

Comprehensive Economic Development Strategy Puerto Rico

Fiscal Year
2014



May 21, 2014

Mr. Willie C. Taylor
Regional Director
U.S. Department of Commerce
Economic Development Administration
The Curtis Center, Suite 140 South
601 Walnut Street
Philadelphia, PA 19106-3323

Dear Mr. Taylor:

On behalf of the Commonwealth of Puerto Rico, the Puerto Rico Development Area, the Office of the Governor, the Puerto Rico Planning Board (PRPB), and the Comprehensive Economic Development Strategy (CEDS) Committee, please accept submission of the Puerto Rico CEDS for the fiscal year 2014 and 2015.

This document was prepared in accordance with the guidelines established by the U.S. Department of Commerce under the provisions of Public Works and Economic Development Act of 1965, as amended; and the comprehensive amendments the Economic Development Act of 1998; and the Investment Policy Guidelines of the EDA.

As always, we look forward to continuing our efforts to improve economic development planning in Puerto Rico, in partnership with the EDA and its distinguished Region 2 Staff.

Sincerely,



Luis Garcia-Pelátti
Chairman

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COMPREHENSIVE ECONOMIC DEVELOPMENT STRATEGY FY 2014

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SECTION I: ORGANIZATION & MANAGEMENT

Puerto Rico's Constitution, approved in 1952, defines internal government structures based on the principles established in the United States (U.S.) Constitution; for example, Puerto Rico has a two-chamber Legislature, an Executive and a Judicial Branch. Every four years, following the calendar of US Presidential elections, Puerto Ricans elect a Governor- currently the Honorable Alejandro J. García Padilla - as well as a Legislative Assembly, mayors and municipal assemblies.

Puerto Rico is a Commonwealth in association with the United States. Traditionally, the three mainstays of Puerto Rico's affiliation with the U.S. are a common currency, a common defense and US citizenship. While Puerto Rico does benefit from representation in the United States House of Representatives through its Resident Commissioner, persons who maintain fulltime residency on the Island can neither vote in Presidential elections nor for the election of members of the United States Senate or House.

THE EXECUTIVE BRANCH

The Executive Branch of Puerto Rico has undergone significant structural reorganization, and continues to do so, the focus of which has been downsizing government, improving efficiency and lowering operational costs. Up until now, the primary means of lowering operational costs has been through the concept of "Umbrella Departments" whereby departments of the central government that share similar public policy goals and render related services have been joined under one authority or "umbrella".

Although the "umbrella" concept has reduced the number of direct reports to the Governor and, to some extent has streamlined procedures, it has achieved relatively little progress in cutting down

bureaucratic procedures and the excessive size of government.

The "Umbrella Department" concept was promulgated on April 6, 1993 under the Executive Reorganization Act of 1999, or Act Number 5, which also established the foundational "umbrella" departments, they are:

- 1) Security (Commission on Security and Public Protection), Prisons (Department of Correction and Rehabilitation);
- 2) Natural Resources (Department of Natural Resources and the Environment);
- 3) Agricultural Activities (Department of Agriculture);

- 4) Industry, Trade and Tourism (Department of Economic Development and Commerce);
- 5) Human Resources and Employment Programs (Department of Labor and Human Resources);
- 6) Public Finance (Department of the Treasury); and
- 7) Family and Community Services (Department of the Family).

These “umbrellas” continue to operate as defined above with minor changes in composition. Over the years the elimination of 18 public instrumentalities as well as the consolidation of several

public bodies and the privatization of the Puerto Rico Maritime Shipping Authority provided some savings to the Government, although the size of government employment continues to be a major concern. The present Administration is fully committed to decreasing the size of government and re-engineering key processes so as to assure a more agile and effective government. A Commission was recently established, chaired by the Secretary of State, to begin the process of decentralizing central government activities through the creation of a regional structure. The 2015 budget submitted by the Executive includes the consolidation of 25 agencies.

THE PUERTO RICO PLANNING BOARD (PRPB)

The Puerto Rico Planning Board (PRPB) is part of the Office of the Governor of the Commonwealth of Puerto Rico and was created pursuant to Act No. 213 of 1942, and later reorganized under the PRPB’s Organic Law, or Law No. 75 of June 24, 1975 (currently under revision).

The full Board is comprised of the following:

- 1) Luis García Pelatti Chairman
- 2) Pedro M. Cardona Vice-Chair
- 3) Norma I. Peña Associate Member
- 4) Juan C. Santiago Associate Member
- 5) Sylvia Rivera Díaz Alternate Member

The PRPB has served as the key entity in economic, social, and physical planning. Consequently, the PRPB is uniquely positioned to coordinate and manage the preparation and application of the Comprehensive Economic Development Strategy (CEDS).

This capacity is derived from the PRPB’s ability to function as a fulcrum, where participation of the public and private sector is augmented by sound Micro and Macro analysis in strategy development. Extensive data collection capabilities, as well as its primary role in land use planning are key components of the PRPB’s activities. The PRPB is particularly adept at both economic and demographic analysis and has considerable experience in organizing

public participation in policy formation. It is for this reason that the PRPB is uniquely prepared to manage the CEDS process.

The PRPB's objective in preparing the CEDS report is to develop an efficient instrument capable of guiding targeted

and effective investment of taxpayer resources. CEDS recommendations are entirely consistent with Administration priorities and aim at providing Puerto Rico with clear objectives and strategies that will promote economic and social development.

CENTRAL GOAL AND PRINCIPAL OBJECTIVES OF THE PRPB

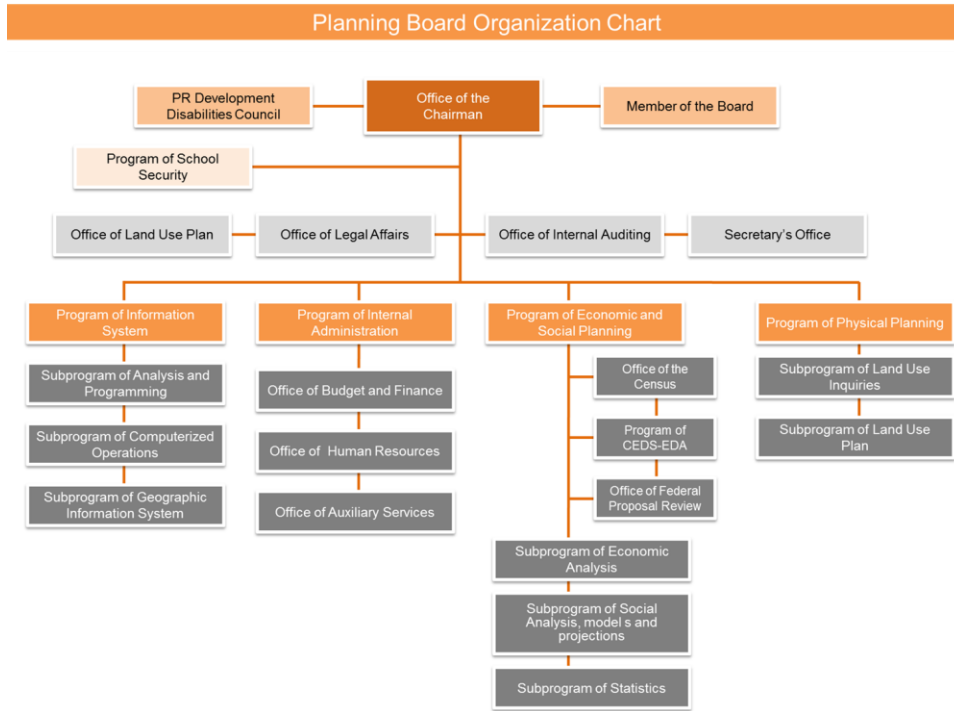
The central goal of the PRPB is to provide guidance for the integrated economic, social and physical development of the Commonwealth. To accomplish this central task, the PRPB adheres to eight (8) principal objectives:

- 1) To develop information on the physical, economic and social resources of the Island and coordinate their use for the sustainable development of Puerto Rico;
- 2) To prepare, adopt and recommend to the Governor and the Legislative Assembly the programming of capital improvement initiatives;
- 3) To make viable the implementation of the Municipal Reform Law and the municipal land use plans, promote regionalization and transfer of services to the municipalities and the private sector;
- 4) To formulate an island wide land use plan;
- 5) To coordinate the permitting process;

- 6) To promote citizen participation in the development of our cities and establishment of educational programs concerning the environment;
- 7) To produce studies and analyses that support the formulation of public policies; and,
- 8) To assure that Federal funding in Puerto Rico is used in an effective and efficient manner.

Together, these objectives constitute the policy context of the PRPB's activities as it meets the responsibilities and the mandates set forth in its Organic Law.

The PRPB is now committed to an inclusive focus as recently demonstrated in its introduction of the land use plan for Puerto Rico. During 2013 the PRPB proposed a new approach to the land use planning process based on functional regions that has been adopted by the Decentralization Commission as the framework for the creation of regions as the unit for decentralizing certain central government tasks.



INSTRUMENTS OF PLANNING POLICY

In the final section of this Report, an outline of the policy instruments being used and/or being developed by the PRPB is included. In its almost seventy years since being established the instruments used by the Board to carry out its responsibilities have changed. New ones have been added to the inventory and others have been discarded. The present Administration is

committed to providing the PRPB with the essential tools to make it an effective entity.

The Comprehensive Economic Development Strategy (CEDS) is considered a key instrument and for that reason it is integrated into PRPB activities and priorities.

PRPB INVESTMENT ANALYSIS AND THE EDA INVESTMENT POLICY GUIDELINES

The entire island of Puerto Rico is classified as a “Redevelopment Area”—the Puerto Rico Economic Development Area—as determined by its persistent high unemployment and, low family income levels as well as those guidelines

established by the EDA. Therefore, the CEDS Committee is responsible for the evaluation of all Investment Proposals (formerly known as project proposals) for economic development seeking EDA funds that originate in Puerto Rico. It is

the principal goal of the Government of Puerto Rico, the PRPB, and the CEDS Committee, to make certain that all investment proposals that the CEDS Committee recommends for participation in the EDA's proposal phase for EDA funding consideration, have been evaluated and recommended by a body of individuals who are representative of various sectors and groups in the community of the Puerto Rico Economic Development Area.

The decisions of the CEDS Committee are made in accordance with the public policies of The Commonwealth of Puerto Rico and the EDA Investment Policy guidelines. The CEDS Committee works and operates independently of the daily operations of the PRPB, although funding needs for the CEDS Committee and its activities are met through both Federal and Local funding shares.

MEMBERSHIP OF THE CEDS COMMITTEE

The CEDS Committee is composed of the designated heads (or their representatives) of the following public and private entities that represent the

indicated group. Those participants identified in the Bylaws of the CEDS Committee are:

- | | |
|---|---|
| 1) Luis García Pelatti,
Planning Board | 8) Oscar Jiménez
INTECO |
| 2) Alberto Bacó
Department of Economic
Development and Commerce | 9) Yanaira Vázquez
INTENOR |
| 3) Joey Cancel Planas
Economic Development Bank | 10) Edgardo Agrait
INTENE |
| 4) Francisco Chévere
Puerto Rico Trade Co. | 11) Nelson Peréa
PRTEC |
| 5) Antonio Medina
PRIDCO | 12) Carmen Martí
SBDC |
| 6) Miguel A. Torres
Department of Public Works | 13) José F. Méndez
Ana G. Méndez University System |
| 7) Carlos M. Santini
Commissioner of Municipal Affairs | 14) Waleska Rivera
Manufacturers Association |
| | 15) Manuel Reyes
MIDA |

Each individual named above is either the Secretary, Executive Director or the President of the entity he or she represents, or his/her's designated representative. The Chairman of the Committee is Luis García Pelatti, Secretary of the Puerto Rico Planning Board. The Secretary of the Committee is Planner Roberto González, Executive Director.

Once a person is designated by the organization or representing entity, this person is considered a “permanent member” of the CEDS Committee as defined in the Bylaws. However, the CEDS Committee may always recommend changes in its composition to the Chairman of the PRPB or his/her delegate.

Although, the CEDS Committee Bylaws preserve the right of the PRPB Chairman to take action to change the composition of the CEDS Committee given certain

conditions, functionally, the post on the CEDS committee is held by the institution representing that community. Normally, the term of the individual on the CEDS Committee coincides with the term during which the individual occupies their post in the organization.

A majority of the members who are present at the pertinent meeting, wherein the Chairman of the PRPB (or his/her delegate) presides, chooses the CEDS Committee President. If a majority elects to, the CEDS Committee may also establish other positions and designate its members, properly chosen by a majority of the permanent members present at the pertinent meeting, to additional positions such as CEDS Committee Vice-president or Secretary, among others. The CEDS Committee Executive Director or Secretary may be a permanent member of the CEDS Committee, although, it is not required.

THE CEDS COMMITTEE

The entire CEDS Committee, whose composition is detailed above, is comprised of both government officials and citizens from the wider community. Members are invited to participate on the committee in response to the particular expertise or knowledge area their participation is expected to provide.

The President, or his delegate on the CEDS Committee, at the request of a majority of the members of the Committee, may designate a

subcommittee whose function will be to analyze any issue of interest to the members of the CEDS Committee. The CEDS Committee has established a Subcommittee for the Evaluation of Investment Proposals. Composed of members from the larger board, the Subcommittee for the Evaluation of Investment Proposals meets at least once per year, but as often as necessary, in order to render its recommendations to the CEDS Committee.

The principal functions of the CEDS Committee are coordinated and administered by the Executive Director who is contracted, hired, or assigned to

the task of Executive Director by the Chairman of the PRPB in order to supply “Staff Support” to the CEDS Committee.

STAFF SUPPORT FOR THE CEDS COMMITTEE

In order to meet the obligations of the EDA’s planning assistance investment program the PRPB is required to contract, hire, or designate an Executive Director to the CEDS Committee. In addition, the PRPB is obligated to provide a secretary for the Executive Director. Together, the CEDS Committee Executive Director and his/her secretary form the “executive staff” of the CEDS Committee. Support is received from PRPB staff as required.

The executive staff expedites the activities of the CEDS Committee and ensures that its work is conducted with greater effectiveness, efficiency, and in such a manner as to minimize any undue

burden on any individual member of the CEDS Committee. It also assures that the CEDS document, the annual report, is completed to the satisfaction of the EDA. For this reason, the majority of the day to day procedural aspects of the work of the CEDS Committee has been delegated to the Executive Director.

Currently Planner Roberto González fills the position of Executive Director as well as that of secretary of the CEDS Committee. Planner González is an experienced planner who, prior to joining the Program worked extensively as a private consultant with municipalities and community based organizations throughout Puerto Rico.

SECTION II: PUERTO RICO'S ECONOMY

THE ECONOMY OF PUERTO RICO: TRENDS AND PROJECTIONS FOR FY 2013 AND 2014

INTRODUCTION

The Puerto Rico Planning Board (PRPB), in compliance with its mandate, is the agency of the Government of the Commonwealth of Puerto Rico responsible for monitoring the economy of Puerto Rico, in order to identify the

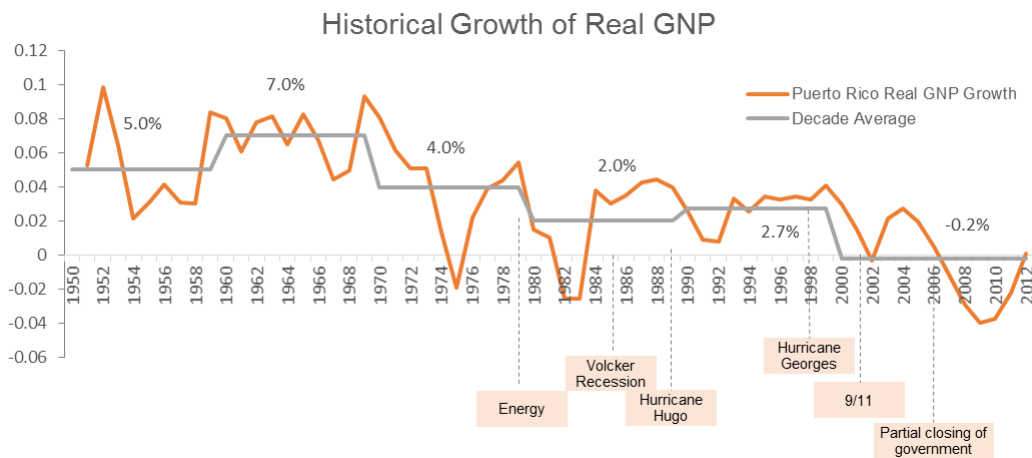
performance of the island economy. Based on this, the PRPB develops projections and analysis, which together with other policy tools, are used as the foundation of policy decisions in both the private and public sectors.

BACKGROUND

AN UNDERPERFORMING ECONOMY

After a period of significant economic expansion during the fifties and sixties (average annual growth of 5.3% and 7.0% respectively) the economy has experienced a consistent-if gradual-slowdown for the last 4 decades. Real average annual economic growth contracted from 3.5% in the 70s to 2.0% in the 80s, 2.8% in the 90s and 0% since

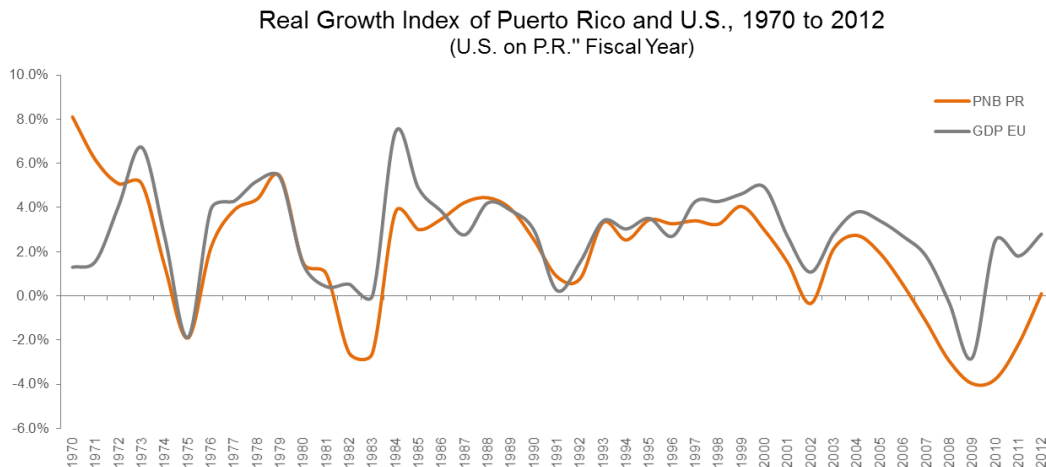
2001. Real growth by decades has experienced declining numbers since the 1970s. Since 2001 only FY 2003 had a growth rate above 2.5%, lower than the previous decade growth average of 2.7%. While there are several explanations behind these isolated periods of short-term economic growth, most signs point to a structural problem with the local economy.



Source: PR Planning Board and Estudios Técnicos, Inc.

Beginning in 2005 it became clear that the Island’s rate of growth could not continue to be driven by government expenditures financed through debt. The level of public debt had reached unacceptable levels and rating agencies had made known their concerns. In May 2006 the government partially closed due to cash flow insufficiencies. In subsequent years the debt issue became critical and lead to serious economic consequences.

