AFP ASSOCIATION FOR FINANCIAL PROFESSIONALS Puerto Rico

Seminario Almuerzo

Abogando por el 20%

con el Sr. Jorge Irizarry,

Director Ejecutivo, Bonistas del Patio, Inc.

Fecha: 18 de agosto 2016
Hora: 11:30 am - 1:30 pm

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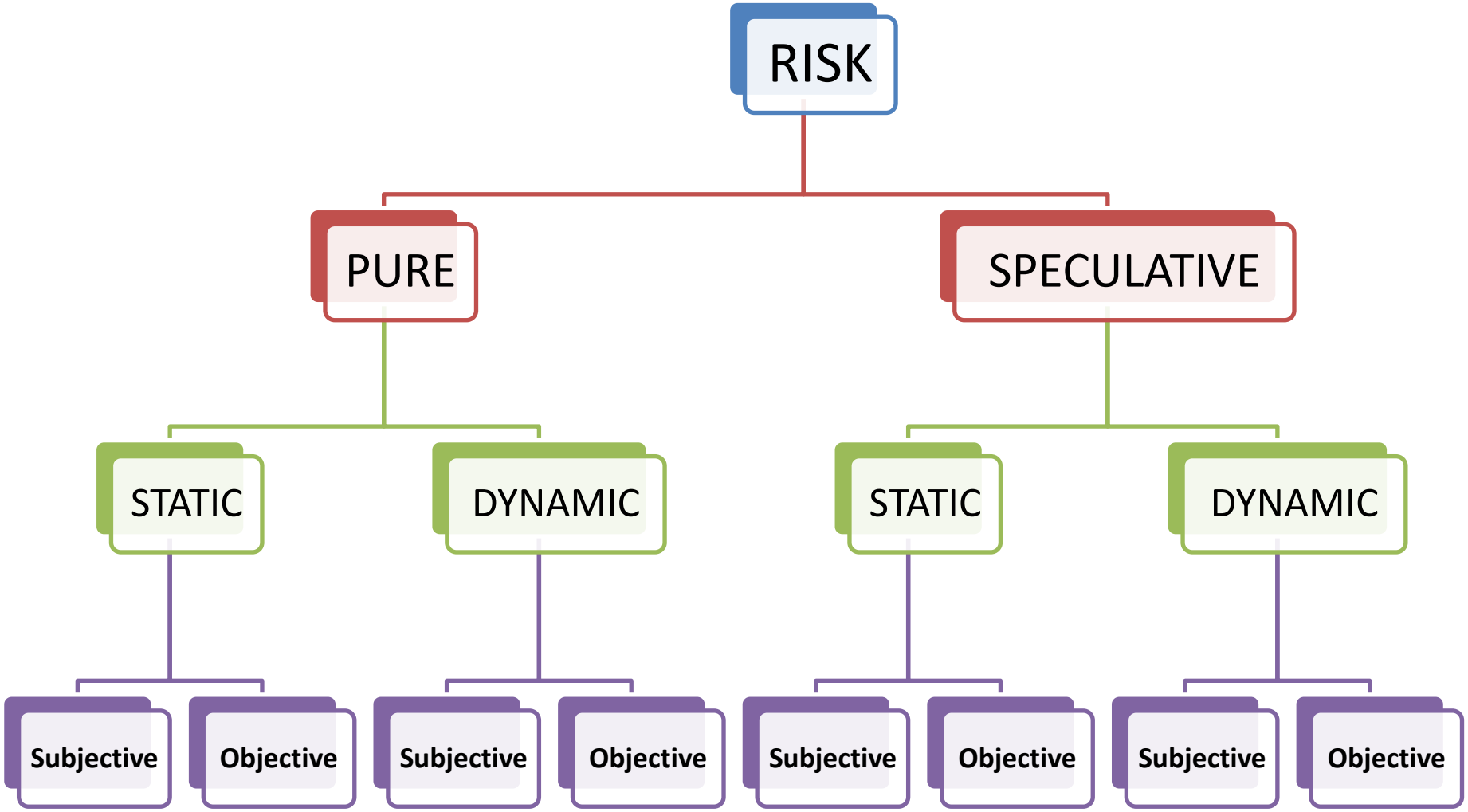
Introducción al tema de la Situación Económica de Puerto Rico

Dr. José Toral
Economista y
Profesor Universitario

STRUCTURAL STAGNATION

Colander 2013

"A particular kind of downturn . It is a cyclical downturn that we do not expect to end any time soon without mayor changes in the structure of the economy. It is a short term problem that extends into the long term. ..many unemployed cannot get a job at the pay they were getting or in the field where they worked. …there are no expectations that even the government has the ability to pull out of it without running stimulus policies such as massive deficits. …the economy is stuck in a rut, with no easy way to get out."



Trieschmann – Gustavson - Hoyt

EL IMPACTO DE LA JUNTA DE CONTROL FISCAL EN LA ECONOMÍA DE PUERTO RICO

- No existe precedente sobre un acto como este en Puerto Rico.
- Se ha hablado mucho sobre lo que sucederá y lo que se espera resuelva esta junta.
- Al día de hoy no se sabe quien compone la misma.
- Podemos especular sobre lo que creemos que pueda pasar y los efectos en la economía de Puerto Rico

EL IMPACTO DE LA JUNTA DE CONTROL FISCAL EN LA ECONOMÍA DE PUERTO RICO

- Nombre; Junta de Control Fiscal.
- Fiscal: proviene de fisco, "*fiscus*" en latín que es cesto o canasta para transportar aceitunas al la almazara. La hacienda pública recaudaba los impuestos al que llamaban "*aerarium*" (de aes, bronce o metal acuñado) hoy erario. De ahí se deriva "*confiscare*" hoy confiscar. (RELA 2016), (Etimología 2016).

EL IMPACTO DE LA JUNTA DE CONTROL FISCAL EN LA ECONOMÍA DE PUERTO RICO

- ¿Como la Junta de Control Fiscal recibirá la cultura empresarial puertorriqueña?
- ¿Como esta junta podrá conciliar la cultura fiscal de Puerto Rico con la cultura del tratamiento de impuestos en los Estados Unidos?
- ¿En materia de impuestos sobre la propiedad como la junta va a conciliar la valorización de las propiedades en Puerto Rico (1958) con el sistema federal?

