**
  - **Expedited lien filling process**
  - **Change criteria for eligibility for SUT reseller certificate**

Source: PR Dept. of Treasury.

Tax compliance initiatives

Initiatives
• Interagency agreements to increase audits capabilities
• Municipal Agreements to increase SUT compliance
• Increase field agents
• Implementation of Tax Information Intelligence System
• IVU-lotto

Source: PR Dept. of Treasury.

Expense reduction and stabilization funds provide enough liquidity for fiscal year 2010

OBJECTIVE 2:
TO SAVE PUERTO RICO'S CREDIT

Status and Projections of Department of Treasury Cash Flow, as of Sept-25-2009

($ 000)	ACTUAL Jul.	Ago.	Sept.	Oct.	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Beginning Balance	39	144	81	62	(178)	(328)	(549)	(639)	(753)	(736)	(587)	(823)
Collection and Receipts	1,037	821	845	880	880	1,193	1,000	893	1,042	1,420	1,004	1,258
Expenses Incl. Debt Service	1,426	1,475	1,223	1,332	1,242	1,635	1,125	1,142	1,159	1,096	1,065	1,025
Total Financing Activity	494	411	94	(38)	(38)	(29)	-	-	-	(310)	(310)	(310)
Total Stabilization Funds	-	180	264	250	250	250	35	135	135	135	135	135
Ending Cash Balance w/o Expense Reduction	144	81	62	(178)	(328)	(549)	(639)	(753)	(736)	(587)	(823)	(765)
Reconstruction Plan Initiatives + Stabilization Funds Re-Programming		-	28	268	151	216	109	129	9	(26)	(26)	(26)
Cummulative Effect of Initiatives	-	-	28	297	447	663	772	902	911	886	860	834
Ending Cash Balance	144	81	90	119	120	114	133	148	176	299	37	69

Source: PR Dept. of Treasury and GDB.

