Fiscal Situation Update

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An Analysis of the Governor's Budget Request for Fiscal Year 2013

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A popular Government, without popular information, or the means of acquiring it, is but a Prologue to a Farce or a Tragedy; or, perhaps both. Knowledge will forever govern ignorance: And a people who mean to be their own Governors, must arm themselves with the power which knowledge gives.

—James Madison, 1822

Introduction

This report by the Center for the New Economy (CNE) presents an analysis of the proposals contained in the Governor's budget request for fiscal year 2013. The analysis is based on CNE's interpretation of the budget data, rather than the Administration's, and may incorporate estimates made by CNE's staff or by other private sector analysts. CNE's analysis also includes a review of the fiscal trends for the fiscal year 2012, which ends on June 30, as well as an update of ten budget indicators that CNE has followed over the last five or six years.

Fiscal Year 2012

Revenues – General fund net revenues for the first ten months of fiscal year 2012 (comprising the period from July 1, 2011 to April 30, 2012) amounted to \$6.845 billion, approximately \$455 million, or 7.1%, more than the \$6.390 billion recorded for the same period during the previous fiscal year. This increase is mainly due to the collection of \$1.527 billion product of a temporary excise tax imposed on sales made by certain multinational companies with operations in Puerto Rico to their offshore affiliates. This excise tax has been imposed pursuant to the terms and conditions of Act 154 of October 25, 2010.

This increase in revenues was partially offset by (1) a decrease in collections of \$145 million from income taxes on individuals; \$244 million from income taxes on corporations, and \$12 million from withholdings to non-residents, all of which were primarily a result of the tax reform enacted in January 2011; (2) the elimination in fiscal year 2011 of a special property tax imposed on residential and commercial property; and (3) decreases in some excise taxes and miscellaneous non-tax revenues as a result of current economic conditions in Puerto Rico.

General fund revenues year-to-date are 1.4% below forecast.[1] However, the official general fund revenue estimate for the current fiscal year remains at \$8.650 billion. The Puerto Rico Treasury Secretary expects this revenue target will be met due to increased enforcement measures and the revenues generated by the new excise tax imposed by Act 154.

Expenditures – On the spending side, general fund expenditures are budgeted at \$9.260 billion. Thus, the Administration forecasts the deficit for fiscal year 2012 will be approximately \$610 million. This deficit calculation, however, ***excludes*** (1) approximately \$685.2 million of principal and interest payments on Commonwealth general obligation bonds that were refinanced through GDB loans, which loans are expected to be repaid from the proceeds of a bond issuance, and (2) \$154 million of interest payments on Commonwealth guaranteed Public Building Authority Bonds that were refinanced through other GDB loans, which are expected to be repaid from the proceeds of the issuance of Public Building Authority Bonds. In our view, debt service should be treated as a recurring expenditure. Therefore, we forecast total general fund obligations for fiscal year 2012 will add up to \$10.099 billion (\$9.260 billion + \$685.2 million + \$154 million).

Accordingly, CNE estimates the deficit for fiscal year 2012 to be approximately \$1.449 billion, which is equal to the difference between revenues of \$8.650 billion less expenditures of \$10.099 billion. This deficit calculation is consistent with

[1] Standard & Poor's, *Summary Credit Profile – Puerto Rico Public Finance Corp; Puerto Rico Appropriation Bonds; Puerto Rico General Obligation Bonds,* 6 June 2012, p. 3.

estimates made by UBS analysts in New York, who forecast Puerto Rico's budget deficit for fiscal year 2012 to be around $1.429 billion.[2]

We pause here to note that the practice of refinancing current-year *debt service* by rolling it over with the issuance of new debt is not unique to Puerto Rico. However, the consensus among analysts appears to be that it is not the most prudent financial practice and it does constitute a significant credit risk for holders of Puerto Rico bonds.

Fiscal Year 2013

Revenues – The Governor announced a general fund budget of $8.750 billion for fiscal year 2013. This amount would be $100 million, or 1.15%, higher than this year's general fund budget of $8.650 billion.

The general fund revenue forecast includes a significant increase in the proceeds of the Sales and Use and Tax, from $560 million in fiscal year 2012 to $691 million in fiscal year 2013, an increase of $131 million, or 23.4%. This increase in SUT revenues is to be generated from enhanced enforcement through the implementation of IVU Lotto.

In our view, this forecast is inconsistent with both the historical pattern of SUT revenues and the current weak state of the Puerto Rican economy. Therefore, we are adjusting downward the expected year-over-year growth rate in SUT collections from 23.4% to 5%, which we believe is more in line with the historical trend. We estimate the general fund will receive approximately $588 million from the SUT during fiscal year 2013 and forecast total general fund recurring revenues to be around $8.647 billion.

Expenditures – The proposed budget for fiscal year 2013, as has been the case since fiscal year 2009, provides that certain expenditures traditionally charged to the general fund be charged instead against the Fiscal Stabilization Fund, a special fund set up with the proceeds of COFINA bond offerings. For fiscal year 2013 these expenditures are estimated to total $333 million. Therefore, the Administration estimates general fund expenditures for the next fiscal year to be around $9.083 billion, an amount that is some $177 million, or 1.91%, lower than this year's budgeted general fund expenditures of $9.260 billion.

We note, however, that the general fund budget for 2012-13 *does not* include $600 million for the *debt service* due on General Obligation bonds that should have been included in the general fund budget—an amount that, presumably, will be refinanced at some point during the next fiscal year. Therefore, we estimate the true amount of general fund spending to be around $9.683 billion.[3]

In sum, we estimate the deficit for fiscal year 2013 to be approximately $1.036 billion, which is equal to the difference between revenues of $8.647 billion less expenditures

[2] UBS Wealth Management Research, *Municipal Bonds – Commonwealth of Puerto Rico*, 11 January 2012, p. 6.

[3] In an interview with Bloomberg News, the president of the Government Development Bank acknowledged "the 2013 budget proposal includes a $933 million funding gap, down from the $1.4 billion shortfall for the year ending June 30." Michelle Kaske, *Puerto Rico Plans to Stop Deficit Borrowing by Fiscal 2014*, Bloomberg News, 10 May 2012.

of $9.683 billion. This deficit amount would be $413 million, or 28%, less than the $1.449 billion deficit we estimate for fiscal year 2012.

Table 1
Non-recurring Revenues (General Fund)

FY 11-12	**Amount**
Fiscal Stabilization Fund	$610,000,000
Debt Service to be Refinanced	$839,200,000
Total non-recurring revenues	**$1,449,200,000**
General fund expenditures FY11-12	$10,099,200,000
% Non-recurring revenues	14.3%
FY 12-13	**Amount**
Fiscal Stabilization Fund	$333,000,000
Debt Service to be Refinanced	$600,000,000
Adjustment to SUT revenue increase	$103,000,000
Total non-recurring revenues	**$1,036,000,000**
General fund expenditures FY12-13	$9,683,000,000
% Non-recurring revenues	10.6%

Source: CNE analysis

Non-recurring Revenues – As shown on Table 1 above, the general fund budget for fiscal year 2012-13 includes $1.036 billion in non-recurring revenues, an amount that is $413 million, or 28%, lower than the $1.449 billion in non-recurring revenues included in the general fund budget for the fiscal year 2011-12.

The amount of non-recurring revenues as a portion of total general fund revenues has decreased significantly from 14.3% in fiscal year 2012, or roughly 1 out of every $7 spent from the general fund, to 10.6% during fiscal year 2013, or roughly 1 out of every $10 spent.

The consolidated budget includes another $272 million in non-recurring revenues from the American Recovery and Reinvestment Act (ARRA). Thus, total non-recurring revenues included in next year's consolidated budget amount to $1.308 billion, an amount that is $650 million, or 33%, less than the $1.958 billion in non-recurring funds that were included in the current year's consolidated budget.

Therefore, the proposed consolidated budget reflects a significant reduction in the use of non-recurring funds in comparison with the current budget. This reduction is due mostly to (1) the phase-out of stimulus spending authorized by the American Recovery and Reinvestment Act (2) a decrease in the use of the Fiscal Stabilization Fund.

Public Debt

Table 2
Puerto Rico Public Debt and GNP

(US$BN)

FY	Debt	%Δ	GNP	%Δ	PD/GNP
2000	24.1890	--	41.4186	--	58.40
2001	27.1600	12.3%	44.0466	6.3%	61.66
2002	30.0330	10.6%	45.0713	2.3%	66.63
2003	32.5250	8.3%	47.4794	5.3%	68.50
2004	37.4340	15.1%	50.7087	6.8%	73.82
2005	40.2680	7.6%	53.7524	6.0%	74.91
2006	43.1360	7.1%	56.7323	5.5%	76.03
2007	46.1830	7.1%	59.5205	4.9%	77.59
2008	53.3930	15.6%	61.6652	3.6%	86.59
2009	58.4140	9.4%	62.5981	1.5%	93.32
2010	62.2062	6.5%	63.0582	0.7%	98.65
2011	64.2790	3.3%	64.1062	1.7%	100.27
2012*	68.4600	6.5%	66.4150	3.6%	103.08
CAGR	**9.06%**		**4.01%**		

