PUERTO RICO CREDIT CONFERENCE 2013

Fiscal Progress, Pension Reform, and Proposed FY 2014 Budget

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Agenda

1. **Recent Achievements**
2. Fixing our Retirement System (Act 3 of 2013)
3. General Fund Budget
4. Government Development Bank
5. Concluding Remarks

In less than five months, we have tackled several key challenges faced by Puerto Rico for decades to protect our investment grade ratings

- Puerto Rico has delivered on its long-standing promise of enacting meaningful pension reform
- After discussions with our manufacturing partners, we secured an important revenue component by increasing and fixing at 4% the Act 154 excise tax for the next five years
- Puerto Rico demonstrated its commitment to promoting economic activity in one of its main growth areas by completing the concession of our international airport -- first ever under the FAA pilot program
- Commitment to transform our public corporations into self-sustaining enterprises, beginning with PRASA
- With the proposed budget for FY 2014, we are taking steps to achieve a balanced budget that matches recurring revenues with recurring expenses, while reducing our reliance on deficit financing

We are keenly aware of the continuing fiscal challenges facing Puerto Rico and our main focus is to proactively address them

Main fiscal challenges

Recurring Budgetary Deficits	Public Corporations	Teacher's Retirement System

- We are working to achieve budgetary structural balance, restructure our principal public corporations and address the pending Teachers retirement system reform.

- We have moved swiftly to correct the main challenges weakening our credit rating and restraining Puerto Rico from sustainable economic growth.

Agenda

1. Recent Achievements
2. **Fixing our Retirement System (Act 3 of 2013)**
3. General Fund Budget
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On April 4, 2013, the Commonwealth of Puerto Rico enacted sweeping pension reform to rescue the Puerto Rico Government Employees Retirement System (“ERS”) and address its unfunded liability.

Puerto Rico has enacted one of the most comprehensive and meaningful pension reforms ever passed in the United States

Key Takeaways:

- The reform eliminates the projected need for pay-as-you-go contributions from the General Fund by:
  - (i) restructuring the System's benefits so as to decrease projected System disbursements; and
  - (ii) increasing contributions to the System so as to provide additional cash flow to pay pension benefits as they become due.
- The restructuring of future liabilities of the System, coupled with an increase in inflows into the System, is projected to allow the System to pay all pension benefits as they become due.
- Reform is designed to protect accrued pension benefits. Core pension benefits of all current retirees are left untouched.

Everyone contributes:

Retirees →
- Reduced Special Law Benefits

Active Employees →
- Change in benefit structure
- Increase in the retirement age for certain groups
- Increase in employee contribution

Taxpayers →
- Act 116 increase in employer contributions
- Allocation to the System of savings produced by changes in Special Laws' benefits
- Additional annual contribution of $140 million

For the first time in Puerto Rico history, a law is enacted to move all employees (current and new) to a single new hybrid plan

Act 447 of 1951

- Established defined benefit plan for government employees
- Maximum merit pension of 75% (30 years in service and 55 years of age)
- Benefit: 1.5% of average salary during the first 20 years in service and 2.0% of average salary during subsequent years
- Average salary computation based on highest salaries during any 36 month period
- Retirement age: 58 years(a)
- Active members: 22,866 / Retired employees: 109,097(b)

Act 1 of 1990

- Reduced the defined benefit structure under the original law (Act 447)
- Benefit: 1.5% of average salary during years in service
- Average salary computation based on the last 5 years in service
- Retirement age: 65 years(a)
- Active members: 46,452 / Retired employees: 7,540(b)

Act 305 of 1999

- Closed the Defined Benefit Plan for new employees
- Benefit: Pension depends on the employee's contribution plus return on investment
- Upon retirement, the total value accrued is disbursed to the member's account
- Retirement age: 60 years(a)
- Active members: 62,043 / Retired employees: 21(b)

Act 3 of 2013

- **Freezes defined benefit plan for employees under Act 447 and Act 1**
- **Moves all employees to new Hybrid Plan, where retirement benefits depend on the employee's contribution plus return on investment**
- **Upon retirement, the member will receive a pension based on:**
  - **The accumulated defined benefit pension up to the Reform effective date, and/or**
  - **An annuity based on the total value of the members' account**
- **Retirement age: 67 years (61 years for Act 447 and 65 years for Act 1 and System 2000)(a)**

(a) Except for High Risk Employees and other exceptions, (refer to "Increases in Retirement Age" section).

(b) As of December 31, 2012.

Pension Reform has seven main components that will take effect on July 1, 2013

<u>These components could be analyzed as having their effect in three phases:</u>

Phase I -----------> Change in measures that extend System's assets through 2030

Phase II -----------> Annuitization mandated so that cash will be available to pay benefits in the 2030's

Phase III -----------> Annuitization mandated so that cash can begin to accumulate in the 2040's and beyond

Measures	Increase in Contributions	Decrease in Disbursements	Delay of Cash Flows	Phase I	Phase II	Phase III
1) Hybrid Plan		X	X		X	X
2) Annuitize System 2000		X	X		X	X
3) Increase Retirement Age		X	X	X		
4) Increase Member Contributions	X			X	X	X
5) Reduce Special Laws		X		X	X	
6) Remove Disability Benefit		X		X		
7) Changes in Survivor Benefits		X		X	X	

Through a freeze of the defined benefit plan and an annuitization of the defined contribution plan, projected obligations and cash outflows will be substantially reduced

1 New Hybrid Plan

- Moves all participants (employees) under the defined benefit pension plans (Act 447 and Act 1) and the defined contribution plan (System 2000) to a new hybrid plan ("New Plan").
- Effectively stops defined benefit accrual (participants under Act 1 currently accrue benefits at an annual rate of 1.5%, and participants under Act 447 currently accrue benefits at an annual rate of 1.5% for the first 20 years of creditable service and at 2.0% for the years of creditable service in excess of 20 years).
  - Under the New Plan, participants will receive a pension at retirement age equivalent to what they have accrued under Act 447 and Act 1 up to June 30, 2013, and a supplemental annuity corresponding to contributions made after July 1, 2013.
  - Eliminates the possibility of accruing a merit pension (payable once the participant has achieved 30 years of creditable service) after June 30, 2013. A merit pension is equivalent to 65% of average salary, based on the highest salaries earned during any 36 months (75%, if the participant is 55 years or more).
- Eliminates service purchase option after June 30, 2013.
- New participants under the New Plan will receive a lifetime annuity based on the accumulated balance of their individual accounts.

2 Annuitize System 2000 Benefits

- Participants under System 2000 will no longer receive a lump-sum payment upon retirement, but rather a lifetime annuity calculated at retirement based on a factor that will incorporate the individual's life expectancy and a rate of return.

By increasing the retirement eligibility age, the life of the System's assets are extended and future obligations reduced

3 Increase in Retirement Age

	Prior to Reform		Post Reform	
	Regular Employees	High Risk Employees[(a)]	Regular Employees	High Risk Employees[(b)]
Act 447 Employees	Age 58 or at any age with 30 years of service or at age 55 with 25 years of service	Age 50 or with 30 years of service	Age 61 (with lower retirement ages for employees 56 and 57)	Age 55 with 30 years of service
Act 1 Employees	Age 65	Age 55 or with 30 years of service	Age 65	Age 55 with 30 years of service
Act 305 Employees ("System 2000")	Age 60	Age 55	Age 65 (with lower retirement ages for employees 56 through 59)	Age 55
New Employees	n/a	n/a	Age 67	Age 58

(a) Police and firefighters.
(b) State and municipal police, firefighters, and custody officials.

Employees will have to contribute more from their salaries and current retirees will see a reduction in the amount of Special Law benefits received

4 Increase Employee Contributions

- Increases employee contributions from 8.275% to a minimum of 10.000%.

5 Modification of Special Laws

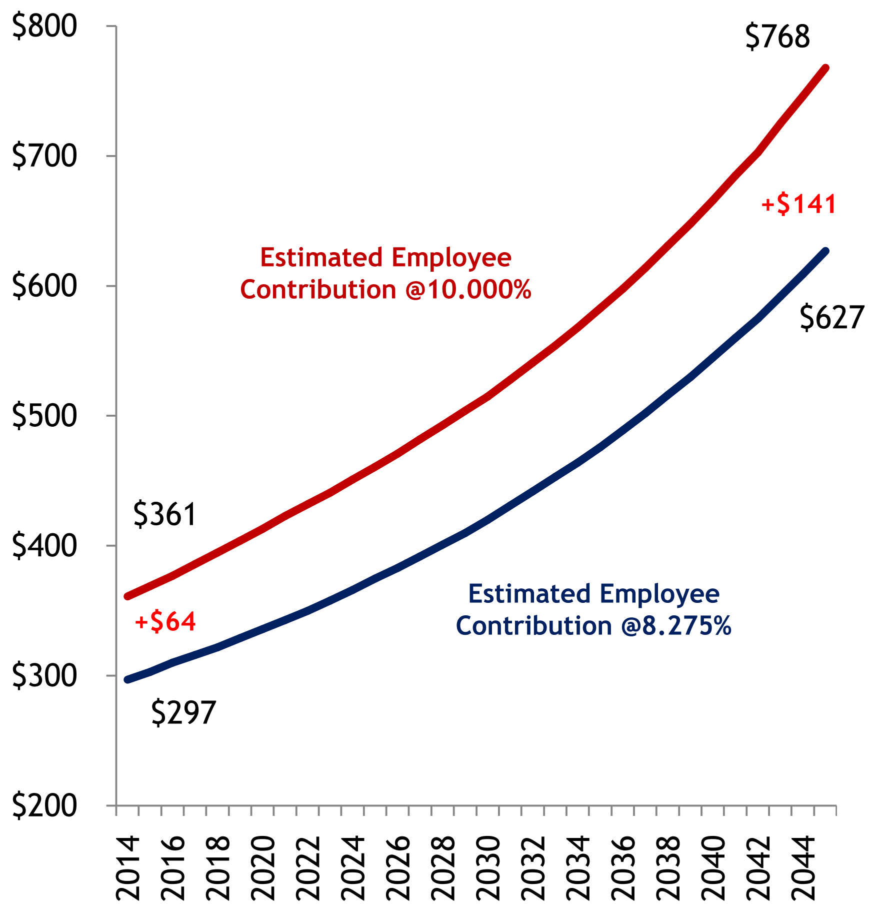
- Modifies Special Law benefits to reduce $500 in benefits paid to current retirees, as follows:
  - Reduction in Christmas bonus from $600 to $200,
  - Elimination of summer bonus of $100, and
  - No change in medical plan contribution of up to $1,200 and medicine bonus of $100.
- Eliminates Special Law benefits to future retirees.
- Employers will contribute $2,000 per retiree and future retiree (originally under Act 447 and Act 1); the System will benefit from the savings generated between this employer contribution and the Special Law benefits paid out to retirees.
- Given these changes to Special Laws, the minimum monthly pension for current retirees was increased from $400 to $500.

6 Changes in Disability and Survivor Benefits

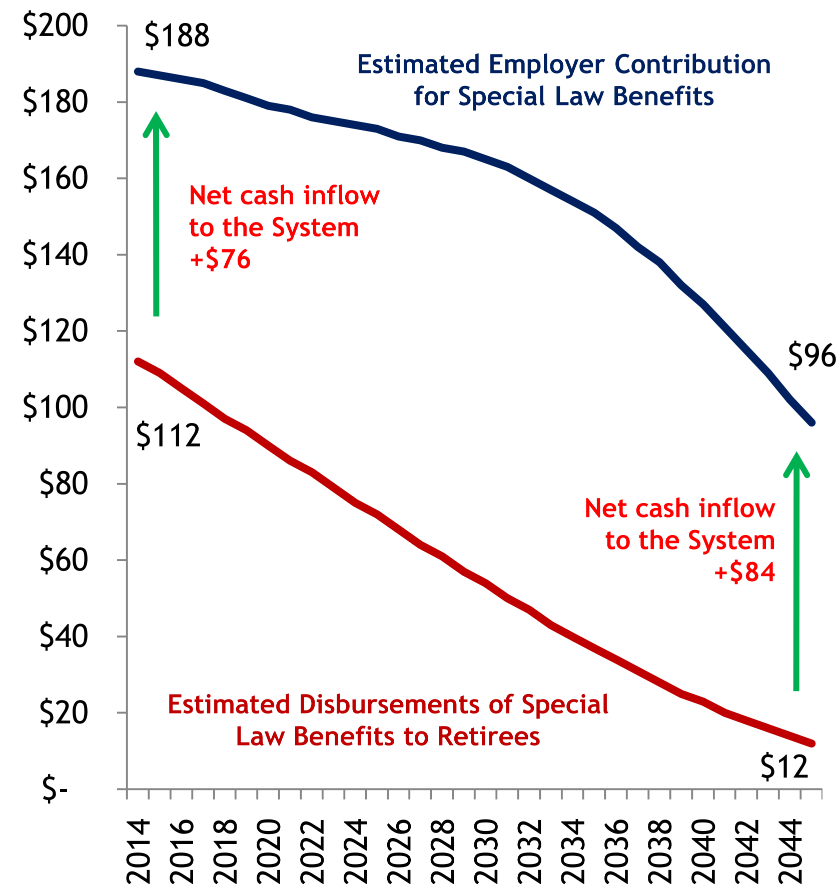
- Reform eliminates existing disability benefits and changes survivor benefits going forward.