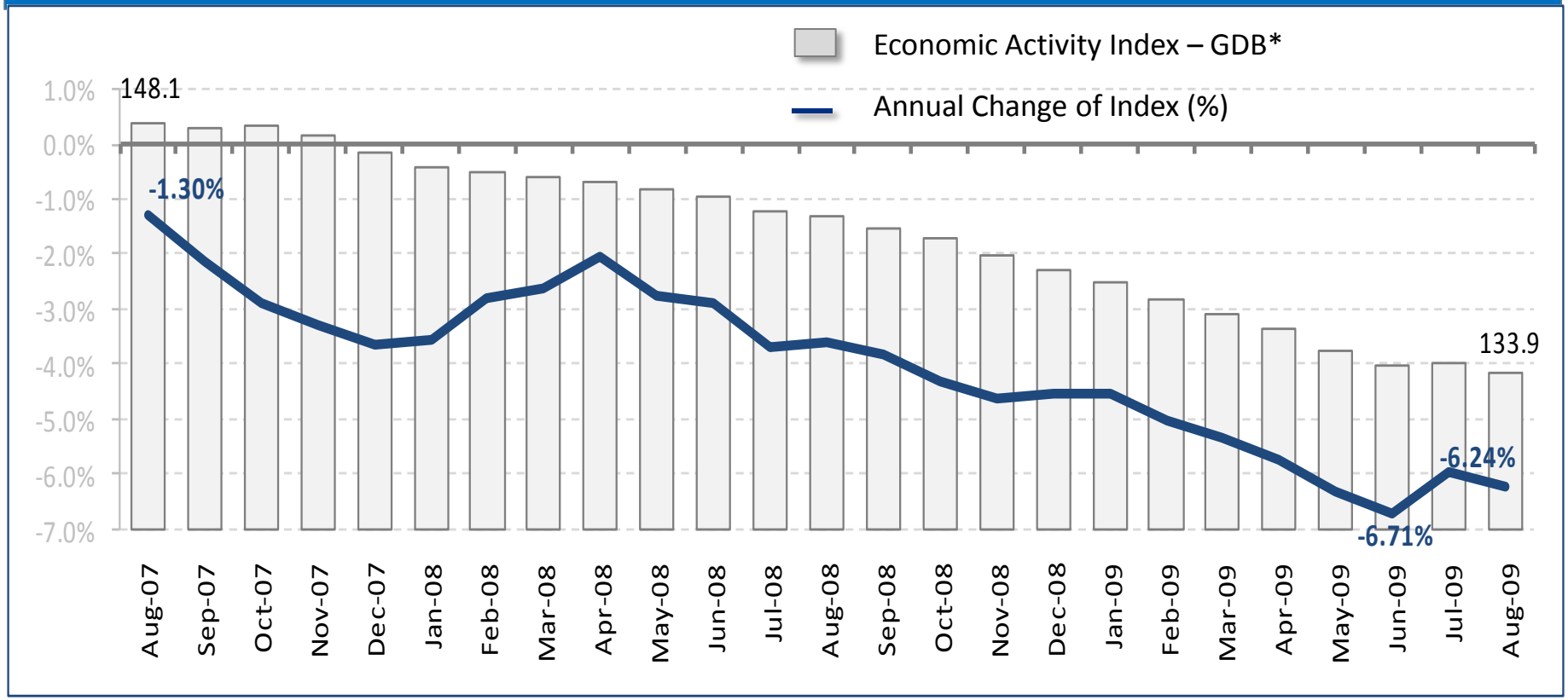
Agenda

1.	We have made substantial progress and remain committed to the objectives of the Fiscal and Economic Reconstruction Plan
2.	The local economy is expected to stabilize with the Federal and Local Stimuli and the New Strategic Economic Model is a solid blueprint for medium and long-term growth
3.	Concluding Remarks

We are monitoring the economic activity on a monthly basis through the GDB Economic Activity Index

OBJECTIVE 3:
TO REBUILD THE ECONOMY

The contraction calls for extraordinary measures in the short and long-term



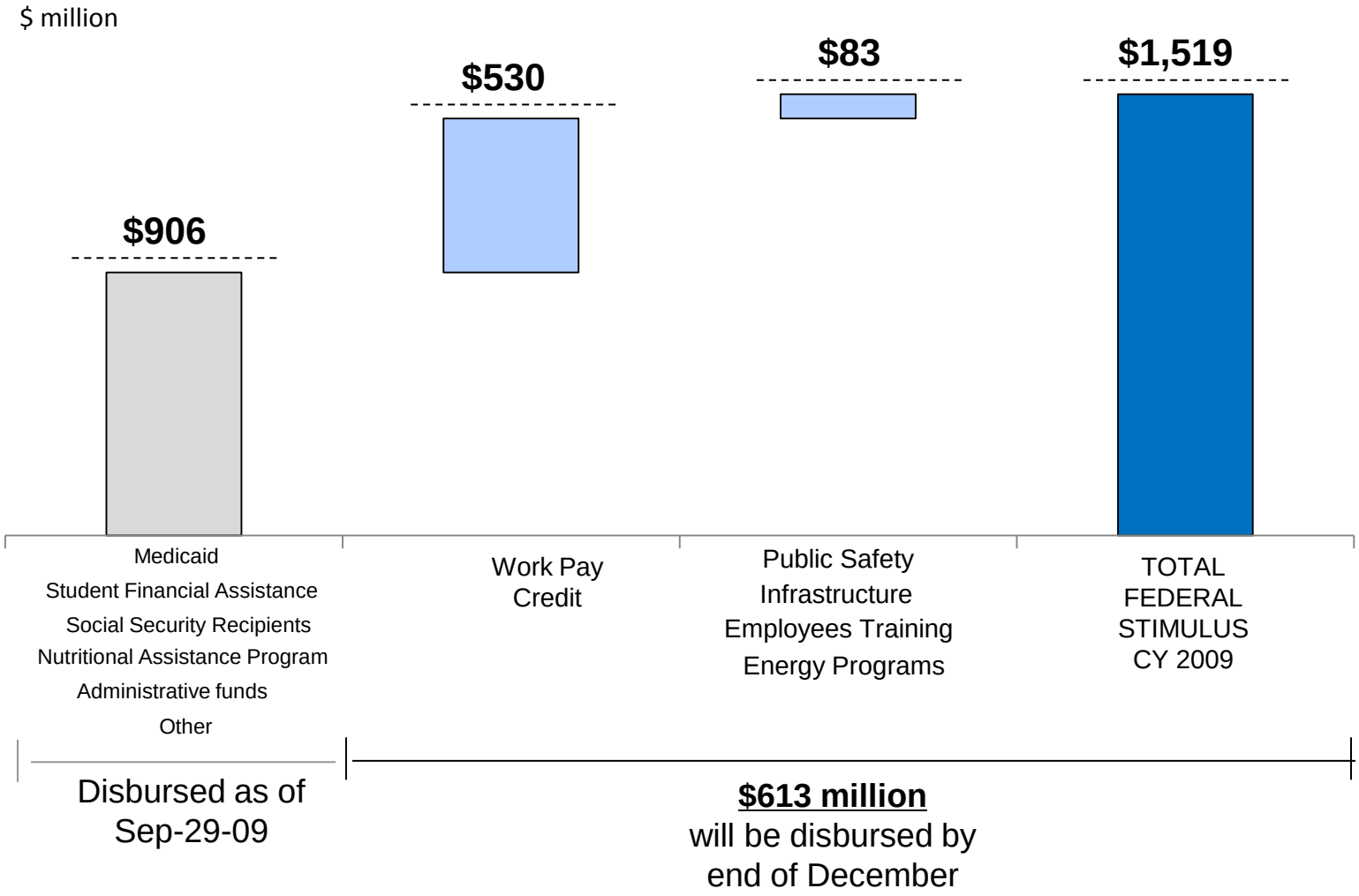
Source: GDB.