A recent development in Puerto Rico’s economic development has been the widening gap between the Island’s economic growth and that of the Mainland. Since 2006 the gap has widened consistently, as the following graph illustrates, more so by fiscal 2008, pointing to the existence, as mentioned above, of serious structural problems in the local economy that are hampering its development.



Source: Puerto Rico Planning Board; US Bureau of Economic Analysis

INCOME LEVELS

Income levels are still concentrated in the lower brackets, and that situation is expected to continue for the next several years. About 37% of the households have an annual income of \$18,000 or lower, with 14% in the next bracket, meaning that 51% of households have incomes of \$27,000 or lower. Per Capita Personal Income in Puerto Rico is \$14,200, which compares with Mississippi’s \$29,000, Florida’s \$38,500 and the U.S. as a whole, \$38,600.

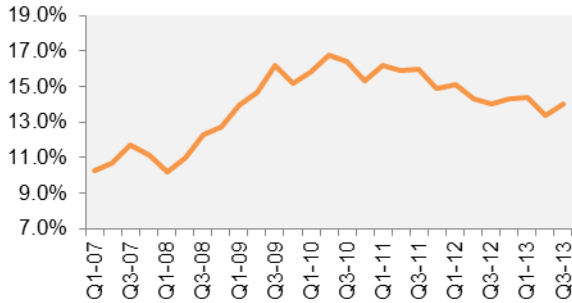
Household Formation by Income Level 2008-2012			
Income Levels (2008 prices)	5 yr Change	Annual	Percent of Total
\$0,000-\$18,000	35,082	7,016	37%
\$18,000-\$27,000	13,511	2,702	14%
\$27,000 - \$44,000	17,180	3,436	18%
\$44,000 - \$89,000	18,818	3,764	20%
More than \$89,000	9,537	1,907	10%
Total	94,128	18,826	100%

Source: PR Planning Board and Estudios Técnicos, Inc

EMPLOYMENT AND UNEMPLOYMENT

Puerto Rico’s non-farm salaried employment has fallen consistently since the start of the current recession. According to BLS and local Labor Department figures, there has been a loss of some 200,000 jobs since 2006. The latter is a result of job losses across all areas, but most importantly in manufacturing and construction where jobs losses have been severe since the middle of the last decade. For fiscal 2012, the average unemployment rate reached 15.0%, a figure made worse by a very low participation rate that by the middle of fiscal 2013 had reached 39.3%, a much lower figure than that of the U.S. as a whole of 63%.

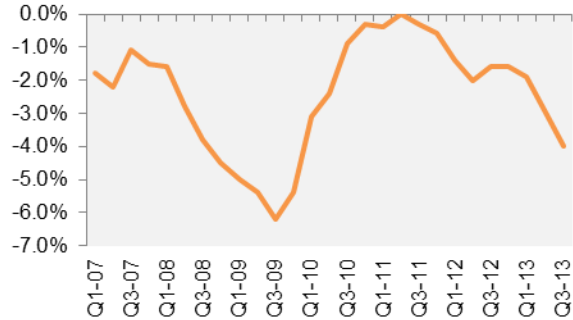
Unemployment Rate
(Quarterly Average)



Source: PR Department of Labor

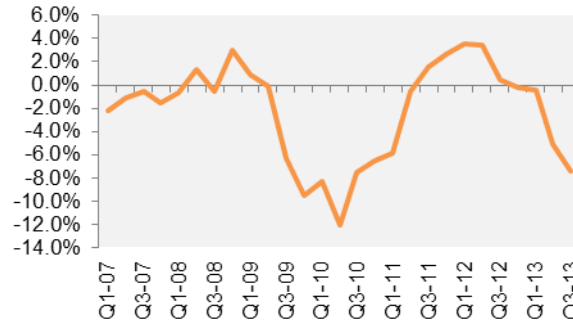
Private employment has been decreasing consistently during the past three years, with a modest improvement in the first four months of 2014. Public employment, although declining in the past four years still represents a high percentage of total non-farm salaried employment.

Private Employment



Source: PR Department of Labor

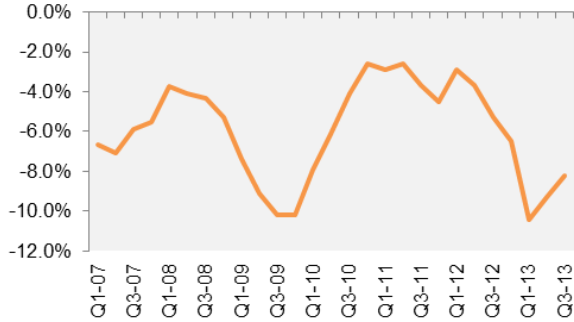
Public Employment



Source: PR Department of Labor

The result of changing conditions in the global economy, technology changes, the elimination of Section 936 of the U.S. Internal Revenue Code, was a reduction of external investment. Employment in the manufacturing sector has declined throughout the years, although still representing 8% of total non-farm employment. This development is not exclusive to Puerto Rico, as it has happened not only on the Mainland but in some of our key competitors, such as Ireland. Between 1996 and 2013, the sector has lost over 75,000 jobs.

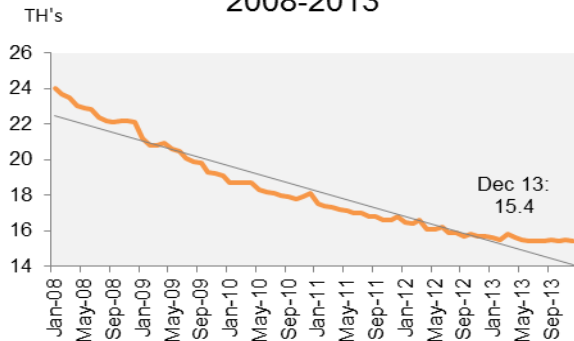
Employment- Manufacturing



Source: PR Department of Labor

Within manufacturing, employment in the pharmaceutical sector, which represents 23% of manufacturing employment, has declined over the past three and a half years. Between 2003 and 2013, the sector registered a net loss of close to 4,000 jobs. This reflects changes in the industry, such as mergers worldwide and transfer of operations to other sites, and is a worrisome development that the government has attempted to mitigate, for instance with the new Industrial Incentives Law of 2008 and more recently by providing the means to cut reduce energy costs.

Employment in the Pharmaceutical Industry, 2008-2013

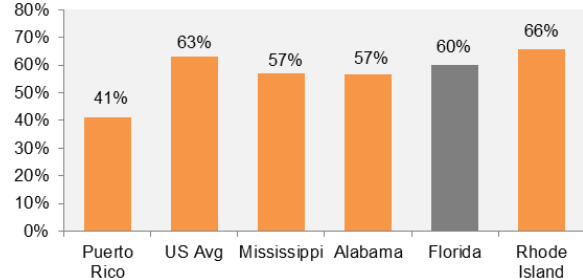


Source: U.S. BLS, Establishment Survey.

One important characteristic of the labor force in Puerto Rico is its low participation rate, not only with respect to the Mainland but also with that of other economies. For the Mainland the LFPR is 63%, higher in the case of the competing economies of Ireland and Singapore, and even in the case of Latin America and the Caribbean.

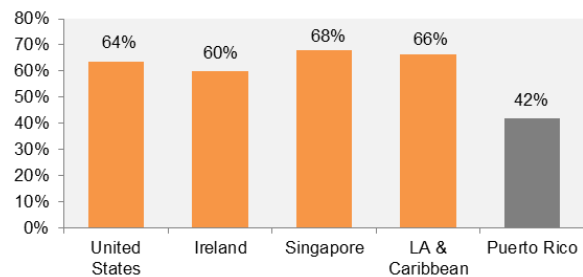
Puerto Rico's labor force participation rate is not only very low compared to the average for the mainland, but also with respect to, for example, Alabama (61.4%), Florida (64%), Mississippi (60%), and Rhode Island (69%), among other states.

Labor Force Participation Rates 2013



Source: PR Department of Labor. U.S. BLS.

Labor Force Participation Rates 2012

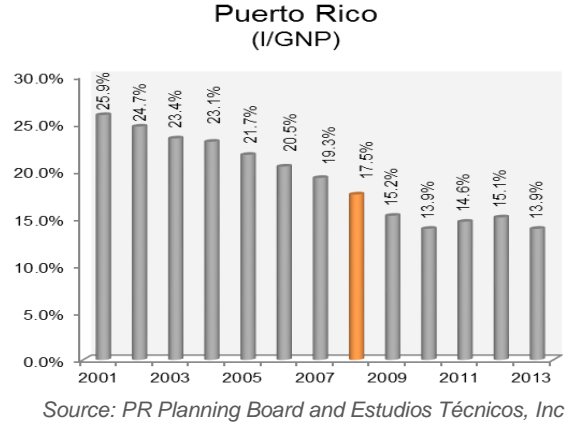


Source: The World Bank

INVESTMENT

Another troublesome development in the local economy is the decreasing share of investment in GNP, placing the Island at a disadvantage with respect to other economies with which it competes. Between 2001 and 2012 the share went down from 28% to 15%, due mostly to a reduction in construction investment. On the other hand, the share is higher in the case of Singapore (29%), South Korea (29%) and Ireland 26%). This is an indication that consumption – 89% of GNP - has replaced investment as the

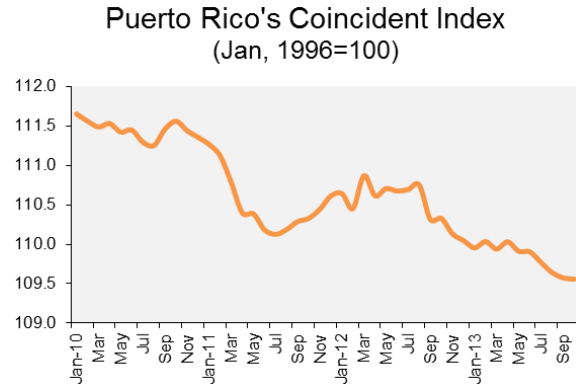
key driver of the economy, not a healthy development.



RECENT ECONOMIC ACTIVITY

COINCIDENT INDEX¹

The local economy has been undergoing a deep contraction. The trend has been consistently downward since July 2007 as shown in the coincident index (CI). After a modest recovery, the level of the index continued to be on the downside, with an annual reduction of 3.2%. The index has declined since early in fiscal 2007. The indicator that has contributed most to the decline is net employment.



The economy will confront strong headwinds from several factors during the coming years including increasing interest rates and the consequences of the downgrade of the public debt that will limit the government’s role in stimulating economic growth. Very high electric

energy costs in Puerto Rico continue to be a major hurdle. The average cost of electric energy in Puerto Rico is roughly three times that of the U.S. on average and exceeds that of all states with the exception of Hawaii, with roughly similar

¹ The index consists of the following monthly series: total net employment (Household Survey) excepting manufacturing

and public employment, total consumption of electricity, net revenues to the General Fund, and total exports.

costs. Although more favorable conditions with respect to petroleum and natural gas production in the mainland have developed, the cost of fossil fuels will continue to be high. Prospects for

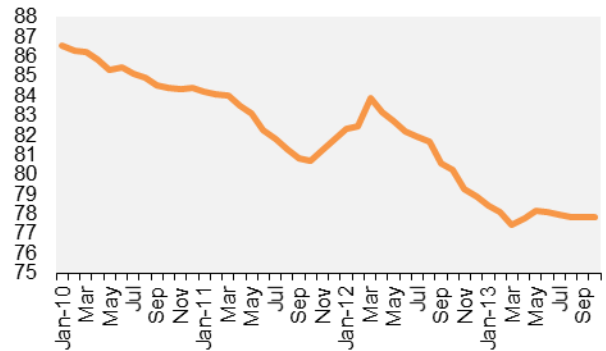
higher oil prices and expected higher interest rates will continue to hinder the Island's capacity for growth.

Source: Estudios Técnicos, Inc

LEADING INDEX²

The leading index has also experienced a downswing since August 2007. The index fell by 1.1% in the first quarter of the current year, suggesting slow growth ahead.

Puerto Rico's Leading Index
(Jan, 1996 = 100)

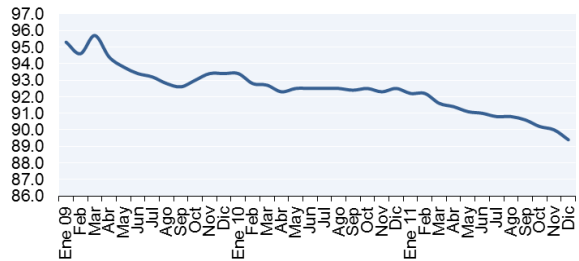


Source: Estudios Técnicos, Inc

MANUFACTURING INDEX³

Manufacturing activity has been stagnant in the same period, with a contraction of 4.3% in the manufacturing index.

Puerto Rico's Manufacturing Index



Source: Estudios Técnicos, Inc

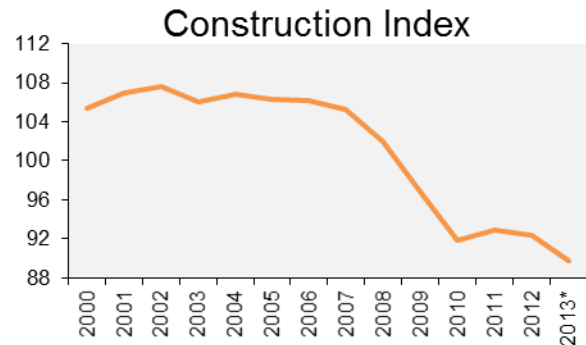
² It is a composite index consisting of the following monthly series: average monthly price of WTI oil, the University of Michigan's consumers confidence index, the value of construction permits, and the number of permits issued for the construction of new housing units.

³ Employment (Establishment Survey) excluding the food and apparel sectors, payroll of production workers, average weekly hours for production workers, total exports, and electricity consumption of the sector.

CONSTRUCTION INDEX

Construction activity has slowed considerably since mid-2005. The index is a weighted composite of the number of construction permits and cement sales (in volume). In 2008, the average index fell to 98.6 or 12.1% below the average of the previous year, a reflection of the serious deterioration in construction activity since 2007. Investment in construction declined in real terms by 9.0% in Fiscal 2008 and has continued to decrease, although with some improvement in 2012. As the index shows, the situation has not improved

since. Indicators for 2012, continue to reflect the very serious downsizing of the sector.

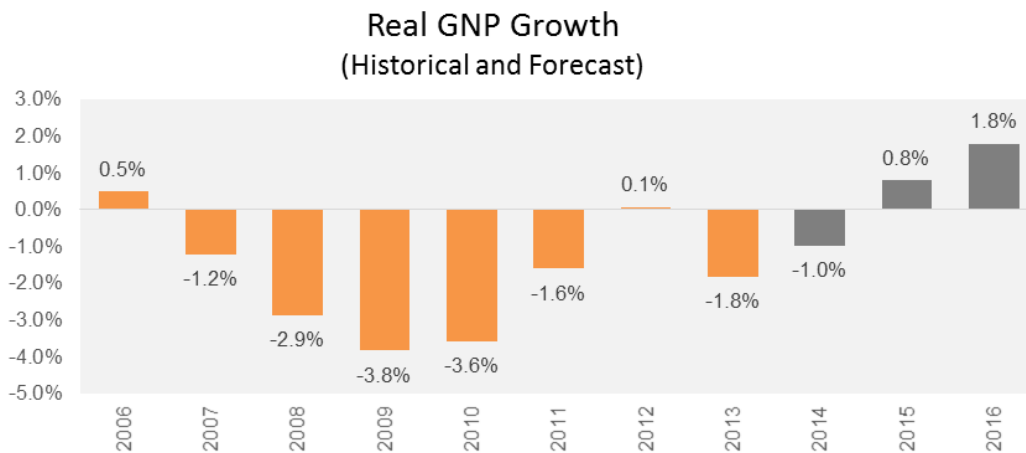


Source: Estudios Técnicos, Inc.

FORECAST FOR FISCAL YEARS 2013 THROUGH 2016

As a reflection of continuing deterioration in economic conditions, the local economy experienced a contraction in fiscal 2013 and slight improvements in fiscal 2014 and 2015. ARRA funds that totaled close to \$6.0 billion had little impact on growth.

During the coming three years the economy will experience numerous factors that will influence economic developments, such as a potential reduction in federal funds, the impact of the reduction in public spending, and the expected increase in interest rates. These will be closely monitored by the Planning Board.



Source: PR Planning Board

A STATISTICAL SUMMARY

This section presents an overview of the structure and evolution of the main economic sectors, in terms of output (GDP) and employment, and of other selected indicators.

EMPLOYMENT AND UNEMPLOYMENT

The number of persons employed in Puerto Rico during fiscal year 2013 averaged 1,030,000, a substantial decrease from 1,203,000 in fiscal year 2008. The local unemployment rate is approximately two and a half times the U.S. average as of late 2013.



The following table presents annual statistics of employment and unemployment for fiscal years 2008 through 2013. These employment figures are based on the Household Survey, that includes self-employed individuals, instead of the non-farm, payroll employment survey (the “Payroll

Survey”), which does not. The number of self-employed individuals represents around 15% of total employment in Puerto Rico, more than double the level in the United States.

Commonwealth of Puerto Rico Employment and Unemployment (1) (persons age 16 and over) (in thousands)				
Fiscal Years Ended June 30.	Labor Force	(Annual Average)		Unemployment Rate(2)
		Employment	Unemployment	
2008	1,355	1,203	152	11.2%
2009	1,325	1,144	181	13.7%
2010	1,285	1,075	210	16.3%
2011	1,249	1,047	202	16.2%
2012	1,221	1,035	186	15.2%
2013*	1,197	1,030	167	14.0%

(1) Totals may not add due to rounding.

(2) Unemployed as percentage of labor force.

* Until November

Source: Department of Labor and Human Resources - Household Survey

ECONOMIC PERFORMANCE BY SECTOR

From fiscal year 2008 to fiscal year 2012, the manufacturing and service sectors generated the largest portion of gross domestic product. The three sectors of the economy that provide the most employment are manufacturing, services and government.

The table in the next page presents annual statistics of gross domestic product by sector and gross national product for the five fiscal years ended June 30, 2008 through 2012

Commonwealth of Puerto Rico
Gross Domestic Product by Sector and Gross National Product
 (in millions at current prices)

	Fiscal Years Ended June 30				
	2008	2009	2010	2011	2012⁽¹⁾
Manufacturing	\$40,234	\$43,872	\$46,577	\$46,832	\$46,114
Services ⁽²⁾	29,857	28,138	28,647	29,948	30,649
Government ⁽³⁾	8,762	9,047	8,350	8,216	8,278
Transportation, communication and public utilities	5,460	5,288	5,569	5,538	5,319
Agriculture, forestry and fisheries	519	567	822	796	818
Construction ⁽⁴⁾	2,031	1,777	1,518	1,462	1,471
Statistical discrepancy	-312	480	-294	-238	543
Total gross domestic product	<u>\$93,639</u>	<u>\$96,386</u>	<u>\$98,381</u>	<u>\$100,196</u>	<u>\$101,034</u>
Less: net payment abroad	<u>(30,936)</u>	<u>(32,768)</u>	<u>(34,087)</u>	<u>(34,629)</u>	<u>(31,573)</u>
Total gross national product ⁽⁵⁾	<u>\$62,703</u>	<u>\$63,618</u>	<u>\$64,295</u>	<u>\$65,567</u>	<u>\$69,462</u>

(1) Preliminary

(2) Includes wholesale and retail trade, finance, insurance and real estate, tourism, and other services.