The combination of the increase in employee contributions and decrease in Special Laws will result in an ongoing increase in cash flowing into the System

Effect of Increase in Employee Contribution (in millions)

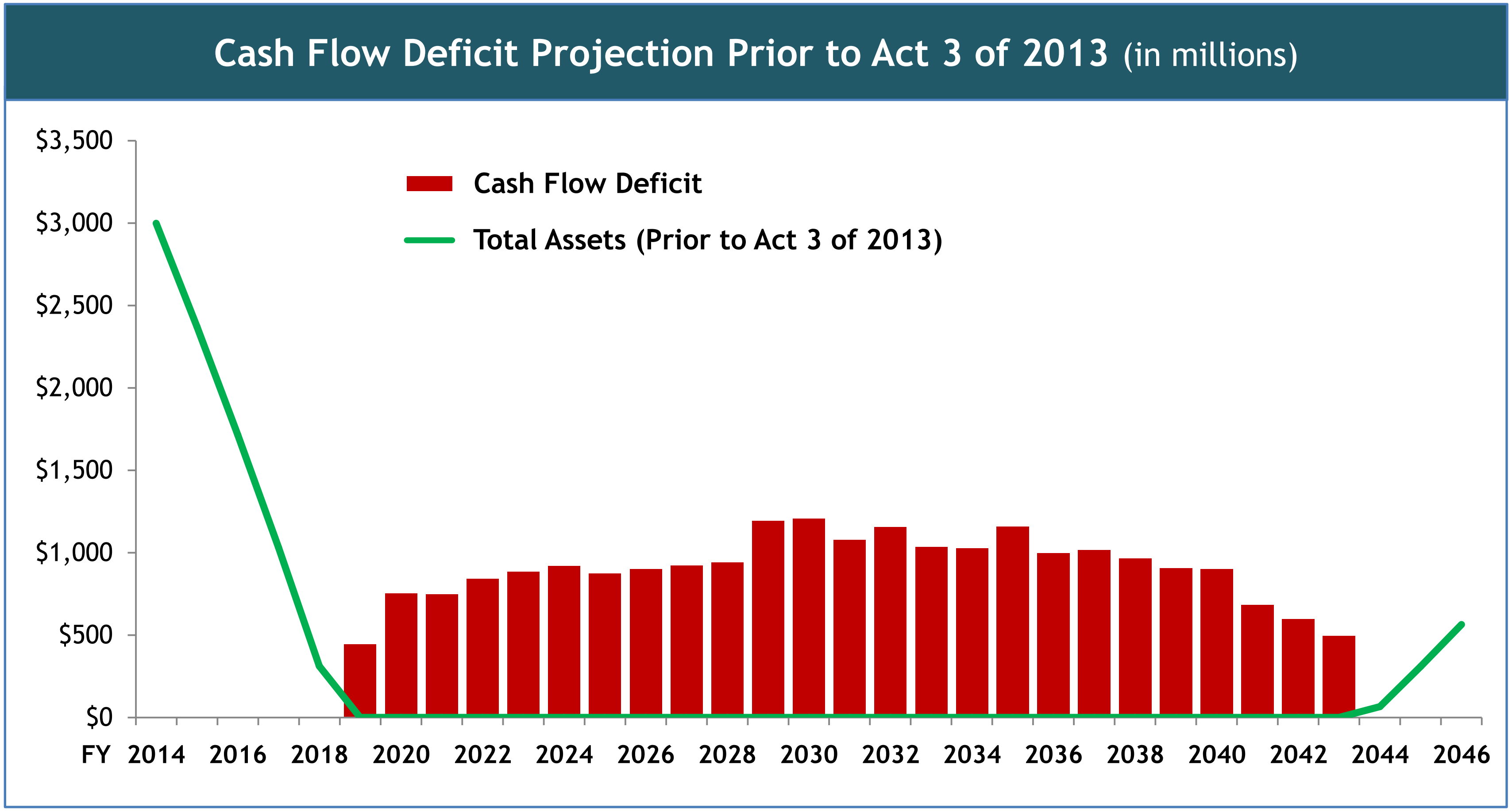


Benefit from Change in Special Law Benefits (in millions)



The Employees Retirement System faced a significant cash flow deficit that stretched for over two decades

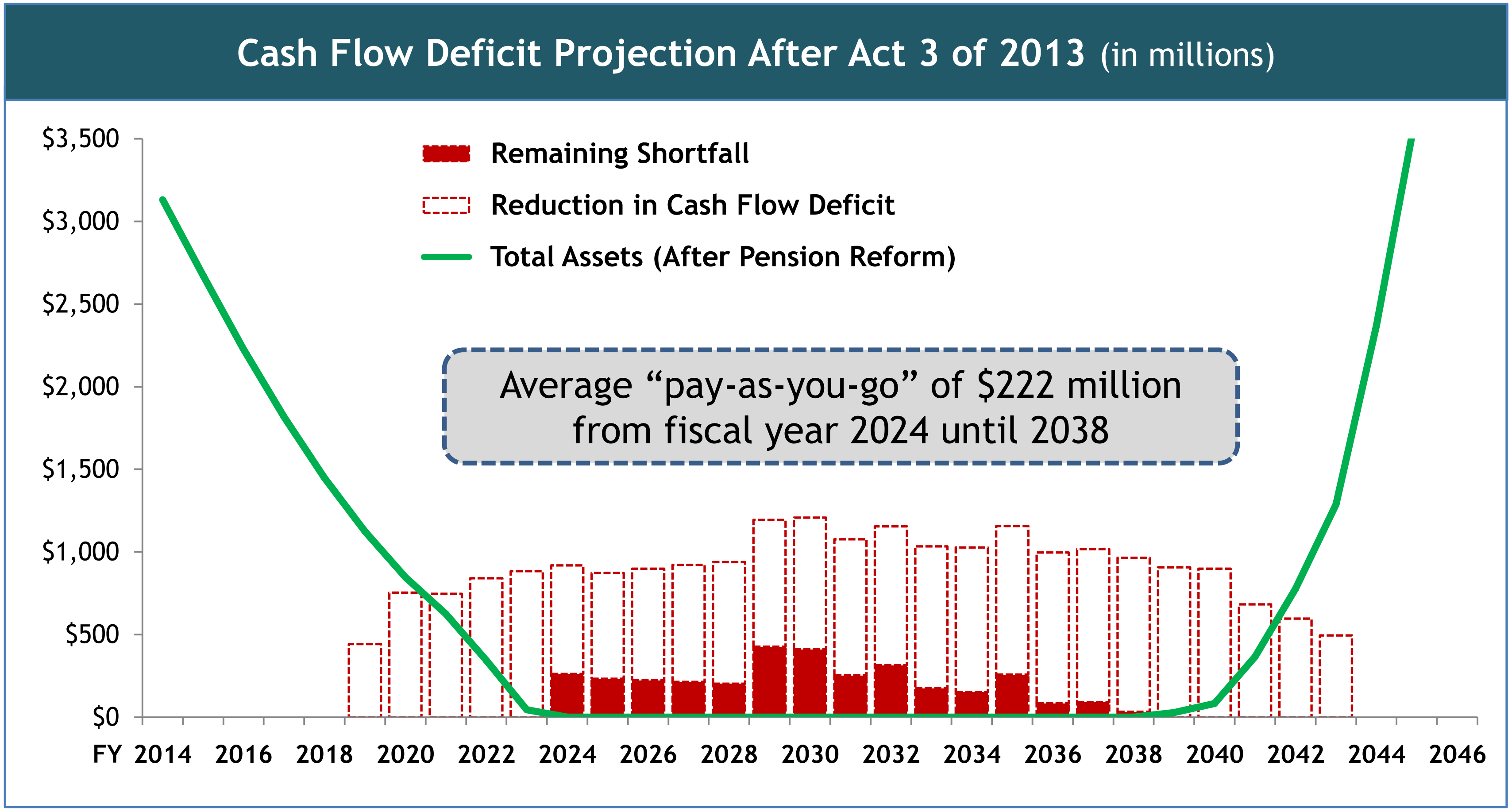
- Annual cash flow shortfall under the previous System (known as "pay-as-you-go") averaged $905 million annually during the period from FY2018-2019 until FY2042-2043, totaling $8.5 billion on a present value basis. This means that the government would have had to make an annual contribution of $905 million, on average, on top of the employer contribution increase already legislated under Act 116 of 2011.



Note: The amounts presented are estimates, the end result could vary. This chart takes into account an investment rate of return of 6.00%.

After incorporating all the restructuring measures, the projected cash flow deficit was reduced from $8.5 billion to $1.2 billion on a PV basis

- Amendments include moving Act 447 and Act 1 participants to the New Plan, annuitizing System 2000 benefits, increasing retirement age, increasing employee contribution, modifying (and eliminating for future retirees) Special Law Benefits, eliminating disability benefits, and changing survivor benefits.

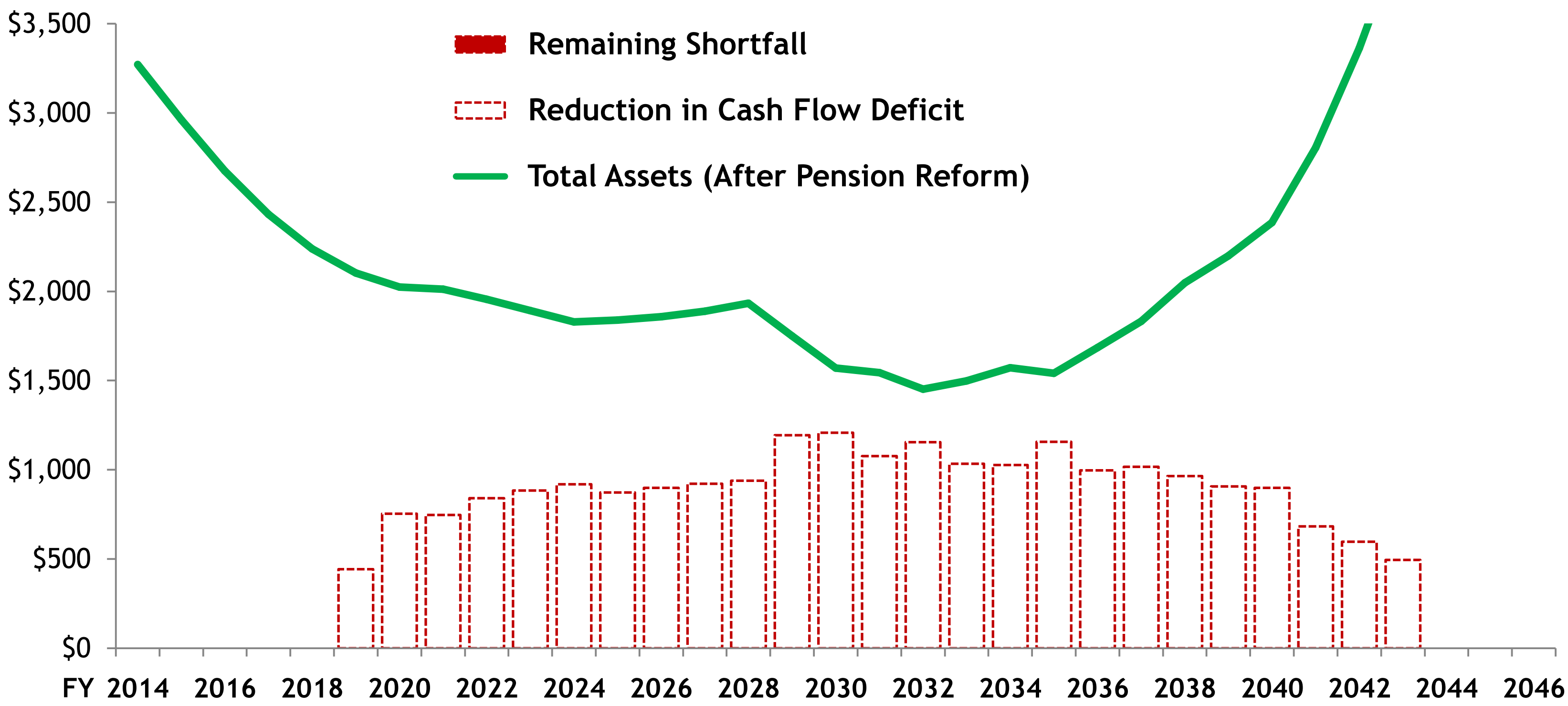


Note: The amounts presented are estimates, the end result could vary. This chart takes into account an investment rate of return of 6.00%.

With a $140 million annual contribution through 2033, the projected cash flow deficit is eliminated going forward while maintaining total assets above the $1 billion level

- Amendments include moving Act 447 and Act 1 participants to the New Plan, annuitizing System 2000 benefits, increasing retirement age, increasing employee contribution, modifying (and eliminating for future retirees) Special Law Benefits, eliminating disability benefits, changing survivor benefits, and an additional $140 million annual contribution.

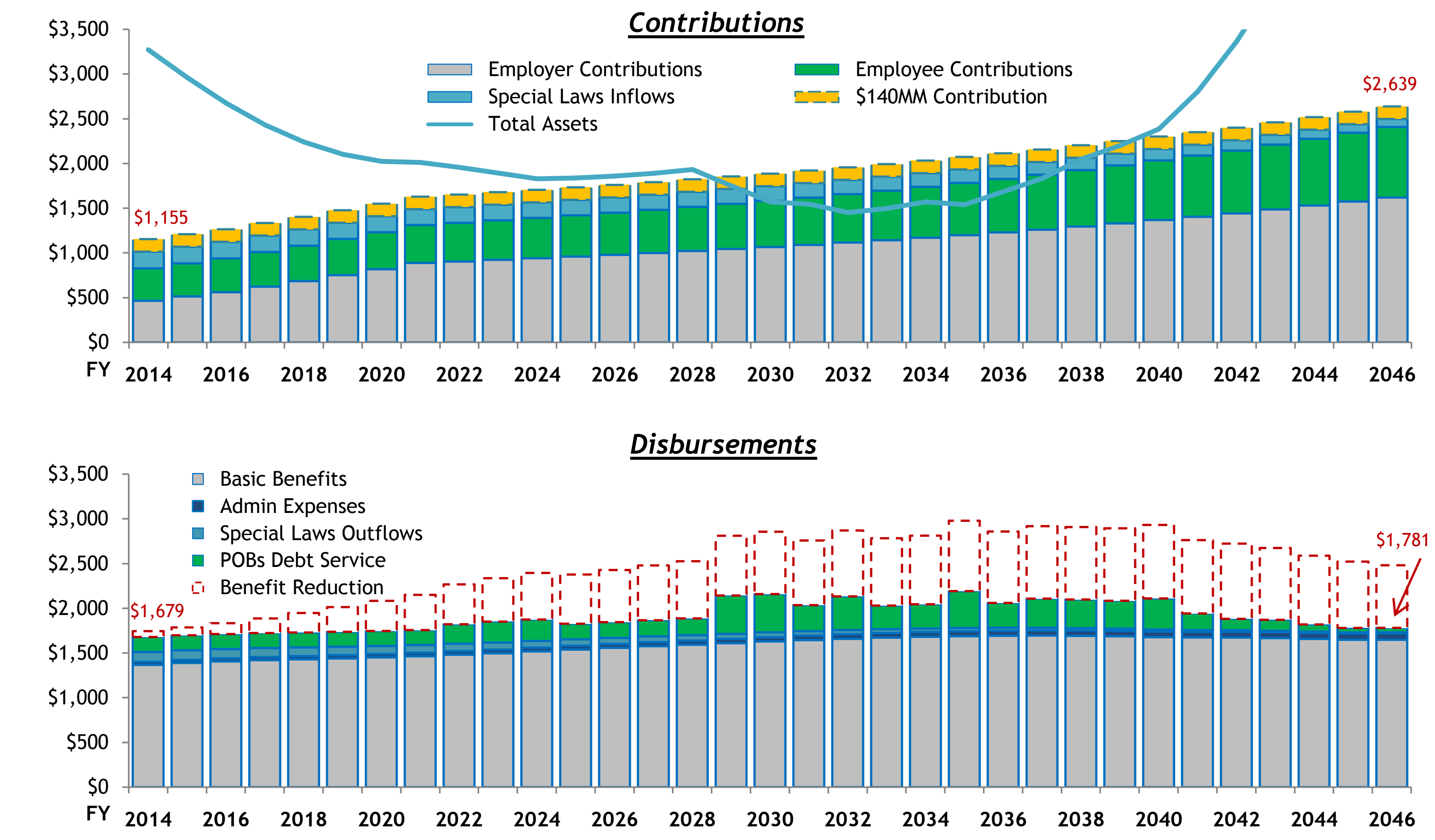
Cash Flow Deficit Projection After Act 3 of 2013 (in millions)



Note: The amounts presented are estimates, the end result could vary. This chart takes into account an investment rate of return of 6.00%.

