

# **Financial Oversight and Management Board for Puerto Rico FY18 Budget**

**June 30, 2017**



Information contained herein has not been independently verified and is subject to material change based on continuing review. Accordingly, the information contained herein is not intended to be and should not be relied upon by any third party as legal, auditing, or accounting advice.

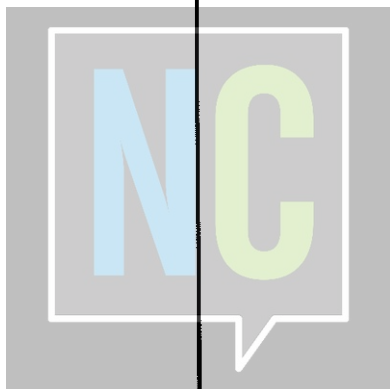
The financial information and projections contained in this report, including its base assumptions and underlying data (collectively, "Financial Information"), are the product of the Financial Oversight and Management Board (the "Board"), and consist of information obtained solely from the Government of Puerto Rico (the "Government") or publicly available resources. With respect to prospective Financial Information relative to the Government, there has not been any examination, compilation or application of agreed-upon procedures to such information in accordance with attestation standards established by the AICPA. Consequently, no assurance of any kind is given with respect to, or on, the information presented.

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Many of the numbers set forth herein are estimates or based on assumptions which are subject to change. Such changes may be material and can materially affect the calculation of other amounts reflected herein.

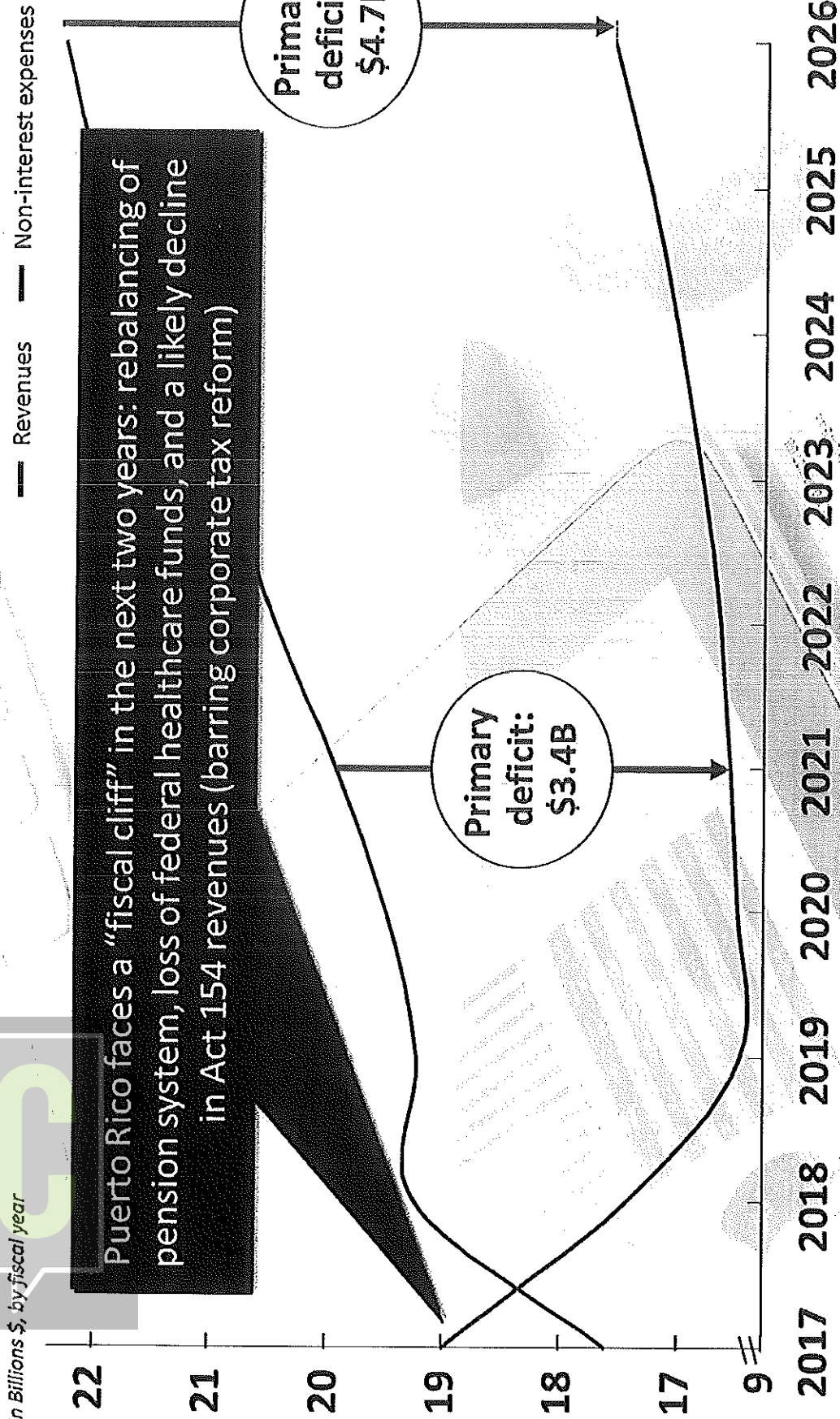
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## FISCAL PLAN OVERVIEW

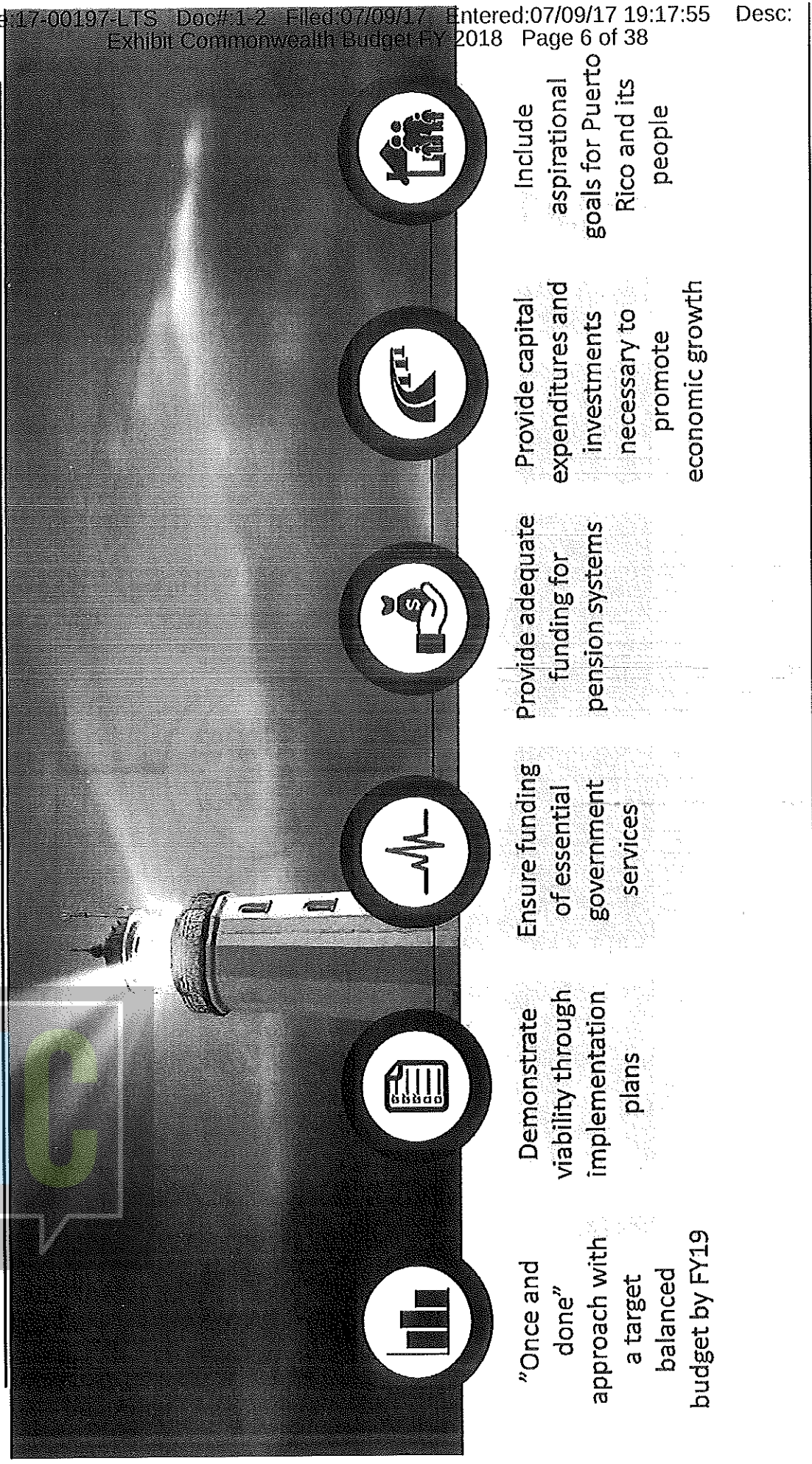
## Without action, Puerto Rico will confront a large and growing deficit



Note: Deficit does not account for reduced expenses and additional revenues that result from proposed Fiscal Reform Measures  
 Note: Amounts provided by AAFAF, from issuer agencies and from publicly available information. Estimated amounts are subject to further review and may change  
 Source: Government of Puerto Rico December 2016 Fiscal Baseline