EL IMPACTO DE LA JUNTA DE CONTROL FISCAL EN LA ECONOMÍA DE PUERTO RICO

- Efecto de despido de empleados públicos:
- Baja en el PIB
- Aumento en la morosidad de préstamos
- Aumento en la reposición de propiedades.
- Disminución en el consumo.
- Aumento en el gasto público en salud.
- Aumento en el desempleo(aumento en el alcoholismo, maltrato, suicidios) (Parkin 1995)

EL IMPACTO DE LA JUNTA DE CONTROL FISCAL EN LA ECONOMÍA DE PUERTO RICO

- La deuda soberana de Puerto Rico representa el 101% del PNB no del PIB.
- El estado produce servicios, no produce bienes.
- El estado adquiere bienes de las empresas privadas.
- La disminución del empleo o el gasto gubernamental afecta fundamentalmente los servicios que ofrece el estado.

EL IMPACTO DE LA JUNTA DE CONTROL FISCAL EN LA ECONOMÍA DE PUERTO RICO

- PIB = C + I + (x – i) + G
- Multiplicador del gasto de gobierno en PR es 1.167 (JP 1992)
- Multiplicador del empleo de gobierno tipo II en el 2014 es 1.55 entre empleos directos e indirectos. (Junta de Planificación 2014)
- La reducción del gasto y el empleo sería devastador para la demanda agregada de Puerto Rico. No se trata del gasto de gobierno, lo importante es la reducción de la demanda agregada.

EL IMPACTO DE LA JUNTA DE CONTROL FISCAL EN LA ECONOMÍA DE PUERTO RICO

- Una reducción en la demanda agregada indica reducción en la compra de bienes y servicios en las empresas privadas.
- Además de una reducción en los recaudos de estado provocando además una baja en el PIB y el PNB.
- En Puerto Rico hay 6 empleados públicos por cada 10,000 habitantes. (Alameda 2011)

EL IMPACTO DE LA JUNTA DE CONTROL FISCAL EN LA ECONOMÍA DE PUERTO RICO

- Virginia tiene 14 por cada 10,000 habitantes (NASBO 2011) (según la definición de empleado público)
- El pago de la deuda como se conoce hoy no es posible ni probable con el PIB de Puerto Rico.
- La única solución posible y positiva para todas las partes es el aumento del PIB y el PNB.

EL IMPACTO DE LA JUNTA DE CONTROL FISCAL EN LA ECONOMÍA DE PUERTO RICO

- Hiroshima y Nagasaki
- Shumpeter (Destrucción Constructiva)
- Naomi Klein: The Shock Doctrine
- Escuela Monetarista de Chicago.
- Neoliberalismo
- Mercados

EL IMPACTO DE LA JUNTA DE CONTROL FISCAL EN LA ECONOMÍA DE PUERTO RICO

- ¿Qué pido a la junta y a ustedes?
- Prudencia
- Fortaleza
- Templanza
- Justicia

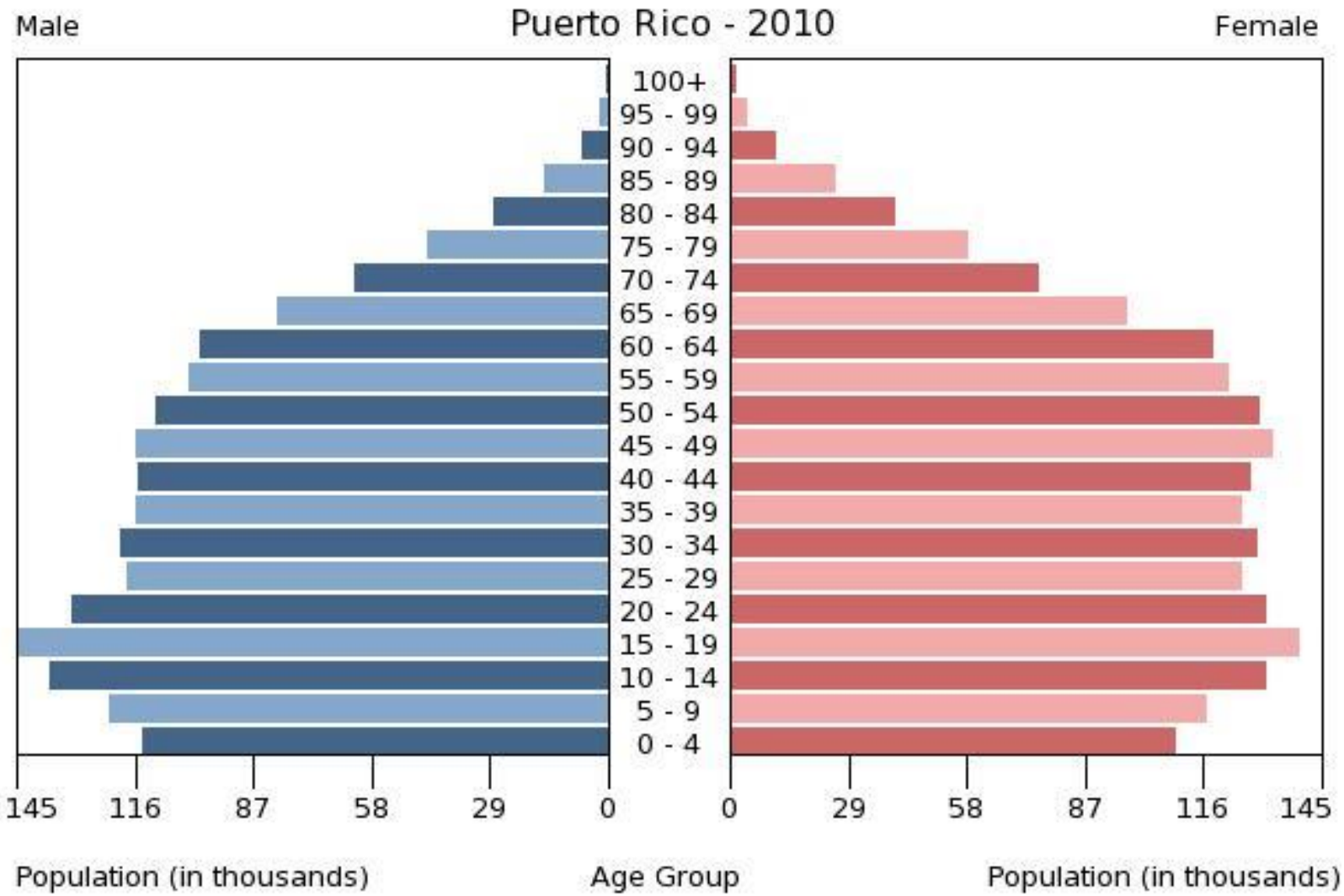
Platón define cómo un individuo puede lograr estas virtudes:

- la prudencia viene del ejercicio de razón,
- la fortaleza de ejercer las emociones o el espíritu,
- la templanza de dejar que la razón anule los deseos, y desde estas,
- la justicia viene, un estado en que cada elemento de la mente está de acuerdo con los otros

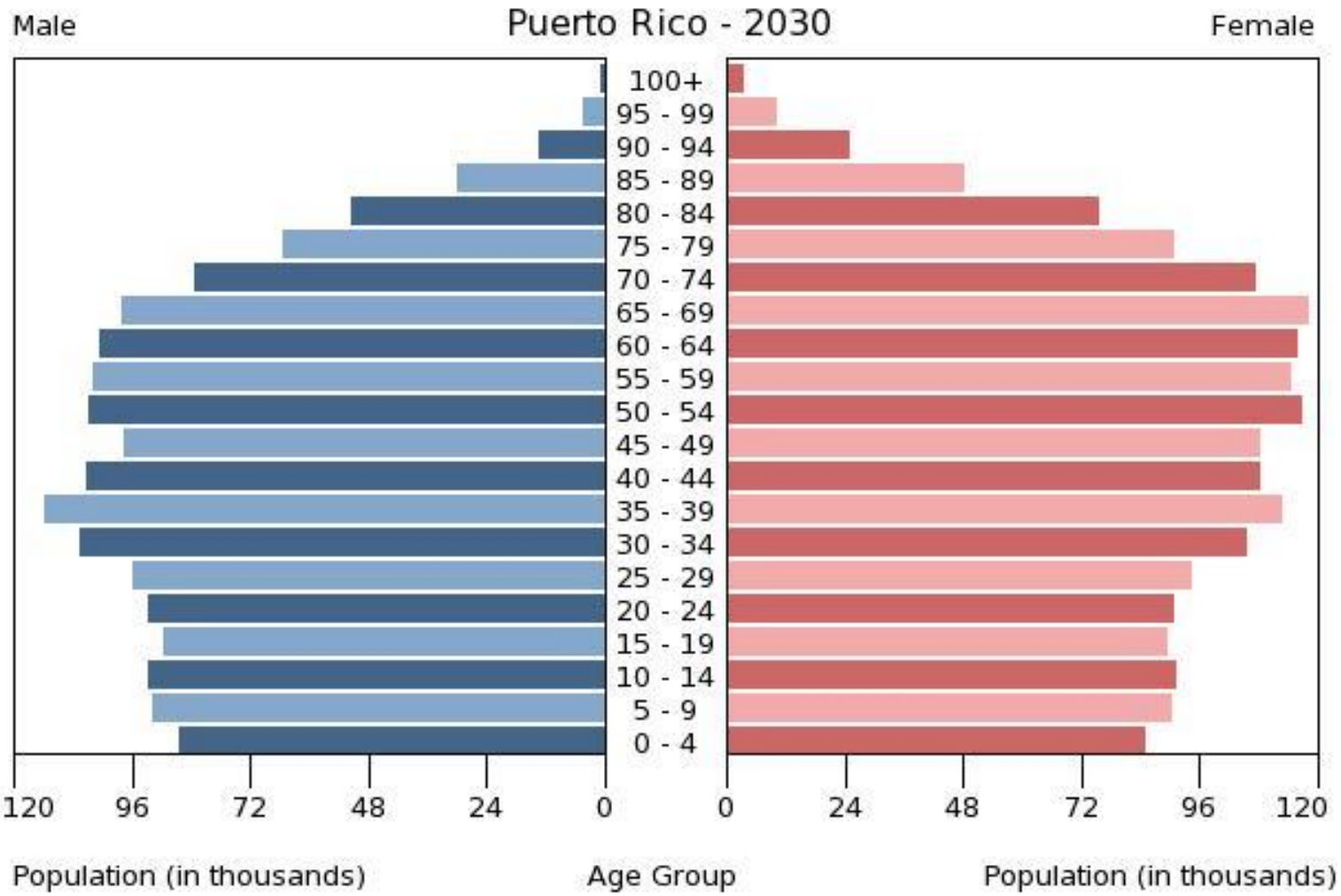
PROYECCIONES DEMOGRÁFICAS:

“De mantenerse las tendencias de fecundidad, mortalidad y migración se proyecta que la población continuará disminuyendo y envejeciendo rápidamente.”