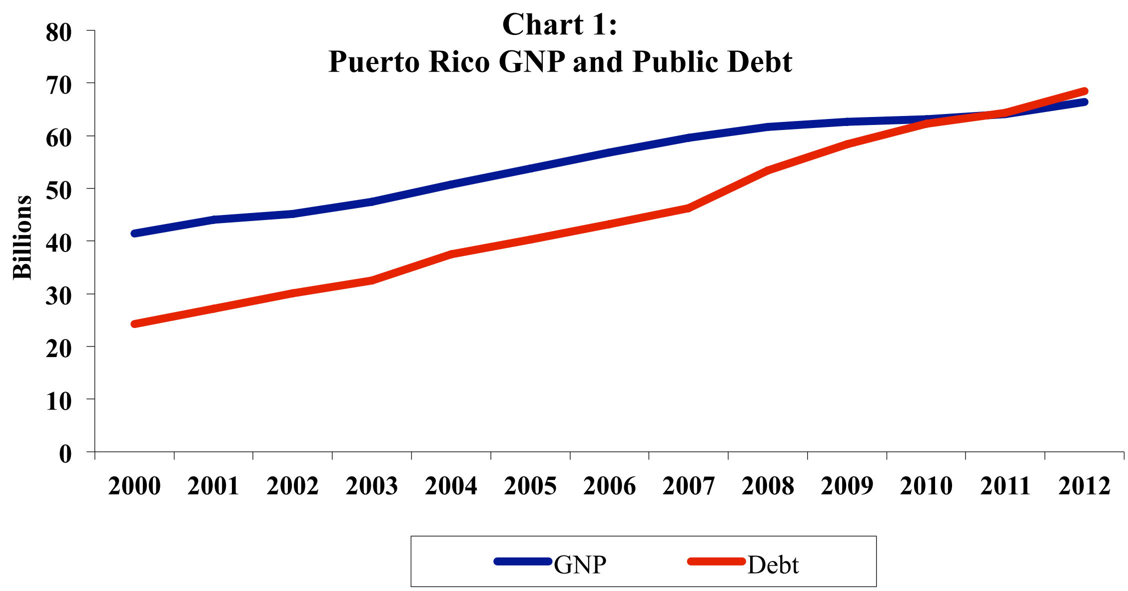
*Debt data for 2012 is as of March 2012
Source: GDB, PRPB, and CNE Analysis

Sizeable Increase in Indebtedness – During the last twelve years Puerto Rico's total public debt has exploded both in absolute terms and relative to the size of the Puerto Rican economy. At the end of fiscal year 2000 total Puerto Rico public debt amounted to approximately $24.2 billion, while as of March 2012 it amounted to $68.5 billion, an aggregate increase of $44.3 billion, or 183.05%. During this period public indebtedness increased at a compound annual growth rate of 9.06%.

Meanwhile, Puerto Rico's Gross National Product (GNP), at current prices, increased from $41.4 billion in 2000 to an estimated $66.4 billion at the end of fiscal year 2012, an aggregate increase of $25 billion, or 60.4%.[4] During this period Puerto Rico's GNP increased at a compound annual growth rate of 4.01%.

Given that Puerto Rico's indebtedness has grown at an average annual rate that is 2.25 times faster than the growth rate of its GNP during the last twelve years, it should not be surprising that Puerto Rico's total public debt currently exceeds its GNP. Indeed, Puerto Rico's public debt to GNP ratio has increased from a relatively manageable 58.4% in 2000 to a decidedly risky 103.08% in 2012.

[4] In Puerto Rico, GNP, which measures income earned by residents or by locally owned production factors, is a more accurate measure of economic activity than GDP due to distortions induced by the transfer pricing practices of multinational companies operating in the island. For a technical analysis of the GNP/GDP gap in Puerto Rico see "Economic Growth" by Barry P. Bosworth and Susan M. Collins in *The Economy of Puerto Rico: Restoring Growth*, (Brookings Institution Press: Washington, DC, 2006), p. 17-81.



Source: GDB, PRPB, CNE Analysis

Serious Concerns About Fiscal Sustainability – Recently, several private sector analysts have questioned the soundness and sustainability of Puerto Rico's public finances over the medium to long-term. For example, a couple of months ago, Ms. Cate Long, a reporter at Reuters, stirred-up a hornet's nest by comparing Puerto Rico with Greece. Although any comparison between a sovereign country like Greece and a crumbling colonial backwater like Puerto Rico needs to be taken with a grain of salt, in our view Ms. Long's concern is justified.

There are, of course, some differences between Puerto Rico and Greece, especially in connection with borrowing spreads and the level of overall indebtedness, but there exist several fundamental similarities for all see and none to misunderstand. Both places have been running primary deficits for years; both have high debt ratios, as we have seen Puerto Rico's debt to GNP ratio is currently over 100%, and that is *excluding* unfunded public pension liabilities; and both suffer from high unemployment, widespread corruption, and massive tax evasion.

At a more fundamental level, neither country has control of monetary policy, so neither can devalue its currency to jumpstart the economy; neither has a strong productive base it can bootstrap to ignite growth in the short term; and perhaps most important of all, both countries are economic mirages based on consumption levels that have been sustained by a monetary illusion, that is, by having access to a stronger currency than their economic fundamentals would warrant. In our view, these broad-based fundamental similarities are more important and outweigh any narrowly defined quantitative differences between both countries.

Risk of Default in the Short Term is Low – Having said that, we must also make it clear that Puerto Rico is not currently in danger of defaulting on its obligations. Furthermore, in the event that during any fiscal year resources available to the Commonwealth are insufficient to cover the appropriations approved for such year, the Governor may take administrative measures to reduce expenses and submit to both houses of the Legislative Assembly a detailed report of any adjustment necessary to balance the budget, or make recommendations to the Legislative

Assembly for new taxes or authorize borrowings under provisions of existing legislation or take any other necessary action to meet the deficiency.

Any such proposed adjustments shall give effect to the "priority norms" established by law for the disbursement of public funds in the following order of priority:

First, the payment of the interest on and amortization requirements for public debt (defined as Commonwealth general obligations and guaranteed debt for which the Commonwealth's guarantee has been exercised);

Second, the fulfillment of obligations arising out of legally binding contracts, court decisions on eminent domain, and other unavoidable obligations to protect the name, credit and good faith of the Commonwealth;

Third, current expenditures in the areas of health, public safety, education, welfare, and retirement systems; and

Fourth, for all other purposes.

Table 3
Commonwealth of Puerto Rico Public Debt
($MM)

	March 2012
Direct Full Faith and Credit Obligations	$10,793
Puerto Rico Guaranteed Debt	$5,466
Debt Supported by Puerto Rico Appropriations or Taxes	$3,727
Tax and Revenue Anticipation Notes	$900
Pension Obligation Bonds	$2,948
Total General Fund Related Debt	**$23,834**
Sales and Use Tax Debt (COFINA)	$15,224
Public Corporations and Agencies	$23,641
Municipal Debt	$3,498
Limited Obligations/Non-Recourse Debt	$2,263
Total	**$44,626**
TOTAL PUBLIC DEBT	**$68,460**

Source: Commonwealth of Puerto Rico, Official Statement, 7 March 2012

Therefore, payment on (1) the Commonwealth's full faith and credit debt and (2) debt explicitly guaranteed by the Commonwealth has an *absolute preference* over every other kind of government obligation in the event of a liquidity crisis.

Not all Debt is Created Equal or Is It? – Note, however, as shown on Table 3 above, that the *explicit* Commonwealth's full faith and credit pledge applies only to a sub-set of Puerto Rico's total public debt. For example, the Commonwealth's full faith and credit guarantee, including the preference for payment and the first claim on Commonwealth resources, *would not* generally apply to appropriation debt or to debt issued by public corporations. It is important when analyzing Puerto Rico credit risk to establish clearly who is the issuer and which entity bears the ultimate legal obligation for repayment. It may be useful, therefore, to breakdown and analyze the risk of Puerto Rico public debt in a continuum that ranges from the safest, relatively more secure debt (GOs, Puerto Rico directly-guaranteed debt, COFINA), moving on to slightly riskier issuers (public corporations, municipalities) and ending with the riskiest debt (appropriation debt, pension obligation bonds, and limited obligation/non-recourse debt).

Notwithstanding the clear legal limitations on the applicability of the Commonwealth's full faith and credit pledge, it appears to us that the capital markets seem to assume, and the Commonwealth for many years has actively encouraged the perception, that there exists an *implicit* Commonwealth guarantee backing all debt issued by Puerto Rico, or at the very least that the GDB would intervene to avoid an event of default, even if it is not legally obligated to do so. Indeed, this has already happened with respect to the Puerto Rico Aqueduct and Sewer Authority, which was essentially bailed out by the GDB during he early 1990s, even though it was not required to do so.

This implicit reliance on the central government is one of the factors that led Moody's Investors Service to restate and reclassify a portion of Puerto Rico's debt for purposes of calculating the Commonwealth's Net Tax Supported Debt (NTSD). According to Moody's, obligations amounting to $4.067 billion between the GDB and other government agencies that were previously excluded from the NTSD calculations will now be considered debt of the Commonwealth. In addition, Moody's also decided to include an additional $2.790 billion in the Commonwealth's NTSD, encompassing (1) all the debt of the Puerto Rico Aqueduct and Sewer Authority, "as the Authority has had ongoing reliance on subsidies from the Commonwealth", and (2) a portion of the Puerto Rico Port Authority debt, which is guaranteed by GDB.[5]