(3) Includes the Commonwealth, its municipalities and certain public corporations, and the federal government.
 Excludes certain other public corporations like the Electric Power Authority and the Aqueduct and Sewer Authority whose activities are included under Services in the table.

(4) Includes mining.

(5) Totals may not add due to rounding.

Source: Puerto Rico Planning Board

In the case of the Mainland, the share of manufacturing in total output is much smaller compared to Puerto Rico's, 11.5%, and has been declining from 16.3% in 1990, as the economy moved to a greater reliance on services.

The table below presents a breakdown of non-farm employment by industrial sector (based on NAICS), for fiscal years 2008 through 2012. As in the United

States as whole, the numbers are based on the Payroll Survey, which is designed to measure employment by sector. The Payroll Survey excludes agricultural employment and self-employed persons. The majority of employment is in services, followed by employment in government, manufacturing and construction, as shown in the following table.

Commonwealth of Puerto Rico
Non-Farm, Payroll Employment by Economic Sector⁽¹⁾
 (persons age 16 and over)

	Fiscal Years Ended June 30,				
	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012⁽²⁾</u>
Mining, Logging & Construction	59,675	49,067	35,942	31,767	34,542
Manufacturing					
Durable Goods	43,100	39,242	34,792	33,900	33,250
Non-Durable Goods	60,950	57,483	53,533	51,658	49,800
Sub Total	<u>104,050</u>	<u>96,725</u>	<u>88,325</u>	<u>85,558</u>	<u>83,050</u>
Trade, Transportation, Warehouse & Utilities					
Wholesale Trade	33,717	33,267	32,533	31,983	31,467
Retail Trade	130,883	127,492	126,233	128,017	128,117
Trade, Transportation, Warehouse & Utilities	16,433	15,392	14,233	14,008	14,217
Sub Total	<u>181,033</u>	<u>176,150</u>	<u>173,000</u>	<u>174,008</u>	<u>173,800</u>
Information	21,442	20,217	18,783	18,733	18,650
Financial Activities	48,483	48,492	45,808	43,708	44,425
Professional & Business	108,150	103,333	102,508	105,592	108,800
Educational & Health	108,550	109,992	111,333	114,108	117,550
Leisure & Hospitality	73,408	70,933	70,850	71,150	72,633
Other Services	21,217	20,117	18,758	17,925	17,558
Government	297,742	300,708	276,533	260,033	258,458
Total Non-Farm	<u>1,024,058</u>	<u>996,033</u>	<u>942,158</u>	<u>923,642</u>	<u>928,508</u>

(1) The figures presented in this table are based on the Payroll Survey prepared by the Bureau of Labor Statistics of the Department of Labor and Human Resources. There are numerous conceptual and methodological differences between the Household Survey and the Payroll Survey. The Payroll Survey reflects information collected from payroll records of a sample of business establishments, while the Household Survey is based on responses to a series of questions by persons in a sample of households. The Payroll Survey excludes the self-employed and agricultural employment. Totals may not add due to rounding.

(2) Preliminary.

Source: Department of Labor and Human Resources, Current Employment Statistics Survey (Establishment Survey - NAICS Codes)

MANUFACTURING

While in terms of employment manufacturing represents less than 10% of the total, with respect to output (as measured by GDP) its share is much higher, remaining at levels in excess of 42.0% for several years. The high share

of manufacturing in total output is due to the importance of the pharmaceutical sector. It accounts for close to two thirds of manufacturing production in the island. The table below presents a breakdown of manufacturing’s GDP by industrial sector.

Commonwealth of Puerto Rico
Gross Domestic Product by Manufacturing Sector
 (in millions at current prices)

	Fiscal Years Ended June 30,				
	2008	2009	2010	2011	2012
Pharmaceuticals (Chemical and allied products)	\$29,339	\$30,380	\$32,527	\$32,872	\$31,555
Machinery and metal products:					
Machinery manufacturing	234	174	233	228	246
Electronic Products and Electrical equipment	5,120	7,692	8,156	8,124	8,792
Other machinery and metal products	399	352	375	344	353
Food products	822	977	868	862	813
Apparel and Textiles	267	282	295	286	275
Other ⁽¹⁾	4,053	4,015	4,123	4,115	4,081
Total gross domestic product of manufacturing sector⁽²⁾	\$40,234	\$43,872	\$46,577	\$46,832	\$46,114

(1) Includes petroleum products; petrochemicals; tobacco products; stone, clay and glass products; textiles and others.

(2) Totals may not add due to rounding

Source: Puerto Rico Planning Board

Most of the island’s manufacturing output is shipped to the United States mainland, which is also the principal source of raw and semi-finished manufactured products on which further manufacturing operations are performed in Puerto Rico. The United States minimum wage laws are applicable in Puerto Rico. For fiscal year 2012, the average hourly manufacturing wage rate in Puerto Rico was approximately 66.0% of the average mainland United States rate.

Manufacturing in Puerto Rico has been tax driven since its inception. Local tax

exemption and federal tax incentives such as Section 931 and subsequently Section 936 of the Internal Revenue Code have played a key role in making Puerto Rico an attractive location. Section 936, together with Section 482, were influential in making the Island a pharmaceutical hub. The former permitted dividends sent to mainland headquarters to be tax free and the latter permitted the transfer of intangibles – the results of R&D – to be transferred to Puerto Rico manufacturing operations with no tax consequences. Federal

legislation enacted in 1996, however, which eliminated Section 936 of the U.S. Code, phased out these federal tax incentives during a ten-year period that ended in 2006. This has led to a long-term decline in local manufacturing employment.



The table below presents the distribution of employment in the sector. The majority is in the non-durable goods sectors (58%), and the rest in durable goods production. The table also shows how

employment in the sector has declined considerably in the past several years. Total employment in the manufacturing sector decreased from a high of 165,000 in 1006 to the present level. Manufacturing employment had been declining during the past decade, but the decline accelerated during fiscal years 2002 and 2003, falling -10.6% and -4.8%, respectively. After that, manufacturing employment seemed to stabilize around 118,000 jobs, but the deceleration reappeared in fiscal year 2006 with the sector experiencing another significant drop of -4.7%. For fiscal years 2007 and 2008, manufacturing employment decreased by -4.1% and -3.6%, respectively. During fiscal year 2008 the manufacturing sector lost around 3,658 jobs. By fiscal 2013, the sector registered fewer than 80,000 jobs.

Commonwealth of Puerto Rico
Non-Farm Payroll Manufacturing Employment by Industry Group*
 (persons age 16 years and over)

Industry Group	Fiscal Years Ended June 30,				
	2008	2009	2010	2011	2012⁽¹⁾
<u>Durable Goods</u>					
Nonmetallic Mineral Products Manufacturing	3,758	3,058	2,492	2,133	2,042
Fabricated Metal Products	5,375	4,908	4,042	3,625	3,600
Computer and Electronic	8,600	7,042	5,733	5,967	5,200
Electrical Equipment-Appliances and Components	6,658	5,867	5,058	5,042	5,100
Electrical Equipment Manufacturing	4,383	3,917	3,575	3,642	3,817
Miscellaneous Manufacturing Manufacturing	11,967	11,975	11,675	11,633	11,767
Total-Durable Goods	<u>43,100</u>	<u>39,242</u>	<u>34,792</u>	<u>33,900</u>	<u>33,283</u>
<u>Non-Durable Goods</u>					
Food Manufacturing	11,725	11,383	11,592	11,908	11,467
Beverage and Tobacco Products Manufacturing	3,267	3,133	3,275	3,000	2,508
Apparel Manufacturing	9,633	9,825	8,808	8,775	9,692
Chemical Manufacturing	27,900	25,042	22,392	21,033	19,975
Pharmaceutical and Medicine Manufacturing	24,033	21,500	19,058	17,608	16,542
Plastics and Rubber Products Manufacturing	1,983	1,967	1,908	1,750	1,608
Total - Non-Durable Goods	<u>60,950</u>	<u>57,483</u>	<u>53,533</u>	<u>51,767</u>	<u>50,175</u>
Total Manufacturing Employment	<u>104,050</u>	<u>96,725</u>	<u>88,325</u>	<u>85,667</u>	<u>83,458</u>

*Totals may not add due to rounding.

(1) Preliminary

Source: Department of Labor and Human Resources, Current Employment Statistics Survey (Establishment Survey - NAICS Codes)

There are several reasons which explain the reduction in employment: the end of the phase-out period for Section 936, the net loss of patents on certain pharmaceutical products, the escalation of manufacturing production costs (particularly labor and electricity), and the increased use of job outsourcing. Puerto

Rico's manufacturing sector is facing increased international competition, and new ideas and initiatives are necessary to improve this sector. Nevertheless, Puerto Rico maintains a strong industrial sector. The table in the next page includes key manufacturing firms in the Island.

Leading United States and Foreign Companies
with Manufacturing Operations in Puerto Rico¹

<u>Employment 2,500 and over</u>	<u>Product</u>		
Baxter International, Inc.	Medical Devices	Sara Lee Corp.	Apparel
Johnson & Johnson	Pharmaceuticals	Sitnasuak Native Corporation	Apparel
Medtronic Europe SA	Medical Devices	St. Jude Medical Inc.	Medical Instruments
Pfizer, Inc.	Pharmaceuticals	Stryker Corp.	Surgical Instruments
		Unilever PLC	Consumer Products
		Zimmer Holdings, Inc	Pharmaceuticals
<u>Employment 1,000 to 2,499</u>	<u>Product</u>	<u>Employment 200 to 499</u>	<u>Product</u>
Abbott Laboratories	Pharmaceuticals	Bacardi Limited	Food
Altadis	Cigars	B. Braun Medical Inc.	Medical Devices
Amgen, Inc	Pharmaceuticals	Biovail Corporation International	Pharmaceuticals
Bristol-Myers Squibb. Cop	Pharmaceuticals	Bumble Bee Seafoods	Food
Coopervision Inc	Ophthalmic Products	Carolina Underwear Co.	Apparel
Eaton Corporation	Electronics Instruments	Checkpoint Systems, Inc.	Electronic Instruments
Edwards Lifesciences LLC	Surgical Instruments	Coca Cola Company	Food
Eli Lilly and Company	Pharmaceuticals	C.R. Bard, Inc	Medical Devices
General Electric Industrial Systems	Electronics Instruments	Curtis Instruments Inc.	Electrical Instruments
Glaxo Smithkline	Pharmaceuticals	Davis Creek Managing Partners	Metal Products
Hewlett-Packard Co.	Computers	E.I. DuPont de Nemours & Co	Chemicals
Merck & Co. Inc	Pharmaceuticals	Essilor International	Medical Devices
Propper International, Inc.	Apparel	F. Hoffman-La Roche	Medical Devices
Tyco International, Inc.	Surgical Instruments	Honeywell Aerospace	Engineering Consulting Services
Wyeth	Pharmaceuticals		
<u>Employment 500 to 999</u>	<u>Product</u>		
Astra Zeneca PLC	Pharmaceuticals	Inversionistas Foraneos	Electronic Instruments
Atento Teleservicios	Communications	Legacy Pharmaceuticals International	Pharmaceuticals
Becton-Dickinson & Co.	Surgical Instruments	Loctite Corporation	Chemicals
Cardinal Health, Inc	Surgical Instruments	Lutron Electronics Co. Inc.	Electronic Instruments
Centennial Communication	Wireless Communications	Mylan Laboratories, Inc	Pharmaceuticals
Eagle Industries, Inc.	Apparel	Novartis	Pharmaceuticals
Grupo Gloria	Food	PepsiCo, Inc	Food
Guidant Corp.	Medical Instruments	Pratt & Whitney	Software
Hamilton Sundstrand Corp.	Electrical Instruments	Sears Roebuck & Company	Electronic Products
Hubbell Incorporated	Electrical Instruments	Standard Motor Products, Inc	Motor Vehicle Parts
Ingersoll-Rand Co.	Electrical Instruments	Symmetricom Inc.	Electronic Equipment
Nypro International	Electronics	Thomas & Betts Corporation	Electronical Instruments
Patheon Inc.	Pharmaceuticals	Warner Chilcott PLC	Pharmaceuticals
Procter & Gamble Co	Pharmaceuticals	West Pharmaceutical Services	Pharmaceuticals
		Winston-Salem Industries for the Blind, Inc.	Apparel

¹ Based on the last employment figures reported by each company to PRIDCO.

Source: PRIDCO; Economic Analysis and Strategic Planning Area

SERVICES

Puerto Rico has experienced significant growth in the services sector, which includes finance, insurance, real estate, wholesale and retail trade, tourism and

other services, in terms of both income and employment over the past decade, showing a favorable trend as compared with certain other industrialized economies. During the period between

fiscal years 2004 and 2008, the gross domestic product in this sector, in nominal terms, increased at an average annual rate of 4.7%. The services sector ranks second to manufacturing in its

contribution to gross domestic product, and it is the sector with the greatest employment. In fiscal year 2012, services generated \$38.3 billion of gross domestic product.

Commonwealth of Puerto Rico Gross Domestic Product by Service Sector* (in millions at current prices)					
	Fiscal Years Ended June 30				
	2008	2009	2010	2011	2012 ⁽¹⁾
Wholesale and retail trade	\$7,520	\$7,313	\$7,466	\$7,599	\$7,636
Finance, insurance and real estate	\$20,218	\$18,765	\$19,026	\$20,129	\$20,766
Other services ⁽²⁾	<u>\$8,938</u>	<u>\$9,049</u>	<u>\$9,181</u>	<u>\$9,683</u>	<u>\$9,918</u>
Total	<u>\$36,677</u>	<u>\$35,127</u>	<u>\$35,673</u>	<u>\$37,411</u>	<u>\$38,319</u>

* Totals may not add due to rounding. (1) Preliminary. (2) Includes tourism. Source: Puerto Rico Planning Board.

In Puerto Rico’s labor market, self-employment, which is not accounted for in the Payroll Survey, represents approximately 15% of total employment according to the Household Survey. Most of the self-employed are concentrated in the service and construction sectors. The development of the services sector has been positively affected by demand generated by other sectors of the economy, such as manufacturing, construction and agriculture. The services sector in Puerto Rico has a diversified base.

The high degree of knowledge, skills, and expertise in professional and technical services available in Puerto Rico places the Island in a favorable competitive position with respect to Latin America and other trading countries throughout the world.



Employment in services has remained fairly stable, experiencing a minor decrease in 2012 when compared to 2008, but experiencing growth in the last three years as reflected in the table below. Trade, Transportation and Utilities, Retail Trade, Education and Health are the biggest generators of employment.

Commonwealth of Puerto Rico
Non-Farm Payroll Employment by Services Sector*
 (thousands of persons age 16 and over)

	Fiscal Years Ended June 30,				
	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012(1)</u>
Wholesale Trade	33,717	33,267	32,533	31,983	31,467
Retail Trade	130,883	127,492	126,233	128,017	128,117
Trade, Transportation & Utilities	181,342	176,450	173,317	174,333	174,150
Information	21,442	20,217	18,783	18,733	18,650
Finance	48,483	48,492	45,808	43,708	44,425
Professional and Business	108,150	103,333	102,508	105,592	108,800
Educational & Health	108,550	109,992	111,333	114,108	117,550
Leisure & Hospitality	73,408	70,933	70,850	71,150	72,633
Other services	<u>21,217</u>	<u>20,117</u>	<u>18,758</u>	<u>17,925</u>	<u>17,558</u>
Total	727,192	710,292	700,124	705,550	713,350

* Totals may not add due to rounding. (1) Preliminary. Source: Department of Labor and Human Resources, Benchmark on Employment, Hours and Earnings.

HOTELS AND RELATED SERVICES – TOURISM

The number of non-resident persons registered in tourist hotels during fiscal year 2012, was 1,508,000, an increase over the number of persons registered in fiscal year 2011. The average occupancy rate in tourist hotels during fiscal years 2012 was 70.3%.

San Juan is the largest homeport for cruise ships in the Caribbean and one of the largest homeports for cruise ships in the world.

The following table presents data relating to visitors to Puerto Rico and tourist expenditures for the five fiscal years ended June 30, 2012.

Commonwealth of Puerto Rico
Tourism Data⁽¹⁾
 Number of Visitors

	<u>Tourist Hotels</u>	<u>Cruise Ship</u>	<u>Others⁽²⁾</u>	<u>Total</u>	Total Visitors' Expenditures (in millions)
<u>Fiscal Years Ended June 30,</u>					
2008	1,342,810	1,496,853	2,373,436	5,213,099	\$3,341
2009	1,277,749	1,232,010	1,905,503	4,415,262	\$3,002
2010	1,349,449	1,193,549	1,836,157	4,379,155	\$3,039
2011	1,408,536	1,165,758	1,639,379	4,213,673	\$2,973
2012	1,507,984	1,127,842	1,561,103	4,196,929	\$3,025
2013 (p)	1,586,089	1,038,024	1,613,583	4,237,696	\$3,178

(1) Only includes information about non-resident tourist registering in tourist. They are counted once even if registered in more than one hotel.

(2) Includes visitors in homes of relatives, friends, guesthouses, and in apartments. (p) Preliminary.

Source: Puerto Rico Planning Board. Puerto Rico Tourism Company.



The Commonwealth, through the Convention Center District Authority, has completed the development of the largest convention center in the Caribbean, and the centerpiece of a 100-acre, private development, to include hotels, restaurants, cinemas, office space and

housing. The convention center district is being developed at a total cost of \$1.3 billion to improve Puerto Rico's competitive position in the convention and group travel segments. The convention center opened on November 17, 2005, there is one major hotel in operation and a second one to be opened during 2014.

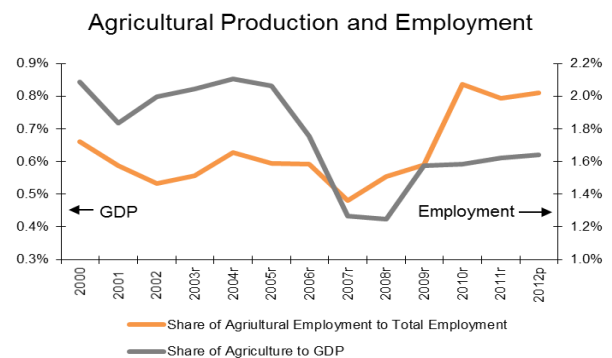
The Convention Center District Authority also controls a multi-purpose coliseum located in San Juan. The coliseum, known as the Jose Miguel Agrelot Coliseum, was inaugurated in 2004 and has been host to a large number of artistic and other events.

AGRICULTURE

The Department of Agriculture and related agencies have directed their efforts at increasing and improving local agricultural production, increasing efficiency and the quality of produce, and stimulating the consumption of locally produced agricultural products. During fiscal year 2008, gross income from agriculture was \$792.0 million, and has remained at that level. Agriculture gross income consists of the total value of production in the principal agricultural sectors, which include coffee, livestock products, legumes, fruits, starchy vegetables, other vegetables, ornamental plants, and other products.

Agriculture accounts for a very small share of employment, less than 2% of total employment (Household Survey),

and has been declining since the 1980's. Although agriculture still retains its importance in the local economy, that importance has declined considerably over the past decades. As of fiscal year 2012, the share of the agricultural sector in the island's GDP in 2008 was 0.4%, and farm employment represents only 1.2% of total employment.