Through a combination of increases in contributions and reductions in benefits, the System is projected to cover all of its future obligations

Retirement System after Act 3 – Contributions vs. Disbursements (in millions)



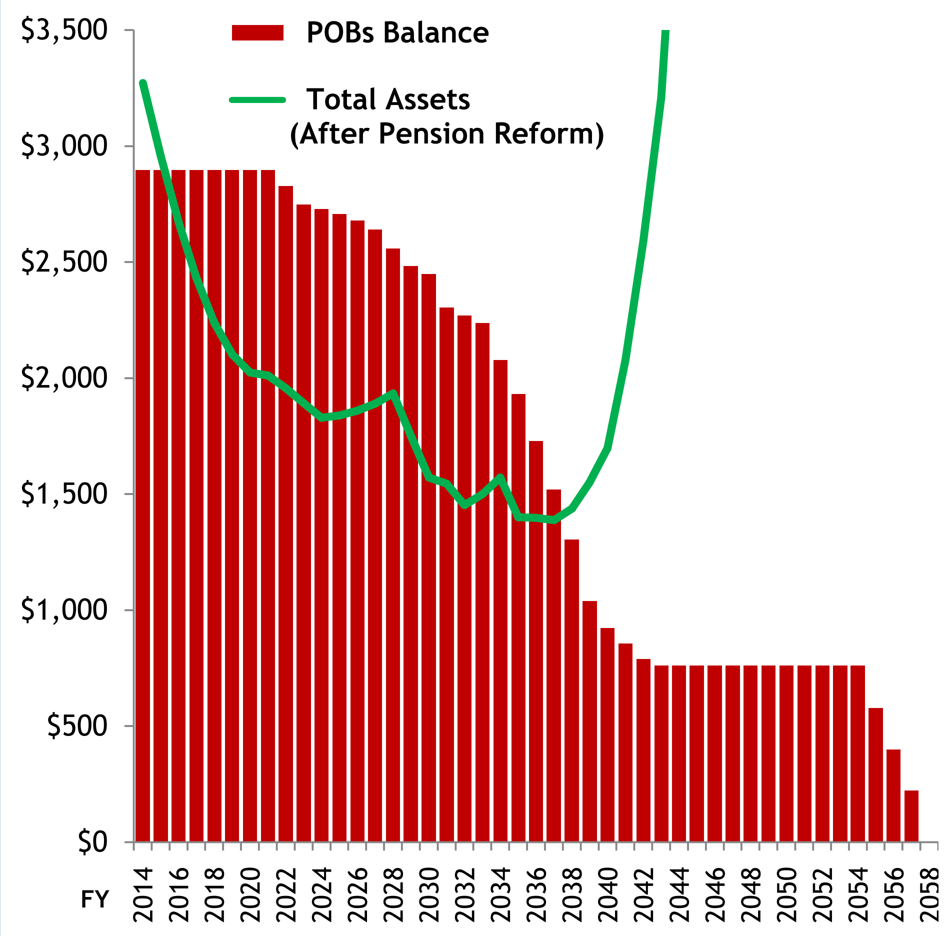
Note: The amounts presented are estimates, the end result could vary. This chart takes into account an investment rate of return of 6.00%.

ERS is expected to have enough assets to cover its obligations for the near and long-term

Reform Considerations Regarding Assets

- With the enacted measures, sufficient funds are expected to cover all annual obligations throughout the life of the System.
- Due to the POBs structure, on a net asset basis we are still expecting many years of low or negative funded status. Whenever gross assets are below the POB balance, net assets are negative.
- The actuarial liability for GASB reporting purposes will stay high for a long time.
- Assets will start accumulating during the early 2040's.

POB's Outstanding Balance vs. Total Assets (in millions)



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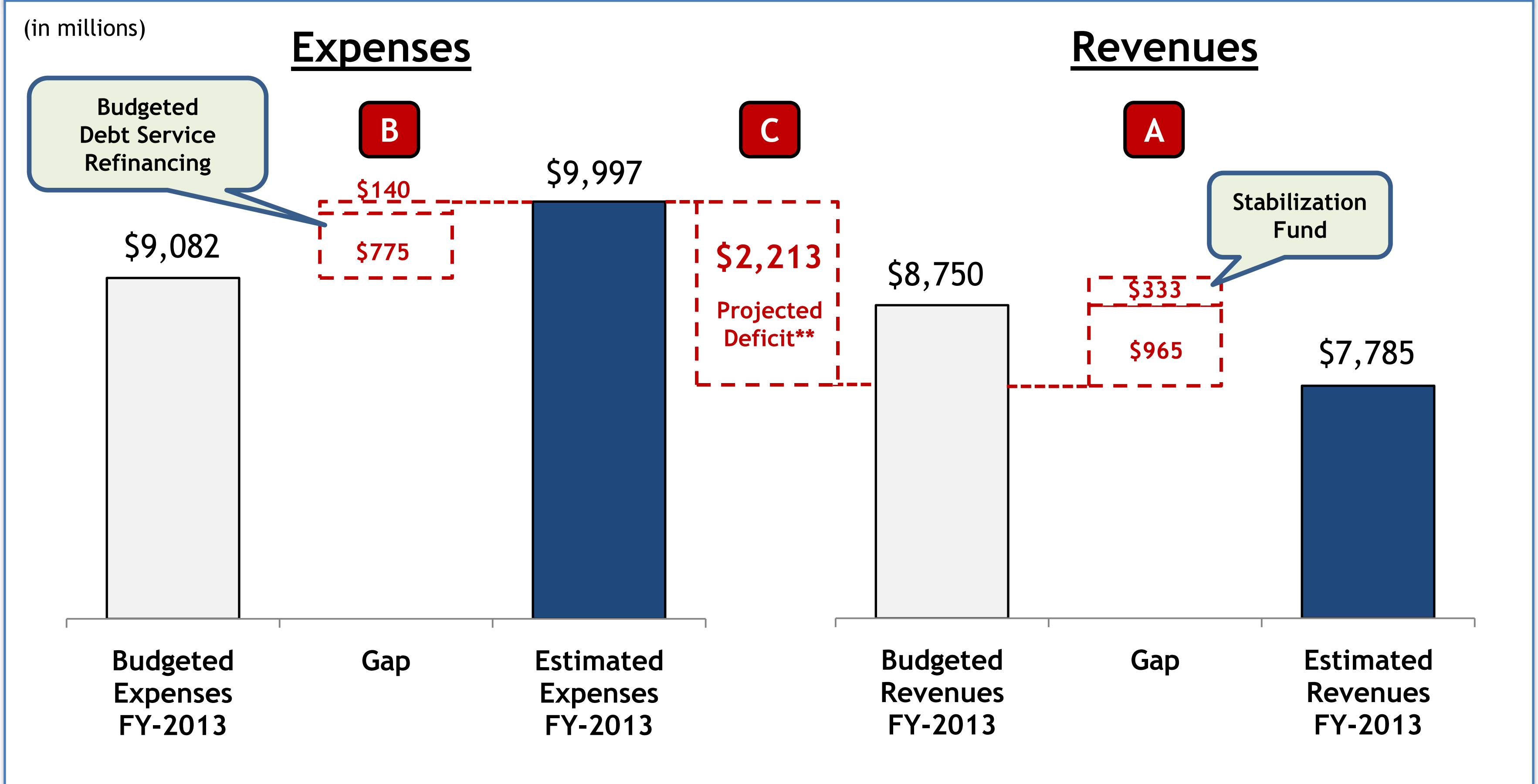
A

Fiscal Year 2013 Progress

As of January 31 projected deficit for end of FY 2013 amounted to $2.2 billion

FY 2013 Projected Budget - As of January 31, 2013



* All numbers are preliminary and unaudited based on revenues and expense projections as of January 2013.
** Does not include corrective measures implemented prior to January 31, 2013.

We have reduced our projected revenue shortfall for FY 2013 with targeted corrective measures

Remaining projected shortfall for FY 2013 assumes the following items:

- $333 million built-in original deficit financing*
- $775 million in debt service payments that are being paid from GDB lines of credit (intent is to "bond-out" with tax exempt refinancing)
- $50 million in excess spending**
- Non-recurring revenues of approximately $520 million related to the release of moneys from the swap collateral account of $240 million and advance payments by companies subject to the non-resident withholding tax of $280 million
- Recurring base revenues of $7.785 billion (base revenues for FY 2014)

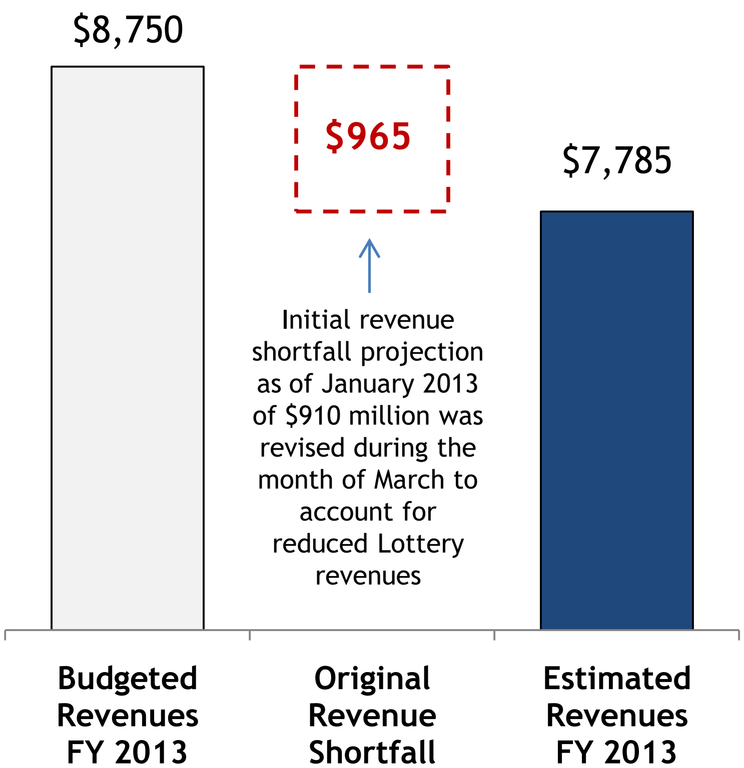
Projected Deficit for FY 2013 as of March 31 2013		
Built-in deficit financing	$333 million	Executed
DS Restructurings	$775 million	Executed
Budget excess spending	$50 million	Executed**
Remaining revenue shortfall	$445 million	Pending
Total projected deficit	**$1.602 billion**	

* On April 30, 2013, GDB closed a Bond Anticipation Note with a private bank for $333 million to be paid with future COFINA proceeds.
**OMB notes that this forecast could be further revised downward due to lower than budgeted spending, specially in January and February. However, since these were government transition months, OMB believes it is best to be conservative until further monthly closings occur.

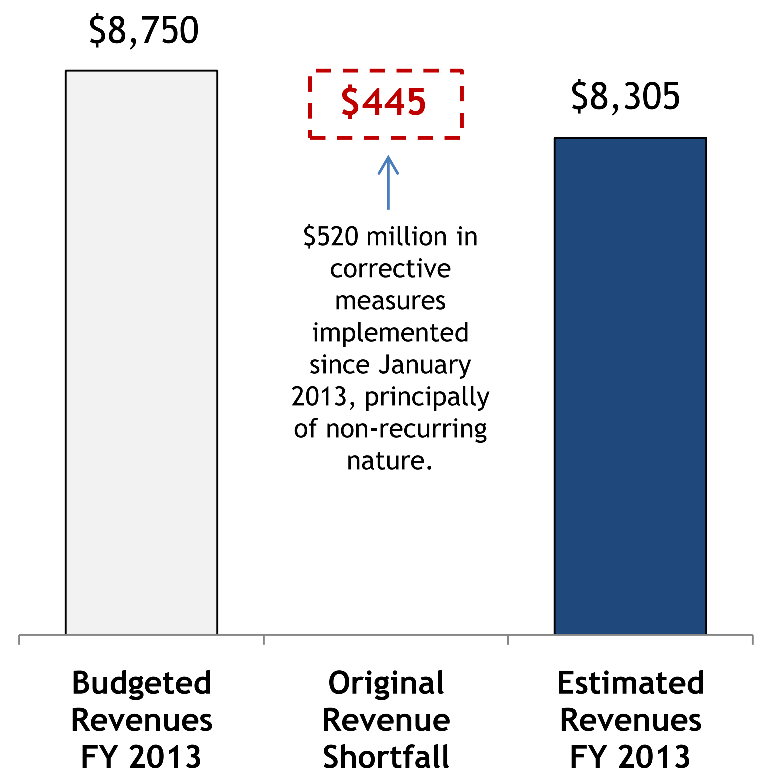
Fiscal Year 2013 projected revenue shortfall

Projected Revenue Shortfall* (in millions)

Projected Revenue Shortfall
(as of January 31, 2013)



Revised Projected Shortfall
(as of March 31, 2013)



*Preliminary numbers and subject to independent auditor's review.