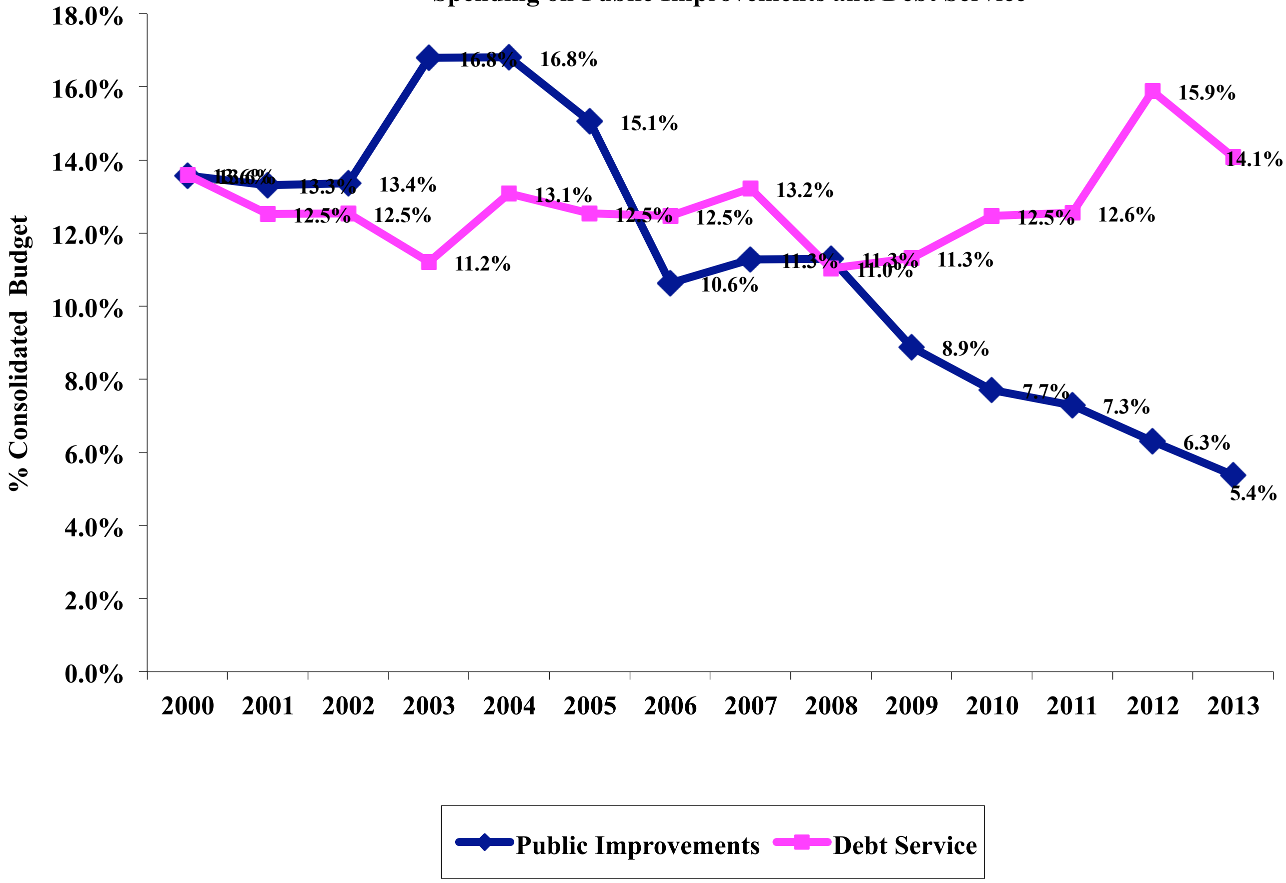
It is not clear to us how this informal guarantee would actually work out in the context of a conflict with other politically sensitive obligations. For example, what would happen if four or five years from now one of the big public corporations does not have enough cash to service its debt and the central government does not have enough cash to pay its pensioners? Who would take the hit? What criteria would be used to decide?

(Mis)Use of Borrowed Funds – In addition to the overall amount, relative size, and growth rate of the public debt, it is important also to analyze the uses given to the borrowed money. Public investment in infrastructure such as roads, ports, airports, railroads, hospitals, schools, electric generation, water and sewer treatment plants, and the electric grid, among others, is good for the economy for several reasons.

In the short term, government spending on infrastructure, or public improvements as they are called in Puerto Rico's budget, generates economic activity and creates direct, indirect, and induced jobs in connection with the design and construction of the public works. Over the long term, a good public infrastructure provides a solid base for private sector enterprises to grow, create jobs, generate income, and increase overall wealth.

[5] Moody's Investor Service, Issuer Comment, *Revised Calculations Show Higher Puerto Rico Debt*, 18 May 2012, p. 2.

Chart 2:
Spending on Public Improvements and Debt Service



Source: CNE Analysis, OMB data

Governments traditionally issue long-term debt to finance these expenditures. This practice makes sense given that the public goods to be built will probably have a useful life of 25 or 30 years, probably more. Thus, it is only fair that the people who benefit from and use these public goods over time also pay a portion of the total cost associated with their construction and maintenance.

Chart 2 above shows the portion of Puerto Rico's consolidated budget (which includes the central government and public corporations) dedicated to spending on public improvements and the portion of the consolidated budget dedicated to debt service over the last thirteen years. From the graph it is obvious that since 2006 the portion dedicated to expenditures on public improvements has declined significantly, while the portion dedicated to debt service continues to increase.

Furthermore, given that (1) total public debt has exploded since 2000; (2) the GDB has been fairly efficient in refinancing debt at lower rates whenever possible; and (3) spending on public improvements has decreased significantly while debt service continues to increase, it is fairly obvious that most of what the government of Puerto Rico has borrowed since 2006 has been used to fund operational expenses instead of investment on infrastructure. Indeed, almost all of the $15 billion borrowed by COFINA since 2006 has been used to pay current expenses, finance deficits, or to fund other outstanding debts.

This kind of borrowing, in the words of financial journalist Michael Lewis, creates "a false prosperity", which allows a country to "import the future into the present" for a limited time. The problem is that "it isn't the actual future so much as some grotesque silicone version of it. Leverage buys you a glimpse of a prosperity you haven't really earned."

Furthermore, and perhaps more important in the case of Puerto Rico, "when people pile up debts they will find difficult and perhaps even impossible to repay, they are saying…their present wants are so important that, to satisfy them, it is worth some future difficulty. But in making that bargain they are implying that when the future difficulty arrives, they will figure it out. They don't always do that."[6]

In our view, the government of Puerto Rico over the last dozen years or so has created a false sense of prosperity by borrowing massive amounts to finance current consumption, generating a phony prosperity that Puerto Ricans have not really earned. It remains to be seen whether Puerto Rico will have the wherewithal to make on good on all its obligations when the day of reckoning finally arrives.

Budget Indicators

The Center for the New Economy, in fulfillment of its mission to provide rigorous, independent analysis to policymakers, the press, and the public at large, has established a fiscal analysis program to monitor and keep track of important fiscal trends affecting the Puerto Rican economy.

Table 4 below sets forth the series of budget indicators we update every year around the time when the governor submits the recommended budget to the legislature for its enactment. Among the indicators included in the table you will find the following:

(1) The trend for the consolidated budget, both in absolute and per capita terms;

(2) The trend for federal funds, both in absolute terms and relative to the consolidated budget;

(3) The trend for the general fund budget;

(4) The trend for payroll expenditures relative to the general fund;

(5) The tax revenue trend, both relative to the general fund and to GNP;

(6) The trend for recurring and non-recurring revenues;

(7) Various indebtedness and debt service ratios; and

(8) The trend in government employment, both in absolute terms and per 100 inhabitants.

[6] Michael Lewis, *Boomerang: Travels in the New Third World*, (W.W. Norton & Co.: New York, 2011).

