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# The Commonwealth of Puerto Rico

## Update on Fiscal and Economic Progress

*FY2015 Q1 Investor Webcast - October 2014*

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## Forward-Looking Statements

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The information included in this presentation contains certain “forward-looking” statements. These forward-looking statements may relate to the fiscal and economic condition, economic performance, plans and objectives of the Commonwealth of Puerto Rico (the “Commonwealth”) and/or its agencies or instrumentalities. All statements contained herein that are not clearly historical in nature are forward-looking, and the words “anticipates,” “believes,” “continues,” “expects,” “estimates,” “intends,” “aims,” “projects,” and similar expressions, and future or conditional verbs such as “will,” “would,” “should,” “could,” “might,” “can,” “may,” or similar expressions, are generally intended to identify forward-looking statements.

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## Commonwealth Report

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This webcast presentation should be read in conjunction with the information contained in (i) the Commonwealth's Financial Information and Operating Data Report dated October 30, 2014 (the "Commonwealth Report") and (ii) the Government Development Bank for Puerto Rico Special Liquidity Update dated October 17, 2014 (the "GDB Liquidity Report"). The Commonwealth Report contains a summary of the principal fiscal and economic challenges faced by the Commonwealth. The GDB Liquidity Report contains information about GDB's liquidity resources, including risks and challenges related to such liquidity. In case of any conflict between this presentation and the Commonwealth Report or the GDB Liquidity Report, the Commonwealth Report or the GDB Liquidity Report shall prevail, as applicable.

# Agenda

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**1** Executive Summary

2 Liquidity and Plan of Finance

3 HTA and PREPA Update

4 Budget Update and Comprehensive Tax Reform

5 Economic Development

6 Next Steps

# The Commonwealth will execute an ambitious fiscal and economic plan for the rest of FY 2015

1 Extend Liquidity Runway	<ul style="list-style-type: none"><li>○ Closing of \$900 million GDB Notes transaction to fund Commonwealth TRANs ensures sufficient working capital to meet General Fund cash flow needs.</li><li>○ Proposed PRIFA transaction expected to materially strengthen GDB's liquidity and balance sheet.</li><li>○ Puerto Rico will re-access market, subject to market conditions, to strengthen liquidity.</li></ul>
2 Ensure the Financial Viability of our Public Corporations	<ul style="list-style-type: none"><li>○ Proposed HTA/PRIFA bill expected to place HTA on path to self-sufficiency.<ul style="list-style-type: none"><li>- Expected to materially strengthen HTA's credit profile by deleveraging balance sheet and ensuring sufficient revenues for debt service, operations and capex.</li></ul></li><li>○ Forbearance Agreement ("FA") with PREPA creditors places public corporation on restructuring path based on consensual, negotiated solution.<ul style="list-style-type: none"><li>- FA milestones require substantive progress on set timeline.</li><li>- CRO hire ensures transparency and expert guidance and execution.</li></ul></li><li>○ The Recovery Act is intended to be used only in situations where it is absolutely necessary in order to implement reforms at the public corporations.</li></ul>
3 Execute on Approved FY 2015 Budget	<ul style="list-style-type: none"><li>○ Q1 FY 2015 revenues 4.4% above Q1 FY 2014, although 2% below budget.</li><li>○ Q1 FY 2015 expenses 4% lower than budget due to successful implementation of corrective expense measures, including budgetary reform at Department of Education.</li><li>○ Commonwealth shall take quick corrective action to address any budgetary shortfalls.</li></ul>
4 Reform our Tax Code and Grow the Economy	<ul style="list-style-type: none"><li>○ Commonwealth expects to execute ambitious tax reform agenda during Q3 FY 2015.<ul style="list-style-type: none"><li>- Reform is expected to reduce marginal income tax rates, repeal gross profit tax and shift tax system from taxing work towards taxing consumption.</li><li>- To drive material increase in General Fund tax revenues, sized to match projected increase in budgetary expenses during 5-year forecast period.</li><li>- Aimed at reducing tax inefficiencies that act as hindrance to economic growth.</li></ul></li><li>○ Continued successful execution of aggressive economic outreach plan.</li></ul>

**Commonwealth is focused on achieving comprehensive solutions to legacy structural fiscal and economic problems.**

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1 Executive Summary

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3 HTA and PREPA Update

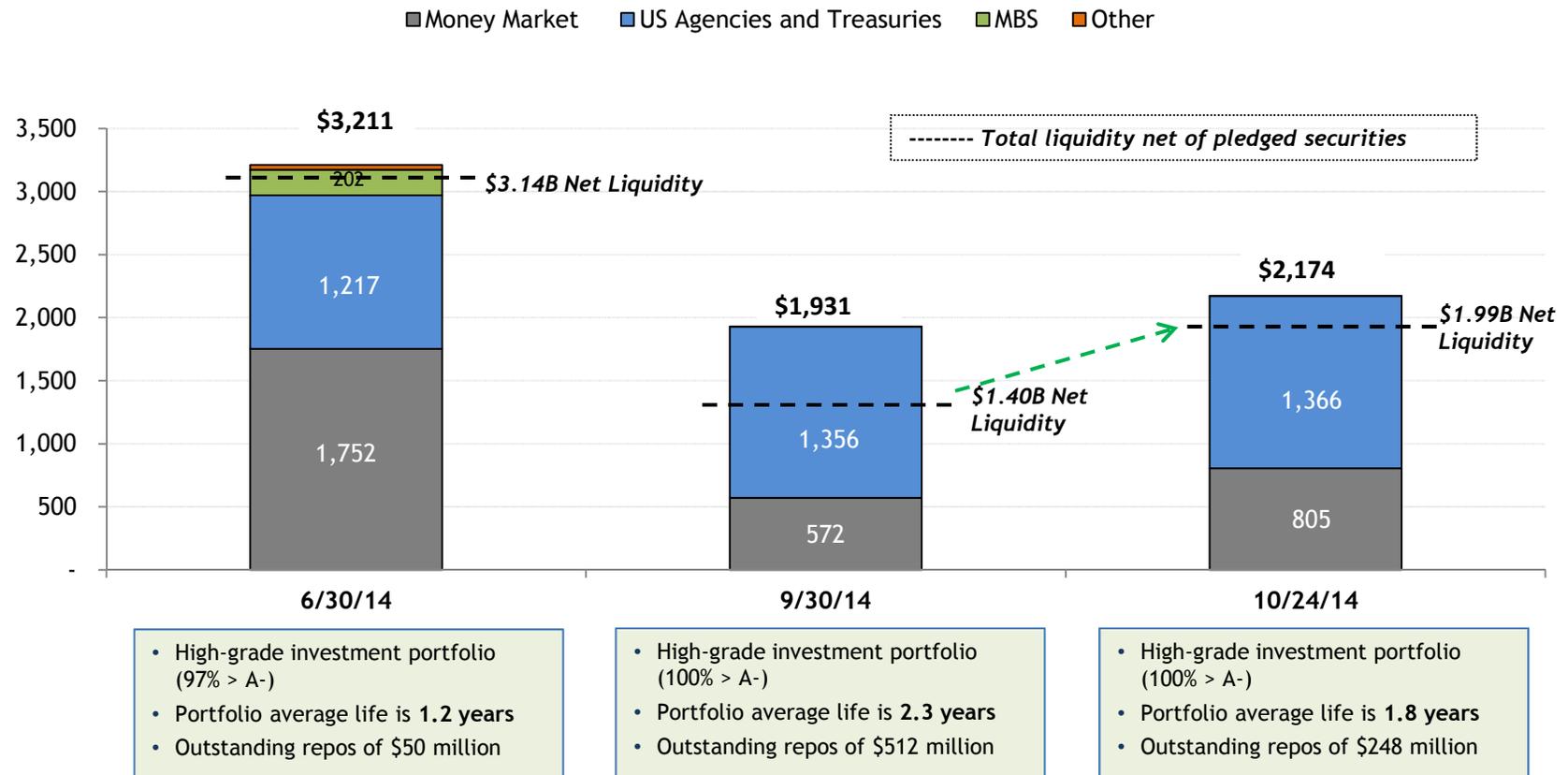
4 Budget Update and Comprehensive Tax Reform

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# GDB net liquidity exceeded \$1.9 billion after closing a GDB Notes financing to fund the Commonwealth's annual TRANs need

## Investment Portfolio Composition<sup>1</sup> (\$ in millions, marked-to-market)

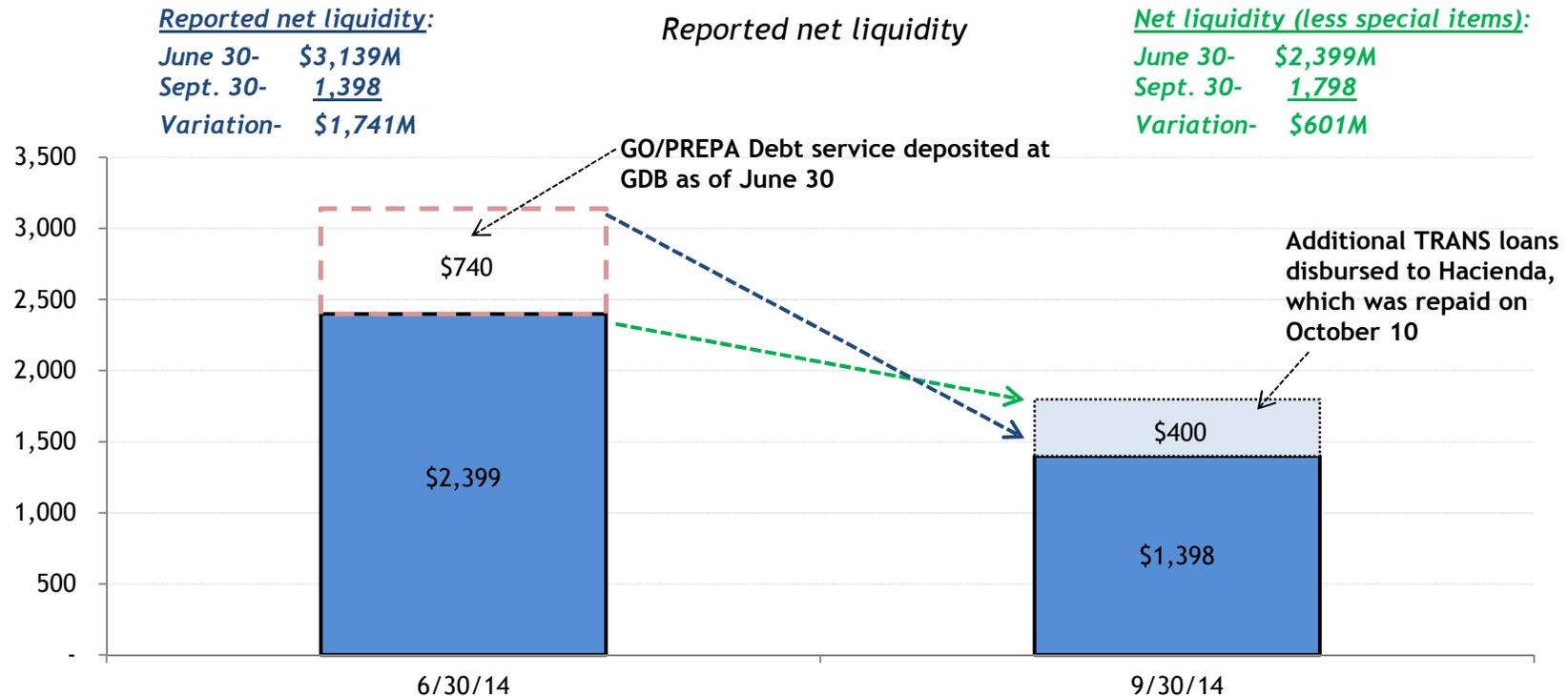


Liquidity as of October 2014 is in line with March projections, net of contingencies.

<sup>1</sup> Unaudited interim financial information as of June 30, September 30 and October 24, 2014; subject to adjustment.

# Net liquidity as of June 30 and Sept. 30 was affected materially by temporary, seasonal factors

## Investment Portfolio Composition<sup>1</sup> (\$ in millions, marked-to-market)

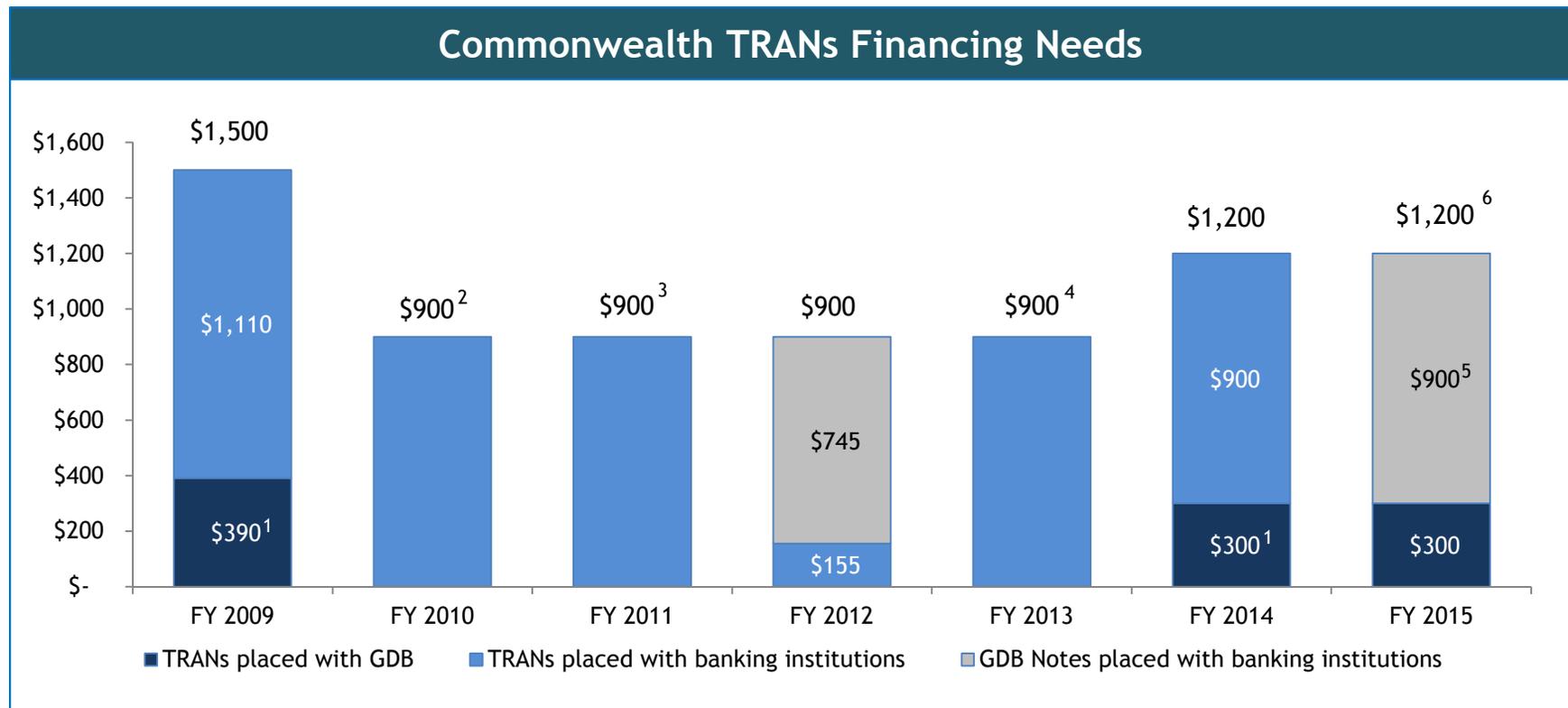


- GO/PREPA debt service deposits and additional TRANS loans explain \$1.1 billion, or 65%, of the reported variation in net liquidity.
- Additional known factors explain majority of remaining \$600 million variation: (1) \$140 million in scheduled GDB debt service payments, (2) \$120 million decline in ending balance at Treasury's operating accounts at GDB, (3) \$85 million decline in PREPA deposits (in addition to debt service deposits) and (4) scheduled \$75 million MWPC repayment to US Treasury.

<sup>1</sup> Unaudited interim financial information as of June 30 and September 30, 2014; subject to adjustment.

# FY 2015 General Fund cash flow and liquidity needs were met by the recent GDB Senior Notes Issuance to fund TRANs

- The Commonwealth issues Tax Revenue Anticipation Notes (“TRANs”) every year to finance operations in anticipation of future budgeted revenues. TRANs have been issued by the Commonwealth since approval of Act 1 of 1987.
- TRANs need fluctuates each year based on budget size, cash flows, and use of other non-recurring financing sources.
- In recent years, the TRANs has been placed privately with banking institutions, with GDB purchasing a portion of the TRANs at least for a certain period.
- Tax reform’s emphasis on consumption taxes expected to more evenly distribute General Fund revenues throughout year, potentially reducing annual TRANs needs.



(1) Revolving credit structure.

(2) GDB initially provided \$475 million in TRANs which were refinanced with banking institutions.

(3) GDB initially provided \$600 million in TRANs, which were refinanced with banking institutions.

(4) GDB initially provided \$400 million in TRANs, which were refinanced with banking institutions.

(5) Contains \$200 million revolving credit structure.

(6) GDB initially provided \$700 million in TRANs, of which \$400 million were refinanced with banking institutions.

