Financial Oversight &
Management Board
for Puerto Rico

2023 Transformation Plan for Puerto Rico

Restoring Growth and Prosperity

Volume 2: Economic trends and financial projections – Additional details

As certified by the Financial Oversight and Management Board for Puerto Rico

April 3, 2023

2023 Commonwealth Fiscal Plan pursuant to PROMESA Section 201

DISCLAIMER

The Financial Oversight and Management Board for Puerto Rico (the "FOMB," or "Oversight Board") has formulated this 2023 Fiscal Plan based on, among other things, information obtained from the Commonwealth of Puerto Rico (the "Commonwealth," or the "Government").

This document does not constitute an audit conducted in accordance with generally accepted auditing standards, an examination of internal controls or other attestation or review services in accordance with standards established by the American Institute of Certified Public Accountants or any other organization. Accordingly, the Oversight Board cannot express an opinion or any other form of assurance on the financial statements or any financial or other information or the internal controls of the Government and the information contained herein.

This 2023 Fiscal Plan is directed to the Governor and Legislature of Puerto Rico based on underlying data obtained from the Government. No representations or warranties, express or implied, are made by the Oversight Board with respect to such information.

This 2023 Fiscal Plan is not a Title III plan of adjustment, it does not specify classes of claims and treatments, and it neither discharges debts nor extinguishes liens. For additional historical financial information, parties are referred to the Disclosure Statement approved in the Commonwealth's Title III case. Parties are referred to the Title III plan of adjustment for the Commonwealth that was confirmed by the Title III court, and the Title III court's related orders, with respect to all matters covered by the Title III plan of adjustment.

The 2023 Fiscal Plan may be amended from time to time, as appropriate at the sole discretion of the Oversight Board.

This 2023 Fiscal Plan is based on what the Oversight Board believes is the best information currently available to it. To the extent the Oversight Board becomes aware of additional information after it certifies this 2023 Fiscal Plan that the Oversight Board determines warrants a revision of this 2023 Fiscal Plan, the Oversight Board will so revise it.

For the avoidance of doubt, the Oversight Board does not consider and has not considered anything in the 2023 Fiscal Plan as a "recommendation" pursuant to Section 205(a). However, for those instances of the 2023 Fiscal Plan which specifically prefer to a Section 205(a) letter issued by the Oversight Board, the Oversight Board herby adopts those instances into the 2023 Fiscal Plan pursuant to PROMESA Section 201(b). Nevertheless, to the extent that anything in the 2023 Fiscal Plan is ever deemed by the Governor or Legislature or determined by a court having subject matter jurisdiction to be a "recommendation" pursuant to Section 205(a), the Oversight Board hereby adopts it in the 2023 Fiscal Plan pursuant to PROMESA Section 201(b).

Any statements and assumptions contained in this document, whether forward-looking or historical, are not guarantees of future performance and involve certain risks, uncertainties, estimates, and other assumptions made in this document. The economic and financial condition of the Government and its instrumentalities is affected by various legal, financial, social, economic, environmental, governmental and political factors. These factors can be very complex, may vary from one fiscal year to the next, and are frequently the result of actions taken or not taken, not only by the Government and the Oversight Board, but also by other third-party entities such as the government of the United States. Examples of these factors include, but are not limited to:

- *Any future actions taken or not taken by the United States government related to Medicaid or the Affordable Care Act;*
- *The amount and timing of receipt of any distributions from the Federal Emergency Management Agency and private insurance companies to repair damage caused by the Earthquakes and/or Hurricanes María, Irma, and Fiona;*
- *The amount and timing of receipt of any amounts allocated to Puerto Rico and provided under the Community Disaster Loans Program;*
- *The amount and timing of receipt of any additional amounts appropriated by the United States government to address the funding gap described herein; and*
- *The timeline for completion of the work being done by the Puerto Rico Electric Power Authority ("PREPA") to repair PREPA's electric system and infrastructure and the impact of any future developments or issues related to PREPA's electric system and infrastructure on Puerto Rico's economic growth.*

Because of the uncertainty and unpredictability of these factors, their impact cannot be included in the assumptions contained in this document. Future events and actual results may differ materially from any estimates, projections, or statements contained herein. Nothing in this document should be considered as an express or implied warranty of facts or future events; provided, however, that the Government is required to implement the measures in this 2023 Fiscal Plan and the Oversight Board reserves all its rights to compel compliance. Nothing in this document shall be considered a solicitation, recommendation, or advice to any person to participate, pursue or support a course of action or transaction, to purchase or sell any security, or to make any investment decision.

Table of Contents

1 Guide to the 2023 Commonwealth Fiscal Plan

The 2023 Transformation Plan for Puerto Rico satisfies the requirement of the Commonwealth Fiscal Plan pursuant to PROMESA Section 201. The document contains three parts:

- *Volume 1: Transformation plan*

  The 2023 Commonwealth Transformation Plan provides an overview of the Government and Oversight Board's achievements under PROMESA, a summary of economic trends and financial projections for the Commonwealth, and highlights priority areas to accelerate economic growth and restore market access for Puerto Rico. In addition, the plan describes areas where the Oversight Board is working with stakeholders to find solutions to priority challenges impacting growth.

- ***Volume 2: Economic trends and financial projections – Additional Details***

  These additional details are provided to expand on the economic trends and financial projections introduced in Volume 1.

- *Volume 3: Implementation requirements and plan*

  These supplementary implementation details are provided to guide the Government's implementation of the requirements of this 2023 Fiscal Plan. Additional initiatives from prior fiscal plans remain mandatory and must still be implemented fully.

Economic trends in Puerto Rico

2023 Commonwealth Fiscal Plan pursuant to PROMESA Section 201

2 Economic trends in Puerto Rico

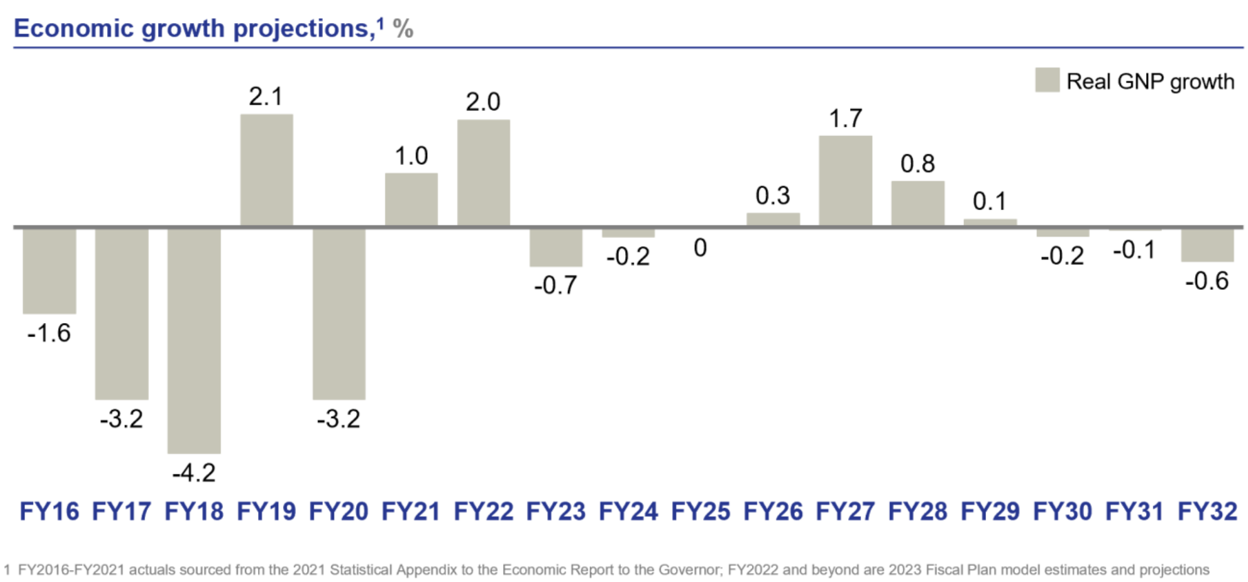
2.1 Macroeconomic overview

The 2023 Fiscal Plan includes an updated macroeconomic forecast reflecting the impact of fiscal and structural measures, natural disasters and COVID-19, and federal funding in response to such natural disasters and the pandemic on the baseline economic trajectory. The baseline economic outlook model, which forecasts growth in real gross national product (GNP), relies primarily on a comprehensive dataset of the Puerto Rican economy from 1965 to 2017. It includes dozens of variables that collectively describe the economy (e.g., economic growth, population, capital stock, etc.). Major drivers of this forecast include projected U.S. GDP growth, certain federal transfers, trends in capital stock growth, and key commodity prices.

The baseline macroeconomic forecast is then impacted by four major factors: (a) the impact of hurricanes, earthquakes, and COVID-19 on economic activity, employment, and the capital stock; (b) federal and local relief assistance for hurricanes, earthquakes, and COVID-19 (discussed in *Section 2.2*); (c) incremental federal funds from the Bipartisan Infrastructure Law (*Section 2.2*); and (d) proposed government efficiency measures, investments, and structural reforms. While the 2023 Fiscal Plan maintains these key inputs from the prior Fiscal Plan model, the Fiscal Plan forecast in the short term particularly accounts for recent changes in the macroeconomic environment, including higher U.S. inflation, declining economic growth, and spikes in energy and food prices.

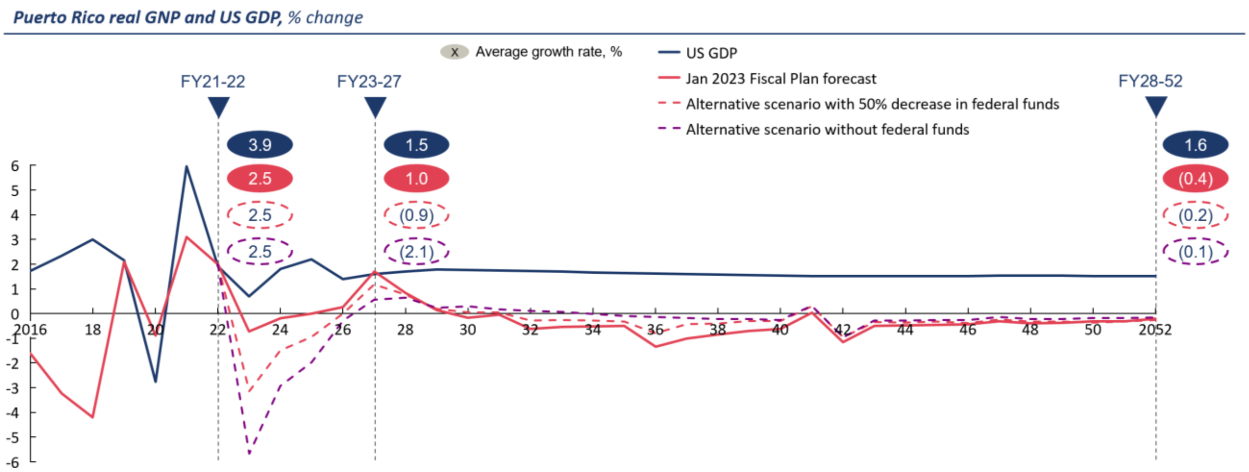
Exhibit 1 shows the resulting projection for real GNP growth. The 2023 Fiscal Plan projects a 0.7% decline in FY2023 real GNP followed by a period of near-zero growth in FY2024-FY2026 (Exhibit 1). A brief growth rebound in FY2027-FY2028 is followed by the return to Puerto Rico's negative historical trend (average decline of 0.5% per year in FY2029-FY2052).

EXHIBIT 1: PUERTO RICO REAL GNP GROWTH RATE



The unprecedented one-time influx of federal funds has strengthened the economy during the pandemic, but those funds are waning and may mask underlying weaknesses in the Island's economy. The 2023 Fiscal Plan assumes full deployment of disaster relief and COVID-19 relief funds by 2035; less than full deployment would substantially lower GNP growth. For example, a scenario with 50% deployment of relief funds would result in a 1.9 percentage point decrease in average GNP growth between FY2023 and FY2027, while a scenario without the effects of relief funds would decrease growth by 3.1 percentage points per year over the same period.

EXHIBIT 2: GNP GROWTH SCENARIOS CONTINGENT ON FEDERAL FUNDS



Over the last year, both U.S. and Puerto Rico have experienced a sharp increase in inflation rates. Prices continue to rise in Puerto Rico and on the mainland. While U.S. inflation dropped to 6.4% in January 2023, the lowest rate since 2021, it remains at historically high levels. Puerto Rico's year-over-year (YoY) inflation rate was 6.0% in October 2022. Puerto Rico inflation has been driven by large increases in the prices of food and beverages, other goods and services, and transportation (including motor fuels).

The 2023 Fiscal Plan U.S. inflation forecast is sourced from the Congressional Budget Office (CBO). Estimates of oil and food prices in the short term (2022-2024) are based on the World Bank Commodity Markets Outlook. The long-term forecast (2025-2052) is based on the U.S. Energy Information Administration's (EIA) long-term forecast. The long-term world food forecast is projected as a function of long-term U.S. inflation.

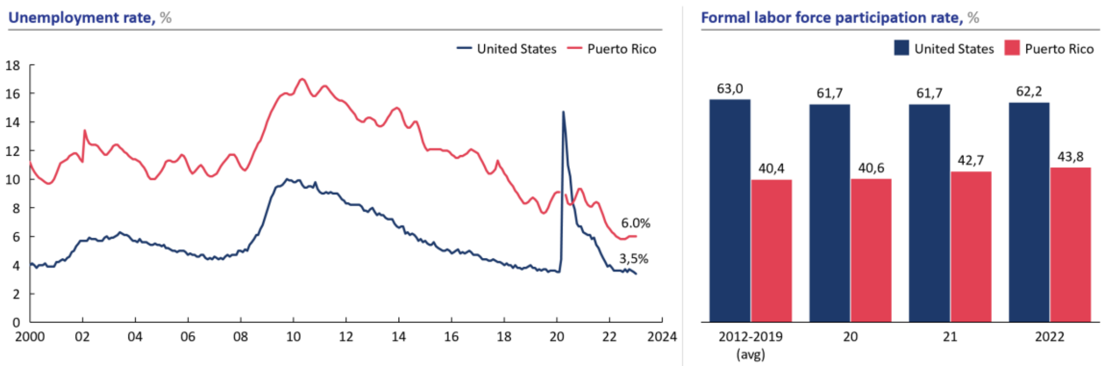
Projections for Puerto Rico inflation, U.S. inflation, world food prices, and world oil prices used for the 2023 Fiscal Plan are summarized in *Exhibit 3*.

EXHIBIT 3: ANNUAL PUERTO RICO PRICE CHANGES

Puerto Rico Inflation	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Inflation	3.3%	2.0%	1.4%	1.3%	1.3%	1.4%	1.4%	1.5%	1.5%	1.5%
US inflation	4.8%	3.0%	2.2%	2.1%	2.1%	2.2%	2.3%	2.3%	2.3%	2.3%
Change in world oil prices	(8.0%)	(13.0%)	(4.6%)	5.0%	5.1%	4.7%	3.4%	4.2%	4.3%	3.7%
Change in world food prices	(6.2%)	(0.4%)	1.8%	1.7%	1.7%	1.9%	1.9%	1.9%	2.0%	2.0%

The unemployment rate in Puerto Rico reached a historic low of 5.8% in August 2022. While unemployment is still relatively high compared to the mainland, Puerto Rico has narrowed the gap to just over 2 percentage points.