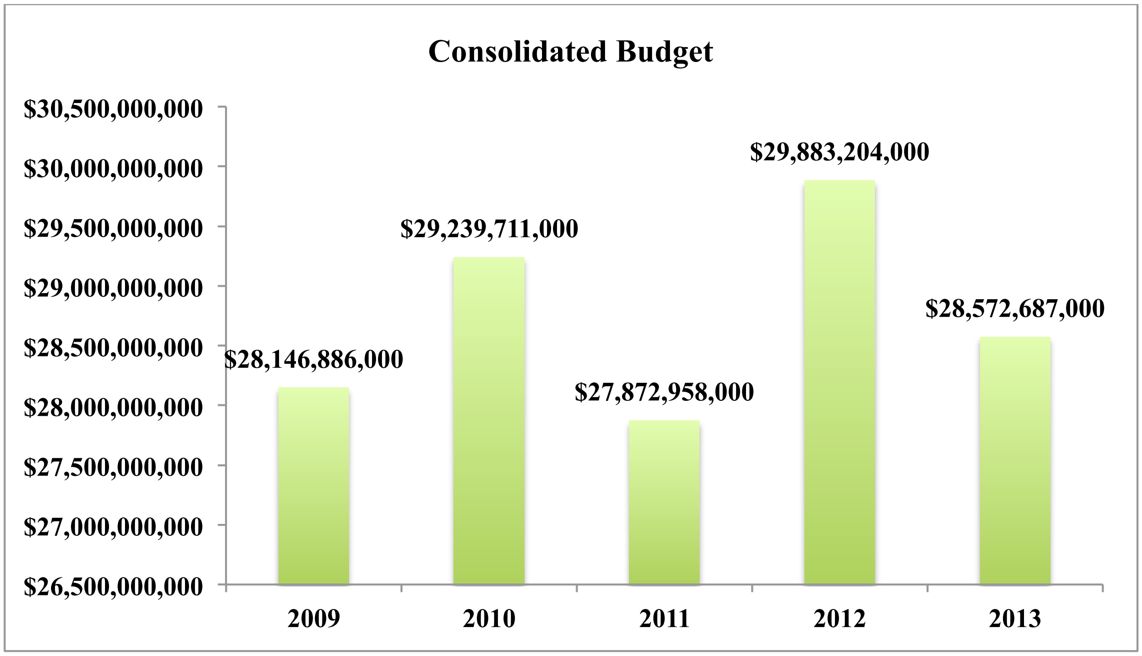
Table 4

Budget Indicators 2009-2013

	Fiscal Year					
	2009	**2010**	**2011**	**2012**	**2013**	**CAGR**
1.Consolidated Budget (CB)	$28,146,886,000	$29,239,711,000	$27,872,958,000	$29,883,204,000	$28,572,687,000	0.38%
CB per capita	$7,094.74	$7,847.92	$7,519.64	$8,104.11	$7,789.21	
CB/GNP	44.96%	46.37%	43.48%	44.99%	41.22%	
2. Federal funds[1]	$7,021,403,000	$6,919,556,000	$6,760,150,000	$6,924,402,000	$6,790,987,000	-0.83%
Federal funds/CB	24.95%	23.66%	24.25%	23.17%	23.77%	
3. General fund budget (GF)	$9,483,792,000	$7,670,000,000	$8,133,500,000	$8,650,000,000	$8,750,000,000	-1.99%
GF/GNP	15.15%	12.16%	12.69%	13.02%	12.62%	
4. GF Payroll	$5,501,074,000	$4,608,861,000	$3,633,914,000	$3,666,044,000	$3,608,789,000	-10.00%
Payroll/GF	58.01%	60.09%	44.68%	42.38%	41.24%	
5. Tax revenues GF	$6,948,100,000	$6,894,000,000	$7,376,000,000	$8,036,000,000	$8,181,000,000	4.17%
Tax revenues/GF	73.26%	89.88%	90.69%	92.90%	93.50%	
Tax revenues GF/GNP	11.10%	10.93%	11.51%	12.10%	11.80%	
6. GF recurring revenues	$7,600,000,000	$7,670,000,000	$7,892,000,000	$8,650,000,000	$8,647,000,000	3.28%
GF recurring expenditures	$10,479,000,000	$9,170,000,000	$9,149,000,000	$10,099,000,000	$9,682,700,000	-1.96%
GF structural deficit	($2,879,000,000)	($1,500,000,000)	($1,257,000,000)	($1,449,000,000)	($1,035,700,000)	
Structural deficit/GF	-30.36%	-19.56%	-15.45%	-16.75%	-11.84%	
7. Non-recurring funds (CB)	$1,173,107,000	$4,379,000,000	$2,266,171,000	$1,958,672,000	$1,308,296,000	2.76%
Non-recurring funds/CB	4.17%	14.98%	8.13%	6.55%	4.58%	
8. Debt service GF	$834,189,000	$662,807,000	$578,402,000	$670,522,000	$564,570,000	-9.30%
Debt service/recurring revenues GF	10.98%	8.64%	7.33%	7.75%	6.53%	
Debt service consolidated budget	$3,184,823,000	$3,645,830,000	$3,499,162,000	$4,748,410,000	$4,021,816,000	6.01%
Debt service/CB	11.32%	12.47%	12.55%	15.89%	14.08%	
Debt service per capita	$802.77	$978.54	$944.01	$1,287.73	$1,096.39	8.10%
Debt service CB/GNP	5.09%	5.78%	5.46%	7.15%	5.80%	
9. Total public debt[2]	$58,415,000,000	$62,206,200,000	$64,279,000,000	$68,460,000,000	--	
Public debt per capita	$14,724.16	$16,696.11	$17,341.35	$18,565.85	--	
GNP[3]	$62,598,100,000	$63,058,200,000	$64,106,200,000	$66,415,000,000	$69,321,000,000	2.58%
Total public debt/GNP	93.32%	98.65%	100.27%	103.08%	--	
10. Government employees[4]	213,502	202,525	180,971	178,179	175,776	-4.74%
Government employees per 100 persons	5.38	5.44	4.88	4.83	4.79	
Population[3]	3,967,288	3,725,789	3,706,690	3,687,415	3,668,241	-1.94%

1. Includes ARRA funds
2. Data for 2012 is as of March 2012
3. Data for 2012 and 2013 are estimates
4. Central government and public corporations only

Consolidated Budget



- The Commonwealth's consolidated budget has increased from $28.146 billion in fiscal year 2009 to a projected $28.572 billion for fiscal year 2013, an increase of $426 million, or 1.51%. This increase is equivalent to a compound annual growth rate (CAGR) of 0.38% during the period between fiscal years 2009 and 2013, which is significantly lower than the 2.58% CAGR of nominal GNP during the same period.

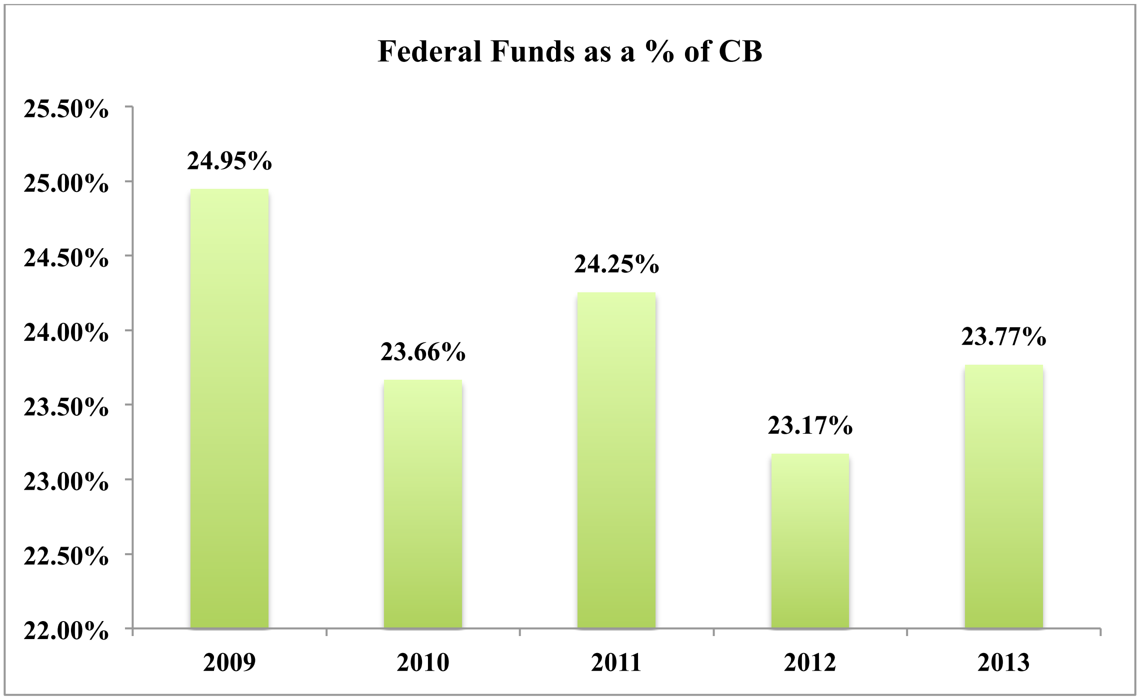
- Relative to the consolidated budget for the current year the proposed budget for fiscal year 2013 shows a net decrease in spending of $1.310 billion, or 4.39%. Thus, this is essentially a very conservative budget.

- On a per capita basis, consolidated budget expenditures show a significant increase, increasing from $7,094 in 2009 to a projected $7,789 for fiscal year 2013. This increase, however, is driven mostly by a reduction in Puerto Rico's population instead of increasing expenditures. Relative to per capita personal disposable income, government expenditure remains fairly high. In 2011, per capita disposable personal income in the island was $15,332; thus, per capita government spending of $7,519 represented 49.04% of per capita disposable personal income. In contrast, federal expenditure per capita in the U.S. is approximately $11,476, which is equivalent to 30.7% of per capita disposable personal income of $37,345.

- Finally, consolidated budget expenditures have declined significantly relative to GNP, from 44.9% in 2009 to a projected 41.2% in 2013.

- In our view, the overall trend with respect to the consolidated budget reveals that the Puerto Rican government has achieved significant success in restraining the growth rate of government spending since 2009.

Federal Funds



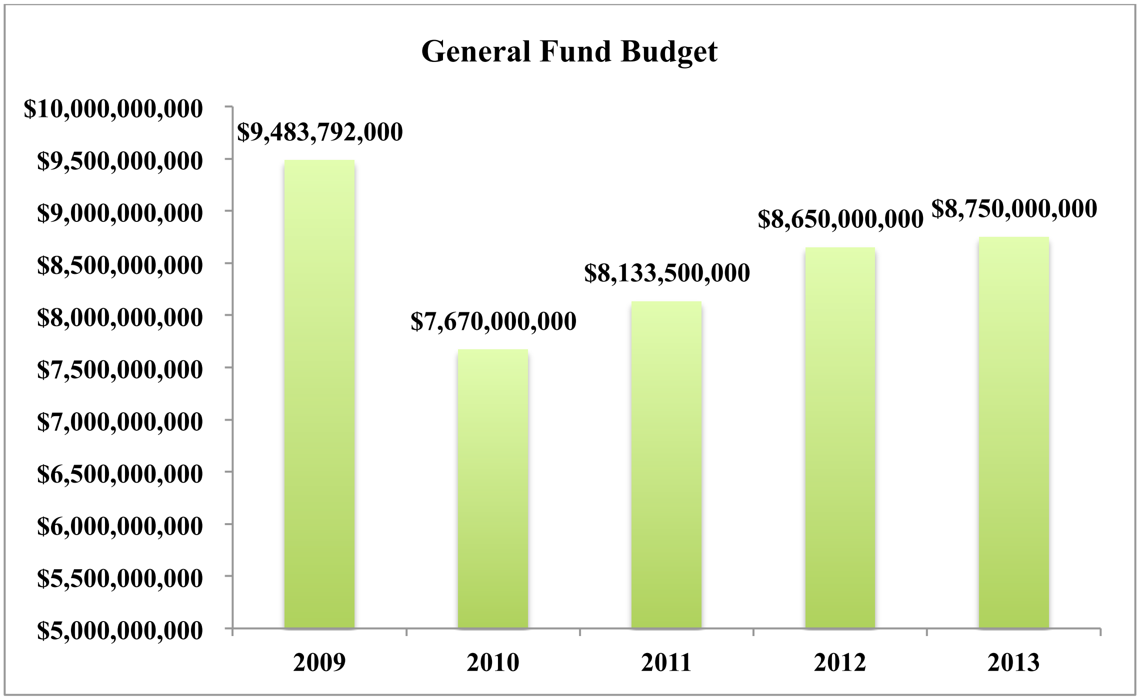
- Grants from the U.S. federal government to the various government agencies of the Commonwealth, including ARRA funds, are expected to total $6.790 billion during fiscal year 2013, a decrease of $134 million, or 1.93%, relative to the $6.924 billion received during fiscal year 2012.

- Federal funds are expected to account for 23.8% of all consolidated budget expenditures during fiscal year 2013, a proportion that is essentially the same as the 23.2% registered in 2012. This means that approximately 1 out of every 4 dollars spent by the Commonwealth's central government during the next fiscal year will come from Washington.

- Since 2009, federal grants to the government have decreased at a CAGR of 0.83%, while the rate of growth of the overall consolidated budget during the period under study was 0.38%. This decrease in the growth rate is due mostly to the phase out of ARRA funds.