Additional corrective measures to address remaining shortfall

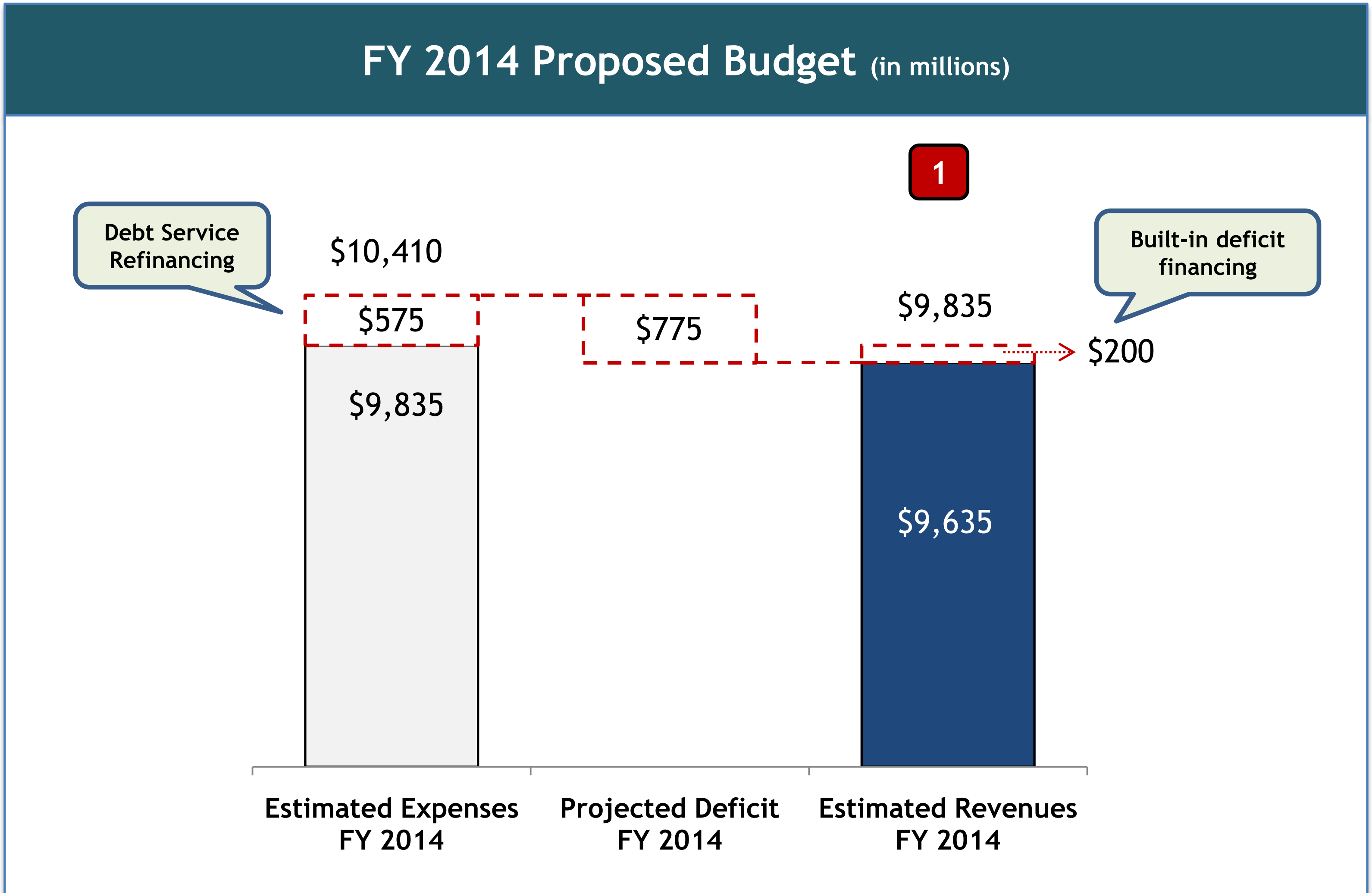
Remaining revenue shortfall = $445 million

1. Tax Amnesty	$200 M
2. Tax Liens	$5 M
3. Closing Agreements	$35 M
4. Law 154 audits	$12 M
5. Other pending initiatives - potential initiatives include sale of accounts receivable (existing and new) and other initiatives	$193 M
Total:	$445 M

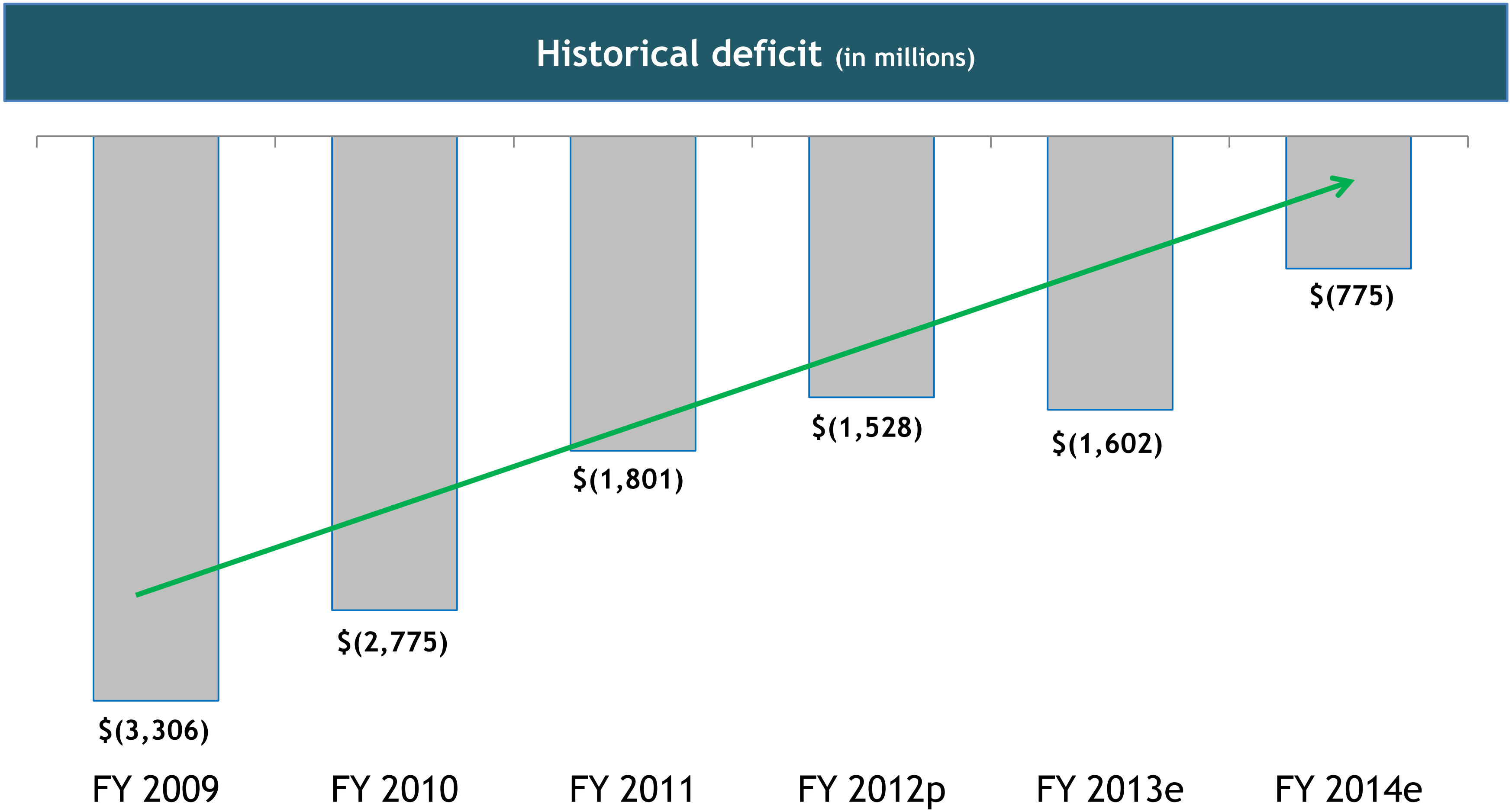
B

Fiscal Year 2014 Proposed Budget

FY 2014 General Fund Proposed Budget - Deficit Forecast



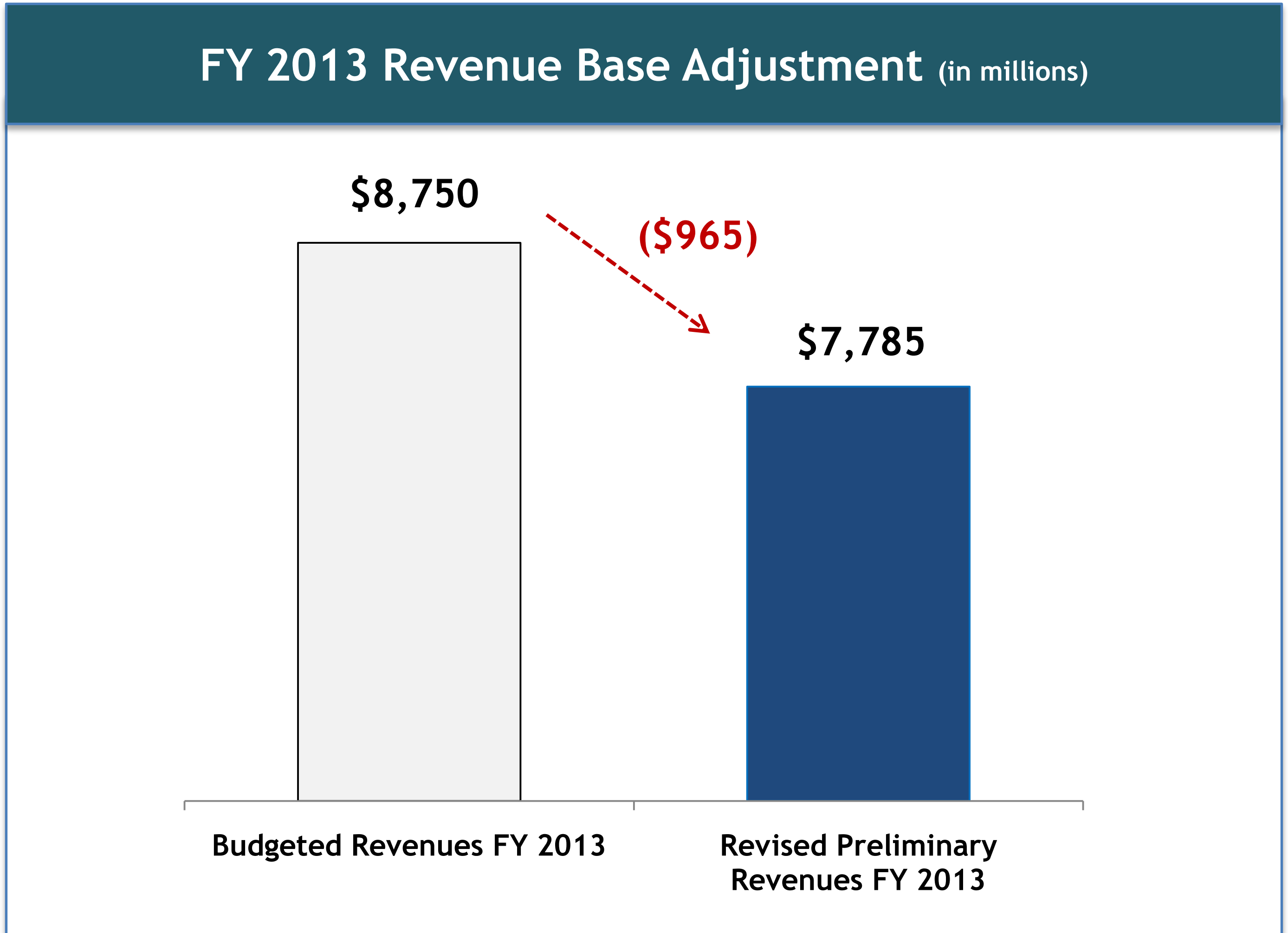
Puerto Rico has made significant progress to reduce the structural deficit



Source: “Commonwealth of Puerto Rico – Financial Information and Operating Data Report, dated May 17, 2013.” Debt restructuring for fiscal year 2014 is preliminary and subject to market conditions.
P: Preliminary unaudited numbers.
E: Estimated

FY 2014 PROJECTED GENERAL FUND REVENUES

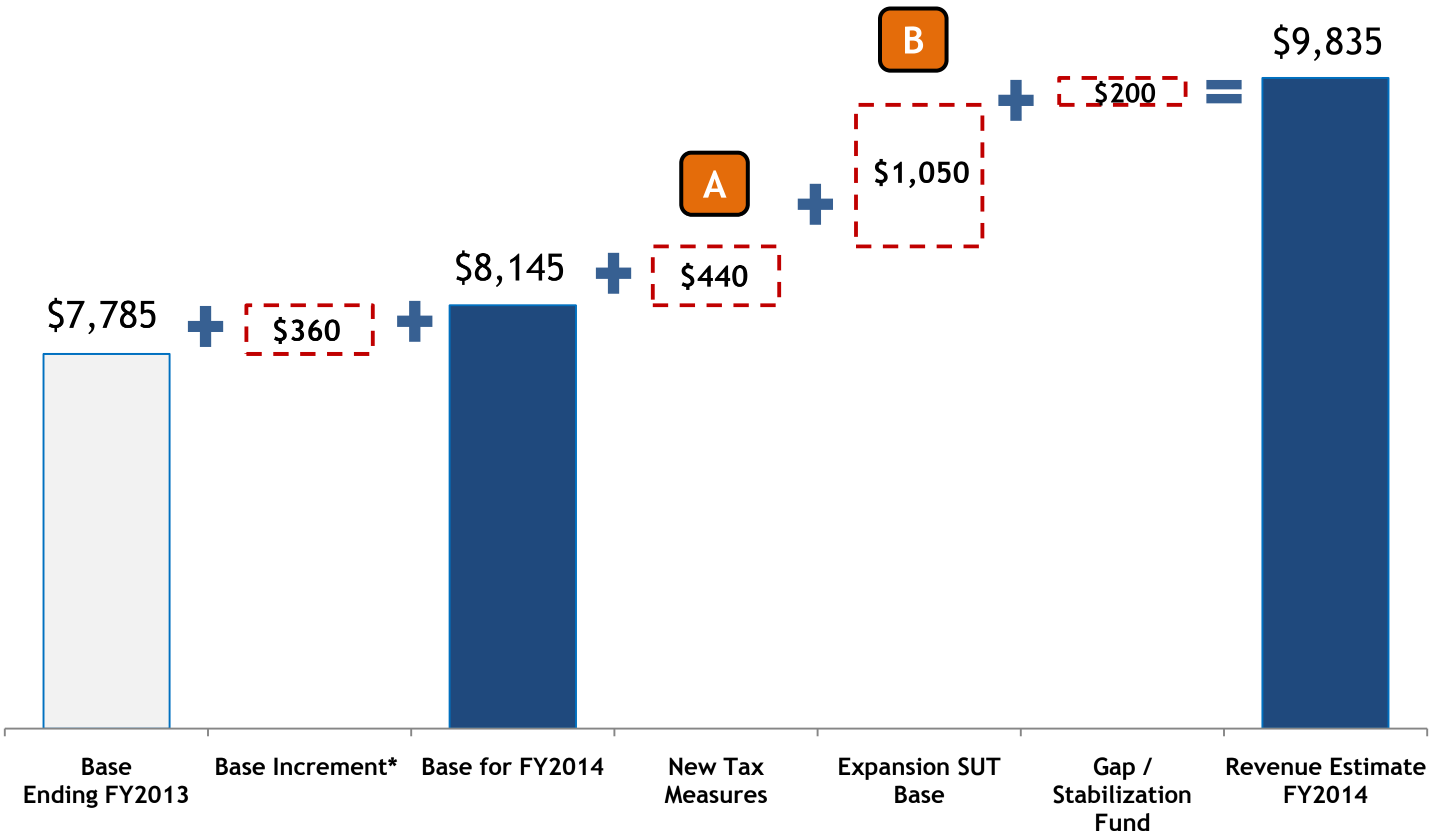
Projected revenue base for FY 2013 has been reduced by $965 million



<u>Continuing our responsible budgetary practices, reduced base revenues for FY 2014 will account for lower economic projections and non-recurring revenues in current year's budget</u>

1 FY 2014 General Fund Projected Revenues

Preliminary Revenue Projection for Fiscal Year 2014 (in millions)

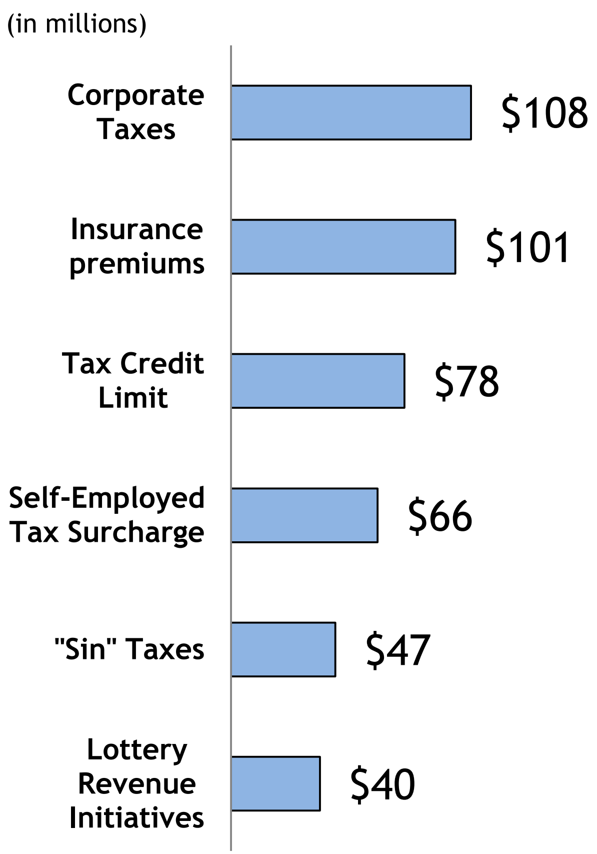


* Base increment is principally as a result of the amendment to Act 154. Also, economic growth projections reflect most recent revision by the PR Planning Board for FY 2014 (+0.2%).