EXHIBIT 4: UNEMPLOYMENT RATE AND LABOR FORCE PARTICIPATION



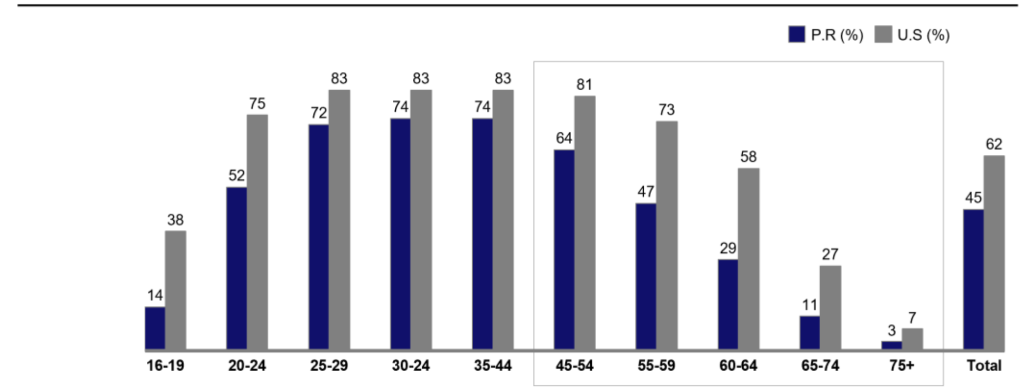
Note: Puerto Rico does not show a positive spike at start of COVID-19 pandemic because: (1) Survey was not conducted in March and April of 2020 and thus the data is missing for there two months; (2) PRDOL did not include those employed but working 0 hours as part of the unemployed.
Source: Bureau of Labor Statistics

Note: While Puerto Rico's labor force participation appears much lower than US average, Puerto Rico has a large informal sector. The formal + informal labor force participation is estimated to be 62%-79%.
Source: PRDOL and Bureau of Labor Statistics

Labor force participation in Puerto Rico, despite being well below that of any U.S. state, continues to rise (*Exhibit 4*). This increase is likely related in part to the recent expansion of the Earned Income Tax Credit (EITC) program in 2021. The low level of labor force participation is especially pronounced among workers under age 24 and over age 45. Given the large share of workers over age 45 in the total population, their low labor force participation significantly affects the average (*Exhibit 5*). Structural challenges in Puerto Rico, including limited access to child and elder care, regional inequities in the availability of jobs, and the average time to complete advanced degrees all may contribute to this gap. Labor force participation is an essential component of economic growth, since it allows firms to expand employment, increase production, and has an important impact on fiscal and budget trends. For additional information on labor force participation, and the Puerto Rico EITC program, see Volume 1 and Volume 3.

EXHIBIT 5: LABOR FORCE PARTICIPATION BY AGE GROUP

Puerto Rico and U.S. Labor Force, by age cohort, %



	16-19	20-24	25-29	30-24	35-44	45-54	55-59	60-64	65-74	75+	Total
PR Pop # 2021	171K	227K	224K	195K	404K	430K	221K	221K	378K	326K	2.8M
PR Pop % 2021	5%	7%	7%	6%	12%	13%	7%	7%	11%	10%	84%
US Pop % 2021	5%	7%	7%	7%	13%	13%	7%	6%	10%	6%	80%

*Totals are derived from BLS and PRDOL and represent values for December 2022 while age disaggregation is derived from Census
SOURCE: Bureau of Labor Statistics; Puerto Rico Department of Labor; Census ACS 2021 5-year estimates

2.2 Federal and local fiscal stimulus

In recent years, Puerto Rico has received an unprecedented infusion of federal funds in the form of Disaster Relief Funding and COVID-19 stimulus that has helped the economy recover. Through successive federal stimulus packages, Puerto Rico received approximately $120 billion in federal funds, equivalent to over 150% of the Island's 2022 GNP. To put this in perspective, comparable levels of federal support for major U.S. states would be equivalent to New York state receiving over $2 trillion or California receiving nearly $4 trillion in relief funds. Most of these COVID-related funds, such as enhanced unemployment benefits, Paycheck Protection Program (PPP) loans, and economic impact payments were one-time infusions that temporarily boosted output.

2.2.1 Federal stimulus: Disaster Relief Funds, COVID-19 stimulus, and the Bipartisan Infrastructure Law

Disaster Relief Funds (DRF)

Disaster spending tends to have a short-term stimulative effect on an economy in the wake of a crisis, but not in a long-term effect. In Puerto Rico, the level of committed public and private disaster relief spending is significant when compared to the overall economy. Public and private disaster relief spending has and will continue to impact the economy in two major ways:

- **Stimulative impact from post-hurricane disaster relief spending**. This stimulus comes from aid packages and can take multiple forms, such as construction companies hiring local, unemployed workers, or workers from the U.S. mainland who will pay local withholding taxes and spend money on food and lodging.
- **Expected reconstruction of the capital stock on the Island.** The 2023 Fiscal Plan reflects the long-term impact of federal funds on repairing the capital stock damaged by the hurricanes. The extraordinary infusion of federal and private disaster relief funds accounts for a large share of capital stock reconstruction and contributes to economic growth in the long run.

The 2023 Fiscal Plan presents updated disaster relief funding disbursement projections, based on actual disbursement data for FY2020-FY2022, and July-November FY2023. Actual disbursement data show that for the majority of DRF categories, except for CDBG-DR, disbursement was lower than projected in the 2022 Fiscal Plan. However, FY2023 actuals, coupled with new guidelines that facilitate the application process for FEMA approval, suggest that disbursement will pick up starting in FY2023. These changes are reflected in the 2023 Fiscal Plan.

While the updated disbursement projections are based on actuals and procedural changes, continued efforts from the Government to maintain more efficient disbursement will be necessary to meet projections.

The 2023 Fiscal Plan projects that about $81 billion of disaster relief funding in total, from federal and private sources, will be disbursed as part of the reconstruction effort over 18 years (FY2018-FY2035). The funding will benefit individuals (e.g., reconstruction of houses, personal expenditures related to the hurricane such as clothing and supplies), the public (e.g., reconstruction of major infrastructure, roads, and schools), and will cover part of the Commonwealth's share of the cost of disaster relief funding (recipients often must match some portion of federal public assistance spend).[1]

Of the total, about $47 billion is estimated to come from the Federal Emergency Management Agency (FEMA) Disaster Relief Fund (DRF) for Public Assistance, Hazard Mitigation, Mission Assignments, and Individual Assistance. An estimated $7 billion comes from private and business insurance payouts, and another $7 billion from other sources of federal funding.

The 2023 Fiscal Plan includes about $19 billion from the federal Housing and Urban Development (HUD) Community Development Block Grant-Disaster Recovery (CDBG-DR) program, of which about $2.3 billion is estimated to be allocated to offset the Commonwealth and its associated entities' expected FEMA-related cost-share requirements.[2] This portion of CDBG-DR funding will be used to cover part of the roughly 10% cost-share burden on federal expenditures attributable to the Commonwealth, PREPA, PRASA, and HTA from FY2019 to FY2032. The 2023 Fiscal Plan allocates about $4.2 billion for Puerto Rico's cost-match responsibility. After the CDBG-DR funds, out-of-pocket cost-share is reduced to $2.5 billion for Puerto Rico, of which $1.4 billion is attributable to the Commonwealth.

In 2022, Hurricane Fiona struck Puerto Rico, with material negative impact on the economy, although not to the same degree as Hurricanes Maria and Irma. Most of the negative economic impact is expected to be offset by disaster relief funds provided by FEMA. As of February 2023, about $600 million of individual assistance has been approved and about $115 million of public assistance emergency and permanent work obligated. However, detailed disbursement data and projections have not been made available. The net economic impact of Fiona will be included in the next Fiscal Plan update once more comprehensive data is available.

COVID-19 stimulus

The 2023 Fiscal Plan incorporates updated allocation and disbursement projections for federal COVID-19 relief spending, including initial support rounds, CARES Act, ARP Act, CRRSA Act. The update reflects a slower-than-expected pace of disbursement of federal funds with around $4 billion less in actual disbursement in FY2021-FY2022 than the 2022 Fiscal Plan projection. The 2023 Fiscal Plan projects accelerated deployment of remaining COVID-19 relief funds in FY2023 through FY2025, with around $9.3 billion expected to be disbursed, compared to $4.5 billion projected in the 2022 Fiscal Plan. In the first months of FY2023, the Government achieved progress in accelerated disbursement of previously lagging funds, particularly, School Emergency Relief Funds. Complete, efficient, and effective disbursement of the remaining stimulus support is critical to improving the growth outlook in the next several years.

Bipartisan Infrastructure Law

The 2023 Fiscal Plan continues to account for $2.3 billion in federal funds to Puerto Rico from the Bipartisan Infrastructure Law (BIL). The BIL funds were allocated to Puerto Rico to improve the Island's infrastructure over FY2022-2026. Incremental funding from the BIL, accounting for prior federal infrastructure support, amounts to around $1.6 billion.

1 Puerto Rico's cost-match responsibility was estimated using FEMA-provided data, adjusted by category as necessary for waivers and exceptions

2 Estimate based on early assessment of CDBG-DR and CDBG-MIT Action Plans for Puerto Rico (with public data as of October 16, 2022), as well as patterns of cost share coverage from CDBG-DR in previous storms

EXHIBIT 6: PROJECTED DISBURSEMENT OF DISASTER RELIEF, COVID-19, AND BIL FUNDS[3]

Federal disaster relief funds by category, $M

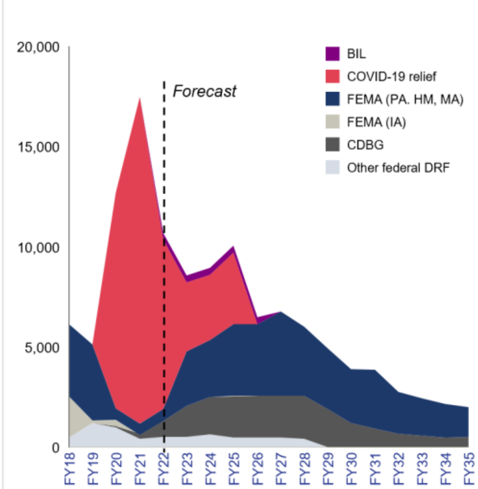
Federal funds	FY18, $M, %	FY19, $M, %	FY20, $M, %	FY21, $M, %	FY22, $M, %	FY23, $M, %	FY24, $M, %	FY25, $M, %	FY26-35, $M, %	Total, $M
Total federal disaster relief programs	6,167	5,139	1,942	1,196	1,915	4,783	5,350	6,146	41,144	73,780
	8%	7%	3%	2%	3%	6%	7%	8%	56%	
FEMA Public Assistance, Hazard Mitigation, Mission Assignments[1]	*3,607*	*3,772*	*544*	*585*	*596*	*2,708*	*2,845*	*3,578*	*26,992*	45,226
	8%	*8%*	*1%*	*1%*	*1%*	*6%*	*6%*	*8%*	*60%*	
FEMA Individual Assistance[1]	*2,050*	*130*	*317*	*(70)*	*10*	*4*	*0*	*0*	-	2,442
	84%	*5%*	*13%*	*-3%*	*0%*	*0%*	*0%*	*0%*	*0%*	
CDBG	-	-	*66*	*257*	*787*	*1,532*	*1,858*	*2,054*	*12,643*	19,198
	0%	*0%*	*0%*	*1%*	*4%*	*8%*	*10%*	*11%*	*66%*	
Other federal disaster relief funding	*509*	*1,237*	*1,014*	*426*	*522*	*539*	*646*	*513*	*1,509*	6,915
	7%	*18%*	*15%*	*6%*	*8%*	*8%*	*9%*	*7%*	*22%*	
COVID-19 relief programs[2]	-	-	10,764	16,275	8,465	3,465	3,276	2,583	-	44,828
	-	-	24%	36%	19%	8%	7%	6%	-	
Bipartisan Infrastructure Law	-	-	-	-	322	323	324	325	326	1,620
	-	-	-	-	20%	20%	20%	20%	20%	
Total	**6,167**	**5,139**	**12,706**	**17,471**	**10,702**	**8,571**	**8,950**	**9,053**	**41,470**	**120,228**

Forecast

1.Includes federal assistance for 2019/2020 earthquakes

2.Includes CARES Act, CRRSA Act, ARPA, Preparedness and Response Supplemental Appropriations Act, Families First Coronavirus Aid Package, CW stimulus package

Federal disaster relief funds and stimulus, $M



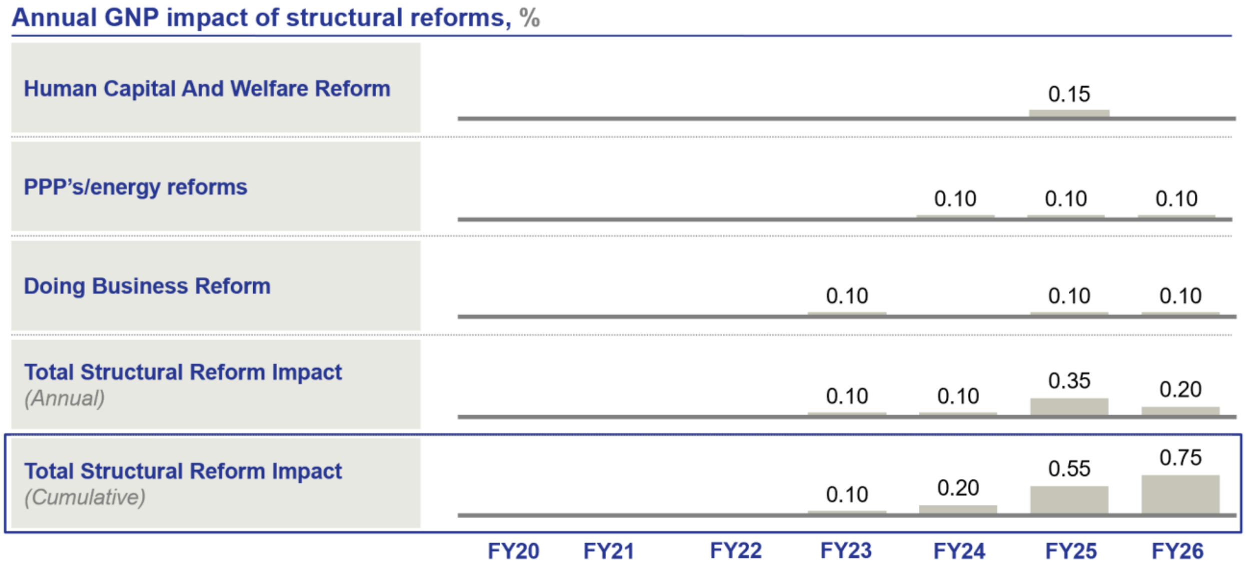
2.3 Impact of structural reforms

The estimated impact of structural reforms is based on work by the International Monetary Fund on labor reforms implemented in Europe (e.g., Spain and Estonia) and South America (e.g., Peru and Colombia), among other jurisdictions; utilities reform in Latin America; broadly accepted metrics for measuring improvement in the World Bank's Doing Business Rankings (as well as examples of growth experienced by countries that have implemented such reforms) and education reforms in Europe and elsewhere. Structural reform benchmarks, to the extent possible, come from nations or jurisdictions with constraints similar to Puerto Rico's (e.g., limited monetary policy options and high informal labor markets).

Reforms related to power sector / energy and ease of doing business are projected to increase GNP by 0.60% by FY2026. Human capital and welfare reform is expected to add another 0.15% in FY2025. K-12 education reforms should add another 0.01% annual impact beginning in FY2037, resulting in total GNP increase from structural reforms of 0.75% by FY2026 and 0.91% by FY2052

3 Please reference previous Fiscal Plans for detailed description of all major DRF categories

EXHIBIT 7: MACROECONOMIC IMPACT OF STRUCTURAL REFORMS



2.4 Population projections

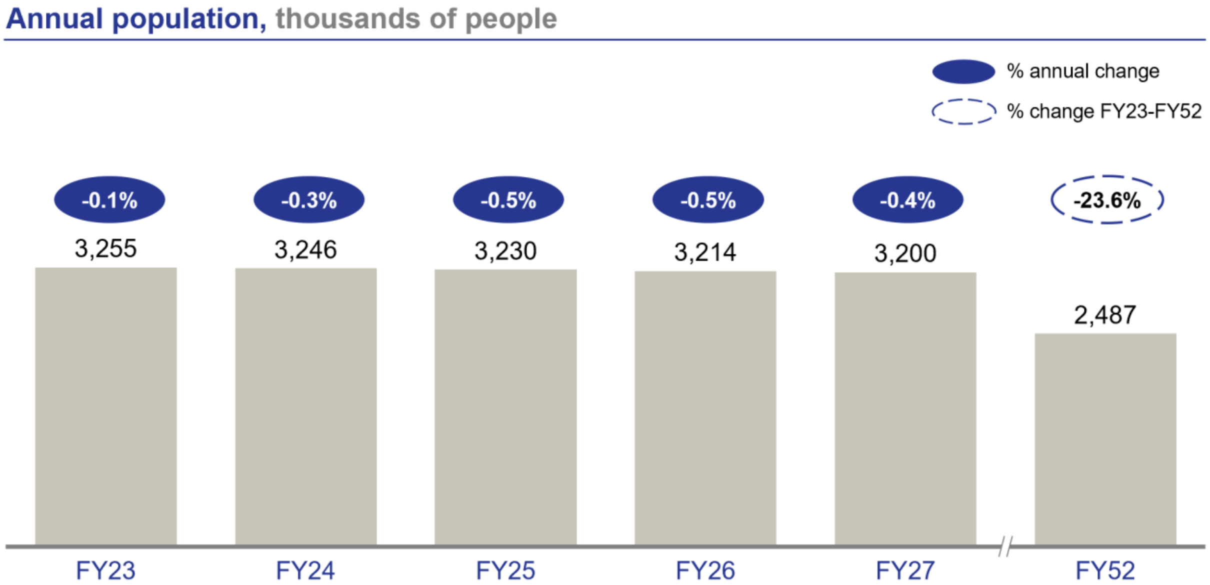
The trend in population has significant implications for economic opportunity in Puerto Rico, as well as the nature and scope of services that the Government will need to deliver in the future. Puerto Rico's population has been trending downwards for the past decade and this trend is forecasted to continue for many years to come. In 2021, the U.S. Census Bureau's forecast projected a declining population outlook (-1%) due in part to Puerto Rico's rapidly aging population. This high average age range results from extremely low age-adjusted birth rates and outmigration of younger people. In 2016, Puerto Rico began to experience negative natural population change – a higher number of deaths than births – which has continued unabated into 2023.