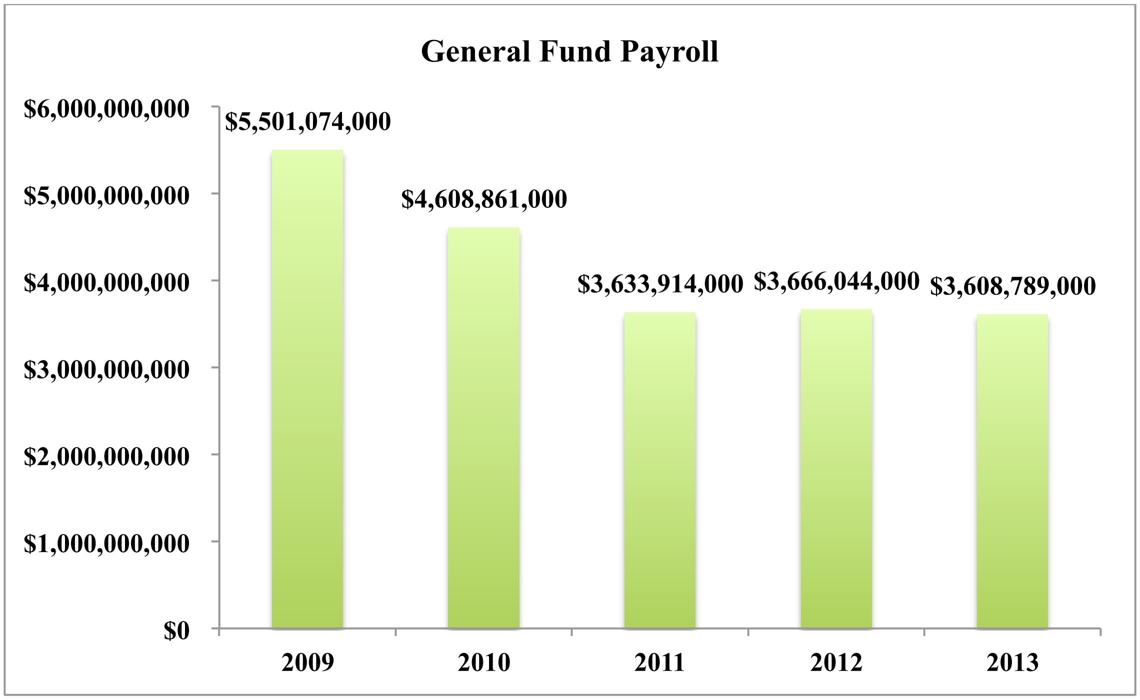
- In our opinion, the high relative weight of federal funds in the consolidated budget is a negative factor because the amount of federal funds received by the island depends solely on the fiscal and political dynamic in Washington DC, where Puerto Rico has limited representation.

General Fund



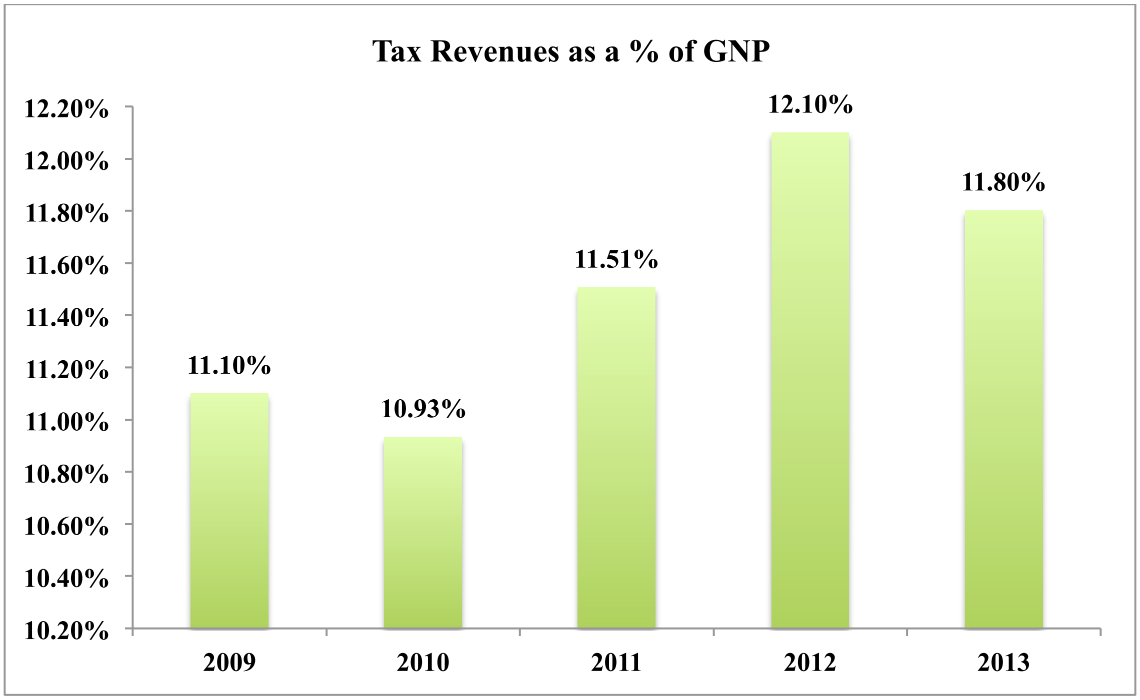
- The Commonwealth's general fund budget has decreased from $9.483 billion in fiscal year 2009 to a projected $8.750 billion for fiscal year 2013, a decrease of $733 million, or 7.7%. This reduction is equivalent to a CAGR of negative 1.99% for the period between fiscal years 2009 and 2013.
- However, the magnitude of this decrease is deceptive because, as we have already noted, some expenditures traditionally charged to the general fund will be charged instead against the Fiscal Stabilization Fund, a special fund set up with the proceeds of COFINA bond offerings. During fiscal year 2011 the general fund is slated to receive $333 million from this special fund.
- Actual general fund spending for the next fiscal year is estimated to be around $9.083 billion, an amount that is $177 million, or 1.91%, less than the fiscal year 2012 general fund budget of $9.260 billion.
- However, the general fund budget for 2012-13 does not include $600 million for the debt service on General Obligation bonds that should have been included in the general fund budget—an amount that, presumably, will be refinanced at some point during the next fiscal year. Therefore, we estimate true general fund spending to be around $9.682 billion.
- Overall, the trend with respect to the general fund budget is difficult to discern. On one hand, the government appears to have successfully controlled the growth rate, perhaps even reduced actual spending, for certain segments of general fund expenditure. On the other hand, however, the use of ARRA funds, the Stabilization Fund, and debt refinancing during the past three fiscal years casts some doubt on the true extent of the reduction in general fund spending.

General Fund Payroll



- The amount of the general fund allocated to payroll has decreased from $5.501 billion for fiscal year 2009 to a projected $3.608 billion during fiscal year 2013, a decrease of $1.893 billion, or 34.4%. This decrease is equivalent to a CAGR of negative 10%.
- In essence, the general fund payroll in nominal terms has remained flat since fiscal year 2011 staying at around $3.6 billion per year.
- In relative terms, the portion of the general fund allocated to payroll has decreased significantly from 58% in 2009 to a projected 41.2% in 2013.
- The general fund payroll shows a clearly declining trend since 2009. In our view this is clear evidence of the government's strong control over spending during the past four years.

Tax Revenue Trend



- General fund tax revenues, the principal component of the general fund, are expected to increase from $6.948 billion in fiscal year 2009 to a projected $8.181 billion during fiscal year 2013, an increase of $1.233 billion, or 17.7%. This increase is equivalent to a CAGR of 4.1%.

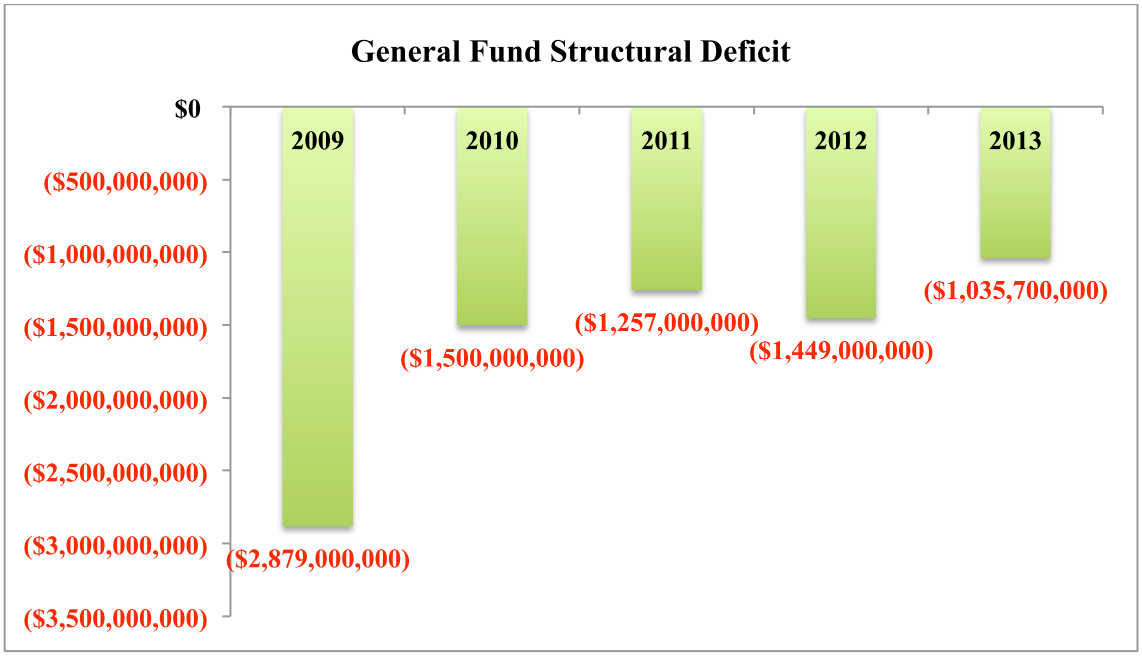
- In our view, the estimated year-over-year increase in sales tax revenue expected to go into the general fund, from $560 million in 2012 to $691 million in 2013, some $131 million, or 23.4%, is on the aggressive end of the spectrum and should be revised.

- General fund tax revenues have stayed essentially flat relative to GNP, increasing slightly from 11.1% in 2009 to a projected 11.8% during fiscal year 2013. To put this data in perspective, total federal tax receipts in the U.S. currently amount to approximately 15% of GDP.

