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# Puerto Rico's Crisis

*Prepared by the Puerto Rico Fiscal Agency and Financial Advisory Authority*

September 29, 2016

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# Executive Summary

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**Puerto Rico is facing an economic crisis that has caused severe hardships for the ~3.5 million U.S. citizens living on the island. Such hardships are likely to intensify if the U.S. government removes billions of dollars of revenues from the island as will occur under current Federal policy**

- The 2006 full repeal of section 936 of the U.S. Tax Code, which provided certain U.S. tax benefits for corporate income generated in Puerto Rico, combined with the onset of the U.S. financial crisis helped contribute to Puerto Rico experiencing:
  - Significant and recurring contractions in GNP
  - Reductions in its private sector employment and private investment
  - Extreme contraction in its banking sector
  - Large increases in unemployment and decreases in its labor force participation
- This economic crisis has fueled a negative spiral that has resulted in and has been further exacerbated by:
  - Significant outmigration, as those able to work are leaving Puerto Rico, including the young and professionals (*e.g.*, doctors)
  - A smaller tax base available to the government, leading to recurring government deficits
  - Increased government borrowing to fund these deficits and ultimately a liquidity crisis ending in a government debt default
- The default occurred despite significant efforts by the government to reduce expenses through salary freezes and decreases in payroll along with increases in taxes
- Today Puerto Rico is facing:
  - No access to capital markets and significant increases in payables, leading to threatened stoppages in essential services
  - Elevated levels of poverty
  - Deteriorating education and healthcare systems
  - Significant unfunded pension liabilities for an aging population that already receives pension payments below the U.S. median
- These hardships will only become worse if the U.S. Federal Government fails to extend its current level of healthcare funding to Puerto Rico and fails to allow the continued tax creditability of the Act 154 excise tax paid by Puerto Rico corporations, each of which could cost Puerto Rico over a billion dollars in revenues that it currently receives from these services

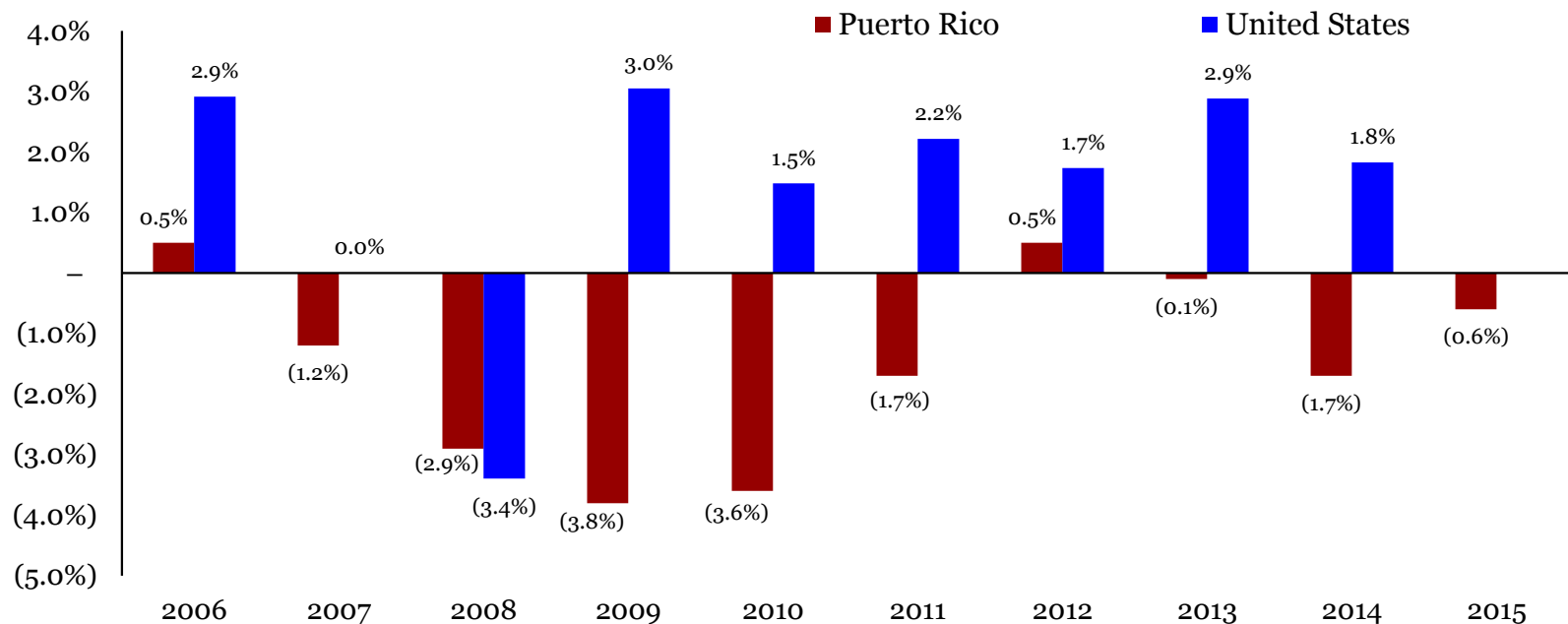


# Puerto Rico's Economy Has Been Declining Since 2007

The 2006 elimination of Section 936 of the U.S. Tax Code, which provided certain U.S. tax benefits for corporate income generated in Puerto Rico, combined with the onset of the U.S. financial crisis, has led to negative real GNP growth in every year but one since 2007

- The GNP declines would have been even worse had it not been for large stimulus spending, such as the ~\$7.1 billion of funds allocated to Puerto Rico under the 2009 American Recovery and Reinvestment Act and the creation of a \$500 million “Local Stimulus Fund” funded from the Puerto Rico Sales Tax Financing Corporation (“COFINA”) bond issuances in 2009 and 2010<sup>(1)</sup>

Real GNP Growth Rates – Puerto Rico vs. United States<sup>(2)(3)</sup>



1. 2011 Comprehensive Annual Financial Report p. 27.

2. Puerto Rico Fiscal Authority Agency and Financial Advisory Authority. Economic Activity Index (“EAI”) Reports for Puerto Rico GNP data and the U.S. Bureau of Economic Analysis for the United States GNP data. Both Puerto Rico and U.S. fiscal data reported on a Puerto Rico fiscal year basis (July to June).

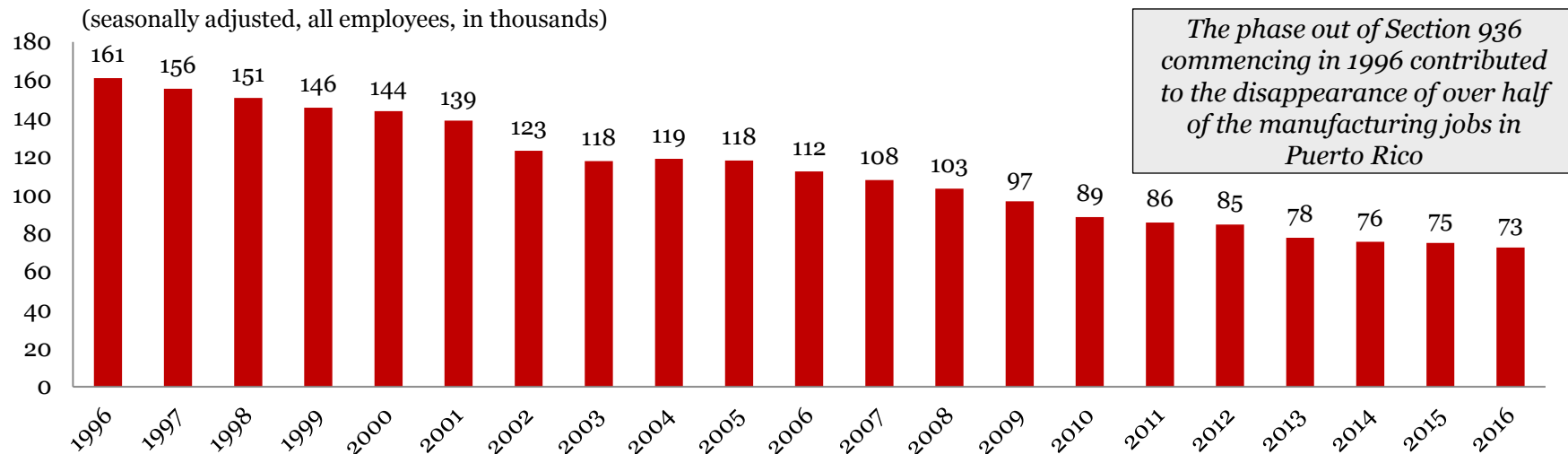
3. Puerto Rico values are based on real GNP calculated at 1954 prices; U.S. values are based on real GNP at 2009 prices.

# The Economic Decline was Precipitated in Part by U.S. Policy Decisions in the mid-90s to Remove Key Puerto Rico Competitive Advantages

**The phase out of Section 936 of the U.S. tax code combined with expanded U.S. free trade agreements may have contributed to the disappearance of over half of Puerto Rico manufacturing jobs**

- As a result of Section 936's tax benefits, the manufacturing sector in Puerto Rico had grown significantly, in particular for firms, such as pharmaceutical companies, that could transfer patents to Puerto Rico and then source income generated by those patents to Puerto Rico in order to receive tax credits under Section 936
- Manufacturing sector growth took place in spite of Puerto Rico's comparatively higher labor costs relative to other, non-U.S. mainland manufacturing centers due to the applicability of U.S. minimum wage laws
- In 1996, the U.S. enacted legislation to phase out Section 936 over a ten-year period, removing a key competitive advantage Puerto Rico had in attracting business and foreign investment to the island
- Manufacturing jobs immediately began to decline following the Section 936 phase out

Decline in Puerto Rico Manufacturing Payrolls<sup>(1)</sup>



- Additionally, NAFTA which expanded the right to provide duty free imports to the U.S. (a right that had already been enjoyed by Puerto Rico), had been signed two years prior, potentially contributing to the loss

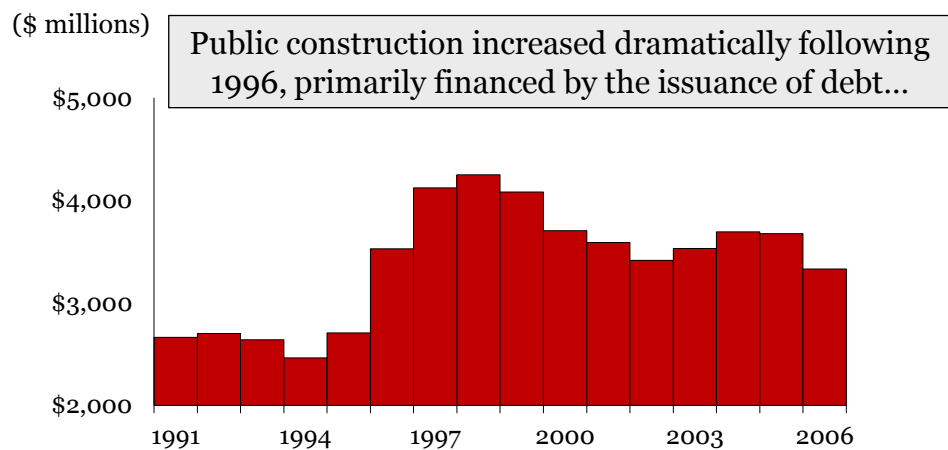


1. Bureau of Labor Statistics State and Area Employment, Hours, and Earnings - January totals.

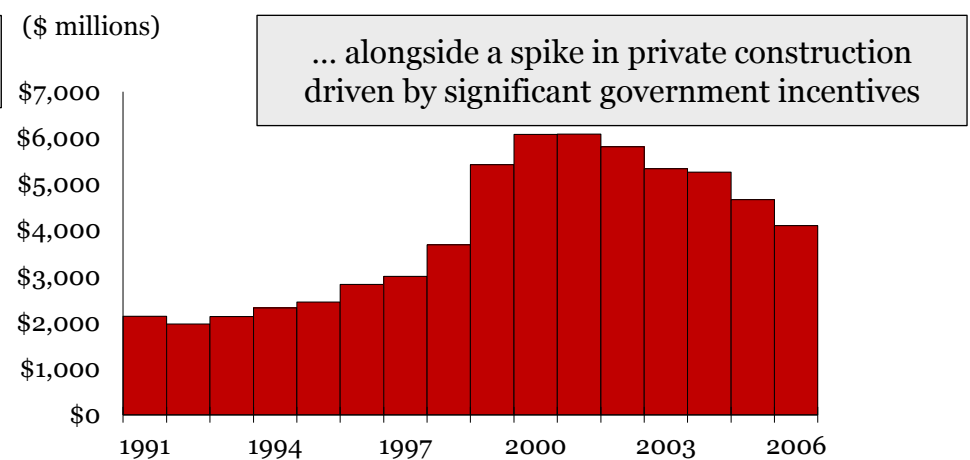
# The Government Tried to Forestall the Economic Decline Through an Increase in Construction Spending (Both Direct and through Incentives for Private Investment) and an Increase in Public Sector Employment

