

Puerto Rico: Separating Fact from Fiction

June 2017

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**“Transparency is a guiding principle
specifically mandated by PROMESA.”**

- Oversight Board Chairman Jose Carrion in a June 16, 2017 Letter to Governor
Rosselló and other Commonwealth Officials

Puerto Rico's Fiscal Situation Is Dramatically Improving

The Facts On Puerto Rico's Fiscal Situation:

- The Commonwealth has budgeted a \$3bn primary surplus in 2018, yet claims it has virtually no money for debt service.
- This massive surplus occurs even while the Commonwealth *is increasing year over year expenses by \$575mm*, and refusing to identify essential services despite the Oversight Board's recent demand that it do so.
- General Fund revenues continue to outperform all official estimates, including the Fiscal Plan.
- Recent disclosures of official documents show approximately \$1bn in additional cash, and \$1bn in reduced accounts payable.
- Rather than correct the Fiscal Plan to incorporate any of these developments, the Oversight Board and the Commonwealth are engaged in subterfuge to hide economic data from creditors and officials in Washington.

A Massive Primary Surplus, Increasing Revenues, & \$1bn of Available Cash

The Spin: *"The government's liquidity and solvency problems are massive and Title III has now become necessary to protect the people of Puerto Rico."* – Oversight Board Chairman Jose Carrion, June 3, 2017

The Facts:

- **The Commonwealth has budgeted a massive \$3bn primary surplus in Fiscal Year 2018**
 - The primary surplus factually demonstrates that tax collections are significantly outpacing government spending, even when factoring in an increase in spending on non-essential services.
 - Despite this massive primary surplus, the certified Fiscal Plan calls for just \$404mm of cash available for debt service in FY2018.
- **Fiscal YTD General Fund revenues are up, powered by robust consumer consumption**
 - Fiscal YTD General Fund revenues outpace budget by \$236mm (3.2%), led by consumption-based taxes.
 - Sales and Use Tax revenue increased 8.6% year over year; Motor Vehicle Tax revenue increased 34% year over year, with unit sales up 5.8% year over year.
 - Robust consumer consumption is indicative of an economy that is expanding, not contracting.
- **Disclosures from the Puerto Rico Department of Treasury show close to \$1bn of excess cash**
 - The Commonwealth has a projected ending cash position of \$1.15bn as of June 30th compared to \$291mm as forecast by the Fiscal Plan.
 - Notably, this information only became available as part of litigation brought by the Center for Investigative Journalism.
- **The Fiscal Plan does not reflect nearly \$1bn in payables that have either been paid or written down in Fiscal Year 2017**
 - The Fiscal Plan contemplates paying \$1.3bn in deferred payables over the projected period, however, \$1bn of these outstanding payables appear to have been written off or paid, according to documents that were made public by the Center for Investigative Journalism.

The Board and Commonwealth Are Engaged in Budget Subterfuge

Puerto Rico's economy is expanding, but the Board and the Commonwealth say otherwise. How are the Board and the Commonwealth obscuring the facts about Puerto Rico's fiscal situation?

1. Governor Rosselló's Budget increases, rather than decreases expenses

- Core General Fund expenses increase by \$575mm in FY18 Budget, obscured by accounting gimmicks, specifically the creation of "below the line" reserve accounts, which function as slush funds for the Commonwealth.
- The so-called Reconciliation Adjustment (\$545mm) and Budgetary Reserve (\$305mm) actually allow for an increase in General Fund expenditures, including increasing expenditures on non-essential services.
- Governor Rosselló has promised to reduce taxes for businesses and individuals, despite being in default on Constitutionally-protected first priority, full faith and credit debt.

2. The Board and the Commonwealth are projecting a steep decline in GNP and overall revenues, in the face of conflicting data

- Despite seeing actual nominal GNP growth in almost every year since 1981, the Fiscal Plan projects an economic contraction that starves the budget of \$600mm+ of revenues.
- Local politicians have highlighted the conservative nature of the General Fund revenue projections.