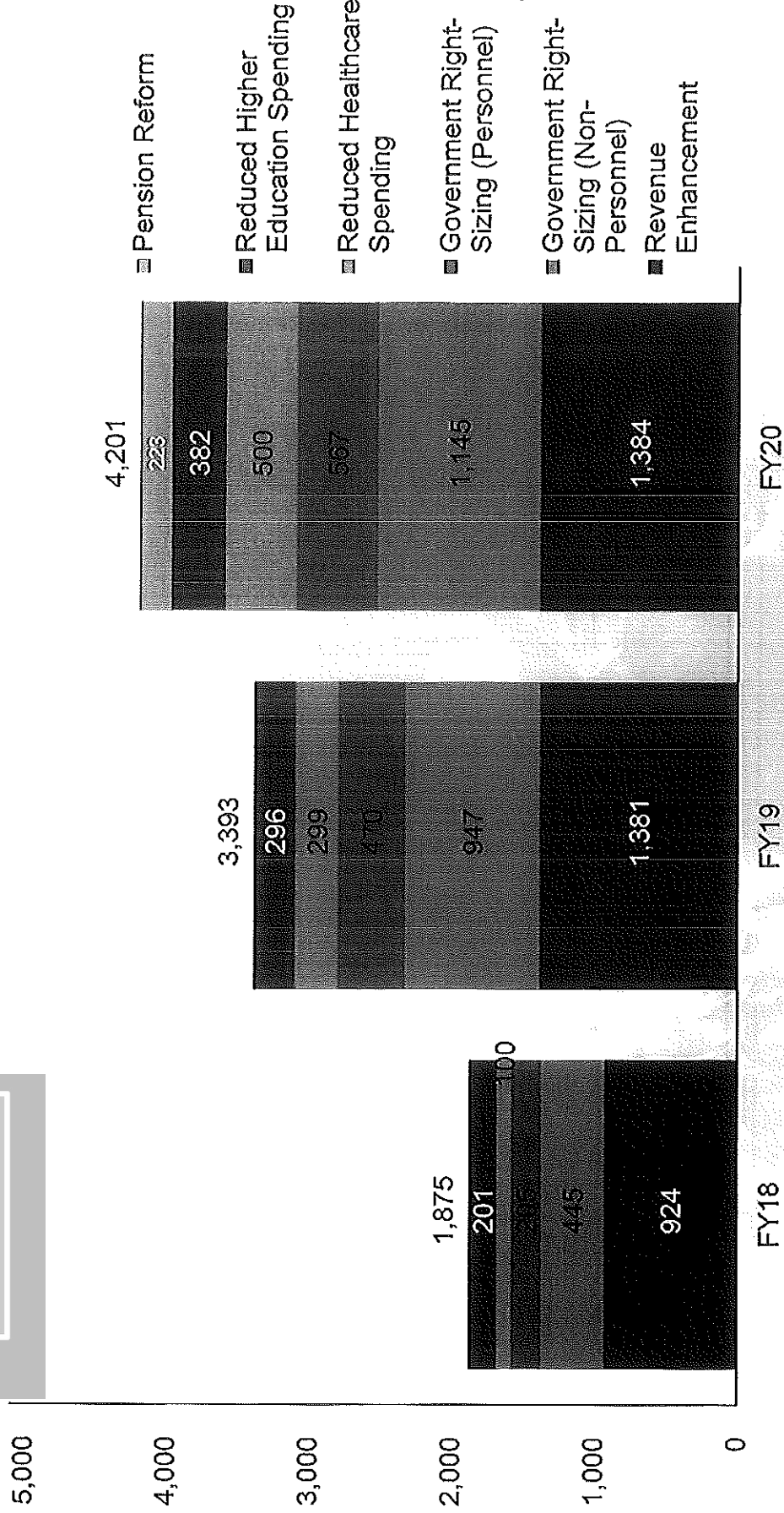
The Fiscal Plan reform area targets were designed by the Government and certified by the Board to promote structural balance while following a core set of principles



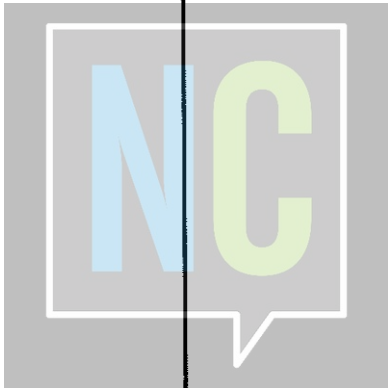


## The Budget incorporates Fiscal Plan measures that start to set Puerto Rico on a path towards financial sustainability

**Fiscal Reform Measures**  
In Millions \$, by fiscal year



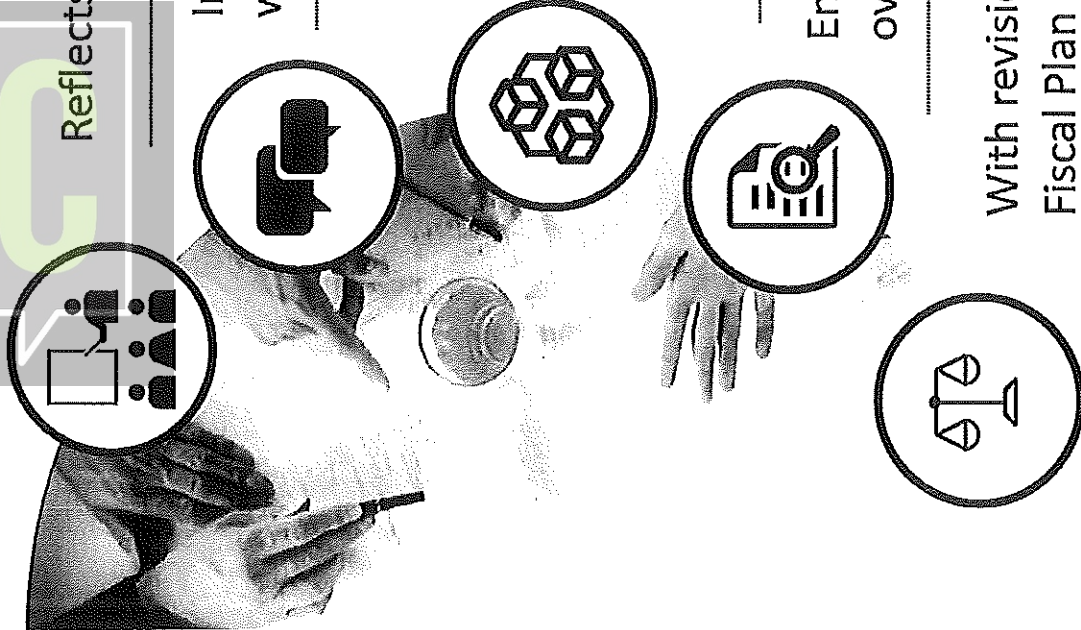
Source: Puerto Rico Fiscal Plan



## EXECUTIVE SUMMARY



## The FY18 Budget represents another step towards Puerto Rico's recovery



Reflects the Government's public policy priorities

Includes level of revenues and expenses generally consistent with the Fiscal Plan

Majority of funds allocated to education, public safety, welfare, healthcare and economic development

Allocates additional Government funds to pensions and healthcare system

Embeds financial controls to monitor implementation and overspending

With revisions, the FY18 Budget is generally consistent with the Fiscal Plan

## The Board closely reviewed the FY18 Budget



### Preparation of FY18 Budget



### Evaluation of FY18 Budget



### Reconciliation of Budget to Certified Fiscal Plan

- OMB issued guidelines to submit budget requests based on requirement to achieve the agency's guiding principles
- The Board provided revenue forecast for use in developing FY18 Budget
- Budget prepared based on FY17 Budget and considered Fiscal Plan measures, impact of new initiatives and cost savings incurred/expected

- The Board requested the Government prepare the FY18 Budget consistent with trajectory for primary fiscal balance in the Fiscal Plan
- Onsite due diligence was carried out to review FY18 Budget
- Meetings with key individuals included OMB, AAFAF, Hacienda, individual governmental agencies and the Legislature

- The Budget includes difficult adjustments in many areas, including reduced funding for municipalities and UPR, and cuts to education, health, public safety and welfare programs
- While certain amendments are needed, FY18 Budget is generally consistent with the certified Fiscal Plan



## Several recommendations have been proposed to the FY18 Budget

### Spending Adjustments

#### *Recommendations to reduce spending in several areas*

- Spending by certain government entities
- Spending increases as compared to FY17
  - Earmarks and special expenditures

### Technical Corrections

#### *Recommendations to correct several technical elements*

- Use of federal matching funds
- Justice Dept. monthly allocation
- Future modifications to the budget

## FY18 Budget incorporates strict financial controls to monitor overspending and maintain accountability



### Limitations on spending

- Agency expenses cannot exceed the amounts in the budget
- Multi-year appropriations authorized in previous fiscal years are suspended and no new multi-year appropriations with the exceptions of appropriations related to permanent improvements

### Approval for access to reserves

- No expenditure shall be charged against the Budgetary Reserve unless it is approved by the Board
- Expenses above and beyond the budget will need Board approval

### Regular reporting requirements

- Weekly and monthly reports of the actual cash revenues, cash expenditures, and cash flows of each agency
- Monthly and quarterly actual vs. budget reports from each agency of the Government on a modified accrual basis
- Monthly tracking of key performance indicators for each fiscal reform measure initiative
- Quarterly reports on macroeconomic performance



## CONSOLIDATED BUDGET OVERVIEW

## Consolidated Budget Overview

- Key components of the Consolidated Budget include the following:

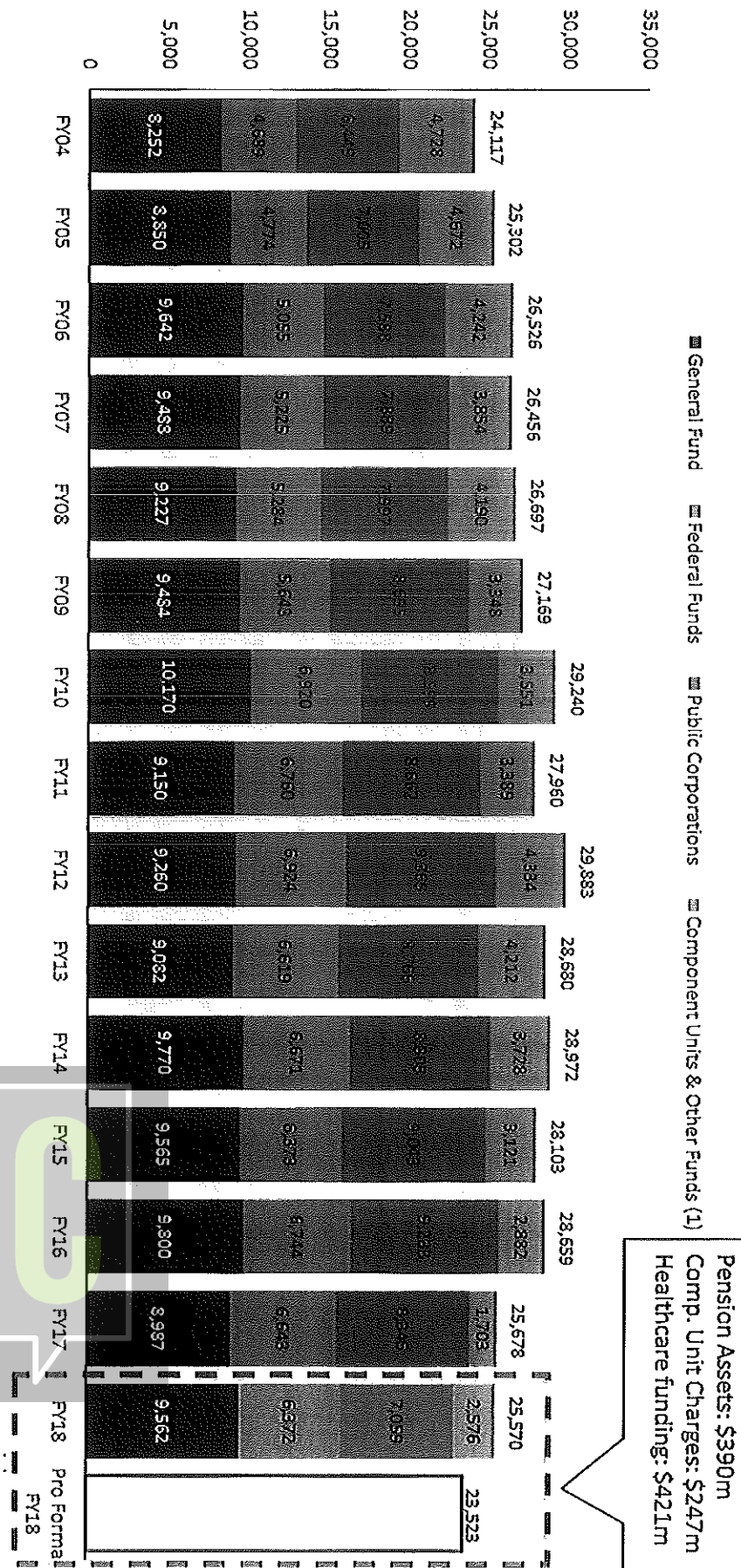
General Fund	<ul style="list-style-type: none"> <li>The primary operating fund of the Government</li> </ul>
Special Revenue Funds	<ul style="list-style-type: none"> <li>Funds created by law, not subject to annual appropriations and have specific uses established by their respective enabling legislation</li> </ul>
Component Units / Public Corporations	<ul style="list-style-type: none"> <li>Legally separate from primary government but Puerto Rico appoints a majority of these organizations governing bodies<sup>1</sup></li> </ul>
Federal Funds	<ul style="list-style-type: none"> <li>Expenses funded by Federal Government money</li> </ul>
Other Funds	<ul style="list-style-type: none"> <li>Debt Service and other funds</li> </ul>