Raúl Figueroa, Demógrafo



US Census Bureau



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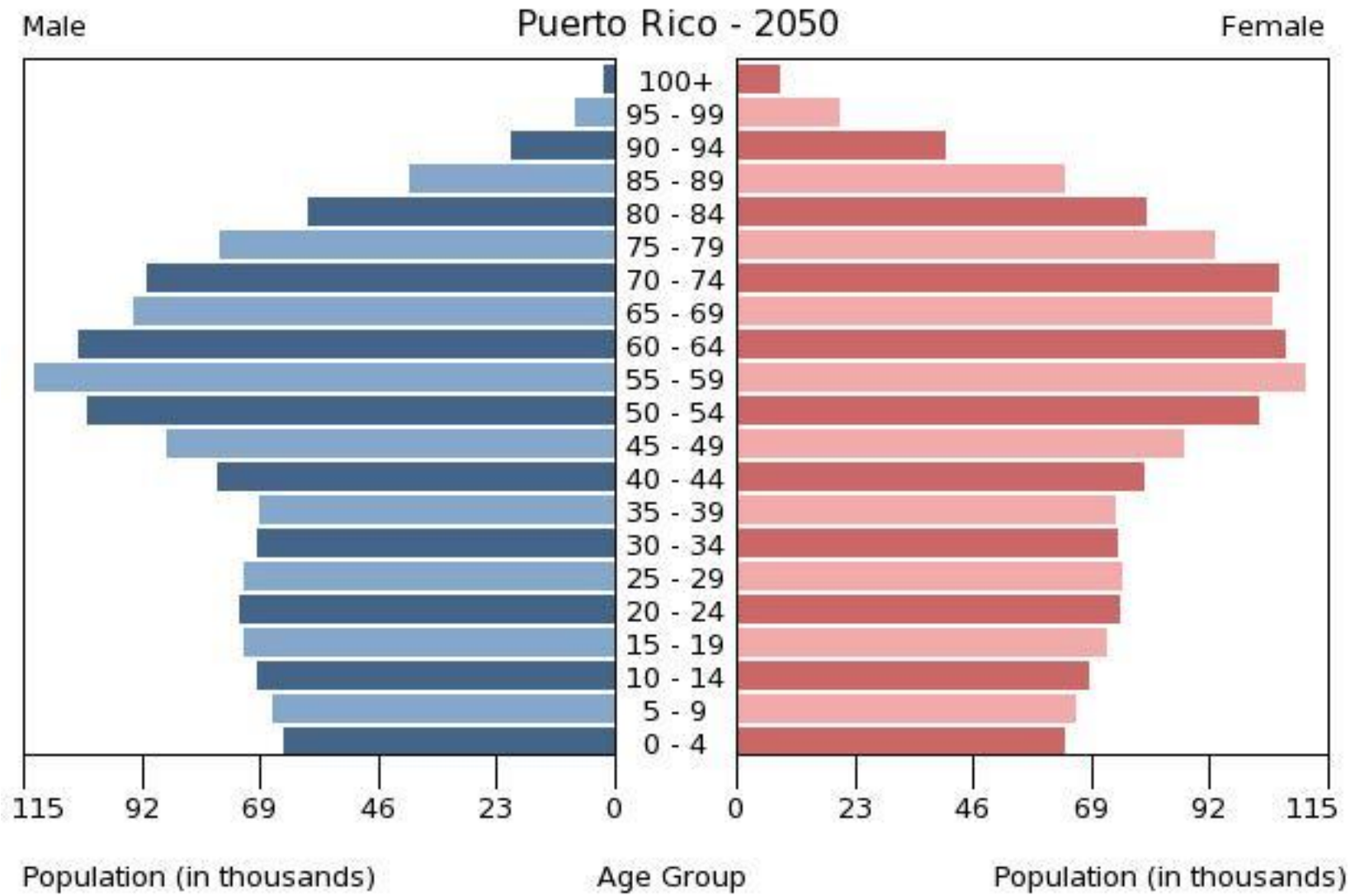


US Census Bureau

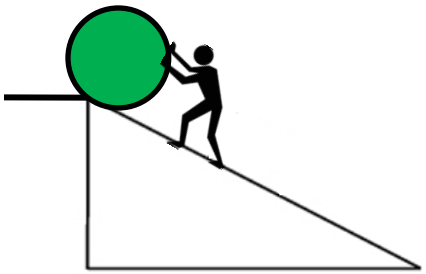
“El principal desafío para Puerto Rico no proviene de su demografía, sino de la incapacidad de la sociedad y de sus líderes de afrontarla.”

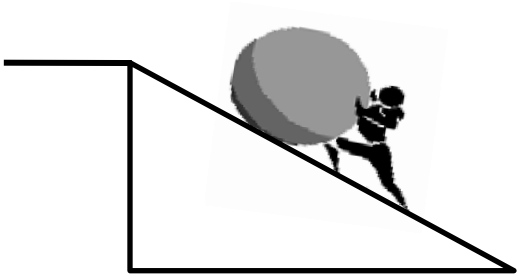
Raúl Figueroa
The Elders’ Colony

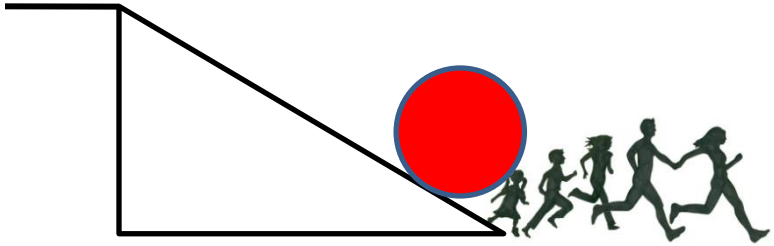
Expectativas a corto plazo

- Baja en la producción (PIB)
- Baja en la participación laboral.
- Baja general en el precio de los bienes raíces.
- Baja en la intermediación financiera de la banca por el efecto del "shadow banking"
- Concentración de la industria bancaria (HHI).
- Aumento en el índice de desigualdad en PR y EUA (Gini)
- Achicamiento de la clase media (productiva)
- Pérdida de empleos en el sector manufactura.
- Disminución en los recaudos del estado
- Corrección en los mercados financieros.
- Mantenimiento, financiamiento y pago de deuda infraestructura para 3.8 millones de habitantes con solo 2.9 millones hasta el 2050.

PNB = f (T)







“Aparte del valor cultural del estudio de la Ciencia Económica, el conocimiento de los procesos económicos fundamentales es esencial para la más eficaz participación del ciudadano en la vida pública”

Antonio J. González, PhD 1976

EL IMPACTO DE LA JUNTA DE CONTROL FISCAL EN LA ECONOMÍA DE PUERTO RICO

¡Muchas Gracias!

Abogando por el 20%

Jorge Irizarry
Director Ejecutivo
Bonistas del Patio

A View of PR Fiscal and Debt Situation

Presented to Asociacion para Profesionales de Finanzas

Jorge Irizarry, Director Ejecutivo, Bonistas del Patio Inc.