## On October 10, 2014, \$900 million in GDB Senior Notes were placed with top-tier banking institutions

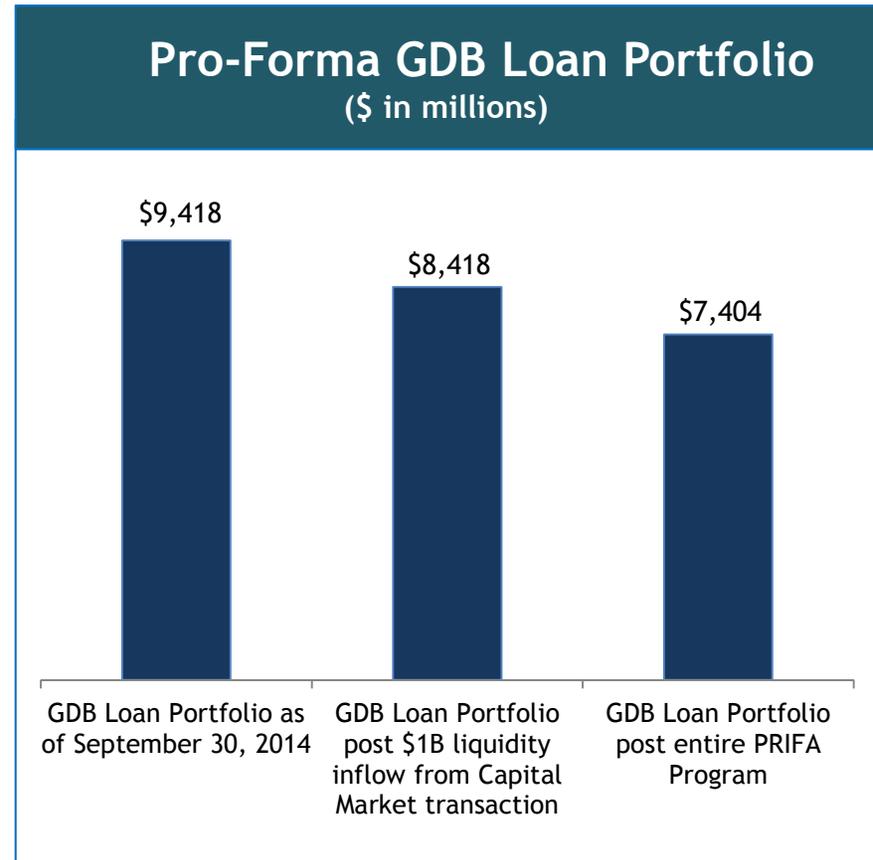
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- Participation from top-tier banks demonstrates continued access to traditional sources of financing:
  - J.P. Morgan
  - Morgan Stanley
  - Bank of America
  - Banco Popular de Puerto Rico
  - Barclays
  - Amalgamated Bank
- The FY 2015 TRANs need, which was unchanged from FY 2014, was funded by GDB as follows:
  - \$900 million from the issuance of the GDB Senior Notes; and
  - \$300 million from internal liquidity sources (consistent with recent practice).
- GDB Senior Notes' issuance repaid \$400 million in TRANs purchased by GDB, increasing GDB liquidity.
- GDB Senior Notes contain a \$200 million revolving tranche, which provides cash flow flexibility to the Commonwealth and reduces aggregate financing costs.

Total Facility Size:	\$900 million: <ul style="list-style-type: none"><li>• \$700 million non-revolving with a fixed interest rate of 7.75%</li><li>• \$200 million revolving with a floating interest rate of 1M Libor + 7.55%</li></ul>
Maturity Date:	June 30, 2015 (six semi-monthly amortizations commencing April 16, 2015)
Use of Proceeds:	Purchase up to \$900mm aggregate principal amount of TRANs of the Commonwealth

# Planned PRIFA financing program is expected to materially strengthen GDB's liquidity and balance sheet

- Proposed House Bill 2212 (formerly H.B. 2039):
  - Assigns \$8.25/barrel Petroleum Products Tax to PRIFA, subject to CPI adjustments.
  - Includes optional GO Guaranty authorization of up to \$2.9 billion in PRIFA bonds.
  - Provides a statutory lien on revenues.
- New structure can be used to refinance:
  - HTA Series 2013 BANs; and
  - Up to approximately \$2.2 billion of GDB Loans, including accrued interest.
- GDB loans to HTA constitute 21.4% of GDB's loan portfolio.
  - Inaugural transaction expected to refinance at least \$1 billion of GDB loans to HTA, boosting liquidity.
  - Liquidity can be used to repay GDB notes coming due, materially reducing GDB refinancing risk.
- GDB currently expects to complete initial transaction on or before Q3 FY 2015, subject to market conditions.



- The PRIFA financing program may allow GDB to refinance its entire HTA loan portfolio, which would decrease GDB's total loan portfolio to approximately \$7.4 billion.

Transaction is part of broader, integrated plan to place HTA on self-sufficient footing.

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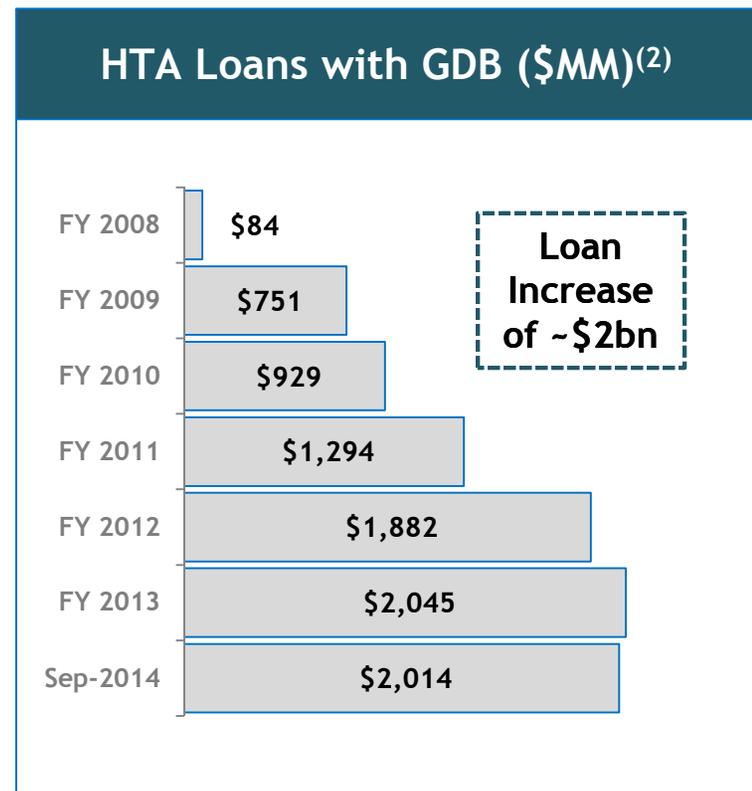
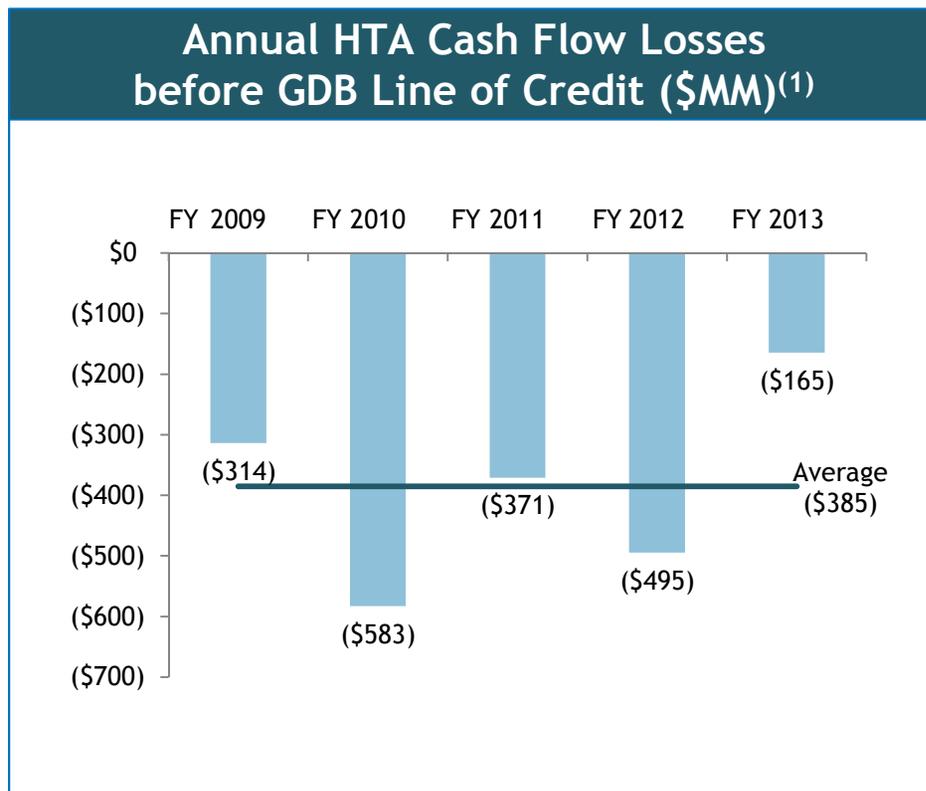
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# Comprehensive HTA Reform

## Since 2008, HTA has relied on GDB to fund its liquidity needs

- Historically, GDB has assisted HTA by providing financing to address its operating deficits, capital needs and non-refinanced debt maturities.
- However, due to other liquidity priorities and Act 24-2014, it is no longer financially or legally feasible to provide ongoing deficit financing to HTA or other public corporations.



House Bill 2212 (formerly H.B. 2039) provides a permanent solution to HTA's recurring cash shortfall while providing a financing vehicle to refinance HTA Loans at the GDB.

(1) The reduced deficit in 2013 was caused by an extension of payables and other accrued liabilities as well as federal grants approximately twice as large as the average of those received in the previous four years.  
 (2) Includes purchased variable rate debt obligations for FY2014 ("VRDOs") and excludes accrued interest totaling \$201 million as of 6/30/2014.

## Since January 2013, HTA has taken a number of actions to improve corporate governance, strengthen its fiscal controls and bolster its cash flows

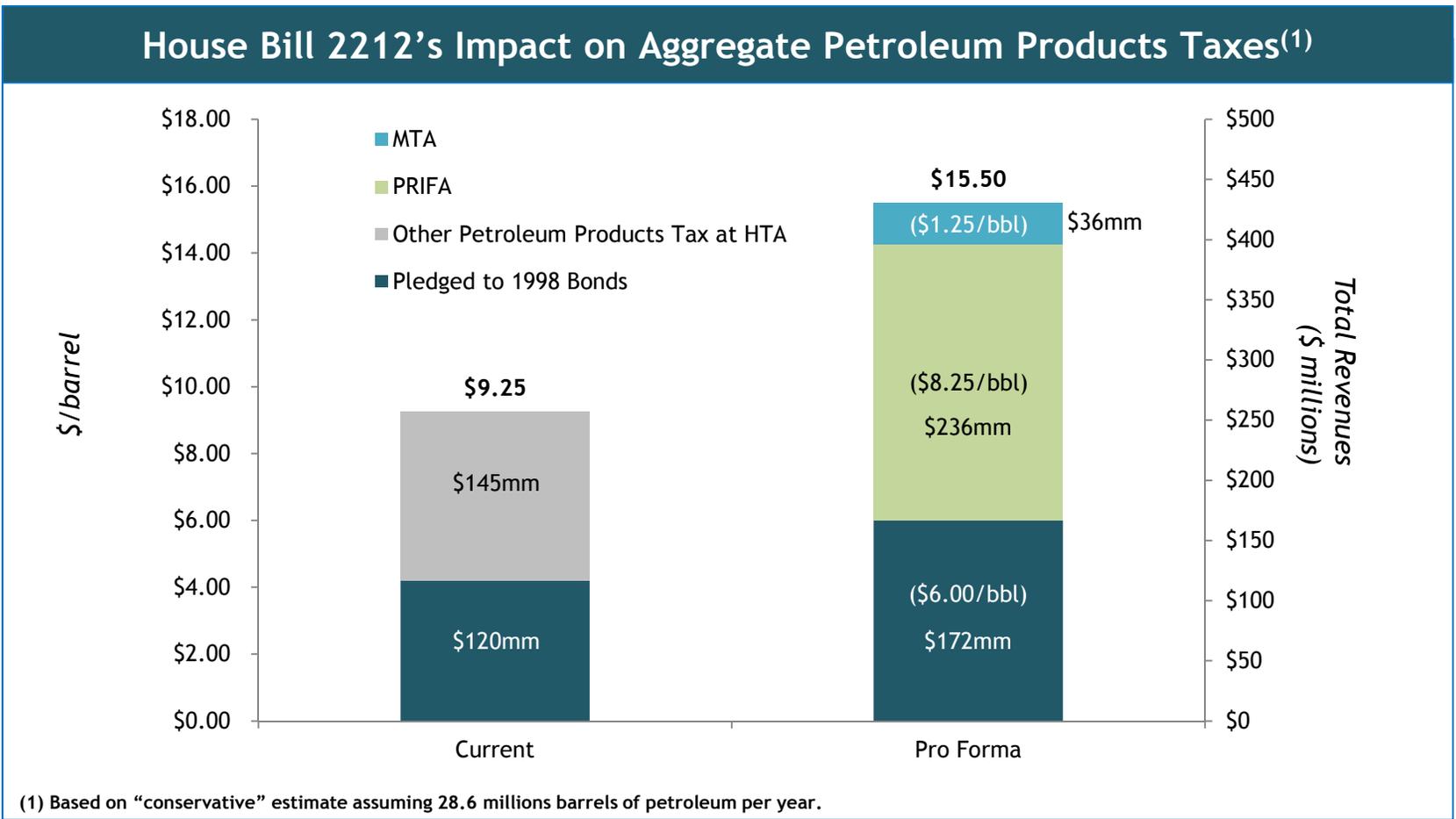
### Actions to date:

- 1 Act 41 of 2014 improved corporate governance by instituting a new seven member board.
- 2 Acts 30 and 31 of 2013 provided HTA with new sources of revenue to repay HTA's obligations with GDB.
  - Act 31 of 2013 also implemented new CPI adjustment for the petroleum products tax.
- 3 HTA has identified funds needed to satisfy 20% state matching requirements for federal grants for highway construction projects, reducing future annual cash needs by approximately \$30 million.
- 4 HTA expects Sustainability Act and other initiatives to result in approximately \$25 million in savings for FY 2015.
- 5 New legislation creating the Mass Transit Authority should reduce HTA's operational needs by approximately \$55 million on run-rate basis by facilitating transfer of the Tren Urbano.
- 6 HTA is implementing additional revenue enhancement and cost saving initiatives that are expected to save between \$15 million and \$30 million per year.
  - Significant cost reductions resulting from the planned procurement of certain of HTA's key operating contracts.
  - New revenue from traffic camera violations started in October 2014 and expected to reach an annualized level of \$10 million in 6 months.
  - \$7 million projected revenue increase from increase in train fares and reduced toll discounts, implemented in October 2014.

Notwithstanding these initiatives, additional revenue increases are still necessary to meet all operational, capex and financial needs.

# Passage of House Bill 2212 (formerly H.B. 2039) will provide sufficient additional measures required to make HTA self-sufficient

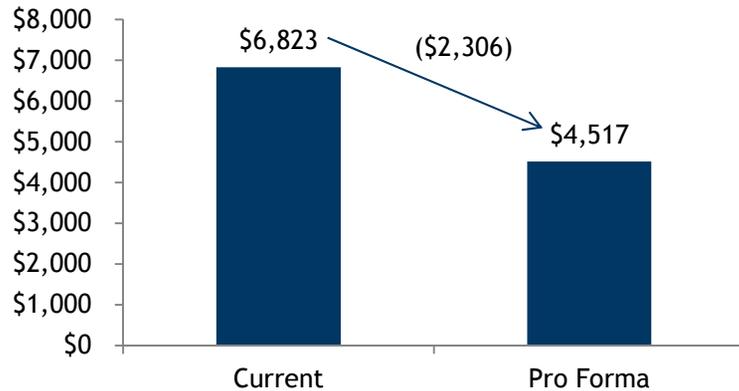
- The proposed legislation would (i) increase aggregate petroleum product taxes by \$6.25 per barrel, (ii) permit the transfer \$3.25 per barrel of existing petroleum products tax to the Puerto Rico Infrastructure Financing Authority (“PRIFA”) and (iii) permit a significant portion of HTA’s debt to be transferred to PRIFA.



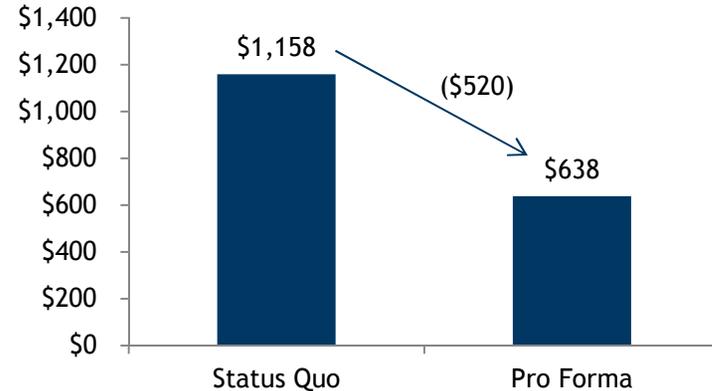
House Bill 2212, together with PRIFA debt refinancing and transfer of the Tren Urbano to the new ATI, is expected to address HTA’s legacy challenges without use of the Recovery Act.

# HTA Reorganization Plan expected to deleverage HTA and make it cash flow positive

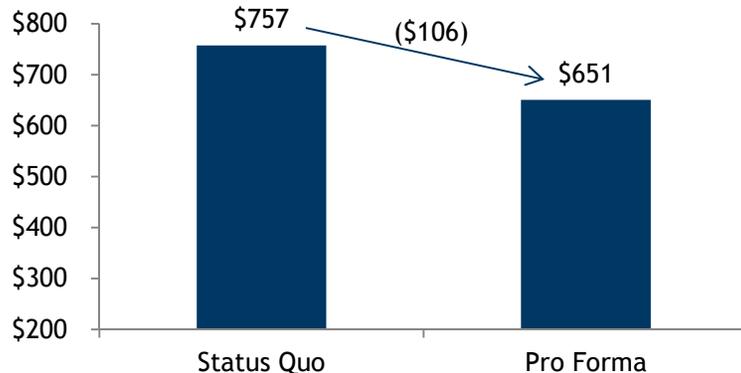
**Total Debt (\$ millions)<sup>(1)</sup>**



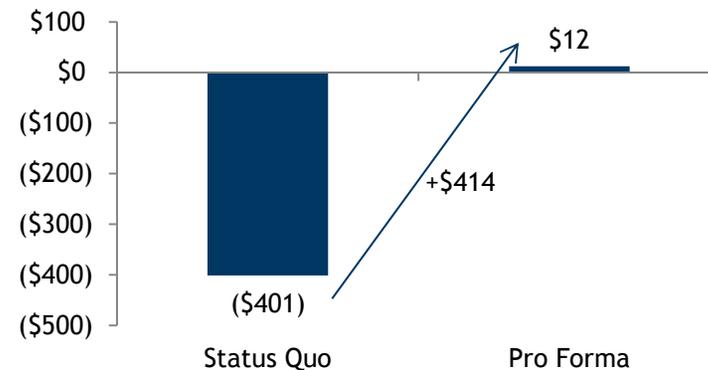
**Expenses (\$ millions)<sup>(2)</sup>**



**Revenues (\$ millions)<sup>(3)</sup>**



**Cash Flow (\$ millions)**



The reorganization plan resulting from House Bill 2212 (formerly H.B. 2039), Tren Urbano transfer, and other expense and revenue measures are expected to make HTA self-sustaining.

(1) Current debt balance reflects outstanding bonds after principal payments on July 1, 2014, BANs of \$292 million and GDB loan balances exclusive of accrued interest. Bonds outstanding excludes any balances associated with the 2003 Series A Special Facility Revenue Refunding Bonds (related to Teodoro Moscoso Bridge).  
 (2) Includes pay down of past due accounts payable. The Status Quo estimates already include impact of various cost reduction initiatives implemented by HTA over the last several months, including implementation of use of toll credit (\$30 million), changes in business rules with the toll operator (\$5 million), reduction in electricity costs (\$5 million), and reduction in employee bonuses (\$3 million).  
 (3) The Status Quo estimates already include impact of various revenue enhancement initiatives implemented by HTA over the last several months, including changes in business rules with the toll operator (\$15 million) and increase in train fares (\$7 million). Pro forma revenues may increase as CPI increases in the Petroleum Product Tax take effect in 2017.