(1) Many public corporations and other instrumentalities traditionally relied on subsidies, in the form of appropriations from the General Fund and/or assignments of Puerto Rico tax or other revenues, to fund a material portion of their operations



# FY18 Budget was developed based on FY17 budgeted amounts and reflects a reduction in spending

## Historical Consolidated Budget In Millions \$, by fiscal year

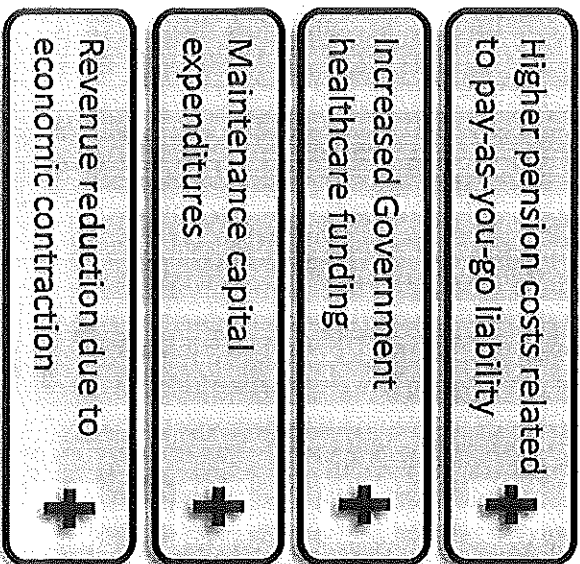


(1) Component Units & Other Funds includes Special State Funds, Special Revenue Funds, and the incremental healthcare funding to cover the loss of Medicare funds  
Source: Puerto Rico Office of Management and Budget – Budget Data

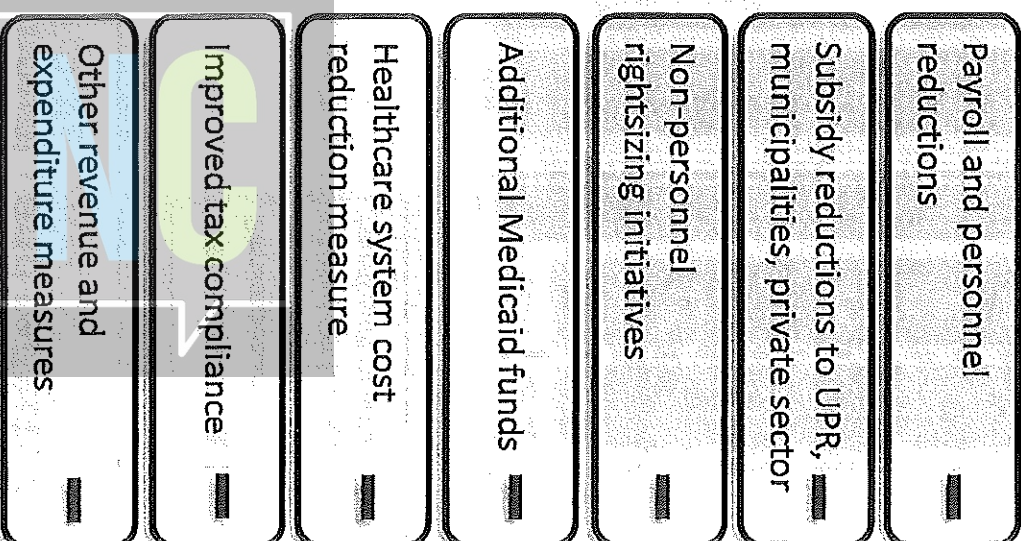
## The FY18 Budget includes a reasonable level of revenues and spending

- The Consolidated Budget includes several factors that increase costs relative to FY17, including higher pension and healthcare liabilities
- These increases are offset, in part, by reductions in costs, including various personnel and non-personnel savings and additional funds
- These are the first steps toward restoring fiscal responsibility and setting a path to achieve the Fiscal Plan's objectives

### Cost Escalators



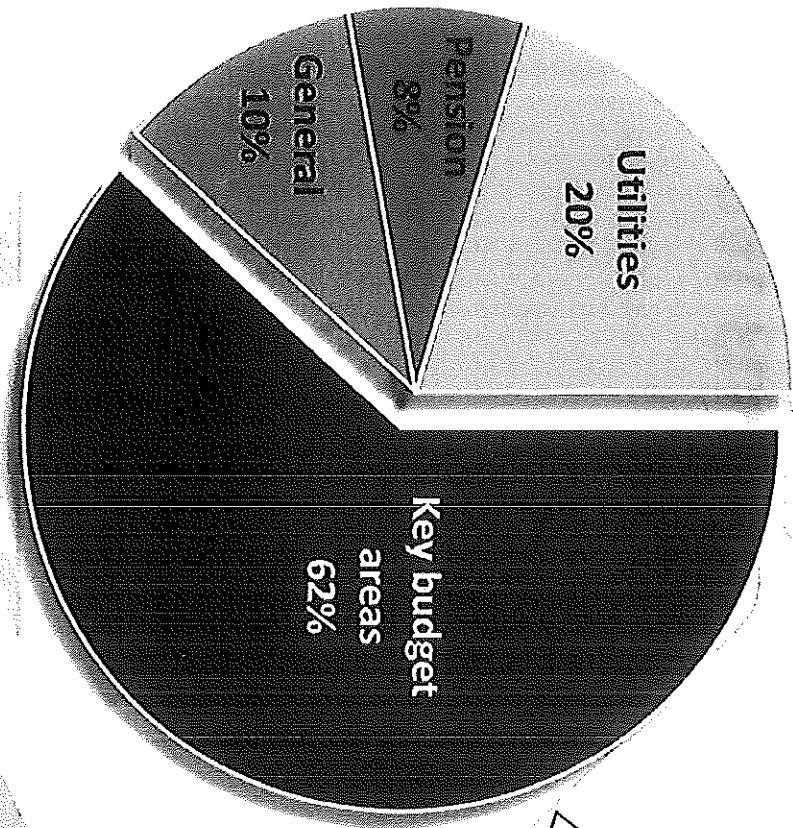
### Cost Reducers



## The majority of the FY18 Consolidated Budget is dedicated to five areas

### FY18 Consolidated Expenditures In Millions \$

**Total Spending = \$25.6b**



Education	\$3,972
Public Safety	2,015
Health	4,653
Welfare	3,597
Econ. Development	<u>1,534</u>
<b>Total</b>	<b>\$15,771</b>

Note: Utilities spending are budget allocations to PREPA and PRASA

Note: General spending includes municipal appropriations, OMB funds, liquidity reserve, Hacienda, Legislature and the Public Buildings Authority

Source: Puerto Rico Office of Management and Budget – Budget Data



## GENERAL FUND OVERVIEW



## The General Fund is the Government's principal operating fund

### General Fund - \$9.562 billion

#### Discretionary

Operating cost of the central government including programs, payroll, and administrative costs

Special appropriations for programs and some may be pass-through grants to non-profit or non-public entities

##### Examples Include:

- Payroll
- Rent and utilities
- Purchased and Professional Services
- Materials, Equipment

#### Semi-Discretionary

Contributions or block grants to entities outside the central government or large entitlement programs

##### Examples Include:

- Public Health Insurance
- Special appropriations – OMB custody
- Contributions to Municipalities
- Contributions to Legislature

#### Non-Discretionary

Expenses from appropriations by formula and other pre-legislated or agreed-upon commitments

##### Examples Include:

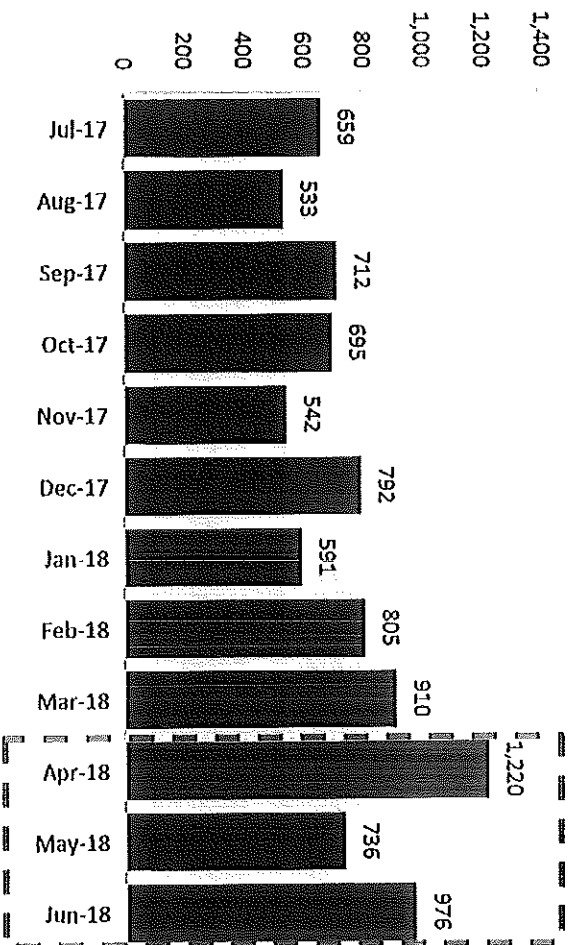
- Pension pay-as-you-go
- Judicial Branch Formula
- Municipalities Formula
- Legislature Formula
- UPR Formula
- Oversight Board

## FY18 General Fund revenue is projected to be \$9.562b, which is \$369m higher than FY17 General Fund revenue

- The Board evaluated revenues in the certified Fiscal Plan and incorporated revisions based on more recent analysis and new information
- The final revenue estimates were provided to the Government and are generally consistent with the Fiscal Plan