Aug 18, 2016

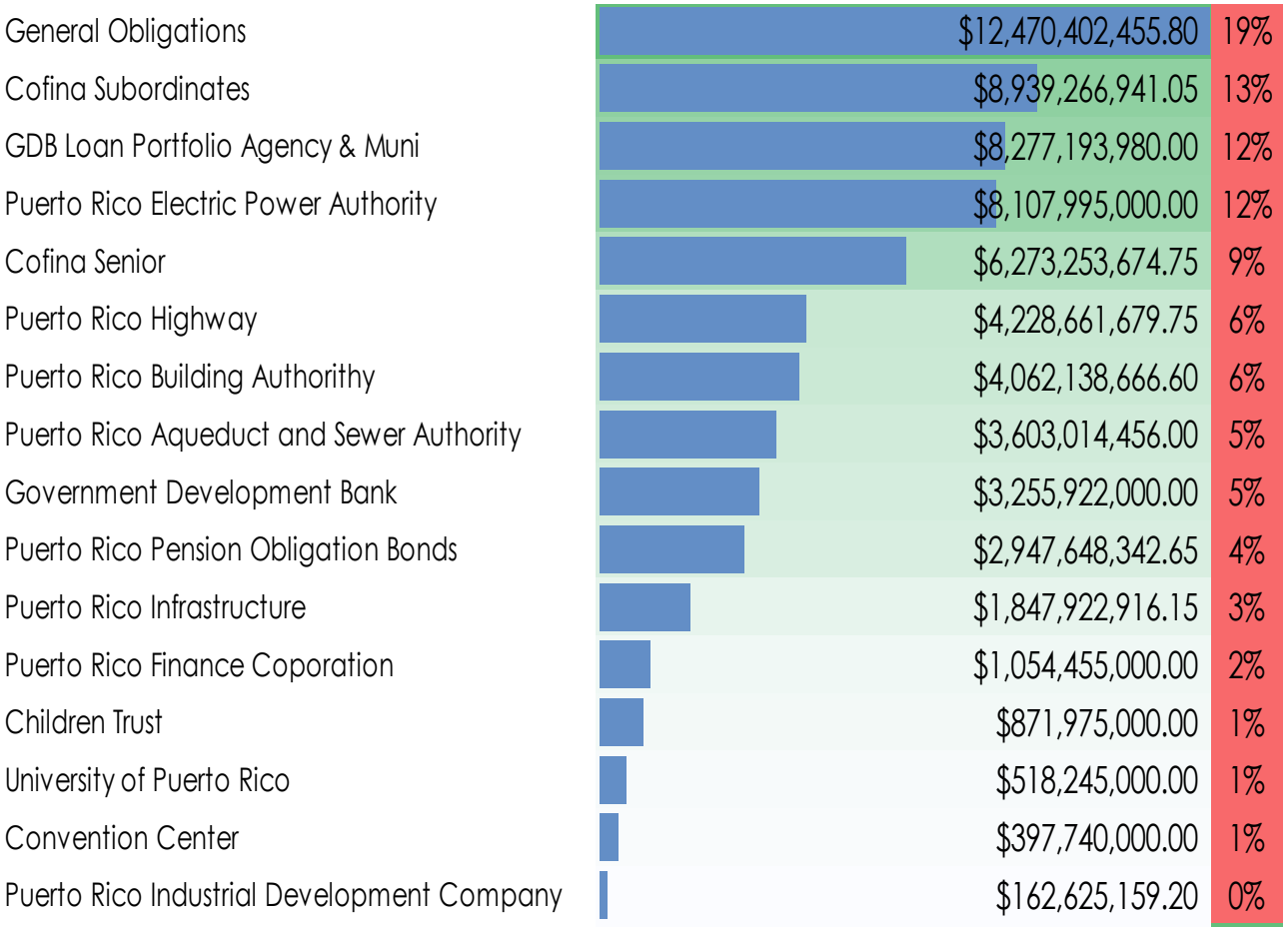
Background on PR Debt and Local Bondholders

Background of Resident Bondholders

- It is estimated that local individual bondholders total 60,000. Including their families, brings the total persons affected to over 200,000 residents.
- Bonistas del Patio includes a broad range of people including government employees, retired people, private sector professionals, small and medium businesses, corporations and some wealthy families.
- Many are retirees who had put their life savings in PR bonds and depend on the interest payments as their main source of income
- All agree a Fiscal Oversight Board is needed on a temporary basis to assure PR puts its fiscal and economic situation in order
- All require that full interest on their debt holdings continue to be paid under all circumstances