The FY18 Budget Hides General Fund Expenditure Increases

<u>General Fund Year-Over-Year</u>	FY17 Budget	FY18 Budget	Variance
Direct Payroll	3,271	2,792	(479)
Direct Operational Expenses	907	774	(133)
Utilities	260	260	-
Special Appropriations	3,891	3,437	(454)
General Fund Expenses	8,329	7,263	(1,066)
Incremental Retirement	266	1,449	1,182
Reconciliation Adjustment	-	545	545
Budgetary Reserve	220	305	85
Other	172	-	(172)
Total General Fund Budget	\$8,987	\$9,562	\$575

- The FY18 Budget moves hundreds of millions of pension expense from Direct Payroll (i.e., General Fund expense) to Incremental Retirement, below the General Fund Expense line.
- The “Reconciliation Adjustment” – straying far from its Board-stated purpose of being a “hypothetical extrapolation of potential understatement of general fund expenditures” – provides a slush fund for increased and new appropriations. This is another example of “below the expense line” budgeting that allows Governor Rosselló to increase actual spending.
- The “Budgetary Reserve” provides another \$305mm in FY18, in addition to the \$395mm of contingency reserve funded in the last 5 weeks of FY17, to fund appropriations above debt service even though a significant portion of the reserve is to be used only when there is insufficient income for the year **“to honor the payment of the public debt”**
- All in all, the Rosselló budget proposes to INCREASE spending by \$575mm year over year.

The “Reconciliation Adjustment” is a Slush Fund

The Reconciliation Adjustment has morphed into a slush fund for previously unbudgeted non-essential services

- The Oversight Board has described the Reconciliation Adjustment as “a hypothetical extrapolation of historical general fund expenditures [that] suggests a potential understatement of general fund expenditures in the FY17 projections”
- In practice, the Reconciliation Adjustment is being used to fund new additional expenses across specific agencies. For example, it is already being appropriated to entities (HTA and Cardio Center) which never received General Fund appropriations.

*“Gov. Ricardo Rosselló’s fiscal 2018 budget proposal includes hundreds of millions of dollars in agency-level earmarks for unspecified ‘**other operational costs**’ that could be used to pay down legacy debts, Office of Management and Budget Director José Iván Marrero said.”*

*“House Minority Leader Rafael ‘Tatito’ Hernández circulated a list of such **earmarks** totaling \$525 million at 13 agencies that he referred to as ‘fiscal plan reconciliation adjustments.’”*

- Reorg Research June 8, 2017
(emphasis added)

The Size of Puerto Rico's Primary Surplus is Massive

“In the next few months, we will be facing challenges in terms of cash” – According to Elias Sanchez in a June 16, 2017 press release