High levels of government construction spending combined with private sector construction incentives such as cash grants, financing assistance, subsidies and tax exemptions, and an increase in public sector employment helped to forestall the decline in the economy

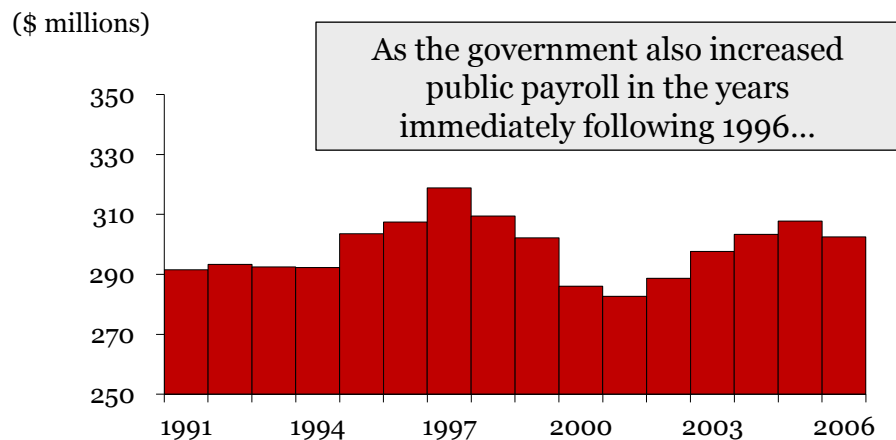
Puerto Rico Public Construction Investment 1991-2006<sup>(1)</sup>



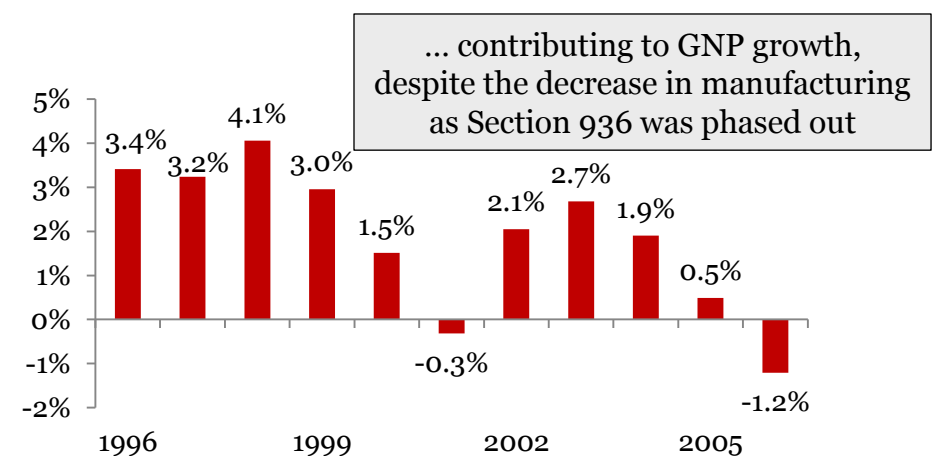
Puerto Rico Private Construction Investment 1991-2006<sup>(1)</sup>



Puerto Rico Public Payroll Employment 1991-2006<sup>(1)</sup>



Puerto Rico Real GNP growth 1996-2006<sup>(2)</sup>

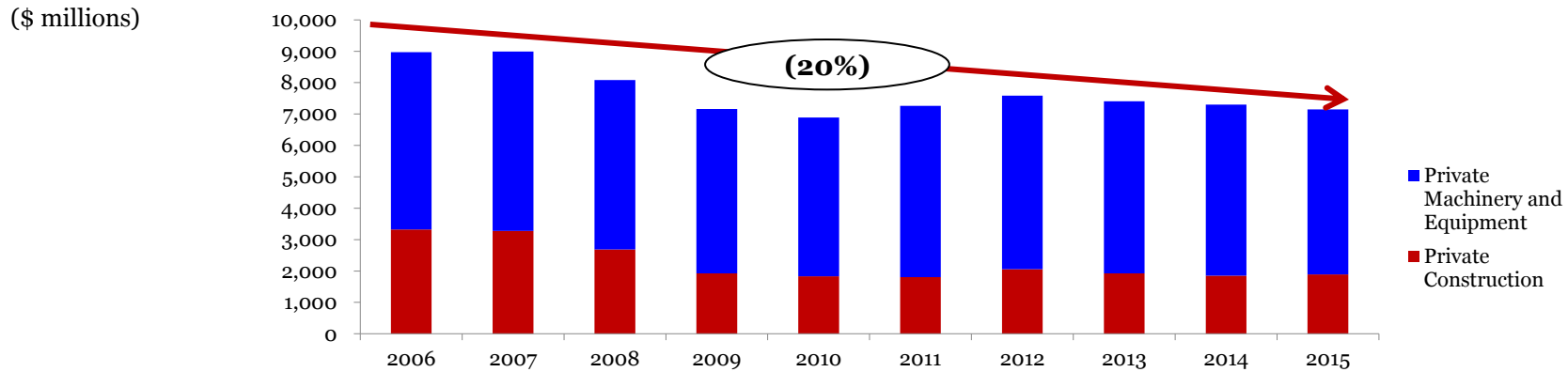


1. Planning Board of Puerto Rico. *Statistical Appendix of the Economic Report to the Governor*. Historical values provided by Puerto Rico Fiscal Authority Agency and Financial Advisory Authority. Values are presented on a Puerto Rico fiscal year basis (July to June).  
 2. Data provided by Puerto Rico Fiscal Authority Agency and Financial Advisory Authority. And is on a Puerto Rico fiscal year basis (July to June). Time series is spliced to make pre-2001 values comparable to post-2001 values. Growth rates based on adjustment to constant 1954 dollars.

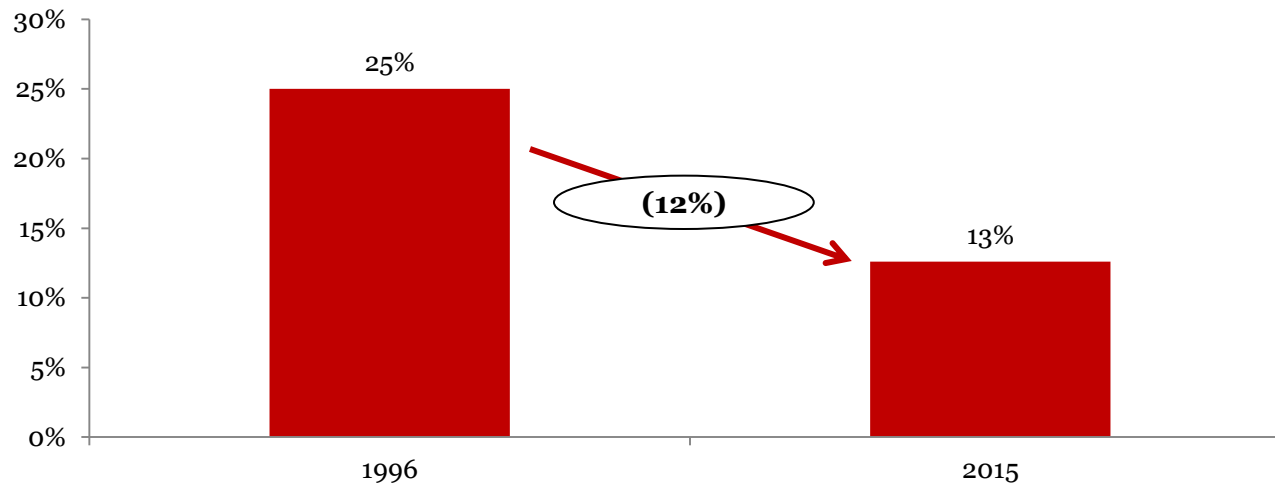
# But Government Investment was Not Enough to Continue to Attract Private Capital, and from 2006 on Private Investment Declined Drastically

Following the full phase-out of Section 936 in 2006 private investment in Puerto Rico has declined dramatically. Today, the share of GNP<sup>(1)</sup> that private investment comprises is approximately half of the level in 1996, when the phase out of Section 936 first began

Puerto Rico's Nominal Gross Fixed Investment – Private Sector (Construction, Machinery & Equipment) 2006 to 2015<sup>(2)</sup>



Puerto Rico's Nominal Gross Fixed Investment as a Percentage of GNP by Final Demand Category<sup>(3)</sup>

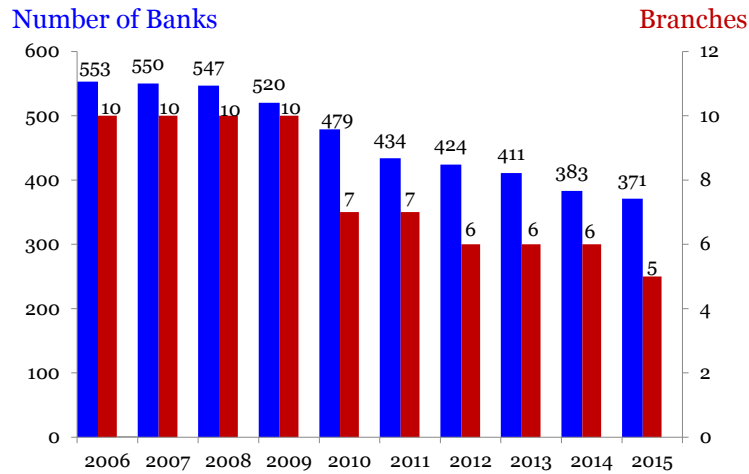


1. By Final Demand Category.  
 2. GDB Statistical Appendix.  
 3. Planning Board of Puerto Rico. Economic Report to the Governor Statistical Appendix. 1996 value provided by Puerto Rico Fiscal Authority Agency and Financial Advisory Authority.  
 Note that values in the above figures are presented on a Puerto Rico fiscal year basis (July to June).

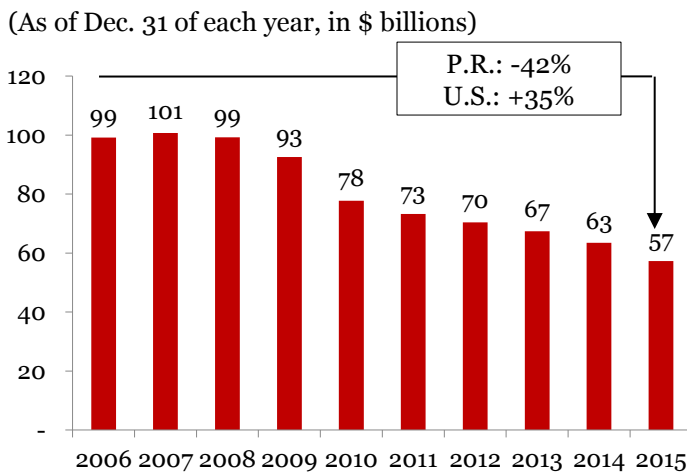
# As Private Investment Fell, So Too Did the Banking Sector, Including Financing Available for Economic Activity

The banking sector, which is highly correlated with the island's economic performance, has significantly decreased in size since the full phase out of Section 936 in 2006

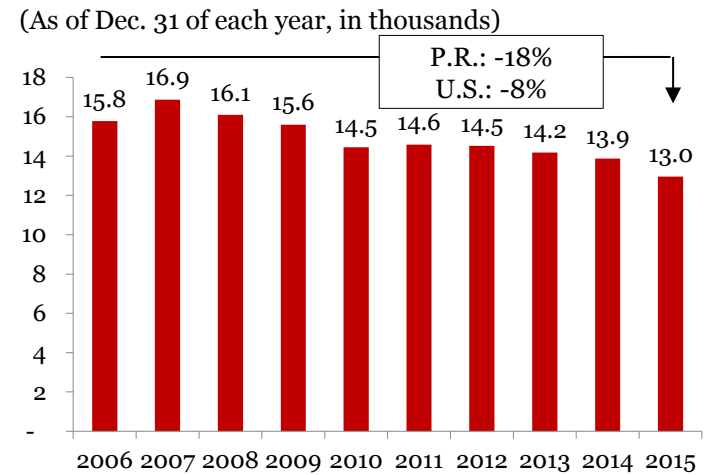
Number of Commercial Banks and Branches<sup>(1)</sup>



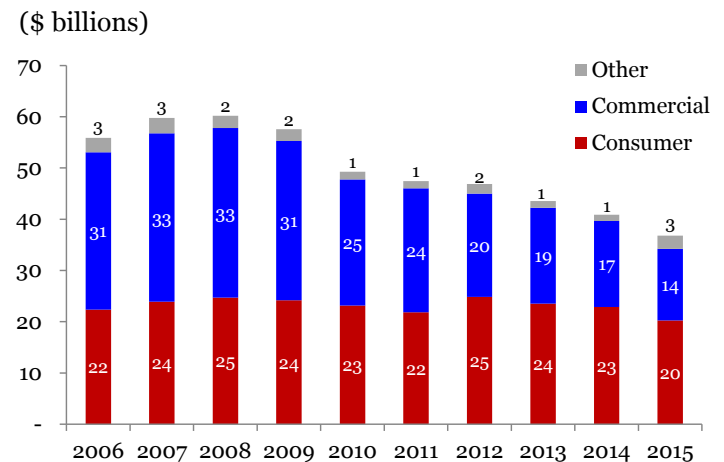
Total Banking Sector Assets



Total Banking Employees<sup>(2)</sup>



Total Loans and Leases<sup>(3)</sup>



1. Puerto Rico branches include service type codes 11, 12, and 23. Commercial bank data as of Dec. 31 of each year. Branch data as of June 30 of each year.