### FY18 Monthly General Fund Revenues

In Millions \$



Nearly 32% of annual revenues

### FY17 Compared to FY18 General Fund Revenue

In Millions \$, by fiscal year

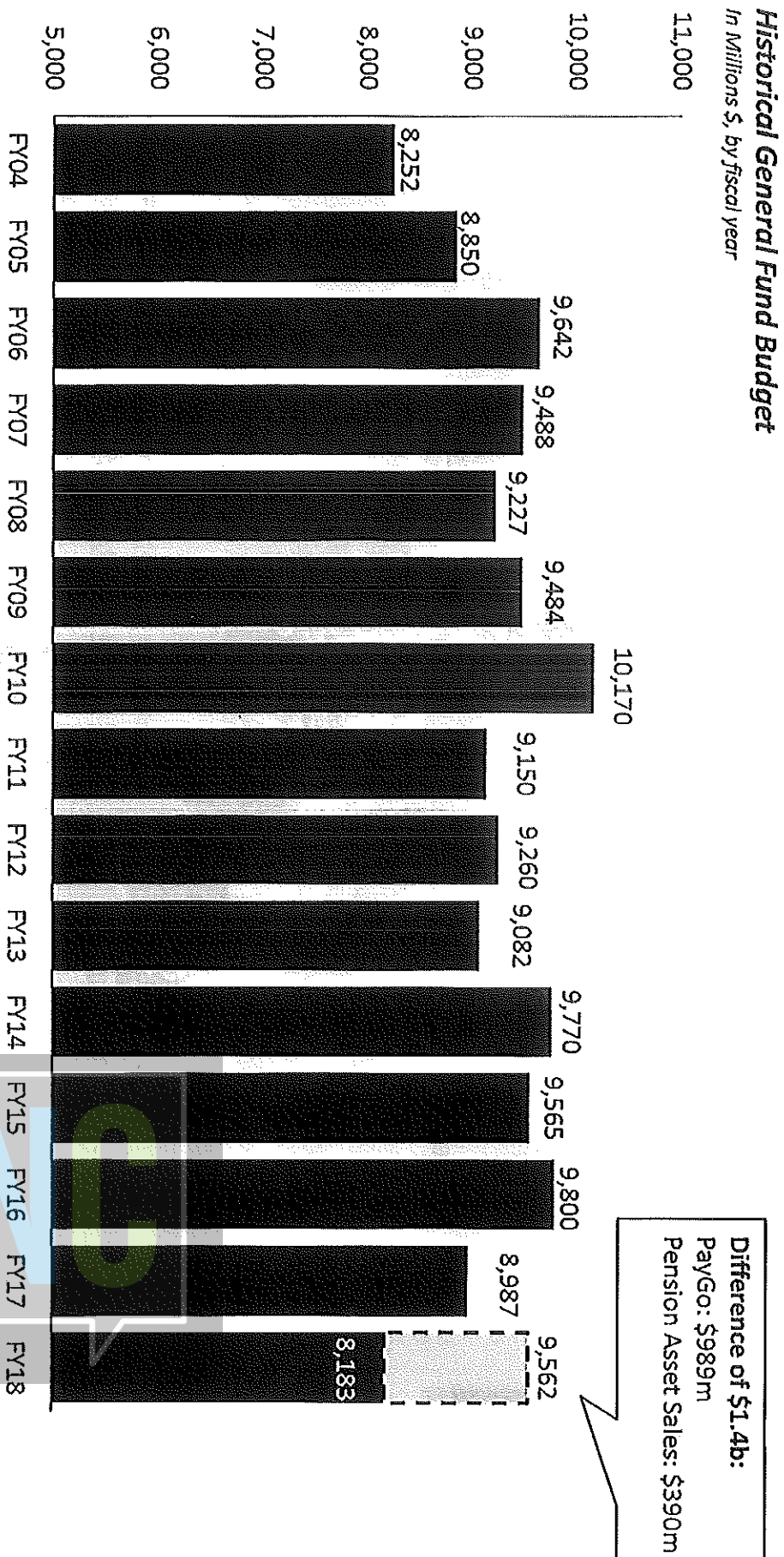
	FY16 Budget	FY17 Budget	FY18 Budget	FY17-FY18 Change
<b>Base Revenue</b>				
Individual Tax Collections	\$2,135	\$1,892	\$1,800	(\$92)
Corporate Tax Collections	1,793	1,515	1,510	(5)
Non-Resident Withholding Tax	822	685	640	(45)
Sales & Use Tax	1,738	1,718	1,567	(151)
Alcoholic Beverage Tax	270	268	257	(11)
Excise Tax (Act 154)	1,905	2,075	1,533	(\$542)
Tobacco Products Tax	133	112	110	(2)
Excise tax from rum remittances	186	206	149	(57)
Other	513	721	681	(40)
<b>Sub-total</b>	<b>\$9,495</b>	<b>\$9,192</b>	<b>\$8,247</b>	<b>(\$945)</b>
<b>Additional Fiscal Plan Measures</b>				
Extension of Act 154	-	-	\$519	\$519
Inc. Collections Sales & Use Tax	-	-	150	150
Inc. in other revenues and taxes	-	-	255	255
Pension asset sales	-	-	390	390
<b>General Fund Revenue</b>	<b>\$9,495</b>	<b>\$9,192</b>	<b>\$9,562</b>	<b>\$369</b>

Note: Monthly revenue does not include pension asset sales for \$390m



## Excluding pension adjustments, the FY18 General Fund Budget is 9% lower than the FY17 Budget

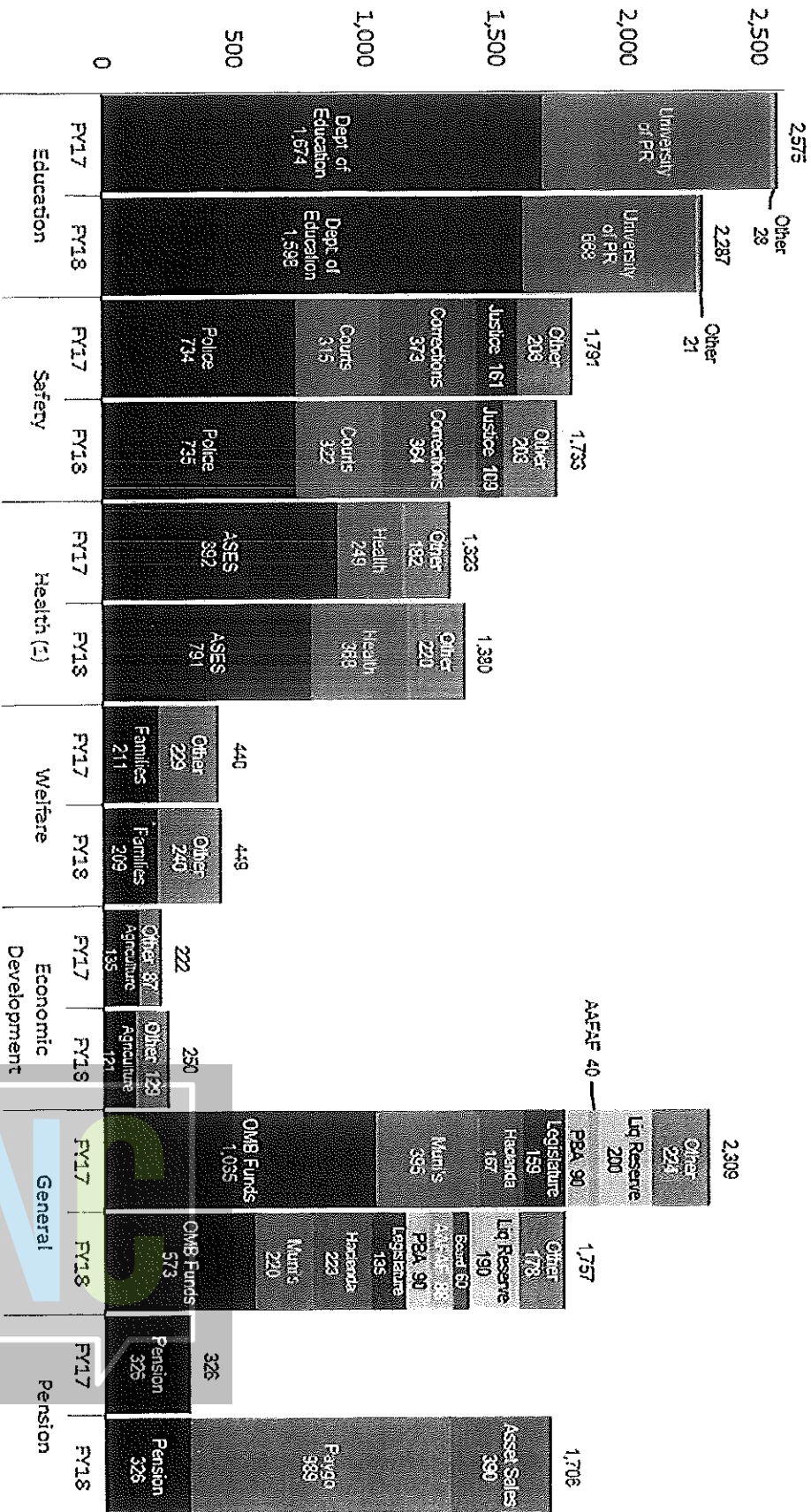
- The General Fund incorporates an additional \$1.4b to cover pension outlays as the retirement systems transition to a pay-as-you-go basis



Note: FY16 General Fund revenue was subsequently reduced to \$9.175b by the Government  
Source: Puerto Rico Office of Management and Budget

## A majority of the General Fund Budget is dedicated to education, public safety, health and welfare

### FY17 Compared to FY18 General Fund Budget by Type In Millions \$, by fiscal year



(1) The increase in healthcare costs is primarily related to an increase in local funding.  
Note: General Fund capital expenditures of approximately \$48m (of a total Consolidated Budget of \$1.2b) is split between multiple agencies.  
Source: Puerto Rico Office of Management and Budget - Budget Data