A

Recommended budget for FY 2014 includes new tax measures expected to result in $440 million of additional revenues

New Tax Measures = $440 million*



Commentary

Measures include:

- Modified corporate AMT – Adjustment Net Operational Loss and Book-Tax Adjustment
- Tax on intercompany expenses in agreements with holding companies

- 1% tax on underwriting premiums

- Substantial amount of credits with questionable impact on economic growth legislated over time reduced by 50%

- 2% top-line tax on sole proprietorships and self employed professionals earning over $200,000
- Limit on mortgage interest deductions

- Increase excise tax on cigarettes
- Effect calculated net of demand elasticity

- Lottery revenue from certain initiatives (changes in modality)
- Effect of already repealed UPR scholarship extraction

* Numbers are preliminary estimates and subject to change.

B

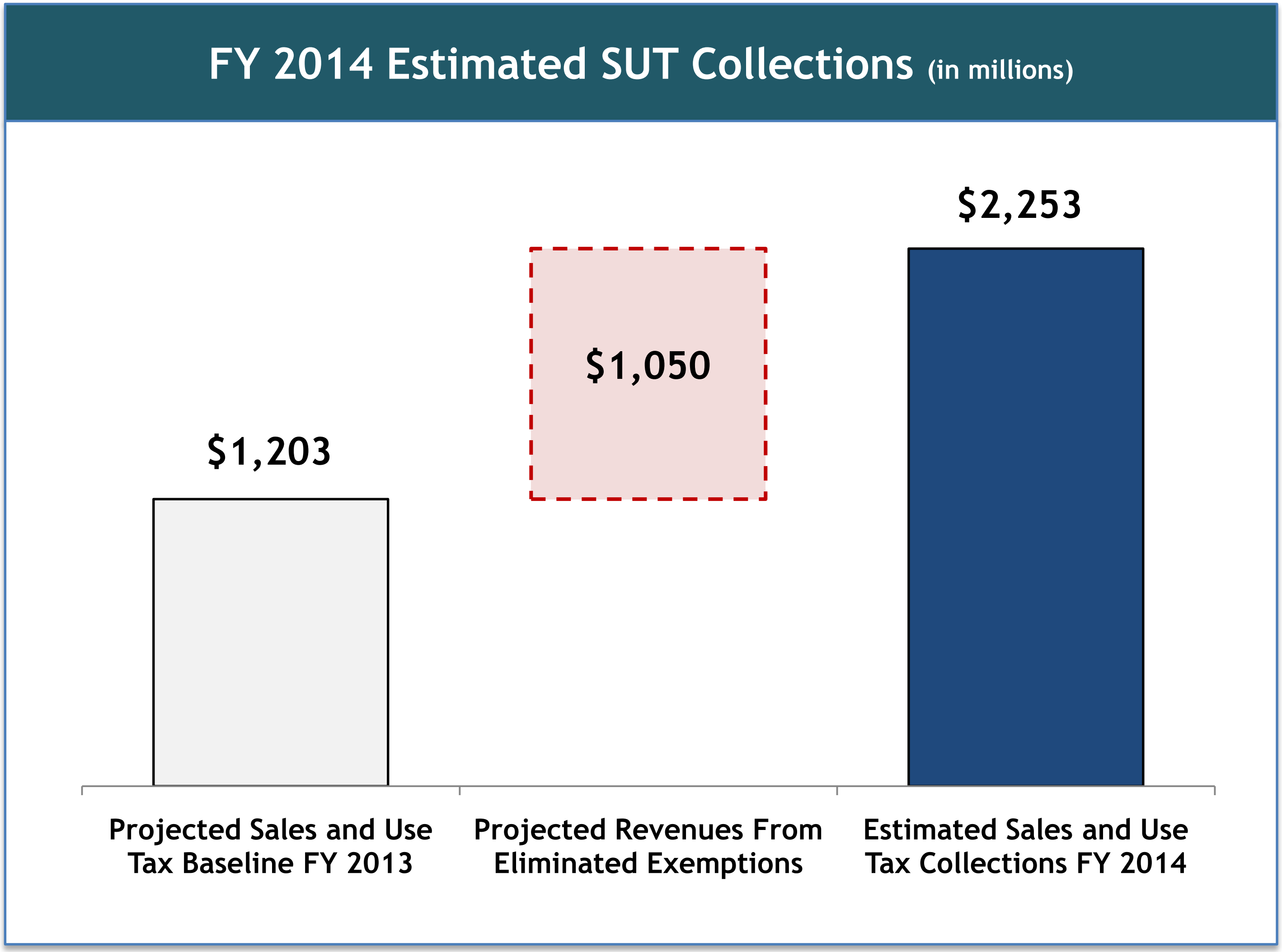
Expansion of Sales and Use Tax ("SUT") base principally relies on the inclusion of business-to-business services

Elimination of the following exemptions	
1. Business-to-Business services	$883 M
2. Business telephone services	$63 M
3. Purchases made by:	
• Credit unions	$16 M
• Universities	$7 M
• Hospitals	$7 M
• Hotels	$17 M
• Others	$7 M
5. Resellers' Exemption Certificate	$50 M
Total	**$1.05 B***

- A detailed study was conducted by a group of local economists to assess potential impact on consumer spending.
- According to the study, if additional tax revenues were passed through to consumers, a slight decline of 1% in current-dollar private consumption expenditures could be expected.
- Conversely, if all additional revenue arising from B2B were absorbed entirely by business units, then private consumption in current dollars would increase about 0.5% in fiscal year 2014.
- A sharp decline in consumption is not to be expected as the current economic recession is principally due to a persistent contraction in investment (especially construction), not to reduced consumption.
- In addition, Puerto Rico is not facing inflationary pressure at this time and taxing of B2B services should not materialize in significant increase in consumer prices.

* The study assumed a capture rate of 88% for highly regulated businesses such as commercial banks and telecommunication companies and a 68% rate for other businesses.

Estimated SUT collections could significantly expand current revenue base of $1.2 billion to over $2.0 billion

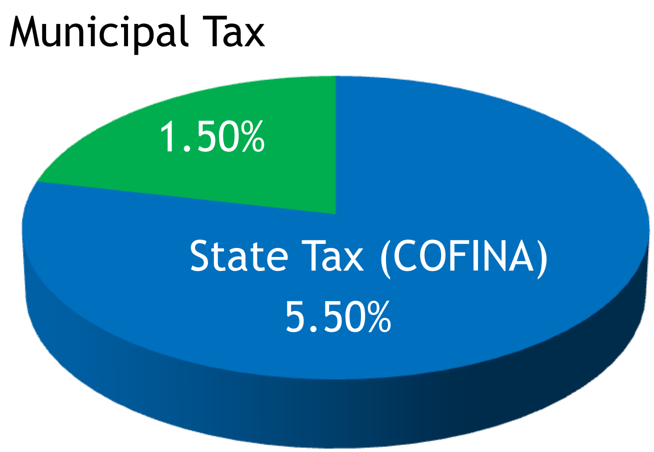


Governor's proposal to expand SUT base revenues will go together with a 0.5% reduction in the current rate after December 1, 2013

<u>Rate reduction will not affect COFINA bondholders</u>

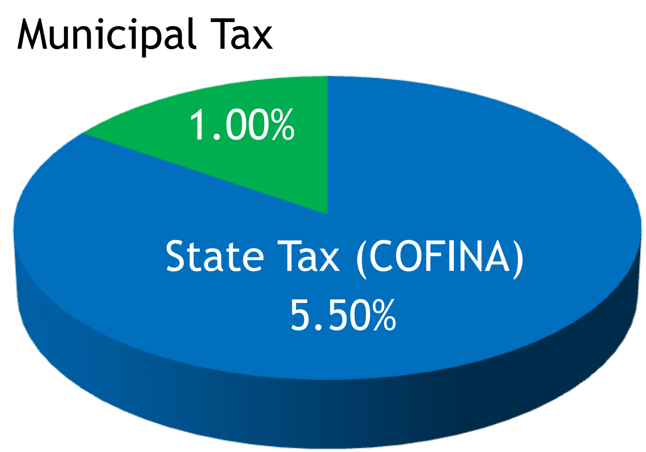
Current SUT allocation

SUT Rate: 7.0%



Proposed SUT allocation after December 1, 2013

SUT Rate: 6.5%



- 0.5% reduction on the 1.5% currently allocated to municipalities is not expected to affect their operations as elimination of exemptions will also increase their current revenue base.
- This measure is expected to result in net positive revenues for municipalities.

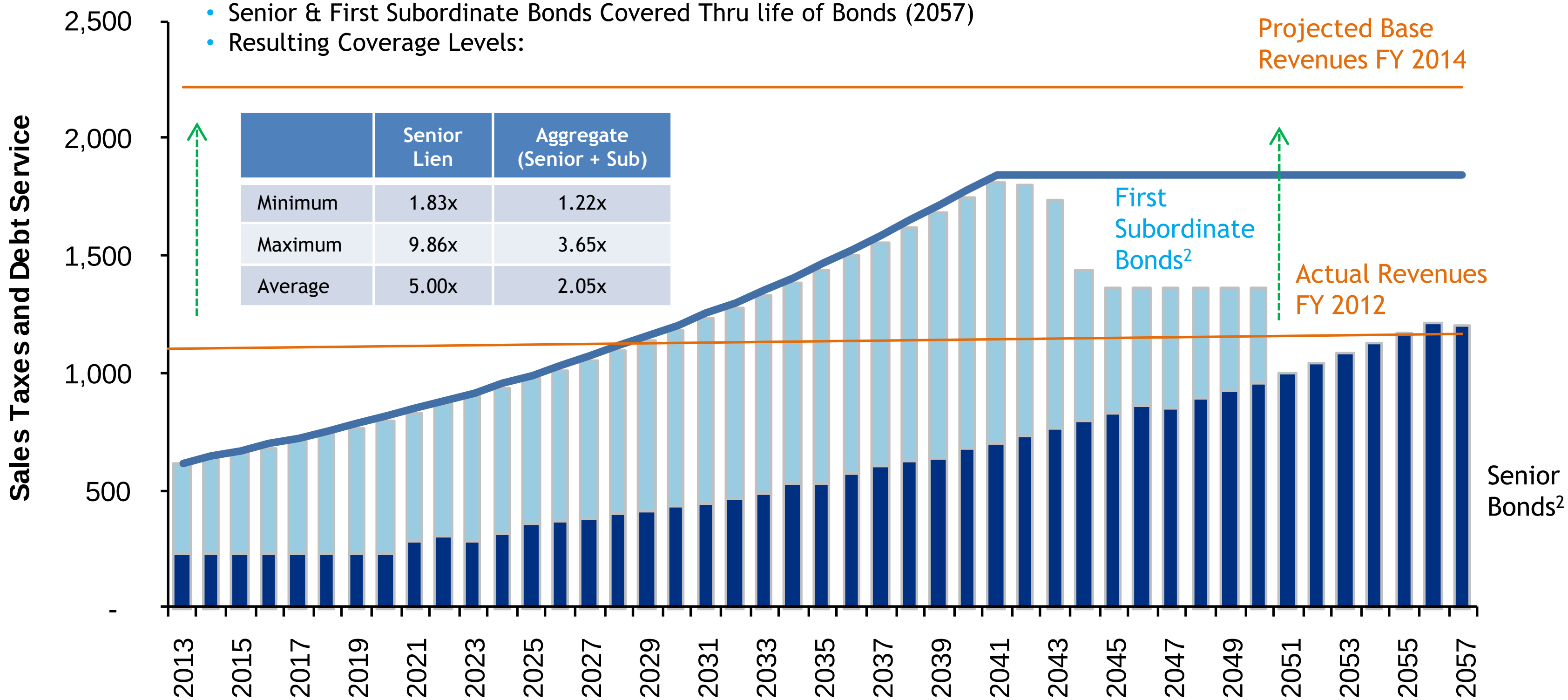
COFINA debt service coverage levels are expected to be enhanced with broadened SUT collections

Sales Tax Revenues and Debt Service[1]

With Current Base Revenues Plus Broadened SUT Collections ($2.216b):

- Additional $1.05b of SUT collections result in revenues greater than maximum Pledged Base Amount ($1.85b)
- Senior & First Subordinate Bonds Covered Thru life of Bonds (2057)
- Resulting Coverage Levels:

	Senior Lien	Aggregate (Senior + Sub)
Minimum	1.83x	1.22x
Maximum	9.86x	3.65x
Average	5.00x	2.05x



1 - Assumes Projected Base Revenues for FY 2013 of $1,166,939,000; Assumes broadened SUT collections result in additional revenues of $1.05 billion

2 - Assumes Actual Senior Bond Debt Service and First Subordinate Bond Debt Service

ENFORCEMENT MEASURES

SUT Collection Automation Initiative

- Treasury is working with the Puerto Rico Bankers Association, all the banks in Puerto Rico, processors of credit and debit cards and other related parties to develop this initiative.
- The initiative will collect SUT directly from points of sale ("POS") transactions during daily settlement process, thus increasing the SUT capture rate while decreasing evasion and fraud.
- It will also establish a strategic alliance between key players to further strengthen the SUT collection process and will improve cash sales monitoring processes based on the same technology.

Our goal is to transform our current "voluntary remittance" state to an automatic remittance process at the POS

Tax Compliance Division

- Achievements:
  - Currently, the Tax Crimes Division has over 200 active investigations.
  - More than 30 cases have already been referred to the Department of Justice, while 50 additional are expected to be referred soon.
  - There are well over 120 cases that are in the beginning of the investigative process, for we expect them to be concluded within the next few months.
  - Within the past two months, Treasury has began investigating more than 50 new cases.

Merger between bureaus in order to increase efficiency and effectiveness:

Consumer Tax Bureau (“CTB”)

Responsible for managing the necessary processes to carry out the imposition of excise and sales and use tax

Alcoholic Beverages & Licenses Bureau (“ABL”)

Responsible for managing procedures and inspection activities as needed to maintain control and supervision of alcohol, licenses and adult entertainment machines

Consumer Tax Bureau (“CTB”)

Integrated efforts will strengthen SUT compliance and collection efforts

- ✓ Unified task force agents
- ✓ Uniform approach regarding fines
- ✓ CTB and ABL able to investigate both SUT & ABL compliance regulations

Prospective Initiatives for FY 2014

1. **Interphase with PRITAS on tablets**
   Last year, fiscal agents were provided with a tablets to perform their audits. We continued to enhance and expand the data information that is accessible by providing access to Treasury's tax system (PRITAS). They will be able to obtain information such as filling compliance record, payment records, map localization and registration information, among others of each active merchant.