Puerto Rico Debt Issuers

Outstanding Principal Amount as of May 2016



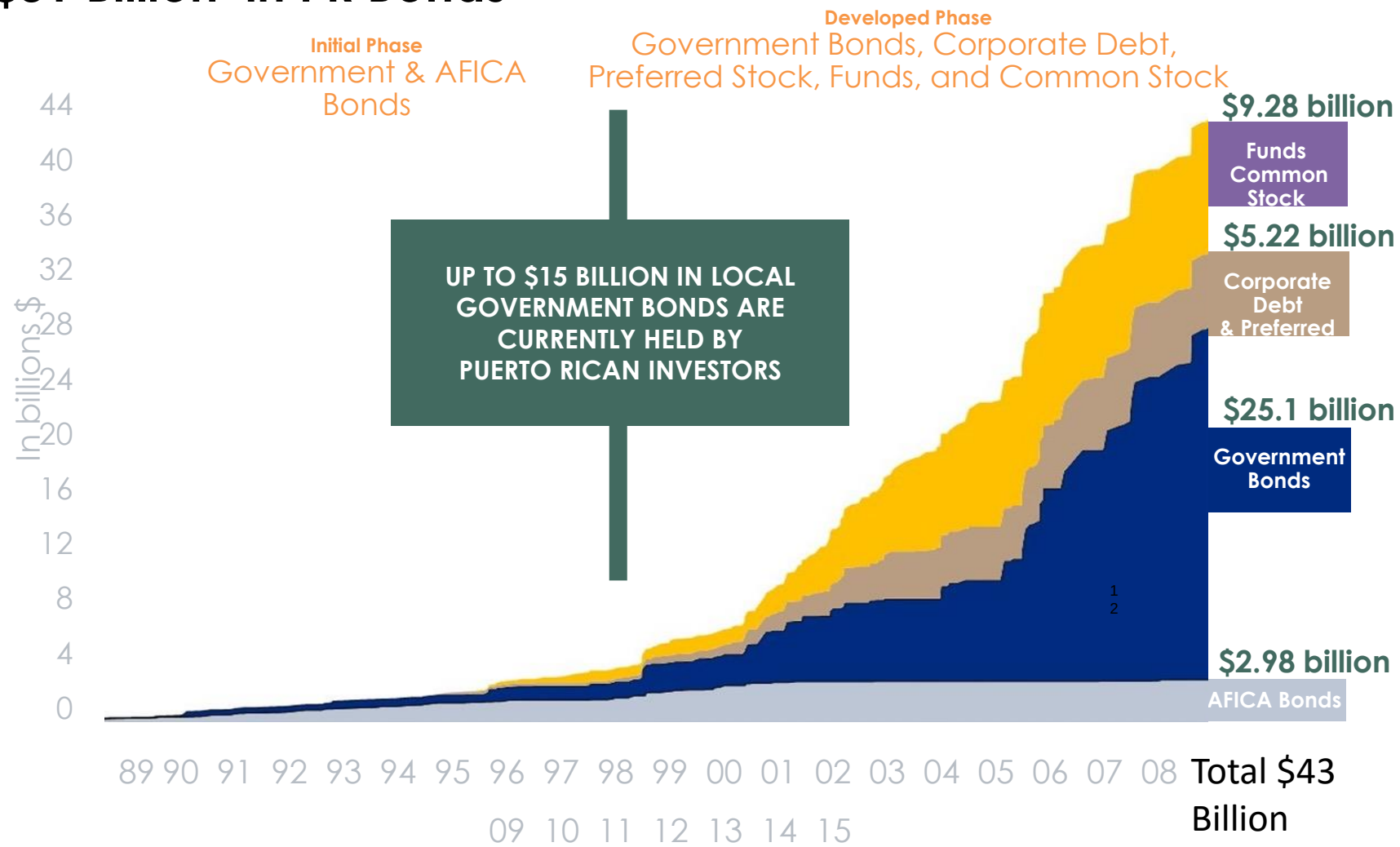
Total
$67,010M

- ✓ Approximately 22% of the total debt of Puerto Rico is in local hands.
- ✓ Local bondholders hold a stake that is comparable to that held by the Hedge Funds.
- ✓ The debt is payable over a period of more than 30 years

In addition, according to 6-30-2014 audit, Pension liability totals $33 Billion

Puerto Rico Capital Market Evolution

Since 1996 Local Puerto Rico Investors have invested over $31 Billion in PR Bonds



Current Bond Holdings of PR Residents

- PR residents generally acquired bonds that did not qualify for federal tax exemption under Sec 103 of the IRC
- Although precise information is not readily available, we estimate the most common holdings of PR residents, in order of magnitude are:
  - Cofina Subordinate
  - GDB Notes
  - POBs
  - PFC
  - Various Others

Current Bond Holdings of PR Residents

- Residents of PR currently hold about $15 Billion of the outstanding public debt
- In 2013 PR government bond holdings were about $24B, an estimated 2/3rds of the total $35B brokerage assets in PR at that time
- This $9 Billion drop in holdings is due to falling bond prices which have put holders under pressure to sell to contain losses and/or reduce leverage
- Annual debt service payable to PR residents is estimated at over $1.2B
- Interest payments to PR residents alone are estimated to be $700-800 Million
  - This represents more than 1% of GNP

A Decade of Lost Wealth in Puerto Rico

- It is estimated that PR residents incurred total capital losses of $60B from 2005-2012
  - 2005 bank stock crisis
  - 2008 real estate crisis - $27B (CNE)
  - 2010 bank stock crisis (3 publicly held banks were liquidated by FDIC) $11B (CNE)
- In 2013, total brokerage assets in PR were $35B of which an estimated 2/3rds was in PR Government bonds
  - Total brokerage assets have fallen to $25B since 2013
- Residents of Puerto Rico still hold about $15 Billion of the public debt
- Based on government proposals, which offer recovery of 56%, **residents could face additional losses of $6-7B,** almost half the $15B held.

PR Resident Bondholders are Different

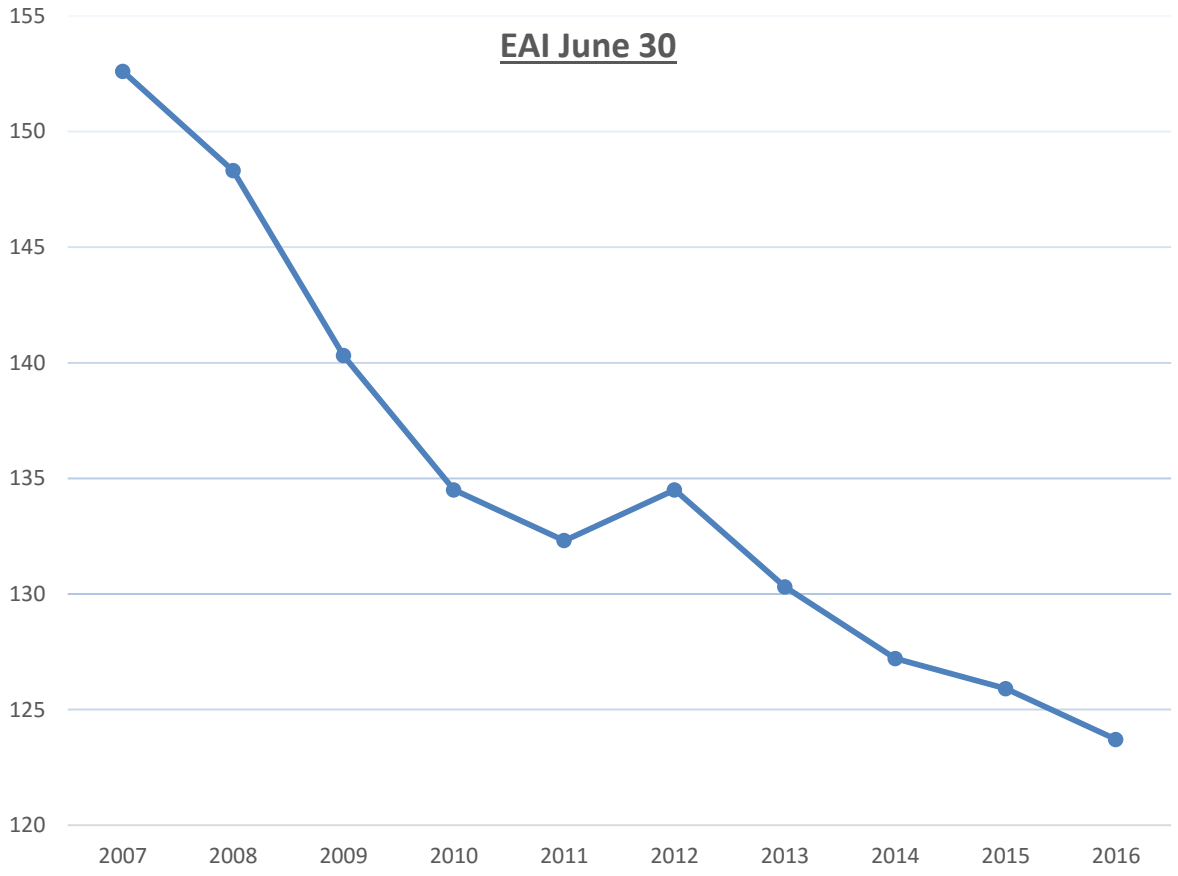
- It is said by the government that all parties must share in the pain of a restructuring (June 29, 2015 Governor: “it is time to for bondholders to share our pain”)
- However, we feel strongly that as loyal bondholders, we need to be fully represented and considered as patriots for contributing our savings to finance the government
- Clearly we all believed in the **ability, good faith and intent** of our own government to repay its debt
- In this regard, and in contrast to all non-resident bondholders, we put nearly 100% of our savings in PR bonds, thus facing a much more severe impact in a restructuring
- **Ultimately, the tax revenues that will keep the PR government operating to provide essential services and provide the funds to repay any debts in the future, including our own bonds, will come out of our pockets, not those of non-residents.**