## ADDITIONAL SPENDING ANALYSES

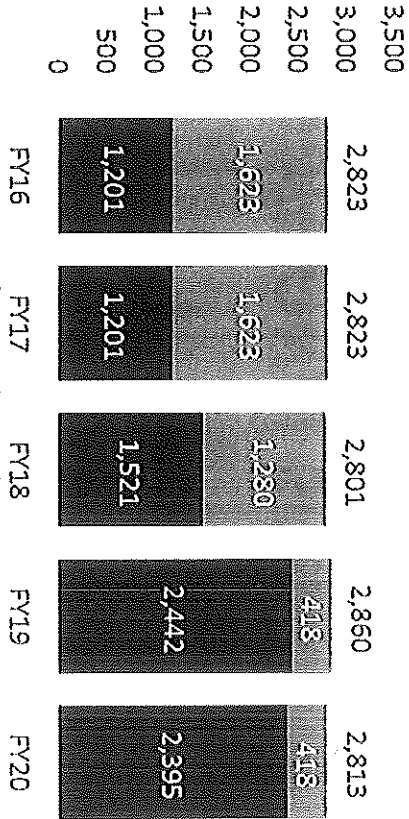




## Additional healthcare and pension funding was allocated in the FY18 Budget

### Government Funding Increases due to Medicaid Cliff

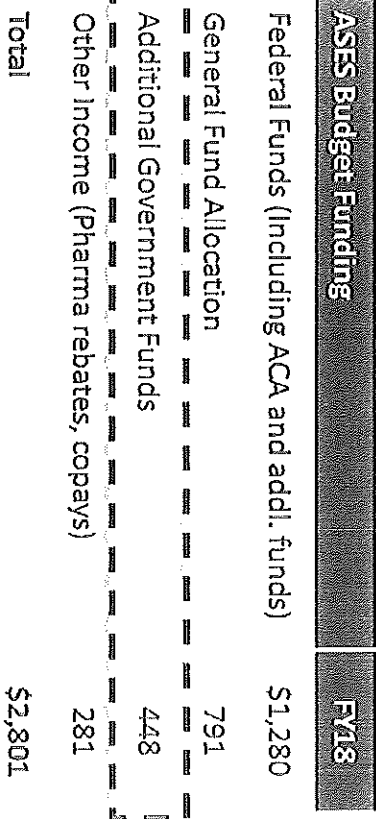
In Millions \$, by fiscal year



Note: Figures net of \$100m in FY16, \$299m in FY19 and \$500m in FY20 from Fiscal Plan savings  
Source: March 13, 2017 Fiscal Plan, OMB

### Estimated Distribution of Healthcare Resources in FY18

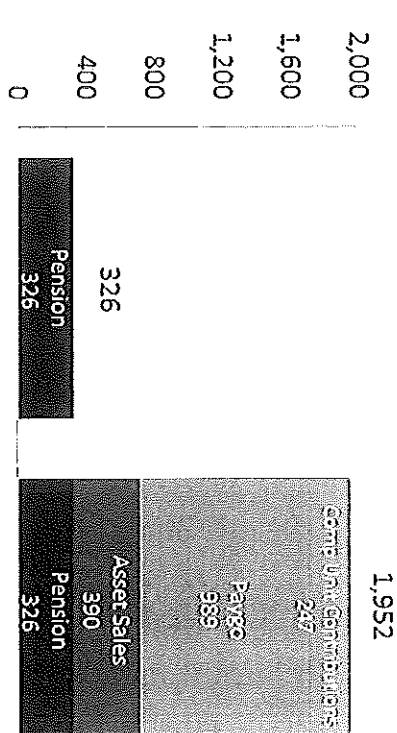
In Millions \$, by fiscal year



Source: Puerto Rico Office of Management and Budget -- Budget Data

### FY18 Consolidated Budget Pension Components

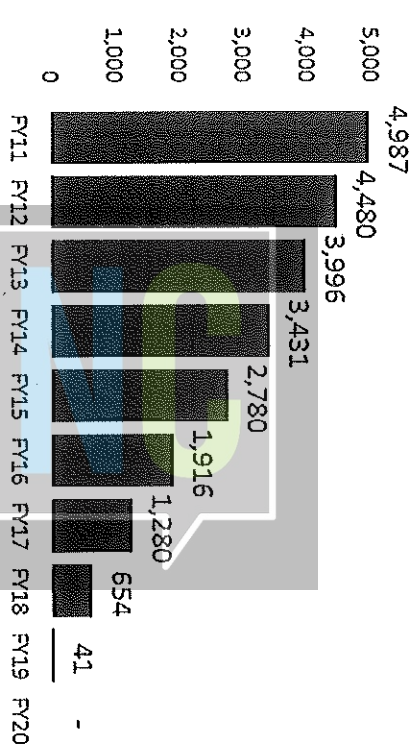
In Millions \$



Note: FY17 and FY18 pensions costs exclude employer pension cost  
Source: Puerto Rico Office of Management and Budget

### Liquid & Illiquid ERS System Assets

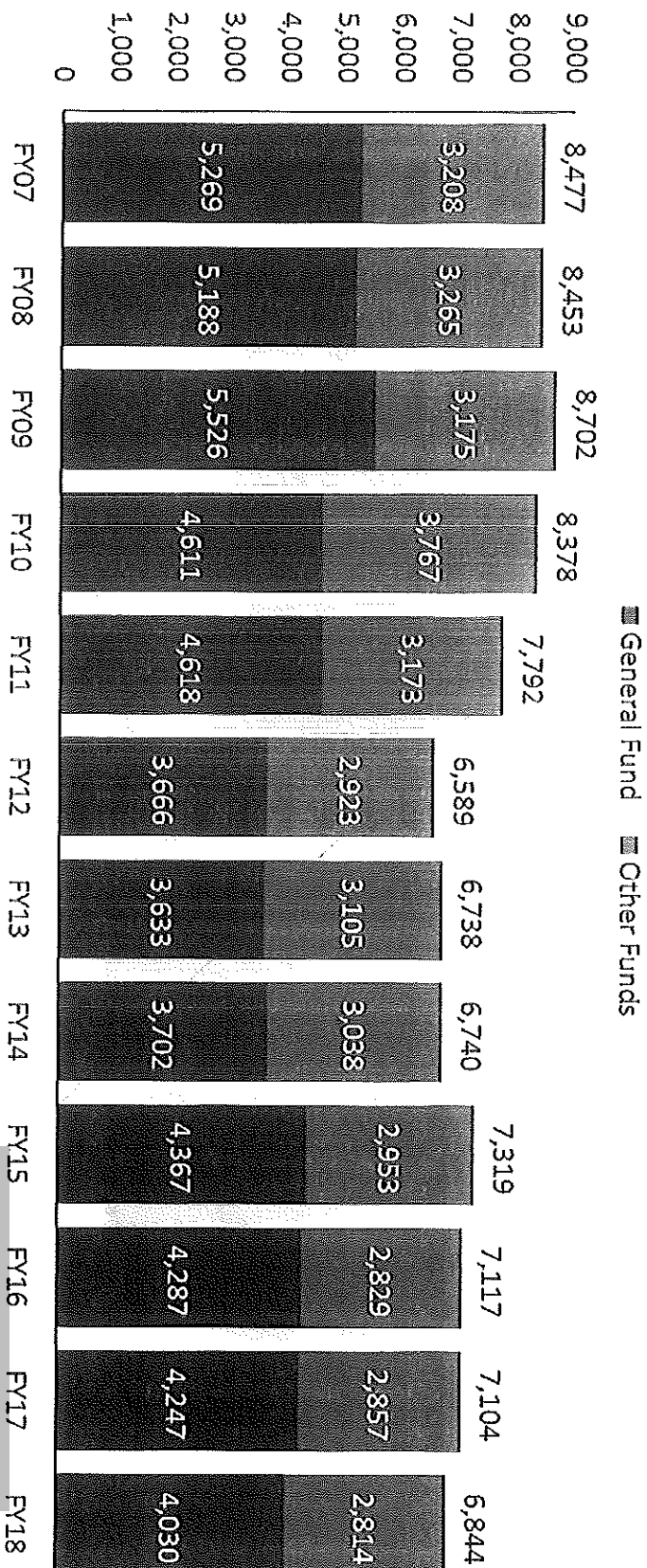
In Thousands \$



Source: Represents actuarial assets based on Actuarial Valuation Reports through 2015

## Payroll costs decline in the FY18 Budget, due to attrition and reduction of transitory employees

*General Fund and Consolidated Budget Historical Payroll*  
In Millions \$

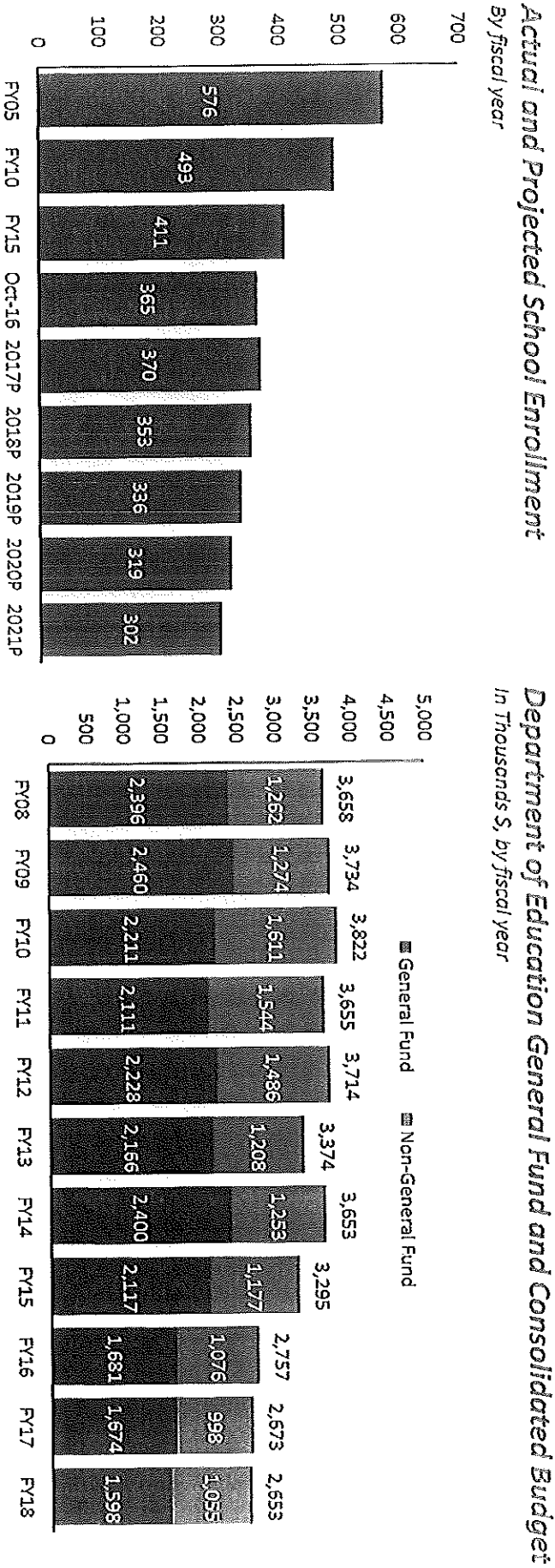


- General Fund payroll represents approximately 42% of total General Fund spending
- Other Funds payroll consists of payroll at component units, the largest being PREPA and PRASA

Note: Payroll increases from FY14 to FY15 because certain schoolwide program payroll costs at the Department of Education were misclassified as Other Agency Spending. The misclassification was corrected beginning with the FY15 Budget.  
Note: Total Payroll for FY13 includes employer pension costs of \$598m.  
Source: Puerto Rico Office of Management and Budget – Budget Data