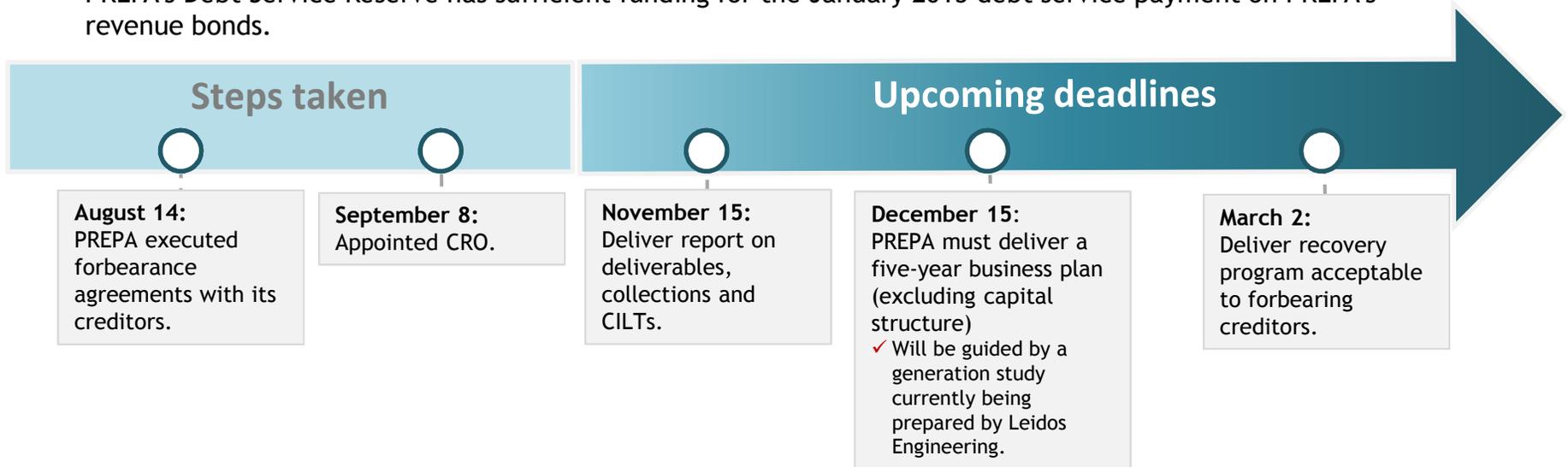
Please refer to Appendix B for additional details.

# PREPA Restructuring Update

# PREPA Forbearance Agreements place entity on consensual restructuring path

PREPA is continuing its efforts to reform its operations and become an engine of economic growth for Puerto Rico.

- On August 14, 2014, PREPA executed forbearance agreements with its creditors.
  - Enabled PREPA to avoid a default on certain working capital lines of credit.<sup>(1)</sup>
  - Provided PREPA with incremental liquidity through the suspension of certain debt service reserve payments and access to construction fund reserves.<sup>(2)</sup>
- To date, PREPA has borrowed \$25 million from its Construction Fund, which has since been repaid.
- PREPA's Debt Service Reserve has sufficient funding for the January 2015 debt service payment on PREPA's revenue bonds.



CRO appointment is expected to increase transparency to all stakeholders and provide expert guidance to ensure PREPA meets required milestones.

(1) Pursuant to the forbearance agreements, PREPA is not required to make previously scheduled maturity payments on its working capital line loans, though it will continue to make interest payments.  
(2) PREPA will also continue to make regular payments of interest and principal to bondholders, but it will not be required to make sinking fund payments contemplated under the trust agreement governing PREPA's bonds. In addition, the forbearing creditors permitted PREPA to access construction fund reserves under certain circumstances. See PREPA's Electronic Municipal Market Access System disclosure on August 14, 2014 for additional details.

## PREPA Situation Update

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Since executing the forbearance agreements and hiring a CRO, PREPA has focused on:

- Business Plan: Developing the five-year business plan, which will be guided by a generation plan currently being prepared by Leidos Engineering and which will serve as baseline for discussions of Recovery Plan.
- Operational Improvements: Examining operating initiatives that will improve PREPA's operating results in the near-term including, but not limited to, reforming customer billing and collection policies, transportation procedures, fuel inventory management and employee overtime.
- Fuel Supply: Executing agreements with key fuel suppliers to guarantee that PREPA will continue to have adequate fuel supplies to continue providing reliable power.
- Safety Protocols: Selected Dupont, a world-class independent safety consultant, to perform a comprehensive safety assessment to improve existing safety protocols.
- PREPA will continue to work to reach a consensual agreement with its stakeholders so it can:
  - address recurring operating and budgetary shortfalls;
  - modernize its system and provide efficient reliable power for the long-term; and
  - diversify its fuel supply.

The resolution for PREPA will require contribution from all stakeholders in order to create a new, modern and sustainable utility that will serve the people of Puerto Rico over the long-term.

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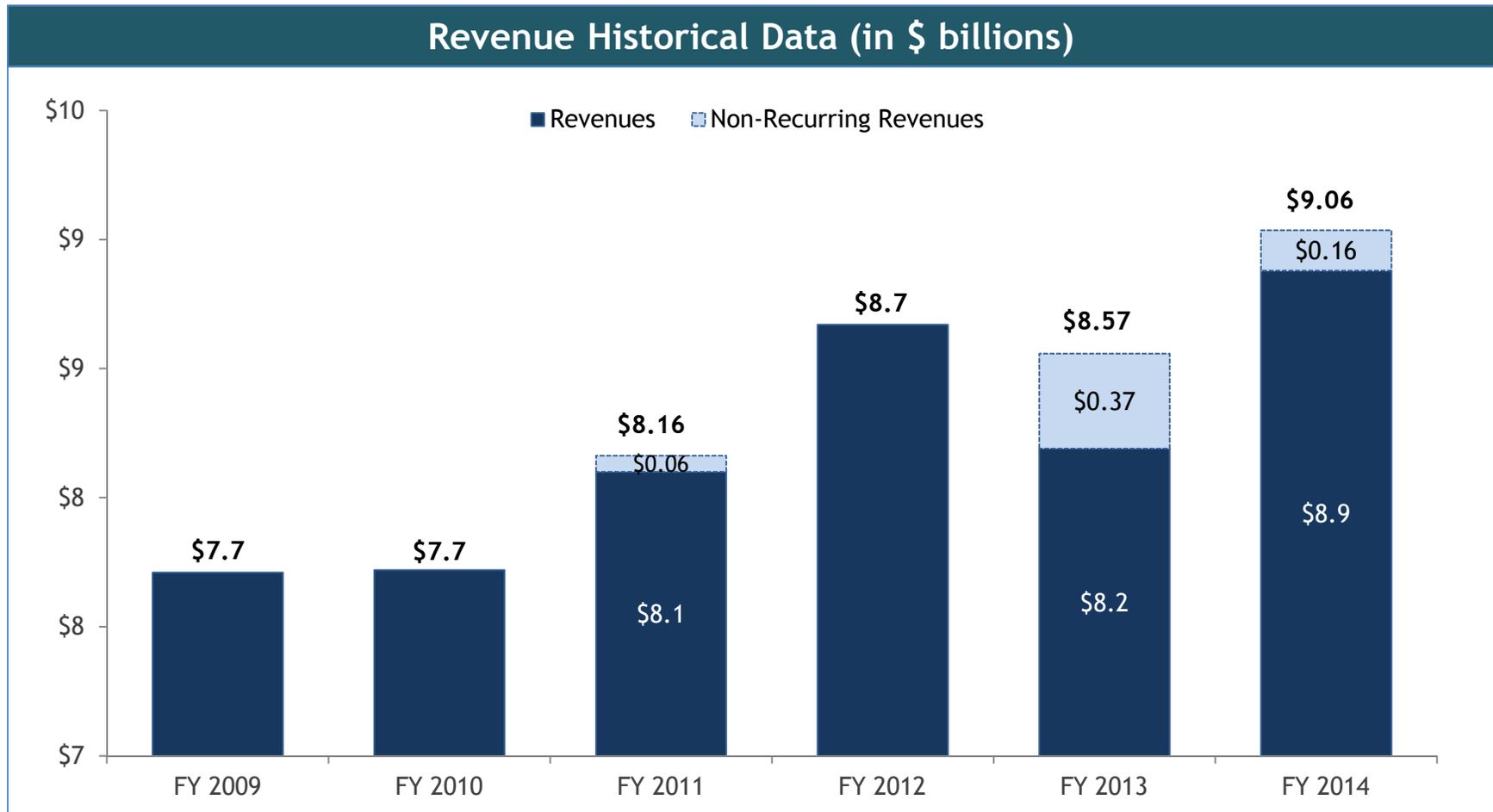
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# FY 2014 Budget Update

# Total recurring General Fund revenues reached their highest levels to date in FY 2014

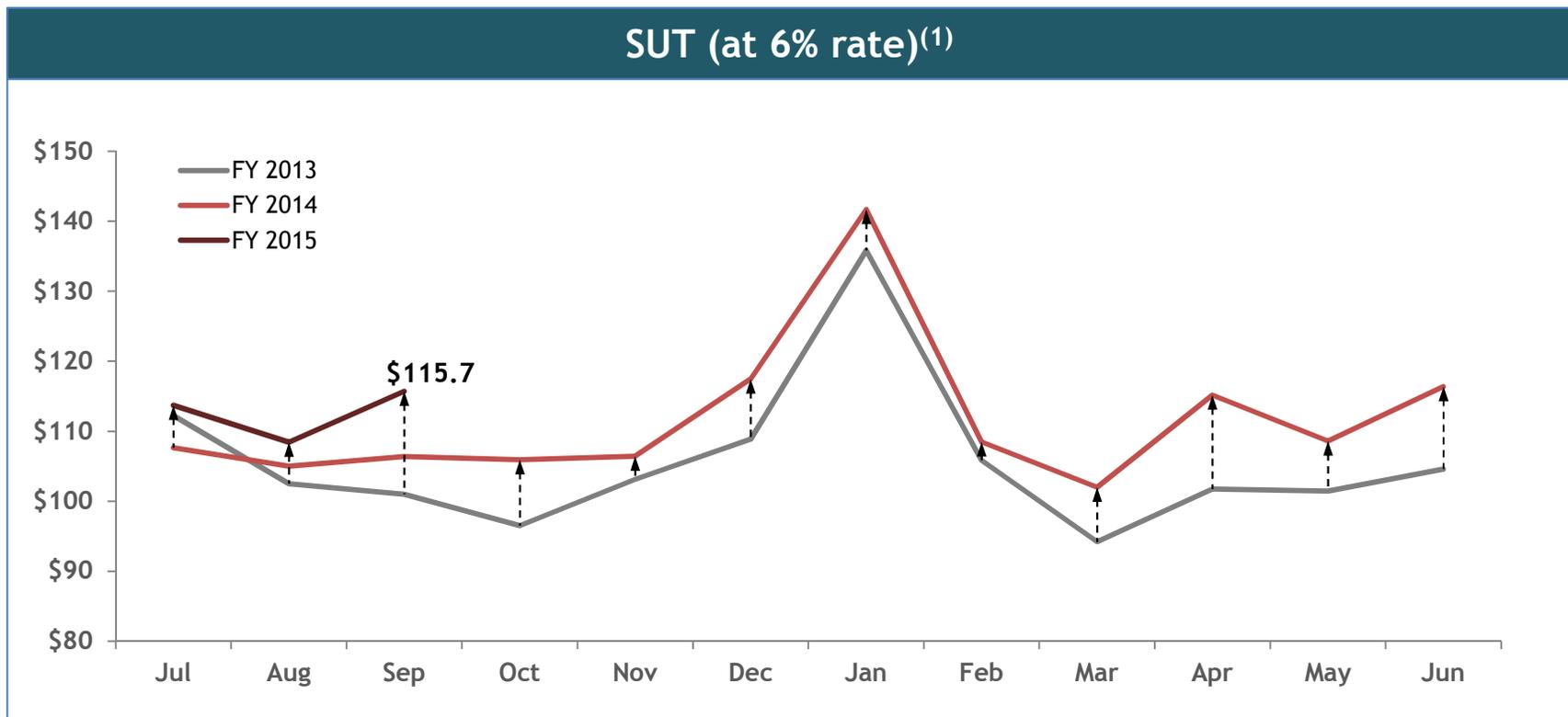


FY 2014 revenues increased by \$686 million, or 8.4 %, when compared to FY 2013 revenues due to the impact of new revenue measures.

Please refer to Appendix A for additional details.

## SUT collections have increased consecutively during the last 14 months

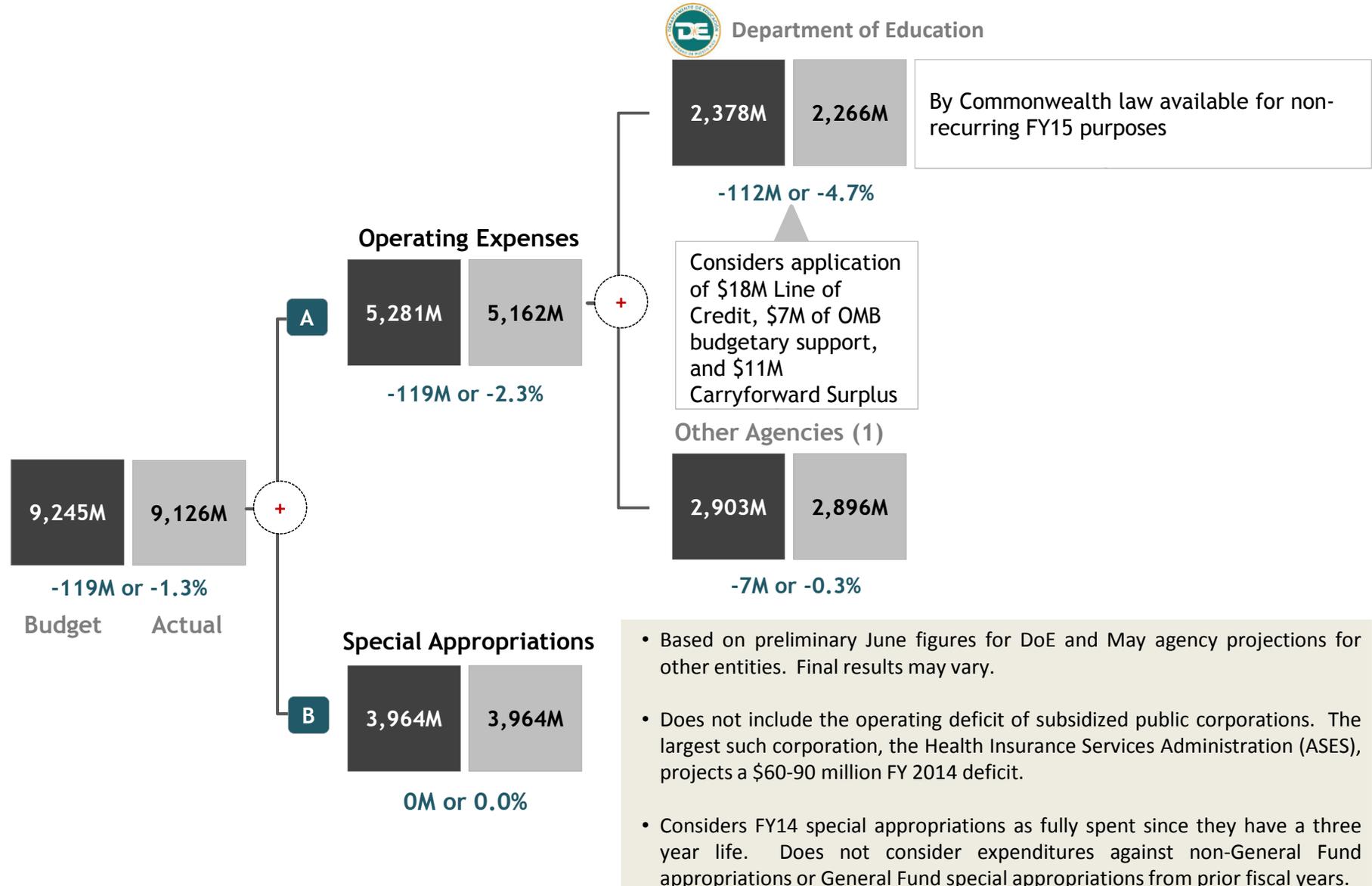
- SUT increase driven primarily by implementation of new enforcement and legislative measures, including Act 40 of 2013 (which expanded the SUT base) and Act 80 of 2014 (which expanded collection at point of entry).



September FY 2015 was the highest September for SUT revenues since the introduction of the SUT in 2006.

<sup>(1)</sup> "State" portion of Sales and Use Tax ("SUT") increased from 5.5% to 6.0% pursuant to Act 18 of 2014; "municipal" portion of SUT decreased simultaneously from 1.5% to 1.0%. For purposes of proper comparison, SUT incomes from non-recurring tax amnesty are excluded from July 2013 results.