The Commonwealth supports agricultural activities through incentives, subsidies, and technical and support services, in addition to income tax exemptions for qualified income derived by bona fide farmers. A number of recent initiatives by the government to stimulate the agro-industrial sector include operating a rice growing operation in the South west and initiating sugar cane farming in the Northwest, among others.

Act No. 225 of 1995 provides a 90% income tax exemption for income derived from agricultural operations, an investment tax credit equal to 50% of the investment in qualified agricultural projects, and a 100% exemption from excise taxes, real and personal property taxes, municipal license taxes and tariff payments. It also provides full income tax exemption for interest income from

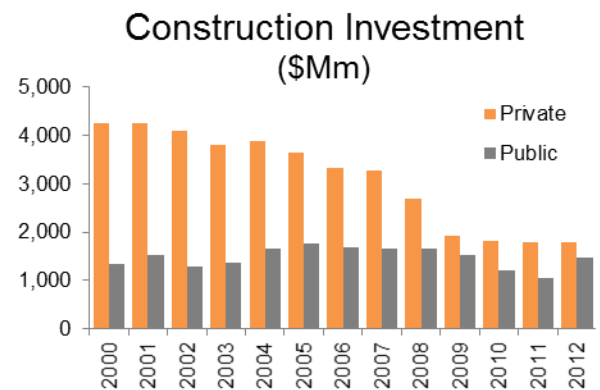
bonds, notes and other debt instruments issued by financial institutions to provide financing to agricultural businesses. Subsequent legislation imposed an aggregate annual limit of \$15 million on the investment tax credits available under Act No. 225.

Policy changes, in addition to the two mentioned above, have been implemented to promote employment and income generated by the agricultural sector. The policy initiatives include a restructuring of the Department of Agriculture, an increase in government purchases of local agricultural products, new programs geared towards increasing the production and sales of agricultural products, and a new system of agricultural credits and subsidies for new projects.

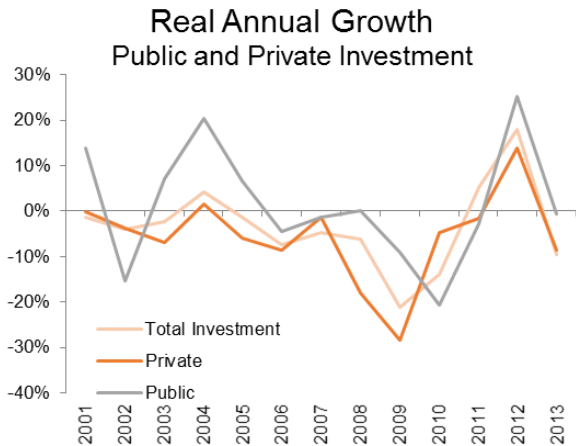
CONSTRUCTION

Although the construction industry now represents a relatively small segment of the economy compared to other sectors, it had made significant contributions to the growth of economic activity, due to its multiplier effect on the whole economy. During the period from fiscal year 2004 through fiscal year 2012, construction investment has decreased at a significant rate. Total construction investment for fiscal year 2012 decreased for both public and private sectors and since 2004 has fallen by approximately \$3.2 billion. The two following graphs tell the story of

the sector that has been most affected by the contraction in the economy.



Source: Puerto Rico Planning Board.



Public investment has been an important component of construction investment. During fiscal year 2008, approximately half of the total investment in construction

GOVERNMENT

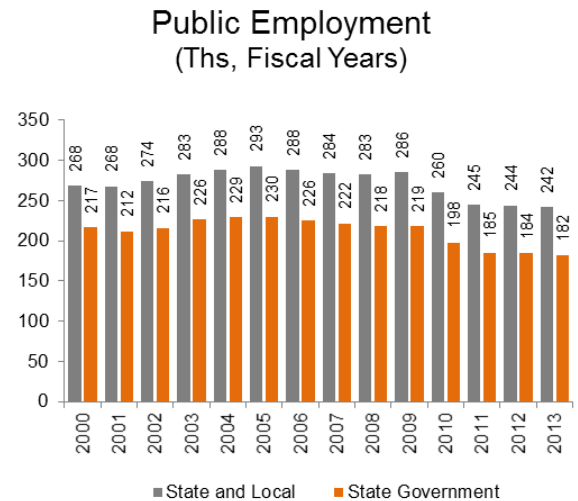
The government sector (including municipalities) of Puerto Rico plays an important role in the economy. In fiscal year 2013, the government accounted for 242,000 or approximately 25% of Puerto Rico’s total employment, even though there has been a significant decrease since 2009.

On February 25, 1998, legislation was enacted permitting the unionization of employees of the central government (excluding municipal employees). Under this law, government employees are given collective bargaining rights subject to a number of limitations. Among those limitations are: employees are prohibited from striking; salary increases are contingent on the availability of budgeted revenues; employees cannot be required

was related to public projects. For fiscal year 2008 compared to fiscal year 2007, the total value of construction permits increased 12.9% and total sales of cement, including imports, decreased 10.7%, the largest decline during the last decade. Average payroll employment in the construction and mining during fiscal year 2008 was 66,700, a reduction of 1.0% from fiscal year 2007.

Recent indicators continue to reflect weakness in the sector with cement sales being 18.0% below last year when comparing December 2013 with the same month in 2012, the lowest level in decades.

to become union members and pay union dues; and collective bargaining negotiations cannot occur in an election year.



Source: US BLS, Establishment Survey.
*Including Public Corporations.

HIGHER EDUCATION

During the five decades from 1950 to 2000, Puerto Rico made significant advances in the field of education, particularly at the college and graduate school level. The transformation of Puerto Rico during the 1950s and 1960s from an agricultural economy to an industrial economy brought about an increased demand for educational services at all levels. During the 1970s and 1980s, certain higher wage, higher technology industries became more prominent in Puerto Rico. More recently, employment in the services sector has increased significantly. This has resulted in an increased demand for workers having a higher level of education and greater expertise in various technical fields. During the same time period, enrollments in institutions of higher learning rose very rapidly due to growth in the college-age population, and the increasing proportion of college attendance by such population. During the 1990s and into the current decade, college attendance and college attendance as a percentage of the college-age population continued to increase. The college-age population has declined since 2000.

The table in the next page presents comparative trend data for Puerto Rico and the United States with respect to college-age population and the percentage of that population attending institutions of higher learning. The University of Puerto Rico, the only public

university in Puerto Rico, has eleven campuses located in Puerto Rico. The University's total enrollment for academic year 2007-2008 was approximately 63,205 students. The Commonwealth is legally bound to appropriate annually for the University of Puerto Rico an amount equal to 9.60% of the average annual General Fund revenue for each of the two fiscal years immediately preceding the current fiscal year.



In addition to the University of Puerto Rico, there are 60 public and private institutions of higher education in Puerto Rico. Such institutions had an enrollment during academic year 2012 of approximately 265,000 students and provide programs of study in liberal arts, agriculture, education, business, natural sciences, engineering, technology, secretarial and computer sciences, nursing, medicine, and law. Degrees are offered by these institutions at the associate, bachelor, master, and doctoral levels.

Enrollment at other postsecondary education programs, including technical

and vocational programs include enrollment at federal Title IV eligible, nondegree granting institutions reporting data to the National Center for Education Statistics (Integrated Postsecondary Education Data System).

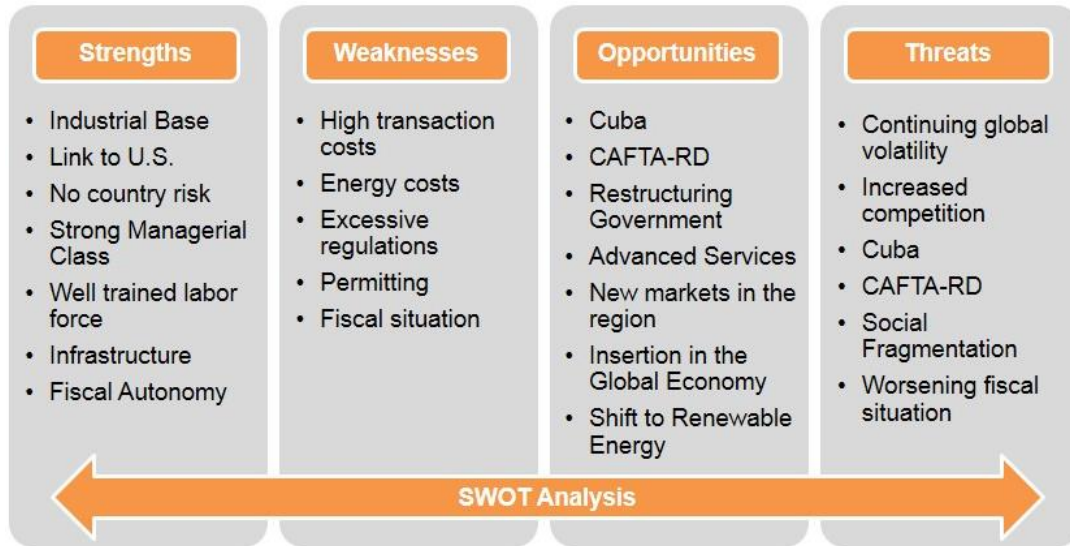
Institutions providing education in Puerto Rico must satisfy state licensing requirements to operate. Also, the vast majority of educational institutions are accredited by USDE-recognized accrediting entities

Commonwealth of Puerto Rico Trend in College Enrollment						
Academic Year	Commonwealth of Puerto Rico			Mainland United States		
	Population 18-24 Years of Age	Higher Education Enrollment	Percent ⁽¹⁾	Population 18-24 Years of Age	Higher Education Enrollment	Percent ⁽¹⁾
1970	341,448	57,340	16.8%	23,714,000	8,580,887	36.2%
1980	397,839	130,105	32.7%	30,022,000	12,096,895	40.3%
1990	417,636	156,147	37.4%	26,961,000	13,621,000	50.5%
2000	428,892	203,850	41.0%	27,143,455	15,313,000	56.4%
2001	426,194	228,534	43.4%	27,971,000	15,928,000	56.9%
2002	423,852	236,377	45.0%	28,463,000	16,612,000	58.4%
2003	420,295	232,527	47.5%	28,947,000	16,900,000	58.4%
2004	416,020	236,380	49.8%	29,245,000	17,272,000	59.1%
2005	411,580	249,732	50.5%	29,307,000	17,487,475	59.5%
2006	407,134	247,286	51.5%	29,312,950	17,758,870	60.3%
2007	396,057	246,886	56.9%	29,492,415	18,248,128	60.9%
2008	398,003	254,744	64.0%	29,636,552	19,102,814	64.5%
2009	398,788	266,403	66.8%	29,838,236	20,427,711	68.5%
2010	375,145	270,792	72.2%	30,672,088	21,509,470	70.1%
2011	381,744	271,938	71.2%	30,660,377	21,497,218	70.1%
2012	379,106	264,914	69.9%	30,913,871	21,185,336	68.5%

(1) Number of persons of all ages enrolled in institutions of higher education as percent of population 18-24 years of age. Source: United States Census Bureau (Mainland United States Population), United States National Center for Education Statistics, Planning Board (puerto Rico Population) and Council on Higher Education of Puerto Rico.

SECTION III: ANALYSIS OF ECONOMIC DEVELOPMENT PROBLEMS AND OPPORTUNITIES

ECONOMIC DEVELOPMENT PROBLEMS AND OPPORTUNITIES



Fulfilling Puerto Rico's development potential requires knowing precisely what its strengths and weaknesses are and

identifying environmental threats and opportunities. (Appendix I, provides additional statistical information).

STRENGTHS

Over the past thirty years, Puerto Rico has developed a strong industrial base characterized by sophisticated, high technology industries. This includes a major concentration of pharmaceutical firms and biotechnology, medical instruments and more recently aerospace activities. In fact, a number of major firms in these industries have their principal manufacturing base in the Island, the case with Amgen, for example.

The Island's character as a regional economy of the United States provides it with a strong competitive advantage vis a vis other locations in the region at the same time that it shares with the other 50 states similar access to U.S. legal, regulatory and program initiatives. It has meant that bilingualism (Spanish and English) prevails in the working population.

Perhaps the major advantage lies in the fact that being part of the United States economy makes Puerto Rico a location

with zero country risk. Given the uncertainty that characterizes the global economy, this is a major attraction for external investment in sectors such as manufacturing and tourism. In addition, and taking into account its privileged geographic position, it places Puerto Rico in a particularly favorable position to become a trade and logistics hub in the region and a major exporter of advanced services.

One of the Island's major strengths is the fact that its rapid industrial development over the past thirty years has provided it

with a world class managerial group and a well-trained and sophisticated work force.

Although much remains to be done, the fact is that the Island has adequate physical infrastructure that is continually being improved upon. The Public Private Partnership mechanism provides a means for continuing to improve infrastructure in a restrained fiscal environment. The present Administration is committed to using PPPs for “greenfield” projects that will generate investment and jobs.

WEAKNESSES

Perhaps the Puerto Rican economy's major weakness at this point in time is the serious fiscal situation that it shares with, but is worse than that of many other states. This has created a serious constraint on the flexibility of government to initiate new programs, while at the same time it has meant putting in place very strict fiscal measures aimed at reducing public sector costs and generating new income through various tax measures.

Puerto Rico is a high transaction cost location due primarily to the very large influence of government and an extremely cumbersome regulatory framework, including the permitting

process. Although steps are being taken by the Administration to deal with these issues, fully implementing these measures will take some time.

The cost of electricity is very high in Puerto Rico, over twice the average cost in the mainland, due to a number of factors but primarily because the Electric Power Authority has been the single electricity provider in the Island for decades and because of the high proportion of energy that is petroleum based (70%). New initiatives to address this weakness are discussed later in the document, and have been put in place to deal with both of these conditions.

OPPORTUNITIES

This document addresses the opportunities that present themselves to Puerto Rico and lays out the strategies and programs to fulfill these opportunities.

The Island's economic future hinges on how successful the Government is in laying the groundwork through an appropriate legal and regulatory framework for private enterprise to develop fully its capabilities in activities generally associated with knowledge based economic development. This does not necessarily mean dealing exclusively with multinational high technology firms, but rather with creating the conditions for innovation across the many sectors. Puerto Rico has developed a strong advanced services infrastructure and is well positioned to become a regional powerhouse in areas such as financial and legal services, US trade regulations, US Customs Brokers services, medical, educational, environmental, design, engineering, project management, communications and information technology related services.

Both CAFTA+DR and the eventual opening of Cuba to the market economy provide major opportunities for Puerto Rico in areas associated with the advanced services mentioned and in providing expertise in manufacturing processes. Taking advantage of these opportunities will require planning and coordination with the private sector.

Some specific activities in which Puerto Rico has the wherewithal to experience growth include the development of those related to renewable energy, not only in manufacturing but in product development and services. In terms of exports, as has been mentioned earlier, the Island has substantial opportunities in areas such as engineering, validation, financial, business, legal and educational services.



The shift to non-fossil energy sources offers major opportunities not only in terms of a diversified, less costly energy system, but also as a generator of economic activity. Likewise, a concerted strategy for inserting Puerto Rico in the global economy will generate major opportunities for local manufacturing and advanced services. Puerto Rico will need to improve transportation links and identify specific areas in which it has competitive advantage to successfully integrate its economy in the regional and global economies. The government's new economic strategy identifies

advanced services as one sector in which those competitive advantages exist.

THREATS

There are, of course, threats and, while CAFTA+DR and the opening of Cuba present opportunities, they also present significant threats to the Island's economy. By becoming part of CAFTA+DR, the countries reduce the level of country risk significantly to U.S. and other investments and, given the much lower labor costs in these countries, they become very attractive for more labor intensive manufacturing. In agriculture, the competition from these countries is already a major factor.

In the case of Cuba the threats are concentrated in two areas: tourism and the pharmaceutical/biotechnology industries. Tourism is already highly developed in Cuba and almost certainly an open Cuba will prove a very attractive location initially because of the novelty factor. Cuba has also developed R & D capacity in pharmaceutical and biotechnology related areas and this is bound to prove attractive to firms in the sector. However, it has very little or no manufacturing capacity. The construction of a major port in Mariel, financed mostly by Brazil, will position Cuba very favorably when trade opens up with the United States.

Law 20 of 2010 offers significant incentives for service export activities.



Puerto Rico shares with other states and countries the threats that result from an uncertain and much more competitive global environment. One consequence of the very serious economic situation of the last two years will be a more fragmented world in which countries such as India and China will become more formidable competitors.

A major threat facing Puerto Rico is its weakened fiscal and financial situation, the result of many years of using debt as a way of mitigating the effects of poor economic management. Total public debt is now 100.0% of GNP and rating agencies had been warning about a downgrade to junk status for a number of years. At the time this report is being written – March, 2014 – Puerto Rico's public debt is now below investment grade with two exceptions, debt supported by the sales and use tax and that of the Electric Power Authority.

GUIDING PRINCIPLES

Any development effort must be based on clearly expressed principles that lay out the fundamental beliefs that underlie the strategies to be developed. The

Government of Puerto Rico understands that these guiding principles are the following:



The market has to play the major role in defining development possibilities and guiding actions. Obviously, there are market failures and the government has to assume a more active role when the conditions exist that generate these failures, for example, absence of competitive conditions in a particular activity. Nevertheless, development has to be market driven.

The Government's role is primarily to assure that the institutional framework provides for conditions to exist that promote economic development and for maintaining a social and physical environment that maximizes the welfare of the population. It should, however, except for very special situations, abstain from the task of allocating society's

economic resources, which should be left primarily to the private sector.

Developing a strong local entrepreneurial foundation is considered a key requirement for sustainable economic development. A number of programs are in place to support its development, including the Economic Development Bank's incursion in venture capital initiatives, the establishment, together with the BBVA Foundation, of a program for micro-loans, the Federal Reserve of New York's program with Sacred Heart University whose aim is to promote entrepreneurial know how among intermediate and high school students. The Economic Development Center at UPR Mayaguez has been instrumental in

developing an interest in entrepreneurship in Puerto Rico.

The future of Puerto Rico's economy hinges on its ability to innovate and to improve productivity, both of which are highly interconnected. Innovation has to be the keystone of economic development policies in the present and

prospective global environment. To the extent that Puerto Rico is able to generate the conditions for becoming an innovation driven economy it will be successful and will at the same time generate the conditions for improved productivity across all sectors and activities.

GOALS AND OBJECTIVES

Specific goals and objectives are described below. There is, however, recognition that the overall economic development model that Puerto Rico has depended on must be transformed. Historically, the development process was tax incentives driven and focused on attracting capital from abroad. It was also based on low labor costs and on the fact that Puerto Rico had privileged access to the U.S. market. The Island is no longer a low labor cost location and access to the U. S. market is now much broader given the overall reduction in barriers to trade.