Hurricanes Irma and Maria compounded the problem, spurring an additional outflow of people just as natural population decline set in, as many residents lost houses, jobs, and loved ones. In 2018, just after the hurricanes, Puerto Rico suffered the highest decline in population, a 4.4% net decrease. While some of those who departed have returned to the Island, the population is still projected to decline over the course of the 2023 Fiscal Plan period and beyond. While net migration is a large driver of population change in the short term, this factor is volatile; in the long run, net migration is projected to return to more balanced trends. The declining trend in natural population change is driven by continued decline in births combined with a projected slow rise in deaths in the mid-term.

In April 2022, the Census Bureau revised the 2020 Census data, showing a population of about 3.3 million in Puerto Rico at the end of 2020. The 2023 Fiscal Plan includes updated population forecasts that reflect the revised 2020 Census data as well as updated data on migration trends and births and deaths in Puerto Rico.

While the updated population forecast in the 2023 Fiscal Plan shows a higher population than in the 2022 Fiscal Plan, the declining population trend remains. As outlined in *Exhibit 8*, the 2023 Fiscal Plan projects that by FY2027 approximately 2% fewer people will be living on the Island than in FY2022. By FY2052, the population is projected to decline by about 24% compared to FY2023.

EXHIBIT 8: PROJECTED POPULATION CHANGE



Financial projections

3 Financial projections

The 2023 Fiscal Plan projects a surplus between FY2023 and FY2027, driven primarily by strong revenue performance and increases in Medicaid federal funding over this period. The unallocated surplus is projected to amount to roughly $300 million each year for FY2023-FY2027. This surplus is projected to decline over time as federal disaster relief funding slows, nominal GNP growth declines from a cyclical high in FY2022, Act 154 and Non-Resident Withholding revenues decline, and with the projected decrease in Medicaid federal funding in FY2028 under current law. Please see the Appendix for additional details.

3.1 Revenue forecast

Major revenue streams include non-export sector General Fund revenues (including individual, corporate, and sales and use taxes) and export sector revenues (including Act 154 excise taxes and Non-Resident Withholdings), as well as federal funding. The 2023 Fiscal Plan also includes certain Commonwealth revenues that the Commonwealth appropriated to certain instrumentalities prior to PROMESA pursuant to statutes enacted by prior legislatures. The inclusion of these revenues in the 2023 Fiscal Plan is based on the Oversight Board's legal conclusions that (i) such monies are property of the Commonwealth, (ii) each pre-PROMESA statute appropriating or transferring such monies to instrumentalities of the Commonwealth is preempted by PROMESA, (iii) such statutes were enacted by prior legislatures that cannot bind the current legislature, and (iv) under the Commonwealth Plan of Adjustment (POA), the debt obligations of such instrumentalities were discharged and certain statutory provisions providing for appropriations to such instrumentalities were preempted, and therefore there is no need for the Commonwealth to transfer those revenues for their originally intended use.

The macroeconomic environment is highly dynamic due to the Federal Open Market Committee (FOMC)'s actions to control the high levels of inflation and the early evidence of a slowing economy. Despite this volatility, the 2023 Fiscal Plan projects strong revenue collections for FY2023 and FY2024 driven by the remnant of historically unprecedented stimulus money provided by the Federal Government, with a return to trend in FY2025 onwards, which is in line with the projections of most U.S. mainland states. Since the April 2021 Fiscal Plan, collections data reflects a strong economic recovery related to resumption of economic activity post COVID-19 and federal stimulus funding. Correspondingly, Puerto Rico continues to see strong General Fund performance, reflected in outperformance in actual FY2022 General Fund revenues (roughly 9%) primarily driven by Personal Income Tax, Corporate Income Tax, and Sales and Use Tax. Some of the revenue outperformance is projected to be cyclical.

Additional details on the 2023 Fiscal Plan revenue streams are provided below, with details on the financial projections included in the Appendix. The following sections describe the approach to estimating revenues for key revenue streams.

EXHIBIT 9: MAJOR REVENUE STREAMS

Key general fund revenue drivers, post-measures, $M

	FY23	FY24	FY25	FY26	FY27
Corporate taxes[1]	4,783	4,278	4,033	4,075	4,161
Corporate income tax	*2,728*	*2,570*	*2,426*	*2,464*	*2,543*
Act 154/ Act 52	*1,447*	*1,199*	*1,199*	*1,199*	*1,199*
Non-resident withholdings	*559*	*463*	*367*	*370*	*376*
FEDE	*49*	*45*	*41*	*42*	*43*
Personal income tax[2]	3,036	2,604	2,184	2,216	2,290
Sales and use tax[3]	2,716	2,692	2,704	2,734	2,812
Other general fund revenues[4]	2,406	2,092	2,032	2,060	2,109
FAM portion of SUT	160	153	155	157	162
Incremental excise taxes on off-shore rum	129	167	168	169	170
Petroleum, gasoline, diesel taxes	486	529	503	503	504
Vehicle license fees	53	77	102	103	104
CRIM property tax inflows	123	125	126	128	132
Incentive Funds (excluding FEDE)	14	14	15	15	15
Miscellaneous other	56	63	69	69	69
Total	13,961	12,794	12,092	12,229	12,530

1. Including CIT, NRW, Act 154, Act 52, FEDE
2. Includes expense related to EITC
3. Sales and use tax (SUT) reflects collections after payout of the COFINA settlement
4. 'Other' general fund revenues include cigarette, rum, motor vehicles, alcoholic beverages, and other GF taxes; exclude adjustments for revenue gross up

3.1.1 Non-export sector General Fund revenue projections

Individual income taxes

Relative to FY2020, the individual income tax (net of EITC payments) was 4.7% higher in FY2021 and 24.8% higher in FY2022. The high performance for personal income tax has continued into FY2023 to date, about 19% above FY2022 collections. The 2023 Fiscal Plan projects that disaster relief spending and federal pandemic support will continue to contribute to the income tax base through increased consumption, increased employment from local and mainland workers related to disaster relief projects, among other effects. The 2023 Fiscal Plan also reflects recurring increases to individual income taxes driven by improvements in tax compliance due to the implementation of the Internal Revenue Unified System (SURI, by its Spanish acronym) platform and increases in public workers' salaries.

Corporate income taxes (CIT)

Corporate income tax receipts year-to-date for FY2023 have increased by 14% over the same period in FY2022. The 2023 Fiscal Plan includes updates to the near-term forecast to reflect the waning effects of federal stimulus, while incorporating changes to the expected contribution of disaster relief spending to the corporate tax base in future years. Like individual income tax, the 2023 Fiscal Plan also accounts for recurring increases to corporate income tax revenue driven in part by improvements in compliance due to the implementation of the SURI platform combined with enhancements to information reporting.

Sales and use taxes (SUT)

As with corporate and personal income taxes, SUT outperformed relative to GNP in FY2018 and FY2019, likely boosted by the increased economic activity resulting from post-disaster reconstruction. Since FY2020, the SUT collection has increased persistently along with post-COVID economic recovery and reached its peak in FY2022 at almost $2.7 billion. The year-to-date SUT receipts for FY2023 are mostly flat compared to the same period in FY2022, rising by just 1%.

Other excise taxes (including motor vehicles, alcoholic beverages, and cigarettes)

Motor vehicle receipts surged in FY2018 and this trend continued into FY2022, as residents continued to purchase motor vehicles at an accelerated rate in the aftermath of the 2017 hurricanes and during the COVID-19 pandemic supported by federal stimulus payments. FY2023 year-to-date motor vehicle receipts have remained mostly flat compared to the same period in FY2022, showing a roughly 2% decline.

Export sector revenue projections

Act 154 and Non-Resident Withholding (NRW) tax revenues are concentrated in a small number of multinational corporations. The 2022 Fiscal Plan projected that Act 154 revenues will gradually decrease until reaching a steady state of about $900 million in FY2030. The projected decline is due to U.S. federal tax reform (reducing Puerto Rico's attractiveness as a low tax jurisdiction for multinationals), global supply chain diversification, patent expirations, and Puerto Rico's introduction of an Act 154 alternative, Act 52. After calendar year 2022, parent corporations of Controlled Foreign Corporations (CFCs) paying Act 154 could lose a significant tax advantage of locating CFCs in Puerto Rico.[4]

In response to the expected loss of creditability of Act 154, Act 52 was signed into law by the Governor on June 30, 2022. The law builds a framework for companies to voluntarily transition from the Act 154 excise tax into a regime that taxes industrial development income (IDI) and royalties. The new Act 52 sets the statutory tax rate at 10.5% but could increase it to 15% if the U.S. enacts a qualifying 15% or higher minimum tax on corporate income.[5] For some companies, income exemptions reduce the effective tax rate (tax as percentage of IDI) to as low as 1.6%. To raise revenue, Act 52 repeals or limits some tax credits, establishes a new Credit Management System and increases taxes on certain digital products.[6] Act 52 also changes the withholding tax rate on license fees, rents and royalties paid by Puerto Rican companies. The new tax rate is 12%, but with a 37.5% exemption for certain companies.

The Oversight Board remains uncertain about the long-term effect of Act 154/52 changes, given that the tax is highly concentrated in a handful of multinational entities. Considering this, the 2023 Fiscal

4 During FY2021, the Government submitted comments for the U.S. Treasury's consideration in response to the IRS notice of proposed rulemaking REG-101657-20 publication. On December 29, 2021, the U.S. Treasury issued final guidance agreeing to delay for one year, until January 1, 2023, the application of new foreign tax credit regulations to the excise tax imposed by Act 154. Thus, the Act 154 excise tax paid by multinational corporations will continue to be creditable against the U.S. income tax liability through calendar year 2022.

5 While the Inflation Reduction Act imposed a 15% alternative minimum tax on adjusted financial statement income of certain corporations, Hacienda ruled in Informative Bulletin No. 22-22 that the US changes do not trigger the Act 52 increase

6 The Act also includes an increase in the cap for conservation tax credits, which lowers revenue to the Commonwealth, and changes the application date for tax incentives for physicians, which may lower revenue, unless accompanied by appropriate guardrails or pay-fors

Plan does not budget incremental revenue relative to the projections in the 2022 Fiscal Plan related to Act 154 revenues. As required in the 2023 Fiscal Plan, the Government set aside a $250 million reserve out of FY2022 revenue surpluses to fund any potential Act 52 near term revenue shortfall. The $250 million reserve must be retained until at least December 31, 2025, to allow an assessment of Act 52's FY2023 revenue, after which the Act's revenue implications will be re-examined by the Oversight Board. In the interim, actual receipts under Act 52 will be closely monitored and the 2023 Fiscal Plan forecast will be updated as appropriate based on actual performance.

Additional information about improvements to tax administration and parameters around tax law changes can be found in Volume 3.

3.1.2 Medicaid funding

Under Section 1108(g) of the Social Security Act, Puerto Rico can access federal funds for Medicaid but is subject to an annual funding ceiling for the federal non-CHIP (Children's Health Insurance Program) Medicaid fund – meaning the Commonwealth is responsible for covering all costs above this cap. Historically, the actual cap applied to Puerto Rico's Medicaid Program varied based on a series of one-time legislative actions to increase funding to the Island's Medicaid Program. Most recently, under the 2023 Consolidated Appropriations Act, Puerto Rico is eligible to receive more than $19 billion over FFY2023-FFY2027. This total includes additional enhancements to the base federal allotment subject to certain conditions that Puerto Rico must meet. About $140 million of the Section 1108(g) funds are allocated to the Department of Health each year to cover the eligible federal match on expenditures related to Federally Qualified Health Centers (FQHCs, or "Centros 330") and Medicaid Program operations. That portion of federal funding is therefore considered unavailable for use on other Medicaid expenditures.

In addition, the 2023 Consolidated Appropriations Act extends the increased federal medical assistance percentage (FMAP) of 76% until September 30, 2027. The incremental FMAP of 6.2 percentage points that was tied to the COVID-19 Public Health Emergency period (PHE) will ramp down and end by December 31, 2023.

EXHIBIT 10: INCREMENTAL FMAP IN RESPONSE TO COVID-19 PANDEMIC

Effective period	Incremental FMAP
January 1, 2020 – March 31, 2023	6.2%
April 1, 2023 – June 30, 2023	5%
July 1, 2023 – September 30, 2023	2.5%
October 1, 2023 – December 31, 2023	1.5%
January 1, 2024 onwards	0%

1 To both support Medicaid and provide broad fiscal relief as state revenues declined precipitously, the Families First Coronavirus Response Act authorized a 6.2 percentage point increase in the FMAP (retroactive to January 1, 2020) available if states meet certain "maintenance of eligibility" (MOE) requirements while the COVID-19 PHE lasted. The 2023 Consolidated Appropriations Act mandated a ramp-down of this incremental FMAP beginning on April 1, 2023.

Beginning in FY2028, the Commonwealth could face a "Medicaid fiscal cliff," where it becomes responsible for a significantly higher share of Medicaid expenses – expenditures that have been covered by federal funding since 2011. The Congressional Budget Office's cost estimates of the 2023 Consolidated Appropriations Act suggest that in October 2027 the federal Medicaid funding cap for Puerto Rico will fall to about $500 million annually.[7] The cap will grow each year from FFY2028 according to the medical care services component of the Consumer Price Index for All Urban Consumers (CPI-U), but this growth rate does not keep pace with the Island's projected healthcare expenditure growth.[8] In October 2027, Puerto Rico will also revert to receiving a 55% statutory FMAP for most beneficiaries.

The 2023 Fiscal Plan financial projections do not assume that future legislation will materialize that may change Medicaid federal funding for Puerto Rico after FY2028, but rather reflects that the Commonwealth would assume the relevant costs under current law in the absence of incremental federal legislation. Periodically since 2010, except for FFY2022 when the Centers for Medicare & Medicaid Services (CMS) issued an interpretation of Section 1108(g) to effectively raise the cap, the Federal government has enacted legislation to provide additional Medicaid funding to mitigate a federal funding shortfall (*Exhibit 11*). Between FFY2011-FFY2022, the Commonwealth received an average of about $2 billion in federal Medicaid funding per year.