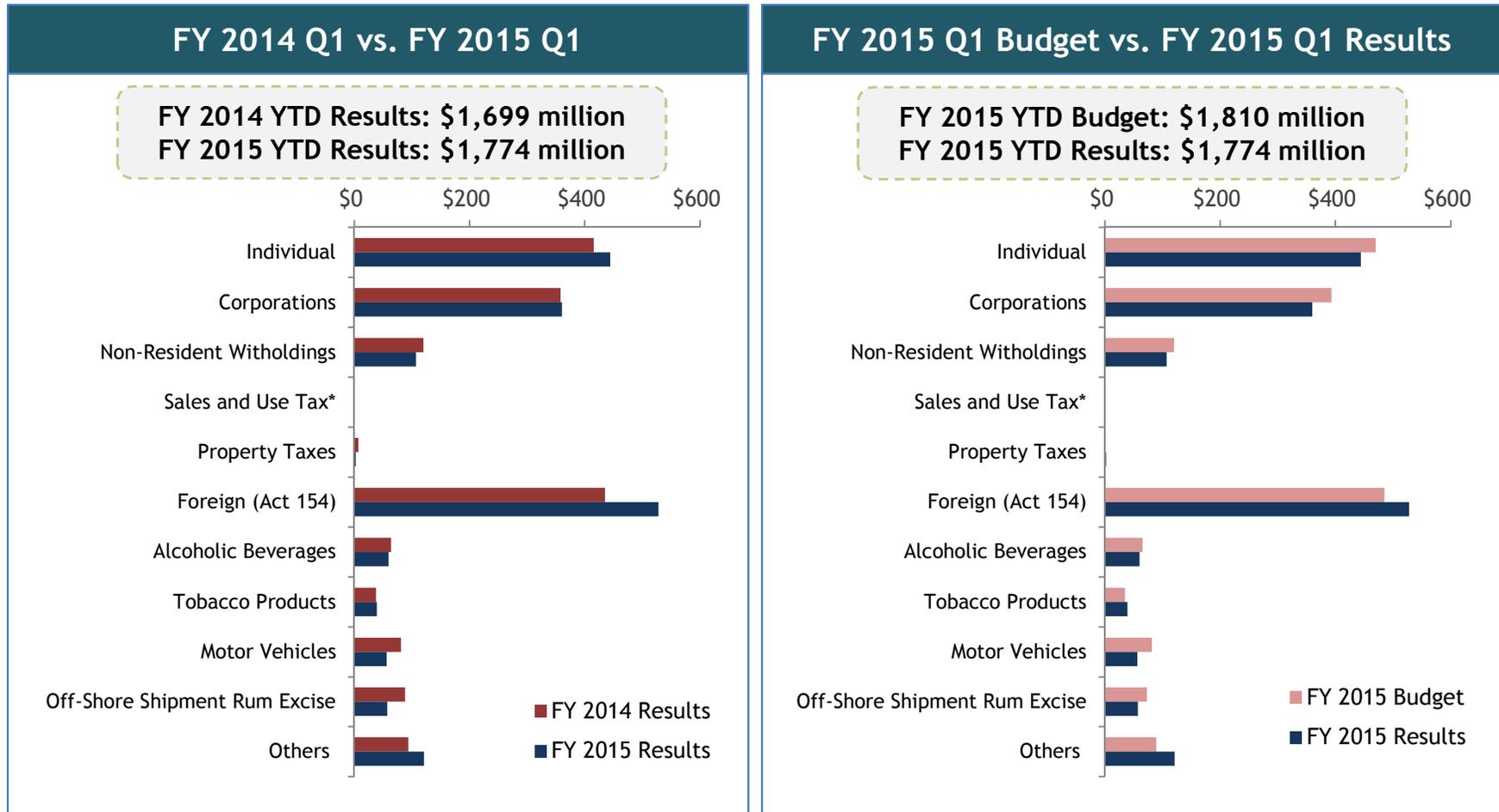
# Preliminary Fiscal Year 2014 Projected Results



(1) Results reflect transfer of \$31 million in projected surpluses at other agencies to the Department of Education to cover various expenses, including school repairs and expenses related to the consolidation of schools for the upcoming fiscal year.

# FY 2015 Revenue Update

# FY 2015 Q1 revenues are 4.4% above FY 2014 Q1 results

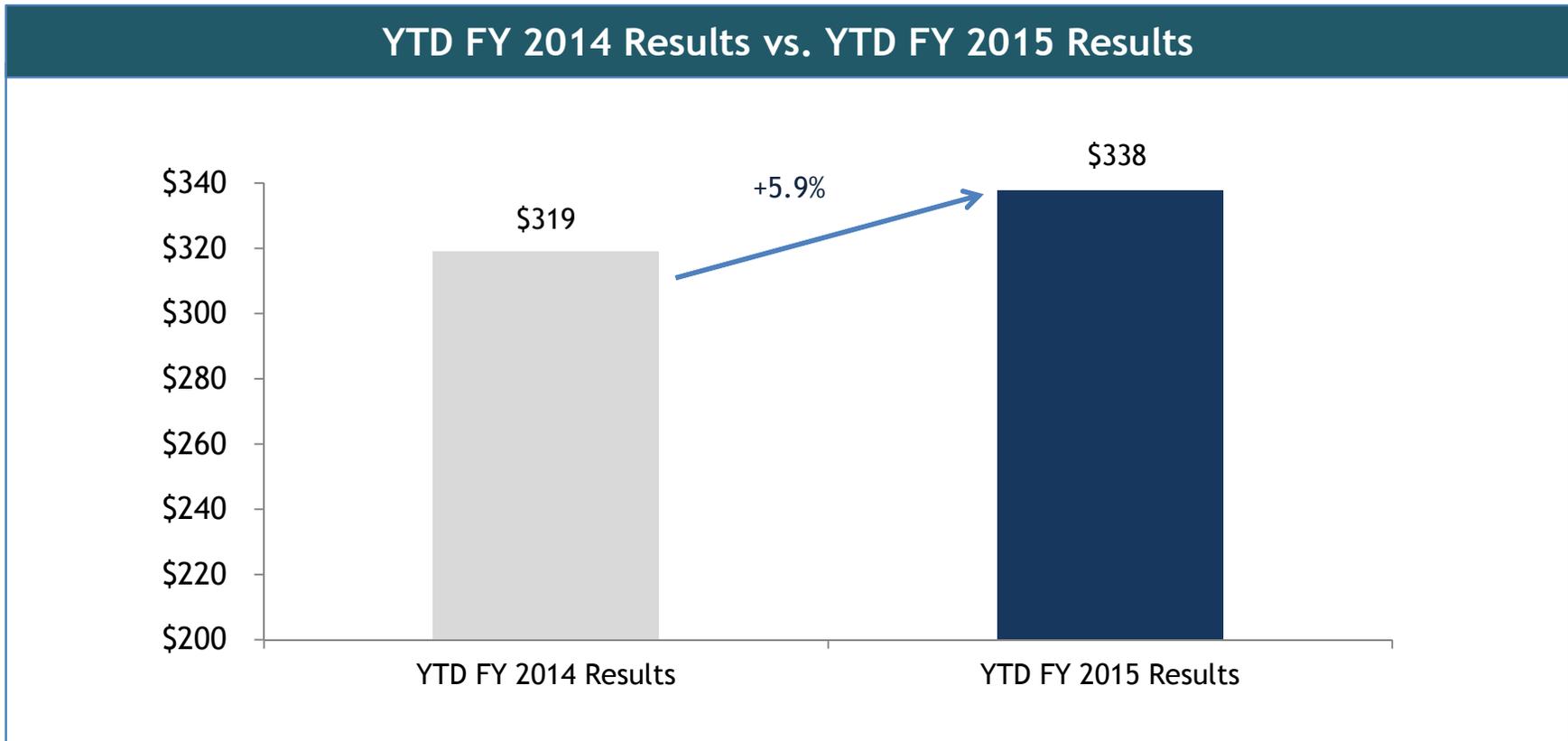


General Fund July-September (Q1) preliminary revenues are (i) \$75 million above FY 2014 Q1 results and (ii) \$36 million below budget for FY 2015 Q1.

\* Sales and Use tax revenues flow to COFINA until receiving the Pledged Sales Tax Base Amount.

## Sales Tax Fiscal YTD revenues are 5.9% above last year's results

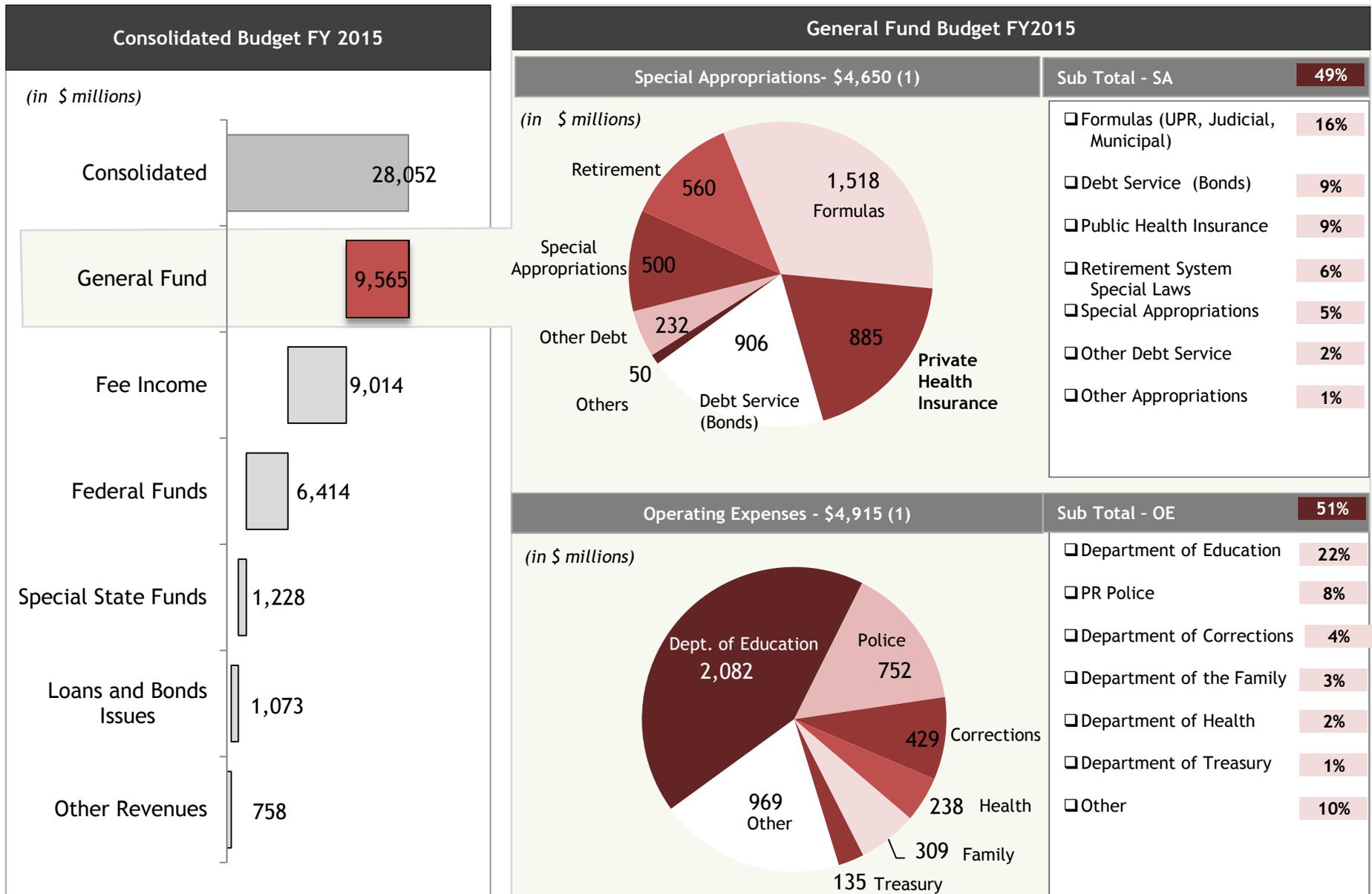
SUT Revenues for FY 2015 Q1 were \$19 million higher than for the same period in FY2014.



July-September (Q1) preliminary SUT collections of \$338 million are 5.9% above the same period of FY 2014.

# FY2015 Expense Update

# Distribution of Approved FY15 Consolidated Budget

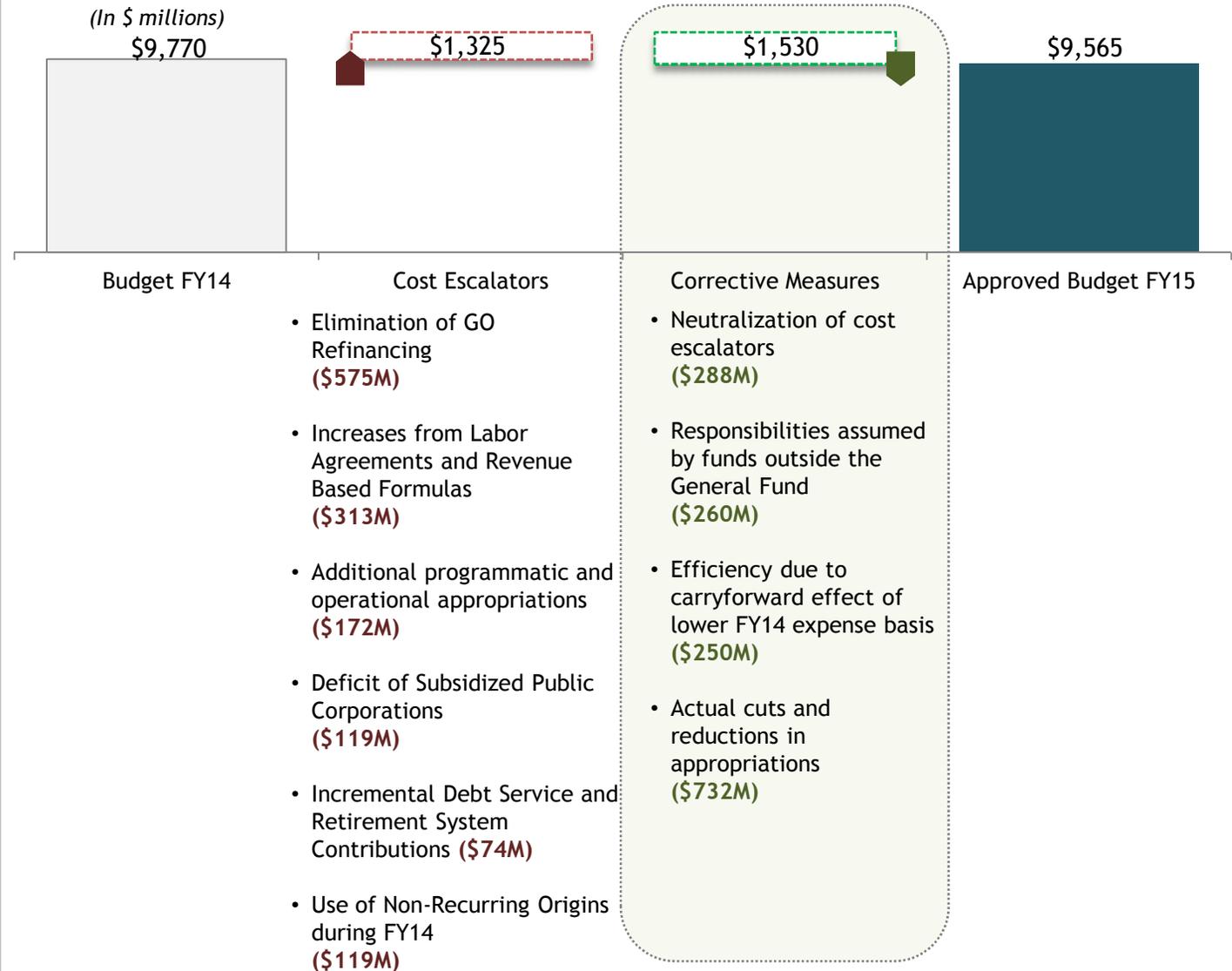


(1) This distribution is used by OMB management for analytical purposes and is not found on the official "budget module" produced by OMB

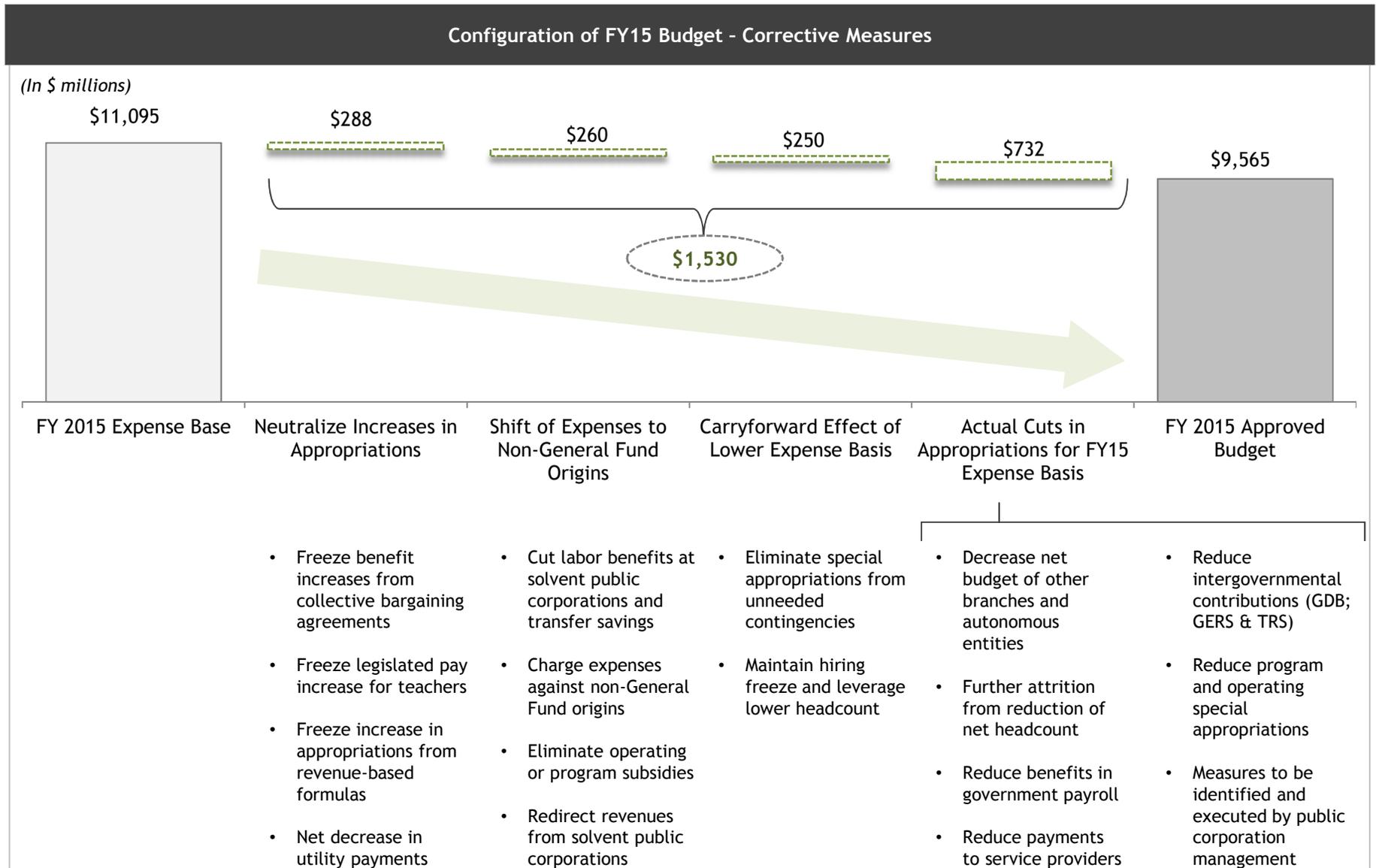
# Review of Overall Configuration for FY15 General Fund Approved Budget

## Configuration of FY15 Budget - Updated Post-Approval

- The recommended budget included cost escalators of ~\$1,227 million and corrective measures of \$1,357 million.
- After budget submittal, estimates of escalators and measures were updated to reflect (i) additional priorities and policy choices; (ii) updated expense projections and other assumptions; and (iii) changes from the legislative process, among others.
- Overall, there is an element of judgment in what is considered an escalator, a corrective measure, and how they offset each other. The information is presented merely for providing context of the challenges faced and strategies selected.