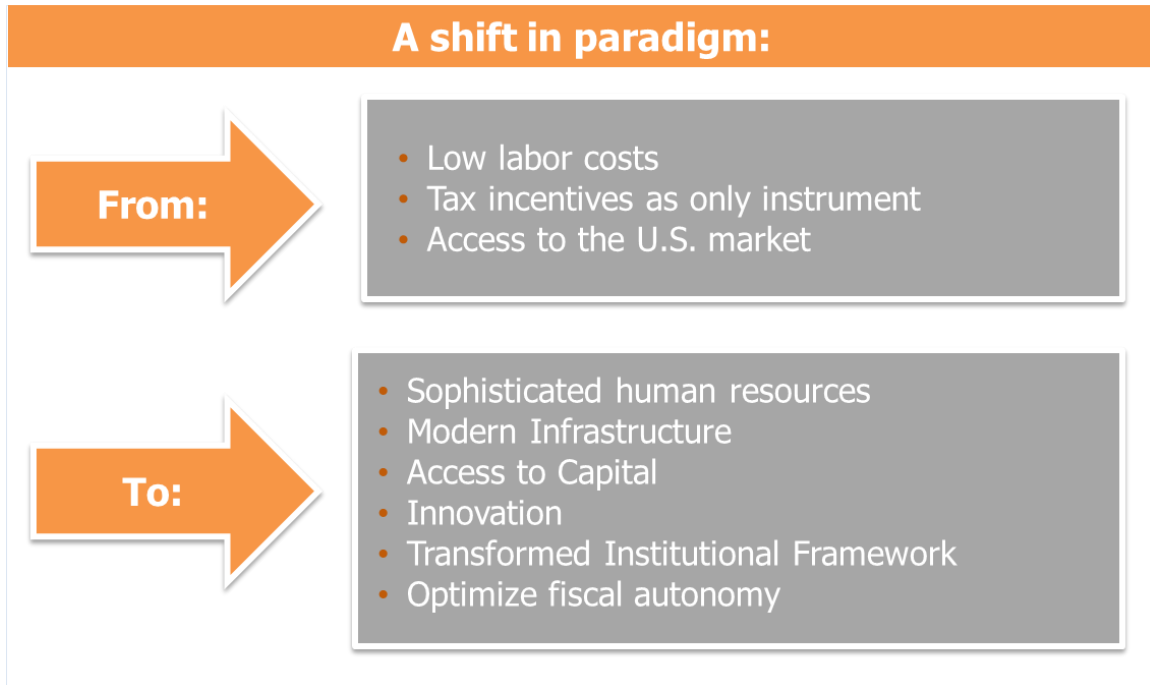
That model served Puerto Rico well through the sixties but it is now clear that changing global competitive conditions call for different approaches to economic development. In fact, tax incentives, although still being offered by most of Puerto Rico's competitors, are not the major determinants of location decisions for potential investors. The key factors influencing the location of economic

activity have to do with meeting certain minimal conditions with respect to infrastructure, education and health services, science and technology capability, and agile, transparent and effective government.



Nevertheless, the present Administration has made it clear that it will utilize Puerto Rico's fiscal autonomy to pursue economic development. It is already doing so by applying Laws 20 and 22, the first to stimulate service exports and the latter to attract investment from new residents in the Island, attracted by tax incentives and a favorable business environment.

OVERARCHING GOALS



The State of Florida exemplifies many of these conditions and has been successful in transforming itself from a two industry economy - tourism and agriculture - to a more diversified industrial economy with a strong high technology component. It has done so by innovating in the manner in which it has organized its economic development process.

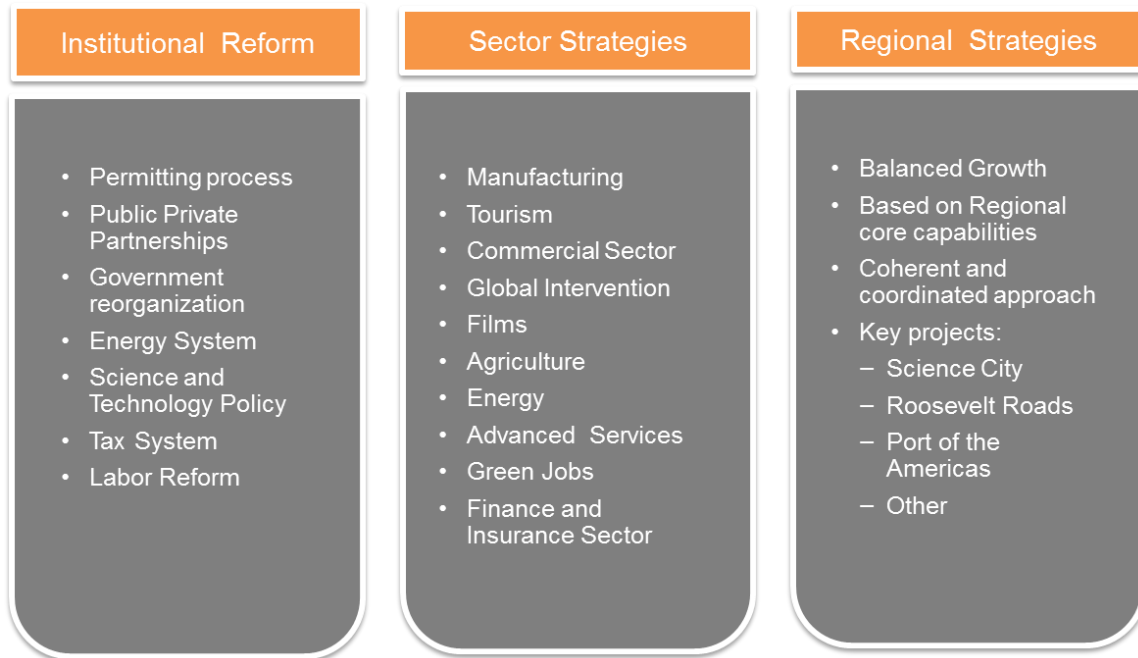
The overall vision that will guide Puerto Rico's economic development efforts is to achieve an economy that is characterized by:

- Global competitiveness
- A strong local entrepreneurial foundation
- Migration to a Knowledge Based Economy
- Environmental sustainability
- Integrated social development
- Broad consensus on goals and objectives

In order to achieve this vision, the Administration has developed strategies that are outlined in the next section.

SECTION IV: STRATEGIC PROJECTS, PROGRAMS AND ACTIVITIES

The Three main areas of government intervention are reflected in the following chart and are described in detail below.



INSTITUTIONAL REFORM

Over the years and in various reports on global competitiveness (World Economic Forum) and the ease of doing business (World Bank), one of the persistent problems identified is the difficulty of obtaining a construction permit in Puerto Rico. It is a cumbersome, complex and intractable system that has evolved over the years into an incoherent mass of regulations and processes. The García Padilla Administration has made reforming the permitting process a very high priority in this first year and has

amended the existing legislation to make it more agile and responsive. It calls for a much more transparent process that should assure much faster and better decision-making. The completion of an island-wide land use plan will be a major contributor to improving the permitting process.

As mentioned earlier, one key institutional reform was the approval of legislation that makes possible Public Private Partnerships (Law 29 of May,

2009). This Law makes it possible for the Government to use private sector financing and expertise in expanding and improving the Island's infrastructure as well as a host of other government activities. Public Private Partnerships have a number of characteristics and benefits, including:

- Access to private sources of financing
- Risk is allocated between government and private partner
- Brings private sector expertise and operating procedures to public initiatives
- Facilitates long term planning, particularly in infrastructure

Although risks exist, Puerto Rico is not starting from zero and there are many experiences, both local and from other jurisdictions that provide valuable lessons.

Puerto Rico's Law 29 establishes public policy concerning PPP's and specifies the components of PPP's considered necessary for success. The Law also provides for transparency in the selection procedures and establishes the procedures to assure effective implementation. The present Administration has made it clear that it will emphasize "greenfield" projects, two of which are presently under consideration, building a train between Caguas and San Juan and extending PR-22 to the municipality of Aguadilla.

In the area of Institutional Reform, Governor García Padilla issued an Executive Order creating a Commission to formulate a decentralization strategy. The report of the Commission calls for regionalizing a number of services and creating two regions as pilot projects. The needed legislation will be approved during 2014.

With respect to labor, a key emphasis is increasing the Island's labor force participation rate that, as mentioned above, is well below that of the United States as a whole and most states. In addition to the earned income tax credit, other programs will be put in place to stimulate entry into the formal work force. The Government has adopted a Jobs Bill that provides significant incentives for job creation and that has had a mitigating impact on the deteriorating job situation.



Energy costs are considered to be a key obstacle to economic growth and steps have already been taken to deal with this problem. Law 73, the Incentives Law approved in May of 2008 contains a number of measures aimed at facilitating the shift from fossil based fuels to renewable sources of energy. Other laws were approved to promote moving away

from fossil fuels and stimulating competition in energy production and distribution. Both the Executive and legislative branches have put forth initiatives dealing with restructuring the Puerto Rico Electric Power Authority (PREPA) and new legislation will be adopted for this purpose.

The Administration's plans call for changes in the tax system to make it both more effective in obtaining revenues and less of a burden on citizens and businesses. Governor García Padilla created a Fiscal Reform Commission that is to submit its recommendations by December 31, 2014. Its task is to simplify the tax system and make it less costly to businesses and individuals in terms of compliance.

In addition, fiscal procedures are being simplified to reduce paperwork and bureaucratic obstacles that increase

transaction costs for businesses and create hardships for ordinary citizens.

The Chief Information Officer in the Office of the Governor is working closely with the Office of Management and Budget to simplify procedures and provide greater capacity to coordinate decisions in this area and will improve the implementation capabilities in the Government with respect to technology decisions. There has been a great deal of progress in securing access to broad band throughout the Island.

There is a commitment to strengthen the Science, Technology and Research Trust as a key player in designing Puerto Rico's future as a knowledge based economy. Some specific projects include a Comprehensive Cancer Center under construction, and continuing the development of the Science City Project that will include a number of research and higher education centers.

SECTOR STRATEGIES

Manufacturing: Over the last decade manufacturing employment has fallen from a high of 160,000 to the present 70,000. This loss has had a major impact on the Island's economy for these were typically well paying jobs. In addition it reflects the need for rethinking the future of manufacturing in Puerto Rico's economy. The Administration's plans, as mentioned above, call for the approval of a Science and Technology Policy to guide efforts that will support moving to knowledge based economy. In addition

PRIDCO, the government agency primarily responsible for promoting manufacturing activity, will put in place a number of measures to assure future growth of the sector. These include, among other specific initiatives:

- An aggressive plan to assure that new pharmacy or bio-tech product-lines are manufactured in Puerto Rico.
- Diversifying the industrial base and focusing on fast growing activities

such as health care, medical instruments, renewable energy, and aerospace.

- The integration of advanced services into PRIDCO's promotional initiatives
- Emphasize completion of locally based supply chains so that the value chain of manufacturing is fully realized in Puerto Rico

Tourism: Although tourism has grown in the recent past, it continues to reflect weaknesses in a number of areas, including the absence of a consistent brand identity, high costs of operation, problems related to obtaining permits for new hotels, lack of consistency in quality and others. The Administration's plans call for a new branding exercise, better quality controls, promoting cruise ship tourism, diversifying markets and products, promoting nautical tourism, promoting the increase of Port Calls, development of home port use and generating attractions outside of Metropolitan San Juan. A major initiative of the present Administration is to diversify air routes to and from Puerto Rico to improve connections with Europe and Latin America. This has already, by late 2013, attracted new airlines to the Island.

Commerce: The Administration is fully committed to a number of initiatives aimed at strengthening the local commercial sector. These include the improvement of the permitting process related to starting a new business,

reducing bureaucratic obstacles, providing assistance to small and medium size businesses for improvement of management practices, and making available to these firms financing for expansion and export activities. The Puerto Rico Trade Company, in collaboration with the Economic Development Bank, has in place a number of programs aimed at supporting entrepreneurial initiatives through financing and support in improving their management and marketing capabilities. Together with the foundation of Spanish bank BBVA, the EDB established a program for micro loans to support very small enterprises. Legislation has been proposed to stimulate growth by local commercial firms that have been hard hit by the economic contraction and by the entrance of the "big box" retailers into what can be classified as a "zero sum" market.



Global insertion: It has become clear that regional economies such as Puerto Rico's have to be effective in inserting themselves in the global economy, not only through exports but also by having local firms insert themselves in the

supply chains of global enterprises located in the Island as well as off-Island. Achieving success in this endeavor will require changes in the Puerto Rico Trade Company and in some of the current laws and regulations. Measures such as increasing facilities in the Free Trade Zones are already under way and an aggressive training program on globalization and international trade is in place. The Puerto Rico State Department, in collaboration with the Department of Economic Development and Commerce, has recast its role in promoting Puerto Rico's insertion in the global economy and has put forth a number of initiatives to stimulate exports and to facilitate the entry of local firms to markets abroad.



Film and Creative Industries: Over the recent past, Puerto Rico has served as the location for filming a number of movies (*The Rum Diary*, *Meant to Be*, *One Hot Summer* and *Store of Dreams*, among others). Although the existing legislation has proven to be adequate, changes will be made to make certain that Puerto Rico is competitive as a site for movie production. The industry is a welcome addition to Puerto Rico's development since it pays high salaries and the Island has an ample supply of highly trained individuals in the required skills. This Administration, however, also sees the need not just for attracting movie production to the Island, but for generating endogenous capacity in the film industry as part of a more broadly conceived "creative economy" sector.

Agriculture: Measures to stimulate agricultural production include strengthening investment in the sector, protecting land with agricultural potential, stimulating the introduction of technology and improving management practices among others. The Governor recently signed legislation that will stimulate technology transfer in the sector. Puerto Rico has a well developed agro-industrial sector in fields such as dairy production, the production of fruit juices and the production and export of premium coffee. U.S. Farm Bill funds are looked upon as a potential source of support for increasing agriculture's contribution to GNP, now less than 1.0% and employment approximately 15,000, according to the lasted Planning Board figures. Efforts are being made to grow

rice and sugar cane as part of the initiatives in the sector.

Energy: The Puerto Rican Government is committed to an energy policy that places a high priority on moving towards alternative sources of energy. To that effect, Law 73 of May, 2008 provides incentives to stimulate competition in the energy production and distribution sector and for the use of renewable energy sources. Specific targets have been adopted in terms of the sources of energy and Puerto Rico expects to be generating 17% of its electrical energy needs from renewable sources by 2017. This new emphasis not only has as its main objective lowering energy costs in Puerto Rico and reducing dependence on petroleum, but also provides the potential for directly generating jobs in Research and Development, manufacturing and operation of the new systems. The government is aware of the need to develop "green jobs", i.e., jobs in activities that are either environment friendly or that arise from activities that generate environmental benefits such as, for example, energy from renewable sources. Legislation will be approved in

2014 that will stimulate the rise of non-fossil fuels and provide for greater transparency in decision-making at the PR Electric Power Authority.

Advanced Services: Moving to a knowledge based economy means developing the required infrastructure (broad band access and improved telecommunications, for example) and those advanced services that support it, but that also provide great opportunities for exporting and completing the value chains of multinational firms. Some key advanced services are: communications and information technologies, validation services, environmental services, health care, engineering, design, financial, legal, insurance and business support services, educational activities (including research and development), logistics and construction management. Strategies that focus on these services are being put in place in order to maximize opportunities locally and in export markets in the region. The Government is making a concerted effort to strengthen the science and technology infrastructure, in particular the Science, technology and Research Trust Fund.

PUERTO RICO REGIONAL STRATEGIES

The Administration has made balanced economic growth a major priority and it thus seeks to initiate major development projects in the various regions in order to generate economic activity throughout the Island. The Commission on Decentralization, previously mentioned, is charged with developing the needed

actions to achieve decentralization goals. Some key projects are the following:

Roosevelt Roads: This project calls for major investments in transforming the former Roosevelt Roads Base into a regional tourism based economic development project. It will provide the

foundations for regional development in Southeast Puerto Rico as well as the two island municipalities of Vieques and Culebra. RFP's for initial projects have been prepared and it is expected that a number of activities will commence in the former Navy Base in 2014 and 2015.

The Port of the Americas: The first phase of the port development was completed in 2004 while the second phase, which resulted in container yard with capacity of up to 250,000 Twenty-Foot Equivalent Units per year, was completed in March 2009. The completion of the port's rehabilitation will result in an annual terminal processing capacity of up to 500,000 Twenty-Foot Equivalent Units as well as the installation of basic infrastructure required to develop an industrial value-added zone on land adjacent to the Port. The project is a state of the art port facility capable of handling Post Panamax ships. Together with the Port, a Value Added zone will be developed adjacent to the Port, to generate traffic for the Port and economic activity for the region. Recently approved legislation establishes clearer lines of responsibility for the Port between the Municipality and the Central Government. The Secretary of Economic Development and Commerce chairs the Port of the Americas Board.

Science City: This is the flagship initiative of Puerto Rico Science, Technology and Research Trust, which was created pursuant to Act 214 of 2004. Science City represents a critical part of the Administration's efforts to move

Puerto Rico to the forefront of the science, technology and research and development. A Molecular Biology building has been completed and work has begun on a Cancer Center with an investment estimated at \$193 million. These developments seek to leverage the significant competitive advantages in these knowledge-based sectors that put Puerto Rico in an ideal position to undertake a more proactive role in providing advanced services in the Caribbean region. Among the factors that support this:

- An established and growing life sciences industry: within the entire United States, Puerto Rico employs the second highest number of workers in the life-sciences industry.
- A global center of pharmaceutical manufacturing: 25% of all pharmaceutical products shipped worldwide are manufactured in Puerto Rico.
- A home to world class infrastructure and centers of scientific innovation and excellence: for example, Puerto Rico's New Molecular Science Lab and Cancer Center.
- A top tier education system: the University of Puerto Rico graduates 9,000 science and engineering majors each year.

Ramey: The objective is to redevelop the Aguadilla Airport, a former SAC base, as the second most important International

Airport of Puerto Rico and as a regional logistics center. It already is home to cargo related activities as well as passenger traffic and a number of peripheral activities have been developed.

These projects will be developed within the framework of a regionalization scheme that will provide for decentralization of certain central government activities and programs. Regionalization is considered a key component of the Administration's plans for government reform. It is also seen as an effective means of mobilizing local resources in support of economic development.

There are currently five regional initiatives built around identified regional core competences and their objective is to develop projects based on these. In some cases, projects will be regional in nature, in others (such as the Port of the Americas), of an island wide nature, although with significant regional impacts.

- INTECO, in central Puerto Rico has health services and medical instruments as its key sectors;

ACTION PLAN

The Administration has already put in place a number of measures to implement the strategies mentioned above. An initial priority was to deal with the fiscal situation and the government did so by cutting expenses, putting in

- INTENOR in the North has the pharmaceutical cluster in Barceloneta as its core;
- In the Northeast INTENE's strength is in the development of tourism and transportation;
- DISUR in the South is developing initiatives in areas such as logistics, agro-industry and health services, and
- PR-TEC in the West, the oldest of the initiatives, was developed around the concentration of various high tech industries in region, including the aerospace industry, and the existence of the UPR Mayaguez Campus and its strength in Engineering and Science.

These regional organizations represent strategic alliances between municipal governments, academia, and the business sector to promote and maximize Puerto Rico's competitiveness and sustained regional and local economic growth in the context of a global economy.

place new taxes and by a more aggressive use of PPPs.

The Governor has created a multi-sectorial Commission to deal with medium and long range economic and social development issues. The topmost

priority is job creation and the government committed to creating 50,000 new jobs in 18 months. In order to do so, as mentioned previously, legislation was approved that provides significant incentives for firms to generate jobs.

The responsibility for the Jobs Program was assigned to the Puerto Rico Trade Company and its Executive Director. The agency has established an aggressive campaign to educate both firms and individuals on the Law, but also to actively identify potential areas in which jobs can be created.