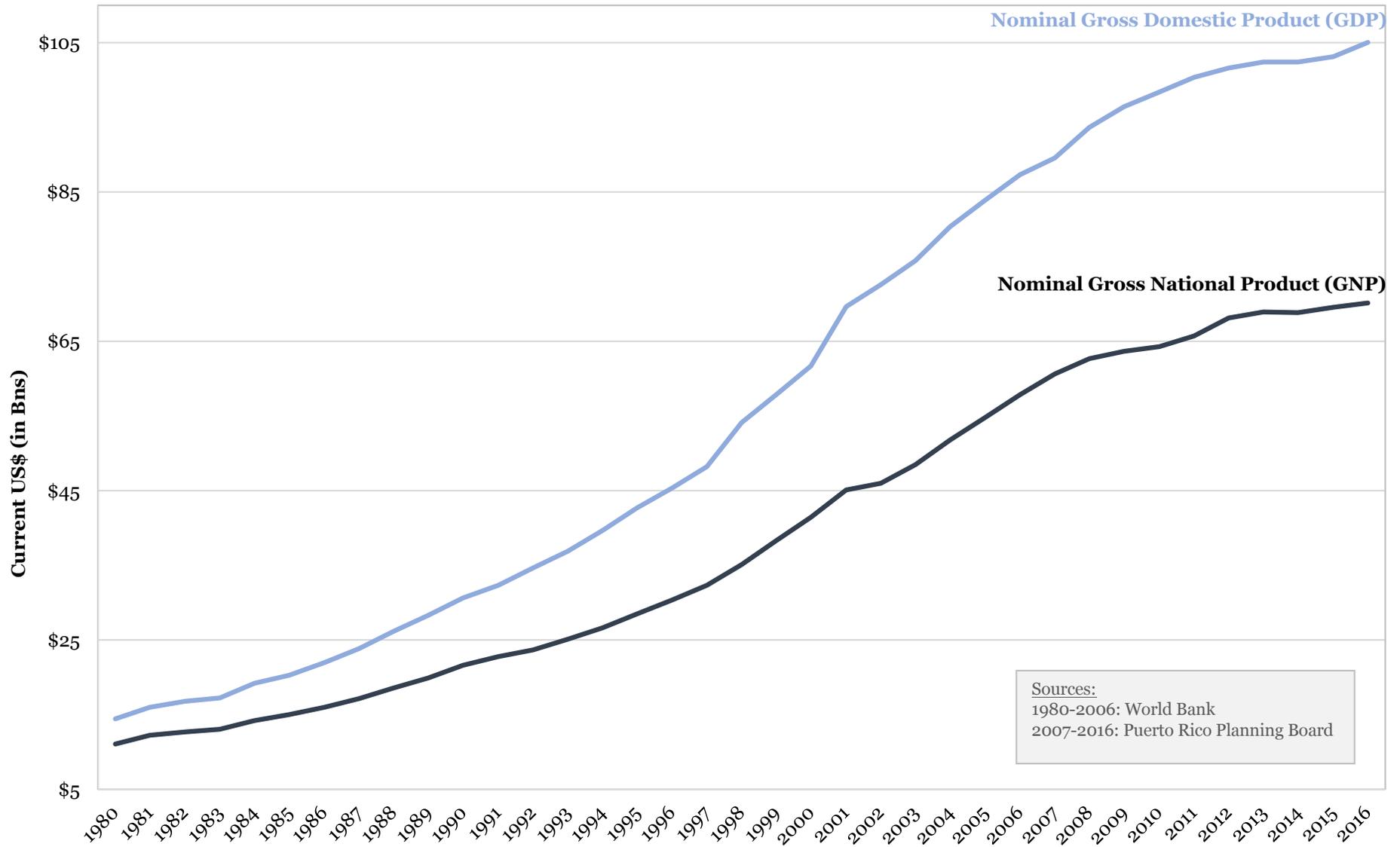
- The Board and Commonwealth claim that Puerto Rico's situation is dire, but the facts don't support these claims.
- While our calculation of the Primary surplus is based on the Commonwealth's own numbers, we have substantial critiques of their revenue and expense calculations, and believe stakeholders should be afforded the opportunity to further diligence these items.
- To arrive at the General Fund Primary Surplus, we add the “Reconciliation Adjustment”, the Budgetary Reserve, and Net Pension Expense
- To arrive at Other FP Primary Surplus, we subtract non-General Fund expenses in the Fiscal Plan from non-General Fund revenues in the Fiscal Plan
- **The Result: Total FY18 Primary Surplus is \$3.038bn**
 - This compares to roughly \$950mm per year in annual GO and GO-guaranteed interest expense

FY18 Primary Surplus Calculation

Reconciliation Adjustment	545
Budgetary Reserve	305
Net Pension Expense (1)	1,648
General Fund Primary Surplus	2,498
<u>Other Fiscal Plan Revenues</u>	
Additional SUT	358
Escrowed SUT	519
Other Tax Revenues	1,294
Other Non-Tax Revenues	575
Additional Medicaid Funding	296
Loss of ACA	(865)
Total Other Fiscal Plan Revenues	2,177
Other Fiscal Plan Expenses	(1,637)
Other Fiscal Plan Primary Surplus	540
General Fund Primary Surplus	2,498
Other Fiscal Plan Primary Surplus	540
Total FY18 Primary Surplus	\$3,038
<i>Fiscal Plan 2018 Cash Available for Debt Service</i>	<i>404</i>

(1) General Fund pension expense less \$390mm Pay-Go Reimbursements.