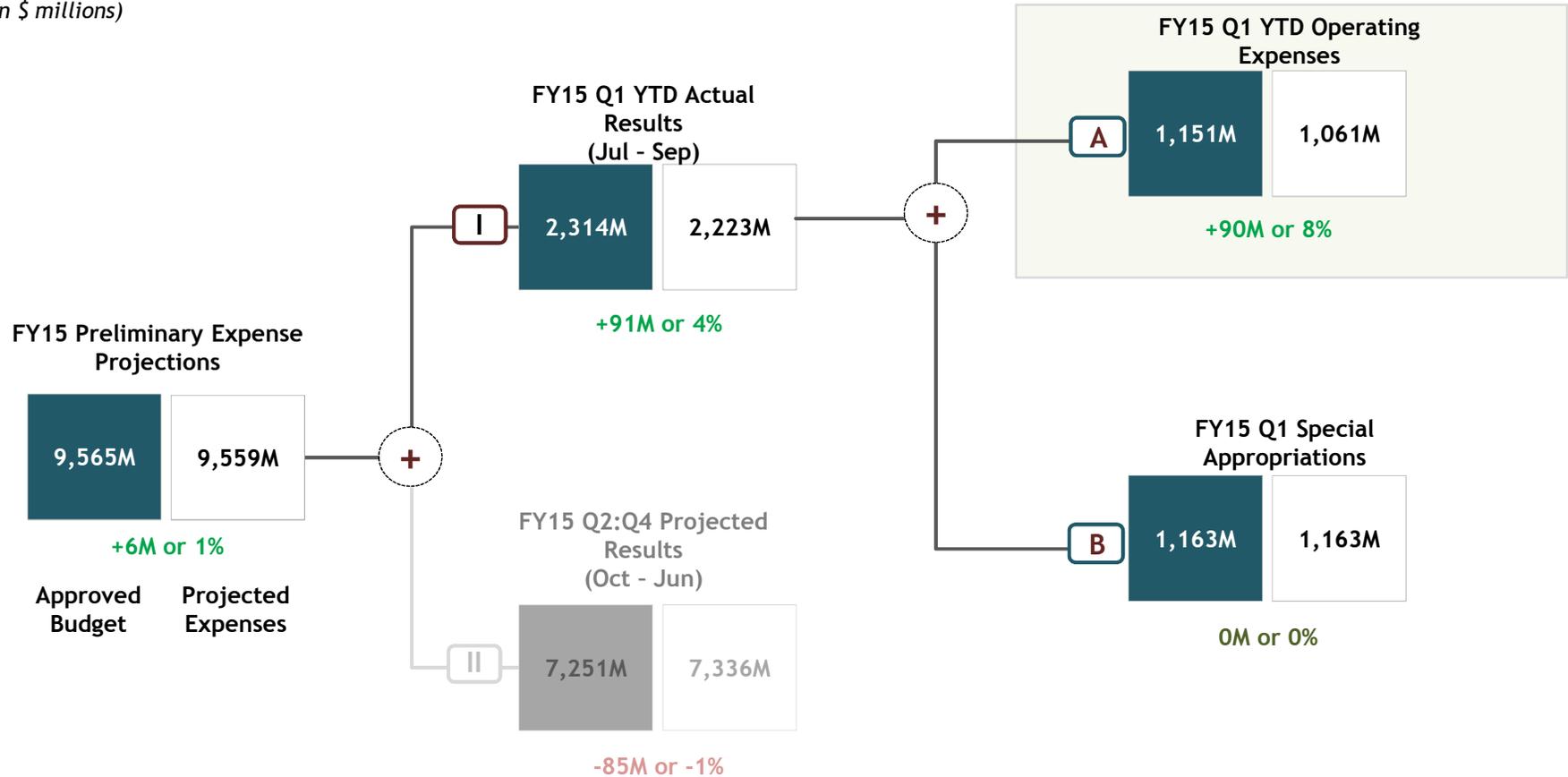


# Review of Corrective Measures for FY15 General Fund Approved Budget



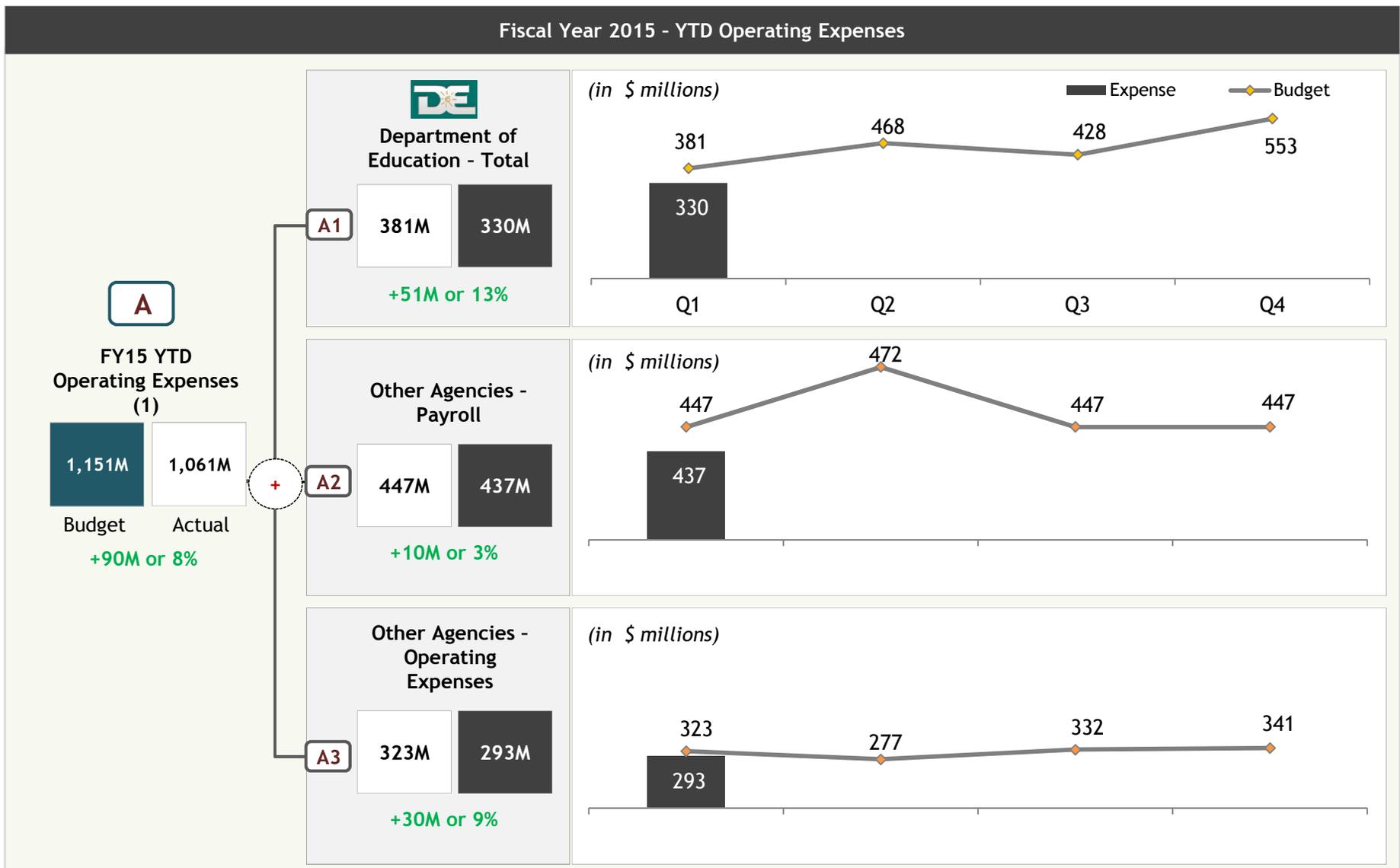
# Preliminary FY15 General Fund Budget Results Projection

(In \$ millions)



- The OMB estimates that expenses and obligations of appropriations for FY2015 will be lower than the approved balance. Based on OMB-adjusted agency projections as of September. Does not include the operating deficit of subsidized public corporations. The largest such corporation, the Health Insurance Services Administration (ASES), currently projects a \$50M year-end deficit, before the effect of the new provider contract negotiations.
- Considers FY15 special appropriations as fully spent since they have a three year life; however, does not include expenditures against General Fund special appropriations from prior fiscal years. Also does not consider expenses charged against other origins including non-General Fund appropriations and Dep. Education carryforward surplus reserves.

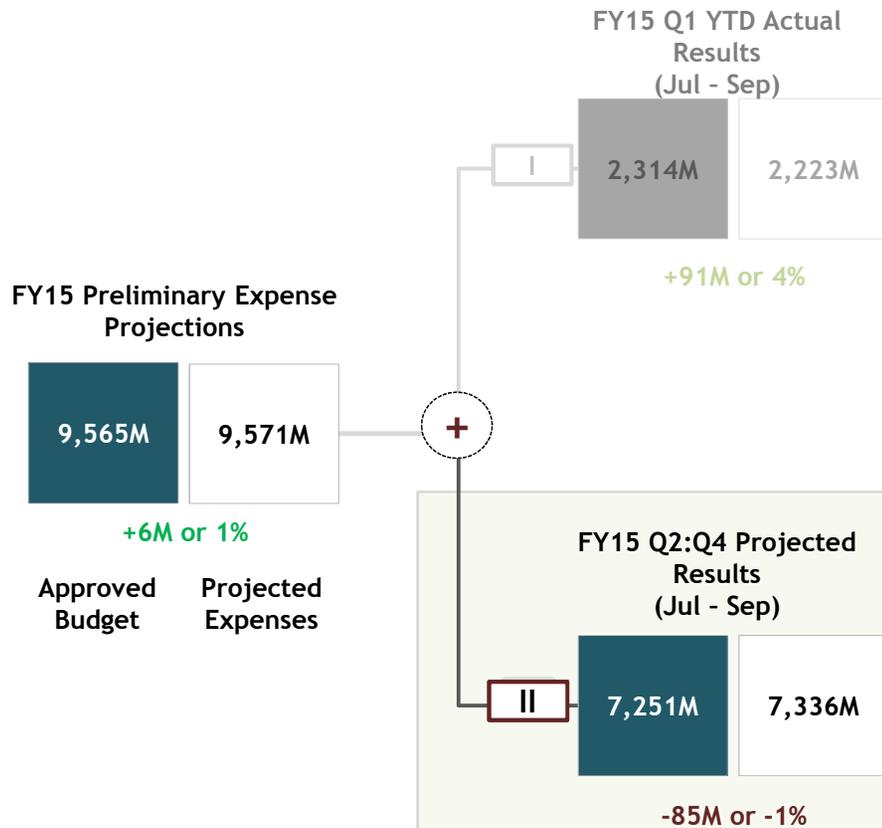
# A Detail of General Fund FY15 Q1 Operating Expenses - by Quarter



(1) The monthly expense distribution pattern for the Dep. Education based on the prior year for each concept. The distribution pattern for Other Agencies-Payroll based on an even distribution per quarter after deducing the Q2 payment of the Christmas Bonus. The distribution pattern for Other Agencies - Operating Expenses based on the average of the past two years for most concepts, which are susceptible to the procurement cycle; and linearly for those which are not, with some exceptions. The budget and expense per quarter may change retroactively to account for budgetary transfers and expense corrections.

# Preliminary FY15 General Fund Budget Results Projection

(In \$ millions)



## KEY ASSUMPTIONS

### Dep. of Education:

- Successful execution of the Department of Education (DoE) budgetary plan.
- Projected overspending of \$31M is covered from FY14 and FY13 carryforward surplus reserves balances. Additional existing balance on carryforward surplus reserves is contemplated for other non-recurring uses; however, it may be possible, by re-prioritizing expenses, to cover any further widening of the overdraft (1).

### Other Agencies - Payroll:

- Headcount at other agencies outside the DoE remains flat or lower due to hiring discipline
- Average salary and benefits remain flat as result of Fiscal Sustainability Act and negotiations with public sector unions

## CHALLENGES AND OPPORTUNITIES

### Challenges

- On direct General Fund expenses, key challenges include higher than expected FY15 TRANs costs. On non-General Fund expenses that may impose an indirect cost pressure, key challenges include the cost structure at the Integrated Transit Authority and the effect of the contract negotiations for new insurance providers at the PRHIA.
- Due to limitations in managerial, reporting and accounting systems, other important risks may materialize, and the underlying estimates for the projection may be incomplete. See Commonwealth Report.

### Opportunities

- There are contingency reserves from FY14 unused special appropriations, from Dep. Education carryforward surplus reserves, and from non-General Fund origins particularly special state funds.

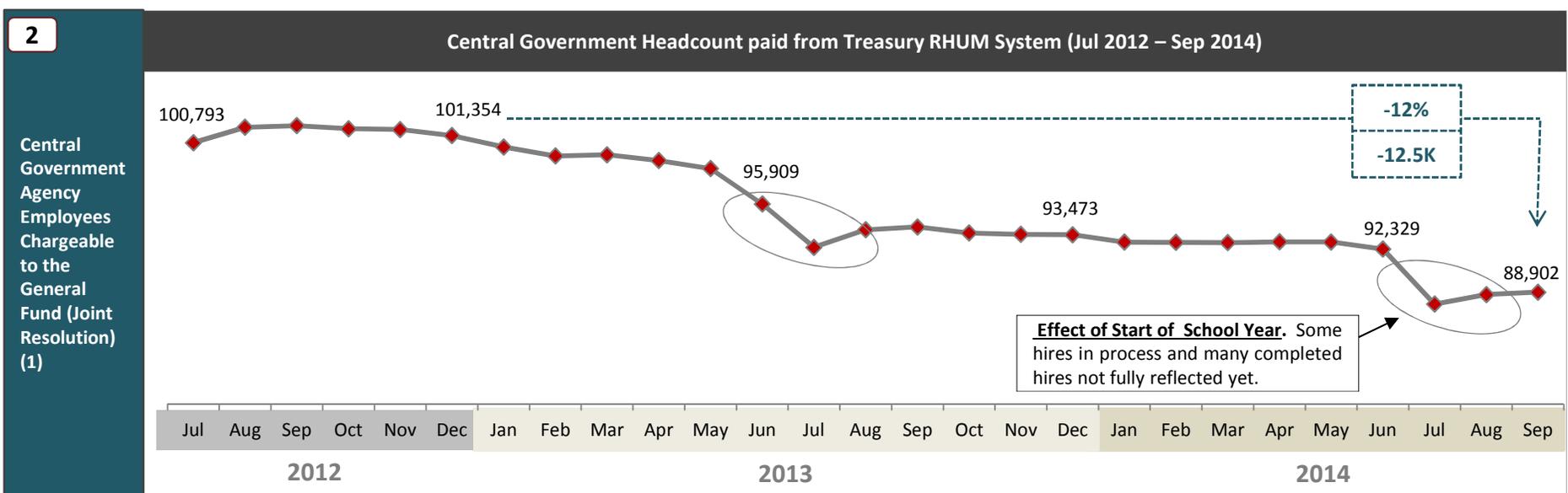
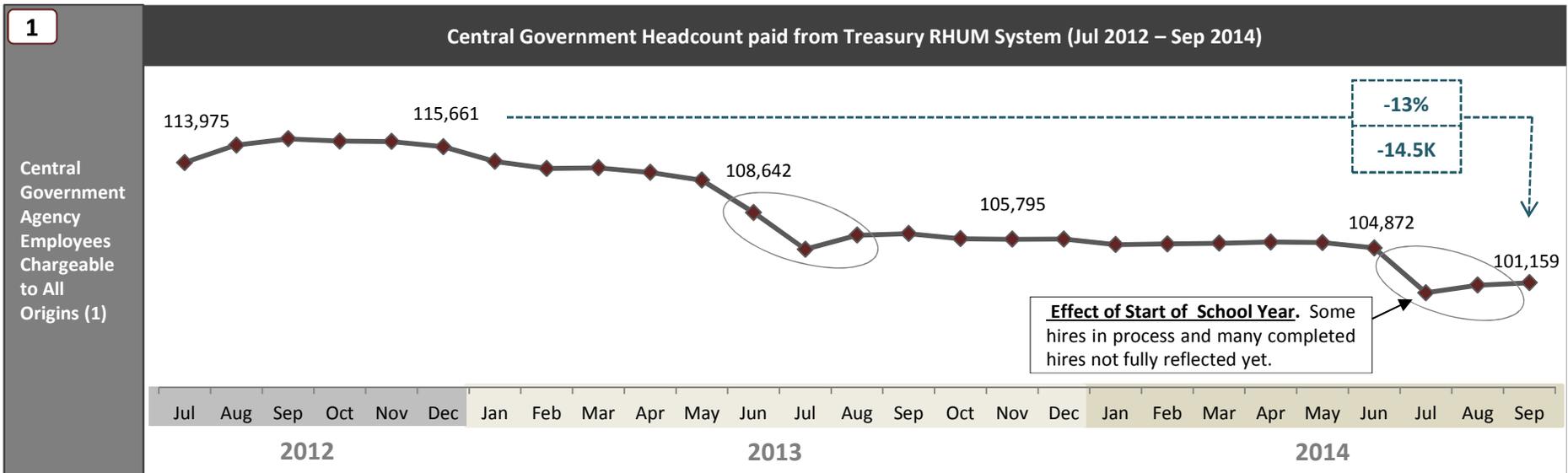
\* Numbers may vary due to rounding

# Key Assumptions: Successful Execution of Department of Education Budgetary Plan

Description of Corrective Measure	Estimated Impact at Budget Approval	Completion Percentage	Status
1 Reduce teacher headcount without affecting service by consolidating schools and classrooms	\$118M	 75%	Estimated reduction at latest count of 2,300 teachers without affecting service delivery. Liquidations covered with GDB Act 70-11 line of credit.
2 Channel savings from Fiscal Sustainability Act and other assets from the State Insurance Fund and other solvent corporations to the General Fund	\$56M	 75%	CFSE (State Insurance Fund) and ACAA (Automobile Accident Insurance) have contributed \$37M and certified additional payments for \$15M in FY15.
3 Reduce transportation expenses by 40% by adjusting rates and subcontracting to municipalities	\$55M	 100%	New contracts in place with different rate structure. Three pilot regions with 16 municipalities with 100% uptake. Savings in the \$65M target range projected.
4 Reduce Christmas Bonus and intra-year liquidation of excess sick leave	\$33M	 100%	The Fiscal Sustainability Act was adopted and unions under its negotiation provisions forwent pay increments and certain pre-existing benefits.
5 Net cumulative effect of earnings from utility measures, including claiming invoice tax credits	\$21M	 75%	Existing credits against the Public Building Authority were taken, however, an overdraft is projected in this area.
6 Consolidate schools to reduce operating costs and improve services	\$19M	 100%	Seventy one schools were successfully consolidated for the school year that began in August.
7 Reduce professional services and purchased services by 10% through reduction in rates	\$19M	 50%	10% reduction in rates for special education therapies. Issued security RFP to reduce manpower requirement and lowered projected expense from \$65M in FY14 to \$31M in FY15.