2. Full-time equivalent employees only.

3. Office of the Commissioner of Financial Institutions of Puerto Rico.

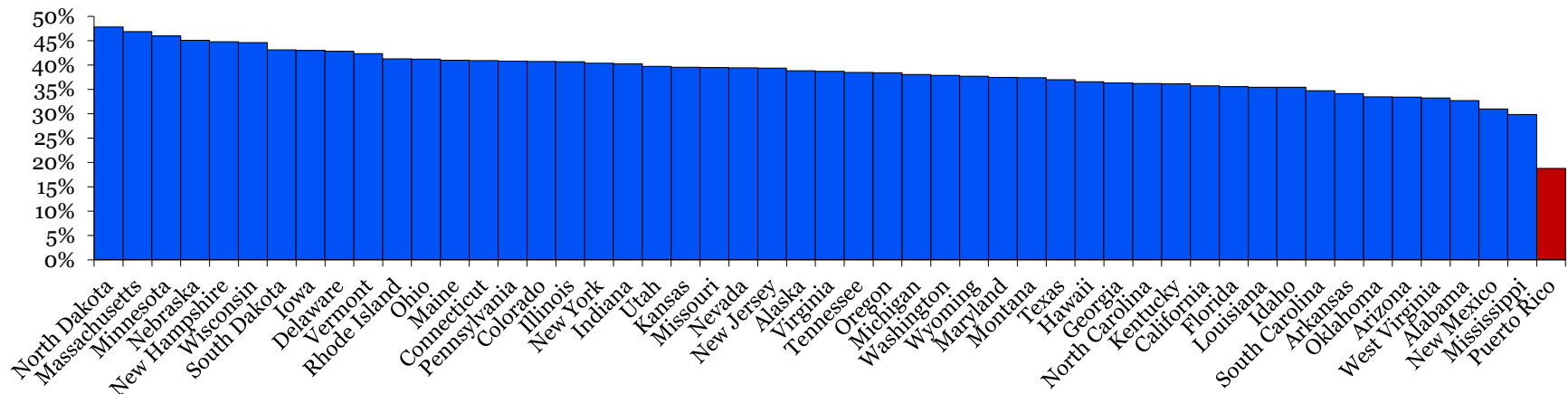
Sources: FDIC, "Call Reports", 10-Q SEC filings, quarterly results calls, Summary of Deposits (SOD), Statistics on Depository Institutions Report, analysis by "Financial Institutions Practice" V2A.



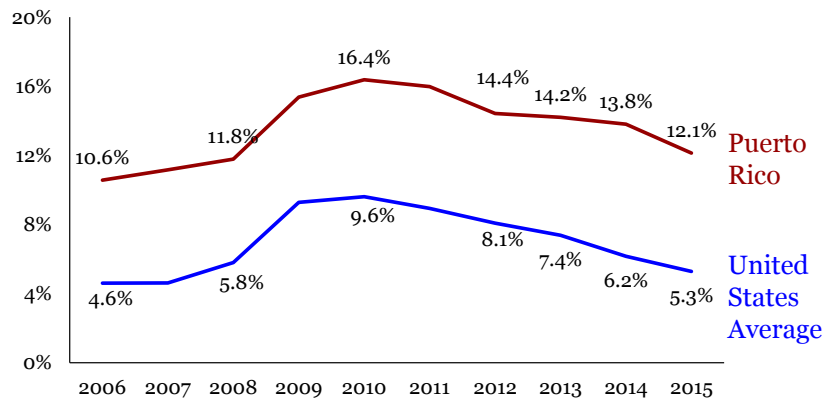
# Unemployment, which was Already High Relative to the U.S., Spiked Significantly as Private Sector Jobs Disappeared

The number of private sector jobs in Puerto Rico as a percentage of the total population is now significantly lower than any mainland state, helping to cause a significant increase in Puerto Rico's unemployment rate, which today is still double that of the U.S. average, and a significant decline in labor force participation as Puerto Rico citizens face dismal job prospects<sup>(1)</sup>

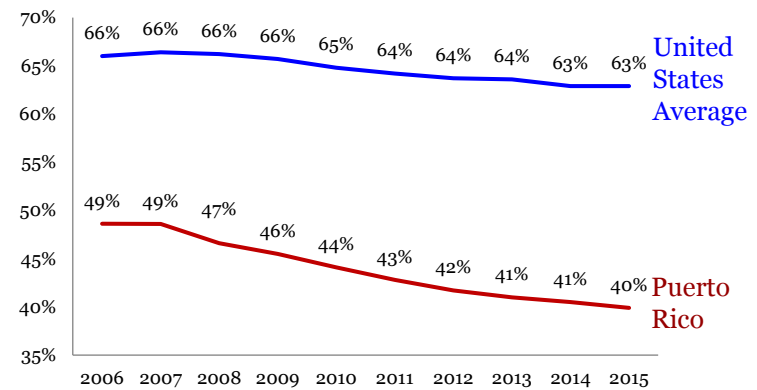
Private Payroll Employment as a Percentage of Total Population by State – 2015<sup>(2)(3)</sup>



Puerto Rico Unemployment Rate 2006-2015<sup>(4)</sup>



Labor Force Participation 2006-2015<sup>(5)</sup>



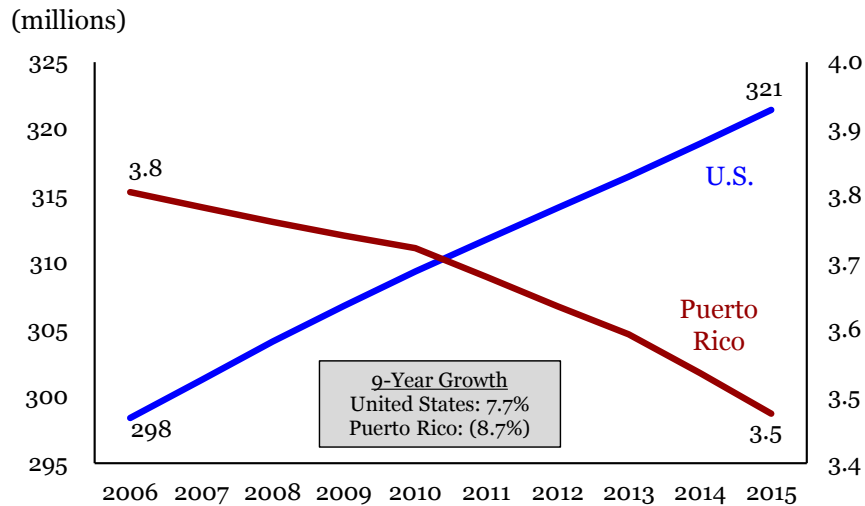
1. Reflects percentage of people working or looking to work over the total population over 16 years of age.  
 2. U.S. Department of Labor, Employment as of July 2016 and population as of July 2015.  
 3. U.S. Census Bureau.

4. Bureau of Labor Statistics (Non-Farm Payroll Employment Survey).  
 5. Puerto Rico Fiscal Authority Agency and Financial Advisory Authority, U.S. figures from the Bureau of Labor Statistics Current Population Survey and represent January values.

# Declining Economic Prospects Resulted in Significant Outmigration

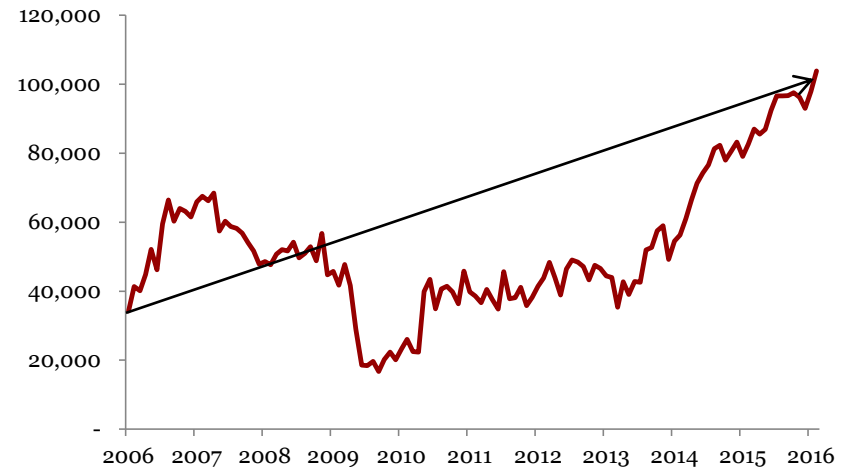
Puerto Rico's population declined by approximately 9% from 2006 to 2015 and the rate of outmigration appears to be increasing

Puerto Rico Population 2006 to 2015<sup>(1)</sup>



Puerto Rico lost ~331K people in the period from 2006 to 2015

Puerto Rico Net Outgoing Air Passenger Traffic (Total on a Rolling Last Twelve Month Basis)<sup>(2)</sup>



Based on outgoing passengers less incoming passengers, it appears the pace of those migrating from the island may be increasing

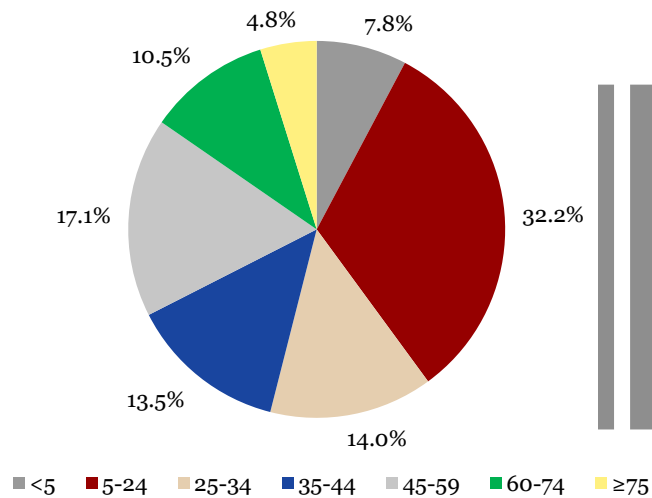


1. U.S. Census Bureau, Population Division. Yearly data shown as of July 1.  
 2. Puerto Rico Institute of Statistics.

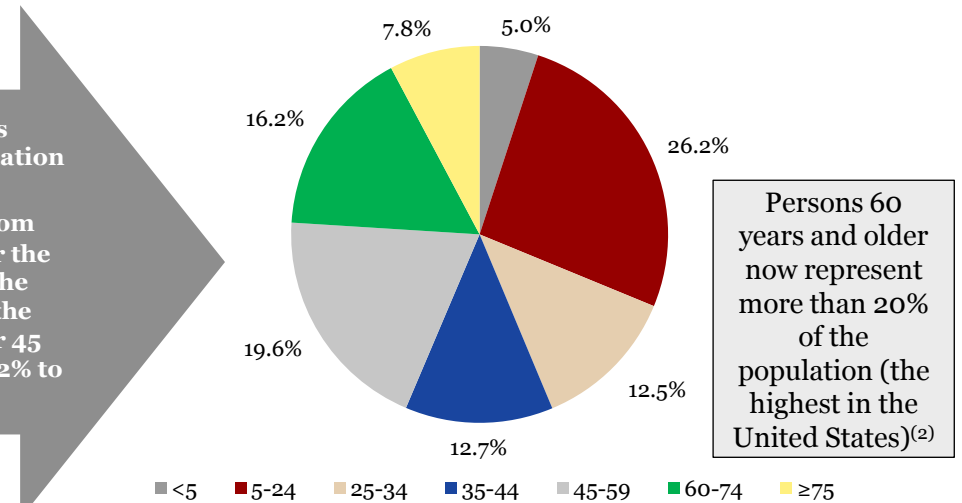
# Outmigration has Exacerbated Unfavorable Demographic Shifts