- In our view, the biggest risk to budgetary stability in the short term comes from the revenue side. The administration has changed the structure of general fund revenues, reducing its dependence on income taxes on individuals and corporations and increasing its reliance on the temporary excise tax on foreign multinationals. This tax, which currently accounts for 22% of general fund revenues, is scheduled to be fully phased-out by 2017.

- It is very difficult to accurately forecast tax revenues at this time because taxpayers, both individual and corporate, are still adjusting to the new rules enacted in January 2011. The government, however, has been quite successful in generating significant revenues with the implementation of the special excise tax.

Structural Deficit



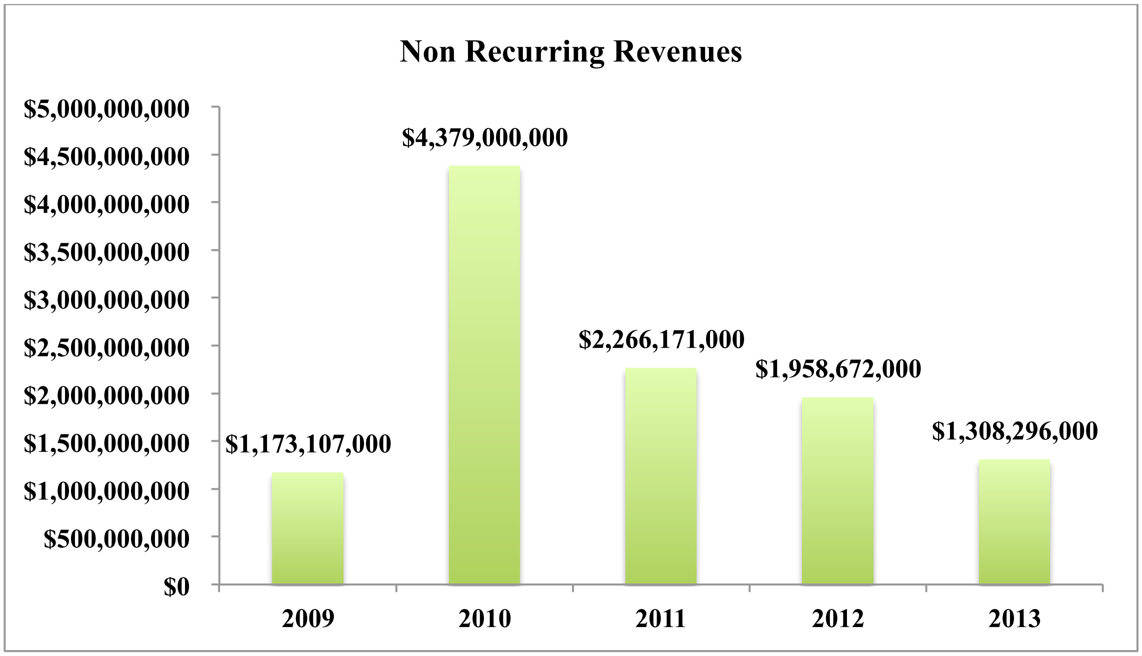
- The structural deficit is defined as the excess of recurring expenditures over recurring revenues. According to our analysis, the Commonwealth's structural deficit has decreased significantly, from $2.879 billion in 2009 to a projected $1.036 billion for fiscal year 2013, a decrease of $1.843 billion, or 64%. For fiscal year 2013, the projected structural deficit of $1.036 billion is the difference between recurring revenues of $8.647 billion and recurring expenditures of $9.683 billion.

- The government estimates the structural deficit for fiscal year 2013 will be around $333 million. The $703 million difference between our estimate and the government's is due to (1) the government's failure to include in their calculations some $600 million for the servicing the debt on certain General Obligation bonds and (2) our downward adjustment of SUT receipts by $103 million.

- Relative to the current fiscal year, the general fund structural deficit decreases from $1.449 billion to $1.036 billion in fiscal year 2013, a decrease of $413 million, or 28.5%.

- Finally, as a percentage of total general fund expenditures, the structural deficit has also decreased significantly, from 30.4% in 2009 to a projected 11.8% in 2013. In our view, the trend with respect to the structural deficit is positive because it shows a pronounced reduction over the last five years, both in absolute and relative terms.

Use of Non Recurring Funds



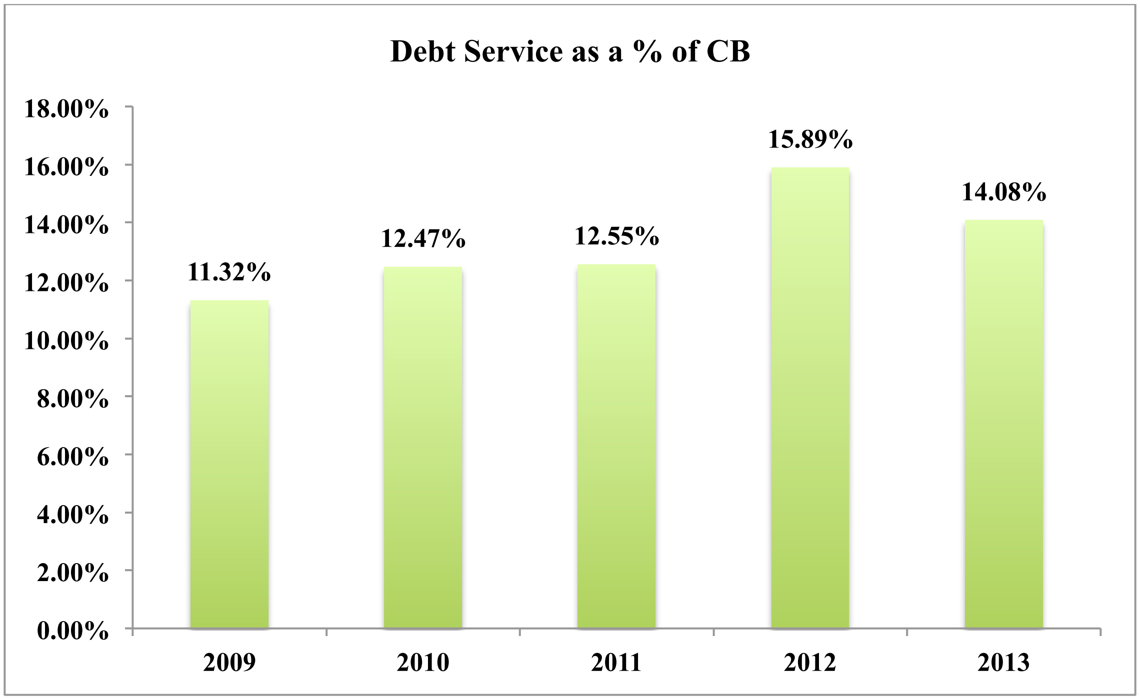
- To cover its yearly deficits the Commonwealth government has turned to using non-recurring revenues. Total non-recurring revenues included in the *consolidated budget* have increased from $1.173 billion in fiscal year 2009 to $1.308 billion for 2013, an increase of $135 million, or 11.5%.

- The *general fund* budget for fiscal year 2012-13 includes $1.036 billion in non-recurring revenues, an amount that is $413 million, or 28.5%, lower than the $1.449 billion in non-recurring revenues included in the general fund budget for the fiscal year 2011-12.

- Therefore, the proposed general fund budget reflects a significant decrease in the use of non-recurring funds in comparison with the current budget. In addition, the amount of non-recurring revenues as a portion of total general fund revenues has also decreased significantly from 14.3% in 2012 to a projected 10.6% in 2013.

- Overall, this indicator shows a positive trend, as the reliance on non-recurring revenues appears to have moderated in the case of the consolidated budget and decreased meaningfully, both in absolute and relative terms, in the case of the general fund.

Debt Service



- The amount of the general fund allocated to debt service has decreased from \$834 million for fiscal year 2009 to a projected \$564 million during fiscal year 2013, a decrease of \$270 million, or 32.3%. This decrease is equivalent to a CAGR of negative 9.3%. In relative terms, the amount allocated to general fund debt service has also decreased significantly from 10.9% of general fund recurring revenues in 2009 to a projected 6.5% of recurring revenues in 2013.

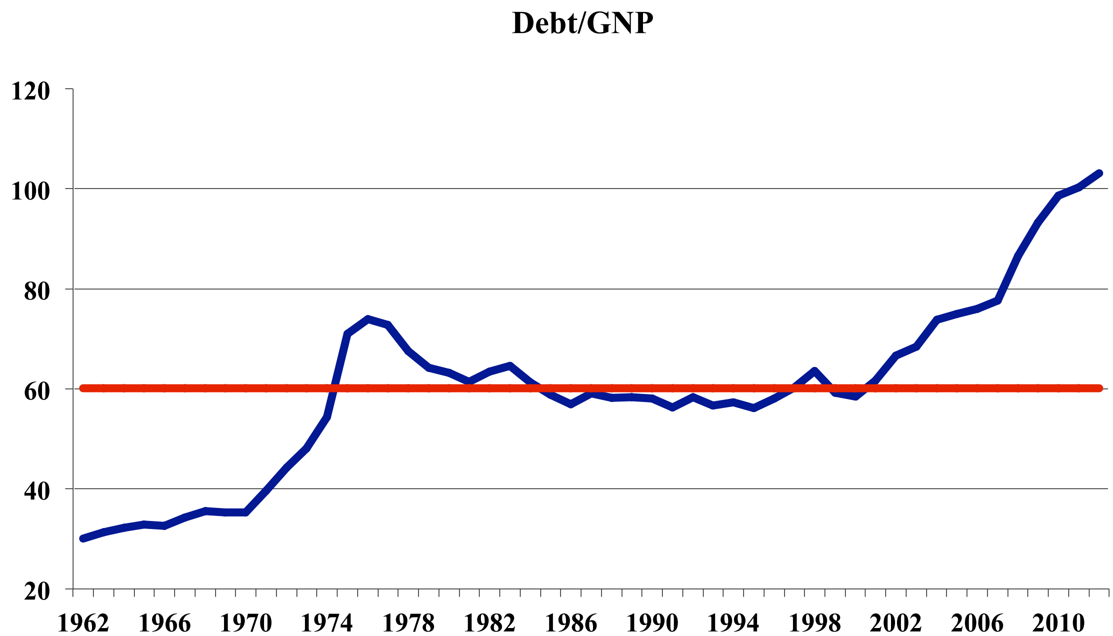
- This trend, however, is misleading due to the practice of excluding certain debt service obligations that are expected to be refinanced later in the fiscal year.