- Given the execution of the budgetary plan to date, the current projection is a \$31M overdraft from the FY15 appropriations, despite a reduction of \$337M in the DoE General Fund budget.
- The DoE faces significant budgetary pressures from an increase in special education operation expenses, which increased sharply between FY12 and FY14 due to a 20% increase in special education enrollment. The DoE is subject to a court-supervision regime as a result of a civil rights federal lawsuit related to the program and its ability to control expenses in this area is constrained.

# Key Assumptions: Flat or Declining Headcount Against General Fund



(1) Includes only employees paid from the central RHUM Treasury HR system. Certain smaller or autonomous agencies (~3% of the total) not included. Numbers for PR Police are self reported. Does not include irregular employees. General Fund number does not include employees paid from special appropriations. September 2014 numbers may reflect a lag since employees exercising functions may be entered at a later date than their start date, and compensated retroactively.

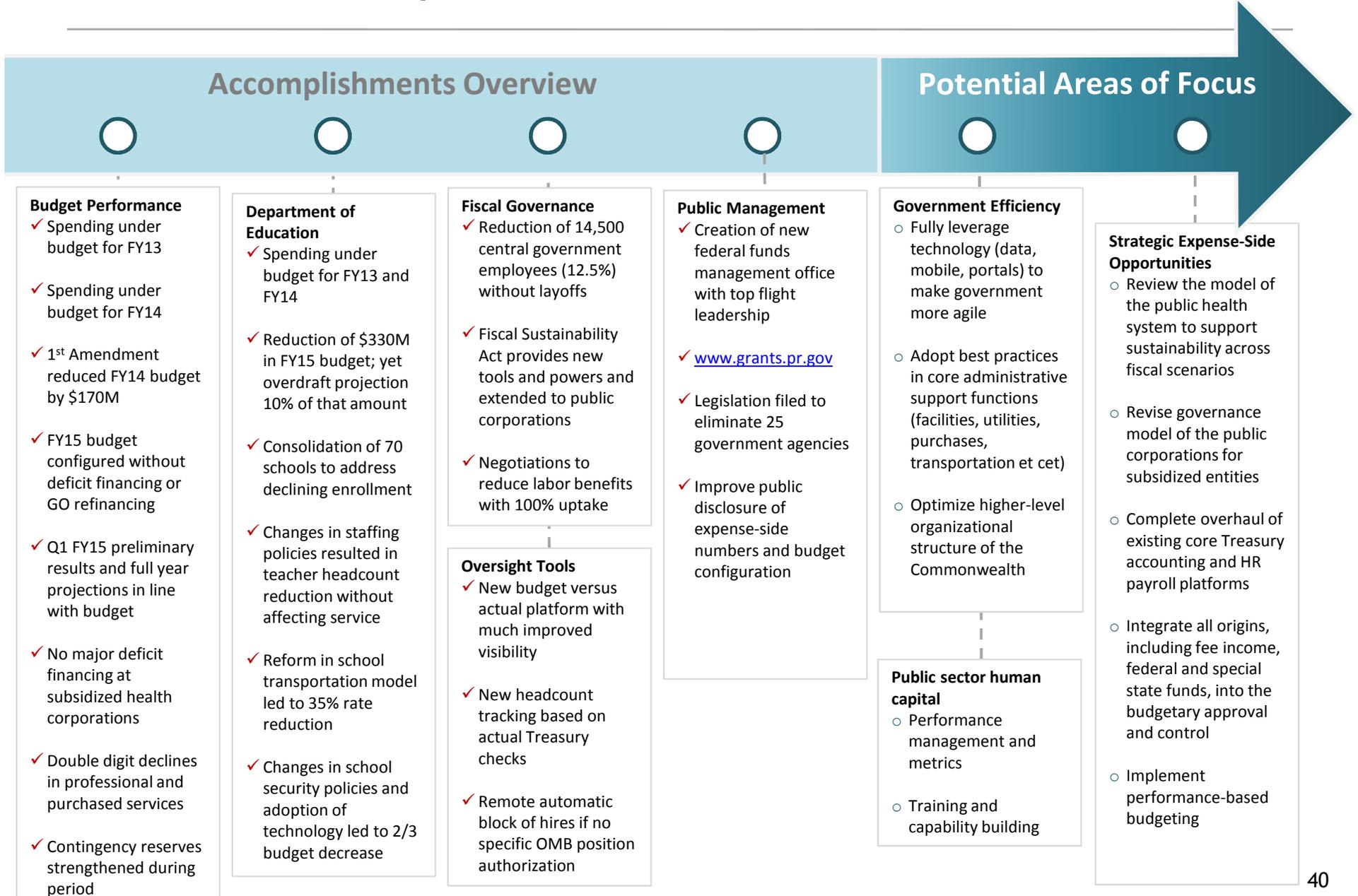
# Key Assumptions: Stable Average Salaries and Reduction in Certain Other Benefits

Key Provisions of the Sustainability Act	Uptake of Voluntary Negotiations with Public Sector Unions
<ul style="list-style-type: none"> <li>The Fiscal Sustainability Act (FSA), Act 66-2014, freezes all wage and benefit increases during a three year period; reduces or eliminates certain benefits, including the Christmas Bonus and intra-year sick leave liquidations, and adds flexibility to non-economic collective bargaining agreement clauses.</li> <li>The FSA provides that labor unions for the Commonwealth and for public corporations may alternatively negotiate and ratify amendments to their collective bargaining agreements, provided these produce comparable savings. If not, the FSA default provisions enter into effect.</li> <li>One hundred percent of Commonwealth public sector unions reached and ratified alternate arrangements.</li> <li>Many, but not all, public corporation unions also reached agreements under the FSA. For certain corporations with better financial conditions, the FSA provides that savings will be contributed to support General Fund expenditures.</li> <li>This arrangement allows for flat salaries and lower benefit structure for FY15 and two fiscal years thereafter.</li> </ul>	<p><b>Total Unionized Workers</b> 59,985 100%</p> <p><b>Central Government</b> 41,443 69%</p> <p><b>Public Corporations</b> 18,542 31%</p> <p>100% union uptake of negotiations</p> <p>67% union uptake of negotiations</p> <p><b>Key Holdouts</b></p> <ul style="list-style-type: none"> <li>PREPA (UTIER)</li> <li>HTA (PROSOL UTIER)</li> <li>AMA (HEO &amp; TUAMA)</li> <li>CAM (AFM)</li> </ul>

# FY15 General Fund Budget Challenges and Opportunities

IDENTIFIED CHALLENGES		IDENTIFIED OPPORTUNITIES		
 <ul style="list-style-type: none"> <li>TRANS interest costs for FY15 is projected to be substantially higher than budgeted</li> <li>General Fund appropriation for FY15 of \$42M, which is 68% higher than for FY14, is insufficient to cover cost</li> </ul>	25M to 30M	<p><u>FY14 Special Appropriations Surplus Balances</u></p>	<ul style="list-style-type: none"> <li>FY14 appropriations have available balances to support contingencies</li> <li>OMB may transfer these balances to support other uses – such as TRANS or Health Insurance Plan subsidies – if FY15 appropriations are inadequate or if it deems that further budgetary support is appropriate</li> </ul>	2M to 30M
 <ul style="list-style-type: none"> <li>Ongoing PRHIA procurement with private insurance providers for new contract starting in April. Would impact the PRHIA state matching share for 4QFY15</li> <li>Not directly a General Fund expense, however, Commonwealth may elect or need to provide support</li> <li>Impact depends on premium % cost increase. Every % cost increase over 5% has a ~\$2M impact in FY15</li> </ul>	2M to 30M			
 <ul style="list-style-type: none"> <li>New Integrated Transit Authority requires \$35M to match operating needs from FY14/ Takes over Urban Train operation from Highway and Transit Authority</li> <li>Organic law provided for \$30M transitional special fund which is now unavailable, went to FY14 revenues</li> <li>Not directly a General Fund expense, however, Commonwealth may elect or need to provide support</li> </ul>	35M	<p><u>HTA Fiscal Reform</u></p>	<ul style="list-style-type: none"> <li>Strategies to address HTA deficiencies may include additional revenue for Integrated Transit Authority</li> <li>Management has begun to implement corrective action including Urban Train operating hours and changes in bus routes</li> <li>Commonwealth and OMB may elect not to provide support</li> </ul>	30M to 40M
 <ul style="list-style-type: none"> <li>Projected overdraft of \$32M for FY15 General Fund operating deficit</li> <li>DoE has additional non recurring needs in the areas of equipment, lawsuits, contingencies, and materials</li> </ul>	32M to 60M	<p><u>Dep. Education 161 Fund</u></p>	<ul style="list-style-type: none"> <li>Dep. Education has carryover General Fund surplus balances for approximately \$162M</li> <li>Surplus balances will cover FY15 projected overdraft</li> <li>DoE may decline to address non recurring needs in order to provide further budgetary support if FY15 overdraft projection widens</li> </ul>	162M
 <ul style="list-style-type: none"> <li>Additional risks may exist or manifest over time.</li> <li>The management information systems at the Central Government are not adequate and uncertainty is significant.</li> <li>Does not consider unbudgeted lawsuits such as the Doral settlement</li> </ul>	???	<p><u>Other Reserve Funds</u></p>	<ul style="list-style-type: none"> <li>OMB can access multiple other reserves with balances to cover uses authorized by law, including the Budgetary Fund, the Emergency Fund, the Amnesty Fund (for Security and Health expenses) and surplus balances from previous Capital Improvement Programs</li> </ul>	65M

# Overview of Accomplishments and Potential Future Areas of Focus



# Comprehensive Tax Reform

## The Commonwealth has embarked on an aggressive agenda to streamline Puerto Rico's tax structure and maximize revenues

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The Treasury Department, together with OMB and GDB, is working with KPMG to design and enact a comprehensive tax reform that will:

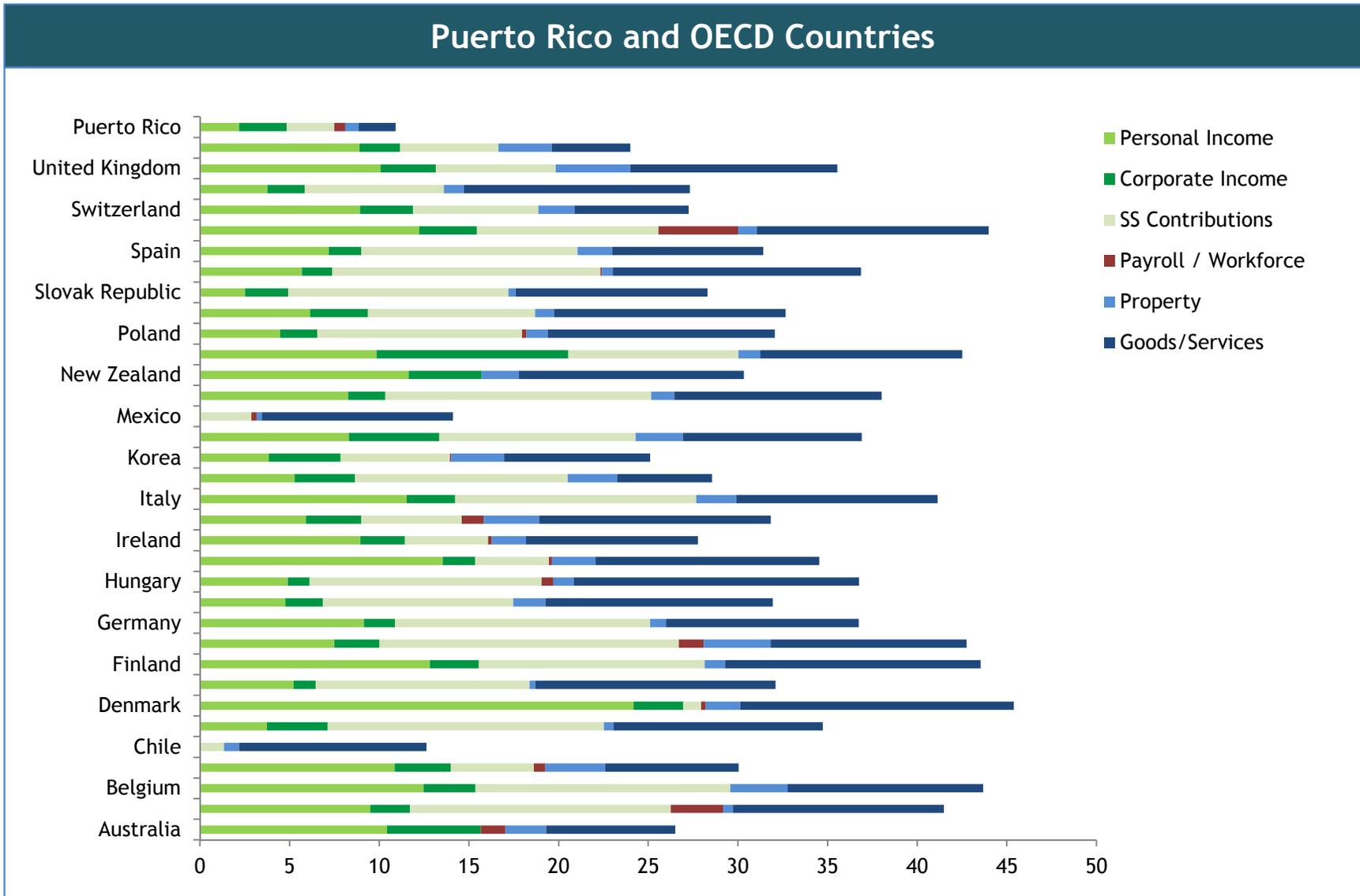
- materially increase General Fund revenues,
- equitably distribute the burden of taxation,
- promote economic growth,
- increase international competitiveness of products, workers and businesses,
- minimize interference with private decision making and
- streamline tax compliance and administration.

As part of the design of the proposed tax reform, the Commonwealth, with the assistance of KPMG, developed a Puerto Rico-centric macroeconomic model for Tax and Economic Policy to aid the development of fiscal projections.

- Model is expected to materially improve revenue and economic projections at the Department of the Treasury.
- Model will be shared with the Planning Board, GDB and the Institute of Statistics.

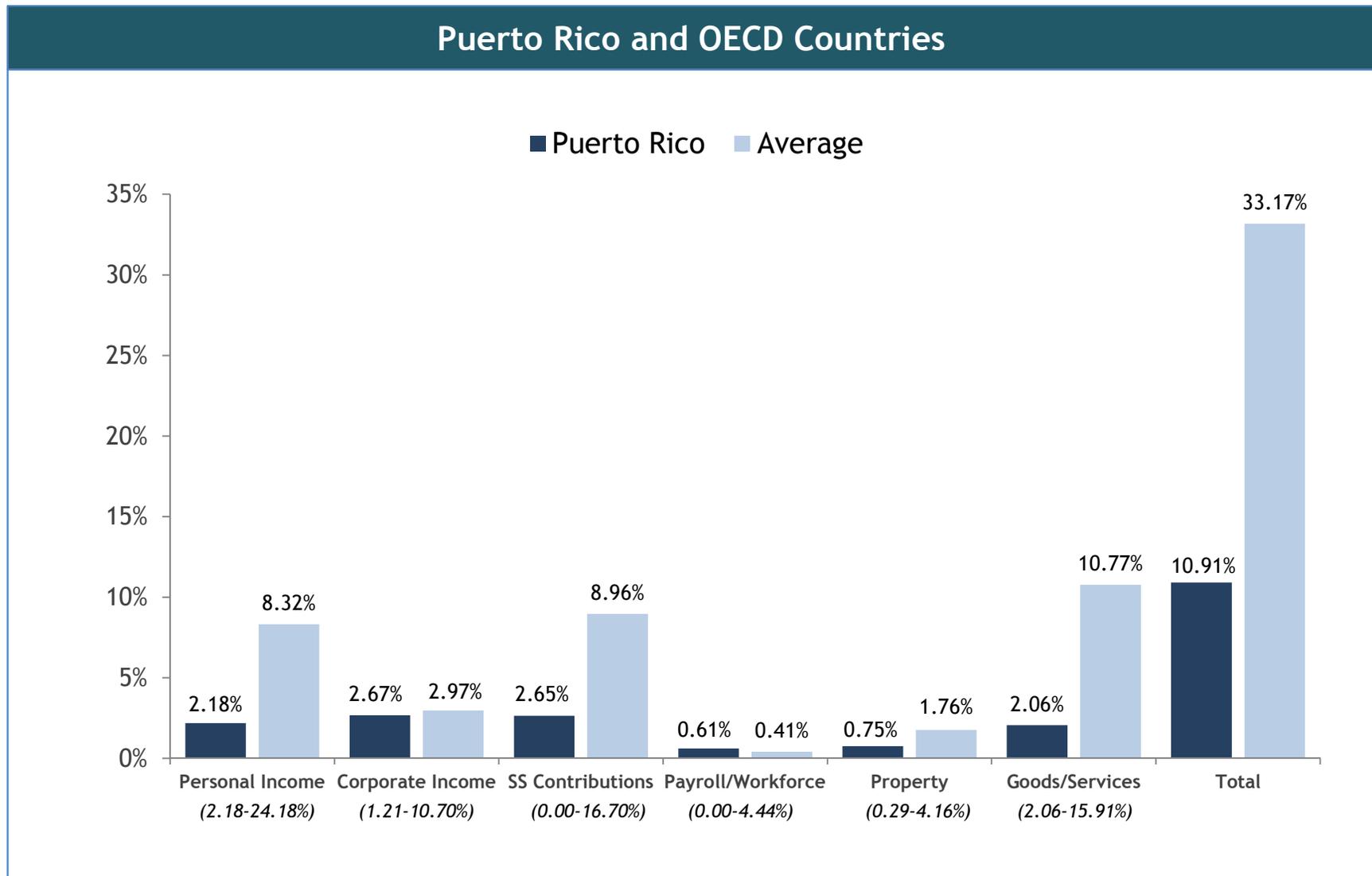
Tax reform is expected to be passed by legislature during Q3 FY 2015.