2. **Integration of different databases**
   Enhance integration with Municipalities in order to compare volume of sales reported by merchants.

3. **Collections of IVU at source**
   This initiative will increase revenue and daily cash flow, eliminate POS Sales Tax retention, evasion and fraud, generate up-to-date control and ease POS Sales Tax reporting

4. **Improve Use Tax enforcement**
   Treasury Department initiated a procedure with Federal Agencies to obtain data related to air cargo shipped to PR from all sources

5. **Standardization of Procedures and Guidelines**
   Publication of New SUT Guidelines regarding fines and the use of technology

Other initiatives to tackle SUT evasion

Most common SUT Evasion Schemes

Non Filers but active in SUT Lotto

Automatic **Notification for Filing** SUT returns is sent to the withholding agent

Filers and active in SUT Lotto but not reporting correct amount of sales

Automatic **Deficiency Notification** is sent to the withholding agent

Filers and active in SUT Lotto but not reporting correct amount of sales

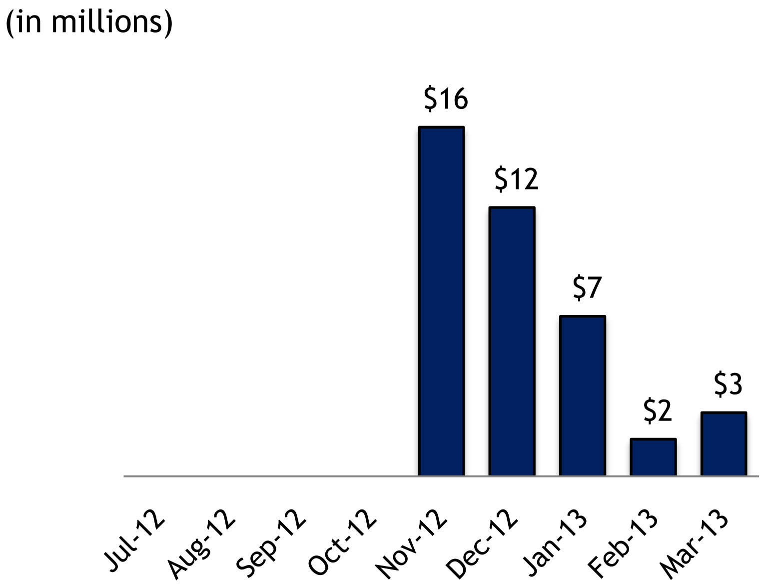
Automatic **Payment Requisition Notification** is sent to the withholding agent

- ✓ We have identified **205,912** unfiled monthly returns
- ✓ Which we have sent notices to 60,561 merchants and retailers
- ✓ Of which **42,148** had responded to the notices
- ✓ 65,578 unfiled returns were filed resulting in taxable sales reported of approximately **$218MM and SUT collections of $4.9MM**

As of April 2013 these initiatives have resulted in $16M additional revenues and we project additional compliance to result in $50-$80M during FY 2014

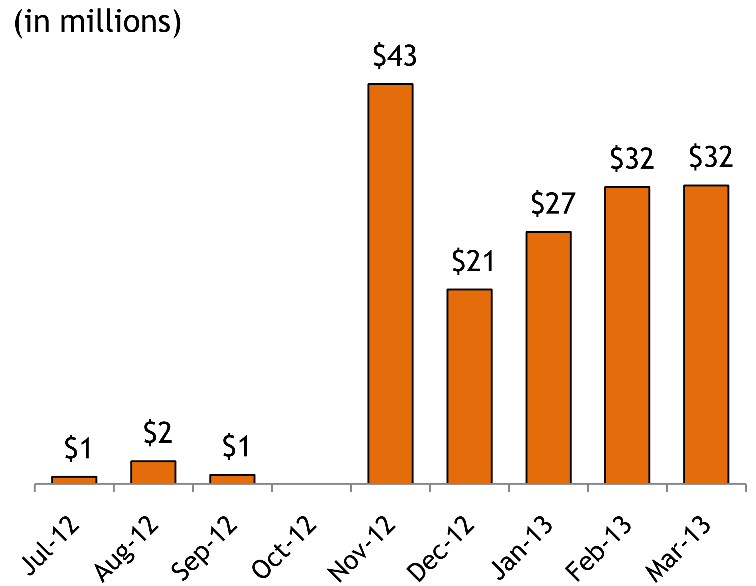
Bank accounts' liens program

Sales and Use Tax



SUT amount of tax liens as of
March 31, 2013 is **$40.3 million**

Other taxes



Other taxes bank account liens as of
March 31, 2013 is **$161 million**

This program has resulted in over $40.3 million bank account liens as of March 31, 2013, from which $8.2 million has been collected.

An additional $2.7 million has been agreed to be paid through payment plans.

New initiatives as part of the reorganization of the Tax Audit Bureau

Recruiting
Treasury understands the need to increase human capital to intensify tax examinations and enforcement efforts. Therefore, during FY 2013-2014 we will hire 41 additional auditors (an increase of 50%).

Mentorship Program
The program will hire experienced tax auditors in order to help in the development of less experienced supervisors.

Training and Development Program
To enhance auditors' skills on the understanding of the changes in the PRIRC.

Increase Information Technology Tools
Additional tools in order to aid in the tax examination process, help supervise and monitor the amount of time incurred in each tax examination and to implement the electronic tax file and data management.

Exchange of information with local agencies and federal government
Expand the processes of information sharing in order to support tax examinations, which involves the use of circumstantial evidence to determine the tax liability based on omitted income and overstated expenses.

Reorganization will allow the development of key initiatives to address tax compliance

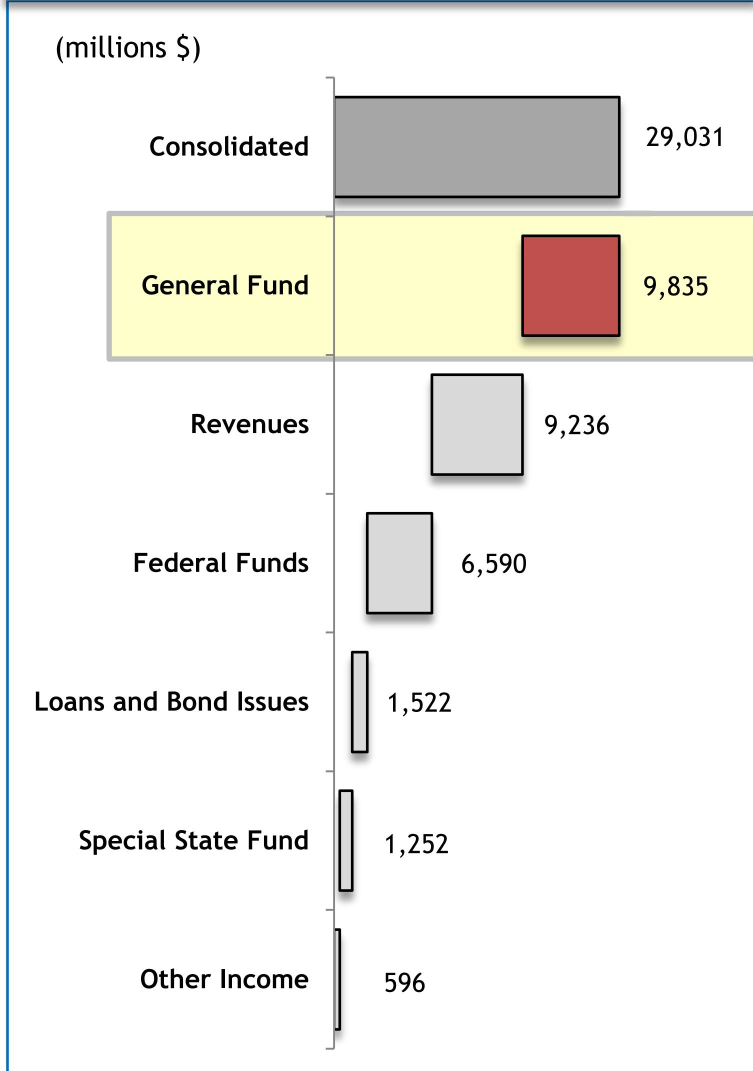
New audit project initiatives

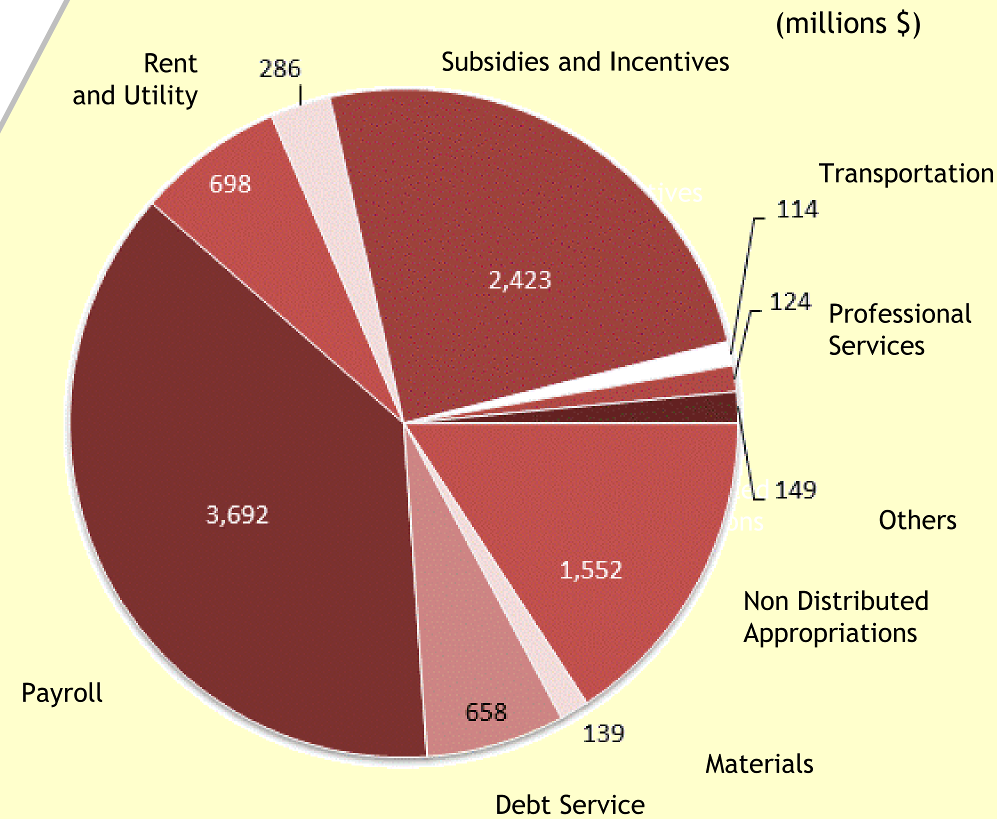
Voluntary Disclosure	Taxpayers that initiated the process but did not complete it (no payment issued)
Equity and Distributions	Compliance of withholding at source provisions as well as taxation on deemed dividends distributions from foreign corporations
Payroll	Identify businesses that deduct salary expenses but are not complying with quarterly returns
Focused Audits	Identify tax avoidance transactions to ensure compliance with the corresponding tax obligation

FY 2014 PROJECTED GENERAL FUND EXPENSES

Recommended Consolidated Budget FY 2014

Consolidated FY 2014 Budget

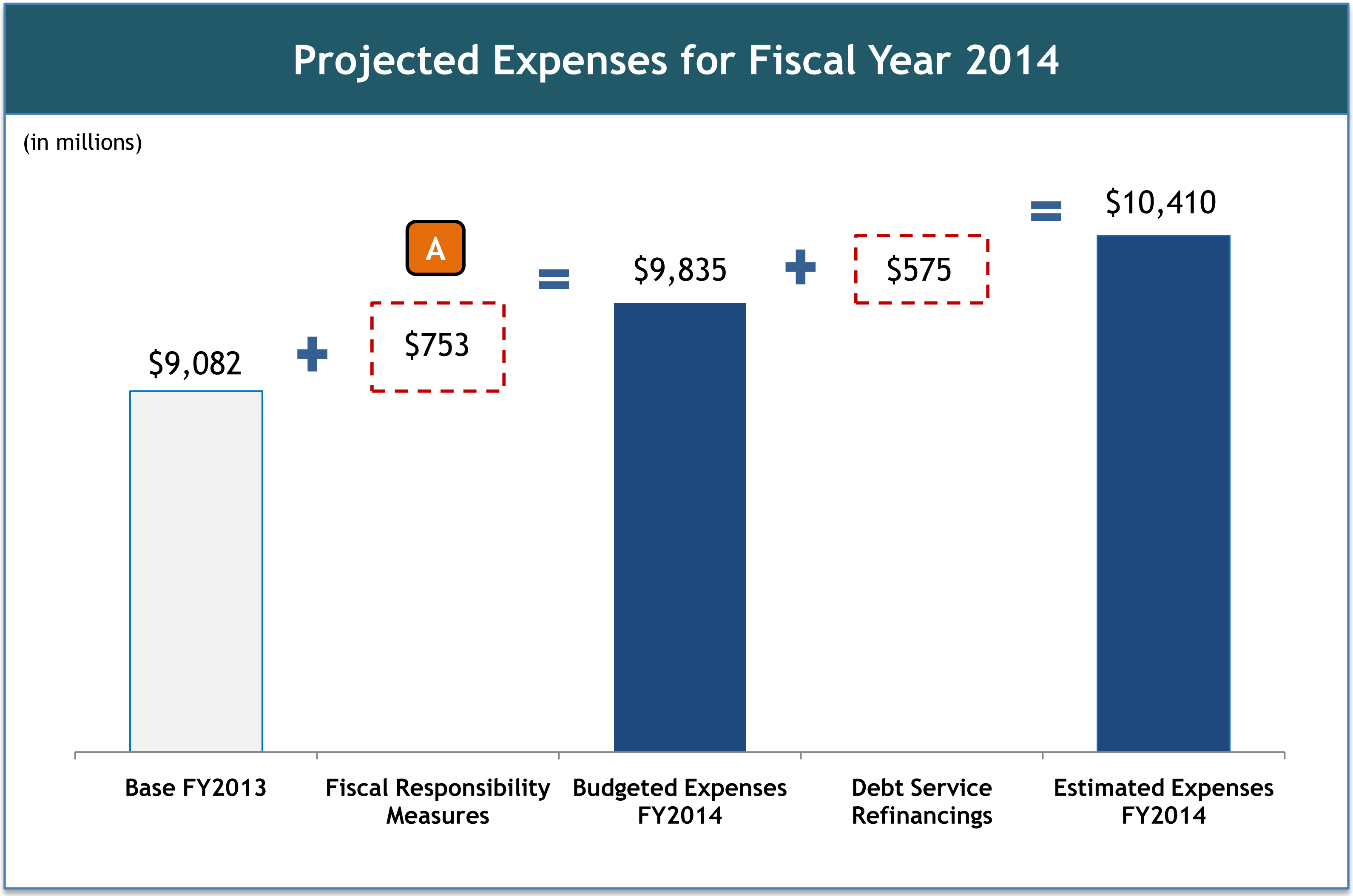




General Fund - $9.835 billion

Payroll	38%	Subsidies and Incentives	25%	Non Distributed Appropriations	16%
Rent and Utility	7%	Debt Service	7%	Purchased Services	3%

FY 2014 General Fund budget expenses reflect an increase of $753 million, entirely allocated to fiscal responsibility measures



A Increases in budget expenses are related to responsible measures to address our retirement system and payment of our GO debt

Increases from Fiscal Year 2013 Budget amount to $753 million:

Category	Increase	Detail	Amount
Retirement System Contributions	+ $245 million	Early retirement incentives Act 70	$29 MM
		Act 3 of 2013	$140 MM
		Teacher's pension reform	$30 MM
		Scheduled Increases in Employer Contributions (under Act 116 of 2011)	$46 MM
Additional GO and PBA Debt Service Payments	+ $297 million	Public Buildings Authority	$171 MM
		General Obligations	$34 MM
		TRANs	$14 MM
		Other debt with GDB	$78 MM
Other Increases	+ $211 million	UPR Formula and other non-discretionary*	$103 MM
		Department of Education	$121 MM
		Net other operating expenses	$(13) MM

* 9.6% of average revenues from previous two fiscal years (2012-2013).