* The GDB Economic Activity Index (EAI) is published on a monthly basis, and it is 98% correlated to the GNP. It is made up of 4 indicators: Total Payroll Employment (Establishments Survey), Total Electric Power Consumption (MM of kW h), Total Cement Data (MM of Bags) and Gas Consumption (MM of Gallons). For more information about the indicators, see Annex 1 – GDB Economic Activity Index.

25% of Federal Stimulus funds to be disbursed by year end 2009

OBJECTIVE 3:
TO REBUILD THE ECONOMY

AS OF SEP-29-2009



Source: Puerto Rico Infrastructure Financing Authority

$2.6 billion to be induced into the economy during 2H-2010

OBJECTIVE 3:
TO REBUILD THE ECONOMY

Program	$ Millions	Size
State Fiscal Stabilization Fund Allocation 81.8%	457.8	18%
LEA--Education Grants	322.0	13%
Nutritional Assistance Program	276.2	11%
Student Financial Assistance	175.1	7%
American Opportunity Tax Credits	115.0	4%
Title V Unsubsidized Guaranteed Loans	113.7	4%
Special Education Grant	112.4	4%
Unemployment Compensation Benefits	95.1	4%
State Fiscal Stabilization Fund Allocation 18.2%	86.8	3%
Medicaid	83.9	3%
Other	733.8	29%
	$2,572	**100%**

Other major programs include:

HUD Public Housing
Highways Improvements
Community Service
Low Income Housing
Schools improvements
U.S. Corps of Engineers

The Local Stimulus Plan complements ARRA funds and will be adjusted* to achieve greater flexibility

GDB

RESTORING GROWTH

Local Stimulus Plan (*PEC*)

PROGRESS REPORT

Objective:

- Introduce $500 million in stimuli at the local level, of which approximately $100 million are in the process of being disbursed

Investment / Economic Impact :

- Total Investment:
  - Estimated: $500 million
  - Disbursed up-to-date: $27.4 million

Total projected disbursements up to Dec-31-2009 reach $154.2 million**

- $132.8 MM Municipal Improvements Program, and Strategic Projects
- $6.4 MM Employee Training
- $15 MM Bonus to Retirees
- SMB program (small / med businesses) guarantee increased to 100%
- Creation of bonus for mortgage closing costs for Housing Stimulus Program

Challenges:

- Low participation in guarantee loan programs by banks
- Limited effect of housing stimulus due to recession

* Senate Bill 1122 (PS 1122) was submitted on Sep-11-09.

