

**WELLS
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SECURITIES

CUNY Journalism Presentation on Puerto Rico

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Together we'll go far



Thoughts on Puerto Rico, June 2015

- **What investors think**
 - **Triple tax free – a good yielding bond for mom and pop for many years; also a building block for mutual funds (like the blank tile in Scrabble).**
 - **Taxable equivalent= tax exempt yield/1- tax bracket. For example, someone in the 39.5% bracket buying 8% tax free Puerto Rico bonds would have to find a 13.2% taxable bond. Someone in the 28% bracket would have to find an 11% taxable bond.**
 - **The switch to hedge funds – dollar bonds – what's the right price? If you buy at \$.50 and sell for \$.60 it's a good deal**
 - **Funds demanded that the March 2014 \$3.5 billion bonds be subject to New York law – Argentina did this with London/UK law.**
 - **Do you want to talk about swaps, terminations and collateral agreements?**

- **Is Puerto Rico going to default on its bonds? All eyes are focused on PREPA and its July 1 payment date, but what about the Commonwealth? Let's follow the money...**

- **How will the Commonwealth resolve its liquidity problems long term?**
 - **Discussion about GDB – it's not really a bank.... Funded by borrowing which is then loaned to Commonwealth and agencies**
 - **The Employee Retirement System is out of cash – on a pay-as-you-go basis – where does the cash come from to write checks?**
 - **Recent discussions of government shut down**
 - **Quarterly report acknowledges low funding level**

The Employees Retirement System (ERS), Under the Hood...

From the Conway Mackenzie 2010 report. You can find this on-line at:

www.slcg.com/pdf/blog/13409.pdf (quote cut off on purpose)

Our findings indicate that the System has essentially been underfunded since its inception in 1951. The underfunding is a direct result of statutory funding requirements that fall below actuarially determined contribution rates. In addition to deficient annual contributions, investment returns and other recurring income levels have been insufficient to cover the System's annual benefit payments and other operating obligations, resulting in negative cash flows. As a result, the System has been forced to liquidate nearly all of its net plan assets to address cash flow shortfalls. In order to bolster the System's prospects of long-term solvency, an increase in the statutorily required contribution rates will be

Puerto Rico Employees' Retirement System							
(\$000s)							
Year	Actual Contribution	Annual Required Contribution	Percent Contributed	Actuarial Value of Plan Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio
2013	\$628,647	\$ 2,192,821	29%	\$ 731,342	\$ 23,712,018	\$ 22,980,739	3%
2012	\$ 589,743	\$ 2,019,467	29%	\$ 1,237,532	\$27,645,786	\$ 26,408,254	5%
2011	\$ 701,709	\$ 1,734,979	40%	\$ 1,723,811	\$25,457,354	\$ 23,733,543	7%
2010	\$ 534,275	\$ 1,459,774	37%	\$ 1,664,991	\$17,501,761	\$ 17,836,770	9%
2009	\$ 594,509	\$ 1,258,695	47%	\$ 1,842,143	\$ 18,943,586	\$ 17,101,443	11%
2008	\$ 581,285	\$ 1,191,275	49%	\$ 2,607,086	ND	ND	NA
2007	\$ 566,524	\$ 816,472	69%	\$ 2,891,501	\$ 16,769,512	\$ 13,878,011	21%

Source: Deloitte, KPMG audits of Employee's Retirement System and Milliman actuarial report for 2007

Observations on ERS

The 2014 KPMG audit for the ERS says:

- **“Emphasis of Matter**

-In the opinion of management, based on information prepared by consulting actuaries, the System’s assets will be less than its obligations...by the fiscal year 2015. In addition, annual cash flow estimates for the foreseeable future are presently estimated to continue to reduce the net position unless other measures are taken...”**

- **The Commonwealth May 7, 2015 report states that funding of ERS is .7% as of June 2014 (one year ago—page 43). How are they making payments to retirees?**

- **Now what? ERS net payments are roughly \$500 million per year – does the Commonwealth have that amount in its 2016 budget?**

Government debt

	12/31/2013	5/31/2014	3/31/2015
Full faith and credit bonds and notes issued by the Commonwealth	\$ 10,215	\$ 13,398	\$ 13,055
Bonds and notes guaranteed by the Commonwealth's full faith and credit			
PRASA	690	686	677
PR State Revolving fund loans made to PRASA	479	488	462
Port of the Americas Authority (held by GDB)	225	225	233
General Services Administration notes	32		
PR Public Building Authority bonds	4,221	4,221	4,138
Subtotal	\$ 15,861	\$ 19,018	\$ 18,565
Debt supported by Commonwealth appropriations or taxes			
Public Finance Corporation	\$ 1,090	1,090	1,090
Public corporations and agencies	2,126	2,146	2,191
Treasury	826	573	720
Mental Health and Anti-Addiction Services	37	37	36
Tax and Revenue Anticipation Notes	1,075	500	1,200
Subtotal	\$ 5,154	\$ 4,346	\$ 5,237
Bonds and notes payable from sales taxes (COFINA)	\$ 15,557	\$ 15,224	\$ 15,224
Debt issued by public corporations and othe instrumentalities	26,197	24,838	24,102
Debt issued by municipalities	4,112	4,155	4,114
Pension Funding Bonds	2,948	2,948	2,948
Other non-recourse debt	2,072	2,072	2,013
Subtotal	\$ 50,886	\$ 49,237	\$ 48,401
Total Public Sector Debt	\$ 71,901	\$ 72,601	\$ 72,203