Outmigration has led to an aging of the remaining population, resulting in a decreased net birth rate (births less deaths) which foretells potential further declines in Puerto Rico's tax base

Puerto Rico Population by Age – Year 2000<sup>(1)</sup>

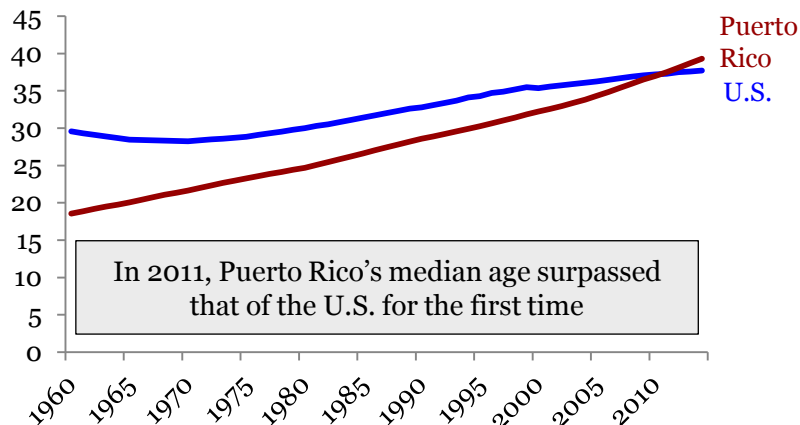


Puerto Rico Population by Age – Year 2015<sup>(1)</sup>

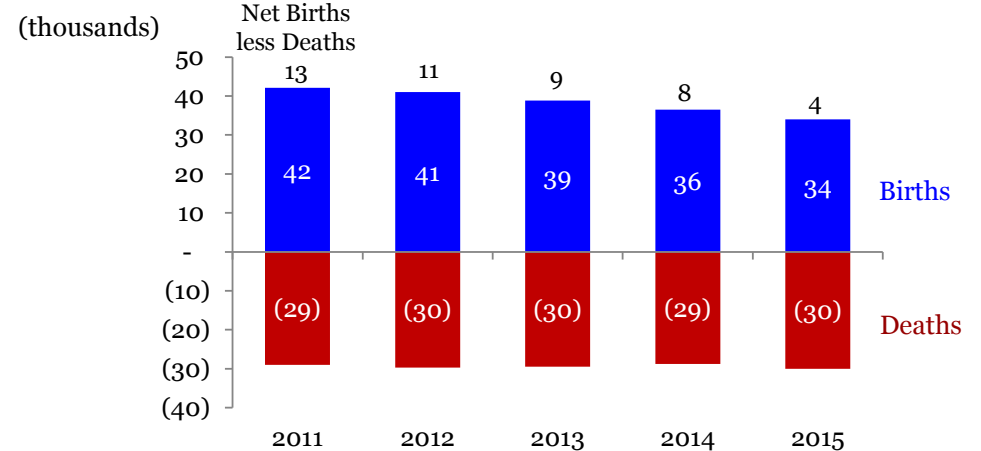


Puerto Rico's cumulative population declined by nearly 10% from 2000-2015. Over the same period, the percentage of the population over 45 increased from 32% to 44%

Puerto Rico vs. United States Median Age 1960-2014<sup>(1)</sup>



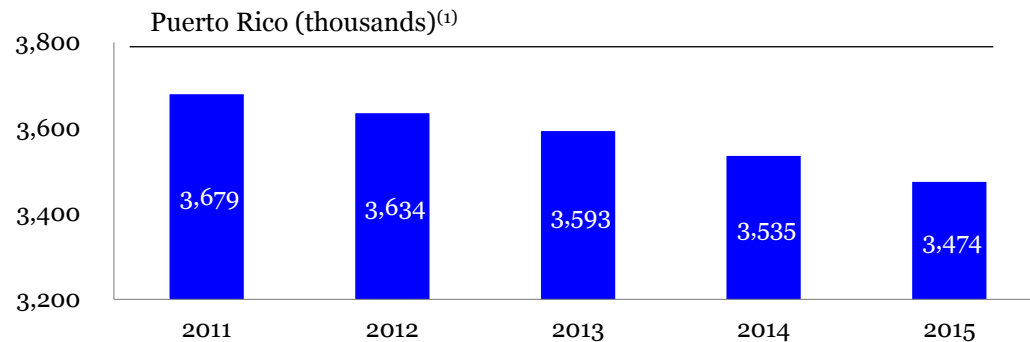
Puerto Rico Births and Deaths 2011-2015<sup>(3)</sup>



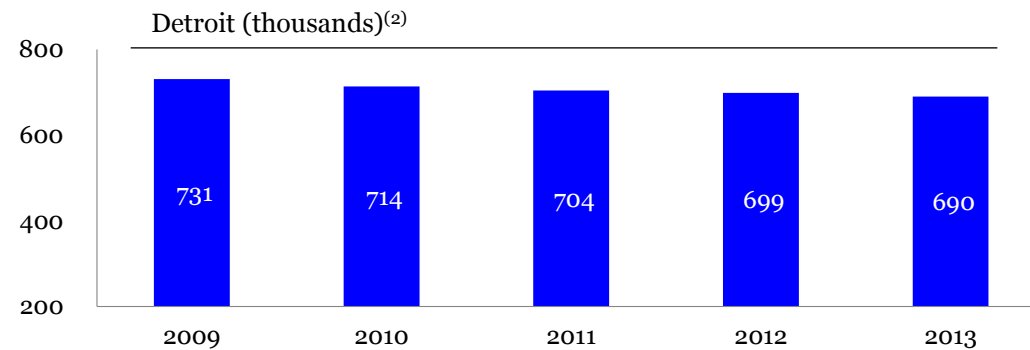
1. U.S. Census Bureau.  
 2. Puerto Rico Planning Board, "Resumen Economico de Puerto Rico", December 2013.  
 3. U.S. Census Bureau. Population Estimates, Estimates of the Components of Resident Population Change.

# Puerto Rico's Outmigration Leading Up to its Default Dwarfs that Experienced by Other Troubled Jurisdictions

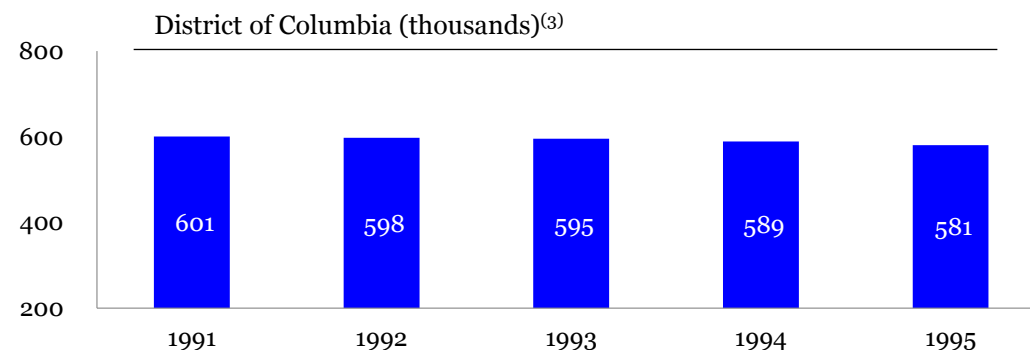
On percentage basis, outmigration on the island has exceeded that experienced in D.C. prior to the implementation of a control board and comparable to that experienced in Detroit prior to its Chapter 9 filing; but in absolute terms, Puerto Rico's total population loss is far greater than either Detroit or D.C.



Puerto Rico's population declined by **6%** or **205K** from 2011-2015



Detroit's population declined by **6%** or **41K** from 2009-2013



The District of Columbia's population declined by **3%** or **20K** from 1991-1995. While over a longer time period (through 2000), D.C. had a larger economic and demographic shift, if current trends continue, Puerto Rico's shift may surpass that of D.C. not only on a nominal basis but also on a percentage basis<sup>(4)</sup>



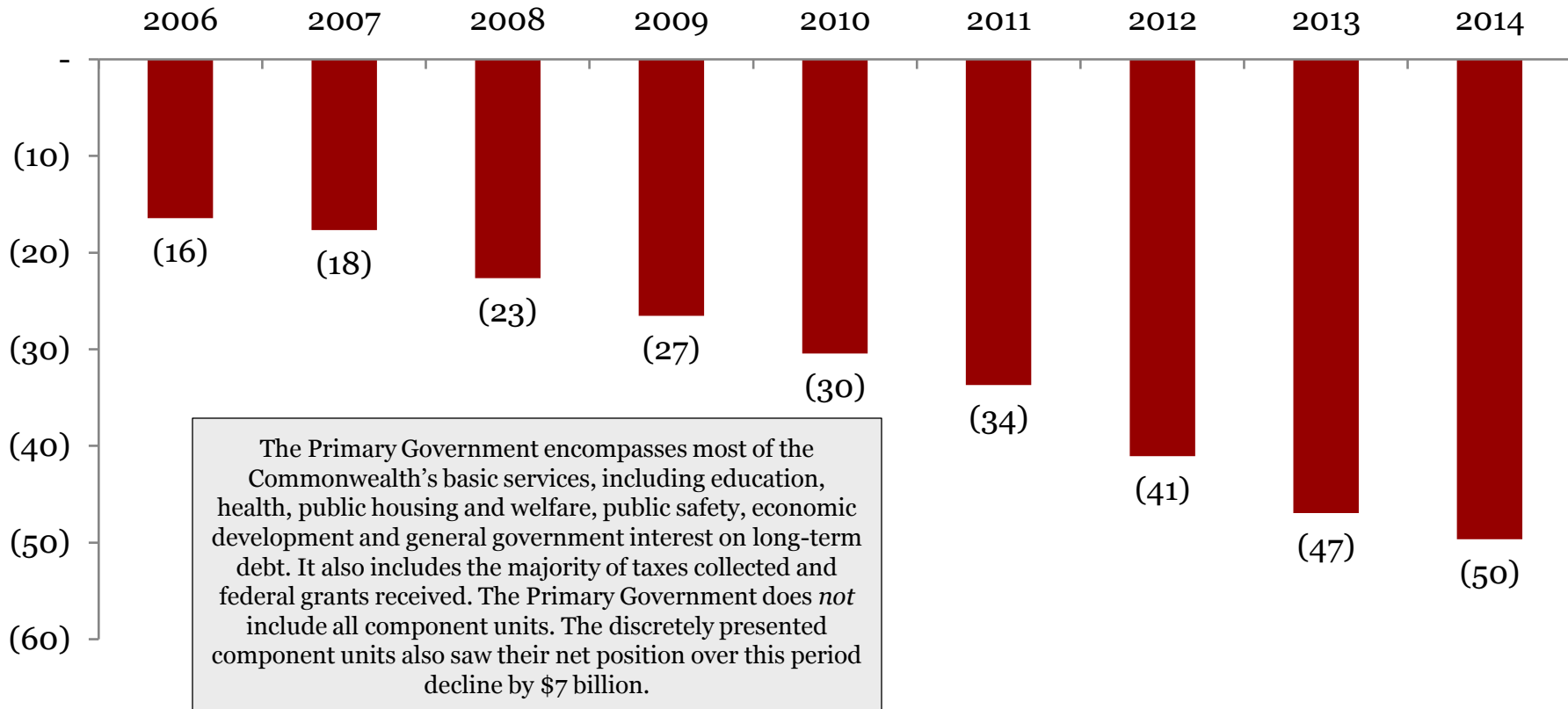
1. U.S. Census Bureau, Population Division, Annual Estimates of the Resident Population.  
 2. Time Series of District of Columbia Intercensal Population Estimates by County: April 1, 1990 to April 1, 2000. Source: Population Division, U.S. Census Bureau.  
 3. Annual Estimates of the Resident Population: April 1, 2010 to July 1, 2015. Source: U.S. Census Bureau, Population Division.  
 4. Compares D.C.'s population from 1980-2000, over which period there was a 10.4% decline. U.S. Census Bureau Intercensal Population Estimates of the Total Resident Population of States.