** Includes: $9.7MM from *PINI* and Strategic Infrastructure Projects; $0.5 MM, *CIPE*; $9MM, Co-participation Program; and $8.6MM Employee Retraining. Of a $226 MM total, which excludes SMB guarantee programs. Data as of August 31, 2009.

Puerto Rico has lost a decade in its economic development… We simply CANNOT lose another!

OBJECTIVE 3:
TO REBUILD THE ECONOMY

Strategic Model for a New Economy
GROWTH | COMPETITIVENESS | JOBS

We have established a New Strategic Model with clear medium and long term goals

- The goals of the Strategic Model are:
  - To achieve Real GNP growth of 3.0%
  - To raise the credit rating of General Obligation debt to "A" category
  - Improve Puerto Rico's competitive ranking (WEF)*
  - Reduce the unemployment rate to 10%
- To establish the Economic Development Steering Committee and the Technical Advisory Committee as the main implementation bodies to ensure results and compliance with objectives
- To realign promotional strategies and foster Puerto Rico's exports and knowledge economy
- To develop a world-class physical infrastructure
- To reform Puerto Rico's institutional and regulatory framework to strengthen the private sector

* WEF = World Economic Forum.

Conceptual Framework of the Strategic Model for a New Economy

OBJECTIVE 3:
TO REBUILD THE ECONOMY

Strategic Model for a New Economy
GROWTH | COMPETITIVENESS | JOBS

OBJECTIVE:
Growth, Competitiveness and Jobs

RESTORE GROWTH		INFRASTRUCTURE		COMPETITIVENESS
Short-Term Stimuli Long-Term Growth Measures	**METRICS** Dashboard	Physical Infrastructure Strategic / Regional Projects	**METRICS** Dashboard	Functional Infrastructure Key Reforms / Cost Reduction

FISCAL AND CREDIT STABILIZATION

TRANSPARENCY AND COMMUNICATION

Restoring economic growth is based on the effective implementation of short-term stimuli and the long-term development of the productive base

RESTORING GROWTH

A combination of measures to restore economic growth

Short-Term Measures of Growth

Federal Stimulus Plan (ARRA*)	• Objective:	Introduce a total of $6.044 billion into the Puerto Rico economy, of which 25% will be disbursed by December 2009
Local Stimulus Plan (*PEC)**	• Objective:	Introduce $500 million in stimuli at the local level, of which approximately $100 million are in the process of being disbursed

Long-Term Growth Measures for All Sectors

Integration into the Global Economy	• Objective:	Foster the development and strengthening of local companies capable of exporting competitive goods and services
Transitioning into the Knowledge Economy	• Objective:	Leveraging the industrial base to create new jobs and businesses. Creating new clusters and consortia with a focus on innovation

* ARRA = American Recovery and Reinvestment Act; PEC = Spanish acronym for the Local Stimulus Plan. **Cluster** = Groups of inter-dependent and complementary businesses and institutions that make up an important area of economic focus and activity. (Michael and Porter, The Competitive Advantage of Nations, 1990.)

Rebuild the physical infrastructure to improve the economy's productive capacity

INFRASTRUCTURE

Strategic investments in infrastructure will expand the Island's production capacity

Capital Improvements Plan	• Objective:	The main public corporations related to infrastructure have scheduled $1.245 billion in capital improvements by FY 2010
Public-Private Partnerships	• Objective:	To accelerate investment in infrastructure and foster private sector participation
Water	• Objective:	To bring water service to the whole citizenry, reduce water loss in the system and ensure water supply
Energy	• Objective:	To reduce the cost of energy and guarantee that electric power is accessible, reliable and sustainable throughout the Island
Transportation	• Objective:	To guarantee developed and updated roads and pathways and safe and accessible collective transportation
Ports and Airports	• Objective:	To maximize the role of ports and airports in the industrial supply chains and tourism development