EXHIBIT 11: LEGISLATIVE ADJUSTMENTS TO PUERTO RICO'S MEDICAID FUNDING

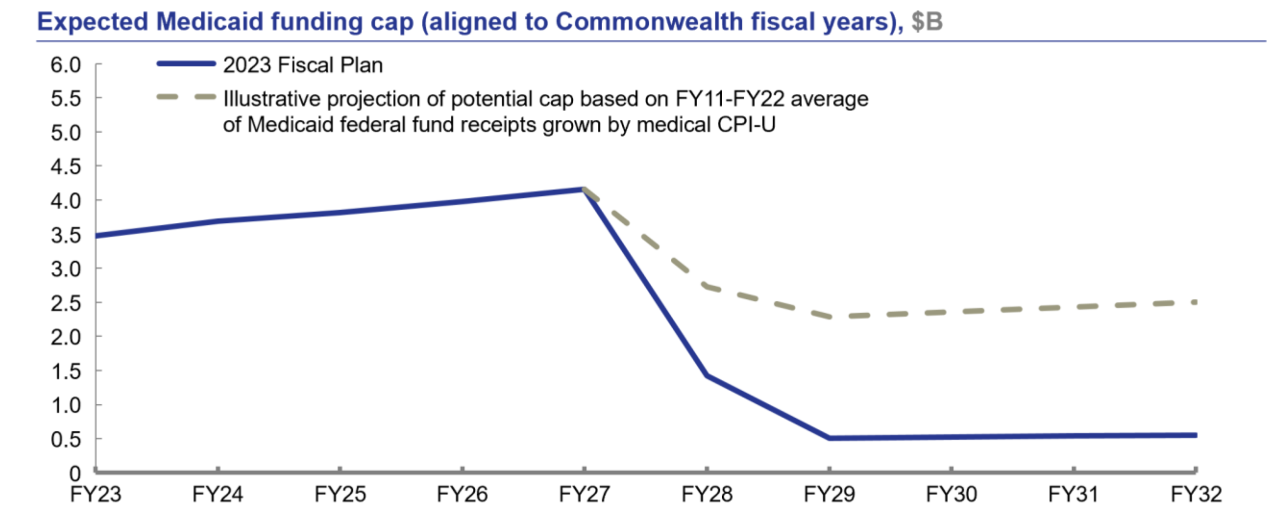
Date passed	Legislation / Interpretation	Provided funding	FMAP	Time period available
03/23/2010	Affordable Care Act	$5.4B	55%	July 2011 – September 2019
03/23/2010	Affordable Care Act	$925M	55%	Through December 2019
05/05/2017	Consolidated Appropriations Act, 2017	$296M	55%	Through September 2019
02/09/2018	Bipartisan Budget Act, 2018	$4.8B	100%	January 2018 – September 2019
12/20/2019	Further Consolidated Appropriations Act, 2020 (year 1)	$2.8B	76%	December 2019 – September 2020
12/20/2019	Further Consolidated Appropriations Act, 2020 (year 2)	$2.9B	76%	October 2020 – September 2021
03/18/2020	Families First Coronavirus Response Act (year 1)	$90M	82.2% (76% + 6.2%)	December 2019 – September 2020
03/18/2020	Families First Coronavirus Response Act (year 2)	$93M	82.2% (76% + 6.2%)	October 2020 – September 2021
09/24/2021	CMS Interpretation	$2.9B (continues to grow by the medical care component of the CPI-U)	N/A	October 2021 – December 2022 (interpretation was superseded by passage of following legislation)
12/23/2022	Consolidated Appropriations Act, 2023	$19.4B	76% (ramp down of 6.2% FMAP)	October 2022 – September 2027

7 This figure is based on the Congressional Budget Office's scoring of the Section 5101 of the 2023 Consolidated Appropriations Act that modified Section 1108(g) of the Social Security Act; see Congressional Budget Office, "CBO Estimate for Divisions O Through MM of H.R. 2617, the Consolidated Appropriations Act, 2023, Enacted as Public Law 117-328 on December 29, 2022," 2023

8 According to Section 1108(g) of the Social Security Act., from 2011 to 2016, the cap grows by the medical care services component of CPI-U as reported by BLS each year. From FY2011 to FY2016, this growth averaged 2.9%. From FY2012 to FY2022, the growth averaged 3.1%. This inflation rate differs from the health care inflation index for Medicaid and Medicare used elsewhere in the 2023 Fiscal Plan (4.5% to 5.5% from FY2020-FY2022, decreasing to 4.75% in FY2051). Instead, the medical care services component of CPI-U includes other factors that lower the inflation rate by approximately 1-3 percentage points, meaning the increase in the federal funding cap will not keep up with actual increases in expenditures.

If similar legislation were passed prior to the expiration of the 2023 Consolidated Appropriations Act funds, the impact of the statutory federal funding shortfall on the people of Puerto Rico could be mitigated. However, the nature of future legislation is unknown and remains a major uncertainty that is reflected in the outyear financial projections. *Exhibit 12* shows the current law's funding of Medicaid through FY2032; it also illustrates where federal funds would be in FY2028 and beyond if the Commonwealth were to receive an allotment grown from that FFY2011-FFY2022 average.

EXHIBIT 12: EXPECTED MEDICAID FUNDING CAP



To continue providing healthcare for the population, the Commonwealth must be able to pay and manage these critical costs, which are projected to grow faster than consumer inflation, regardless of the future federal legislative environment.

Federal funding streams for the Commonwealth, projected based on current law and statutory growth rates, can be grouped in six main categories:

- **Increases in available Medicaid funding from federal legislation as described above:** The 2023 Consolidated Appropriations Act provides specific federal appropriations for FFY2023 through FFY2027 starting at $3.65 billion in FFY2023. In addition, the legislation precludes the Secretary of Health and Human Services (HHS) from determining future federal allotments based on CMS's 2021 interpretation of the statute.
- **Enhanced Allotment Plan (EAP) funding:** The EAP provides an additional source of federal funding to support low-income beneficiaries in their purchase of prescription drugs under Medicare Part D. This allotment can be used only for this purpose and is not countable against the Section 1108(g) funding cap. Estimates for this funding come from the Puerto Rico Health Insurance Administration (ASES, by its Spanish acronym). In FY2024, EAP funding is projected to be about $70 million. The EAP inflation rate is forecasted to be roughly 5.3% annually.[9]
- **CHIP funding:** The Children's Health Insurance Program provides health coverage to eligible children through both Medicaid and separate CHIP programs. CHIP, administered by the Commonwealth according to federal requirements, is funded jointly by Commonwealth and federal funds. This funding is incremental to Section 1108(g) capped funding and is not subject

9 According to ASES, this rate is equal to the expected annual increase in Medicare Part D prescription drug costs.

to a federal funding cap. Without additional legislation, the CHIP matching rate, also known as the Enhanced FMAP (or eFMAP), for Puerto Rico is statutorily set at a minimum of 68.5% under Title XXI of the Social Security Act.

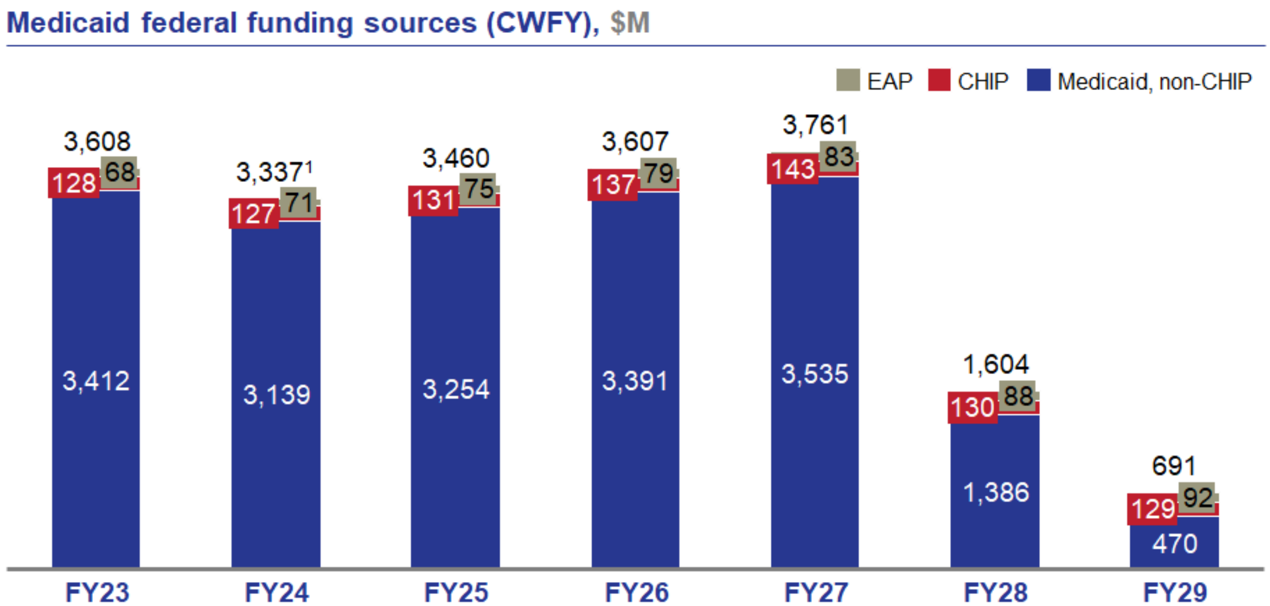
- **Special Revenue Fund (SRF) revenues from municipalities:** Under Act 72-1993 setting up the modern Puerto Rico Medicaid program, municipalities were required to contribute about $164 million annually to fund the public health plan. In 2018, a deal was reached with municipalities to reduce that contribution in years when the federal matching rate (FMAP) exceeded the statutory 55% under which Act 72-1993 was developed. Starting in FY2024, this agreement is projected to reduce the municipal contribution to about $86 million.
- **Special Revenue Fund revenues from Commonwealth employers:** Additional revenue for the Medicaid Program comes from intra-governmental transfers to cover retirement and health care expenses incurred by various Commonwealth entities on behalf of their employees. Please see *Section 3.1.4* for more information.
- **Special Revenue Fund revenues from prescription drug rebates:** In January 2023, ASES joined the Medicaid Drug Rebate Program (MDRP). Puerto Rico's entry into MDRP is expected to yield higher gross rebates from drug manufacturers than those from the Commonwealth's previous local drug rebate program. Partly to enable entry into the federal program, the Government has indicated its intention to update its accounting systems and the methodology it uses to report prescription drug utilization to CMS.[10] In doing so, Puerto Rico will also share a portion of the rebate revenue with the federal government to the extent it reduces the costs eligible for federal matching. Estimates received from ASES indicate MDRP could bring in nearly $630 million in gross rebates in FY2024 and about $660 million in FY2025.

The 2023 Fiscal Plan ensures that the Commonwealth is appropriately funded to meet its matching obligations under current law. If the amount of federal funds expected to become available during any future fiscal year changes, and, depending on the conditions imposed on the federal funds granted, the Oversight Board may revise the General Fund appropriation for ASES accordingly.

Exhibit 13 outlines expected Medicaid federal fund receipts, with funding aligned from federal fiscal years to Puerto Rican fiscal years. Medicaid expenditures are discussed in detail in *Section 3.2.4*.

10 In December 2021, ASES announced a contract with Abarca Health as its pharmacy benefit manager (PBM) and Medicaid Drug Rebate Program (MDRP) manager.

EXHIBIT 13: BASELINE FEDERAL FUNDS RECEIPT PROJECTIONS



1 The decrease in Medicaid federal fund receipts between FY23 and FY24 is due to the entry into the Medicaid Drug Rebate Program (MDRP) and a reduction in federal fund receipts due to a higher level of rebate sharing. This decrease in federal fund receipts is overcome by higher gross rebate projections beginning in FY24.

3.1.3 Other federal funding

In addition to Medicaid funding, Puerto Rico receives other federal funds on a regular basis to cover social benefits and operational expenditures. These are separate from disaster relief funds, which are tied directly to Hurricane Maria and earthquake reconstruction activity, and from COVID-19 response and relief funds, which are meant to cover incremental government spending to respond to the pandemic. These other funds cover both social benefits and operational expenditures. In the 2023 Fiscal Plan, these funds have been modeled based on what types of costs they cover (e.g., benefits or operations) as well as statutory formulas that define the size of Puerto Rico's allotment. For example, while Temporary Assistance for Needy Families (TANF) funds are typically pass-through (i.e., none of these funds go to operational costs), some Title I education funds are projected to be used for operational purposes (e.g., teachers' salaries, school supplies for programs for students with special needs, etc.). For the pass-through category, federal fund inflows and outflows mirror each other (as benefit needs decline, so do funds). For the other funds used for operational purposes, though inflows may decline, it does not necessarily mean expenditures decline as well – as expenditures are based on operations, not on benefits formulas, and the Commonwealth may have to cover operational expenditures via the General Fund should they outpace reduced federal funding. Meanwhile, while Head Start funds are allocated from the federal government based on the number of children living in poverty, NAP funds are provided through a block grant that is capped. The former should therefore change by population, while the latter should grow only with inflation, regardless of population changes.

3.1.4 Special Revenue Funds

Commonwealth agency Special Revenue Fund (SRF) revenues

The Commonwealth collects a significant portion of its revenues through Special Revenue Funds, which are funded from, among other sources, tax revenues transferred by statutes, fees and charges for services by agencies, dividends from public corporations, and financing proceeds. Government tracking and reporting of these SRF revenues, associated expenses, and resulting surpluses or deficits has historically been incomplete and inconsistent. The baseline level of SRF revenues of Commonwealth agencies (excluding Independently Forecasted Component Units or IFCUs) has been updated in the 2022 Fiscal Plan by agency. The 2023 Fiscal Plan does not further detail SRF by type (special state funds, own revenues, and other revenues), as Commonwealth agencies (excluding IFCUs) do not report this level of detail consistently. Future budget and Fiscal Plan processes will aim to further clarify Special Revenue Funds and apply controls to ensure transparency and accountability for these revenues.

Independently Forecasted Component Unit (IFCU) revenues

The Commonwealth contains 12 Independently Forecasted Component Units, which range from public corporations (e.g., the State Insurance Fund Corporation) to public hospitals (e.g., the Cardiovascular Center Corporation of Puerto Rico and the Caribbean). These entities are funded mostly by Special Revenue Funds and may also receive General Fund appropriations. Through the annual budget process and by tracking actual receipts and expenditures, the Oversight Board has gained more insight into the specific revenue streams for these entities to further refine IFCU revenue projections. While most IFCU revenues are projected using GNP, given the unique nature of each IFCU, certain revenue streams are grown by other factors, such as inflation or population, or as governed by legislation.

Municipal contributions to PayGo and ASES

The 2023 Fiscal Plan includes receipts from municipalities to cover retirement and healthcare expenses incurred by the Commonwealth on their behalf. Since the passage of Act 106-2017, municipalities that participate in the Employee Retirement System (ERS) are financially responsible for PayGo expenditures covered by the Commonwealth, which are funded directly by the municipality and paid to the ERS on a monthly basis.

Under Act 72-1993, which set up the modern Puerto Rico Medicaid program, municipalities were also required to contribute about $164 million annually to fund the public health plan. In 2018, a deal was reached with municipalities to reduce that contribution in years where federal matching rate (FMAP) exceeded the statutory 55% under which Act 72-1993 was developed. Starting in FY2024, this agreement is projected to reduce the municipal contribution to roughly $86 million.

Public Corporation PayGo receipts

The 2023 Fiscal Plan includes receipts from public corporations (e.g., PRASA) that participate in the Employee Retirement System (ERS) to cover PayGo expenditures on behalf of their retirees covered by the Commonwealth. The Commonwealth shall be reimbursed for these payments and will act to obtain these contributions if they are not received (e.g., the Commonwealth may withhold payments for utilities).

Municipal Administration Fund

The Municipal Administration Fund (FAM) collects 0.5% of the SUT which is distributed into three funds: (i) 0.2% to the Municipal Development Fund; (ii) 0.2% to the Municipal Redemption Fund; and (iii) 0.1% to the Municipal Improvement Fund (FMM). Pursuant to Section 4050.09 of Act 1-2011, the FMM are to be distributed through annual legislation and appropriated for select capital works and improvement projects for the municipalities (e.g., public housing, schools). The legislature passes resolutions each year to allocate the FMM. These resolutions must be consistent with the 2023 Fiscal Plan and the applicable special revenue funds included in the Certified Budget.

3.1.5 Gross-up for tax credits

Gross-up of revenues to reflect potential revenues without payment of tax incentives

In addition to offering preferential tax rates, tax exemptions, tax abatements, and cash grants, the Government of Puerto Rico provides hundreds of millions of dollars in tax credits to corporations and individuals each year. Some function as entitlement programs: any business that meets the requirements set forth in law is entitled to the benefit. Other tax credits give government officials considerable discretion over which projects receive incentives. Many of these tax credits are intended to advance policy goals such as stimulating employment, stimulating economic activity and economic development, encouraging investment, and protecting local industries. Unlike traditional expenditures, however, tax credits are not incurred in a transparent fashion, and, with only a few exceptions, are currently uncapped by any aggregate amount of benefits conveyed. The issuance of tax credits also tends to be done in an ad hoc manner, with unclear economic justification for the costs incurred and without monitoring of the goals described above (e.g., how many jobs in any particular year were created). This leads to an unpredictable, and potentially costly, foregone revenue stream each year.

Policy makers in Puerto Rico must understand both the budget implications of current and proposed tax expenditures and must manage the size of tax incentives by setting limits on their annual cost and eliminating tax credits with negative returns. The issuance of reliable cost estimates, including a detailed analysis of the budget implications from each tax incentive and annual cost controls is necessary to help Puerto Rico avoid unexpected negative outcomes. Otherwise, the Government will remain powerless to manage the cost of these incentives or keep them from growing uncontrollably.

Recognizing the importance of this question to the fiscal sustainability of Puerto Rico, the 2023 Fiscal Plan includes a forecast of gross revenues inclusive of the value of tax credits to show the foregone revenue associated with these credits. The 2023 Fiscal Plan also includes a forecast of gross revenues based on the historical level of certain tax credits claimed on income tax filings for individual filers, regular corporation filers, and incentive tax filers, as provided by Hacienda. As shown in the period of the report, over 12 tax years (2010-2021), tax credits claimed across all tax filers averaged $257 million annually. The 2023 Fiscal Plan requires all reporting going forward to include monthly and quarterly reports as to the gross revenues, tax credits claimed, and the net revenues received for the period of the report.