- With respect to consolidated budget, the amount allocated for debt service has increased from \$3.184 billion in 2009 to a projected \$4.021 billion in 2013, an increase of \$837 million, or 26.3%. This increase is equivalent to a CAGR of 6.0%.

- In relative terms, the portion of the consolidated budget allocated to debt service has increased significantly, from 11% of the total consolidated budget in 2009 to a projected 14% in 2013. This means that almost \$1 out of every \$7 spent by the government of Puerto Rico is allocated for debt service.

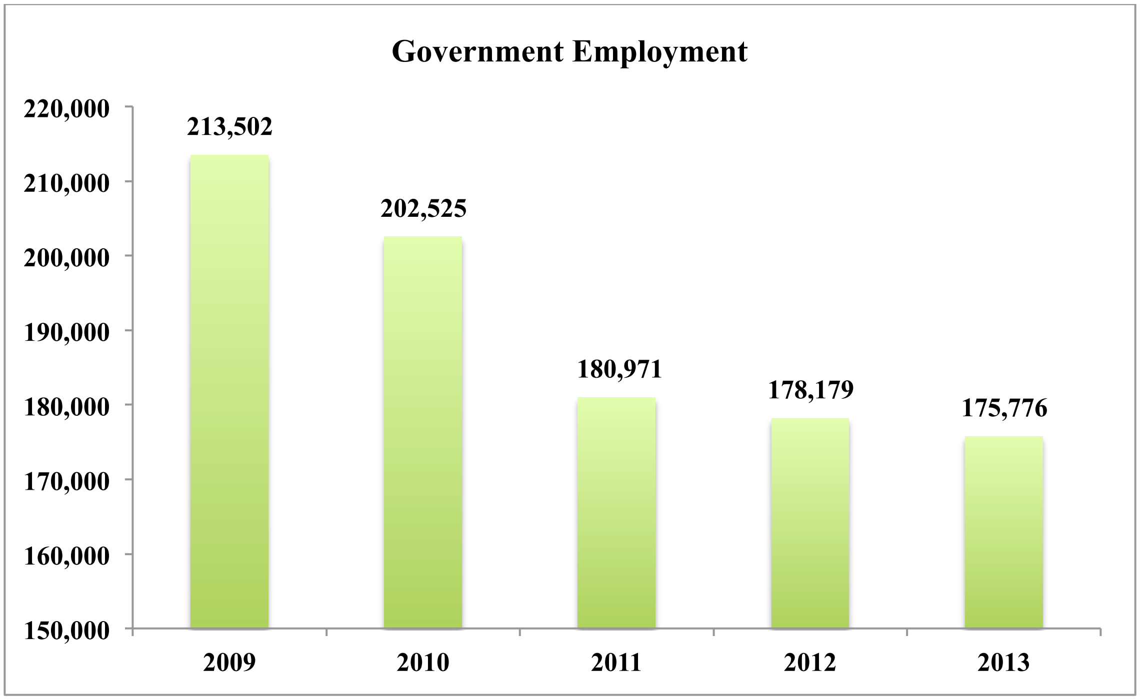
- Relative to GNP, consolidated budget debt service has increased significantly, from 5% of GNP in 2009 to 7.1% in 2012. In general terms, the debt service indicators show a negative trend because both the absolute and relative amounts dedicated to debt service have increased significantly since 2009.

Public Debt



- The Commonwealth's total public indebtedness increased from $58.415 billion in 2009 to $68.460 billion in 2012, an increase of $10.045 billion, or 17.2%. During that same period, Puerto Rico's GNP, at current prices, increased from $62.598 billion to $66.415 billion, an increase of $3.817 billion, or 6.09%.
- Relative to GNP, Puerto Rico's total public debt increased from 93.3% of GNP in 2009 to 103.08% in 2012. The red line in the graph above shows the 60.09% historical average Debt/GNP ratio for Puerto Rico during the 50-year period between 1962 and 2012.
- On a per capita basis, total public debt per capita in 2011 amounted to $17,341 which is equal to 113.1% of the island's per capita personal disposable income of $15,332.
- In our view, the overall trend with respect to total public indebtedness is negative, as it is still growing at a much higher rate relative to the growth in Puerto Rico's income and currently exceeds 100% of the island's GNP.

Government Employment



- According to statistics published by the Office of Management and Budget as part of the Governor's budget request, the number of people employed by the Commonwealth (central government and public corporations only) has decreased significantly from 213,502 in 2009 to a projected 175,776 in 2013, a reduction of 37,726 workers, or 17.7%. This decrease is equivalent to a CAGR of negative 4.74%.
- In relative terms, the number of central government employees per 100 inhabitants has also shown a decrease from 5.38 government workers per 100 people in 2009 to a projected 4.79 government workers per 100 people in 2013.
- Contrary to popular belief, if we compare Puerto Rico's rate of state and local employees per 100 inhabitants with the United States the difference is not significant. According to the U.S. Census Bureau, in 2010 there were 16,581,617 full time equivalent state and local government employees in the United States out of a total population of 308,745,538. This amounts to 5.37 state and local workers per 100 people.

Short and Medium Term Risks

While Puerto Rico has certainly stabilized its fiscal situation, as demonstrated by the improving trend reflected in several of the budget indicators we have reviewed previously, the Commonwealth still faces a challenging fiscal and economic environment and there are several risks that need to be monitored in the short and medium term.

General Fund Revenues – The tax reform legislated in January 2011 includes significant reductions in both individual and corporate income taxes that will be phased-in over a period of six years. This tax relief has been financed with a temporary excise tax imposed on certain multinational corporations with operations in Puerto Rico pursuant to Act 154. The excise tax, which will also be in effect for a period of six years, is based on the value of the personal property or services sold by certain corporations in Puerto Rico to their offshore affiliates and will be imposed at a rate of 4% for calendar year 2011, declining to 3.75% in 2012, 2.75% in 2013, 2.5% in 2014, 2.25% in 2015 and 1% in 2016. This excise tax currently accounts for approximately 22% of all general fund revenues.

Act 154 states that companies subject to the excise tax will become subject to a new income source rule in 2017. The income source rule essentially characterizes certain income of non-resident corporations, partnerships and individuals as effectively connected with the conduct of a trade or business in Puerto Rico and therefore subject to Puerto Rico income tax. The Puerto Rico Treasury Department estimates that the income tax imposed under the new income source rule should generate at least the same amount of revenues as the temporary excise tax. However, the income source rule is based on a complicated formula and it will be difficult both to implement and to enforce.

Furthermore, approximately only 40 taxpayers are currently subject to the excise tax, presumably the same taxpayers that would be subject to the income source rule. In our view, this situation presents a significant risk on two fronts: first, a very small number of taxpayers account for close to a quarter of all general fund revenues. If several of those taxpayers decided to close their Puerto Rico operations, for whatever reason, then the Commonwealth could face a significant revenue gap. Second, many of the companies subject to the temporary tax face patent expirations in 2013 and 2014 for medicines manufactured in Puerto Rico, so it is foreseeable that sales from their Puerto Rico affiliates will decline over the next two or three years as generic versions enter the market.

Federal Funds – As we have seen, the consolidated budget for fiscal year 2013 includes some $6.790 billion in federal funds, an amount equal to 24% of consolidated expenditures for that fiscal year. Therefore, the implementation of the Budget Control Act of 2011, which mandates significant across-the-board cuts over the next ten years in both defense and non-defense discretionary expenditures commencing in January 2013, could have a material adverse effect on the Commonwealth's public finances.

According to the Congressional Budget Office, discretionary non-defense expenditures would have to be cut about 7.8% during 2013 to comply with the requirements of the law.[7] While the law expressly exempts food stamps, Social

[7] Congressional Budget Office, *Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act*, 12 September 2011, p. 8.

Security, TANF, Medicaid, unemployment insurance and other social welfare programs from the mandatory cuts, Puerto Rico could still face significant reductions in federal allocations for education, housing, and highways, among other important government programs. For example, the 2013 budget for the Puerto Rico Education Department includes $1.267 billion in federal funds. A 7.8% reduction would equal some $98.8 million, which presumably would have to be squeezed out of an already tight general fund or borrowed from the GDB.[8]

Deficit Financing Capability is Limited – According to Standard & Poor's, since 2009 Puerto Rico's tax-supported debt has increased by $10.3 billion, or 43.7%. Furthermore, "the majority of this increase ($9.2 billion) is attributable to debt issued by the Puerto Rico Sales Tax Financing Corporation (COFINA), whose corporate purpose was to fund the identified accumulated deficits through fiscal 2012. Under its current legal framework, COFINA no longer has authority to issue additional debt. We anticipate that future budget-balancing measures will rely on a combination of restructuring of existing GO and appropriation debt, and one-time revenue measures."[9]

In our view, the expiration of COFINA's authority to issue additional debt together with the phase-out of federal stimulus spending under the American Recovery and Reconstruction Act will severely limit the flexibility of the Commonwealth's financial managers to fund any unexpected expenditures or cover unforeseen revenue gaps in the short term.

GDB's Balance Sheet – The GDB is another important source of liquidity and market access for the Commonwealth. Loans to the Commonwealth of Puerto Rico and its agencies and instrumentalities amounted to approximately $6.0 billion or 38.7% of the Bank's total assets as of June 30, 2011. As of that date, public sector loans by the Government Development Bank amounting to approximately $2.3 billion were delinquent by 90 days or more or had matured. These loans are expected to be collected from appropriations from, proceeds from bond issuances of, or revenues generated by the Commonwealth of Puerto Rico and/or its agencies and instrumentalities.