## Department of Education expenditures decrease in FY18 Budget as a result of efforts to review and streamline operations

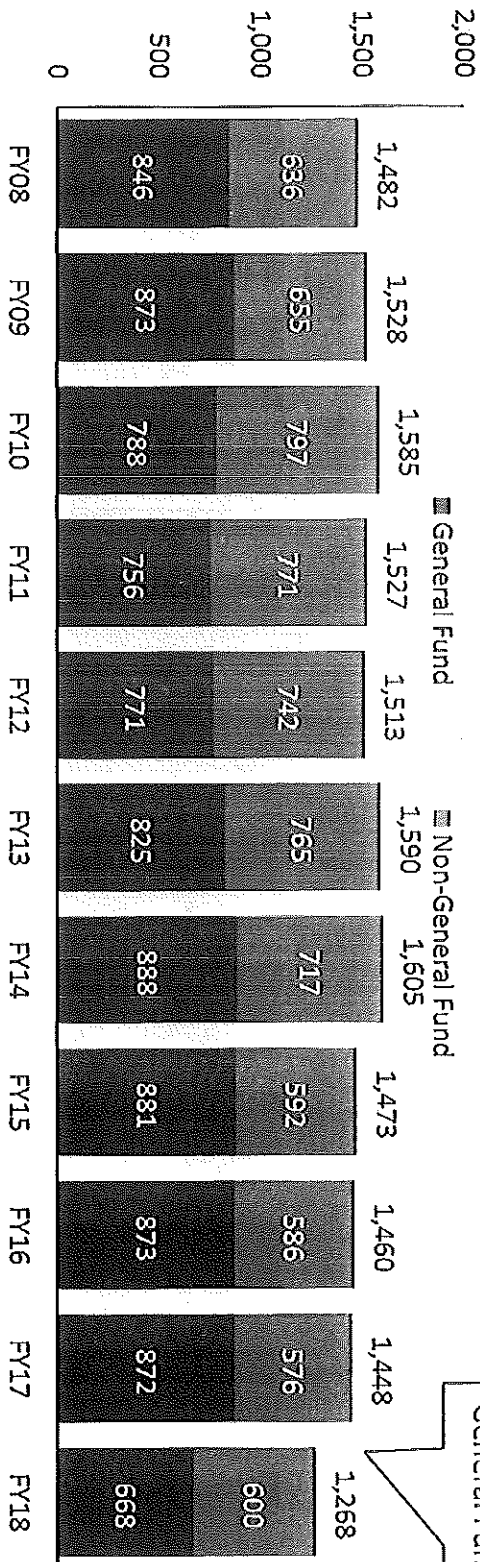


- Efforts are underway to review existing operations, prioritize spending and streamline education services without jeopardizing the delivery of this critical service
- The Government recently announced plans to close 167 schools by August 2017, which is expected to generate approximately \$7.5m in savings



## University of Puerto Rico General Fund appropriation decreases in the FY18 Budget, consistent with the Fiscal Plan

*UPR General Fund Budget and Consolidated Budget  
In Millions \$, by fiscal year*



- The University has 11 campuses, more than 60,000 students, and 5,300 faculty members
- Government grants and appropriations as a percent of operating revenues are one of the highest for public universities
- While the General Fund appropriation declines, this reduction is partially offset by \$40m in incremental funding provided by other parts of the Consolidated Budget

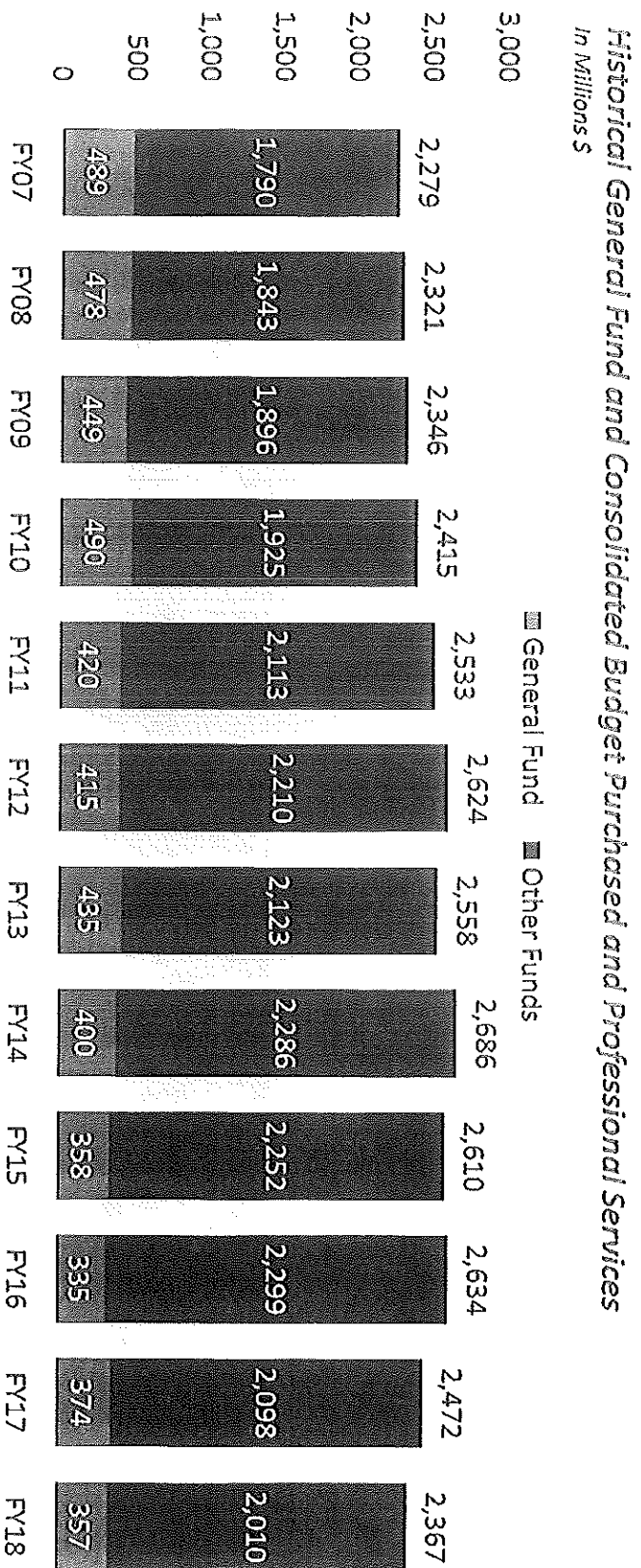
Additional UPR Expenditures	
In Millions \$	FY18

Capital Expenditures	\$15
Other Income Operating Costs	15
Training and Technical Assistance	10
<b>Total</b>	<b>\$40</b>

Source: Puerto Rico Office of Management and Budget- Budget Data

Source: Puerto Rico Office of Management and Budget – Budget Data

## Purchased and professional services decreased \$105m in FY18

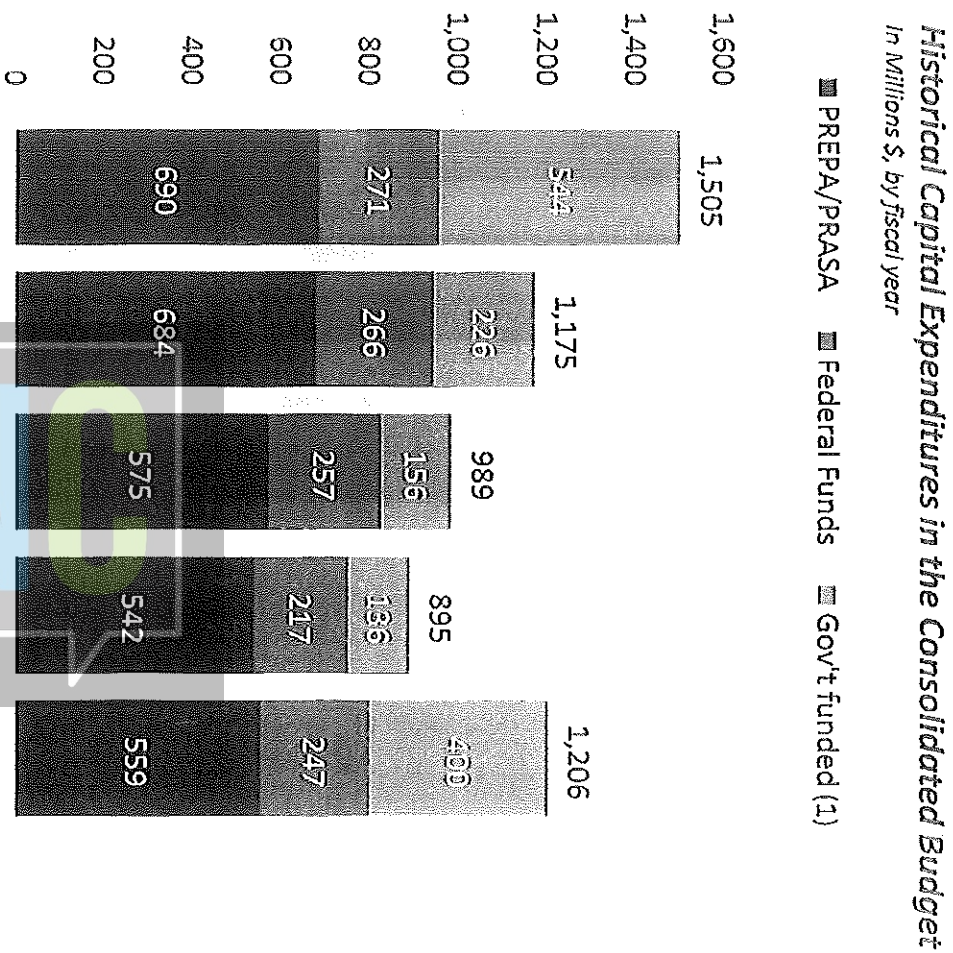


- The General Fund represents 15% of total purchased and professional services
- PREPA, PRASA, Department of Education, and HTA account for 60% of total purchased and professional services expenditures

Note: Chart is based on preliminary Budget allocation, final Budget allocation may differ  
Source: Puerto Rico Office of Management and Budget – Budget Data