EXHIBIT 14: TAX CREDITS BY YEAR

Actual[1], $M	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	AVERAGE
Regular Corporations	131	94	48	89	89	140	66	75	82[2]	145	133	98	99
Incentive Corporations	135	147	133	158	116	78	70	56	66	N/A[3]	N/A[3]	N/A[3]	107
Individuals	65	59	37	90	69	65	66	61	89	157	96	83	78
Total Tax Credits Claimed	**331**	**300**	**218**	**337**	**274**	**283**	**202**	**192**	**237**	**302**	**229**	**181**	**257**

1 The tax credits reflected for a fiscal year correspond mainly to those claimed in the income tax returns of the previous taxable year. For example, for fiscal year 2021, the credits presented are those claimed in the 2020 income tax returns. This changes the period in which tax credit is reflected
2 Regular corporation income tax returns processing for FY18 is incomplete
3 No data available
SOURCE: Office of Economic and Financial Affairs of the Treasury Department of Puerto Rico, as of March 1, 2023

Gross-up for COFIM receipts

The Municipal Finance Corporation (COFIM, by its Spanish acronym) is the public corporation that collects the 1% Municipal SUT established by law for certain municipalities. The 2023 Fiscal Plan includes projections of this 1% revenue stream, along with exact offsetting expenses. COFIM is not an entity that receives appropriations from the General Fund, but rather relies solely on municipal SUT.

3.2 Expenditure forecast

The trend of expenditures is summarized in *Exhibit 15*. Total Commonwealth funded expenditures remains relatively flat through FY2027 as non-recurring expenditures end and are partially offset by increases in federal funds and inflation.

EXHIBIT 15: MAJOR EXPENDITURE CATEGORIES

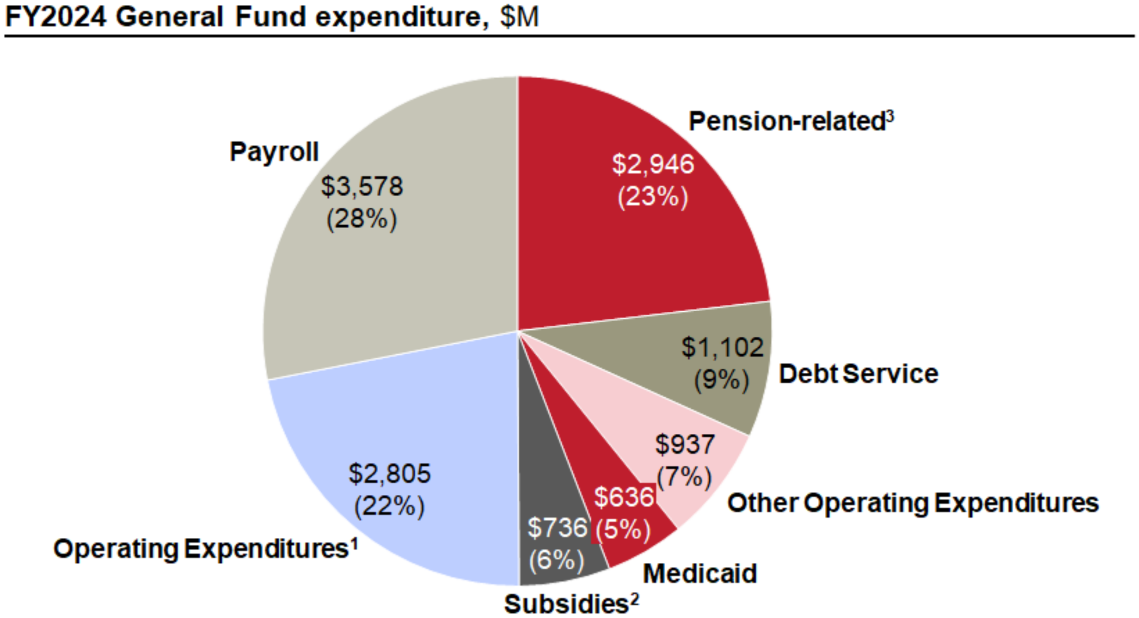
Key expenditure drivers, $M

	FY23	FY24	FY25	FY26	FY27	FY23 - FY27 % change
Payroll (General Fund)	3,352	3,522	3,572	3,620	3,669	9%
Operating Expenditures (General Fund)	2,972	2,815	2,402	2,492	2,540	-15%
CW Appropriations	1,170	1,148	1,156	1,179	1,185	1%
Commonwealth Medicaid Expenditures (GF & SRF)	1,238	1,354	1,433	1,505	1,582	28%
PayGo (GF & SRF)	2,236	2,238	2,235	2,228	2,220	-1%
IFCU & CW SRF (Payroll & Operating Expenditures)	2,788	2,840	2,880	2,917	2,981	7%
Total Operating Expenditures (GF & SRF)	**13,755**	**13,916**	**13,678**	**13,941**	**14,178**	**3%**
Federally Funded Expenditures	8,157	8,050	8,222	8,427	8,642	6%
Other Non-Operating Expenditures, Includes Measures[1]	3,188	2,390	2,075	2,074	2,114	-34%
Debt Service and CVI Payments	1,147	1,102	978	954	951	-17%
Pension Reserve Trust	1,036	906	970	971	1,132	9%
Total CW Funded Expenditures	**27,284**	**26,364**	**25,924**	**26,366**	**27,017**	**-1%**
Year-over-Year % change	17%	-3%	-2%	2%	2%	

1 Includes Disaster Recovery Cost Match, Restructuring / Title III Costs, Other GF Expenses, Social Programs CW Funded, Expense Measures, Adjustments For Expenditure Gross Up, Capital Expenditures, Cigarettes & Rum Tax Disbursements To Public Corporations

3.2.1 General fund payroll and non-personnel operating expenditures

EXHIBIT 16: BREAKDOWN OF GENERAL FUND EXPENDITURE CATEGORIES



1. Other Operating Expenses include: PREPA ($132m), PRASA ($88m), PBA ($134m), PRIMAS ($54m) & Capital Expenditures ($539m)
2. Subsidies include: UPR ($500m), HTA ($192m) & Municipalities ($44m)
3. Pension-related includes: PayGo ($2,039m) & the Pension Reserve Trust ($906m)

Payroll expenditures

Despite progress made through the FY2023 budget process, consistent granular payroll data continues to be a challenge for the Government. During the FY2023 budget process, agencies were analyzed to develop detailed payroll estimates based on agency rosters, actual payroll run rates, and anticipated changes to headcount and salaries. Beginning in FY2024, base payroll has been assumed to mainly grow at the same rate as Puerto Rico's inflation. Adjustments are made to capture any increase or reduction to payroll expenditure projections from investment decisions, attrition, absenteeism, or workforce reductions.

Non-personnel operating expenditures

Non-personnel operating expenditures are assumed to grow at the same rate as Puerto Rico inflation, with select adjustments as necessary. For example, the 2023 Fiscal Plan projects a reduction in professional fees given that the Title III proceedings concluded, and fees are now related only to plan implementation and plan-related litigation.

3.2.2 Special Revenue Funds

Commonwealth agency Special Revenue Fund (SRF) operational expenditures

The Commonwealth funds a significant portion of its expenses with Special Revenue Funds but previously did not report on these expenses transparently in a consistent manner. Starting with the FY2019 budget process, the Oversight Board has certified SRF expenditures with the objective of applying controls and reporting requirements to ensure transparency and accountability for these revenues and expenditures. With data made available by the Commonwealth, the baseline level of SRF expenses of Commonwealth agencies (excluding IFCUs) has been updated and allocated across agencies (by payroll and non-payroll expenditures). Given the mandate of the Office of the CFO to place controls on SRF expenditures, baseline SRF expenses are forecasted to be equal to the estimated revenues in each year.

Independently Forecasted Component Unit (IFCU) operational expenditures

Most IFCU payroll and non-payroll expenses grow at the same rate as Puerto Rico's inflation or nominal GNP, with exceptions for certain expense categories (e.g., health care costs grow with medical inflation, variable costs grow in line with revenues).

The baseline expenditures include municipality and public corporation PayGo, COFIM, and FAM expenditures, including all the conditions outlined in *Section 3.1.4*.

3.2.3 Other federal funding

Most federal funds received by the Commonwealth are passed through to residents directly in the form of social benefits (e.g., TANF, WIC), but federal funds are also used to cover operating expenditures in many agencies. Expenditures related to pass-through federal funds are set equal to the associated revenue stream. Baseline expenditures related to operating expenditures are set based on the FY2018 federal funds budget reported by the Government (updated in select cases for new information received FY2019-2023) and grow with inflation (and in some cases population). In the case of the Community School Program (largely funding under Title I of the Elementary and Secondary Education Act, as amended by the Every Student Succeeds Act), revenues will grow with inflation, but decline with decreasing population and, consequently, enrollment, which is the most salient determinant of Puerto Rico's annual allocation.

3.2.4 Medicaid expenditures

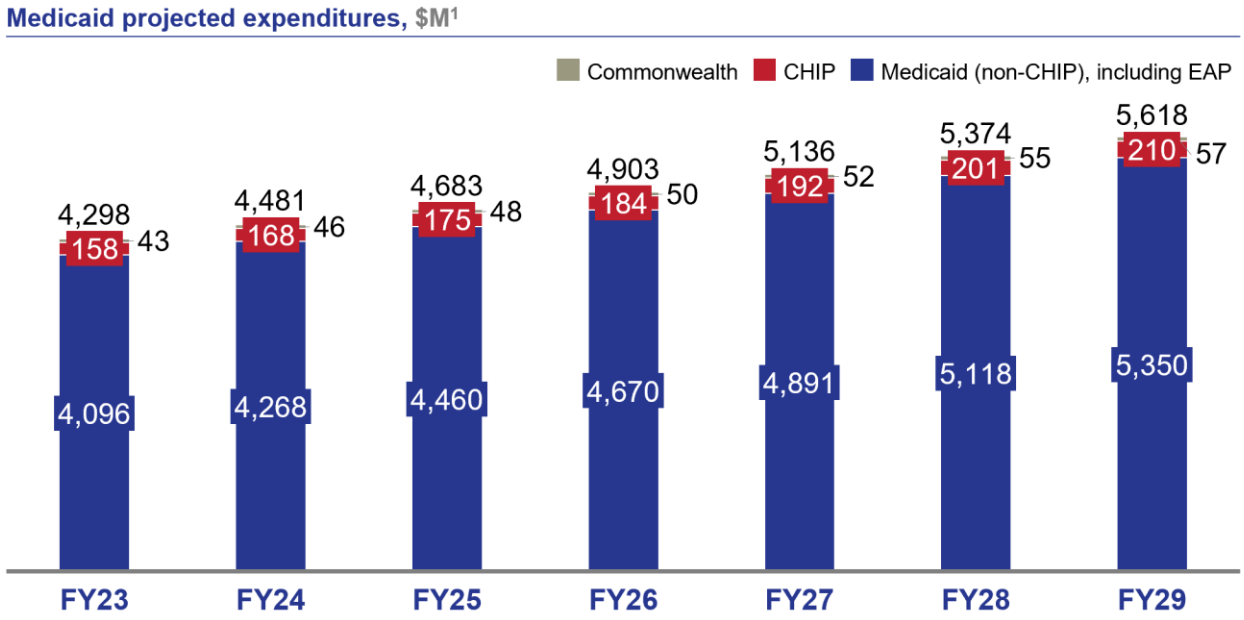
Total Medicaid expenditures are projected to be $4.3 billion in FY2023 and $4.5 billion in FY2024. Beginning in FY2025, the plan assumes the Puerto Rican Medicaid Program's total expenditures will grow at the same rate as population-adjusted health care inflation.[11] Total program expenditures include managed care premiums for all federally eligible enrollment groups, including wrap-around payments for those eligible for both Medicare and Medicaid who enroll in Medicare Advantage programs (also known as Platinos). This total includes eligible direct health expenditures (e.g., Hepatitis C, HIV, and pulmonary programs) that do not flow through managed care. These expenditures also include coverage for the wholly Commonwealth-funded enrollees, whose expenses are not federally subsidized, and non-premium administrative costs to ASES. That said, program size excludes costs incurred by the Department of Health for FQHC and Medicaid Program administration, which are also eligible for federal matching funds. *Exhibit 17* shows a breakdown of projected Medicaid expenditures.[12]

The 2023 Fiscal Plan allocates an additional $100 million in FY2023 to cover a budget shortfall reported by ASES.

11 The post-FY2024 growth rate of the total Medicaid program size is forecasted to be a combination of the PMPM growth rate and the rate of change of the Island's population.

12 Plan Vital for current and future police retirees also included in these expenditures.

EXHIBIT 17: PROJECTIONS FOR MEDICAID AND CHIP EXPENDITURES



1 Does not include ASES payroll and general administrative expenditures

3.2.5 Commonwealth pension expenditures

Projections rely on demographic and actuarial estimations for Employees' Retirement System (ERS), Teachers' Retirement System (TRS), and Judiciary Retirement System (JRS) populations and benefit obligations. Since FY2018, pension benefits for all plans have been paid on a pay-as-you-go basis. Total pension related costs from FY2024 to FY2051 are projected to decrease progressively from $2.6 billion to $0.8 billion, with an average annual cost across the period of $1.9 billion.

3.2.6 Appropriations

Municipalities

Baseline municipal appropriations are currently projected to be $44 million in FY2024, with the full sunset planned for FY2025. Starting in FY2024, once established transformational measures and milestones are achieved, additional funding from the Commonwealth may be made available to municipalities. The Oversight Board, the Commonwealth, and the municipalities must use the FY2024 budget certification process to agree on the financial milestones and conditional funding amounts required for disbursement.

University of Puerto Rico (UPR)

The 2023 Fiscal Plan is consistent with Act 53-2021, which requires a total UPR appropriation of $500 million annually from FY2023 to FY2027. Following this period, the appropriation will be $479 million beginning in FY2028 and grow by Puerto Rico inflation.

For additional information on UPR please refer to Volumes 1 and 3.

Highways and Transportation Authority (HTA)

HTA is currently funded through a combination of its own revenues, federal funds, and Commonwealth funds, including capital and operating appropriations.

Notably in FY2023, the Title III Court confirmed the HTA Plan of Adjustment (HTA PoA) filed by the Oversight Board which became effective on December 6, 2022. The HTA PoA provides that HTA be reorganized through an internal segregation – operational, legal, and financial – between its toll and non-toll road assets within 15 months following the HTA Plan of Adjustment Effective Date. HTA must also transfer its transit assets to PRITA once the agency obtains grantee status from the U.S. Department of Transportation Federal Transit Administration. Consistent with the HTA PoA, the 2023 Fiscal Plan sets the HTA operating transfer to cover the full cost of non-toll assets. The appropriation does not include funding for the HTA emergency reserve, nor does it draw down existing balances. It also assumes toll roads have access to federal funds until reorganization is complete (assumed FY2023), but not thereafter. As a result, over FY2024-FY2051, the 2023 Fiscal Plan includes an average annual operating appropriation of $111 million and average capital appropriation of $68 million per year.

Additionally, the HTA PoA includes one-time cash payments, the issuance of new debt, and contingent value instruments (CVIs). The Commonwealth provided a one-time loan to HTA in FY2023 for $360 million, a portion of which had already been disbursed in FY2022, in addition to the above-referenced annual operating and capital appropriations to ensure HTA's liquidity upon the PoA effective date. The 2023 Fiscal Plan reflects a 30-year multi-draw term loan of $360 million to be repaid over 30 years at a 2.50% interest rate.

3.2.7 Other operating and capital expenditures

Utilities

The PREPA utility rates in the 2023 Fiscal Plan have been updated to reflect the rates in the 2022 PREPA Certified Fiscal Plan and legacy charge. The rates will be amended to reflect the rates and legacy charge included in the 2023 PREPA Certified Fiscal Plan.

The 2023 Fiscal Plan uses the estimated billings for electric and water costs provided by PREPA and PRASA, respectively. Estimated water billings from PRASA are projected to grow at the same rate as water rate increases over the period of FY2024-FY2025; thereafter, PRASA billings are projected to grow according to inflation. Estimated electric billings from PREPA are projected to grow at the same rate as power rate increases over the period of FY2024-FY2051.

Parametric insurance

The 2023 Fiscal Plan includes an investment of about $34 million in FY2024 to cover the Commonwealth's portion of the annual cost of parametric insurance, which is projected to grow by inflation through FY2051. The parametric insurance program is supplemental to the existing budgeted premiums for renewing traditional insurance policies. Certain conditions applicable to Commonwealth entities are placed on the requested funding as outlined in *Section 3.2.12*.