According to the GDB's external auditors, Deloitte & Touche LLP, "the collectibility of these loans may be affected by budgetary constraints, the fiscal situation and the credit ratings of the Commonwealth of Puerto Rico and its agencies and instrumentalities, and their ability to generate sufficient funds from taxes, charges and/or bond issuances. Continuance of and/or significant negative changes in these factors may affect the ability of the Commonwealth and agencies and instrumentalities to repay their outstanding loan balances with the Bank and, accordingly, may have an adverse impact on the Bank's financial condition, liquidity, funding sources, and results of operations."[10]

Overall Indebtedness Levels are Unsustainable – Puerto Rico's total public debt sums $68.460 billion, an amount equal to 103.08% of its expected GNP for fiscal year

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[8] In addition, Republicans have recently enacted legislation in the House to significantly cut Medicaid funding to Puerto Rico. See the report by the Center on Budget and Policy Priorities, *House Bill Would Cut Medicaid Funding for Puerto Rico by About $5.5 Billion Through 2019,* 25 April 2012.
[9] Standard & Poor's, *Summary Credit Profile – Puerto Rico Public Finance Corp; Puerto Rico Appropriation Bonds; Puerto Rico General Obligation Bonds,* 6 June 2012, p. 3.
[10] Deloitte & Touche LLP, *Independent Auditors Report*, included in the GDB's Basic Financial Statements and Required Supplementary Information as of and for the Year Ended June 30, 2011.

2012. Since 2000, Puerto Rico's public debt has increased at a compound annual growth rate of 9.06%, while its GNP, at current prices, has increased an annual rate of 4.01%. On a per capita basis, total public debt per capita in 2011 amounted to $17,341 which is equal to 113.1% of the island's per capita personal disposable income of $15,332. In our view, these levels and rates of indebtedness are not sustainable. Puerto Rico desperately needs to "grow the denominator", that is, to reignite robust economic growth.

However, even if Puerto Rico were to start growing at rates it has not seen in decades, it would take several years to bring down debt ratios to manageable levels. To understand why we need to analyze Puerto Rico's debt dynamics. According to standard macroeconomic theory, government debt growth is driven by two factors: (1) the difference between real interest rates and GDP growth (r-g), and (2) the primary budget balance as a % of GDP (i.e., before interest payments). In any given period the debt stock grows by the existing debt stock (d) multiplied by (r-g), less the primary budget balance (p).

The (r-g) assumption is one of the most important in debt dynamics: an (r-g) of greater than zero (when interest rates are greater than GDP growth) means that the debt stock increases over time. An (r-g) of less than zero causes it to fall. Since 2006, Puerto Rico has been experiencing negative real GNP growth rates, while real interest rates have remained relatively high due to low inflation. In addition, Puerto Rico has also been running substantial primary budget deficits during this period. Therefore, both factors point to a significant increase in the debt stock, which is what has actually happened since 2006. Reversing this trend will require that (1) Puerto Rico's real GNP growth consistently exceed the real interest rate on Puerto Rico's debt and (2) running a primary budget surplus on a regular basis.

Unfunded Pension Liabilities – As of June 30, 2011, the unfunded actuarial accrued liability (UAAL) (including basic and system administered benefits) of the Employees Retirement System, the Teachers Retirement System, and the Judiciary Retirement System was estimated at approximately $21.5 billion, $9.1 billion and $318.8 million, respectively.

Based on the assumptions used in the latest actuarial valuations, including the expected continued funding shortfalls, and taking into account the increases in employer contributions to the Employees Retirement System and the Teachers Retirement System adopted in July 2011: (1) the Employees Retirement System, the largest of the three retirement systems, would deplete its net assets (total assets less liabilities, including the principal amount of certain pension obligation bonds) by fiscal year 2014 and its gross assets by fiscal year 2021; (2) the Teachers Retirement System would deplete its net and gross assets by fiscal year 2021; and (3) the Judiciary Retirement System would deplete its net and gross assets by fiscal year 2018.

In our opinion, the public pension problem raises extremely complicated financial, political, legal, and moral issues. Puerto Rico currently owes $30 billion, approximately 45% of its GNP, to 8% of its population. Wealth transfers of this magnitude do not occur without serious political consequences. In our view, solving this problem will require retirees, current employees, and taxpayers in general to make and honor significant concessions.

Low Employment Levels – Puerto Rico's labor market remains extraordinarily weak. As of April 2012, the labor force participation rate, which measures the economically active portion of the population between 16 and 64 years of age, stood at 39.4%, one of the lowest participation rates in the world. Meanwhile, the employment rate stood at 33.8%, which means that only 1 out of every 3 persons between 16 and 64 years of age reported having a job in the formal sector of the economy. In sum, there are currently about 917,500 persons working in Puerto Rico, out of a total population of 3.7 million.

According to data from the U.S. Bureau of Labor Statistics, these workers earn an average salary of $27,190. They are, in the final analysis, the ones who bear the burden of paying the $98.460 billion that Puerto Rico currently owes its bondholders and its pensioners. This amounts to an average debt burden in excess of $107,300 per worker, almost four times the average annual salary, excluding any personal debts, such as mortgages, car loans, and credit cards.

Demographic Pressures – Puerto Rico lost 2% of its population between 2000 and 2010, joining Michigan as the only other U.S. jurisdiction to experience such a loss between the decennial censuses. Demographers point to two separate yet mutually reinforcing trends to explain this reduction. First, the Puerto Rican fertility rate has declined to about 1.7 children per woman of child bearing age, a rate that is lower than the 2.1 replacement rate demographers have estimated is required to maintain a stable population.[11] Second, migration, mostly to the U. S., increased significantly during the last decade.

These demographic trends mean that there will be less people working in the future, and therefore, there will be less people contributing to pay off the debts incurred by the Commonwealth with bondholders and pensioners. The unavoidable conclusion is that if the population is decreasing while public debts and obligations continue to increase, then the burden of those obligations will weigh more every day on each taxpayer. It would not be surprising if this situation ends up generating a serious taxpayer backlash over the medium term.

Weak Public Corporations – Puerto Rico owns several large public corporations, among them the Puerto Rico Aqueduct and Sewer Authority (PRASA), the Puerto Rico Electric Power Authority (PREPA), the Puerto Rico Highway Authority, and the Puerto Rico Ports Authority. In theory, public corporations are supposed to be financially self-sufficient and administratively independent from the regular departments and agencies of the Commonwealth's executive branch bureaucracy.

In practice, however, instead of reducing red tape, public corporations have added dozens of new bureaucratic layers to government and instead of limiting political intervention in government, public corporations have become important sources of political patronage as they provide ample employment opportunities for loyal party members and generous contracts for politically-connected suppliers.

Financial self-sufficiency has also turned out to be a chimera as many public corporations rely on the central government to help them cover their operational deficits and in some cases the central government has been obligated to assume their debt servicing obligations in order to avoid a default. In addition, most public corporations suffer from a severe lack of accountability, oversight and transparency at all levels.

[11] Consequently, Puerto Rico's population is not only decreasing but also aging rapidly with the median age increasing from 28.5 years in 1990 to 36.9 years in 2010.

The financial situation of PRASA is particularly worrisome. According to a recent analysis by Fitch, PRASA would be unable to generate sufficient cash after fiscal 2013 to meet all its operating expenses and debt service obligations. According to Fitch, PRASA would need either to (1) increase rates by 50% during fiscal 2014 or (2) obtain an annual subsidy from the general fund in an amount estimated to be between $335 million and $425 million in order to meet all its obligations. [12] Given that politicians usually loathe increasing rates for public utility services and that the general fund is already overextended, it is quite possible that PRASA may face a difficult financial situation during fiscal year 2014.

Conclusion

Our analysis of the Commonwealth's financial situation shows that Puerto Rico has made great strides towards achieving fiscal stability. General fund expenditures have been brought under control, payroll expenses have decreased significantly since 2009, the use of non-recurring revenues has diminished, and the structural deficit has been cut by 65%. On the other hand, Puerto Rico is still seriously dependent on federal funding, enlarging the tax base has proven difficult, and the structural deficit, while showing a generally declining trend since 2009, still exceeds $1 billion. Therefore, Puerto Rico's fiscal situation, in our opinion, has stabilized during the last three years but it is still quite fragile.

Perhaps more worrisome in the short term is the fact that Puerto Rico's levels and rates of indebtedness are not sustainable. Puerto Rico's total public debt sums $68.460 billion, an amount equal to 103.08% of its expected GNP for fiscal year 2012. Since 2000, Puerto Rico's public debt has increased at a compound annual growth rate of 9.06%, while its GNP, at current prices, has increased an annual rate of 4.01%. Furthermore, the expiration of COFINA's authority to issue additional debt, the phase-out of federal stimulus spending under the American Recovery and Reconstruction Act, and the relative weakness of GDB's balance sheet, will severely limit the flexibility of the Commonwealth's financial managers to fund any unexpected expenditures, manage an unanticipated liquidity crunch, or cover unforeseen revenue gaps in the short term.

Over the medium term, Puerto Rico's faces a challenging fiscal and economic situation. On the fiscal front, it remains to be seen whether the income source rule would generate enough recurring revenues to achieve structural balance and federal funding is likely to remain stagnant in the best case scenario or be significantly reduced in the worse. At the same time, Commonwealth financial managers will have to balance intense competing pressures on the general fund to (1) make up any lost federal funding, (2) subsidize financially struggling public corporations, (3) keep the public pension systems afloat, and (4) finance all the health, education, and public safety services that the Puerto Rican people expect from their government.

On the economic side, adverse demographic changes and the relative shortage of both public and private investment have combined to limit the growth potential of the Puerto Rican economy. Real growth rates in the 0 to 1.5% range are not sufficient to significantly increase employment, sustain income growth, and create wealth.

[12] Fitch, *Fitch Rates Puerto Rico Aqueduct and Sewer Authority Senior Revenue Bonds 'BBB'*, 6 February 2012.

The fundamental problem boils down to investment. No economy can grow without adequate investment, and in Puerto Rico neither the government nor the private sector is in a position to finance the investment required. The Administration was betting that its P3 program would be attractive enough to bring in billions in new foreign investment. Unfortunately, the program has failed to live up to initial expectations and its performance can be charitably described as an utter disappointment.

In sum, Puerto Rico's public finances have stabilized but are still weak, its levels and rates of indebtedness are not sustainable, its fiscal viability over the medium term is uncertain, and its economic outlook remains quite modest.