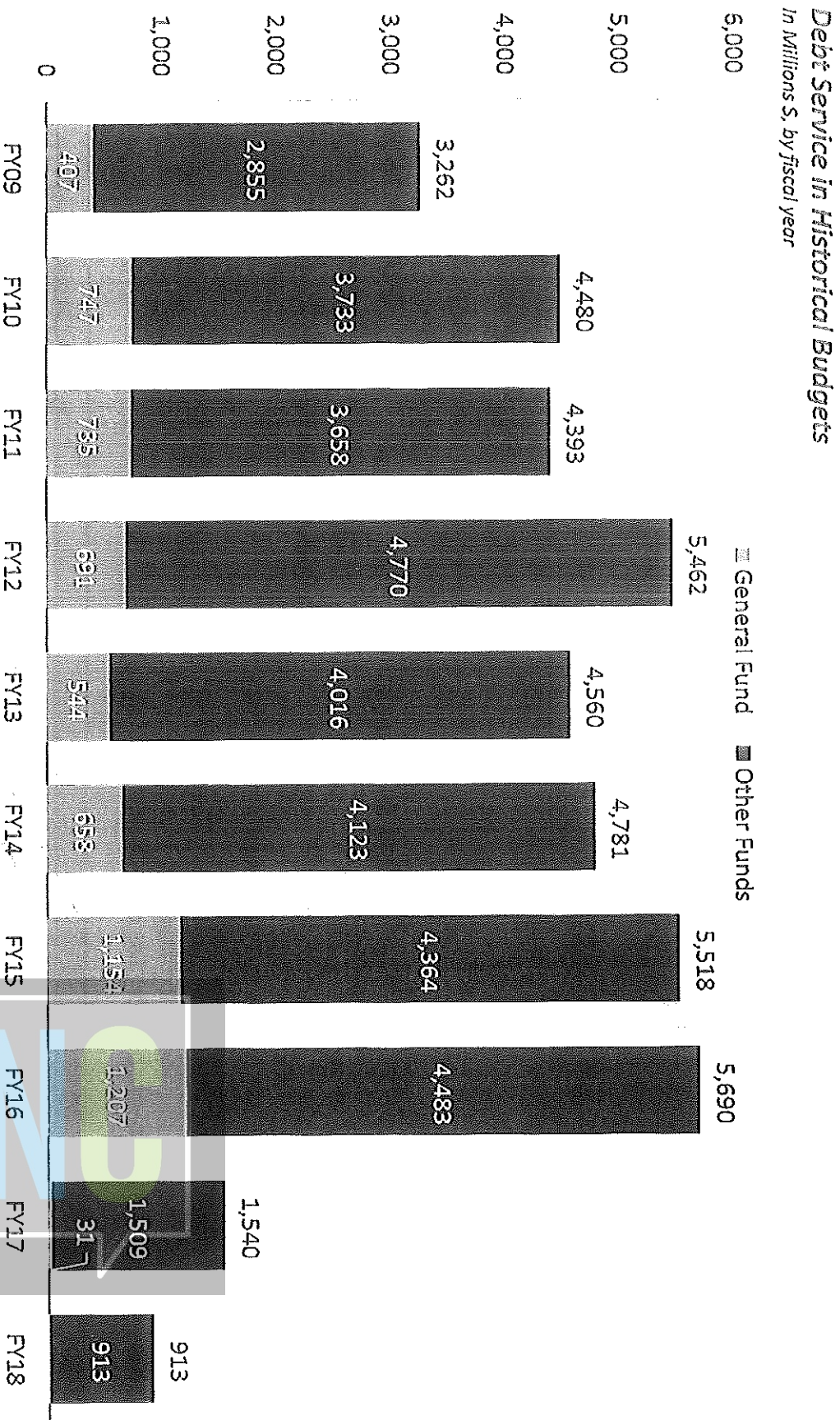
## FY18 Budget includes capital expenditure increases mostly related to PREPA, PRASA and HTA

- Capital expenditures increase \$311m from FY17
- PRASA (\$304m), PREPA (\$275m), and HTA (\$281m) account for 70% of total FY18 capital expenditures
- Departments with the largest increase in capital expenditures from FY17 to FY18 include HTA, UPR, and the Department of Natural Resources



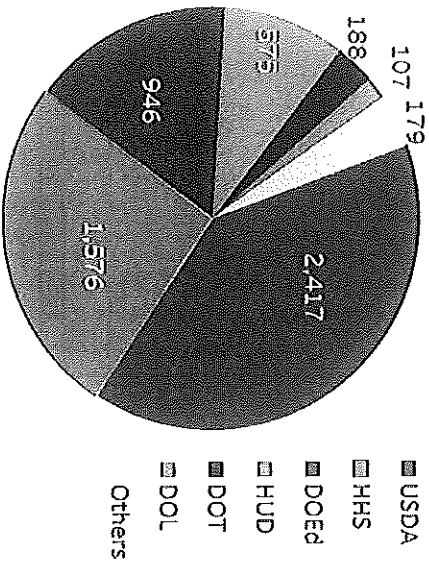
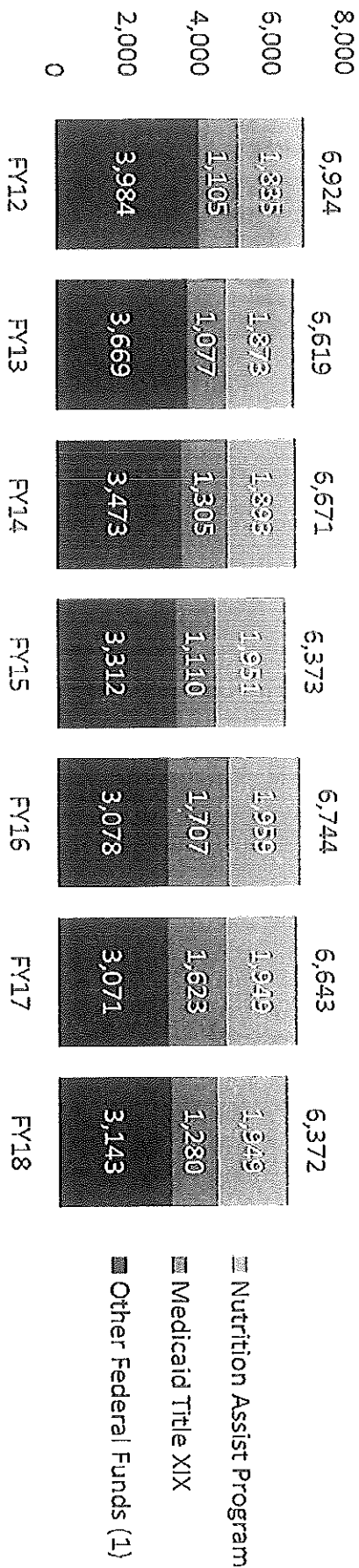


The Budget will allocate funds for debt service after a Title III Plan of Adjustment is confirmed or Title VI agreements are approved by the Court



## Federal funding was reduced by 9% year-on-year, primarily driven by a reduction in Medicaid and Other Federal Funds

### Historical Federal Funding In Millions \$, by fiscal year



(1) Federal Funds increased from FY15 to FY16 in part due to a shift from the third-party administrator to the managed care organization health model which began on April 1, 2015. Source: Puerto Rico Consolidated Budget, Office of Management and Budget. Not comparable with US Census figures because it excludes direct grants to non-profits, private entities and certain Municipalities; the number corresponds to a different year; and the numbers are strictly a compilation of self-reported numbers for Government agencies.

# APPENDIX



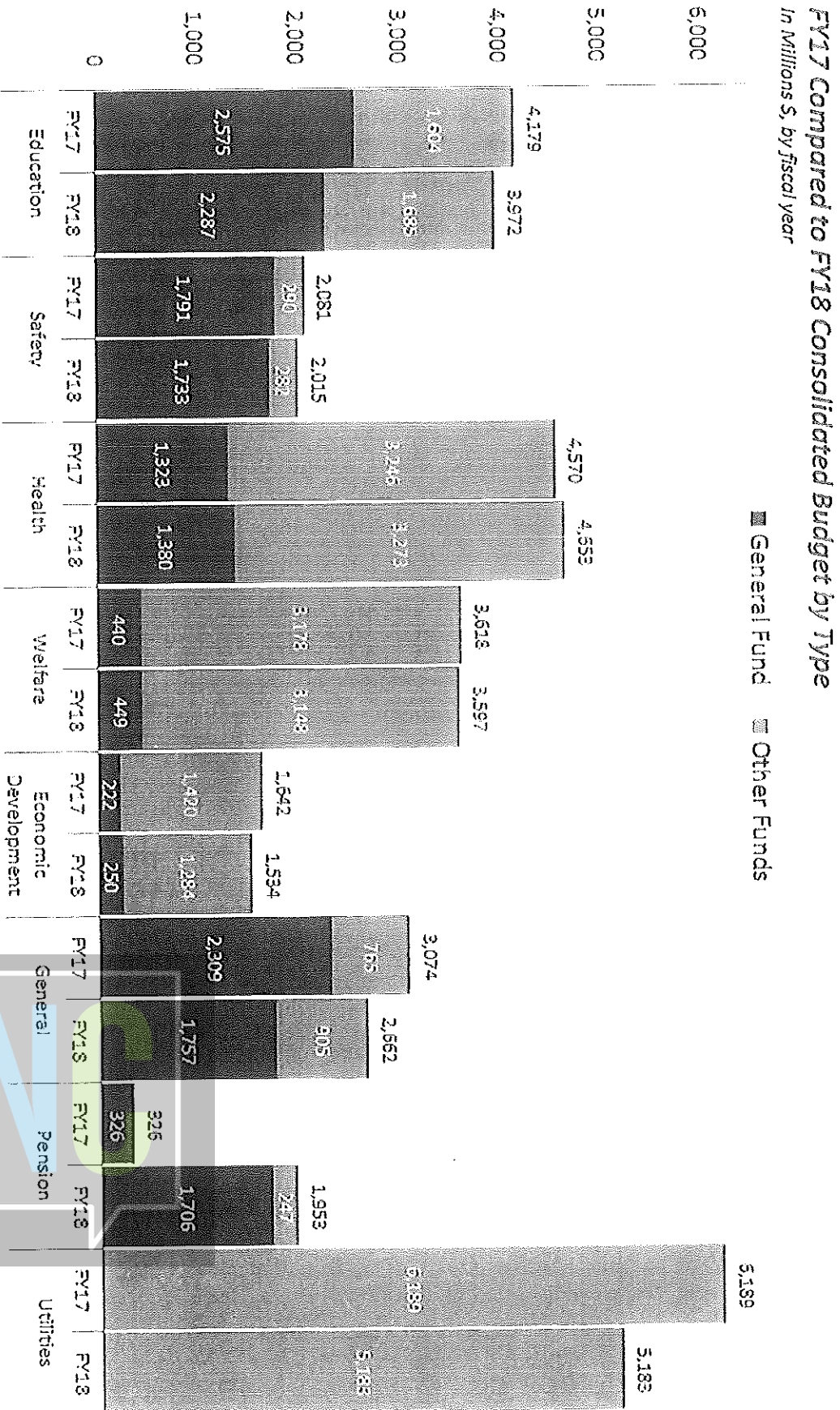


## Revenues and expense measures in FY18 Budget total approximately \$1.875m

Revenue Actions In Budget <i>In Millions \$</i>		Expense Actions In Budget <i>In Millions \$</i>	
Item	Amount	Item	Amount
Extend Act 154 law	\$519	Personnel-related expense	(\$167)
Improved tax compliance	150	Non-personnel related expense	(179)
Increase and right-size fees	56	Reduction of UPR subsidies	(201)
Addl. revenue enhancements	<u>199</u>	Reduction of other subsidies	(210)
Subtotal of revenue measures	\$924	Additional expense measures	(45)
		Reduction of healthcare spending	(100)
		Payroll and operational exp. freeze	<u>(49)</u>
		Total <sup>1</sup>	(\$951)