Source: February 18, 2014 , July 17, 2014 , October 17, 2014 and May 7, 2015 Commonwealth Reports

GDB Loans Outstanding

GDB Loan Portfolio: Top 20 Borrowers (\$ thousands)			
Borrower	31-Dec-13	5-Mar-14	17-Oct-14
Commonwealth			
Treasury	\$2,191,973	\$1,048,299	\$1,550,229
Office of Management and Budget	229,489	229,529	248,283
Department of Education	110,365	\$ 106,308	\$ 106,308
Subtotal	\$2,531,827	\$1,384,136	\$1,904,820
Public Corporations			
Highway and Transportation Authority (HTA)	\$1,709,898	\$2,013,902	\$2,013,902
Aqueduct and Sewer Authority (PRASA)		81,083	98,666
Special Communities Perpetual Trust	360,403	345,841	345,841
Puerto Rico Public Buildings Authority	346,287	175,417	176,339
Puerto Rico Tourism Development Fund	331,758	254,232	254,233
PR Medical Services Administration	274,973	278,282	280,841
Ports Authority (PRPA)	254,974	262,974	259,034
Port of the Americas Authority	224,633	226,677	225,859
PR Health Insurance Administration	183,251	183,251	183,251
Municipal Revenue Collection Center	174,740	150,413	149,664
PR Housing Finance Authority PRHFA	158,234	159,944	209,204
Convention Center District authority (CCDA)	151,369	145,448	145,448
Agropecuary Enterprise Development Administration (AEDA)	105,371	100,968	99,658
PR Industrial Development Company (PRIDCO)	87,325	87,325	87,325
Subtotal	\$4,363,216	\$4,465,757	\$4,529,265
Municipalities (repayment to come from municipal property tax; sales tax and other local revenues)			
San Juan	\$ 428,660	\$ 428,660	\$ 403,403
Guaynabo	142,855	143,024	137,875
Ponce	111,997	113,159	107,319
Total Top 20 Borrowers	\$7,662,842	\$6,534,746	\$7,082,682
Grand Total Loan Portfolio	\$9,967,539	\$8,913,612	\$9,418,412
Source: Special Liquidity Updates, March 5 and October 17, 2014 (Note: PRASA was not included in the earlier liquidity updates.)			

GDB Liquidity

Government Development Bank Liquidity Resources (in millions)							
	31-Jan-14	31-Mar-14	30-Jun-14	30-Sep-14	31-Dec-14	31-Mar-15	
Cash and Bank Deposits	\$ 261	\$ 883	\$ 719	\$ 232	\$ 333	\$ 348	
Federal Funds Sold and Money Market*	339	1,253	1,052	340	191	210	
Investment Securities							
U.S. Treasury and Agencies	1,215	1,092	1,191	1,356	1,363	1,296	
Government-Sponsored MBS and CMO's	373	230	210	2	-	-	
Other Securities	1	39	39	1	226	60	
Sub-total	1,589	1,361	1,440	1,359	1,589	1,356	
Total	2,189	3,497	3,211	1,931	2,113	1,914	
Securities pledged	NA	(50)	(72)	(533)	(1,023)	(796)	
Net Liquidity	2,189	3,447	3,139*	1,398**	1,090	1,118	
Sources: Commonwealth Quarterly Report and GDB Liquidity Reports							
*Includes \$700 million that was disbursed on July 1, 2014 for debt service payments							
** Net of \$400 million used to pay TRANS on October 10, 2014							

- At March 31, 2015 the \$1.118 billion included \$151.7 million PREPA reserves, \$189.8 million PREPA construction money. PREPA is expected to withdraw \$200 million of these funds
- \$263 million is from the Housing Administration – which is HUD money that is supposed to be deposited in an FDIC insured bank, which GDB is not – and these funds are expected to be withdrawn before the end of December
- \$60.2 million is “restricted”
- Effectively, \$594.8 million is not explicitly spoken for in the disclosures (which may be why the GDB is trying to pass legislation to get the other “instrumentalities”, like UPR to make deposits).

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