Distribution of General Fund Expenses by Type

General Fund Expenses – FY 2014 Budget

Non-Discretionary and Semi-Discretionary

$4,429M

45%

- UPR Formula: $834M
- GDB Debt: $267M
- Judicial Formula: $343M
- Other Debt: $564M (1)
- Municipalities Formula: $363M
- PBA Rent Payments: $213M (1)
- Contributions to Retirement Systems: $734M
- Subsidies to Public Corporations: $92M
- Health Insurance Entitlement: $900M
- Legislative Assembly Budget: $119M

Discretionary

$5,406 M

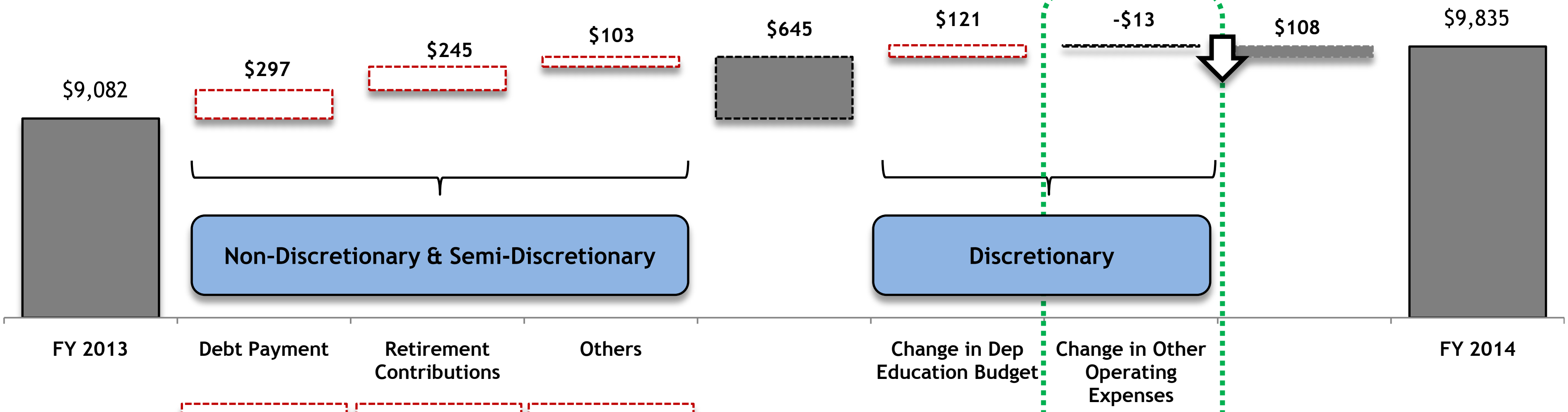
55%

- Special Appropriations: $464M
- Agency Operating Expenses (2): $2,169M
- Contributions to Municipalities & Legislature: $70M
- Agency Payroll: $2,703M

(1) PBA Rent Payment increase due to assumption of full debt payment reclassified as Other Debt
(2) Agency Operating Expenses includes payment to public corporations for utilities (water and electricity) for approximately $210 million

Changes in General Fund Budget FY 2014 by Type of Expense

Change in Recommended General Fund Budget (in millions)



Debt Payment	Retirement Contributions	Others	Change in Dep Education Budget	Change in Other Operating Expenses
+$205M GO & PBA Debt	+$46M Additional 1% Payroll	+$77M UPR Formula		
+$30M GDB Debt	+$140M ERS Additional Contribution	+$18M Health Insurance Plan	+$32M Payroll	-$15M Payroll
+$62M Other Debt	+$30M TRS Additional Contribution	+$3M Subsidies to Public Corps.	+$89M Operating Expenses	-$13M Operating Expenses
	+$37M Act 70-11 New Annuities	+$5M PBA Rent	Need to Replace $105M in Non General Fund Sources for FY13	+$15M Contribution to Others
	-$8M Other Special Laws			

Adjustments in Other Operating Expenses for FY 2014 Budget (Net: -$13M)

	+ +$200M (Increments)	- -$213M (Reductions)
Payroll	**+$110M** • Already-Signed Collective Bargaining Agreements (Phased In) • Payment of ½ of excess sick leave (per agency requests) • Additional hires (Corrections lawsuit) • Deficiencies from layoffs and early retirement windows • New initiatives and programmatic commitments	• Adjustment for actual early retirees (Act 70) during FY13 in excess of budgeted retirees • Adjustment for estimated unusual retirement pattern from enactment of Act 3-2013 • Reduction of political appointee payroll • Adjustment due to current year surplus forecast **-$125M**
Operating Expenses	**+$41M** • Restitution of deficiencies in operating expense budget (particularly program expansions with ARRA funds) • New initiatives and programmatic commitments • Increase in utility payments (power and water)	• Reduction in professional services contracting • Adjustments for utilization of special state funds • Adjustment due to current year surplus forecast **-$54M**
Contributions to Others	**+$49M** • Net effect of assignments under OMB custody • Assignments under the custody includes $58M reserves for replacement of employees or payment of liquidation	• Net appropriations to agencies for programs for new initiatives • Net contributions to Municipalities, Legislature and Others **-$34M**

Other Non-General Fund State Appropriations

Budgetary Support Fund

Uses:	$96.5M
• Claims and Lawsuits	$56.0M
• Programs	$16.0M
• One Time Projects	$12.8M
• Improvements and Works	$11.7M

Sources:	$96.5M
• Printed material fund	$1.0M
• Real estate licensing board funds	$3.0M
• Medical licensing fund	$3.2M
• Post secondary fee collections fund	$3.5M
• Compensation funds for victims of crime	$4.8M
• Licensing and promoting use of weapons fund	$6.0M
• Casinos licensing fund	$15.0M
• Department of Education fund	$20.0M
• Contribution of State Insurance Fund	$40.0M

Science and Technology Fund

Uses: $100.0M

- Development of priority infrastructure projects of science and technology, including Comprehensive Cancer Center: $80.0M
- Municipal Development Fund: $20.0M

Sources: $100.0M

- Special tax of 50% on extraordinary dividend payable by Joint Subscription Association (mandatory car insurance)

- **Match as best as possible non-recurring uses - especially lawsuit payment, improvements, and one time projects - to extraction of excess balances. In FY12 and FY13 structural lawsuits were covered by GDB $150M LOC.**
- **Special State Funds with history of profitability and low turnover were selected.**
- **Where possible, also pair programmatic aims, for example, weapons fund with equipment purchases.**
- **Amount smaller than lower-than-usual recent public improvement funds bond issuances in the ~$300M range.**

Long Term Initiatives to Reduce Expenses by Improving Cost Efficiency

Financial Intelligence

- Cover all central agencies including major cost centers (Dep. Education and Dep. Health)
- Improve expense classification and tracking
- Provide information in real time across all origins (Federal Funds; Special Funds)
- Authenticate expenses and personnel transactions
- Add actionable metrics and business intelligence

Federal Funds Management

- Procure new funding sources and avoid loss of opportunities due to non-utilization or non-compliance
- Strengthen capability building, procurement, and financial management with un-organic efforts importing best practices
- Create strong centralized federal funds office at the OMB

Technology

- Public policy to create CIO as a separate entity with substantially enhanced resources
- Focus on using public databases and APIs to foster economic development
- Continue to expand on pr.gov initiative for e-government

Government Re-Engineering

- Improve cost efficiency across government function types (real estate, fleet management, purchasing, utilities, et cet)
- Engage in medium term re-engineering effort at major agencies in order to import best practices
- Re-organize major agency clusters (Centro Médico, Collective Transports)

General Fund Budget for FY2014

- Much of the budget is pre-committed to debt service, retirement contributions, appropriation formulas, and other non-discretionary or semi-discretionary expenses.

- The great majority of the General Fund budget increase is due to increases in debt service, contributions to retirement systems, restitution of the UPR formula basis, and restoration of carry-forward non-GF reserves that were funding FY13 expenses for the Department of Education.

- The rest of the General Fund budget registers a slight decrease. Essentially, pre-existing labor commitments, especially collective bargaining agreements and sick leave liquidations, are budgeted to be funded by austerity cuts in services, and by diminishing headcount from early retirees. Certain additional non-General Fund appropriations are being funded by calibrated capital extraction measures, aiming as much as possible to match one-time expenses with one-time funds.

- OMB is committed, not just to short-term follow up and transactional review, but also to long term improvements in government efficiency, technology, and funds management. After recent rapid headcount reductions, the focus in the medium term has to be in an efficient, smart and effective government.

Agenda

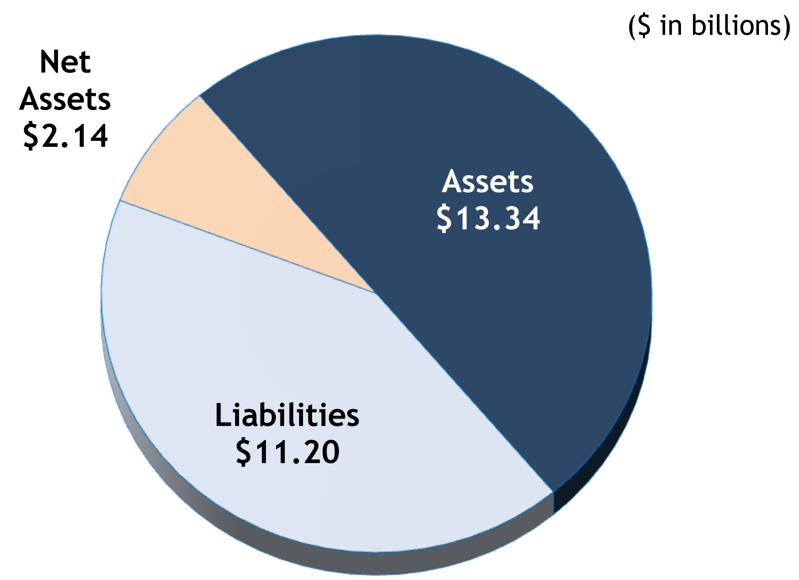
1. Recent Achievements
2. Fixing our Retirement System (Act 3 of 2013)
3. General Fund Budget
4. **Government Development Bank**
5. Concluding Remarks

GDB promotes fiscal stability and economic development through four primary roles:

1	Lending Institution	Structures and approves all permanent financing and provides interim and permanent lending together with private financial institutions to government entities.
2	Fiscal Agent	Oversees the credit and financial management of the Government, its agencies and public corporations.
3	Financial Advisor	Manages all Government, its agencies, municipalities and public corporations financings and capital market activities.
4	Economic Development	Promotes investment in strategic projects to fuel economic development and growth.

Our balance sheet enables GDB to support government entities and key private sector initiatives

Key Financial Highlights - GDB Bank Only*



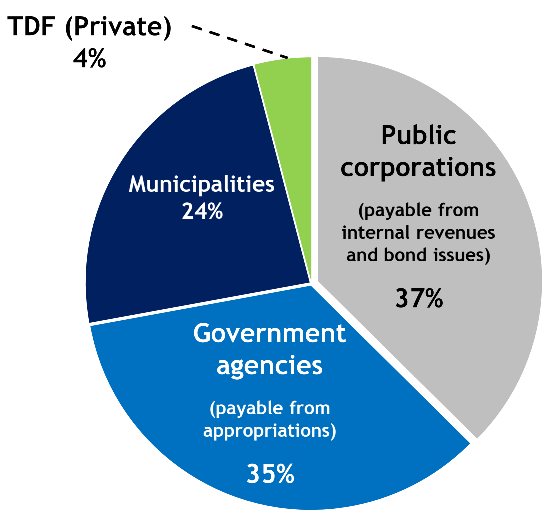
Loans, net:	$9.1 B
Capital Ratio:	16.0%
Rating:	BBB- (Negative Outlook)

* GDB serves a multi-purpose economic development mandate through the direct oversight of 5 subsidiaries. "GDB Bank Only" information refers only to the bank's operating activities, excluding subsidiaries and other component units. Unaudited and preliminary financial information as of March 31, 2013.

Management strategy is focused on reducing our loan portfolio

Loan Portfolio Composition

March 31, 2013*



- **Highways and Transportation Authority**:
  - $2.2 billion in loans outstanding
  - Legislation to increase HTA's revenues in order to repay GDB loans
- **Ports Authority**
  - P3 airport transaction reduced GDB's exposure to $448 million**
- **General Obligations**:
  - $600 million in GO lines of credit for debt restructuring (June2013)
  - $175 million in PBA lines of credit for debt restructuring (June 2013)
- **Municipalities**:
  - $2.165 billion in loans outstanding to municipalities, expected to be reduced through MFA bond issue.