The Government is moving aggressively to transform the permitting process and the PR Planning Board has been working on completing an Island-wide Land Use Plan. This Plan will most likely be completed and adopted during 2014. Already a substantial number of municipalities have completed their land use plans and these will be integrated with the islandwide Plan.

As indicated previously, regionalization is a key component of the Administration's plans. In order to move forward in implementing a more decentralized scheme of government and empowering municipal and regional units, an implementation mechanism has been designed by the Commission charged with the putting together the decentralization plan. It has held roundtables with key institutions and individuals on the subject.

Puerto Rico received approximately \$6.4 billion in ARRA funds. Although these

funds propped up the economy, they had little impact on stimulating growth and job creation.

With respect to transportation initiatives, the implementation of the PPP legislation assumes mayor importance for it will support the implementation of a number of initiatives. The two key initiatives in transportation are the Caguas- San Juan train and extending PR-22 to Aguadilla. The former is already at a fairly advanced stage in terms of receiving proposals and the latter is in the process of completing the EIS.

The present Administration went ahead with the PPP for the Luis Muñoz Marín International Airport, negotiated by the previous Administration. Another key project is completing negotiations with a private operator to run the Port of the Americas, a state of the art facility in Ponce that will be able to handle Post Panamax ships and, as previously indicated, act as a major stimulus to regional economic development in the South. As stated previously, the central government has taken a more direct role in the development of the project. The previous Administration had turned over the project to the Municipality of Ponce.

With respect to improving the energy system, a number of initiatives are being considered for moving towards more sustainable production modes and the use of renewable sources. The Government is moving aggressively in this area and a number of measures have been put in place to implement changes. Among these: the creation of

an Interagency Working Group on alternative energy sources, the adoption of Renewable Portfolio Standards, the creation of a Renewable Energy Fund, implementing an incentive program to stimulate the production in Puerto Rico of equipment related to the use of renewable energy sources, and putting in place measures that will assure transparency in the energy production sector. Law 73, approved in May of 2008, already incorporates measures that will

help reduce energy costs and improve the efficiency of the system, including the promotion of co-generation and "wheeling".

The Government's CIO has placed a very high priority on improving access to Internet and Broadband, both of which are low (55% of households have Internet access) when compared to all states. A state Broadband plan has been prepared and is being implemented.

MONITORING PROGRESS

The PRPB, as previously mentioned, has the responsibility of producing the economic and social accounts for Puerto Rico, including Income and Product and the Balance of Payments. Although typically these provide the means to evaluate whether an economy is growing or not and, to some extent, the efficiency with which it does so, a more detailed set of metrics will be developed to monitor progress.

Effective evaluation will require the strengthening Puerto Rico's Information Infrastructure, task in which the Statistics Institute is playing a key role. The Island's statistical system is fragmented and somewhat obsolete. It also does not recognize the particular aspects which derive from the regional character of Puerto Rico's economy as part of the United States. Frequent complaints refer to tardiness in producing the required information for decision-making, in both government and the private sector.

Improving the Information Infrastructure is an Administration priority.

In addition, the gathering of strategic intelligence on the global, regional and U.S. contexts is essential. A key aspect of gauging progress is to continually benchmark with other states and identify "best practices" in those areas of special relevance to achieving CED's objectives. This will permit the PRPB and the Statistics Institute to place Puerto Rico in a broader framework and evaluate the effectiveness of policy initiatives in the context of what others are achieving.

Plan review and adjustment procedures are essential, and a component of the CEDS since it has in place procedures for evaluating progress and making the required adjustments. The present economic context calls for flexibility as a key component of planning and for developing what has been called the "foresight function". This permits identifying emerging trends and thus

taking the appropriate steps to adjust plans in view of these trends.

In addition to macro-economic indicators, employment and unemployment information and other indicators produced to gauge economic performance in the economy as a whole, the development of more specific metrics is called for. One possible scheme would call for a three level system with Indexes, Indicators and a Data Base. For example, if moving to a greater use of renewable energy sources is an objective, the data base would include

information on producers, users, costs and other such basic data. From this data base analytical indicators would be developed, for example, the percent of electric system users having access to energy from renewable sources. An Index would then be developed from the Indicators. This would permit a quick assessment of progress by looking at the Index, a somewhat more detailed view from the Indicators and detailed information from the data base. Although still in a very initial stage of development, the system can be graphically expressed in the following manner:

A possible scheme for organizing metrics					
	Economic Performance	Social wellbeing	Environmental Quality	KBE indicators	Productivity
Indexes					
Indicators					
Data Base					

SECTION V: IMPLEMENTATION PLAN

This section encompasses two dimensions of the CEDS, related to the role of the CEDS in overall government

economic development strategies and the specific operational activities to be carried out.

OVERALL ECONOMIC DEVELOPMENT STRATEGIES

The Administration of Governor García Padilla has put in place an aggressive development strategy aimed primarily at jump starting an economy that has been experiencing a prolonged and deep contraction. Its efforts have taken place together with putting in place fiscal measures aimed at balancing the budget and strengthening government liquidity. This has become particularly urgent after the degradation of Puerto Rico bonds in February, 2014. Nevertheless, the government is placing its short term initiatives in a longer term framework.

The government's initiatives are summarized in a document made public in April, *Agenda para la recuperación económica: 2014-2018* (Development Agenda: 2014-2018). The document outlines initiatives that focus on:

- Diversifying the industrial base
- Places emphasis on agriculture, tourism and entrepreneurship
- Diversifying energy sources and lowering energy cost
- Transforming the educational system

- Downsizing government and making it more efficient
- Tax reform aimed at having a tax structure that will stimulate development.

The Development Agenda is based on four guiding principles:

- Strengthen competitiveness by improving our human capital and the social and economic infrastructure
- Increase the productive capacity of the economy by promoting local enterprises and by stimulating import substitution
- Putting in place long term planning horizons
- Reestablish confidence in Puerto Rico

The Agenda is a very detailed document but some key components are outlined below:

- Create a new government structure that lowers the number of agencies from nearly 150 to fifty over a number of years with the immediate consolidation of 25 government entities.

- A regionalization process to reduce bureaucratic procedures in the Department of Education and other agencies, along the lines of the recommendations of the Governor's Commission on Decentralization and Regionalization. The Commission's Report identified important avoided cost instances that are generated by decentralizing central government activities in, for example, road, school and public housing maintenance.
- A major incentive program for young entrepreneurs to stimulate the creation of new enterprises. This program has a major objective of reducing emigration by the younger better educated groups.
- Development of the Science City project and the construction of a Comprehensive Cancer Center, as part of an overall strategy for inserting Puerto Rico in the knowledge economy.
- Retain existing bio-pharma activities and attract new ones and expand the aerospace sector in the island. This sector benefits from restrictions imposed by Homeland Security legislation requiring that certain activities be carried out in U.S. territory.
- Lower energy costs from the present level in excess of 26 cents per kwh to 16 cents by 2019, and moving initially to natural gas and in the mid and long terms placing

emphasis on non-fossil fuel sources of energy.

- Improve the PR Electric Power Authority's efficiency through the creation of a new independent regulatory entity, adopting specific objectives and goals for energy production efficiency and specifying needed metrics to monitor progress.
- Improve the permitting process through the use of technology and by revising existing regulations. Since construction is a key sector in job creation, permitting efficiency will have an impact on economic growth in a short term time framework.
- Putting in place a number of agro-industrial programs based on import substitution and providing local industries with a local source of supply. The former is exemplified by the program on rice cultivation and the latter by the planting of sugar to provide molasses to the rum industry.

The government has also been implementing Laws 20 and 22, both from 2010. The former provides incentives for the export of services and the latter provides incentives for non-residents to become residents of Puerto Rico and invest in the Island. Both are still in the initial stages of implementation in May, 2014 and thus impacts are difficult to establish.

The projections for the period 2014 through 2018 are for moderate growth

not exceeding 2.0% per annum in the latter year. This very prudent projection recognizes that recovery from long term and deep contractions is a more

complicated process that will take longer to recover from than what would be the case in a short term cyclical recession.

CEDS COMMITTEE OPERATIONS

Internal operations of the CEDS Committee will endeavor to stimulate the submission of proposals from the various eligible entities in line with policy priorities outlined in the CEDS. To that effect, the CEDS Executive Director will be making visits throughout the Island in order to provide information on EDA programs and funding.

Proposals will be evaluated on the following basis:

- Relation to Puerto Rico's CEDS Priority Level
- Consistent with the EDA Investment Policy Guidelines

The Committee will develop a ranking system that will permit evaluation of proposals on the basis of the above criteria.

What needs to be emphasized with respect to CEDS implementation is that the local Committee and its Executive Director are being proactive in stimulating the preparation of proposals. This should result in a larger pool of proposals to be evaluated. The Action Plan for 2010 calls for visits to municipalities throughout the Island to meet with municipal authorities, Community Based Organizations and other eligible entities to provide orientation on EDA programs and procedures for submitting proposals.

SECTION VI: PRIORITY PROJECT LIST AND EVALUATION CRITERIA

THE CEDS EVALUATION PROCESS

The Comprehensive Economic Development Strategy (CEDS) committee for the Puerto Rico Development Area is responsible for the evaluation of those investment proposals submitted for its consideration.

As the entire Commonwealth of Puerto Rico qualifies as a Redevelopment Area under provisions of the Public Works and Economic Development Act of 1965, the entirety of Puerto Rico's Municipalities, their agencies, and the agencies of the central government of Puerto Rico, are fully eligible to receive assistance from the United States Department of Commerce Economic Development Administration (EDA). Subsequently, each proposal submitted to the committee is considered for inclusion in the CEDS under the established CEDS evaluation process.

The CEDS Priority Projects List ("the list") catalogues qualified development projects that seek funding from the Economic Development Administration's Public Works and Economic Adjustment Programs. These programs direct funds to economically distressed communities to upgrade their physical infrastructure, to attract new industry, to encourage business expansion, and to generate private-sector jobs and investment. Inclusion on the CEDS Priority Projects list is an EDA prerequisite for funding

consideration. Projects demonstrating feasibility, significant community support, and eminent regional value will rank highest on the list and will receive the strongest regional endorsement.

This process provides the EDA with a short list of projects that serve distressed areas, are positioned to move forward quickly, and show promise of sustainable development. EDA then decides which projects to fund.

GENERAL REQUIRED OF ALL PROJECTS

In order to be placed on the CEDS Priority Projects List, a project must have community support. The applicant must provide one of the following, which will be accepted as evidence of community support:

- The project is consistent with a master plan, neighborhood plan, community development plan, or other local plan.
- The project has been endorsed or approved by the local government of the area that the project development.
- A local planning or economic development department or entity supports the project.
- The probability a given proponent shall be required, by virtue of the

undertaking, to carry out additional phases, at a later stage and in a specific area.

- The potential of the investment proposal to generate or retain good jobs, new jobs, permanent jobs, high skill jobs, high wage jobs, jobs paying higher than the area average or median and solid employment opportunities.
- Regionally should be the main consideration in defining economic development needs and goals.

ADDITIONAL EVALUATION POINTS

All applications that satisfy general requirements will be evaluated using the following set of criteria. The scores will be used to rank projects within the Priority Projects List. CEDS Committee will determine if an applicant meets a criterion. The applicant must submit information or evidence as noted:

- The applicant has control of the project site. Site control includes ownership (deed), an option, a purchase or sale agreement, or a lease or other form of agreement with the site owner. The applicant must explain if any of these items are in place and list dates of relevant agreements, land transfer, etc.
- The applicant has received financial commitments to project. Evidence of financial commitments includes a letter of commitment from a lender,

a letter of commitment from a public agency to provide funding, or private commitments.

- The project incorporates environmentally friendly building practices or technologies. To meet this criterion, the applicant must promise to meet at least one standard from a select list of Leadership in Energy & Environmental Design (LEED) standards for new commercial construction and major renovation projects.
- The project entails redevelopment of a building, site or area.

PHASES OF EVALUATION

Currently, the CEDS evaluation process consists of the following phases:

- **Identification of Investment Proposals:** Accepting, finding, and suggesting solid investment proposals and/or encouraging the transformation of good ideas into solid investment proposals.
- **Evaluation of Investment Proposals:**
 - Determination of the *Development Area Priority Level*: This designation relays the level of importance to the development area of each investment proposal, in light of economic trends and projections, and the public policy

embodied in the CEDS document and subsequently results in the designation of a grade reflecting said finding.

- Consideration of the *Level of EDA Appropriateness*: This designation relays the level of appropriateness in light of the EDA's **Investment Policy Guidelines** and subsequently designates a grade reflecting said compatibility.
- **Authorship of an official letter of certification and referral to the EDA for its own consideration for those investment proposals deemed both:**
 - Important to the economic development of the Puerto Rico.
 - Consistent with the EDA Investment Policy Guidelines (Appendix IV and Appendix V).

Nevertheless, having identified important investment opportunities and included them in the CEDS document it is the strong desire of the CEDS committee that, federal agencies and administrations, the government of the Commonwealth of Puerto Rico, the private sector, foundations, not-for-profits, and the public shall embrace the challenge of supporting any and all proposals included in the CEDS as worthy economic development projects.

GENERAL ADVISORY REGARDING PROCESS CHANGES

As the above format represents an innovation in the evaluation process which occurred during Program Cycles FY 2014 and 2015 — an innovation designed to render some return on the investment of time applicants expend in preparing investment proposals for the CEDS committee evaluation process — it remains a possibility that continued and further refinements may occur during the pending program cycle.

It should be understood, that said process innovations occurred as a response to the urgings of both proponents and committee members. As always, the goal of our effort was, and shall remain, to endeavor to amplify the comprehensive and strategy nature of this document and its continued functionality.

FORMAL INVITATION TO THE EDA

The EDA is invited to consider any proposal included in the CEDS document, as each has been identified, to varying degrees, as appropriate in light of the Goals, Objectives, and policy priorities of the Puerto Rico Development Area. However, only those proposals which have also received a grade regarding their appropriateness in light of the EDA's Investment Policy Guidelines (as promulgated during FY 2010) carry the full confidence of the CEDS committee as proposals ready for serious consideration under the EDA's application program and procedures.

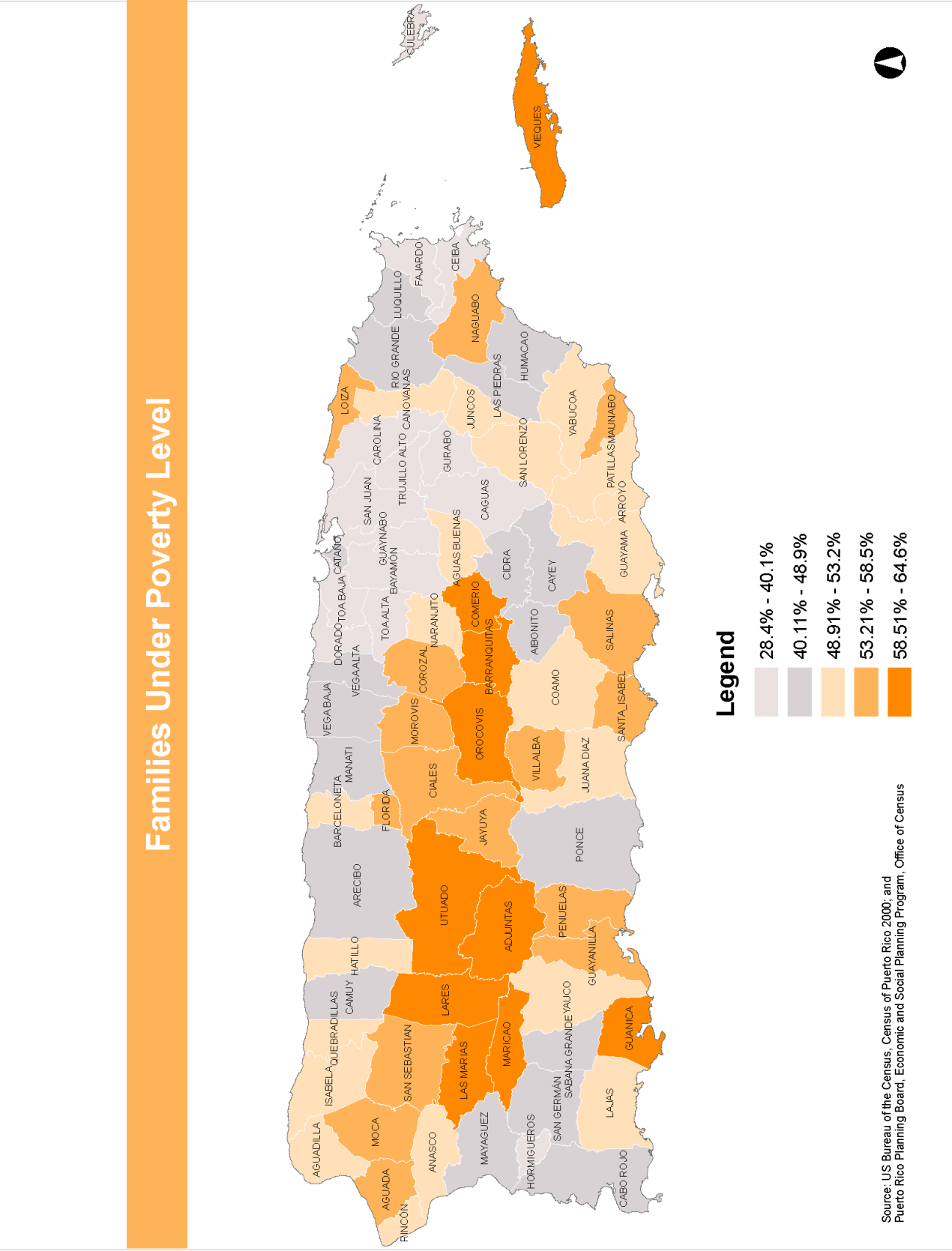
ALL INVESTMENT PROPOSALS CONSIDERED TO THE CEDS, FY 2014

The listing includes the priority order and recommendation classifications rendered by the Committee. It should be noted that during fiscal year 2014, the

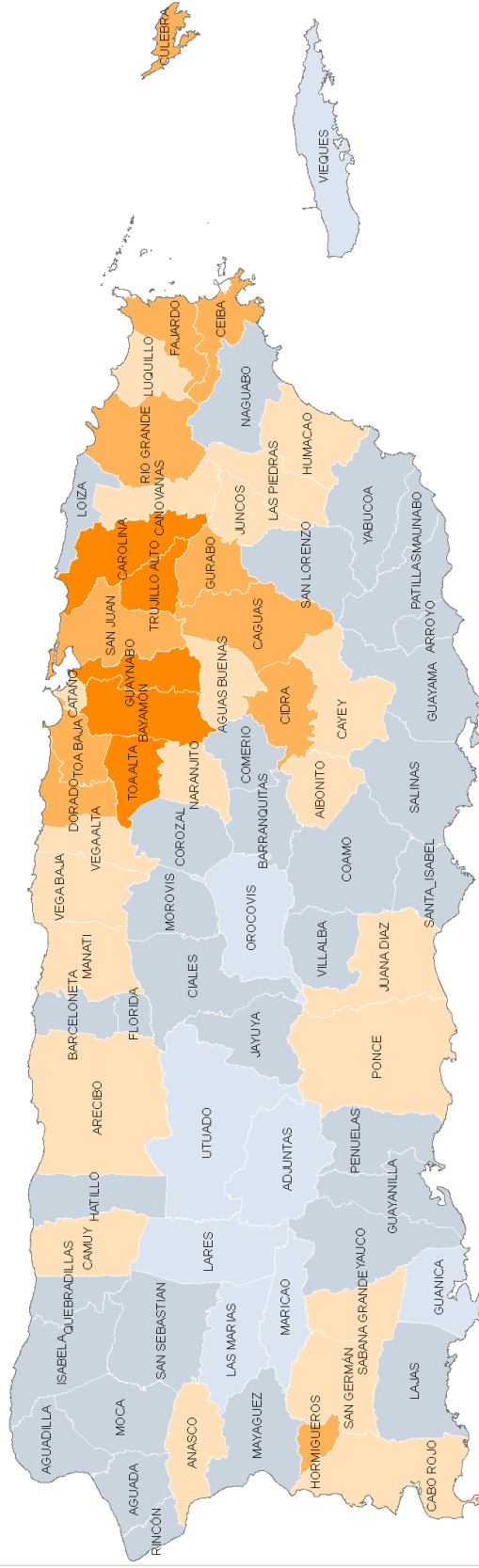
CEDS Committee received proposals for evaluation; after three years without the Committee, evaluate proposals.