Reforms address challenges regarding costs, efficiency and functionality, which currently reduce competitiveness

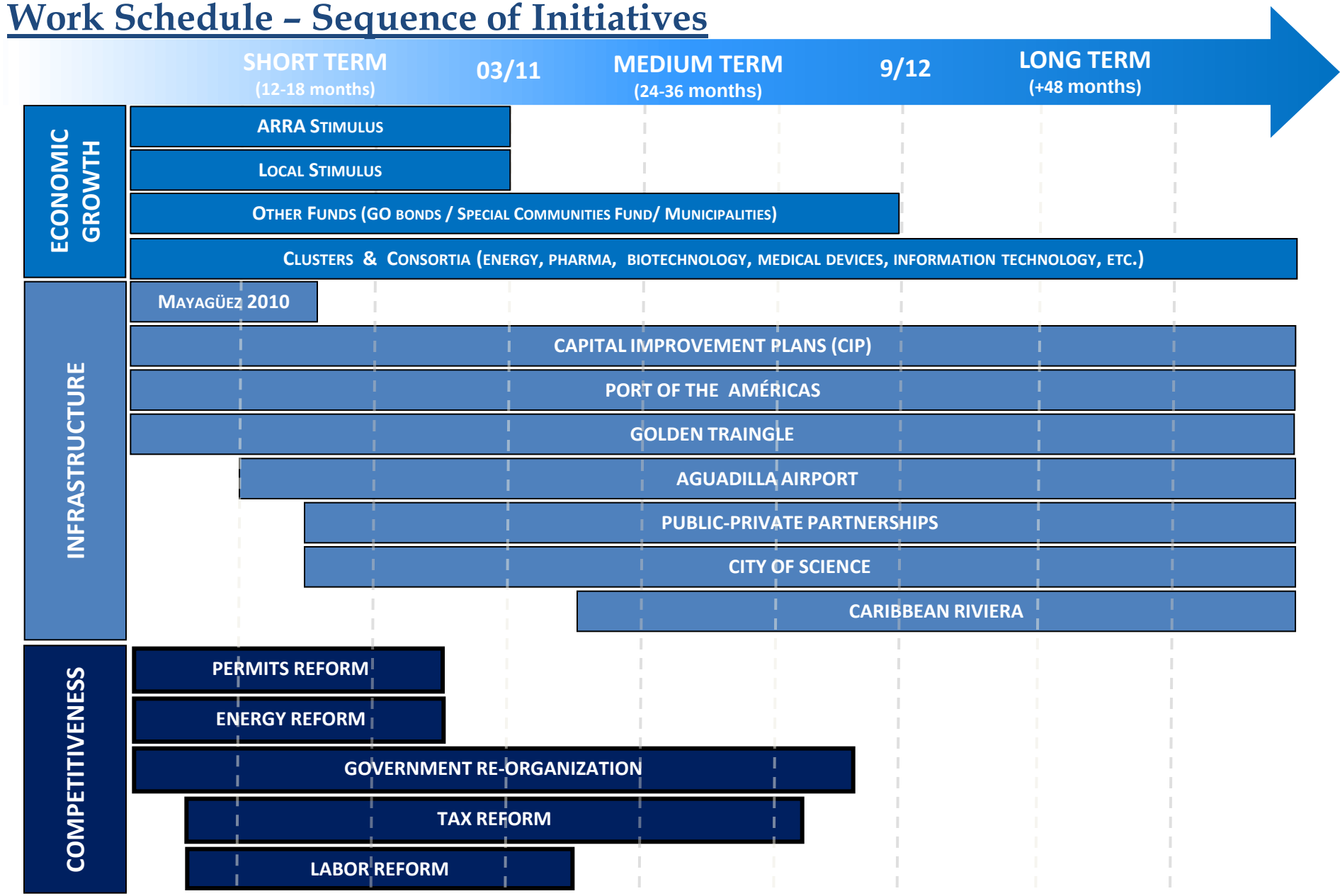
COMPETITIVENESS

Reducing the costs of doing business and facilitating private sector growth

PPPs Reform and Program	• Objective:	Approved **Act 29 of 2009:** Creates new public policy related to infrastructure investment and public services
Permits Reform	• Objective:	Submitted **PC 1649:** Creates a new permits system that is transparent, agile, efficient and accurate
Executive Branch Re-organization and Modernization	• Objective:	Submitted **PC 1644:** Promotes a government structure that responds to current needs and fosters a better quality of life