(1) (Reduction to expense)/ Increase to expenses

**The Consolidated Budget is \$25.6b and reflects year-on-year reductions in every major spend category, other than health and pensions**

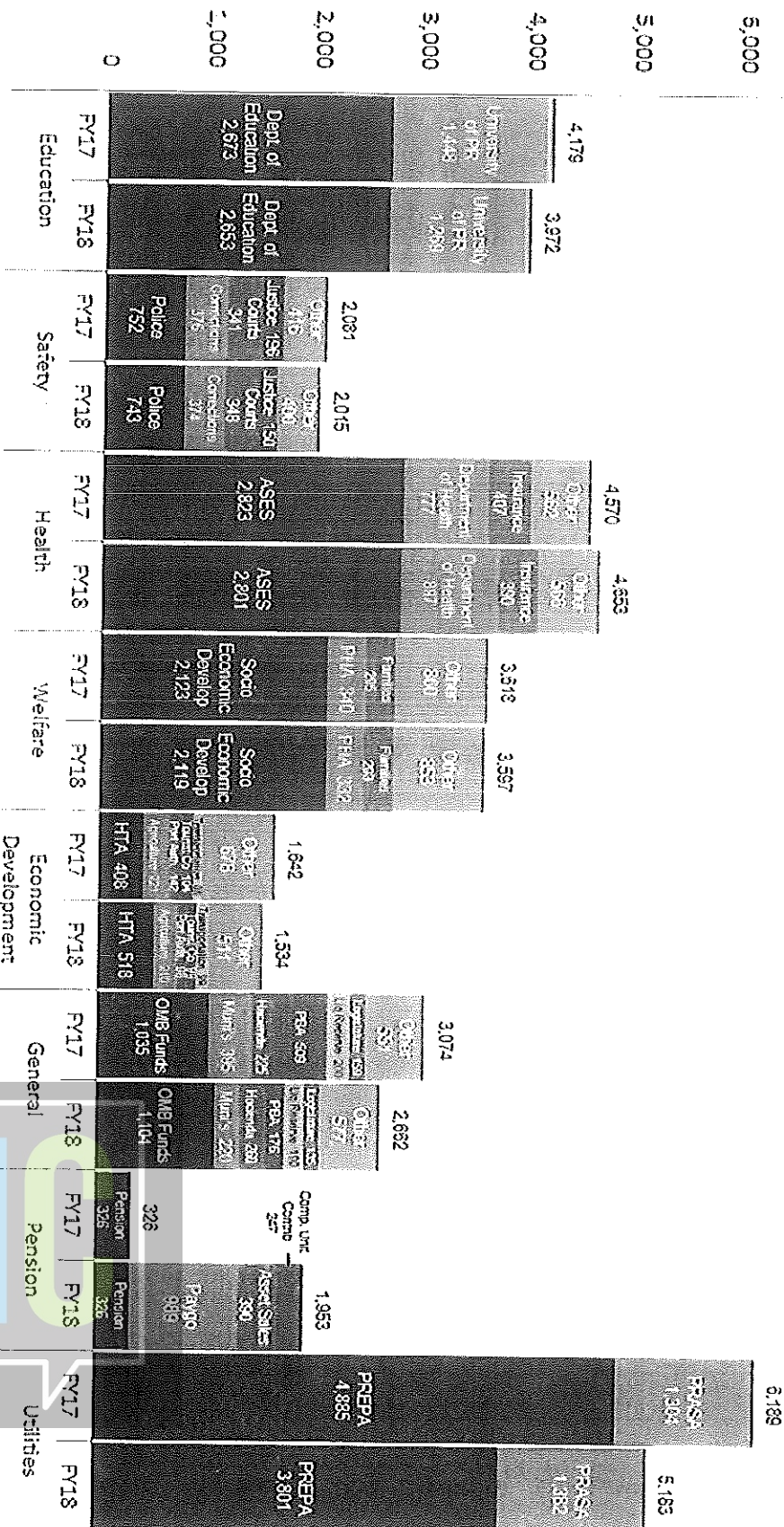


(1) Total pension cost of \$2.5b includes \$598m of employer costs currently sitting in individual agency payroll categories  
Source: Puerto Rico Office of Management and Budget – Budget Data



# Detailed agency comparison of the Consolidated Budget by type for FY17 and FY18

## FY17 and FY18 Consolidated Budget by Type In Millions \$, by fiscal year



(1) Healthcare costs increase primarily due to an increase in local funding of \$445m, additional Medicaid funding of \$256m and a Reconciliation Adjustment of \$100m  
(2) Other Economic Development costs are distributed amongst 24 agencies including: other transportation, agriculture, land, infrastructure and trade & export  
(3) Consolidated capital expenditures of approximately \$1.2b is split between multiple agencies  
Source: Puerto Rico Office of Management and Budget – Budget Data



## FY18 Consolidated Budget is slightly lower than FY17, even after increases in pension related expenses

	FY17	FY18	Change			FY17	FY18	Change	
Allocation					Allocation				
PREPA	\$4,885	\$3,801	(\$1,083)	↓	Hacienda	\$225	\$260	\$35	↑
OMB Custody Funds	1,035	1,104	69	↑	Municipalities	395	220	(175)	↓
Healthcare (ASES)	2,823	2,801	(22)	↓	Care and Development of Children	174	211	37	↑
Department of Education	2,673	2,653	(19)	↓	Housing Finance Authority	221	201	(20)	↓
Socio Economic Development	2,123	2,119	(4)	↓	Liquidity Reserve	200	190	(10)	↓
PRASA	1,304	1,382	78	↑	Agricultural Development	167	181	14	↑
University of Puerto Rico	1,448	1,269	(179)	↓	Public Building Authority	509	176	(333)	↓
PayGo & Component Unit Charge	0	1,236	1,236	↑	Mental Health	126	149	23	↑
Department of Health	777	897	119	↑	Justice	196	150	(46)	↓
Police	752	743	(9)	↓	Puerto Rico Legislature	159	135	(24)	↓
Road Authority	408	518	109	↑	Hacienda Custody Funds	112	112	0	⇒
State Insurance Fund	407	390	(17)	↓	Department of Housing	115	116	1	⇒
Pension Asset Sales	0	390	390	↑	Corp Centro Cardiovascular	79	75	(4)	↓
Corrections	376	374	(2)	↓	Human Resources	127	110	(17)	↓
Courts	341	348	7	↑	Tourist Company	104	99	(5)	↓
Public Housing Administration	340	332	(8)	↓	Transportation and Public Works	88	99	11	↑
Retirement System	326	326	(0)	↓	Ports Authority	142	98	(44)	↓
Families	295	293	(2)	↓	Transportation Authority	103	87	(16)	↓
Corp Service Medical Center	240	234	(6)	↓	Other	1,882	1,691	(191)	↓
Subtotal	\$20,553	\$21,209	\$656	↑	Subtotal	5,125	4,360	(765)	↓
					Total	\$25,678	\$25,569	(\$109)	↓

Source: Puerto Rico Office of Management and Budget – Budget Data

## FY18 General Fund is slightly higher than FY17, and includes incremental pension costs

Allocation	FY17	FY18	Change		Allocation	FY17	FY18	Change	
PREPA	\$0	\$0	\$0	⇒	Hacienda	\$167	\$223	\$56	⇧
OMB Custody Funds	1,035	574	(461)	⇩	Municipalities	395	220	(175)	⇩
Healthcare (ASES)	892	791	(100)	⇩	Care and Development of Children	13	51	37	⇧
Department of Education	1,574	1,598	(77)	⇩	Housing Finance Authority	11	10	(1)	⇩
Socio Economic Development	72	68	(4)	⇩	Liquidity Reserve	200	190	(10)	⇩
PRASA	0	0	0	⇒	Agricultural Development	84	96	12	⇧
University of Puerto Rico	872	668	(204)	⇩	Public Building Authority	90	90	0	⇒
PayGo & Component Unit Charge	0	989	989	⇧	Mental Health	82	105	23	⇧
Department of Health	249	368	119	⇧	Justice	161	109	(52)	⇩
Police	734	735	1	⇧	Puerto Rico Legislature	159	135	(24)	⇩
Road Authority	0	1	1	⇧	Hacienda Custody Funds	0	0	0	⇒
State Insurance Fund	0	0	0	⇒	Department of Housing	13	12	(1)	⇩
Pension Asset Sales	0	390	390	⇧	Corp Centro Cardiovascular	0	0	0	⇒
Corrections	373	364	(8)	⇩	Human Resources	11	7	(4)	⇩
Courts	315	322	7	⇧	Tourist Company	0	0	0	⇒
Public Housing Administration	0	0	(0)	⇩	Transportation and Public Works	32	52	19	⇧
Retirement System	326	326	(0)	⇩	Ports Authority	0	0	0	⇒
Families	211	209	(2)	⇩	Transportation Authority	29	25	(4)	⇩
Corp Service Medical Center	42	64	23	⇧	Other	744	770	26	⇧
Subtotal	\$6,795	\$7,469	\$673	⇧	Subtotal	2,192	2,093	(99)	⇩
					Total	\$ 8,987	\$ 9,562	\$574	⇧

Source: Puerto Rico Office of Management and Budget – Budget Data

## Fiscal reforms included in the Budget

### Revenue enhancements



- Collect outstanding taxes from individuals
- Develop alternative models for new corporate tax regime
- Increase various taxes and fees (gaming, tobacco, military stores, insurance premium, others)
- Sell property tax liens and design a new property tax regime
- Increase sales and use tax compliance

### Right Sizing



- Freeze salaries, eliminating impact of inflation
- Do not renew some one-year contract employees
- Control backfilling of employees who have voluntarily left
- Reduce municipal subsidies
- Reduce UPR subsidies
- Reduce private sector subsidies
- Prevent incremental operating expenses
- Consolidate select agency services and facilities
- Renegotiate contract prices for procured goods and services
- Cancel unnecessary or duplicate contracts
- Reduce quantity of purchased goods and services

### Healthcare



- Implement standard fee schedule for providers and ancillary services
- Replace the current profit sharing contract clause in MCO contract
- Expand coordination of benefits to ensure Mi Salud serves as payor of last resort
- Create Memorandum of Understanding (MOU) with Department of Corrections to identify misclassified beneficiaries
- Create MOU with New York and Florida to identify the beneficiaries that are enrolled in Mi Salud
- Create Medicaid Fraud Control Unit to investigate and persecute Medicaid fraud
- Reduce drug costs
- Adjust benefits
- Switch to a new, single-region MCO Model

### Pensions



- Implement legislative changes to pension benefits
- Reform pension benefits