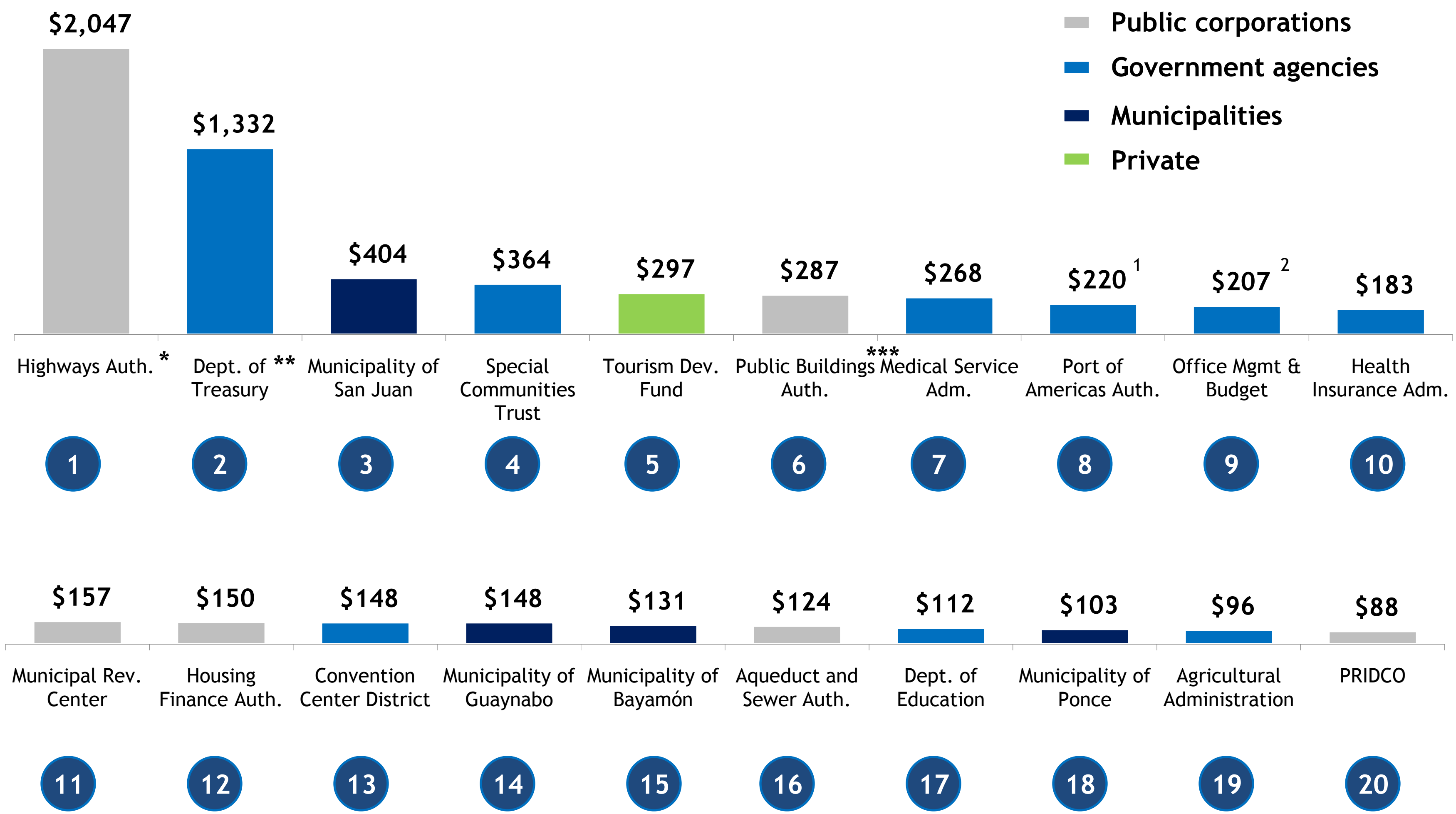
Net loans: $9.1 B

Target loan portfolio level for FY 2014: **$6.0 - 7.0 billion**

* Unaudited and preliminary financial information. ** Includes LOC support for $406.8 million in outstanding PRIFA bonds and $44 million in special infrastructure project loan

Twenty largest borrowers comprise approximately 75% of the loan portfolio or $6.9 billion

Top 20 borrowers as of March 31, 2013 (in millions)

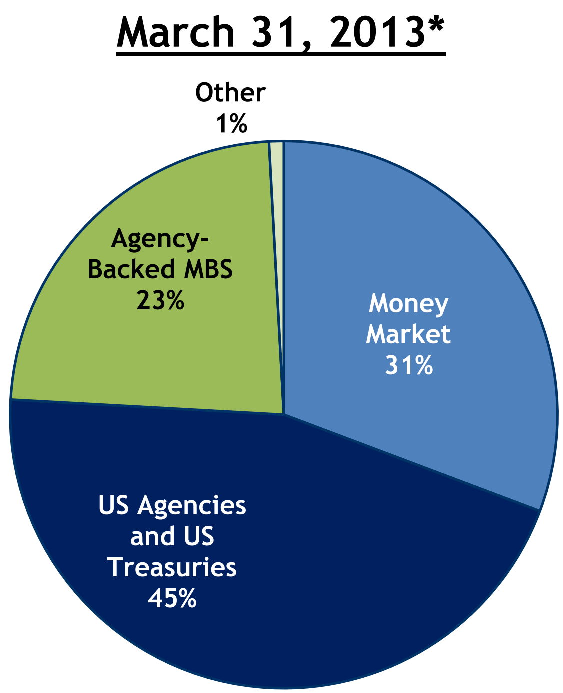


[1] GO guarantee.
[2] Emergency fund / Law 70

* Excludes accrued interest of approximately $120 million.
** Includes $450.4 million currently being used for a portion of GO debt service payments to provide budgetary relief. Repayment is expected upon refunding bond transactions in FY2014. *** Included $131.1 million being used for a portion of PBA debt service payments.

Investment portfolio remains a significant part of our balance sheet

Investment Portfolio Composition



Total: $3.6 B

Investments' Commentary

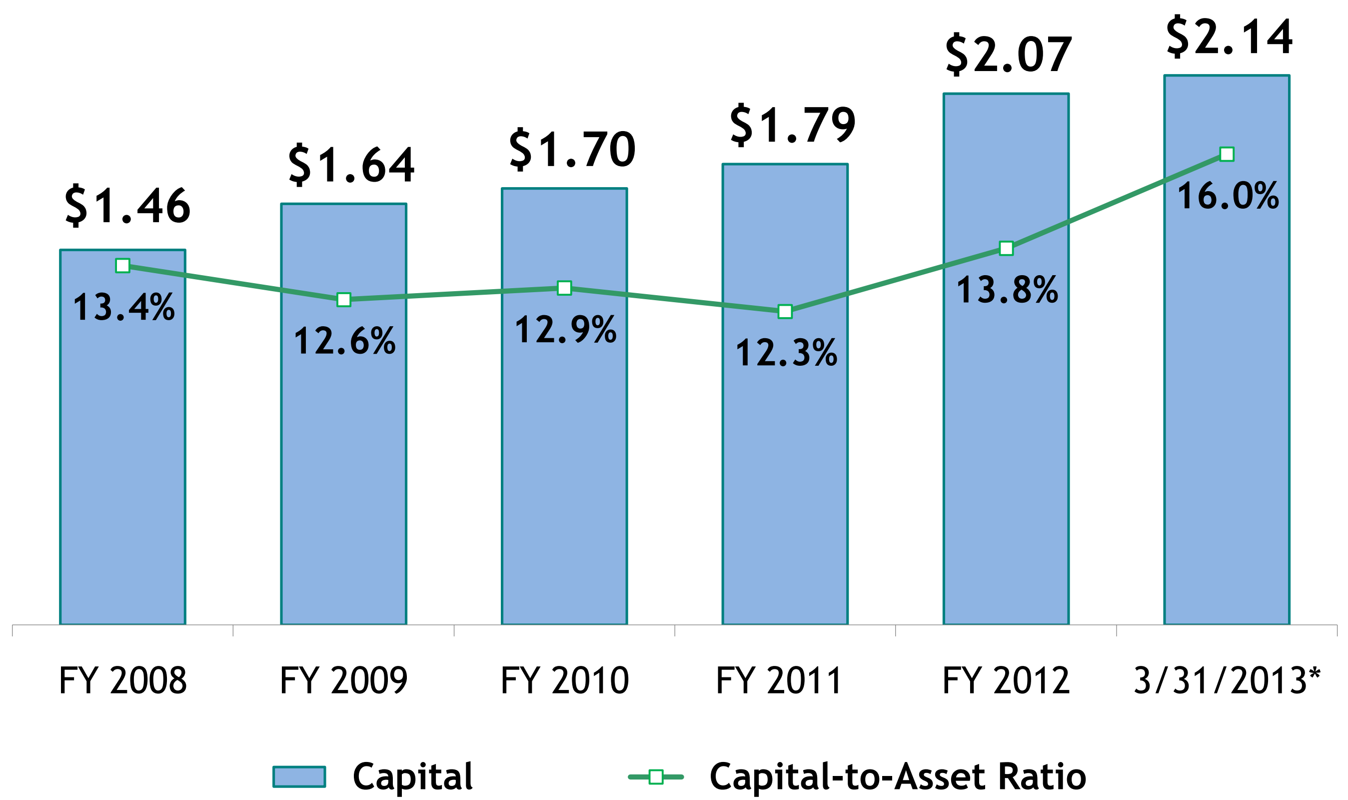
- Money Market includes certificates of deposit, time deposits, short-term investments, reverse repo agreements, and money market funds
- Other investments include mainly US municipal bonds and corporate bonds
- High-grade investment portfolio (85% > A)
- Portfolio average life of 2.25 years
- Liquid securities available for financings thru REPOs

* Unaudited and preliminary financial information.

Our capital base has been growing moderately, reflecting a capital-to-asset ratio of 16.0% as of March 31, 2013

Capital and Capital Ratio (Bank only)

($ in billions)



* Unaudited and preliminary financial information.

Projected Transaction Calendar

Projected Calendar for 2013 and 2014*

Before December 31, 2013

Highways and Trans. Auth. (HTA)

GDB L/C's (Take-out) - $TBD (103)
GDB L/C's (Take-out) - $TBD (Taxable)
Refunding and CIP - $TBD (103)

General Obligation (GO)

Restructuring FY2013 - $600M (103)

Public Building Authority (PBA)

Restructuring/Take-out – $175M (103)

Ports Authority (PRIFA bonds)

Remarketing - $400M (103)

After December 31, 2013

General Obligation (GO)

Restructuring FY2014 - $575M (103)
VRDBs Refunding - $460M (103)

Municipal Finance Agency (MFA)

Refunding for savings – $TBD MM (103)
New Money (Repay GDB loans) - $TBD (103)

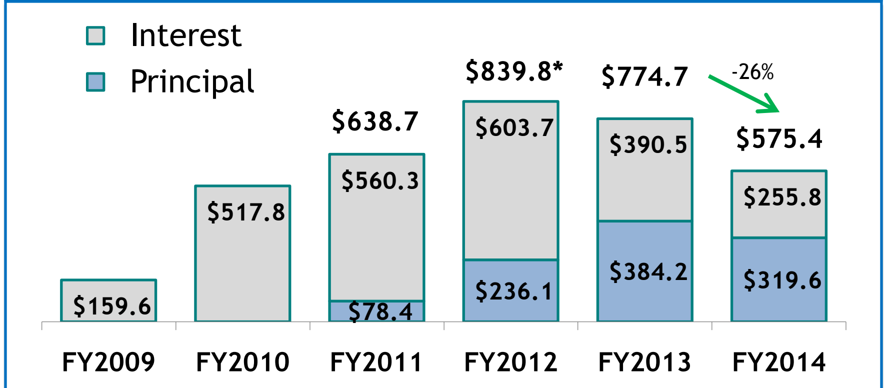
Sales Tax Financing Corp. (COFINA)

BANs Take-out – $333M (103)
Refunding for savings - $TBD (103)
Refunding for savings - $TBD (Local)

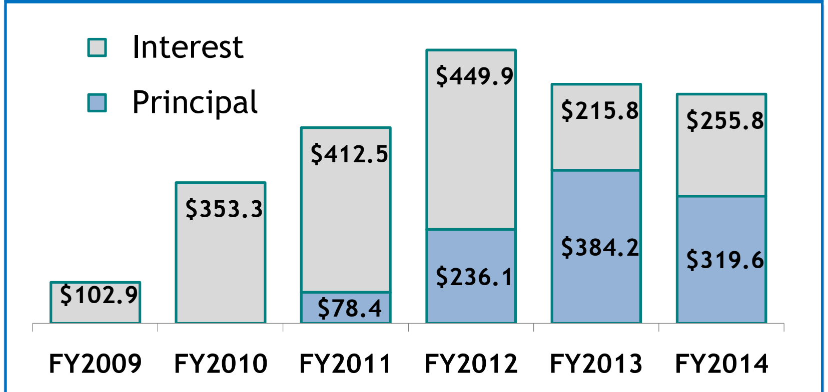
* Calendar is preliminary and subject to change without prior notice, including as a result of market and general economic conditions.

We will continue to phase out of the practice of restructuring GO and PBA debt service payments for budgetary relief

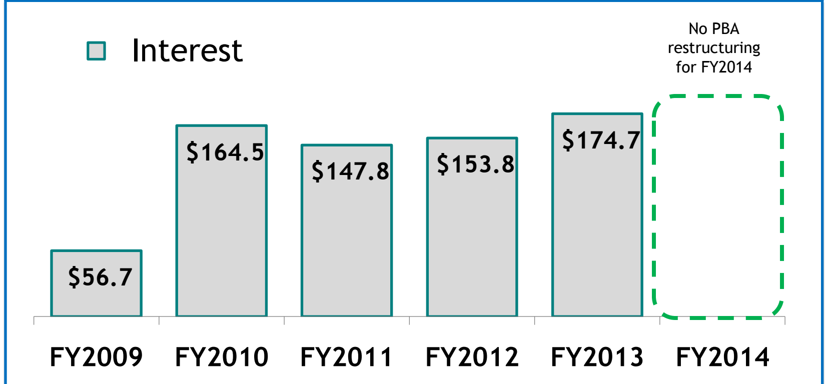
Total Debt Service Restructuring (in millions)



GO Debt Service Restructuring (in millions)



PBA Debt Service Restructuring (in millions)



- General Fund budgets for FY 2013 and FY 2014 were designed with an assumed refinancing of $775 million in General Obligation bonds ($600 million in GO and $175 million in Public Building Authority bonds) and $575 million in General Obligation bonds, respectively.
- The purpose of these refinancings is to provide temporary budget relief to the General Fund.
- The Commonwealth is diligently working to finalize its FY2012 audited financial statements in order to bond-out these loans through a tax-exempt refinancing, while we endeavor to phase out this practice.

Source: "Commonwealth of Puerto Rico – Financial Information and Operating Data Report, dated May 17, 2013." Debt restructuring for fiscal year 2014 is preliminary and subject to change without prior notice, including as a result of market and general economic conditions. * Given favorable market conditions, the Government refinanced an additional $302.1 million of principal due in such fiscal year to provide additional budgetary relief, allowing the Government to redirect the use of moneys that would have been used for such principal payments.

Agenda

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5. **Concluding Remarks**

Concluding Remarks

- We believe we have delivered on our long standing promise of enacting meaningful pension reform in a sensible way, protecting pensions and those retirees with the lowest pensions.
- We recognize there is still work to do and difficult challenges to tackle, including:
  1) Enacting legislation to reform our Teacher's pension plan
  2) Addressing the PRHTA situation
  3) Working to achieve structural balance of our General Fund with real recurring revenues and expenses
  4) Continuing efforts to transform our public corporations into self-sustainable enterprises (PRASA, the first example of this goal)
  5) Reducing our reliance on GO debt service restructurings
- The fiscal team, led by the Governor, will continue addressing the remaining challenges, as well as working closely with the economic development team.
- We are determined to maintaining transparency and open communication with our investor community and stakeholders within applicable laws and regulations.