



COMMONWEALTH OF PUERTO RICO
FISCAL UPDATE

April 26, 2006 • Page 1 of 2

**Puerto Rico Takes Proactive Measures to Continue Operating
Amid an Unprecedented Fiscal Crisis**

The Commonwealth of Puerto Rico faces an unprecedented fiscal crisis resulting from a year-end deficit that precludes the payment of wages to Government employees unless the Legislature enacts measures that would authorize the Government Development Bank for Puerto Rico to make a loan sufficient to cover the deficit. This week the Governor announced that if no additional funds are forthcoming by May 1, 2006, the Government will shut down and only departments necessary for the safety and welfare of the citizenry will continue to operate. The Constitution of Puerto Rico provides that public debt of the Commonwealth constitutes a first claim on available Commonwealth resources, over any other expenditure, including wages. In other words, there is no prospect that the current situation will result in any default on debt service payments, including GO's and debt payable from legislative appropriation.

Following is a discussion of the background leading to this situation and the steps taken by the Government to date to reduce expenditures and attempt to resolve the political impasse, which now requires legislative action. Credit agencies have been notified of the situation, and we will continue to keep you informed as developments dictate.

Background

- The Government of Puerto Rico faces an unprecedented fiscal crisis, which has developed over several years and is highlighted by a structural budget imbalance of \$1.2 billion in FY2006.
- Despite lack of approval by the Legislature of key measures proposed by the Governor in his initial 2006 budget presented in March 2005, the Office of Management and Budget (OMB) has stated that the executive has implemented an estimated \$500 million of recurring revenue and savings measures this year.
- Since November numerous measures have been presented by the Legislature and the Executive aimed at eliminating the structural deficit. These include the implementation of a sales tax of up to 7%, which is expected to significantly increase revenues, and fiscal reform designed to curb the growth of Government spending and debt. Public hearings on this legislation began in February and are on-going.
- Notwithstanding these efforts and without approval of any new revenue measures this year, the Administration requires approximately \$738 million to cover the current year's budget deficit as several agencies face serious shortfalls, headed by a \$364 million deficit at the Education Department.
- The Governor has proposed that the \$531.5 million necessary to cover at least payroll and essential services for the next two months come from a loan by the Government Development Bank or from local private commercial banks, with prior authorization from the Legislature.
- GDB's policy requires a specifically identified source of repayment (in this case, the Legislature passing the proposed sales tax, or any other designated revenue source, as required by law), in order to provide the loan.



COMMONWEALTH OF PUERTO RICO FISCAL UPDATE

April 26, 2006 • Page 2 of 2

Earlier This Week

- Monday night, the Senate of Puerto Rico approved Joint Resolution 630 allowing a \$531.5 million loan to cover payroll expenses and other costs for the rest of fiscal year 2006, which ends June 30th. The bill allocates \$146 million to the Health Insurance Administration and more than \$385.2 million to 13 agencies, including the key departments of Corrections, Education, Health, Police, Medical Emergency Corps and Juvenile Administration, among others.
- Included in the loans are provisions to cover the salaries of some 200,000 Government employees through the end of the fiscal year, estimated at \$100 million per week.
- The bill goes now to the House of Representatives for evaluation and approval.
- The Speaker of the House is aware of the Government's fiscal situation and budget deficit, and has expressed that the House will take "appropriate measures".
- If the measures approved by the Senate become law, the Government will have the necessary resources to continue operating until the end of the current fiscal year.

What's Happening Now

- Tuesday the Governor presented a plan to implement the temporary closing of all but 29 Government agencies that provide essential services such as safety, health and retirement benefits, as a last resort to face the current fiscal shortfall.
- The Treasury Department will use available funds to guarantee the provision of essential services.
- Public corporations that generate their own funds will continue to operate providing services as usual.
- The Education Department has confirmed a lack of funds to pay its 75,000 employees after this week, thus having to end the semester two weeks earlier by finishing classes on Friday.
- The Governor has stated that during the Island's financial crisis he is making the difficult decisions needed to act responsibly in light of Puerto Rico's current fiscal limitations
- He has reiterated that he cannot keep public employees at work if there are insufficient funds to pay them.
- A massive demonstration by Government employees and the general public is expected on Friday urging the Legislature to act on the Governor's proposals, thereby avoiding the shut down.

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