Energy Reform	• Objective:	To establish a new energy public policy and programs to diversify the sources of energy by ARRA, RPS* and GEF**
Tax Reform	• Objective:	To reform the tax system and bring relief to the Puerto Rican taxpayer through reduced and fair tax rates
Labor Reform	• Objective:	To incentivize work by increasing participation and labor demand in the private sector

*RPS is a regulatory policy that requires production increments from renewable energy sources, including the wind, solar, biomass, and geothermal.
** GEF = Green Energy Fund

Work Schedule – Sequence of Initiatives



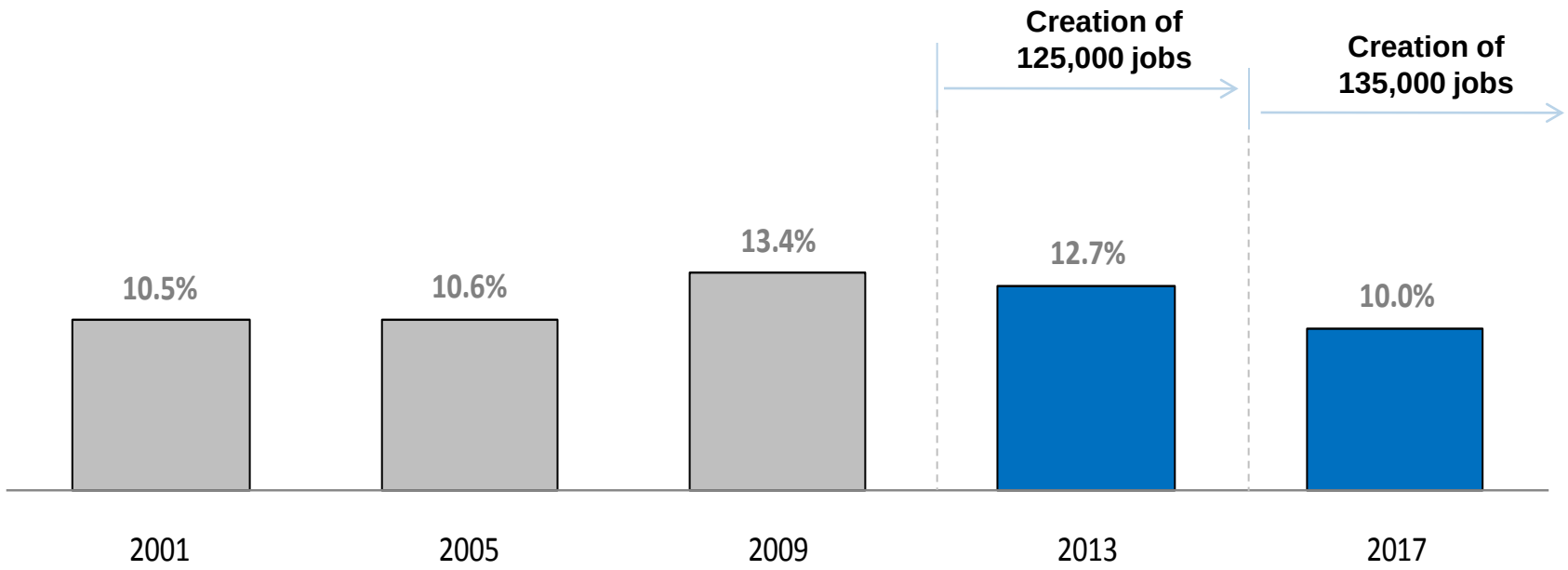
PLANING AND FOLLOW UP

The Strategic Model has the goal of creating approximately 260,000 new jobs in the long-term, which entails a constant reduction of the unemployment rate

