



COMMONWEALTH OF PUERTO RICO **FISCAL UPDATE**

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Puerto Rico Executive and Legislative Branches Sign Historic Documents Initiating Structural Tax and Spending Reform to Ensure Commonwealth's Fiscal Soundness

On Monday, November 21, 2005, the Governor and the leaders of the Puerto Rico House and Senate signed a historic Joint Resolution, which was passed by overwhelming majorities in both chambers, establishing the objectives, principles and framework for far-reaching tax reform and fiscal discipline. Hearings regarding the tax reform will be held in November and December, and it is to be voted upon in the Legislative session that begins in January 2006, looking towards implementation to affect Fiscal Year 2007's revenue and spending budget.

In addition, the Governor on Monday signed an Executive Order adopting fiscal measures outlined in the Joint Resolution and implementing corrective measures that take effect immediately, ensuring that every agency and public instrumentality of the Central Government henceforth stays within the mandated budget.

With these actions, the leadership of both Governmental arms of Puerto Rico underscored their determination to take concrete steps to stabilize and improve the Commonwealth's fiscal condition, specifically to reduce its recurring annual structural deficits. These actions also served to inform the financial community of Puerto Rico's resolve to maintain the high regard of investors and credit agencies for its securities, and to continue to meet all its debt service obligations. Governor Aníbal Acevedo-Vilá, House Speaker Jose Aponte, House Treasury Committee Chairman Antonio Silva, and President of the Senate Kenneth McClintock, all participated in reaching this historic consensus.

As a consequence of these developments, the Government Development Bank for Puerto Rico (GDB) and the Secretary of the Treasury met with credit ratings agencies on November 22, 2005 to acquaint them with the Legislature's and the Governor's plans and to discuss the tax reform in light of two transactions that the GDB will bring to the market before the end of the year and two other transactions that will be placed in the local Puerto Rico market, which combined total more than \$2.7 billion in debt offerings. The Commonwealth General Obligation issue has been rescheduled for early 2006, at which time GDB plans to meet again with the credit ratings agencies.

The fiscal challenge the Commonwealth faces is that, even while Puerto Rico's economy continues its growth, it needs to control the growth of government spending and identify improved sources of recurring revenue. During Fiscal Year 2005 (ended June 30, 2005) the Central Government operated with an authorized budget of \$8.9 billion, but experienced a budget overrun of approximately \$354 million, for a total level of spending of \$9.2 billion. For Fiscal Year 2006, the Governor, acting in accordance with the Commonwealth Constitution, adopted the same budget level for expenditures of \$8.9 billion.

Fiscal Reform Presents Positive Outlook

Monday's agreement on Tax Reform represents a positive outlook for Fiscal Year 2007 and beyond. The proposed broad-based Legislative tax reform program involves, among other things, imposition of a consumption-based tax that would substitute for the general excise tax currently in existence, and is aimed importantly at widening the taxpayer base. While also incorporating reduced income tax levels and effecting other reforms, and more stringent collection procedures, it is fundamentally designed to increase total revenues and promote the Commonwealth's fiscal health.



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The Governor's Executive Order is a stringent program that reverses years of managerial practices in which budget constraints went largely unheeded. The Governor mandated the Office of Management and Budget to institute remedial measures immediately to stop excessive expenditures and also to mitigate the effects already caused.

The Executive Order calls for mandated reductions of expenses, freezing the total number of positions, an absolute prohibition of recruitment, and other measures that are specifically designed to reduce spending throughout the agencies of the Central Government.

"This joint program is a tangible acknowledgement of the issues raised by the financial community, and it is designed to make certain that the message has been understood and that the Commonwealth of Puerto Rico is determined to maintain and improve its financial standing," said Governor Acevedo-Vilá. "Our Legislature and the Central Government have come together in this effort to assure our investors of our total commitment to establish and maintain superior fiscal and financial practices that will benefit us for years to come, as we continue our economy's growth."

Upcoming Bond Issues

As of September 30, 2005, Treasury cash flows continue the normal seasonal pattern of expenditures, which will be supported by issuance of approximately \$1.1 billion in Tax Revenue Anticipation Notes (TRANs), on which the Department of the Treasury expects to use letters of credit enhancement provided by an international bank syndicate. In addition, GDB plans to take to the market shortly \$670 million in Puerto Rico Municipal Finance Agency Long Term Bonds. As noted, in anticipation of the enactment of new tax reform legislation, an issue of Commonwealth General Obligation Bonds has been deferred until early in 2006.

GDB's liquidity position remains strong. Before calendar year-end, GDB expects to receive repayment of approximately \$1.7 billion in loans, and a total of approximately \$2.4 billion for FY 2006. GDB has unsecured lines of credit from nine different banks that amount to \$1.4 billion and \$1 billion in available funds under its commercial paper program. In addition, GDB will sell \$500 million in medium-term notes in the local Puerto Rico market.

Copies of the Joint Resolution and the Governor's Executive Order can be downloaded from www.gdb-pur.com and are also included with this update.

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