# With a Declining Economy and Tax Base, Puerto Rico's Government has Run Significant Deficits

The Primary Government net position<sup>(1)</sup> (*i.e.*, assets less liabilities) deficit increased by ~\$33 billion from 2006 to 2014 (the last year of audited financial statements)

Primary Government Net Position Over Time<sup>(1)</sup>

(\$ billions)

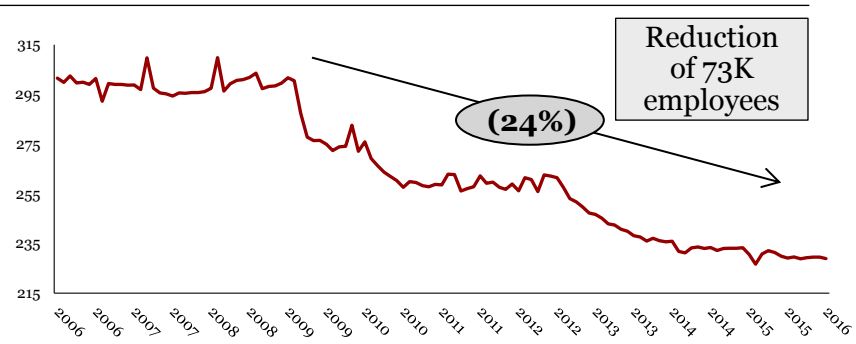


1. Net position data is post-restatement and sourced from the subsequent year's Comprehensive Annual Financial Report ("CAFR") (2014 is from the 2014 CAFR as no 2015 CAFR has been released). Note that Primary Government is presented here on a full accrual basis. For further detail on the Primary Government deficit and other statements of net position reported by the Commonwealth, consult the Commonwealth's comprehensive annual financial reports.

# The Deficits Run by the Government Occurred Despite Large Expense Reductions

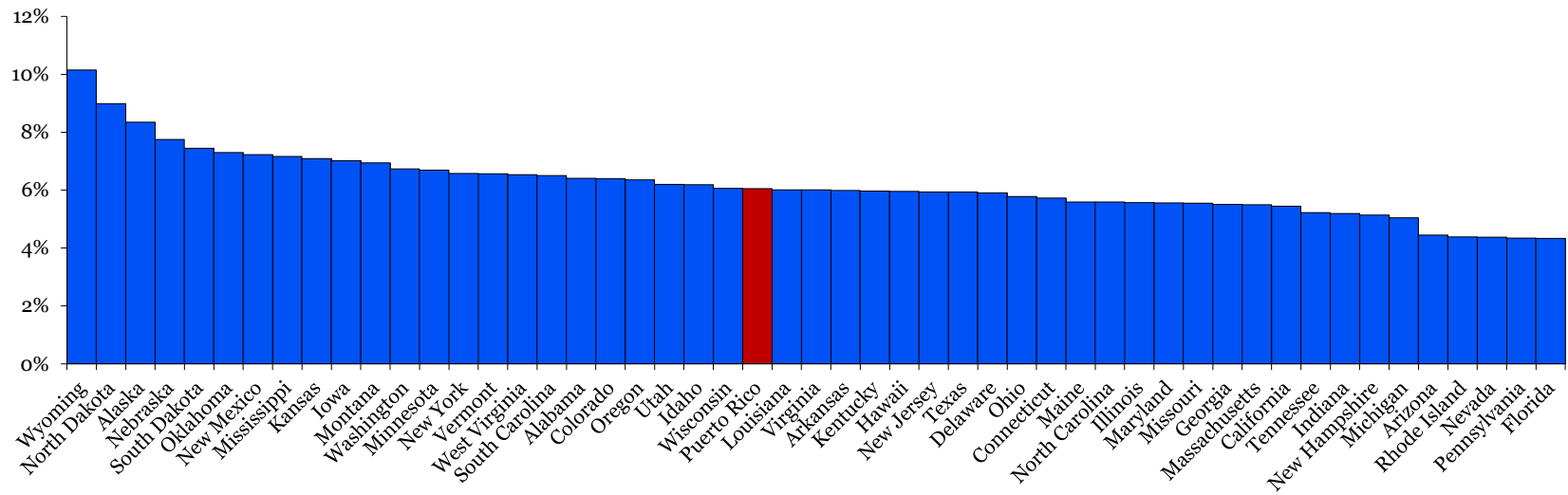
The Government has taken significant steps to try and control expenses, including a significant reduction in Commonwealth and municipal employment that has brought total Commonwealth and municipal government employment as a percentage of the total population in line with the average states

Puerto Rico Government Employees (thousands)<sup>(1)</sup>



The significant reduction in Commonwealth and Municipal Government Employment has led to its share of total population to approximately 6%, which compares favorably to several states of the mainland. Notice that for most states this share is between 5% and 8%

Commonwealth & Municipal Government Employment as a % of Total Population (as of Dec. 2015)<sup>(2)(3)</sup>

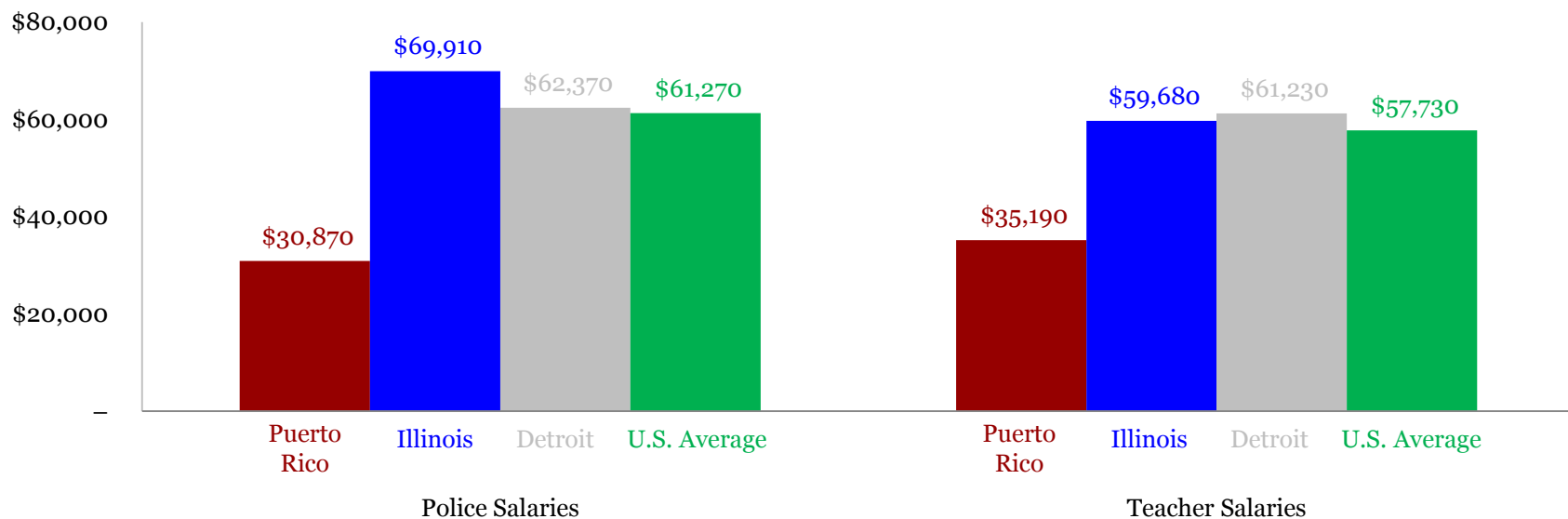


1. U.S. Bureau of Labor Statistics, Seasonally Adjusted Government Employment. Represents state and local government employees.  
 2. U.S. Department of Labor. Employment as of July 2016 and population as of July 2015.  
 3. U.S. Census Bureau.

# In Addition to Government Employee Headcount Reductions, Salaries were also Frozen

The Commonwealth has taken proactive steps to control expenditures by freezing employee salaries, even though such salaries are well below equivalent salaries in the states

Police and Teacher Salaries in Puerto Rico and Other Financially Stressed Jurisdictions<sup>(1)</sup>



The Commonwealth's Special Fiscal and Operational Sustainability Act (Act No. 66-2014) addresses Commonwealth spending by implementing various measures such as cutting costs related to professional contracting services, reorganizing and consolidating the Department of Education, and freezing any increase in payroll costs and/or collective bargaining agreements<sup>(2)</sup>



1. U.S. Bureau of Labor Statistics, Occupational Employment Statistics and National Education Association. Teachers salaries shown herein represent salaries for Elementary School Teachers, Except Special Education, which has the highest number of teachers.  
 2. Act No. 66-2014, June 17, 2014, GDB. [http://www.gdb-pur.com/investors\\_resources/documents/A-066-2014.pdf](http://www.gdb-pur.com/investors_resources/documents/A-066-2014.pdf).

# Deficits were also Incurred Notwithstanding Significant New Tax Collections and Significant Federal Subsidies

Of particular note, the creation of the Act 154 excise tax in 2011 now accounts for ~21% of the General Fund Budget, the increase in the Sales and Use Tax to 11.5% makes it higher than any U.S. state, and the Affordable Care Act provided Puerto Rico with \$6.4 billion in healthcare funding

## FY 2017<sup>(1)</sup> General Fund Revenue Projections

(\$ millions)

	<b>FY 2017 Proj.</b>	
<b><u>General Fund Revenue (Pre-Measures)</u></b>		
Individual Income Taxes	\$1,966	
Corporate Income Taxes	1,525	
Non-Resident Withholdings	763	
SUT	1,608	Sales and Use Tax was increased from 7% to 11.5% on July 1, 2015, making it higher than that of any state <sup>(2)</sup>
Act 154 / Foreign Company Tax Revenues	1,924	
Alcoholic Beverages	272	
Cigarettes	117	
Motor Vehicles	293	
Excises on Off-Shore Shipment Rum	206	
Other General Fund Revenues	426	
<b>Total General Fund Revenues</b>	<b>\$9,100</b>	Act 154 / Foreign Company Tax Revenues represent 21% of total projected FY 2017 General Fund Revenues

<b>Total ACA Funding Provided to PR</b> (\$ millions)	
	Amount
ACA Section 2005(a)	\$5,476
ACA Section 1323	925
<b>Total ACA Funding</b>	<b>\$6,401</b>



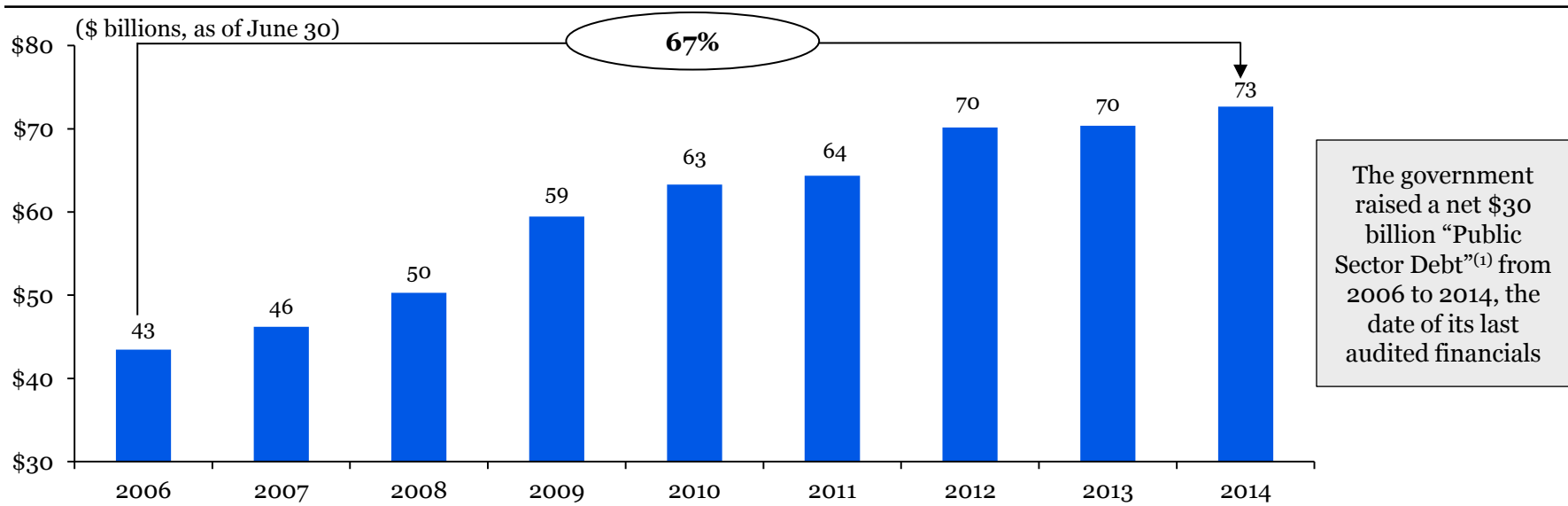
1. Note that the Puerto Rico fiscal year runs from July to June.  
2. "Puerto Rico, At 11.5%, Has America's Highest Sales Tax." August 17, 2015, Forbes.