APPENDIX I
STATISTICAL INFORMATION





Median Household Income



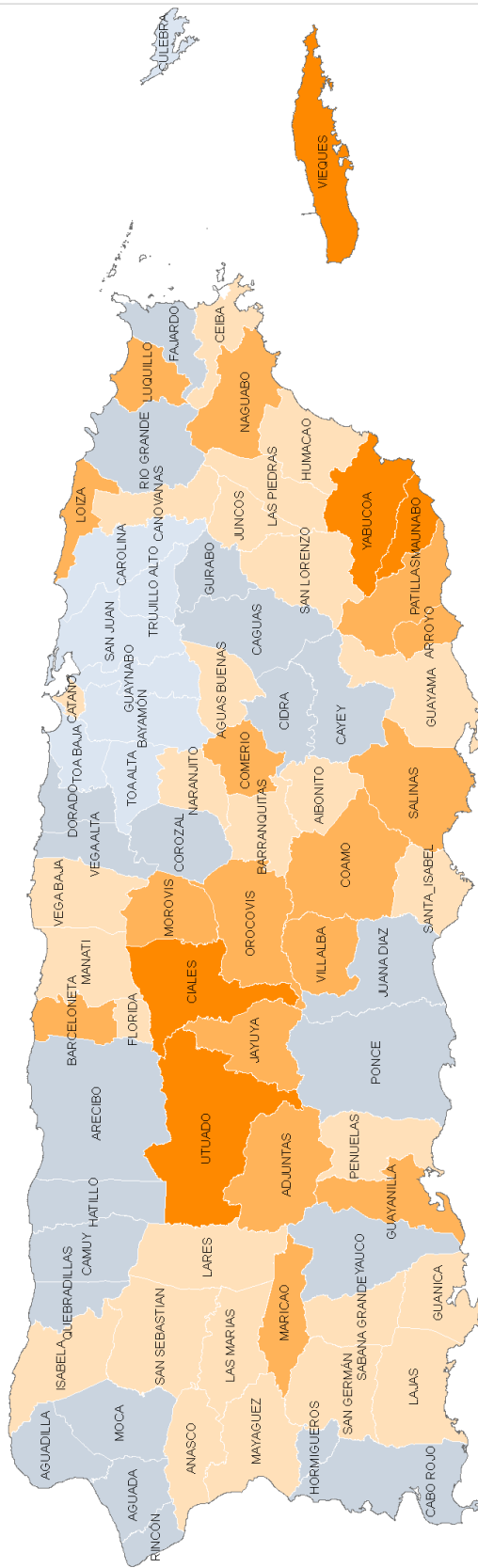
Legend

- 9,243 - 9,948
- 9,949 - 12,378
- 12,379 - 14,622
- 14,623 - 18,331
- 18,332 - 26,211

Source: US Bureau of the Census, Census of Puerto Rico 2000; and Puerto Rico Planning Board, Economic and Social Planning Program, Office of Census



Unemployment Rate



Legend

- 8.9% - 11.7%
- 11.71% - 15.7%
- 15.71% - 18.1%
- 18.11% - 21.5%
- 21.51% - 28.1%

Source: US Bureau of the Census, Census of Puerto Rico 2000; and Puerto Rico Planning Board, Economic and Social Planning Program, Office of Census



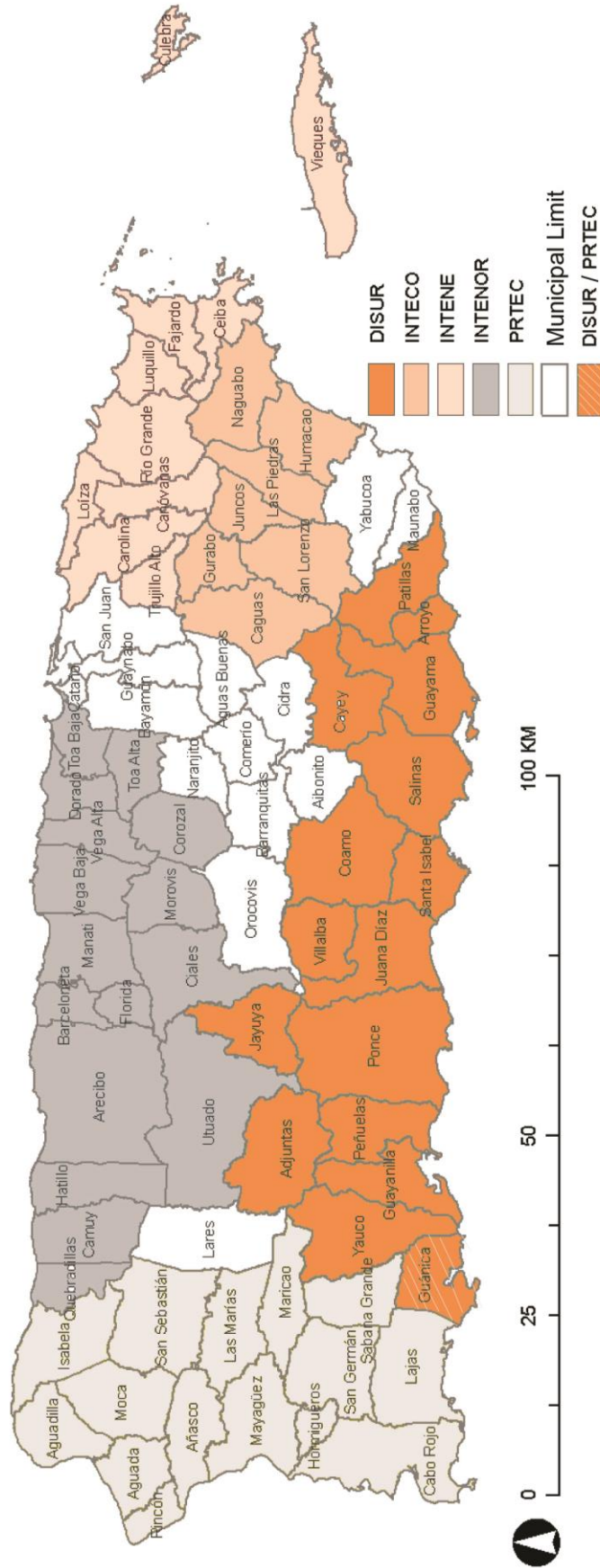
Municipality	Families Under Poverty Level	Median Household Income	Unemployment Rate
Isabela	52.5	\$11,685	15.90
Aguadilla	51.7	\$11,476	15.20
Arecibo	47.8	\$12,496	14.10
Vega Baja	47.2	\$13,933	17.30
Hatillo	52.4	\$12,378	13.70
Camuy	48.1	\$13,168	13.00
Quebradillas	51.8	\$12,210	14.30
Barceloneta	51.6	\$11,706	19.60
Manatí	48.1	\$12,796	17.30
Vega Alta	47.7	\$13,495	13.80
Moca	56.1	\$11,271	15.20
Loiza	57.0	\$11,200	19.10
Carolina	30.8	\$21,236	11.20
Guaynabo	28.4	\$26,211	8.90
Bayamón	31.9	\$19,861	11.70
Rio Grande	43.3	\$15,006	15.00
Aguada	55.8	\$11,384	15.70
Canóvanas	50.4	\$13,034	17.80
Toa Alta	37.0	\$20,134	11.10
San Sebastián	54.3	\$10,962	17.20
Luquillo	46.7	\$13,631	18.90
Florida	55.0	\$11,123	17.50
Fajardo	38.2	\$15,410	15.50
Trujillo Alto	31.7	\$21,980	9.40
Morovis	56.0	\$12,090	18.80
Rincón	53.1	\$11,460	15.30
Ciales	58.5	\$10,981	24.30
Corozal	54.8	\$11,786	15.00
Lares	62.2	\$9,685	18.00
Culebra	33.8	\$17,008	9.30
Utua	60.4	\$9,948	24.20
Naranjito	53.2	\$12,484	16.80
Añasco	49.3	\$12,620	16.80
Caguas	38.8	\$16,522	13.60
Gurabo	40.1	\$16,451	14.40
Agua Buenas	49.9	\$12,957	16.50
Jayuya	57.9	\$11,220	20.00
Ceiba	37.0	\$16,440	16.40
Naguabo	54.3	\$11,461	21.50
Orocovis	64.6	\$9,945	18.80
Las Marías	63.1	\$9,472	17.80
Comerio	59.5	\$10,892	19.50
Las Piedras	45.2	\$14,622	16.30
Mayaguez	46.0	\$11,775	16.30
Juncos	50.3	\$13,072	17.30
Adjuntas	62.2	\$9,888	19.70
Barranquitas	59.1	\$11,322	16.10
Cidra	44.4	\$15,557	15.00
San Lorenzo	51.0	\$12,226	16.50
Maricao	63.3	\$9,243	19.30
Humacao	43.7	\$14,345	18.10
Aibonito	48.9	\$12,725	18.00
Villalba	57.4	\$11,728	19.10
Coamo	51.9	\$12,064	19.70
San Germán	45.4	\$13,089	16.00
Ponce	48.3	\$12,998	13.60
Yauco	53.1	\$11,924	15.00
Cabo Rojo	43.0	\$13,580	13.10
Cayey	47.5	\$13,452	15.40
Vieques	61.4	\$9,331	22.80
Hormigueros	33.6	\$16,745	15.60
Juana Díaz	52.5	\$12,892	15.60
Sabana Grande	48.0	\$12,485	16.50
Guayanilla	55.0	\$11,361	18.70
Penuelas	56.6	\$12,194	17.60
Yabucoa	50.8	\$12,292	22.20
Patillas	51.0	\$12,021	20.60
Guayama	49.3	\$12,112	18.00
Salinas	55.2	\$11,391	20.70
Lajas	53.2	\$11,384	17.20
Maunabo	54.6	\$11,638	28.10
Santa Isabel	53.9	\$11,895	17.80
Arroyo	52.4	\$11,484	20.60
Guanica	60.0	\$9,721	16.60
Cataño	46.7	\$12,852	16.30
Dorado	40.1	\$16,460	12.50
Toa Baja	37.5	\$18,331	11.60
San Juan	37.2	\$17,367	10.20

Source: US Bureau of the Census, Census of Puerto Rico 2000; and Puerto Rico Planning Board, Economic and Social Planning Program, Office of Census.

**APPENDIX II:
MUNICIPAL ALLIANCES**



Municipal Alliances



Note: Blank municipalities not belonging to any of the alliances, at this time.

APPENDIX III:
DOWNGRADE BY S&P,
MOODY'S, AND FITCH OF
P.R.'S CREDIT RATING



DOWNGRADE BY S&P, MOODY'S, AND FITCH OF P.R.'S CREDIT RATING AND ITS IMPACT⁴

On February 4th, 2014, Standard & Poor's Ratings Services cut its rating of Puerto Rico's general obligation debt to 'BB+' from 'BBB-', pushing it to the highest junk level status.¹ It also downgraded the Commonwealth's appropriation secured debt and Employee Retirement System debt to 'BB,' as well as lowered various ratings on the Puerto Rico Highways and Transportation Authority to 'BB+' and the Development Bank (GDB) to 'BB.' It refrained from taking a rating action on sales tax-secured debt of the Puerto Rico Sales Tax Financing Corp. (COFINA), but maintained its negative outlook on its COFINA ratings.

Within a few days, the other credit agencies, Moody's and Fitch, followed with their own credit downgrades, as the decision by S&P, plus economic factors, notwithstanding the measures enacted by the government to manage the situation, weighted heavily in their decisions.²

THE ECONOMY

These developments have serious implications for the performance of the economy, as they give more weight to the possibilities of a more pronounced contraction than originally estimated for fiscal years 2014 and 2015.

The outlook for the economy in the case of GNP growth becomes more negative, considering also the observation made by S&P (2014) that "The Commonwealth may also potentially need monthly cash flow financing in fiscal 2015, following use of a \$1.2 billion of credit line draws for cash flow purposes in fiscal 2014."³

Moody's Ratings		
	Outlook	Classification
January 1976	Stable	Baa1
October 1983	Stable	Baa2
October 2001	Stable	Baa1
June 2002	Stable	Baa1
April 2003	Stable	Baa1
September 2004	Down to negative	Baa1
January 2005	Negative outlook and rating maintained	Baa1
May 2005	Negative outlook maintained and credit rating down	Baa2
February 2006	Under observation for possible revision; negative outlook maintained	Baa2
May 2006	Downgrade of Commonwealth's G.O. bonds with negative outlook	Baa3
May 2007	Maintains rating and negative outlook for pending issues of \$2.0 billion of public improvement bonds	Baa3
November 2007	Maintains rating and stable outlook.	Baa3
April 2010	Revised up to A3 with a stable outlook	A3
August 10, 2010	Outlook changed to negative	A3
August 8, 2011	Negative outlook	Baa1
December 13, 2012	Negative outlook maintained and credit rating down	Baa3
October 3, 2013	Negative outlook maintained	Baa3
February 7, 2014*	Negative outlook maintained and credit rating down two notches	Ba2

Standard & Poor's Ratings		
	Outlook	Classification
October 1983	Stable	A
October 2001	Negative outlook	A
May 2002	Classification down to A- with stable outlook	A-
April 2003	Perspective moved from stable to negative	A-
September 2004	Negative perspective maintained	A-
January 2005	Negative outlook and rating maintained	A-
May 2005	Negative outlook maintained and rating down	BBB
February 2006	On CreditWatch with negative implications	BBB
May 2007	GO debt rating lowered but outlook is upgraded to stable	BBB-
July 2009	Debt rating and outlook maintained.	BBB-
November 2010	Outlook from stable to positive	BBB-
March 7, 2011	Stable	BBB
June 6, 2012	Negative outlook	BBB
March 13, 2013	Negative outlook maintained and credit rating down	BBB-
October 24, 2013	Negative outlook maintained	BBB-
February 4, 2014*	Credit rating down and negative outlook maintained	BB+

Fitch		
	Outlook	Classification
August 8, 2011	Stable	BBB+
March, 2013	Negative outlook and credit rating down	BBB-
November 13, 2013	Negative watch	BBB-
February 11, 2014*	Credit rating down and negative outlook maintained	BB

Sources: Government Development Bank; Rating agencies.
 Note: As of February 14, 2014.
 * The ratings for several public corporations and COFINA was also downgraded.

⁴ This report was prepared for the Puerto Rico Manufacturers Association and is reproduced with its authorization.

Moreover, recently Moody's, for instance, estimated that "if Puerto Rico's credit were downgraded, it faced \$1.0 billion in short-term costs due to collateral calls on loans that are contingent on P.R.'s debt not being rated junk."⁴

An additional downside risk is the effect of the downgrade on the financial system. Recently, S&P lowered the ratings of three financial institutions (Santander, FirstBank and Popular Bank), on the basis of a weak economy that can deteriorate lending activity, affecting the profitability of several of these institutions, plus the exposure of some to government loans.

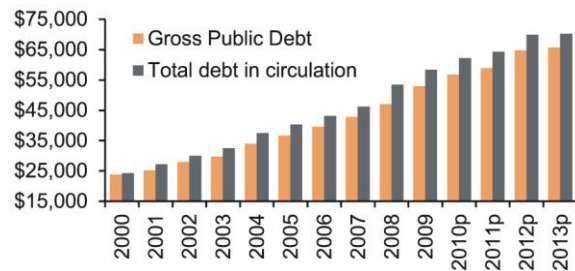
The analysis of past, and recent trends of the selected economic indicators, up to the last quarter of 2013 shows that the local economy continued to face growth challenges. Employment, retail sales, bankruptcies, delinquency rates and cement sales point to an economy that suffered a contraction during fiscal 2014, above that announced by the Puerto Rico Planning Board last October. The situation is expected to deteriorate as a result of the most recent S&P's downgrade to junk level by S&P of P.R.'s general obligation debt to 'BB+' from 'BBB-'.

THE DEBT IN NUMBERS

As of fiscal 2013, it is estimated that the total circulating public debt of Puerto Rico amounted to \$70.2 billion, of which \$65.7 billion corresponded to the gross debt of the central government, corporations, municipal, constitutional and extra-constitutional, and COFINA (which

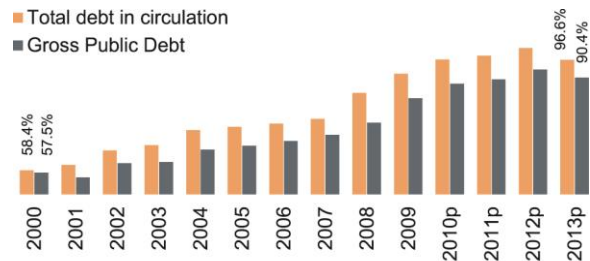
account for 24.5% of the debt, and public corporations 47.0%). As an indicator of high public indebtedness, gross public debt represented 90.4% of the island's GNP (nominal), from 58.4% in fiscal 2000, edging down from 93.2% in fiscal 2012. Total circulating debt represented 97.0%, from 100.7% in fiscal 2012.

Gross Public Debt and Total Circulating Public Debt



Sources: Planning Board (2013); Government Development Bank (2013). * In the case of gross public debt corresponds to debt of central government (including COFINA), public corporations, and municipalities. p = Preliminary

Ratio of Total Gross Debt in Circulation and Gross Public Debt to GNP

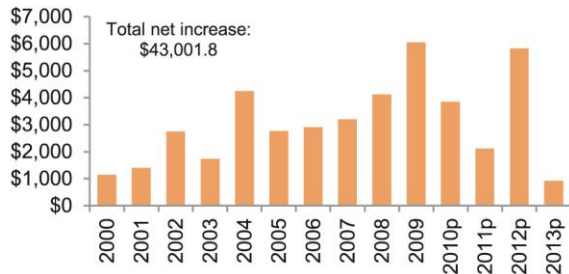


Sources: Office of Management and Budget (2013); Planning Board (2013); Government Development Bank (2013).

To have an idea of how the situation deteriorated, between fiscal years 2001 and 2013, the net increase in the gross public debt amounted to \$43.0 billion, of which \$31.7 billion was incurred during the period 2005-2013. This accounted for 74.0% of the increase in net indebtedness during the period. The net increase in the debt of COFINA accounted for 39.0% of the \$31.7 billion

increase, debt that was issued, in essence, to cover current and recurrent spending.

