



COMMONWEALTH OF PUERTO RICO FISCAL UPDATE

December 29, 2008

PUERTO RICO FISCAL SITUATION STATUS AND CALENDAR AHEAD

This update is intended to inform the financial community about recent events including the release of the initial report presented by the Advisory Council appointed by Governor-elect Luis Fortuño to evaluate the current fiscal situation and provide recommendations for addressing the issues.

A week after the Puerto Rico general election in November 2008, Governor-elect Luis Fortuño appointed an Advisory Council to evaluate and offer recommendations regarding the Economic and Fiscal Reconstruction of the Commonwealth.

The Advisory Council is comprised of a 14-member, experienced, bi-partisan and multi-disciplinary team, headed by the Chairman and CEO of the largest financial institution in Puerto Rico, and includes three former presidents of the Government Development Bank (GDB), a former Secretary of the Treasury, a former Deputy Secretary of the Treasury, partners of local leading corporate law and accounting firms with expertise in public finance and governmental matters, and CEOs or senior executives of leading pharmaceutical, supermarket, dry-goods distribution, insurance and construction companies.

The Advisory Council was tasked with evaluating the government's current fiscal situation and providing concrete recommendations for short and long-term measures designed to achieve fiscal reconstruction and sustainable economic growth for Puerto Rico.

During the week of December 15th, Governor-elect Fortuño, accompanied by his newly designated GDB President Carlos M. García and the Advisory Council's secretary, met with Moody's Investors Service and Standard & Poor's to discuss the fiscal situation facing the incoming administration. The

three shared with the rating agencies the Council's guiding principles for fiscal reconstruction:

- Improve Treasury Department and GDB liquidity
- Achieve a balanced budget by fiscal year 2012-2013
- Reduce governmental size and expenditures
- Increase General Fund recurring revenues and achieve a significant reduction in tax evasion
- Distribute the impact of the recommended measures fairly across all socioeconomic groups

On December 19, 2008, the Advisory Council presented the Governor-elect with a preliminary report and recommendations that included the establishment of Public-Private Partnership programs and their legal framework.

The Advisory Council's Preliminary Report on Fiscal Reconstruction estimates a budget and cash deficit of \$3.2 billion for fiscal year 2009. This projection is based on revenue estimates of \$7.8 billion—an 8.1% reduction versus the \$8.5 billion budget. The projected reduction is based on lower income and sales tax collections due to the three-year long economic recession in Puerto Rico and the negative effect on tax collections of tax credits granted during recent years. The Council estimates that General Fund expenditures for the current fiscal year will be \$10.3 billion, 8.6% over the \$9.5 billion budget. The expense projection is based on a significant \$500-million deficit in the Government's health insurance program, an aggregate \$100-million deficit in several other agencies and the estimated incremental cost of debt due to current market conditions.



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In addition to the foregoing, the fiscal situation is further aggravated by approximately \$750 million in accounts payable to government suppliers, thus reaching the total of \$3.2 billion.

The Council warns that if no action is taken by the Government to reduce expenses and increase revenues, and current trends continue, the deficit could remain at a sustained level of \$3 billion for the next four fiscal years. It is expected that fiscal actions for FY 2009 and beyond will be announced in early 2009 once final recommendations are received. The Council included in its report a list of measures implemented or proposed for implementation by other states faced with budget deficits.

Copies of the two reports are available in Spanish at the GDB website (www.gdbpr.com). The English translation of the preliminary Fiscal and Economic Reconstruction report is expected to be available during the first working week of January 2009 at the GDB website.

The Advisory Council is expected to present its formal recommendations, outlining fiscal and economic stimulus measures, to the Governor-elect by mid-January in keeping with the guiding

principles mentioned above. During the spring of 2009, the Advisory Council is expected to provide more specific recommendations regarding measures for Puerto Rico's economic reconstruction.

Subsequent to the release of the Advisory Council's initial report and the meeting with the credit agencies, Standard & Poor's reaffirmed the Commonwealth's BBB- rating stating that the budget outlook described above did not immediately affect the rating and stable outlook for the General Obligation debt.

In a measure designed to strengthen its liquidity, on December 22, 2008, the GDB successfully priced a \$1.23 billion note offering which was oversubscribed two times. The notes have maturities of 3, 5, 7 and 10 years and coupons ranging from 5.50% to 6.50%. The offering was placed entirely among Puerto Rico retail and institutional investors demonstrating the depth and maturity of the local capital market, which has absorbed over \$5 billion in government issues over the past 18 months.

Another Fiscal Update is expected to be issued by the incoming GDB administration once it takes office in January of 2009.

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