PROMEAS's Oversight Board

Why we need a Fiscal Board

- The government of PR has not provided,
  - transparency,
  - credibility,
  - rule of law,
  - economic growth,
  - agreements with creditors,
  - true attention to payment of pensions,
  - responsible fiscal plans
  - equal treatment from federal programs
  - economic revitalization measures from Congress.
- Close ties to the Congress are needed in order to address this

Economic Growth – Congressional Commission



Economic Growth – Congressional Commission

Title IV, Section 409: Congressional Task Force on Economic Growth in Puerto Rico that would examine

- federal laws and economic growth in Puerto Rico;
- Department of Health Regulation 346
- changes to federal laws to spur sustainable, long-term economic growth;
- federal law and programs that would reduce child poverty

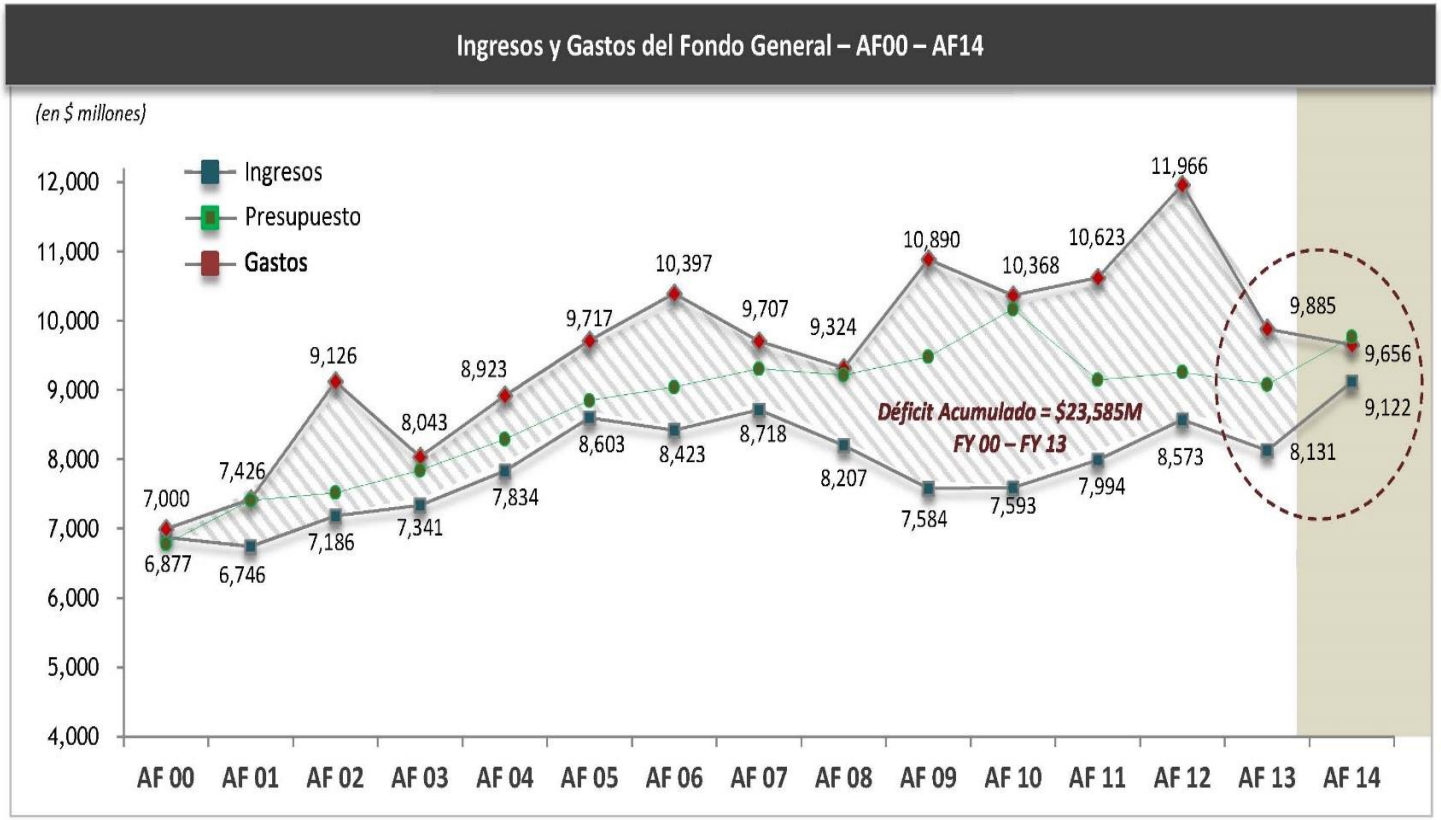
Title V: Puerto Rico Infrastructure Revitalization

Economic Stimulus Measures are Required Urgently

- Bonistas is willing to collaborate in any way possible with the effort of the Congressional Task Force on Economic Growth
- Bonistas del Patio believe:
  - Return to economic growth is ultimately the most important factor that will lead to fiscal recovery
  - The private sector will play a vital role in executing the productive activity required to create sustainable economic growth