Insurance (PRIMAS)

The Commonwealth bears costs related to insurance premiums (e.g., property insurance, liability insurance). Government reporting on these costs has not been transparent or consistent over time (e.g., not all agencies report these costs independently of other operating expenses, reporting is not consolidated across General Fund and Special Revenue Funds). The Government reported that insurance costs increased from FY2018 to FY2020 due to Hurricanes Maria and Irma. Adjustments were made based on agency reported needs for FY2021, FY2022 and FY2023 (e.g., costs for the Department of Housing have been reduced, costs for PRDE and Institute of Puerto Rican Culture have been increased).

Capital expenditures

Centrally funded General Fund maintenance and capital expenditures of the Commonwealth (excluding PREPA, PRASA, HTA self-funded capital expenditures and one-time transfers) are expected to grow at the same rate as inflation from FY2024 to FY2040, at which point maintenance capital expenditures increase to 1.9% of GNP[13] and grow in line with GNP, to account for the new level of capital stock the Commonwealth will be responsible for maintaining post-disaster reconstruction. The 2023 Fiscal Plan includes annual Special Revenue Fund capital expenditures for the Public Buildings Authority of about $2 million for FY2024 onwards for recurring needs.

3.2.8 Reconstruction and restructuring related expenditures

Cost-share for disaster relief funding: Federal funds for FEMA's Public Assistance, Individual Assistance and Hazard Mitigation programs typically require a local match from the entity receiving them – anywhere from 10-25% of funds. In the case of Puerto Rico, the 2023 Fiscal Plan projects that the Commonwealth will need to cover an estimated about 10% of federal Public and Individual Assistance funds that are obligated to them, amounting to $2.6 billion from FY2018-FY2035. (Based on obligation data, instrumentalities are assumed to shoulder a further $1.6 billion in total cost-match expenditures during the same period). A portion of the Commonwealth and instrumentalities' cost-match expenditures are projected to be covered by CDBG funds from FY2020 to FY2035, which amounts to $2.25 billion. As a result, instrumentalities and the Commonwealth are anticipated to need to cover $680 million and $1.4 billion out of pocket, respectively.

After accounting for excess funds budgeted for cost share in FY2018-FY2021 (when DRF disbursements were anticipated to be higher), as well as $135 million in unspent cost share funds considered available for future cost share needs, the ultimate out-of-pocket cost share burden for the Commonwealth is $1.5 billion. Moving forward, cost share matching funds are to be used only on approved projects and requirements under FEMA's Individual Assistance, Public Assistance, and Hazard Mitigation programs. Any unused cost share matching funds in a given fiscal year are to be rolled over to the following fiscal year and to remain available for use in meeting cost share requirements for approved projects and requirements under FEMA's programs. The restriction of use of cost share matching funds is applicable to funds in the current year and any funds rolled over to subsequent years. The use of these funds must be coordinated with CDBG-DR and CDBG-MIT in meeting cost-share requirements.

Restructuring-related costs: Commonwealth restructuring-related expenditures are projected to be $346 million from FY2023 to FY2026, and are comprised of all professional fees, including those of the Unsecured Creditors' Committee, the Retiree Committee, the Government (mostly the Puerto Rico Fiscal Agency and Financial Advisory Authority, or AAFAF by its Spanish acronym), and the Oversight Board. Restructuring-related costs will continue after the PoA effective date to support potential litigation and other Title III implementation costs. Fees were benchmarked versus comparable restructuring situations that yield an average professional-fee-to-funded-debt ratio of 2.08% and median ratio of 2.33% relative to 2.48% projected for the Commonwealth (*Exhibit 18*). In total, from FY2018 to FY2026, restructuring-related expenditures are projected at around $1.6

13 Corresponds to the state average of capex as percentage of GNP.

billion. Uncertainty stemming from recent natural disasters and the COVID-19 pandemic has resulted in an extended restructuring process contributing to the overall estimate. For some perspective, the City of Detroit's restructuring (the largest municipal restructuring prior to that of the Commonwealth of Puerto Rico) took 17 months (July 2013 to December 2014); while the restructuring of the Commonwealth took almost five years. Separately, the Oversight Board's operating costs are forecasted to be flat at approximately $59 million post-measures per year.

EXHIBIT 18: PROFESSIONAL FEES RELATIVE TO OTHER MAJOR RESTRUCTURINGS

Professional fees for restructuring

	Date filed	Outstanding debt, $M	Total fees and expenses, $M	Fees to funded debt, %
City of Detroit, Michigan	Jul 2013	6,400[1]	178	2.8
Residential Capital, LLC	May 2012	15,000	409	2.7
Sabine Oil & Gas Corp.	Jul 2015	2,800	79	2.8
Caesars Entertainment Operating Company	Jan 2015	18,000	258	1.4
Lehman Brothers Holdings Inc.	Sep 2008	613,000	957	0.2
Lyondell Chemical Company	Jan 2009	22,000	206	0.9
American Airlines	Nov 2011	11,000	392	3.6
Washington Mutual, Inc.	Sep 2008	8,000	271	3.4
Edison Mission Energy	Dec 2012	5,000	96	1.9
Energy Future Holdings Corp.	Apr 2014	40,000	450	1.1
Puerto Rico	**2017**	**60,785[2]**	**1,236[3]**	**2.0**

Summary Statistics

Avg.	2.08%
Max	3.56%
Min	0.16%
Med	2.33%

Puerto Rico involves added complexity as the largest public sector restructuring in the history of the United States

1. Excludes pensions and other retirement liabilities
2. Excludes pension liabilities and debt issued by PREPA and HTA; for additional details refer to https://oversightboard.pr.gov/debt/
3. Estimated professional fees through FY22 related to Title III proceedings excluding those associated with the PREPA and HTA Title III proceedings

3.2.9 Emergency reserve

The purpose of the Emergency Reserve fund is to expedite response activities and, upon request, provide the Commonwealth agencies, public corporations, and affected municipalities known as Emergency Reserve Recipients with capital to quickly begin response activities that exceed their capacity during emergency events in Puerto Rico. Starting in FY2019, the Commonwealth started to set aside funds in an emergency reserve that is to total $1.3 billion, or about 2.0% of FY2018 GNP. The methodology supporting this reserve is informed by guidance provided to other Caribbean islands by the International Monetary Fund in defining an adequate emergency reserve (2-4% of GNP, accumulated at 0.5% per year).[14] The 2022 Fiscal Plan assumed the Emergency Reserve would be funded through annual contributions of $130 million over a 10-year period. The 2023 Fiscal Plan allocates $650 million in FY2023 to fully fund the remaining contributions to the Emergency Reserve and mitigate the heightened uncertainty from higher inflation levels, declining revenues and slowing

14 IMF, Bahamas Article IV report, 2018.

disaster relief and Medicaid federal funding. The 2023 Fiscal Plan also assumes a $295 million one-time contribution in FY2023 to replenish previously utilized funds for recovery efforts including Hurricane Fiona.

This Emergency Reserve does not constitute a reserve for economic downturns, which is a common best practice in US states. Restrictions placed on these funds must ensure that they are used only in response to extraordinary events such as natural disasters or as otherwise agreed with the Oversight Board; the Commonwealth can make disbursements only with approval from the Oversight Board. Historically, the Oversight Board authorized use of the emergency reserve in response to the 2017 hurricanes (Maria and Irma), the 2020 earthquakes impacting the southwestern part of Puerto Rico, and the COVID-19 pandemic. Moving forward, a fund advance will require the following:

- The Governor to declare a state of emergency
- AAFAF requests Oversight Board access to the emergency reserve fund for a finite period
- Once the Oversight Board authorizes access to the emergency reserve funds; OMB must submit to the Oversight Board requests from the Emergency Reserve Recipients to approve amount and usage of funds
- Amounts approved by the Oversight Board and disbursed to the Emergency Reserve Recipients must be replenished not later than the following fiscal year
- Emergency Reserve Recipients that received funds from the emergency reserve fund are required to file with FEMA a Request for Public Assistance (RPA) and Project Worksheet to ensure that any federal reimbursements to Emergency Reserve Recipients are replenished into the emergency reserve state fund
- Emergency Reserve Recipients are required to update OMB on a quarterly basis on the process of obtaining Public Assistance from FEMA
- OMB must provide quarterly reporting to the Oversight Board on the use of authorized funds

3.2.10 Expenditure gross-ups

For each of the gross-up revenue items, an equivalent expenditure is included in the baseline expense forecast.

3.2.11 Expenses for mobilized employees

The 2022 Fiscal Plan reflected the mobilization of approximately 2,300 employees from PREPA to public corporations and agencies across the Commonwealth in connection with Transmission and Distribution P3 to transfer the responsibilities of operating and maintain PREPA's electric grid to LUMA. The salary and benefit expenses assumed by the Commonwealth included the assumption that each agency to which a former PREPA employee was mobilized will contribute on behalf of their mobilized employees to the PREPA ERS, in addition to the contributions currently being withheld from the earnings of such employees for their individual employee contributions. The employer contribution amount was assumed to be equal to 15% of payroll for these employees, based on the average estimated cost of additional PREPA ERS pensions that mobilized employees earn in each pay cycle.

For FY2023, these funds were held in a custodial account at the Commonwealth. Upon receipt of the required documentation a contribution of $8 million was released to PREPA ERS based on the Normal Contribution rate identified for the year of 6.51%, covering the period from July 1, 2021, through October 31, 2022. These funds provide for the payment of accumulated employer contributions for former PREPA employees relocated to other government agencies through the PREPA mobility employee initiative. These funds were released based on the documentation of the basis of the Normal Contribution rate, identification of how the contributions were to be transferred and accepted by PREPA ERS, and the Commonwealth providing a formal written legal opinion identifying the legal basis on which former PREPA employees transferred to the Commonwealth may continue to participate in the PREPA ERS, as opposed to being enrolled in the Commonwealth Act 106 Defined Contribution plan, including the Government's ability or obligation to assume the PREPA ERS employer contributions for mobilized employees. The Commonwealth also provided confirmation that any pension reform measures applied to PREPA ERS would also be applied to mobilized employees.

Furthermore, as PREPA continues its transformation via the announced GenCo P3 transaction to transfer the operation of PREPA' generation units, the provisions of Act 120-2018 ensure that government employees maintain employment and vested benefits as part of any P3 transaction. While the P3 operator is seeking to hire many of the approximate 1,000 generation employees, in the event PREPA employees do not elect to work at the private operator, the Commonwealth may be required to absorb the remaining employees as part of a similar mobility program conducted at the end of FY2021 as part of the Transmission & Distribution P3 transaction with LUMA. In the event employees are mobilized, funds may be needed in the FY2024 budget and beyond to fund these employees' salaries and benefits.

To the extent that mobilized employees continue to earn pension benefits in FY2024 and beyond, funds will continue to be held each year in a custodial account at the Commonwealth until documentation of the basis of the calculation of the Normal Contribution rate (with supporting source documentation) is provided, including the estimate of the annual cost.

3.2.12 Funds for parametric insurance

Funds to cover parametric insurance will be made available upon reaching specific milestones and after the approval and authorization from the Oversight Board.

- Develop a comprehensive insurance plan to develop a program that considers the available markets, costs, meeting Obtain and Maintain (O&M) requirements and levels of coverage
- Conduct a risk analysis including hazards / perils covered
- Analyze expected O&M requirements on a building-by-building basis
- Identify the types and extent of insurance needed to protect against risk and meet O&M requirements
- Identify insurance gaps between O&M requirements and insurance that is reasonably available
- Identify the authority for developing, implementing, and enforcing the plan
- Design the financial arrangement structure for funding the plan and pay for losses, which includes a system for fixed contributions, a formalized plan to pay losses as they occur, and a plan for how funds will be distributed

Prioritize insurance and strategically consider options to supplement the existing insurance coverage:

- Identify how the Commonwealth will meet flood insurance requirements
- Consider broader and expanded limits on existing policies
- Consider a separate excess insurance policy that provides coverage above the current limits

- Consider a parametric policy and catastrophe (CAT) bond or a hybrid combination of the two to provide supplemental or excess coverage

Engage the Puerto Rico Insurance Commissioner

- Establish the criteria for the insurance commissioner's certification of the insurance coverage that is reasonably available

3.2.13 Plan of Adjustment expenditures

In accordance with the confirmed PoA, the 2023 Fiscal Plan forecasts and sets aside funding to disburse payments towards new General Obligation (GO) debt service, contingent value instruments, pension trust contributions, and surplus outperformance bonuses as follows:

New General Obligation Debt Service

Per the PoA, the 2023 Fiscal Plan accounts for annual debt service capped at $1.15 billion, including COFINA debt service forecasted separately in its own fiscal plan. Debt service included in the 2023 Fiscal Plan is calculated based on this cap less COFINA debt service to represent payments on the principal and interest of the Current Interest Bonds (CIB). In addition, payments on account of (i) the 5.375% GO Capital Appreciation Bonds (CAB) and (ii) the 5.000% GO CAB are included within debt service (but are not part of the $1.15 billion cap). The 5.375% GO CABs are to be repaid in equal annual installments of $150 million from FY2029-2033 and the 5.000% GO CABs are to be repaid in equal annual installments of $106 million through FY2024.

General Obligation Capital Appreciation Bonds (GO CABs)

The 2023 Fiscal Plan includes payments on account of (i) the 5.375% GO CABs and (ii) the 5.000% GO CABs as set forth in the PoA. The 5.375% GO CABs are expected to be repaid with funds released from the Commonwealth working capital fund for disaster relief advances in equal annual installments of $150 million from FY2029-FY2033 and the 5.000% GO CABs are expected to be repaid with funds previously intended for the Debt Service Reserve Fund in equal annual installments of $106 million through FY2024.

Contingent Value Instruments (CVIs)

There are two CVIs, both backed by a narrow set of revenue streams, one by 5.5% of sales tax collections (5.5% SUT) and the other by rum cover over collections. The 2023 Fiscal Plan includes payments to both CVIs based on portions of the projected outperformance in such revenue streams in comparison to prior certified fiscal plan projections as detailed by the PoA.

Pension Reserve Trust Contributions

The pension reserve trust is designed to protect the Commonwealth's ability to pay future pension obligations and is funded annually through FY2031 with annual base contributions of $175 million, if surpluses as projected in the 2022 Fiscal Plan are lower than $1.75 billion, and 50% of surplus if such projected surpluses are higher than $1.75 billion, capped at the 2022 Fiscal Plan projected contribution amounts, plus an additional contribution based on the actual remaining surplus after funding certain obligations for each fiscal year during the funding period. In the event a significant change occurs to non-own source revenues such as Federal Medicaid funding, or in the event of a federally declared natural disaster or pandemic (other than Covid-19) that reduces the surplus in any given year below the projected surplus, the base contribution is subject to reduction.

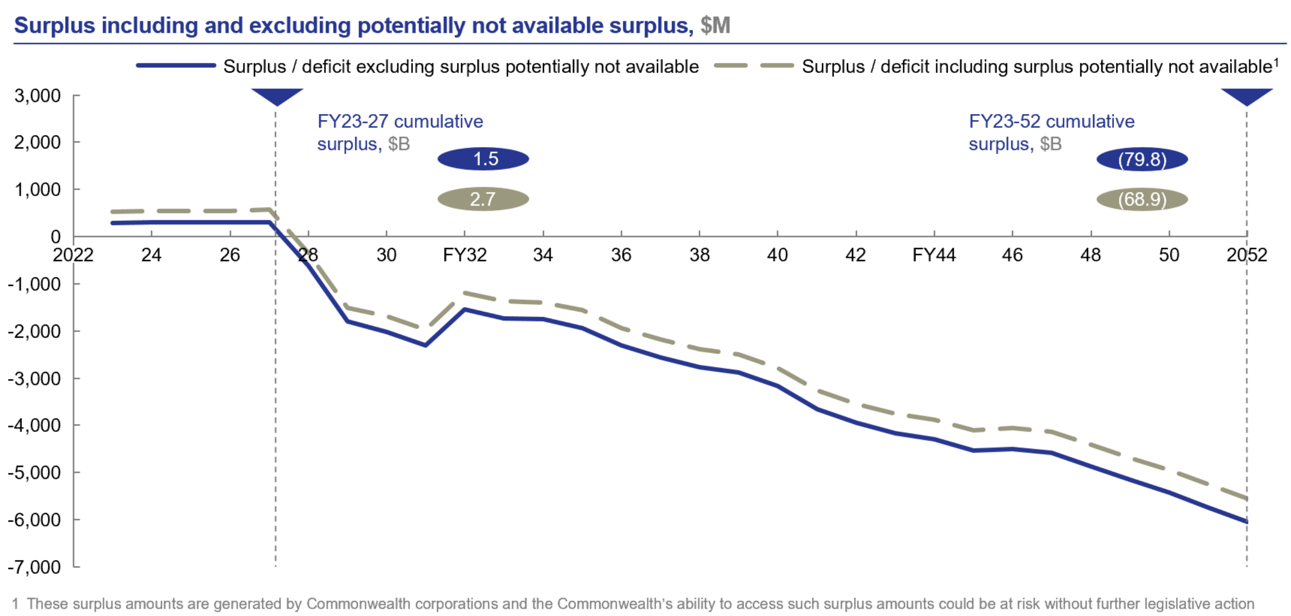
Outperformance Bonus

Through fiscal year 2026, AFSCME / SPU workers as well as other rank and file employees of the Commonwealth and its agencies covered by the 2023 Fiscal Plan will share 25% of the excess cash surplus outperformance relative to the 2022 Fiscal Plan in the event such outperformance yields an excess cash surplus above the projected surplus of at least $100 million in any applicable year. The amount of this bonus is subject to a minimum of $2,000 in any subject fiscal year solely for AFSCME members.