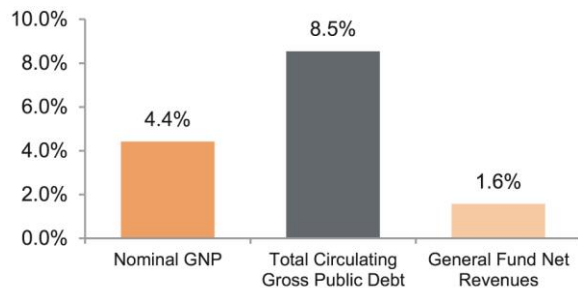
Annual Increases of Gross Public Debt



Sources: Planning Board (2013); Government Development Bank (2013). * Corresponds to debt of central government (including COFINA), public corporations, and municipalities. p = Preliminary

Thus, while during the years 2000-2013, the economy (production) expanded at a nominal rate of growth of 4.4%, and government revenues (net) barely increased, by 1.6%, the size of the public v debt increased 8.5% annually.

Annual Growth of Nominal GNP, General Fund Net Revenues, and Total Gross Public Debt



Sources: Planning Board (2013); Government Development Bank (2013). * Compound annual rate of growth.

AFTER THE DOWNGRADES

Expectations in the short and medium term will be influenced by the downgrades that, although expected, will nevertheless have its impact on

consumers, businesses, and through the fiscal situation of the government, on public spending and investment. GNP growth will thus face strong downside risks during fiscal years 2015 and 2016.

In the wake of Standard & Poor's decision to cut Puerto Rico's credit rating to junk, the governor announced on February 5th several measures to cut the budget deficit. The Bill, E-14-0093, submitted to the Legislature, included several proposals, among them an amendment to the current budget (Fiscal year 2014) to reduce the deficit by \$170 million without laying-off public employees, and requiring 2.0% expense cuts by central government agencies, except the Education Department.⁵ This is coupled with the efforts already implemented to reduce spending, including public payroll.

At the same time, the government will continue to negotiate loans whose payments have been accelerated by S&P's decision — \$575 million in 90 days and \$375 million in less than six months — and in financing alternatives to provide greater liquidity to the GDB.

On the revenue side, the administration has indicated that it is completing the revised revenue projections without new taxes for the next fiscal year, taking into account the economic growth projection and income measures already legislated, together with the efforts to control tax evasion.

On the economic side, the government has identified \$800 million in public and

private investment in infrastructure projects that it will push aggressively.

Nevertheless, the negative economic impact will be strong, at least in the short and medium term. The expected contraction in public spending and investment will lower economic growth perspectives. For incoming fiscal 2015, the government has already announced a reduction of \$820.0 million in spending in order to eliminate the deficit.

On the other hand, of the new GO issue contemplated for next month for \$3.5 billion, most of it will go to pay old debt (\$2.0 billion), an amount that would not provide monies further than 2015 and none for investment. The proceeds are also to be used to terminate interest-rate swaps, fill a \$245.0 million hole in the current fiscal year's budget, and bolster the liquidity of the Government Development Bank. Interestingly, some analysts are of the opinion that despite the risk, there is demand for fresh debt from Puerto Rico, especially among sophisticated investors seeking high returns. Hedge funds and other alternative asset managers believe they see ways of protecting themselves in the face of an increasing risk that Puerto Rico's other debt will have to be restructured at some point.⁶

The impact on the manufacturing sector of the downgrades is somewhat more difficult to pinpoint. Obviously, those sub-sectors related to construction will be impacted, as will those that produce for the local market. To the extent that it produces for export, the direct impact

should be minimal. Any impacts will be in the mid and long terms, through a more restrictive tax environment and costly infrastructure services. Expanding exports from both the manufacturing and service sectors is essential for stimulating economic growth since local markets will remain weak for at least the next three to four years. The main implication of the current crisis is the need for Puerto Rico to adopt an outward orientation in its economic initiatives.

REAL GNP GROWTH

In the case of real GNP growth, our revised forecasts take into consideration the potential effects of the rating downgrade by S&P, for the balance of current fiscal 2014, but its impact will be also felt in coming fiscal 2015.

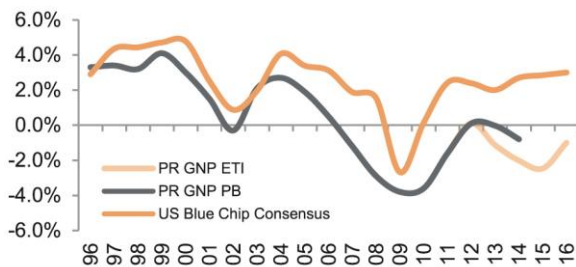
The contraction will extend into fiscal years 2014 through 2016, as the economy is estimated to have contracted by -2.0% this fiscal year, and -2.5% in fiscal 2015, slowing down still in fiscal 2016 by -1.0%.⁷ As a result of the expected limitations in revenues and deficit financing, public spending is expected to contract at an accumulated rate of 4.3% during fiscal years 2014 and 2015, and public investment by 29.7%, as its main source of funds, debt, will be heavily constrained.

The most recent downgrade by Fitch on February 17th of PRSA's credit rating and of the PRPA's to junk level, following Moody's decision on February 10th, will simply make it more difficult (and costly) for these two key public corporations to

entertain an expansion in their investment.⁸

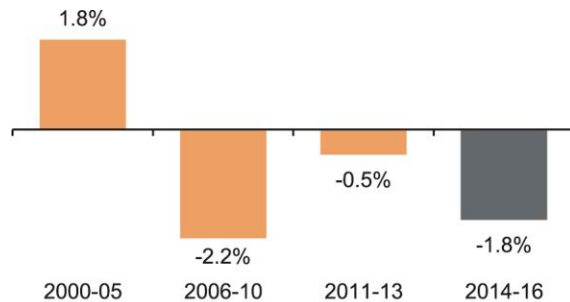
Private investment in construction will continue to be on the downside, led by a housing sector still in the doldrums, and a scarcity of public funds for investment. It is estimated that it will contract at an accumulated rate of 27.8% during fiscal years 2014 and 2015, with fiscal 2016 still on the negative side, -6.4%.

Annual Growth Rates: Historic and Forecast 1996-2016



Sources: PR Planning Board (2013); Estudios Técnicos (2014); U.S. BEA; *Blue Chip Consensus* (February 10, 2014). *US data on PR's fiscal year basis. Note: Shaded area indicates contraction period in PR.

Annual Averages Real GNP Growth: Historic and Forecast



Sources: PR Planning Board (2013); Estudios Técnicos (2014).

On balance, expect the next three fiscal years to continue on a contraction mode,

slightly more pronounced on average than in the previous three years.

PUBLIC MEASURES

STEPS IN THE RIGHT DIRECTION?

The government has initiated or enacted a series of measures to restore fiscal balance, liquidity to the GDB, and the proposed revision of the tax system, submit a real balanced budget for fiscal 2015, are steps in the right direction. Nevertheless, they entail spending cuts, less money for investment, and again raising revenues, which in essence will be of taxes, and user fees for services.

All, one way or the other, will impact consumers and businesses, eroding domestic demand. And none of these options are too appealing.

There is still the issue of the proposed reform to the Teachers Retirement System, whose implementation is pending on a decision by the local Supreme Court. An unfavorable one would send the wrong signals to the bond market and investors.

In the short and medium term, the measures proposed or to be enacted will help to regain credit standing and confidence, but they will take time.⁹ Immediately, and into next fiscal year, the situation will be quite constrained, as explained before.

Projections through 2016 are presented in the table on the next page

Real GNP: Historic and Forecast Growth Rates

	Fiscal Years											
	Annual Growth Rate											
	Historic								Forecast (a)			
	2005	2006	2007	2008	2009	2010	2011	2012p	2013	2014	2015	2016
Real GNP	1.9%	0.5%	-1.2%	-2.9%	-3.8%	-3.6%	-1.6%	0.1%	-1.1%	-2.0%	-2.5%	-1.0%
Personal consumption expenditures	3.4%	2.2%	3.5%	-1.2%	-2.9%	1.4%	0.7%	3.0%	1.2%	1.0%	1.1%	1.5%
Public spending	4.2%	0.1%	-1.5%	-4.7%	2.5%	-3.4%	-4.7%	-0.7%	-0.6%	-1.5%	-2.8%	-1.2%
Gross domestic investment	-4.0%	2.2%	-6.3%	-7.9%	-12.5%	-7.8%	12.8%	4.4%	-7.7%	-8.3%	-10.5%	-5.3%
Construction	-6.9%	-10.9%	-7.6%	-9.4%	-22.2%	-14.1%	2.0%	11.0%	-13.1%	-13.5%	-15.1%	-7.4%
Private	-11.3%	-12.1%	-4.5%	-20.8%	-29.5%	-5.1%	-4.1%	-3.0%	-12.0%	-13.3%	-14.5%	-6.4%
Public	-0.5%	-9.4%	-11.5%	5.7%	-15.0%	-21.5%	8.1%	23.3%	-14.6%	-13.8%	-15.9%	-8.9%
Exports	2.7%	0.7%	-7.9%	-1.3%	-3.6%	-3.9%	1.7%	-4.1%	-1.9%	-2.4%	0.7%	3.8%
Imports	2.7%	1.9%	-4.5%	-1.7%	-3.2%	-0.5%	3.0%	0.5%	-0.5%	-0.6%	0.9%	2.8%

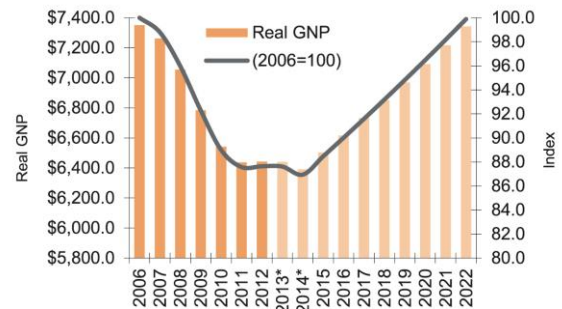
Sources: PR Planning Board (2013). *Statistical Appendix 2012*; Estudios Técnicos, Inc. (February 20, 2014). P = Preliminary (a) Subject to revisions.

LONG-TERM ECONOMIC CHALLENGE

The economic growth challenges are daunting and long-term, as seen in our risk scenarios. Adopting an alternative base line approach, which assumes a conservative annual growth rate of 1.75% for 2015 and afterwards, which is slightly higher than the historic average for fiscal years 2000-2006 (1.61%), and the revised forecasts by the Planning Board for fiscal years 2013 and 2014, it would not be until fiscal year 2022 when Puerto Rico’s real GNP would arrive to its pre-contraction level of 2006.

How much does Puerto Rico have to Grow to Achieve 2006 Level of Real GNP?

(Assuming an annual rate of 1.75% for 2015 - 2022)



Sources: PR Planning Board; Estudios Técnicos, Inc. * Revised forecasts

NOTES

- Standard & Poor’s Rating Services (2014). Puerto Rico GO Rating Lowered To ‘BB+’: Remains on Watch Negative, Rating Direct (February 4). At: www.stndardandpoors.com/ratingsdirect.
- There is a question about what might happen with Moody’s Investors Service and Fitch Ratings following S&P’s downgrade. That might force selling by investors who have mandates preventing them from holding junk-rated debt. On February 7th Moody’s downgraded two notches its ratings to Ba2 from Baa3 with outlook negative. See Moody’s Investor Services (2014), <http://recend.apextech.netdna-cdn.com/docs/editor/InformeMoody.pdf>. On February 11th Fitch did the same with a downgrade to ‘BB’ from ‘BBB-’ with negative outlook. See Fitch Ratings (2014), https://www.fitchratings.com/creditdesk/press_releases/detail.cfm?pr_id=820231&origin=home&cm_sp=homepage-_-Featured_Content_Archive-_-Fitch%20Downgrades%20Puerto%20Rico%20to%20%27BB%27.
- Standard & Poor’s Rating Services (2014), p. 3.
- Cnbc.com (2014). “Why Puerto Rico Needs to Borrow Money – Soon,” (January 24). At: <http://www.cnn.com/>
- The legislation seeks to amend Articles 3 and 8 of Law 45-2013. This Law created in 2013 the Fiscal Reconstruction Fund, under the custody of the Department of the Treasury, and authorized the Government Development Bank to transfer to the

Fund \$245.0 million to finance the administration's economic development plan known as the "Jobs Now Act".

6. M. Williams and M. Corkery (2014), "Puerto Rico Wants to Incur More Debt to Regain Financial Footing," DealB%K (February 18). At: <http://mobile.nytimes.com/blogs/dealbook/2014/02/18/puerto-rico-wants-to-incur-more-debt-to-regain-financial-footing/?smid=fb-share>.
7. The estimates are subject to revision, once the Planning Board publishes its macroeconomic estimates for fiscal 2013, and revised 2012, expected in March, and the annual benchmark revisions of nonfarm employment data that will be available in March from the U.S. BLS.
8. Fitch Ratings (2014). Fitch Downgrades Puerto Rico Aqueduct & Sewer Authority Senior Revs to 'BB+'; Outlook Remains Negative (February 18). At: https://www.fitchratings.com/creditdesk/press_releases/detail.cfm?pr_id=820922; Fitch Downgrades Puerto Rico Electric Power Auth's Revs to 'BB+'; Outlook to Negative (February 18). At: https://www.fitchratings.com/creditdesk/press_releases/detail.cfm?pr_id=820918.
9. Some analysts believe that it will take Puerto Rico within five years to regain its investment grade rating from S&P. See S. O'Leary and M. Shellhorn (2014), What Does Below Investment Grade Mean for Puerto Rico? Nuveen Asset Management (February), p. 4. At: <http://www.nuveen.com/Home/Documents/Default.aspx?fileId=61768>

APPENDIX IV:
EDA INVESTMENT PROGRAMS



EDA Investment Programs:

Public Works: Empowers distressed communities to revitalize, expand, and upgrade their physical infrastructure to attract new industry, encourage business expansion, diversify local economies, and generate or retain long-term, private sector jobs and investment.

Economic Adjustment: Assists state and local interests in designing and implementing strategies to adjust or bring about change to an economy. The program focuses on areas that have experienced or are under threat of serious structural damage to the underlying economic base.

Community Trade Adjustment Assistance: Provides project grants to communities that have experienced, or are threatened by, job loss resulting from international trade impacts.

Partnership Planning: Supports local organizations (Economic Development Districts, Indian Tribes, and other eligible areas) with long-term planning efforts.

Trade Adjustment Assistance for Firms: A national network of eleven Trade Adjustment Assistance Centers to help manufacturers and producers affected by increased imports prepare and implement strategies to guide their economic recovery.

Global Climate Change Mitigation Incentive Fund: Finances projects that foster economic development by advancing the green economy in distressed communities.

University Centers: A partnership of the federal government and academia that makes the varied and vast resources of universities available to the economic development community.

Research and National Technical Assistance: Supports research of leading edge, world class economic development practices and information dissemination efforts.

Local Technical Assistance: Helps fill the knowledge and information gaps that may prevent leaders in the public and nonprofit sectors in distressed areas from making optimal decisions on local economic development issues.

APPENDIX V:
EDA INVESTMENT PRIORITIES



EDA Investment Priorities

Within the parameters of a competitive grant process, all projects are evaluated to determine if they advance global competitiveness, create jobs, leverage public and private resources, can demonstrate *readiness and ability to use funds quickly and effectively* and link to specific and measureable outcomes. To facilitate evaluation EDA has established the following investment priorities:

Collaborative Regional Innovation: Initiatives that support the development and growth of innovation clusters based on existing regional competitive strengths. Initiatives must engage stakeholders; facilitate collaboration among urban, suburban and rural (including Tribal) areas; provide stability for economic development through long-term intergovernmental and public/private collaboration; and, support the growth of existing and emerging industries.

Public/Private Partnerships: Investments that use both public and private sector resources and leverage complementary investments by other government/public entities and/or non-profits.

National Strategic Priorities: Initiatives that encourage job growth and business expansion in clean energy; green technologies; sustainable manufacturing; information technology (e.g., broadband, smart grid) infrastructure; communities severely impacted by automotive industry restructuring; natural disaster mitigation and resiliency; access to capital for small and medium sized and ethnically diverse enterprises; and, innovations in science, health care and alternative fuel technologies.

Global Competitiveness: Investments that support high-growth businesses and innovation-based entrepreneurs to expand and compete in global markets.

Environmentally-Sustainable Development: Investments that encompass best practices in “environmentally sustainable development,” broadly defined, to include projects that enhance environmental quality and develop and implement green products, processes, and buildings as part of the green economy.

Economically Distressed and Underserved Communities: Investments that strengthen diverse communities that have suffered disproportionate economic and job losses and/or are rebuilding to become more competitive in the global economy.

Proponent	Investment Description	Financial Investment Breakdown				
		Proponent	%	Federal Funds	%	Total Investment
Municipality of Aguadilla	Regional Economic Development Strategy for the Aguadilla Airport and FTZ.	\$ 25,000.00	20%	\$ 100,000.00	80%	\$ 125,000.00
Puerto Rico Science, Technology and Research Trust	Bio-Science Technology Commercialization Accelerator	\$ 1,289,900.00	56%	\$ 1,020,000.00	44%	\$ 2,309,900.00
Puerto Rico Science, Technology and Research Trust	Industry/University Collaborative Research Complex (IUCRC)	\$ 1,550,000.00	50%	\$ 1,550,000.00	50%	\$ 3,100,000.00
Municipality of Ponce	Life Sciences Training & Innovation Metropolis	\$ 8,000,000.00	80%	\$ 2,000,000.00	20%	\$ 10,000,000.00
Universidad del Este	UNE's Innovation and Entrepreneurship Incubator (UNE -IEI)	\$ 636,209.00	34%	\$ 1,249,561.00	66%	\$ 1,885,770.00
Municipality of Añasco	Añasco Urban Center Revitalization Program - Strategic Project No. 24: Urban Infrastructure and Improvements to PRIDCO Boulevard - Añasco Industrial Zone	\$ 3,220,001.00	83%	\$ 673,000.00	17%	\$ 3,893,001.00
Municipality of Moca	The construction of ten structures of the developing of a small business opened area, in the artisan promenade, Moca	\$ 854,500.00	64%	\$ 472,000.00	36%	\$ 1,326,500.00
Municipality of Aguada	Aguada Economic Revitalization Plan	\$ 15,000.00	30%	\$ 35,000.00	70%	\$ 50,000.00
Municipality of Orocovis	Improvement to access to Municipal Road, Los Santiago Sector, Gato Ward, Municipality of Orocovis	\$ 668,167.00	43%	\$ 900,000.00	57%	\$ 1,568,167.00
Municipality of Coamo	Renovation of Coamo Industrial Building	\$ 217,000.00	32%	\$ 455,000.00	68%	\$ 672,000.00
PathStone Enterprise Center	Implement an economic development initiative for direct assistance in the form of technical and revolving loan fund services to advance regional economic development	\$ 135,072.00	22%	\$ 473,625.00	78%	\$ 608,697.00
Municipality of Bayamon	Study to determine feasibility of Technology Business Incubator Clusters (TBC) in the Bayamón Central District	\$ 100,000.00	50%	\$ 100,000.00	50%	\$ 200,000.00