Deficit Spending

TOTAL DE INGRESOS Y GASTOS DEL FONDO GENERAL AF 00 – AF 14



Fuente: 1. **AF2000 al AF2013** "Statement of Revenue and Expenditures-Budget and Actual Budget Basis-General Fund" **según los estados financieros auditados del ELA.**
2. AF14 - Preliminar

Lack of Fiscal Discipline

- Surprisingly, in the FEG Plan, General Fund expenditures continue to increase from $7,963M to $9,404M, an 18% increase, over the next five years and continue to grow thereafter.
- On the other hand, General Fund revenues increase by only 1.9% during the next five years which demonstrates no attempt to follow fiscal discipline
- Non-general fund areas and other component units, continue to show operating deficits throughout the ten year period covered by the PRFEGP
- These expense levels, which do not include any debt service, are not feasible or sustainable and certainly not fiscally responsible

Lack of Legal Discipline

- The FEG Plan proposes to cover cash flow short falls by cutting contractual debt service payments in violation of existing law
- Meanwhile, Constitutionally protected debt, which has preference under the law, completely defaulted on July 1, 2016.
- The legality of the local Moratorium Law is challenged in three law suits filed in Federal Court, including one by Bonistas
- The approved 2017 budget provides no funding for Constitutional debt or constitutionally guaranteed debt violating the most basic law of the land

Principals the Board Will Uphold

- Existing law must be respected including the Constitution of PR and the US and compliance with required clawback provisions, which have been violated by the government
- The Government must provide full transparency regarding its receipts, expenditures, cash balances and all other relevant financial information
- Interest on debt who's issuer has payment capacity, should be paid as scheduled
- Principal payments on debt may be deferred for the next five years

Principals the Board Will Uphold

- Attend urgently to the funding challenges of its pension systems
- Expenditures must be reduced to a level consistent with the size of the population and the economy, that is sustainable in the long term without incurring deficits, i.e., balanced budgets, a requirement of Promesa
- Government revenues must be brought to levels representative of best practices regarding tax collection over the next five years
- It is essential for the that the PR Government **regain access to the capital markets** at reasonable rates as PROMESA pursues

La estrategia óptima para Puerto Rico es que la Junta de Control haga su trabajo bien y rápido (Quote from CNE)

- Atender estos asuntos va requerir capacidad para el diálogo franco, el compromiso de negociar de buena fe, y la voluntad de hacer y honrar concesiones por parte de todos los grupos afectados.
- Cada grupo—bonistas, contribuyentes, empleados públicos, empresarios y pensionados—tendrá que ceder algo.
- De lo contrario nos arriesgamos a desgarrar irremediablemente el contrato social que ha regido en la isla durante los últimos 60 años—y Puerto Rico no necesita en estos momentos más incertidumbre, inestabilidad, divisiones políticas y conflicto social", opina el analista del CNE.

Restructuring Approach

Much Existing Debt Can be Paid

- Cofina clearly has capacity to pay as currently structured
  - Sales tax revenues are performing strongly and within budgeted amounts
- The GO is payable and protected by the Constitution
  - In FY 2016, the $9.8B approved General Fund budget, fell short by only $500M in Revenue and included $1.2B for debt serve on the GO
- PBA lease payments covering its debt service and operating costs are also included in the 2016 budget
- The exclusion of full payments on the above in the 2017 budget recently approved by the Legislature violates the Constitution and would deal a mortal blow to market access for PR for many years to come.

Certain Debt May Need Modification

- GDB is a mirror image of government problems
  - Almost no liquidity ($200M) and very limited performing assets ($2-3B) while its liabilities are $3B in deposits and $3.7B in notes
  - Recent financial information is not publicly available
- A majority of outstanding GDB debt is held by PR residents
- Under the PR Moratorium Act, GDB was declared in a state of emergency and its assets are being transferred to a "bridge bank" in violation of creditor rights
- Three law suits challenging the Moratorium law and the actions being taken have been filed, including one by local GDB bondholders

Certain Debt May Need Modification

- PFC is affected by legislature's failure to appropriate debt service in view of General Fund challenges
- The effective payment capacity of HTA is not clear based on available information and must be analyzed further

Restructured Debt Service

Based on the foregoing analysis, we propose the following:

1. Defer all principal payments on the listed issuers for 5 years
2. This represents $5.8B less disbursements for principal over the next five years
3. Pay the interest as scheduled
4. In the Case of GDB, HTA and PFC, we propose Additional deferral of principal of 20-30%
5. Other measures to protect local bondholder recovery

Revenue and Expense Adjustments

- Our analysis is based on the PRFEGP Update of Jan 2016 and made the following adjustments:
- Assume ACA funding is fully replaced
- Expense (reduction) measures of $6,572M, which represent only 7.3% of Non interest expenditures of $87,780M over the next five years, are increased to reach a total of 10% of existing expenditure over the five years through 2021
- Cofina revenues are removed from central government projections as they are not legally available to the government. We also remove the Cofina debt service from the WGP debt service outflows.
- GDB loan inflows and deposit outflows are also removed and will be analyzed separately
- We also assume Component unit expenditures will be brought in line with their revenues ($2,518M vs $897M) over next five years as a matter of fiscal necessity.
- Tax administration and enforcement revenue of $432M represent only 1.05% of Genl Fd revenues. We assume the government can bring that up to 5% or $2,160 given the large underground economy and 60% SUV compliance compared to the national average of over 80%.

The Financing Gap can be Eliminated by 2020

- Considering Bondholder concessions of principal and potential government action regarding revenues and expenses, the PRFEGP cash flow gap can be reduced and actually become a surplus of $1,590M by 2021, allowing for resumed principal payments thereafter.

		2017	2018	2019	2020	2021	5 Yr
FEGP Resid Est Fin Gap After Meas		-3243	-2860	-4257	-3120	-2265	-15745
Adjustments	Principal Defferal	1029	954	1626	1295	1306	6210
	Add Back ACA	0	544	1605	1737	1821	5707
Net Fin Gap After Bdp Adjustments		-2214	-1362	-1026	-88	862	-3828
Addl Exp Meas to reach 10%		1,268	629	335	43	71	2,346
Addl Tax Admin to reach 5%		324	308	298	296	296	1,521
CU deficit reduction to 0 in 5 yrs		53.6	126.8	204.6	280	361	1,026
	Total	1,646	1,064	837	619	728	4,893
Net Fin Gap After Addl Measures		-568	-298	-189	531	1,590	1,065