Puerto Rico's GNP today – At an All Time High



Despite all of This, the Board and Commonwealth Still Refuse to Correct the Fiscal Plan

- In a court filing on June 10, 2017 the Oversight Board states that “the Fiscal Plan contemplates an average of \$787mm in available funds for debt service.”
- That is a material misstatement of fact that excludes current fiscal realities, including Puerto Rico’s massive primary surplus and liquidity improvements covered in this presentation.
- In fact, the Fiscal Plan average annual cash flow available for debt service should improve from \$787mm to \$1.16bn in light of these developments alone.

Fiscal Plan Cash Available for Debt Service	Fiscal Plan Impact	
	Cumulative	Annualized
Pension Adjustment Passed In Amendment To Fiscal Plan	900	90
Fiscal Plan Amendment Incremental Cash Available for Debt Service	900	90
<i>Further changes required based on recent events:</i>		
Outperformance In Cash Balance (FY17 Actual)	859	86
Outperformance In Cash Balance (FY18 Budget) (1)	420	42
Decrease In Supplier Payables	946	95
PRHTA Fiscal Plan Measures (2)	616	62
Additional Cash Available For Debt Service Based on Recent Events	2,841	284
Total Incremental Cash Available for Debt Service	\$3,741	\$374
Fiscal Plan Cash Available for Debt Service	7,873	787
Total Pro Forma Cash Available for Debt Service	\$11,614	\$1,161

(1) Calculation of outperformance in cash balance (FY18 budget):

Cash in Budgetary Reserve	305
Cash in SUT Escrow	519
Total FY18 Cash Balance in FY18 Budget	824
Fiscal Plan Cash Available for Debt Service	(404)
Outperformance in Cash Balance (FY18 budget)	420

(2) PRHTA expense measures pursuant to April 2017 PRHTA Amended Fiscal Plan.

“It is equally of concern that some of the narrative taking hold in the public discourse fails to characterize adequately the truly dire fiscal situation the Commonwealth is facing, thus leading the public to underestimate the true nature and impact of some of the fiscal responsibility measures mandated in the fiscal plan and that, accordingly, will have to be incorporated in the budget.”

- Jose Carrion, in a June 16, 2017 letter to Governor Rosselló and other Commonwealth officials

Materials Relied Upon

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 - <https://juntasupervision.pr.gov/wp-content/uploads/wpfd/50/5931f195b70d1.pdf>
- Letter to Governor Rosselló and the Presidents of the Senate and the House of Representatives Regarding Revisions to the Fiscal Plan. Includes Appendixes A (Letter from FAFAA) and B (Unanimous Consent from the Board) (June 2017), Federal Oversight and Management Board for Puerto Rico
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- FY17 Legislative Budgets - RESOLUCION CONJUNTA (R. C. de la C. 893 and 894) (July 2016)
 - <http://new.reorg-research.com/data/documents/20160705/577c177146fdo.pdf>; <http://new.reorg-research.com/data/documents/20160705/577c18c6d3b51.pdf>
 - See also – “Puerto Rico Governor Enacts Budget as Oversight Board Looms,” Reorg Research, July 5, 2016, <http://platform.reorg-research.com/app#company/all/intel/view/23307>

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 - See also – “AAFAF Chief: \$859M Liquidity Increase Doesn’t Mean Puerto Rico Financial Situation Improved,” Reorg Research, June 14, 2017
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 - https://drive.google.com/file/d/oBwUldNJ-sOg_TkJGdFVtelZCTms/view
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