3.3 Surplus potentially not available for the Commonwealth

The 2023 Fiscal Plan financial projections show the surplus generated by all entities covered by the Commonwealth Fiscal Plan. However, some of the surplus is generated by Commonwealth public corporations, and the Commonwealth's ability to access such surplus amounts could be problematic without further legislative action. As such, the 2023 Fiscal Plan also represents what the surplus would be if these funds were inaccessible.

EXHIBIT 19: SURPLUS POTENTIALLY NOT AVAILABLE FOR THE COMMONWEALTH



3.4 Long-term revenue and expenditure projections

The 2023 Fiscal Plan projects a 0.7% decline in FY2023 real GNP followed by a period of near-zero growth in FY2024-FY2026 (*Exhibit 1*). A brief growth rebound in FY2027-FY2028 is followed by the return to Puerto Rico's negative historical trend (average decline of 0.5% per year in FY2029-FY2052). Population is estimated to steadily decline at an average rate of about 0.9% annually, due to a combination of outmigration and demographic factors.

Most revenues are projected to grow with nominal GNP in the long-term.[15] This includes SUT, corporate income tax, personal income tax, non-resident withholding not paid by Act 154 entities and most General Fund revenues. Exceptions include:

- **Alcoholic beverages and cigarette-related tax revenues**, which are expected to grow at the same rate as inflation and population.
- **Rum excise on offshore shipments,** which is expected to grow at the same rate as U.S. mainland population and is partially driven by the statutory waterfall by which rum excise taxes are paid into the General Fund. The 2023 Certified Fiscal Plan maintains the update to the estimation of statutory waterfall revenues, which now incorporates data allowing for a disaggregation of revenues deriving from locally produced and other rum.
- **Independently Forecasted Component Units (IFCU) revenues**, which are projected on a line-item basis and share growth rate assumptions with corresponding short-term projections (largely at the same rate as nominal GNP, with exceptions for those related to health care, population, or other factors).
- **Federal fund revenues**, which grow based on historical and statutory appropriations. The cap for Medicaid matching funds grows by the medical care services component of CPI-U, and CHIP funding grows proportional to the growth of premiums and enrollment. With the passage of the 2023 Consolidated Appropriations Act, Puerto Rico is eligible to receive more than $19 billion over FFY2023–FFY2027. The federal non-CHIP Medicaid funding cap for Puerto Rico is set at $3.65 billion for FFY2023. This funding helps alleviate some of the cost pressures the Puerto Rico Medicaid Program could have faced over the period and allows the Commonwealth to plan out its expenditures in a more sustainable way.

Just as most revenues are assumed to grow at the same rate as GNP, most expenditures grow at the same rate as Puerto Rico CPI inflation. Exceptions include:

- **Medicaid premiums** grow at a faster pace than standard inflation and are instead assumed to grow at the same rate as the growth rate in per member per month (PMPM) costs and the rate of population change. The PMPM growth rate is estimated through actuarial analysis of historic utilization trends and projected demographic changes on-Island. While PMPMs decreased slightly in FY2022 (mainly due to lower utilization rates in FY2021 given COVID-19), long-term PMPM growth trends (FY2027-FY2051) are expected to be about 5% on average.
- **Capital expenditures** are anticipated to rise to 1.9% of GNP (in line with the mainland average) by FY2041 to account for an enhanced capital stock needing maintenance after the significant reconstruction efforts in the wake of Hurricanes Maria and Irma.
- **Cost match for disaster-related federal funding** reaches an average of about $61 million from FY2027 to FY2035, after full usage of CDBG-DR funds available for local cost matching. The Commonwealth is not responsible for the portion of funds allocated to instrumentalities (e.g., PREPA, PRASA, HTA, UPR).
- **Independently Forecasted Component Units (IFCU) expenditures** are forecasted on a line-item basis. Most grow with standard Puerto Rico inflation or nominal GNP with some exceptions, such as health care- or claims-related expenditures. Over the long-term, the expenses

15 This methodology is consistent with general IMF forecasting approaches and is intended to capture the overall change in consumption, investment and production within the economy.

of some health care related IFCUs (e.g., Cardiovascular Center Corporation of Puerto Rico and the Caribbean) are projected to grow faster than revenues, creating a deficit. This 2023 Fiscal Plan assumes deficits related to health care will be funded by the Commonwealth.

Please refer to the Appendix for details on long-term macroeconomic and financial projections.

Debt Sustainability Analysis

2023 Commonwealth Fiscal Plan pursuant to PROMESA Section 201

4 Debt sustainability analysis

The Commonwealth's Plan of Adjustment and corresponding Commonwealth legislation included a Debt Management Policy to control current and future borrowing. Additionally, the Commonwealth must restore cost-effective market access. Below are descriptions of both concepts.

Debt Management Policy: The Commonwealth's Plan of Adjustment contains an ongoing Debt Management Policy that will lay the foundation for fiscal responsibility critical for future fiscal stability and sustainable economic growth. This Policy is adopted pursuant to Article 3 of Act 101-2020, as amended, known as the "Puerto Rico Debt Responsibility Act", which requires AAFAF adopt and maintain a debt management policy that is consistent with the Plan of Adjustment. Specifically, the Debt Management Policy includes several controls on the current and future indebtedness of the Commonwealth for net-tax supported debt that are described below. The definition of net-tax supported debt includes both the General Obligation bonds, the previously restructured COFINA debt and any debt the Commonwealth may issue in the future that is supported by its taxes. The 2023 Fiscal Plan does not anticipate the Commonwealth borrowing for any purpose over the next five years.

Debt Management Policy concepts:

- Maximum annual debt service on all net-tax supported debt is limited to 7.94% or lower than the prior year's debt policy revenues (at the time of the Commonwealth's Title III exit the ratio was about 6.5%)
- Any new long-term borrowing must be for capital improvements only
- Newly issued debt must begin to amortize within two to five years of issuance
- Newly issued debt must have a maximum maturity of 30 years or less
- A refinancing of any debt must provide cash flow savings in every fiscal year and produce positive present value savings[16]

Restoration of market access at reasonable rates: The Oversight Board will use specific performance standards and consult with independent third-party specialists to determine whether Puerto Rico has achieved market access at reasonable rates. The Commonwealth and its Instrumentalities will have to demonstrate they have achieved and sustained the specific levels of fiscal performance and transparency consistent with municipal regulatory and market standards.

For example, in addition to bringing delinquent audited financial statements up to date, accessing credit markets will require the government to demonstrate its capacity to consistently deliver future audited financials on a timely basis, typically within 180 days from end of the prior fiscal year consistent with industry and Government Finance Officer Association (GFOA) "best practices" guidelines. Furthermore, the Commonwealth and Instrumentalities will have to adopt and institutionalize the financial practices and fiscal management reforms outlined elsewhere in this Fiscal Plan that are consistent with market standards and investor requirements. The government will also need to demonstrate its ability to comply with the regulatory requirements and securities laws for the issuance of municipal securities. This includes the ability to enter into standard Continuing Disclosure Agreement (CDA) with dealers and obtain standard market legal and audit opinions.

16 Refinancings in direct response to a natural disaster are permitted not to have cash flow savings in every year, cannot increase future debt service by more than 10%, and must be repaid within 10 years.

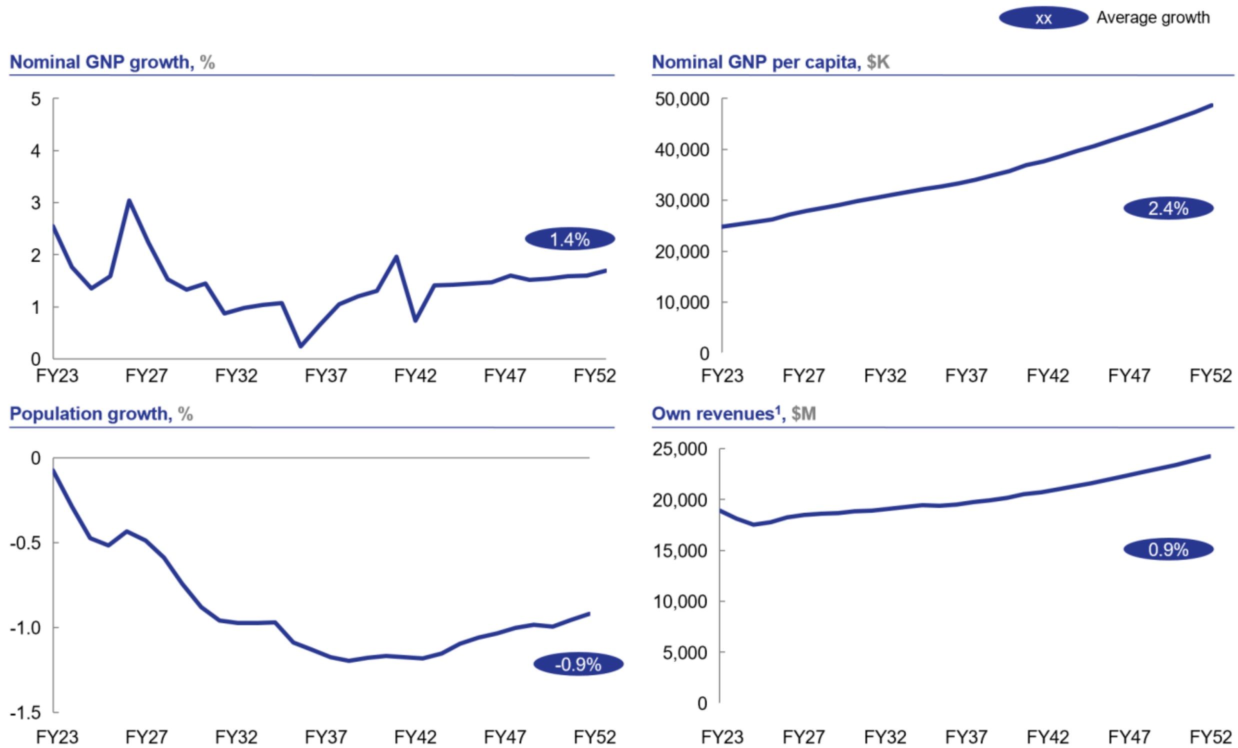
To lay the groundwork to achieving market access, the Government recently met with credit agencies. It is likely credit rating agencies will look beyond the Section 209 provisions in assessing Puerto Rico's credit worthiness. The rating agencies maintain detailed models to assess the riskiness of public sector debts. In addition to its standard metrics, the rating agencies have also historically required sustained periods of fiscal reform and recovery before assigning new credit ratings for previously bankrupt issuers. The government will need to demonstrate its ability to meet the criteria necessary to achieve credit ratings. The Oversight Board continues to work with the Government so it can eventually meet the requirements to gain access to, and the trust of, the credit markets.

In evaluating whether Puerto Rico has achieved reasonable rates, the Oversight Board will look to see whether new or restructured outstanding debt is actively trading in the municipal market at reasonable levels relative to market indices and will look for evidence investors are ready to invest in Puerto Rico again, including the level of interest from traditional municipal bond buyers. The Oversight Board will rely on the expert opinion of independent third-party entities with municipal market experience for compliance with this requirement.

Appendix

Appendix

EXHIBIT 20: FY2023-FY2052 FINANCIAL AND MACROECONOMIC PROJECTIONS



1 Own revenues includes all Commonwealth-collected revenues and excludes all federal transfers and gross up revenues; includes impact of COFINA settlement