# Taxes as a percentage of GDP in Puerto Rico are lower when compared to other jurisdictions



Source: OECD

# As a percentage of GDP, Puerto Rico tax revenues from personal and corporate income, and from good and services, are below peers

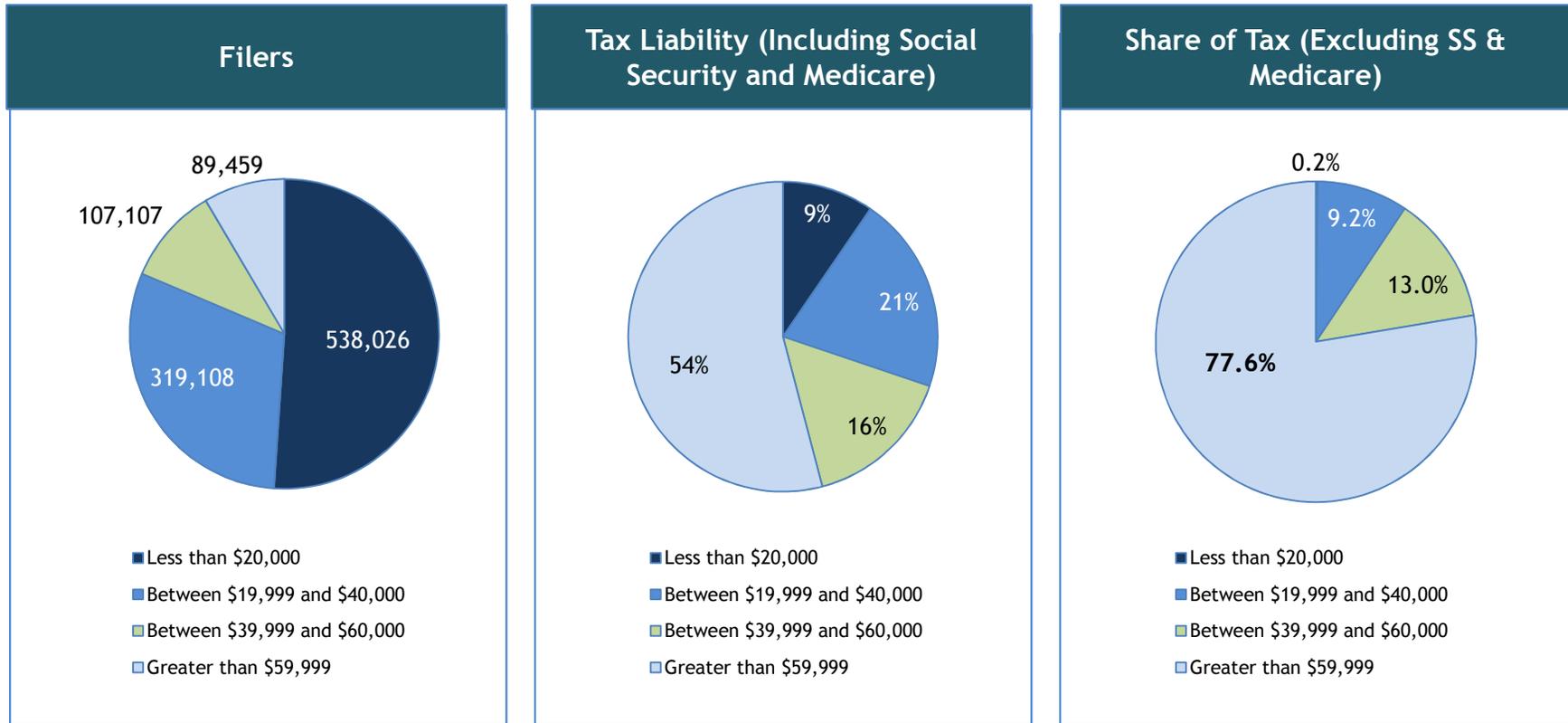


Source: OECD

# Comparative VAT rate with OECD countries



## 2013 income tax liability by income class (in millions of USD)<sup>1</sup>



- Less than 10% of tax filers are responsible for almost 78% of individual income tax receipts.
- Existing tax preferences shrink the tax base and require higher marginal tax rates to achieve revenue targets.

<sup>1</sup> Distributional analysis based on 2012 individual tax returns provided by Department of Treasury.

## Puerto Rico sales tax and excise tax liability, as a percentage of income, falls at higher levels of income

This is a standard feature of sale and excise taxes and its regressive nature, indicating the sales tax and excise tax burden is highest on individuals with lower incomes.

### 2013 Sales Tax Liability By Income Class<sup>1</sup>

Income bracket	Total Sales Tax Liability (In Millions)	Liability Per Household (HH)	Liability As Fraction of HH Income
0 to \$21,790	\$381	\$560	5.51%
\$21,800 to \$33,000	\$194	\$833	3.07%
\$33,050 to \$69,500	\$345	\$1,042	2.22%
\$69,600 to \$84,170	\$66	\$1,464	1.93%
Greater than \$84,170	\$187	\$2,209	1.55%

### 2013 Vehicle, Gasoline, Alcohol, & Tobacco Excise Tax By Income Class

Income Range	Number of Households	Average Income	Excise Tax Liability Per Household	Share of Total Liability/Pct of Households	Liability as Percent of Income
Less Than \$21,800	681,339	\$10,163	\$503.37	31.28%/49.50%	4.95%
\$21,800 to \$33,000	233,080	\$27,107	\$749.50	15.93%/16.93%	2.76%
\$33,050 to \$69,500	331,584	\$47,011	\$1,024.60	30.99%/24.09%	2.18%
\$69,600 to \$84,170	45,579	\$75,990	\$1,416.75	5.89%/3.31%	1.86%
Greater than \$84,170	84,590	\$142,953	\$2,052.02	15.90%/6.17%	1.44%

<sup>1</sup> Figures based on expenditure shares on goods and services provided by the Department of Labor and Human Resources and allocated to income groups based on relative expenditure amounts in the Consumer Expenditure Survey.

## 2013 Income and Consumption Tax By Income Level (in millions)<sup>1</sup>

When estimating income and consumption taxes by income bracket, it is evident that the share of all taxes fall disproportionately on top of certain income levels.

Income bracket	Income Tax	Consumption Taxes	Total	Share of all taxes	Weighted Distribution (Weighted by Number of HHs)
0 to \$21,790	\$10	\$724	\$734	16.94%	3.24%
\$21,800 to \$33,000	\$72	\$368	\$440	10.16%	5.68%
\$33,050 to \$69,500	\$434	\$685	\$1,116	25.75%	10.12%
\$69,600 to \$84,170	\$151	\$131	\$281	6.50%	18.59%
Greater than \$84,170	\$1,410	\$361	\$1,763	40.65%	62.37%
<b>Total</b>	<b>\$2,079</b>	<b>\$2,271</b>	<b>\$4,337</b>		

**Capital income bears a significantly smaller tax burden than labor income.**

<sup>1</sup> Income tax distribution based on 2012 individual income tax returns provided by Department of Treasury.

Note: Sales and Use Tax portion of consumption tax liability based on expenditure shares on goods and services provided by the Department of Labor and Human Resources and allocated to income groups based on relative expenditure amounts in the Consumer Expenditure Survey.

# Lower income tax rates, broad-based GST, primary drivers of comprehensive tax reform

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Tax reform expected to result in shift from taxing productivity to taxing consumption:

- Broad-based Goods and Services Tax (“GST”)
  - GST would include important exemptions for small business and regressivity relief for low income persons.
  - Amount of revenue to be collected is a function of the tax rate, the small business exemption level and the magnitude of regressivity relief.
  - Reform to ensure protection of COFINA revenue and pledge; COFINA will remain important source of financing.
- Reduce Individual Income Taxes
  - Currently considering lowering individual income tax rates, together with material increases in exemptions levels from taxation for singles and couples.
  - Broaden taxable base by eliminating or adjusting certain tax expenditures.
- Reduce Corporate Income Taxes
  - Considering repealing Gross Profits Tax (*Patente Nacional*) and reducing corporate tax rates to rate equal to that paid by individuals in an effort to simplify the system and eliminate the need to create conduit entities as tax planning mechanisms.
  - Revenues would be made up by expanding the tax base through the repeal of certain business tax expenditures.
- Alternatives to Act 154 Revenues
  - In consultation with all stakeholders, considering alternatives to reform, cap or substitute Act 154 revenues.
- Optimization of Existing Property Tax Structure
  - Analyzing, in consultation with the island’s mayors, alternatives to property tax structure to simplify tax system and drive increase in revenues.
- Tax reform is being designed based on 5-year revenue and expense projections to ensure General Fund meets balanced budget targets throughout the period.

Reform expected materially increase General Fund revenues by shifting tax regime from taxing work towards taxing consumption.

# Agenda

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1 Executive Summary

2 Liquidity and Plan of Finance

3 HTA and PREPA Update

4 Budget Update and Comprehensive Tax Reform

**5 Economic Development**

6 Next Steps

# Robust Roadmap guiding successful execution

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## Vision

Build upon Puerto Rico's historic strengths to achieve a *more diversified, knowledge-driven economy* that addresses the challenges of globalization and seizes upon emerging opportunities

## Goals

### Near-term goal

Shore up and diversify the economy by leveraging Puerto Rico's competitive advantages and consolidating its productive base

### Long-term goal

Build sustainable competitive advantage with a diversified, adaptive economy and workforce driven by technology and innovation

## Policy Priorities

- 1 *Defend anchor industries* while diversifying job sources on the Island
- 2 *Stimulate local entrepreneurship* - drive growth of small and medium enterprises (SMEs)
- 3 Restore Puerto Rico's credibility as a *stable, business-friendly jurisdiction*
- 4 Take full advantage of opportunities tied to *Puerto Rico's relative fiscal autonomy*

## Impact

### By beginning of 2016

Over 90,000 jobs created  
\$6 to \$7 billion in incremental GDP

### By beginning of 2018

Over 130,000 jobs created  
\$10 to \$12 billion in incremental GDP

## Clear progress towards a more diversified, knowledge-driven economy that addresses the challenges of globalization

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### DRIVERS

- Fiscal Incentives
- Global Experience
- Strategic Geographic Position and World-class Infrastructure
- Bilingual and Bicultural Human Capital
- U.S. Legal Framework

### RESULTS

- ACT 20 for Exportation of Services
  - 170 approved grants/283 applications
- ACT 22 for Individual Investors
  - 297 approved grants/387 applications
- ACT 273 for International Financial Center
  - 14 licenses granted\*
  - \$267,479,000 in total assets as of June 30, 2014
- ACT 399 for International Insurance Center
  - 97 segregated assets plans\*
  - 103 protected cell arrangements
  - \$149MM in premium income in 2013

*\*As of September 2014*

## New clusters developing

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Private Equity	Hedge Funds	Shared Services
Distressed Investments	Publishers	Specialized Law Firms
India Cluster	App Developers	Architecture Firms
Radiologists	Energy Traders	Family Offices

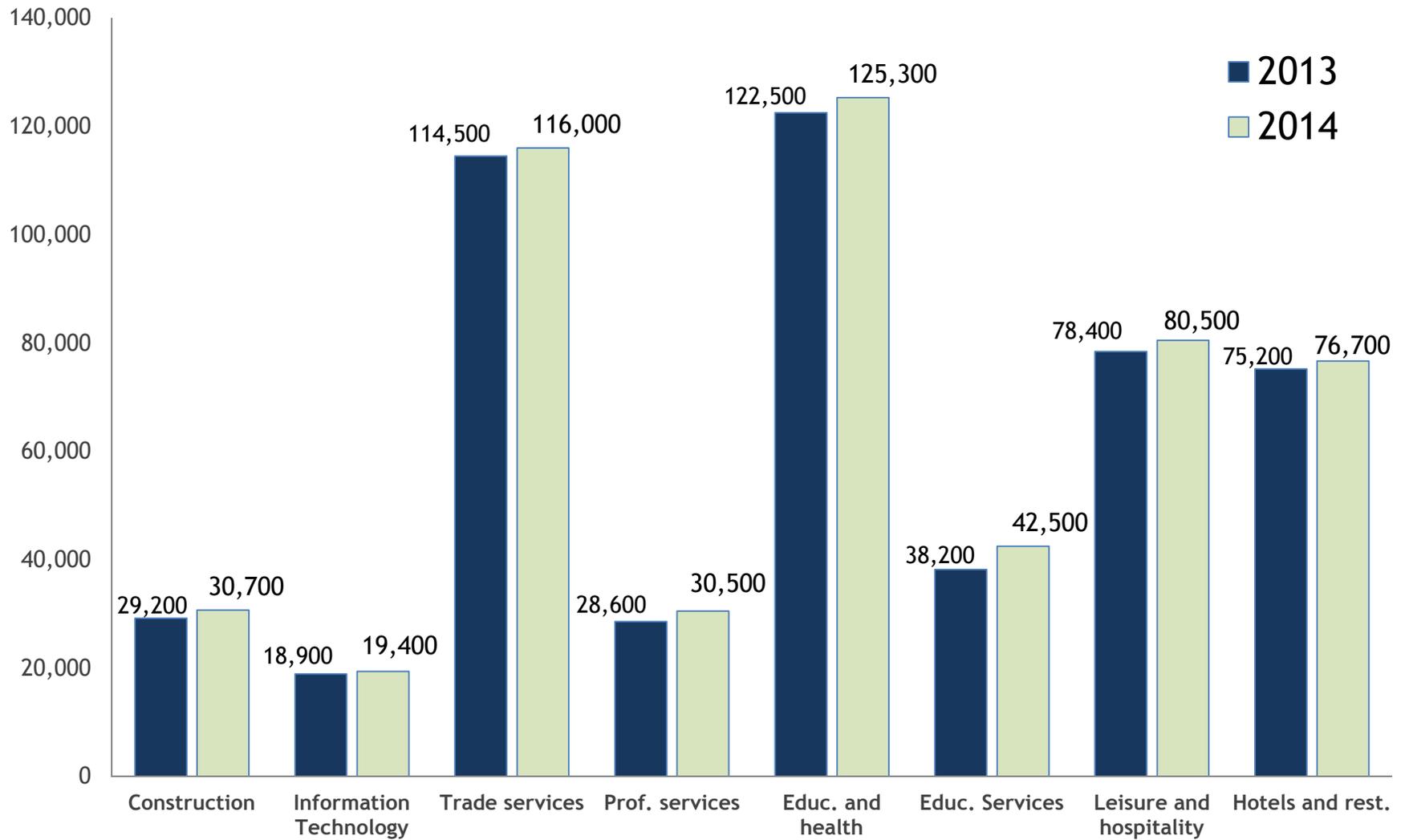
# More jobs

- **47,592 jobs in private sector in 2013\***
- **5,826 more jobs than the same period in 2012**
- **10,047 net jobs created**
- **The highest number since 2006**