OBJECTIVE 3: TO REBUILD THE ECONOMY

Strategic Model for a New Economy
GROWTH | COMPETITIVENESS | JOBS

Target Goal: reduce unemployment rate to 12.7% in FY13 and 10% for FY17



Among the measures that will generate more jobs are the short-term stimulus programs, the PPPs and the regional strategic projects

The Strategic Model focuses on the services sector and on the industrial productive base aimed at exports

OBJECTIVE 3:
TO REBUILD THE ECONOMY

STRATEGIC MODEL FOR A NEW ECONOMY

RESTORING GROWTH			INFRASTRUCTURE			COMPETITIVENESS	
ARRA	PEC	Exports	Capital Improvements	PPPs	Regional Projects	Clusters and Consortia	Key Reforms

Knowledge-based Economy

- Professional Services
- Financial Services
- Health
- Education
- Research and Development (R&D)
- Film and Creative Services

QUANTITATIVE GOAL OF THE STRATEGIC MODEL:
15% of GNP in investment*

Industrial Base / Exports

- Pharma / Biotechnology
- Medical Devices
- Energy
- Agriculture
- Aerospace
- Information Technology (IT)

FISCAL AND CREDIT STABILIZATION

TRANSPARENCY AND COMMUNICATION

* Estimated investment over 4 years. This investment goal is calculated on the GNP base of FY2008, which added up to $60.787 billion.

Objectives and Indicators in the mid- and long-term (4 and 8 yrs.)

OBJECTIVE 3:
TO REBUILD THE ECONOMY

Strategic Model for a New Economy
GROWTH | COMPETITIVENESS | JOBS

Indicator	Actual	2013	2017
GROWTH			
Economic Activity Index	133.9	145.1	160.5
GNP Annual Growth Rate	(5.5 %)	1.8 %	3.0 %
Participation Rate	44.1 %	45.6 %	48 %
Unemployment Rate	15.8 %	12.7 %	10 %
New Jobs (accumulated since August 2009)	---	125,000	260,000
Internet Users per each 100 Individuals	37.5	60	80
Surplus/(Deficit) Budget	($3,200 MM)	- balanced -	- balanced -

Objectives and Indicators in the mid- and long-term (4 and 8 yrs.)

OBJECTIVE 3:
TO REBUILD THE ECONOMY

Strategic Model for a New Economy
GROWTH | COMPETITIVENESS | JOBS

Indicator	Actual	2013	2017
INFRASTRUCTURE			
# of PPP Projects (Accumulative)	---	13	21
Private Investment in PPPs (Accumulative)	---	$4,537 MM	$6,214 MM
% of Energy Dependence on Oil Sources	68 %	55 %	32 %
% of Energy Dependence on Renewable Sources	0.7 %	6 %	13 %
COMPETITIVENESS			
Central Government Credit Ranking	BBB-/Baa3	BBB+/Baa1	A / A2
Competitiveness Ranking (WEF)	42	35	25
Energy Price (cents/kWh)*	21.52	18	14

* Average Price (consumer and industrial).

Agenda

1.	We have made substantial progress and remain committed to the objectives of the Fiscal and Economic Reconstruction Plan
2.	The local economy is expected to stabilize with the Federal and Local Stimuli and the New Strategic Economic Model is a solid blueprint for medium and long-term growth
3.	Concluding Remarks

Concluding Remarks

1. We have made significant progress in the implementation of the Fiscal Reconstruction Plan with 60% of total savings mandated by Act 7 already identified or implemented

2. Expense reduction and stabilization funds provide enough liquidity for fiscal year 2010

3. The local economy is expected to stabilize with the Federal and Local Stimuli and the New Strategic Economic Model is a solid blueprint for medium and long-term growth

4. The Administration has devised a Strategic Economic Model and is swiftly moving into implementation phase

5. The Model has clear goals and places an emphasis on restoring growth, infrastructure investment and improving competitiveness to foster growth beyond the Stimuli period

6. We are committed to continue a strict implementation of the Fiscal and Economic Reconstruction Plan while providing transparency during the process