EXHIBIT 21: MACROECONOMIC TRENDS

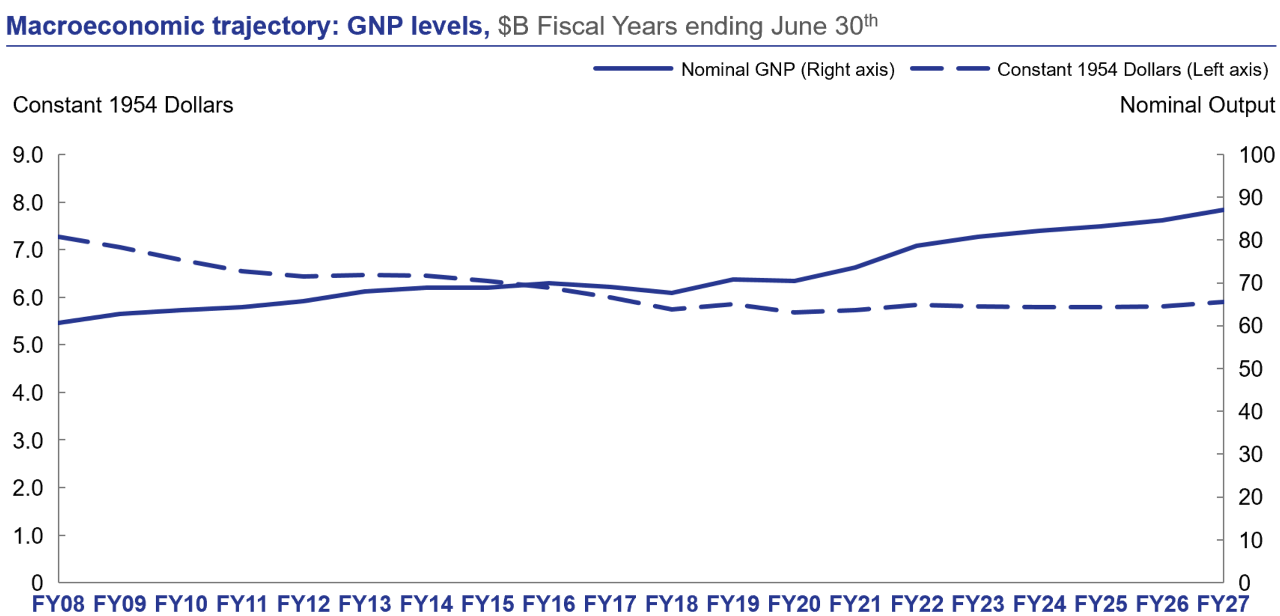


EXHIBIT 22: POPULATION TREND

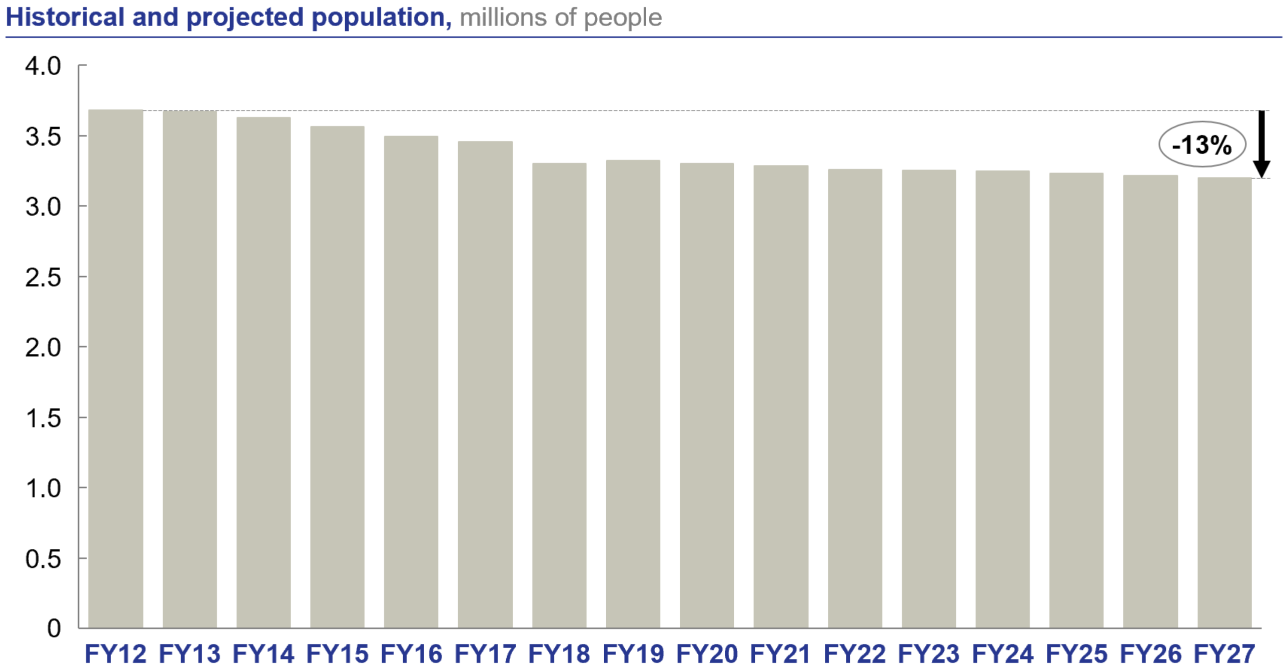


EXHIBIT 23: PER CAPITA GNP TREND

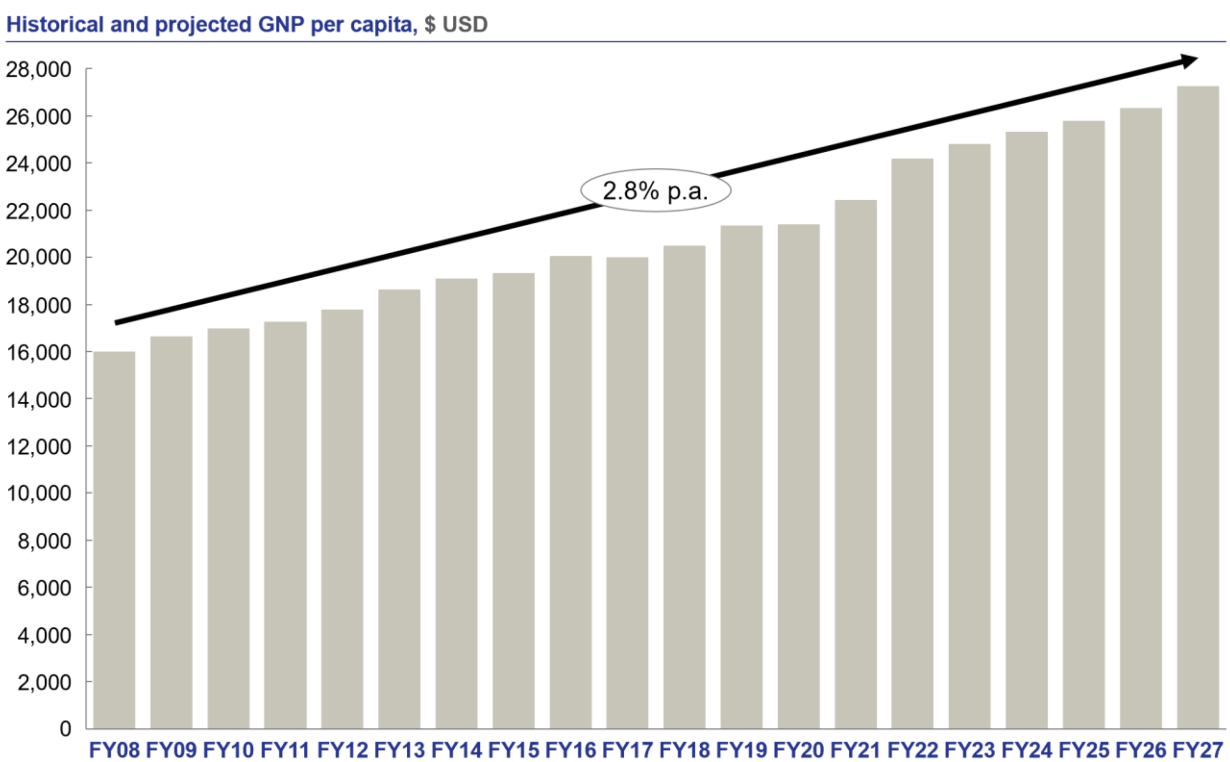


EXHIBIT 24: LONG-TERM FISCAL PLAN PROJECTIONS

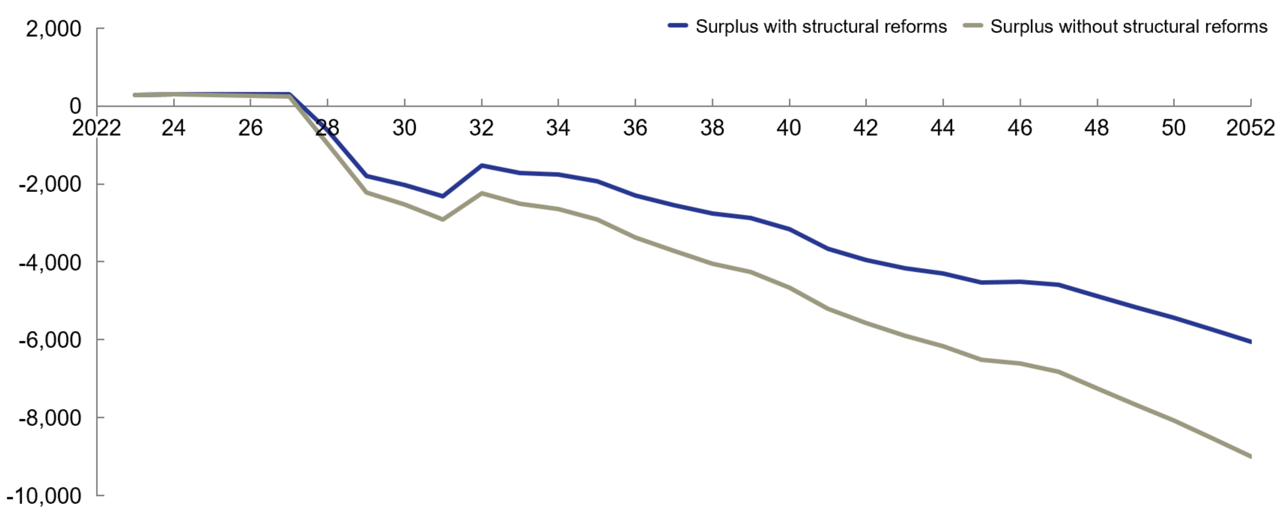
Financial projection detail, units as labeled

Projection	FY27	FY32	FY37	FY42	FY47	FY52
Population, thousand	3,200	3,084	2,929	2,760	2,611	2,487
Population growth rate, %	-0.4%	-1.0%	-1.1%	-1.2%	-1.0%	-0.9%
Real growth rate, %	**1.7%**	**-0.6%**	**-1.0%**	**-1.2%**	**-0.3%**	**-0.2%**
Nominal GNP, $M	**87,114**	**93,769**	**97,570**	**103,837**	**111,722**	**120,899**
Nominal GNP per capita, $	27,226	30,403	33,313	37,618	42,789	48,622
Nominal GNP per capita growth, %	3.5%	1.9%	1.8%	1.9%	2.7%	2.6%
Inflation, %	**1.3%**	**1.5%**	**1.7%**	**1.9%**	**1.9%**	**1.9%**
Disaster relief and infrastructure funding, $M	6,794	2,779	-	-	-	-
Revenues[1], $M	**26,860**	**24,912**	**25,990**	**27,761**	**30,052**	**32,709**
Commonwealth revenues, $M	18,218	18,926	19,526	20,710	22,346	24,261
Federal transfers, $M	8,642	5,986	6,463	7,051	7,707	8,448
Expenditures[1], $M	**(24,210)**	**(25,904)**	**(28,221)**	**(31,386)**	**(34,670)**	**(38,600)**
Commonwealth-funded expenditures, $M	(15,568)	(19,919)	(21,758)	(24,335)	(26,963)	(30,152)
Federally funded expenditures, $M	(8,642)	(5,986)	(6,463)	(7,051)	(7,707)	(8,448)
Surplus potentially not available[2], $M	*268*	*351*	*367*	*402*	*451*	*506*
Debt service and Pension Fund contributions, $M	*(2,083)*	*(193)*	*44*	*83*	*478*	*342*
Unallocated surplus / deficit, $M	**299**	**(1,537)**	**(2,555)**	**(3,945)**	**(4,590)**	**(6,054)**

1 Revenues and expenditures excluding gross up adjustments; revenues do not account for Earned Income Tax Credit
2 These surplus amounts are generated by Commonwealth corporations and the Commonwealth's ability to access such surplus amounts could be at risk without further legislative action

EXHIBIT 25: COMPARISON OF SURPLUS BEFORE AND AFTER IMPACT OF STRUCTURAL REFORMS

Comparison of annual surplus with and without structural reforms,[1] FY23-FY52, $M



1. Surplus excluding surplus of public entities potentially not available to the Commonwealth

EXHIBIT 26: REVENUE BREAKDOWN

Fiscal Year Ending June 30, $M	FY2023	FY2024	FY2025	FY2026	FY2027
General Fund Revenues:					
Individual Income Taxes[1]	3,036	2,604	2,184	2,216	2,290
Corporate Income Taxes	2,728	2,570	2,426	2,464	2,543
SUT	2,716	2,692	2,704	2,734	2,812
Act 154	1,447	1,199	1,199	1,199	1,199
Non-Resident Withholdings	559	463	367	370	376
Alcoholic Beverages	287	293	297	300	302
Cigarettes	80	90	99	100	101
Motor Vehicles	619	493	427	434	447
Excises on Off-Shore Shipment Rum	90	93	96	98	99
Partnerships	479	420	395	402	414
Other excise taxes	69	77	85	86	89
Other General Fund Revenue	665	509	515	524	540
Sub-total before additional General Fund Revenues	**12,775**	**11,504**	**10,796**	**10,927**	**11,213**
Total GF portion of misc. tax streams	441	543	548	552	559
Total Conditionally Allocable Revenues (including CRIM)	775	777	779	781	788
Total Other Non-Tax Revenues	19	18	13	13	14
Total General Fund Revenues	**14,011**	**12,842**	**12,136**	**12,273**	**12,574**
Special Revenue Fund:					
SRF revenues - CW Agencies	1,493	1,417	1,433	1,446	1,484
SRF revenues - IFCUs	1,950	2,351	2,406	2,475	2,562
Enterprise Fund Revenues	1,015	1,040	1,054	1,068	1,083
SRF revenue measures	9	9	9	9	10
Total SRF Revenues	**4,466**	**4,817**	**4,903**	**4,998**	**5,138**
Federal Fund Revenues:					
Central Government	1,236	1,274	1,284	1,301	1,319
IFCUs	162	166	168	171	173
Social Programs	3,381	3,483	3,526	3,570	3,615
Federal Fund Revenues (excl. Medicaid receipts)	**4,780**	**4,923**	**4,978**	**5,041**	**5,107**
Federal Transfers - Medicaid	3,378	3,127	3,244	3,386	3,535
Total Federal Fund Revenues	**8,157**	**8,050**	**8,222**	**8,427**	**8,642**
Revenue Post measures, pre gross up	**26,634**	**25,710**	**25,262**	**25,699**	**26,354**
Adjustments for revenue gross up	728	720	721	721	723
Revenue Post measures, post gross up	**27,363**	**26,430**	**25,982**	**26,420**	**27,078**

1 Includes impact of EITC

EXHIBIT 27: EXPENDITURES BREAKDOWN

Fiscal Year Ending June 30, $M	FY2023	FY2024	FY2025	FY2026	FY2027
General Fund Expenditures:					
Direct Payroll	(3,352)	(3,522)	(3,572)	(3,620)	(3,669)
Non-Personnel Operating Expenses (excl. Capex)	(2,972)	(2,815)	(2,402)	2,492)	(2,540)
Municipal, HTA and UPR appropriations	(1,170)	(1,148)	(1,156)	(1,179)	(1,185)
PayGo	(2,039)	(2,040)	(2,037)	(2,031)	(2,024)
Total GF Operating Expenditures	(9,532)	(9,524)	(9,168)	(9,322)	(9,418)
Medicaid - Commonwealth funded	(896)	(636)	(681)	(708)	(737)
Total GF Expenditures + Medicaid (excl. Other Non-Operating Expenditures)	(10,428)	(10,160)	(9,848)	(10,030)	(10,155)
Special Revenue Funds Expenditures:					
Direct Payroll	(832)	(848)	(860)	(868)	(887)
Non-Personnel Operating Expenses (excl. Capex)	(1,956)	(1,992)	(2,020)	(2,049)	(2,094)
PayGo	(198)	(198)	(198)	(197)	(196)
Total SRF Operating Expenditures	(2,986)	(3,038)	(3,077)	(3,114)	(3,177)
Medicaid - Special Revenue Fund	(342)	(718)	(752)	(797)	(845)
Total SRF Operating Expenditures + Medicaid (excl. Other Non-Operating Expenditures)	(3,328)	(3,756)	(3,829)	(3,910)	(4,022)
Total GF + SRF Operating Expenditures:	(13,755)	(13,916)	(13,678)	(13,941)	(14,178)
Federal Fund Expenditures:					
Direct Payroll	(800)	(825)	(834)	(843)	(853)
Non-Personnel Operating Expenses (excl. Capex)	(1,037)	(1,070)	(1,077)	(1,091)	(1,106)
Medicaid - federally funded	(3,378)	(3,127)	(3,244)	(3,386)	(3,535)
Social Programs - federally funded	(2,943)	(3,028)	(3,067)	(3,107)	(3,148)
Total Federal Fund Expenditures	(8,157)	(8,050)	(8,222)	(8,427)	(8,642)
Other Non-Operating Expenditures:					
Disaster Recovery Cost Match	(11)	(11)	(40)	(73)	(92)
Restructuring / Title III Costs	(168)	(130)	(49)	(1)	(1)
Other GF Expenses	(1,100)	-	-	-	-
Social Programs - Commonwealth funded	(15)	(15)	(15)	(15)	(15)
Expense Measures	528	415	450	458	464
Adjustments for expenditure gross up	(728)	(720)	(721)	(721)	(723)
Maintenance Capex	(290)	(523)	(280)	(284)	(288)
Enterprise Funds	(1,014)	(1,039)	(1,054)	(1,068)	(1,083)
Others[1]	(390)	(367)	(365)	(370)	(377)
Total Other Non-Operating Expenditures	(3,188)	(2,390)	(2,075)	(2,074)	(2,114)
Plan of Adjustment Expenditures:					
Debt Service (CIB and CABs, exl COFINA)	(771)	(752)	(625)	(604)	(582)
CVI Debt Service	(376)	(350)	(353)	(350)	(370)
Pension Reserve Trust	(1,036)	(906)	(970)	(971)	(1,132)
Total Plan of Adjustment Items	(2,183)	(2,008)	(1,948)	(1,925)	(2,083)
Total CW Funded Expenditures	(27,284)	(26,364)	(25,924)	(26,366)	(27,017)

1 Cigarettes & Rum Tax Disbursements To Public Corporations

EXHIBIT 28: DEBT POLICY REVENUES

Year	Adj. Revenue Post Measures (excl. federal transfers), $M	COFINA debt service, $M[1]	Debt policy revenues, $M
FY23	18,479	485	18,964
FY24	17,719	504	18,223
FY25	17,105	525	17,630
FY26	17,343	546	17,889
FY27	17,788	568	18,357
FY28	18,045	591	18,636
FY29	18,158	615	18,773
FY30	18,230	640	18,870
FY31	18,379	666	19,045
FY32	18,473	693	19,166
FY33	18,624	721	19,345
FY34	18,787	750	19,537
FY35	18,962	780	19,743
FY36	18,925	812	19,737
FY37	19,050	846	19,896

Year	Adj. Revenue Post Measures (excl. federal transfers), $M	COFINA debt service, $M[1]	Debt policy revenues, $M
FY38	19,238	880	20,118
FY39	19,449	917	20,366
FY40	19,678	955	20,633
FY41	20,011	991	21,002
FY42	20,202	991	21,193
FY43	20,499	991	21,490
FY44	20,805	991	21,796
FY45	21,121	991	22,112
FY46	21,447	991	22,438
FY47	21,801	991	22,792
FY48	22,150	991	23,141
FY49	22,509	991	23,500
FY50	22,883	991	23,874
FY51	23,268	991	24,259
FY52	23,676	991	24,667

1 COFINA debt service figures based on May 2021 COFINA Certified Fiscal Plan