\* Last quarter of 2013

Source: Bureau of Labor Statistics as of September 2014

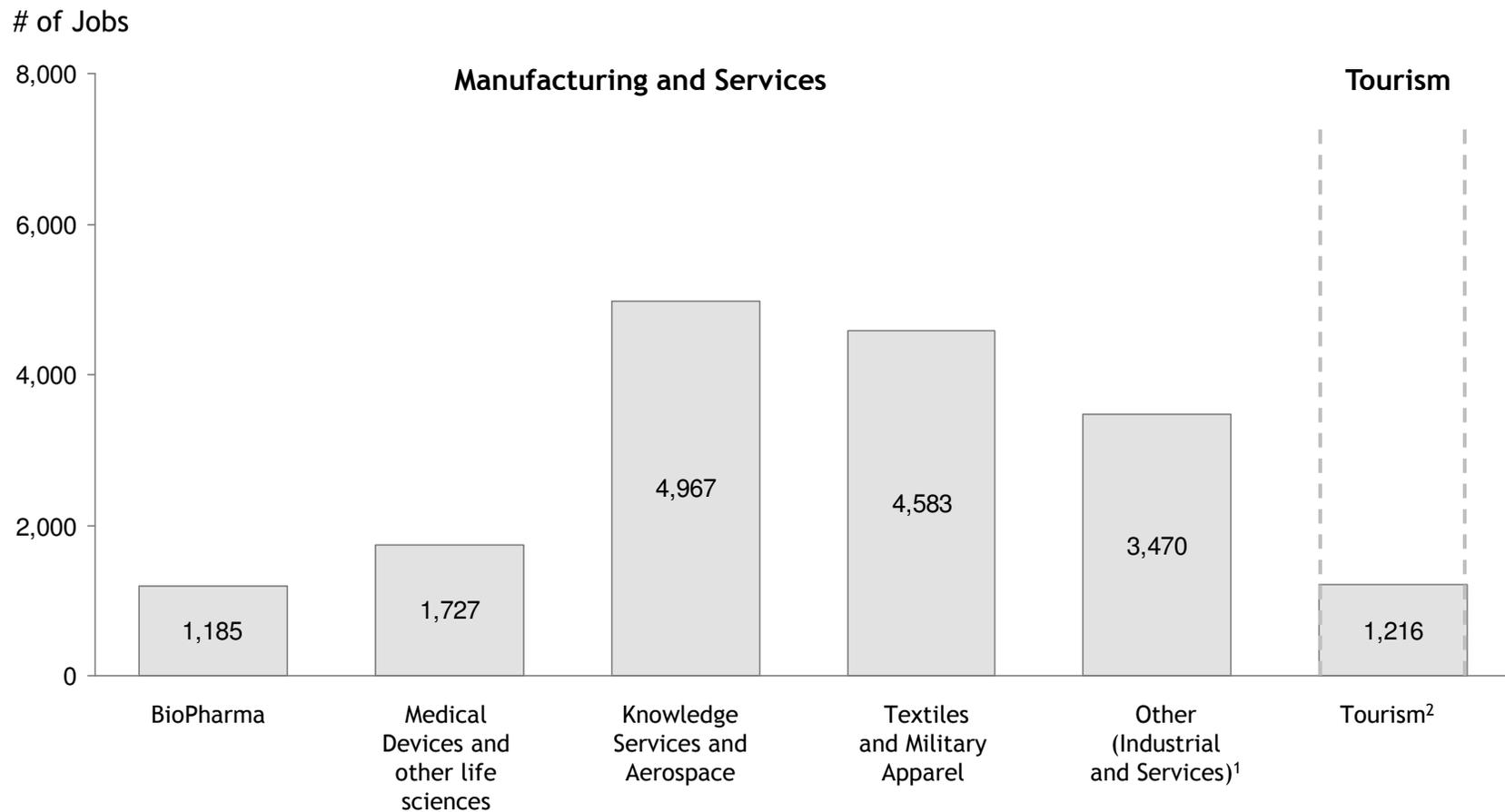
# Employment by sector



Source: Bureau of Labor Statistics as of September 2014

# Over 17K jobs committed by October 2014 in Manufacturing, Export Services and Tourism

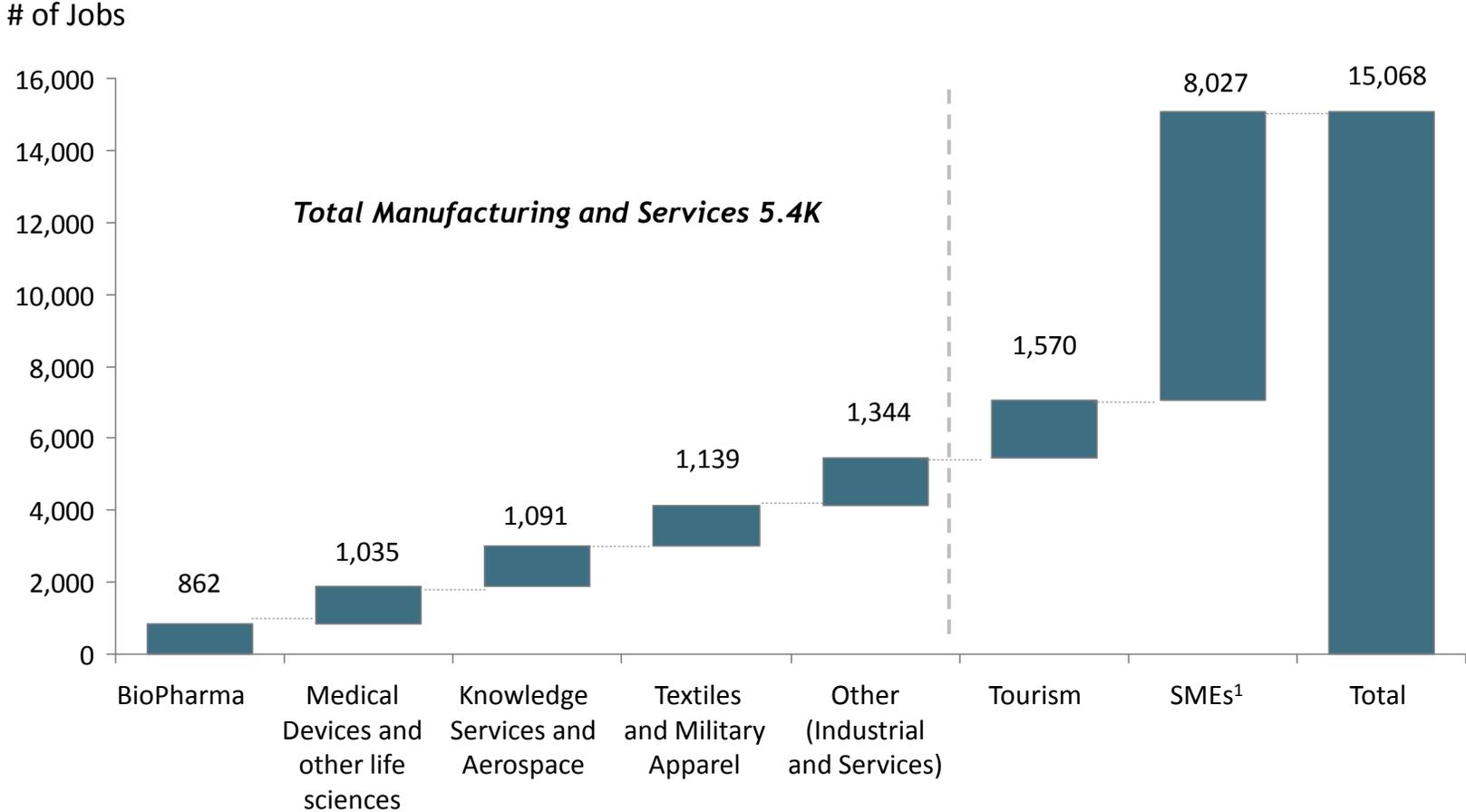
## Sample of jobs committed by sector



1. Includes electronics, IT, Construction & Engineering and Other 2. Includes Casino & gaming, airlines and cruises, tourism products, hotels under construction and hotels opened  
3. Data as of October 24, 2014.  
Source: Puerto Rico Industrial Development Company, Puerto Rico Tourism Company

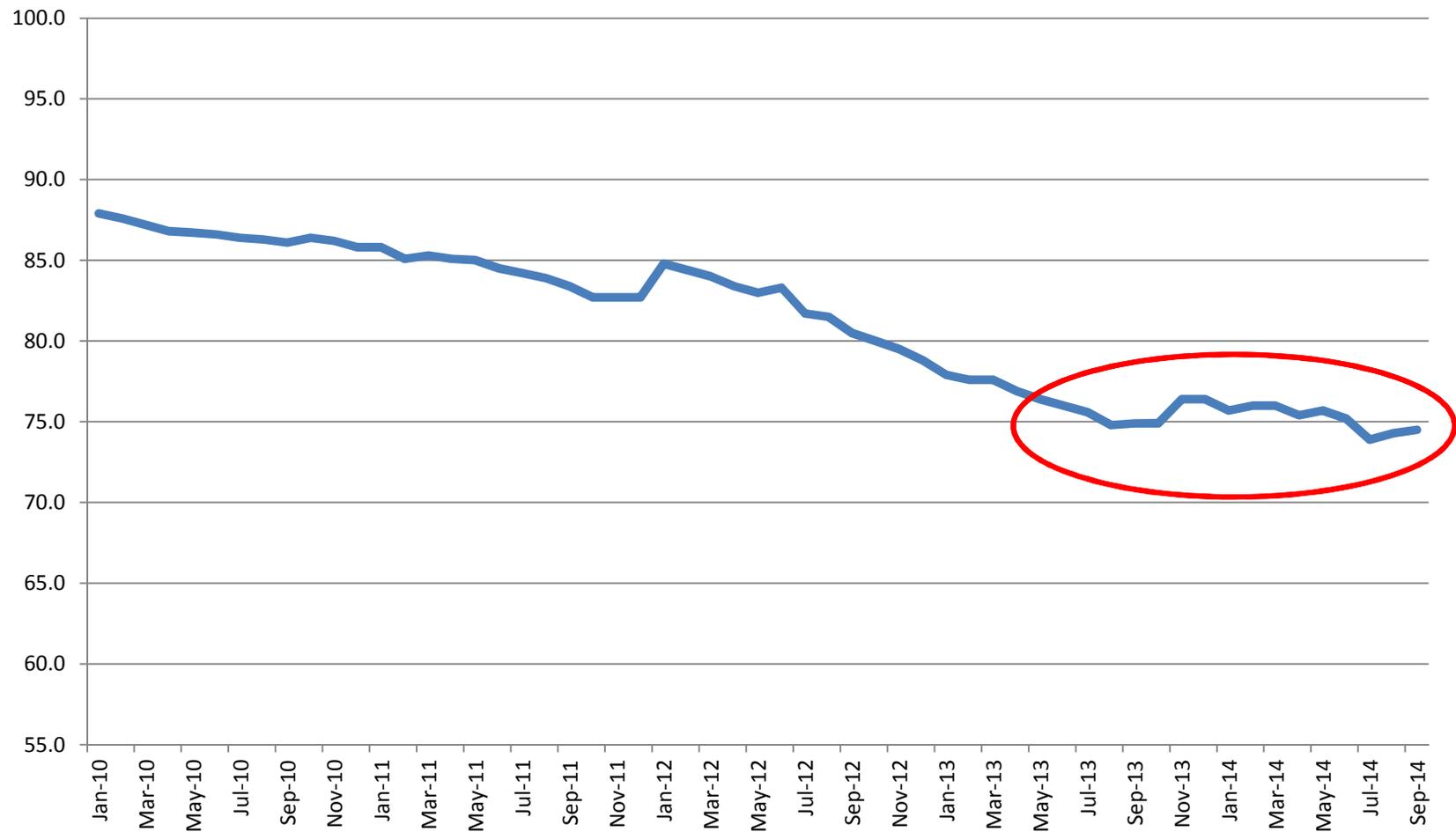
# 15K jobs created in Manufacturing and Services, Tourism and SMEs

Jobs created: Manufacturing and Services, Tourism and SMEs  
(Jan. 2013- Oct. 14)



1. Data as of October 24, 2014  
Source: Puerto Rico Industrial Development Company, Puerto Rico Trade Company, Puerto Rico Tourism Company

# Manufacturing employment data reflects a trend towards stabilization since August 2013, after years of continuous loss



1. Data as of October 22, 2014  
Source: BLS, Non-farm employment data

## Continuous progress in key manufacturing and emerging segments

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### Sector

### Sample Recent wins & progress

#### Aerospace

- **UTC Aerospace Systems:** Additional growth with the creation of 200 highly-skilled jobs and \$9M expected local investment.
- **Lufthansa Technik:** Construction initiated. Project progress includes hiring of initial employees, first group of technicians already in training and second client for the MRO already engaged.

#### Pharma

- **Negotiations** in process for the establishment of a new pharmaceutical company; ~200 new jobs expected.
- **Eli Lilly:** \$40M investment, in addition to the \$200M announced in 2013. Realignment of facilities announced with no impact on jobs or Commonwealth revenue.

#### Medical Devices

- **Expansion deals secured** with two major medical devices manufactures, representing a +350 new jobs commitment.

**+\$640 Million**  
Committed Investment  
in Manufacturing and Export Services Projects

## SMEs were one of the strongest sectors in Puerto Rico during FY 2013-14.

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### Sector

SME's

### Progress

- **823 businesses** were certified under Jobs Now Act divided in the following categories:
  - **493** New Businesses
  - **232** Developing Businesses
  - **98** Expansion of Existing Businesses
- Incentives Act for the Generation and Retention of Jobs in the SMEs sector (successor of Jobs Now Act)
- **Additional Enablers:**
  - Incentives and Financing Act for Young Entrepreneurs
  - Act supporting the SME sector
  - Community Economic Development
  - Business Incubators
  - EDCU - Salary Incentives for SMEs in Urban Centers
  - Export Accelerators
  - Export Franchises
  - Creative Industries

# Agenda

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1 Executive Summary

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5 Economic Development

**6 Next Steps**

## GDB has taken affirmative, unprecedented steps to significantly improve the Commonwealth's disclosure practices

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### Actions taken to improve disclosure practices

**Quarterly Webcasts** - First administration to hold regular investor webcasts once per quarter.

**Commonwealth Report** - Being issued for first time on regular quarterly basis.

**General Fund Cash Flows** - Treasury will for the first time provide monthly updates to General Fund cash flows.

**GDB Liquidity** - GDB has provided unprecedented amount of disclosure to market through its Liquidity Report. Will also publish monthly updates regarding available liquidity resources.

**Budget Results** - Treasury and OMB continuing to provide regular YTD results.

**Bond Transactions** - Have instituted practice of hiring "disclosure counsel" for each bond offering.

**Additional Disclosure** - Commonwealth committed to enhancing disclosure with respect to revenue and expense projections.

The Commonwealth and GDB have demonstrating a commitment to observing best disclosure practices and enhancing amount of information available to market.

# Ambitious FY 2015 agenda to tackle remaining structural challenges

## 1 Access the market, bolster liquidity and deleverage GDB's balance sheet

- Proposed PRIFA transaction would refinance GDB loans to HTA, which constitute 21% of GDB's loan portfolio, strengthening GDB liquidity.
- Debt to be refinanced through PRIFA will not add to total Puerto Rico debt outstanding.<sup>(1)</sup>

## 2 Resolve legacy HTA fiscal challenges

- Proposed House Bill 2212 (formerly H.B. 2039) expected to ensure HTA is self-sustaining on a long-term basis.
- Demonstrates Administration's commitment to find alternatives to Recovery Act.

## 3 Restructure PREPA through consensual, negotiated solution

- Reform will require contributions from all stakeholders.
- Goal is to ensure Puerto Rico benefits from modern, efficient energy infrastructure.

## 4 Enact comprehensive tax reform

- To shift tax regime from taxing productivity to taxing consumption through broad-based GST, lowering of marginal individual and corporate income tax rates.

## 5 Tackle health care-related structural challenges

- Task force to be headed by former OMB director to develop plan to address health costs, principal medium and long-term expenditure driver.

## 6 Complete five-year framework to guide Commonwealth towards long-term fiscal sustainability

- To develop long-term fiscal sustainability model based on revenue and expenditure forecasts.

## 7 Execute Comprehensive Economic Plan

- Build on recent wins and continue implementing job creation and investment agenda to expand diversified economy.

Administration is confident execution of comprehensive fiscal plan will ensure the Commonwealth's long-term fiscal sustainability.

<sup>(1)</sup> Excludes increases due to OID, accrued interest or transaction expenses.



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# The Commonwealth of Puerto Rico

## Update on Fiscal and Economic Progress

*Q & A Session*

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# Appendix A

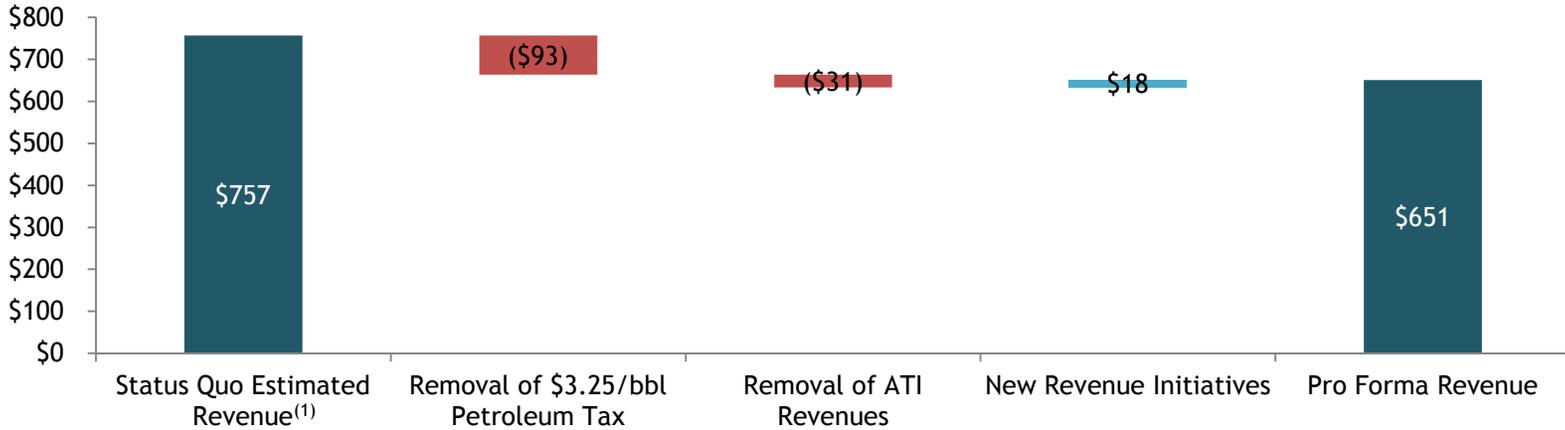
## Historical Series of Revenue

Fiscal Year	Recurring Revenues			Non Recurring Revenues			Total Published	
	Recurring Revenues	Transfer from Lotteries	Total Recurring Revenues	GO Debt Service Transfer	Lotteries non recurring	COFINA Transfers		Total Non Recurring Revenues
2006	\$8,423	\$118	\$8,541	\$0		\$0	\$0	\$8,541
2007	\$8,718	\$145	\$8,862	\$0		\$0	\$0	\$8,862
2008	\$8,207	\$152	\$8,359	\$0		\$0	\$0	\$8,359
2009	\$7,584	\$127	\$7,710	\$0		\$0	\$0	\$7,710
2010	\$7,593	\$123	\$7,716	\$0		\$0	\$0	\$7,716
2011	\$7,994	\$102	\$8,096	\$0		\$62	\$62	\$8,158
2012	\$8,574	\$94	\$8,668	\$0		\$0	\$0	\$8,668
2013	\$8,131	\$63	\$8,195	\$242		\$126	\$368	\$8,562
2014	<b>\$8,809</b>	\$72	\$8,881	\$0	\$82	\$74	\$156	<b>\$9,037</b>

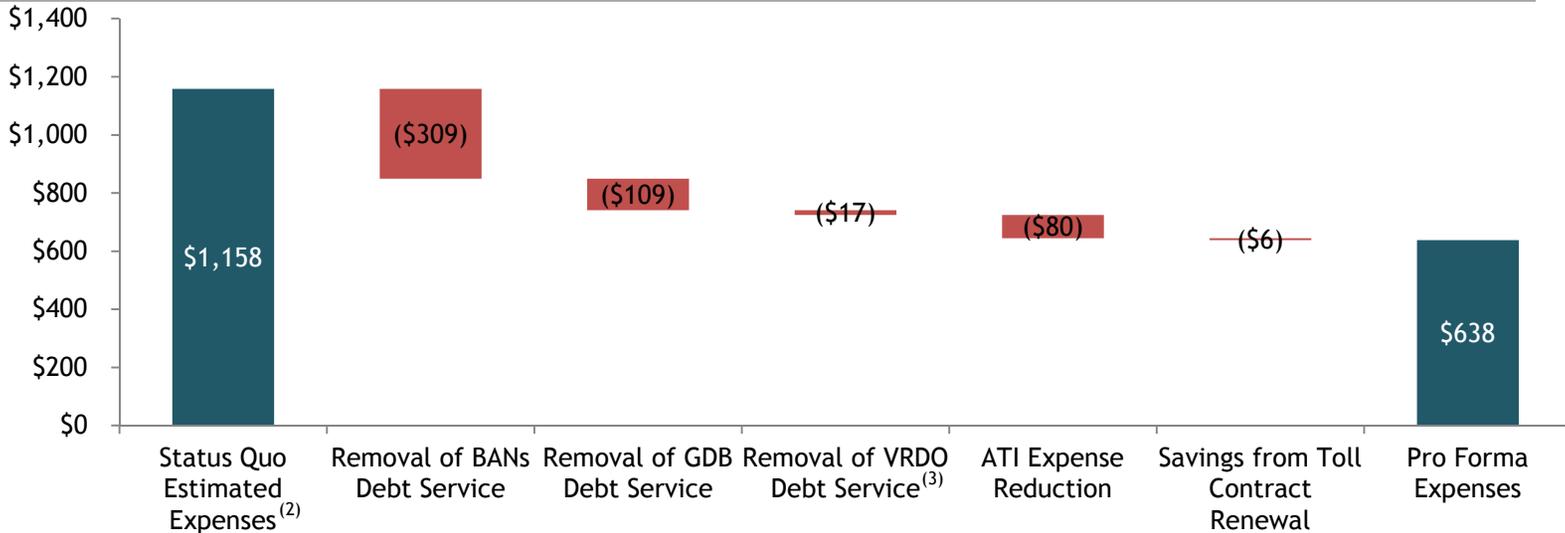
# Appendix B

# HTA Status Quo to Pro Forma Revenue and Expense Bridges

## Revenues (\$ millions)



## Expenses (\$ millions)



(1) The Status Quo estimates already include impact of various revenue enhancement initiatives implemented by HTA over the last several months, including changes in business rules with the toll operator (\$15 million) and increase in train fares (\$7 million).

(2) The Status Quo estimates already include impact of various cost reduction initiatives implemented by HTA over the last several months, including implementation of use of toll credit (\$30 million), changes in business rules with the toll operator (\$5 million), reduction in electricity costs (\$5 million), and reduction in employee bonuses (\$3 million).

(3) Assumes an 8.4% interest rate for illustrative purposes.