# Deficits were Funded Primarily by a Large Increase in Debt as well as Delayed Payments to the Pension Systems

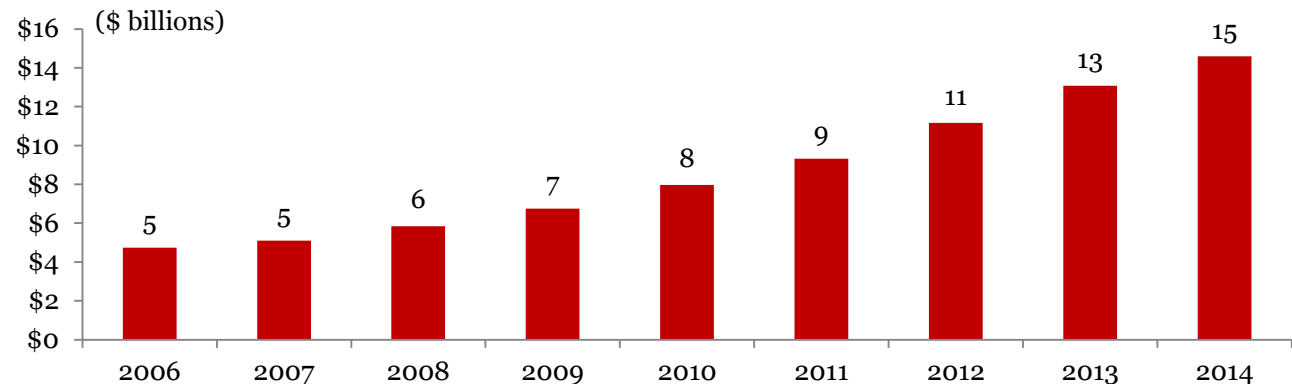
To fund spending, \$30 billion of incremental debt was raised between 2006 and 2014 and primary government obligations to the pension systems increased by over \$10 billion

Puerto Rico Public Sector Debt<sup>(1)(2)</sup>



Puerto Rico Primary Government Obligations to its Pensions (Net Pension Obligation)<sup>(3)</sup>

In addition to growing debt, the Primary Government's net pension obligation, which represents its obligation as a sponsor to fund its pensions (and is distinct from the full \$43 billion of unfunded liability of the retirement systems) has increased by approximately \$10 billion over this same period

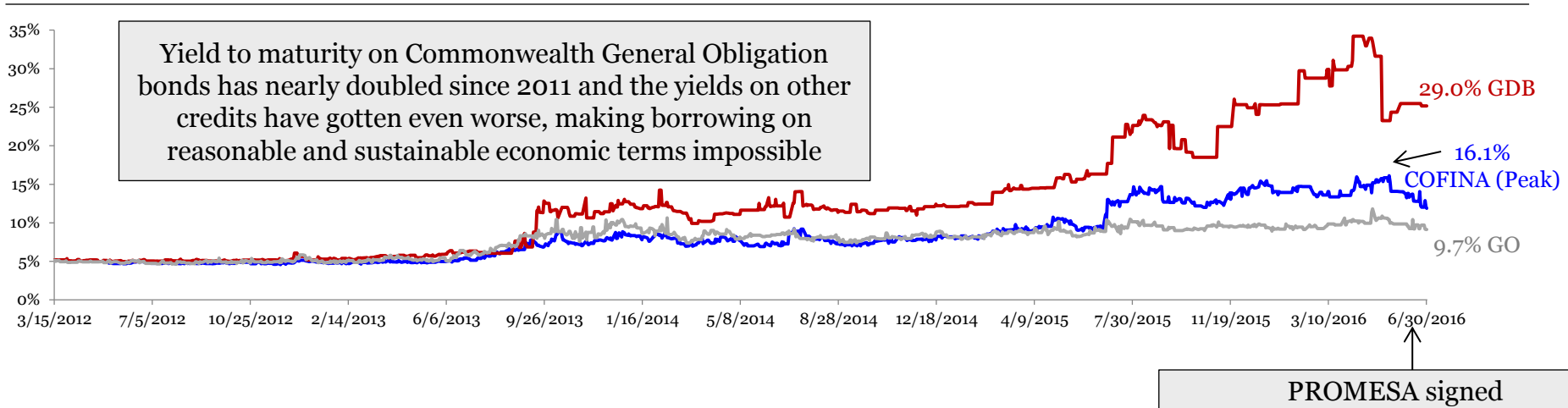


1. Balances shown do not include the accreted value of capital appreciation bonds. Balances are on a Puerto Rico fiscal year basis (July to June) and sourced from Puerto Rico's Public Debt Monthly Report (Tiered Operational Management Information System). Values exclude GDB and MFA bond issuance and include loans from these entities to other Commonwealth entities.  
 2. Does not include unfunded pension liabilities. Based on preliminary valuation reports as of June 30, 2014, the Employees Retirement System, Teachers Retirement System and Judiciary Retirement System ("JRS") net pension liabilities were \$30 billion, \$13 billion and \$442 million, respectively. See the May 7, 2015 Commonwealth of Puerto Rico Quarterly Report for more details.  
 3. Commonwealth Comprehensive Annual Financial Reports.

# Puerto Rico's Economic Decline and Large Debt Burden Reduced Access to the Capital Markets

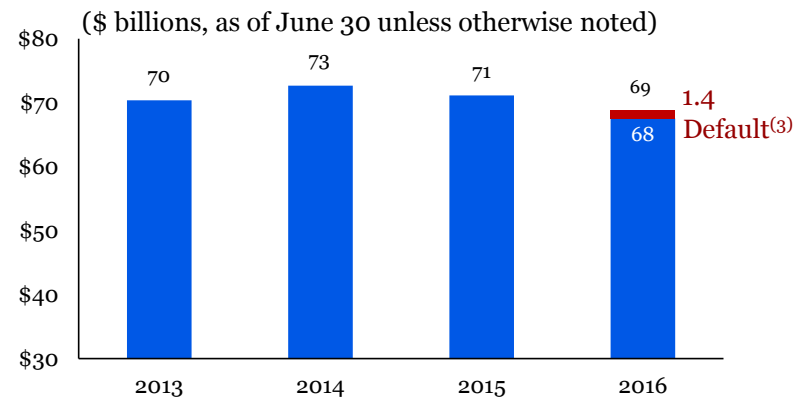
By FY 2016, yields on the Commonwealth's General Obligation bonds had virtually doubled, implying that any debt the Commonwealth could incur would be prohibitively expensive. The yields for certain other credits, such as GDB and COFINA bonds, became exponentially higher

Yield to Maturity of Illustrative GO, GDB, and COFINA Bonds<sup>(1)</sup>



As access to the markets declined, Puerto Rico has been unable to raise new debt financing, with balances remaining relatively flat since 2013. Absent extraordinary liquidity measures including the non-payment of interest, public sector debt has actually declined under the current administration

Puerto Rico Public Sector Debt 2013-2016<sup>(2)</sup>



1. Bloomberg.  
 2. Figures from Puerto Rico's Public Debt Monthly Report (Tiered Operational Management Information System). Values exclude GDB and MFA bond issuance and include loans from these entities to other Commonwealth entities. 2016 balance as of July 2, 2016 and calculated in a manner consistent with prior reporting per data provided by the Commonwealth.  
 3. Balances exclude interest on unpaid interest.

# Without Reasonable Access to the Capital Markets and Upcoming Debt Maturities, Puerto Rico's Liquidity Declined To Levels that Made it Impossible to Pay its Debts

Without access to capital markets to fund its deficits and refinance its maturing debt, the Treasury Single Account<sup>(1)</sup> balance fell to \$244 million at the end of FY 2016 as compared to \$780 million of direct general obligation debt service coming due.<sup>(2)</sup> This decline in liquidity occurred even *after* taking drastic liquidity measures that reduced appropriations to other Commonwealth borrowers which caused payment defaults prior to the end of FY 2016. In all, the Commonwealth had to default on approximately \$1.4 billion of debt service due over the course of FY 2016<sup>(3)</sup>

Total Debt Service Payments Missed in FY 2016 (including July 1, 2016 payments)<sup>(3)</sup> (\$millions)

	<u>Amount Due</u>	<u>Amount Paid</u>	<u>Amount Not Paid</u>	<u>Dates of Missed Payments</u>
GO	\$1,125	\$346	\$779	July 1, 2016
GDB <sup>(4)</sup>	1,064	664	360	May 1, 2016
PBA	276	251	25	July 1, 2016
PFC	94	1	93	August 1, 2015 to July 1, 2016
PRIFA Rum	113	-	113	January 1, 2016 and July 1, 2016
HTA <sup>(5)</sup>	322	318	4	July 1, 2016
<b>Total</b>	<b>\$2,995</b>	<b>\$1,580</b>	<b>\$1,375</b>	

Creditors had been clearly warned about such a possibility, not only by the clear decline in economic activity, but also explicitly in Commonwealth offering documents. For example, in its 2014 Offering Statement for the \$3.5 billion of General Obligations bonds – the largest municipal offering of all time – the Commonwealth warned explicitly that ***“If the Commonwealth’s financial condition does not improve, it may need to implement emergency measures that may include a restructuring, moratorium or other actions affecting creditors’ rights”***<sup>(6)</sup>




1. The Treasury Single Account is the Commonwealth's operational bank account in which it deposits receipts from governmental funds except for blended component units (COFINA, PBA, PRIFA, etc.)  
 2. Approximately \$780 million represents \$1,125 million of total principal and interest due as of July 1, 2016.  
 3. Excludes PRASA Rural Development bonds (reached forbearance agreement ahead of its payment on July 1, 2016) and GO Notes (line of credit from GDB to Treasury whose debt service on July 1, 2016 was not paid).

4. Amounts not paid represents amounts not paid by the Commonwealth and has not been reduced by amounts paid by insurers. GDB unpaid debt service is net of \$40 million of agreed upon maturity extension, which reduces the amount of unpaid debt service.  
 5. Unpaid amounts for the HTA bonds reflect missed payments on the 1998 Resolution Bonds, Series 1998 Subordinate Bonds.  
 6. Per the 2014 General Obligation Offering Statement.

# Minimal Liquidity Has Also Caused the Government's Past-Due Payables To Increase Leading Suppliers to Threaten to Cut Off Critical Services


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The government's ability to pay for essential public services is being threatened as it tries to cope with past-due payments to suppliers




*“The island reached a tentative deal...with Total Petroleum Puerto Rico Corp. after the company **warned it would no longer supply state vehicles with gasoline** because of the government's \$16 million debt”*

-Danny Hernández,  
Spokesman for the General Services Administration<sup>(1)</sup>



*“Carmen Warrel, spokesperson for the Comité Timón Educación Especial parent's association, highlighted that there are cases, such as the **Instituto Modelo de Enseñanza, which is contracted by the Department of Education to serve students with autism, who have announced closure at the end of the month if not paid.**”*

-Univision<sup>(2)</sup>



*“Administrators detailed both delayed funding from insurers and government sources, and how the **hospital had to delay and prioritize payments to provide basic care for its patients. ‘We are hanging by a thread,’** said Dr. Juan Nazaro, executive director of the hospital”*

-The Atlantic<sup>(3)</sup>

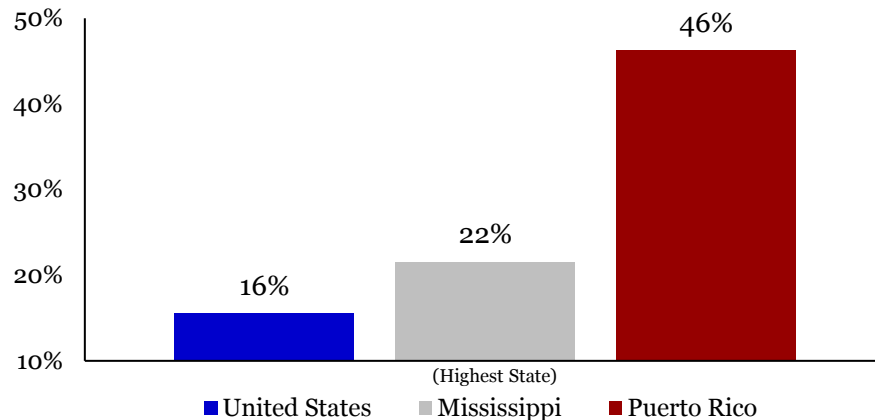


1. “Puerto Rico's Crisis Threatens to cut Gas, Power Supplies”, January 11, 2016, Caribbean Business. <http://caribbeanbusiness.com/puerto-ricos-crisis-threatens-to-cut-gas-power-supplies/>.
2. “Servicios de Educación Especial afectados por falta de liquidez en Puerto Rico”, January 18, 2016, Univision Agencia EFE. <http://www.univision.com/noticias/educacion-especial/servicios-de-educacion-especial-afectados-por-falta-de-liquidez-en-puerto-rico>.
3. “Will Puerto Rico's Debt Crisis Spark a Humanitarian Disaster?”, May 13, 2016, The Atlantic. <http://www.theatlantic.com/politics/archive/2016/05/puerto-rico-treasury-visit/482562/>.

