



COMMONWEALTH OF PUERTO RICO
FISCAL UPDATE

March 2008

Governor Acevedo-Vilá's FY2009 Budget Proposal
Update on FY2008 Revenues & Expenditures

San Juan, Puerto Rico, March 14, 2008 – Governor Aníbal Acevedo-Vilá yesterday presented to the Legislature his balanced budget proposal for FY2009, which provides for total expenditures of \$9,488 million, the same level as approved for FY2007. This marks the third consecutive year in which budget expenditures would be below the FY2006 level, in line with the Commonwealth's current fiscal policy of containing expenditure levels below FY2006.

The budget calls for the level of expenses to be maintained despite certain increases, including, among others, previously enacted legislation, collective bargaining agreements already negotiated, and special additional appropriations required to finance the local elections in November 2008. Notwithstanding these mandated increases, a significant number of measures are being taken to reduce expenditures to established target levels and comply with the requirements of the Fiscal Reform Law of 2006. For example, headcount in the Executive Branch has been reduced by over 17,300 since FY 2005, and the downward trend is expected to continue through FY2009. While the Fiscal Reform Law does not allow for layoffs of public employees, the Governor's effective headcount reduction has been achieved through a hiring freeze instituted since the beginning of his term, along with normal attrition, early retirement and incentive and voluntary separation programs.

In order to balance the FY2009 budget, base revenues will have to be supplemented relative to their projected level of \$8,831 million, not including the reduction caused by previously

approved tax relief and credits of \$343 million. Revenue performance is lagging due to the recession, which began in March of 2006, triggered by the dramatic increase in oil prices and the sharp decrease in market value of publicly traded Puerto Rico bank stocks.

Based on the continuing recession, the budget reflects that real GNP growth projection for FY2008 of -0.8% is likely to suffer further downward revision before fiscal year end. It is important to note that Puerto Rico's economy is not affected by the sub-prime mortgage crisis being faced in many jurisdictions in the continental US, since local banks did not engage in that type of financing and the local real estate market has not suffered from speculative behavior experienced in other markets.

The economy, however, is expected to rebound starting in 2009 based on several already approved local stimulus measures, as well as the Federal stimulus package, which is expected to inject almost \$1.2 billion into taxpayers' pockets in the next few months. The local stimulus measures include approximately \$325 million in income tax relief in FY2008, and \$243 million in FY2009, along with tax credits of up to \$220 million on the purchase of new homes. In addition, public investment by government corporations and local municipalities is expected to total about \$2.3 billion per year in FY2008 and FY2009. As such, revenues going to the General Fund are expected to resume their normal growth of 5% or more starting in 2010.



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To balance the FY2009 budget, the Governor proposed two special measures, which are expected to generate close to \$1 billion. These consist of tax receivable financing of \$500 million and the generation of an additional \$500 million from proceeds of a concession agreement for operation of the Electronic Lottery. Legislation providing authorization for these two measures is being submitted by the Governor along with the Budget.

It is important to note that Puerto Rico is one of at least 21 other state governments requiring special measures to cover 2009 deficits due to recessionary conditions and the credit/housing crisis. These state governments (and their deficits) include: California (\$16B, or 15.4%); New York (\$4.7B, 8.7%); New Jersey (\$3B, 10.6%); Florida (\$2B, 6.5%); Illinois (\$1.8B, 6.6%); and Arizona (\$1.7B, 16.2%).

The Executive Branch is focused on its multi-year plan, formulated in 2006, to achieve structural budget balance by FY2010, as required by Fiscal Reform Law of 2006. Along with this legislation, the Governor formulated a Government Restructuring Plan which established six major strategic objectives designed to make the Commonwealth's economy more resilient and to create a more efficient and effective government. The purpose of the six-part plan is to establish fiscal discipline, protect the Government's credit, and assure the payment of all debt service as scheduled, as has been Puerto Rico's practice for over 50 years.

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The FY2009 Budget proposal will be considered by the Legislature in its normal process over the next several months.

FY2008 Budget Execution

Expenditures for FY2008 will be contained at their target level of \$9,227 million through continuing fiscal discipline being observed in all areas. This level of expenditure is similar to FY2007's actual expenditures.

While revenues for FY2008 are expected to underperform due to the previously noted economic conditions and as of January are \$277 million, or 2.5%, below estimate, the Treasury Department is taking measures to close the gap. As a result, FY2008 is expected to reach a level very close to budgeted total revenues. These measures include increased efforts to obtain reimbursement of amounts due from Federal programs, in particular \$287 million to be received from the U.S. Department of Education; and efforts to collect back taxes that are expected to produce approximately \$60 million by fiscal year end.

Based on the above, FY2008 revenues and expenditures are expected to be very closely aligned.

Sales Tax Amendment Proposal

Regarding the Governor's proposal to reduce the SUT to 2.5% from 7% and institute a revamped excise tax, legislation will be submitted shortly for consideration by the Legislature.