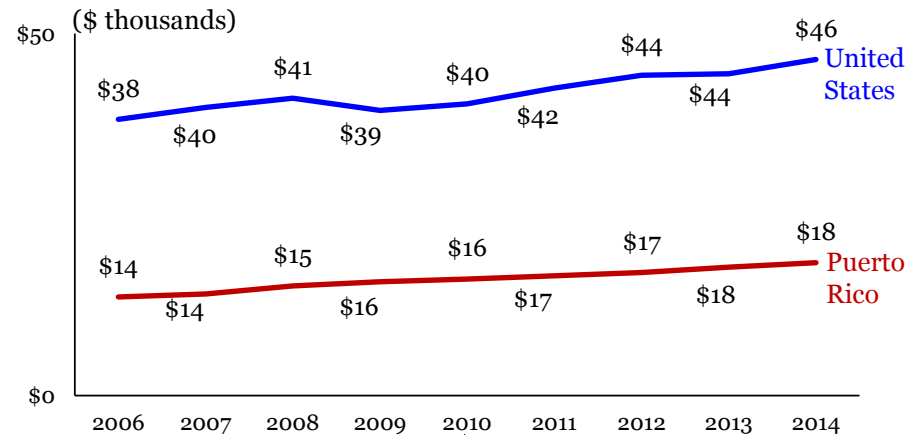
# The Liquidity Crisis Will Make it Even More Challenging for the Commonwealth to Provide for its Residents, Nearly Half of Whom Already Live in Poverty

**Puerto Rico's economic collapse has resulted in nearly half the population living in poverty even though they face a cost of living comparable to the U.S.**

Population below the Poverty Level (2014)<sup>(1)</sup>



Per Capita Disposable Income<sup>(2)</sup>



Cost of Living<sup>(3)(4)</sup>

Rank	Urban Area	Cost of Living Index
1.	Manhattan, NY	227
2.	Honolulu, HI	188
3.	San Francisco, CA	176
4.	Brooklyn, NY	173
...		
47.	San Juan, PR	112
...		
296.	Richmond, IN	81
297.	Harlingen, TX	80
298.	McAllen, TX	78
		<b>Average = 100</b>

Though Puerto Rico's per capita disposable income is only ~40% of the U.S. average, ~70% of the population of Puerto Rico lives in the San Juan MSA, which is ranked 47<sup>th</sup> highest out of 298 U.S. metropolitan areas and 11.6% above the average due to some of the highest prices for utilities, groceries and goods and services in the country<sup>(3)</sup>

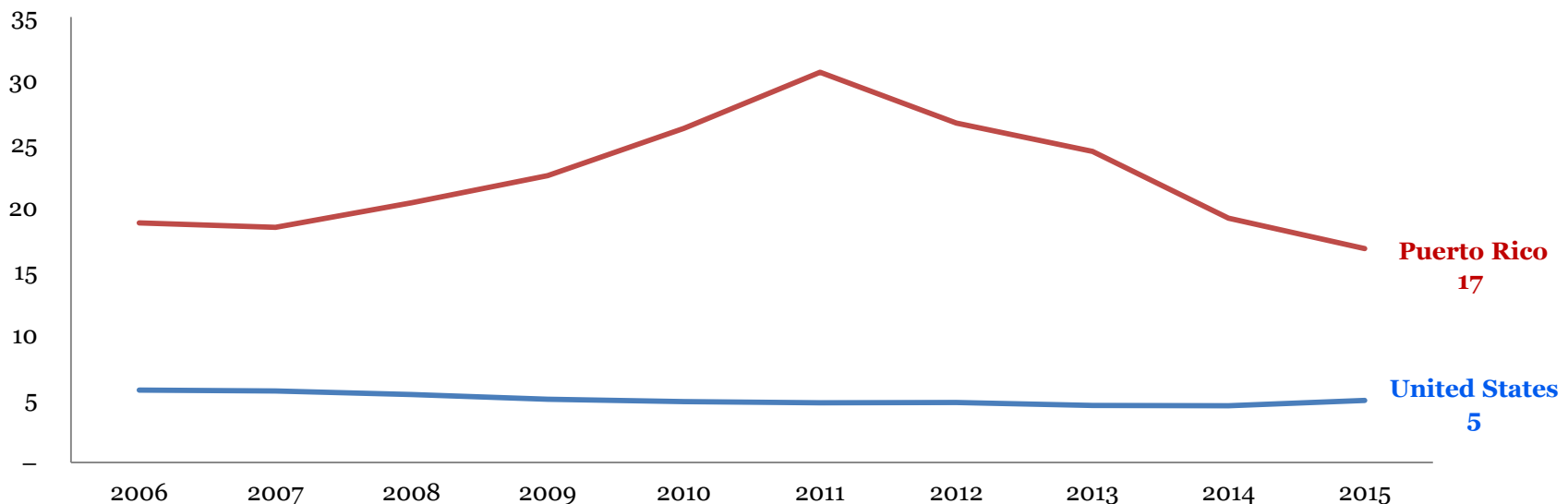


1. U.S. Census Bureau. Current Population Survey, Annual Social and Economic Supplement, 2015 United States data. Puerto Rico poverty level based on 2014 American Community Survey 1-Year estimates.  
 2. GDB Statistical Appendix (Selected Series of Income and Product, Total and Per Capita). U.S. Bureau of Economic Analysis (U.S. Personal Income and Population).  
 3. The Institute of Statistics of Puerto Rico. Index Cost of Living, June 17, 2016.  
 4. Council for Community and Economic Research.

# Poverty is not the Only Issue Facing U.S. Citizens Living in Puerto Rico – Key Crime Statistics are Higher than in any State

Wide spread poverty is not the only issue the U.S. citizens living in Puerto Rico have had to confront – despite recent improvement, key crime statistics, such as homicide rates, remain higher than in any state

Homicide Rate (per 100,000 people)<sup>(1)</sup>



“High unemployment rates (14% to 16% in Puerto Rico and 10% to 14% in the U.S. Virgin Islands), coupled with a strategic geographic location (mid-point between the United States and South America) make the islands attractive to illicit drug traffickers and money launderers”

-U.S. Department of Justice, Drug Enforcement Administration<sup>(2)</sup>

“Due to enforcement successes by Dominican authorities and interdiction efforts by the U.S. Coast Guard, traffickers have been **forced to send multi-ton quantities of cocaine** from Venezuela and Colombia **directly into Puerto Rico**, bypassing the Dominican Republic. This resulted in...**increased smuggling movements directly to Puerto Rico**”

-U.S. Department of Justice, Drug Enforcement Administration<sup>(2)</sup>



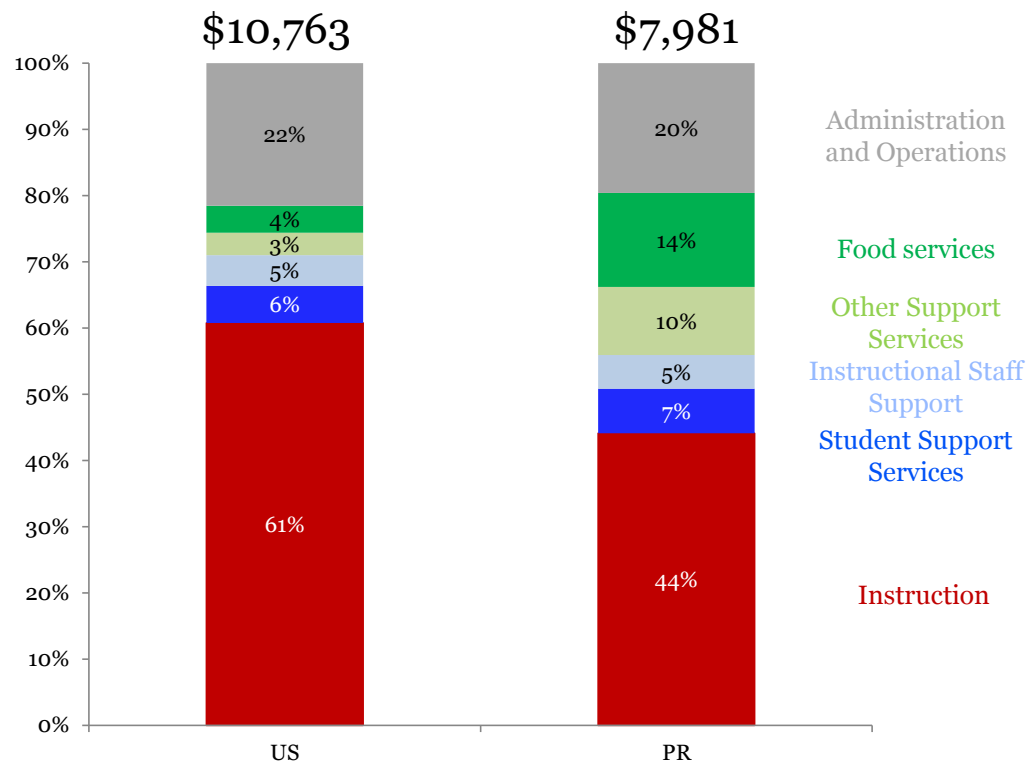
1. Federal Bureau of Investigation, Uniform Crime Report.

2. 2015 National Drug Threat Assessment Summary, November 4, 2015, U.S. Department of Justice, Drug Enforcement Administration. <https://www.dea.gov/docs/2015%20NDTA%20Report.pdf>.

# Puerto Rico's Education System is also Struggling Due to a Lack of Funds and the Need to Direct Funds to Food and Support Services

In addition to spending less per student than in the U.S., Puerto Rico spends a greater percentage on non-instructional assistance, such as food and other support

Total Current Expenditure per Pupil per type of Expense (%)<sup>(1)</sup>



**In a message to Speaker of the House Paul Ryan, R-Wisc., Puerto Rico Education Secretary Rafael Roman Melendez:**

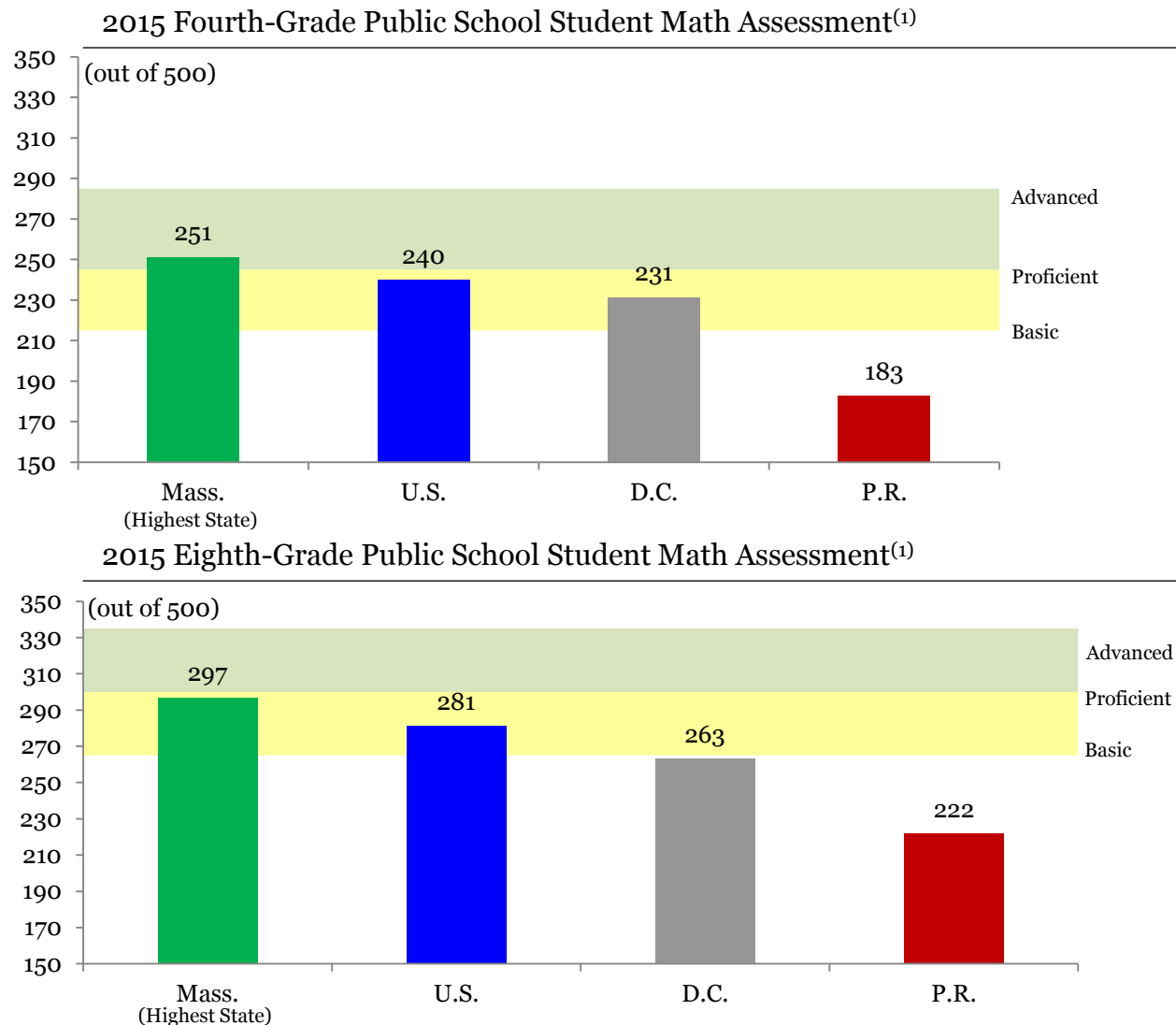
“The programs I oversee are in distress as there is simply insufficient cash to address the needs of 379,818 children that attend public schools in Puerto Rico” ...“children are paying the consequences as a result of the congressional inaction, such as payments for classroom services, transportation, breakfast and lunch food supplies, “which are often the only meals some children consume during the day, as close to 58% of Puerto Ricans live in poverty.”<sup>(2)</sup>



1. The National Center for Education Statistics' Revenue and Expenditures for Public Elementary and Secondary Education FY 2013.  
 2. Latin Post article "Puerto Rico Education Secretary: Debt Crisis Rapidly Affecting Children's Health, Safety, Education Experience" published March 23, 2016.

# Lower Levels of Education Spending are Reflected in Poor Educational Outcomes

**Puerto Rico's students have shown significantly lower math assessment outcomes relative to the United States**



1. The Nation's Report Card's National Assessment of Educational Progress in Mathematics, 2015.



# The Health Care System is Struggling to Provide Adequate Care to Puerto Rico Residents

The health care system is struggling to provide adequate care to its residents as the burden of health care increasingly falls on the local government and hospitals grapple with declining numbers of physicians



“We had 14,000 physicians in 2006. Now we have 9,000 physicians ... The salary in the United States is three to four times more.” - Victor Ramos, president of the College of Physicians and Surgeons and pediatrician<sup>(1)</sup>

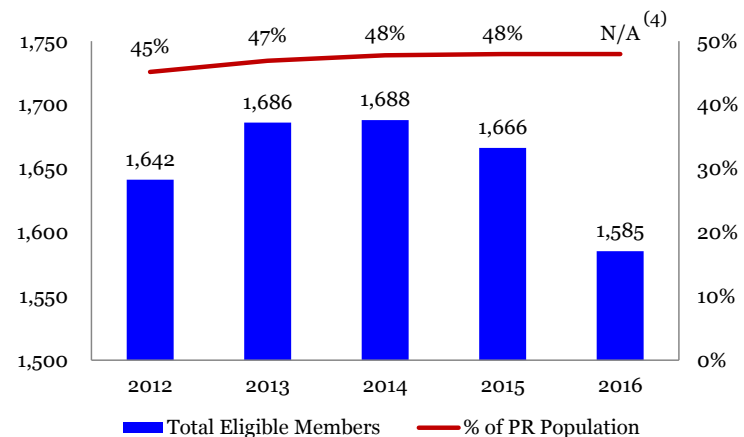


According to a survey by the Puerto Rico Hospitals Association, 76% of hospitals have struggled to find and hire specialists<sup>(1)</sup>



~1.6 million Puerto Ricans receive the government’s “Mi Salud” health card / Medicaid healthcare plan, representing just under half the island’s population

Puerto Rico Population Insured under Public Health Programs<sup>(3)</sup>  
(millions)



The healthcare burden on the Commonwealth is exacerbated by a Medicare Advantage payment per member per month (“PMPM”) that is one of the lowest in the U.S. with a 2014 PMPM premium of \$15.10, lower than 41 states<sup>(2)</sup>



1. Hospitales, Publicacion Oficial de la Asociacion de Hospitales de Puerto Rico, “Dos Logros Historicos en el Trato de Medicare a Puerto Rico,” 2016. [http://hospitalespr.org/revista\\_pdf/revista\\_feb16.pdf](http://hospitalespr.org/revista_pdf/revista_feb16.pdf).  
2. “State of the 2014 Medicare Advantage industry”, February 2014, Milliman. <http://www.milliman.com/uploadedFiles/insight/2014/State-of-2014-Medicare-Advantage-industry.pdf>.

3. Puerto Rico Department of Health. <https://medicaid.pr.gov/Statistics.aspx>. Represents total eligible members under Medicaid, CHIP, Estatal, and Estatal (Otros). Total eligible members as of July 1 of each year shown.  
4. Puerto Rico population data for FY 2016 not yet available as of the date of this presentation.

# Challenges to the Health Care System may only be Getting Worse

The health care system challenges only appear to be getting worse as patients face longer and longer wait times, hospitals are forced to delay payments to suppliers and Zika threatens to become an epidemic

According to a study conducted by the Catholic University of Puerto Rico on a sample of 600 people, many residents have experienced problems with **long wait times in primary care facilities** and hospital emergency rooms as well as with the **lack of physician availability**<sup>(1)</sup>

*“Puerto Rico is in the midst of a Zika epidemic. The virus is silently and rapidly spreading in Puerto Rico... this could lead to hundreds of infants being born with microcephaly or other birth defects in the coming year. We must do all we can to protect pregnant women from Zika and to prepare to care for infants born with microcephaly”*<sup>(2)</sup>

-Lyle R. Petersen, M.D.,  
M.P.H, Incident Manager for CDC’s Zika Response and Director,  
Division of Vector-Borne Diseases

According to a survey by the Puerto Rico Hospitals Association, 57% of hospitals have shut down entire floors, 36% have fired employees and **66% have been forced to structure payment plans with suppliers**<sup>(3)</sup>

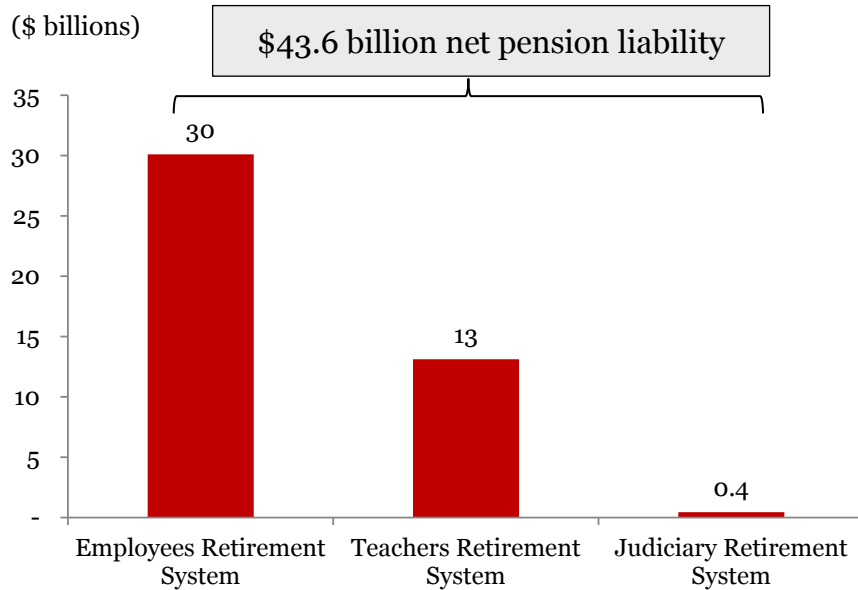


1. “La percepción de la calidad y la satisfacción con los servicios médicos hospitalarios en Puerto Rico,” June 24, 2015. Pontifical Catholic University of Puerto Rico. <https://gcu.universia.net/net/files/2015/6/24/hoja-de-datos-estudio-salud-final.pdf>.
2. “Zika infections increasing rapidly in Puerto Rico,” July 29, 2016. Centers for Disease Control and Prevention. <http://www.cdc.gov/media/releases/2016/p0729-zika-infections-puerto-rico.html>.
3. Hospitales, Publicacion Oficial de la Asociacion de Hospitales de Puerto Rico, “Dos Logros Historicos en el Trato de Medicare a Puerto Rico,” 2016. [http://hospitalespr.org/revista\\_pdf/revista\\_feb16.pdf](http://hospitalespr.org/revista_pdf/revista_feb16.pdf).

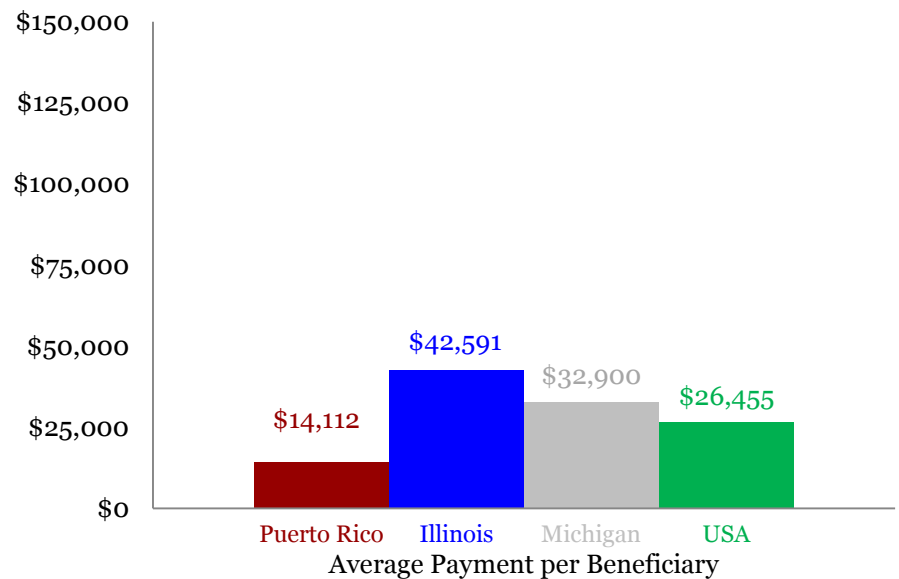
# Puerto Rico's Unfunded Pension Liability has Grown Significantly and Threatens the Already Small Payments Pensioners Receive

The ability to provide for pensioners dependent on the government pension fund for benefits (the levels of which are far below those in the states) is now threatened by rapidly diminishing plan assets

Actuarial Valuations of Puerto Rico's Retirement System<sup>(1)</sup>



Pension Benefit Payments Comparison<sup>(2)</sup>



The relative size of the unfunded pension liability is made even worse by the fact that the average monthly pension payments under the three central government retirement systems are already only a fraction of the U.S. average and far below states and cities that also face large unfunded liabilities. There are approximately 30,000 people in Puerto Rico who are receiving only the minimum monthly pension amount (currently \$500, an increase from \$400 as part of recent pension reform efforts).



1. Actuarial estimates as of July 30, 2014. November 2015 Commonwealth Operating Report.  
 2. State Employee Retirement System of Illinois. Teachers Retirement System of Illinois. Retirement System of the City of Detroit. Michigan Annual Report. Annual Survey of Public Pensions.

# Puerto Rico's Economic Challenges will Get Worse in FY 2018 when the Act 154 Tax Expires and the ACA Funds are Expected to be Depleted

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**Act No. 154** imposes a temporary excise tax on corporations to capture the repatriation of profits and dividends to parent firms on the mainland, which firms can currently neutralize via a credit currently unchallenged by the IRS. However, the IRS has not explicitly ruled on the ability to credit Act 154 payments and indications are such ability would not be extended were Puerto Rico to extend Act 154 beyond its current expiration in FY 2018. Act 154 accounts for approximately 21% of this year's General Fund budget. 85% of the tax is paid by eight corporations, some of whom have expressly indicated they would consider leaving the island if the creditability of the tax is not extended (or their tax bill is not otherwise adjusted)

**ACA funds** provided to Puerto Rico are currently projected to be exhausted by FY 2018. Post the expiration of those funds, the Commonwealth would still receive healthcare funding from the U.S. Federal Government, but at a much lower rate than the 50 states. The Commonwealth's Medicare Advantage match is lower than 41 states and the Commonwealth is subject to a federal spending cap on Medicaid dollars of approximately \$300 million (excluding \$150 million for the Children's Health Insurance Program ("CHIP")) - there is no cap for U.S. states.

***An extension of Act 154 and a replacement for ACA funding (potentially through providing Puerto Rico with Medicare/Medicaid funding equivalent to that of the 50 states) is necessary for Puerto Rico just to maintain its current fiscal position.***

