

Summary of Results

2016 UPDATE: Economic Assessment Act 20/22



Background

- During the last quarter of 2014 ETI performed an analysis that outlined the economic impact of Act 20/22. Even though both acts were enacted in 2012, some direct effects were already observed by the end of 2014. Yet, the greatest impact of such programs is expected to accumulate during the following years.
- ETI's study presented the case for how Puerto Rico has transitioned to a service economy which required the use of economic incentives such as Act 20/22
- Moreover, the use of Act 20/22 incentives added new capital to the economy, which stimulated some niche areas of the real estate sector and provided the basis for the development of an advanced services sector with export potential
- The study concluded that both acts are deemed necessary in order to maintain the competitiveness of Puerto Rico, particularly taking into account a highly competitive regional context



Background

- The first study allowed DDEC to demystify several pre-conceptions attached to both acts
 - Act 20 is an export incentive program that provides benefits to both local and foreign companies;
 - Act 22 does not constitute a full tax exemption, conversely, the study quantified several incremental tax revenues (property tax, sales tax) from Act 22 grantees
- The study provided a full profile of Act 20/22 beneficiaries (company size, country of origin, export market, net worth, among others)
- This data provided an empirical description of the synergy effect between both acts; that is, Act 20 provided an incentive for companies to relocate to Puerto Rico and export services to the U.S. or other jurisdictions, while also benefiting business executives from such companies at the individual level; by directly benefiting decision-makers, combining both acts have proved fruitful



Aggregate Economic Effects

1 Both acts continue to provide an incremental influx of capital, high-paying jobs and knowledge transfer to the local economy



- Examples can be seen in local hiring due to natural incentives in contracting cheaper high-value added services
- Spillover effects in the local business community. i.e. Act 22 participants have engaged with the local creative class and startup community. Institutionalization of dense formal and informal encounters which facilitate the sharing of success, failure and collaborative experiences.

2 The incentive programs provide capital and know-how to create new productive capacity within the economy.

3 The synergies of Act 20 and Act 22 provide a myriad of incremental effects for both the supply and demand side of the economy.

4 Supply = Act 20 companies direct investments; Demand = Act 22 individual's consumption of local goods and services

5 The incentive programs institutionalize a process that relates an open economy with the rest of the world, and also catalyze the development of multiple initiatives that help manage that relation.



Methodology

To guarantee a sound comparison between this update and the original study, the same methodology was followed to estimate the economic impact

ETI followed a hybrid approach which combined data from annual reports and data from applications



Employment, fiscal revenues, investment and consumer spending were particularly analyzed



Several econometric tools employed in the 10-year forecast:



- Potential pool of decrees, estimated 10 years
- Dynamic capture rate
- Multi-generational approach

Growth rates were estimated for each forecasted variable

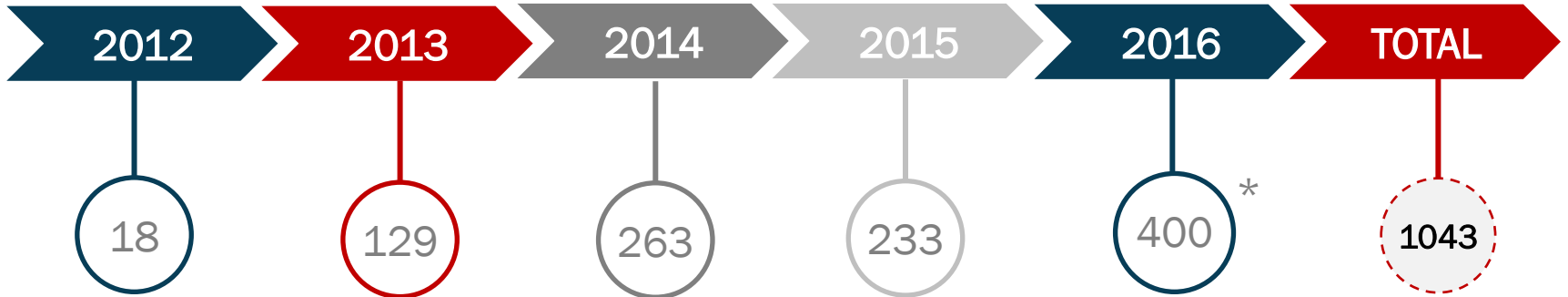


- Employment- avg. growth rate from actual data
- Wages- Forecasted based on PR's salary data
- Gross income- Forecasted based on US GDP growth
- Money spent per decree



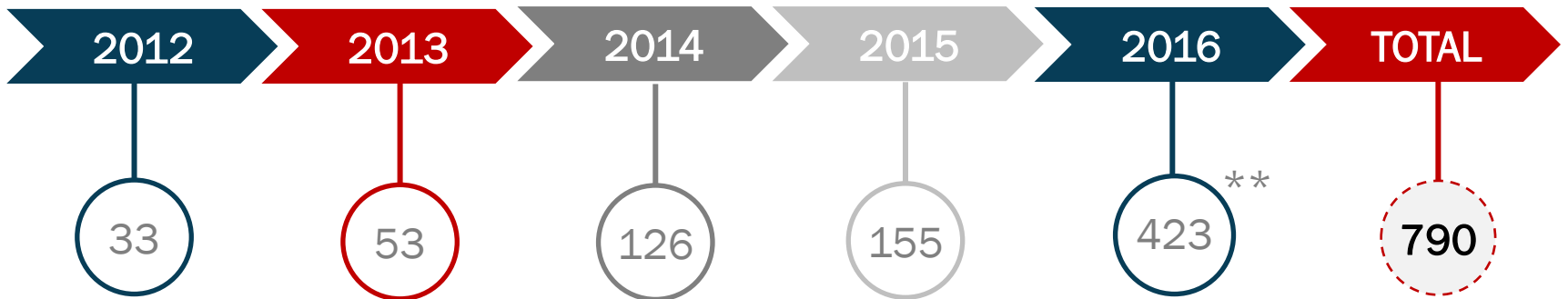
Approved Decrees

Act 22



* Includes 306 approved decrees and 94 pending approval.

Act 20



** Includes 170 approved decrees and 253 pending approval.



ACT 22

Main Effects of Act 22

- Increased the Island's overall tax base
 - Additional tax revenues from salaries, property, consumption (goods and services)

- Increased total capital available in the economy
 - New demand for local goods and services
 - Decreased investment gap

- Provided an stimulus for new Act 20 export companies to establish operations in the Island
 - 20/22 Synergy effect



Act 22

Grantees Profile

Total Net Worth:



Unspecified	17.2%
Less than 10 million	69.6%
10 million to 50 million	10.6%
50 million to 100 million	1.5%
More than 100 million	1.0%

Percentage of Capital Estimated to be Transferred:



Unspecified	27.9%
0% - 25%	23.8%
26% - 50%	10.8%
51% - 75%	11.2%
76% - 100%	20.5%
Other	5.8%

Percentage of Individuals Making Other Investments 46.3%



Act 22

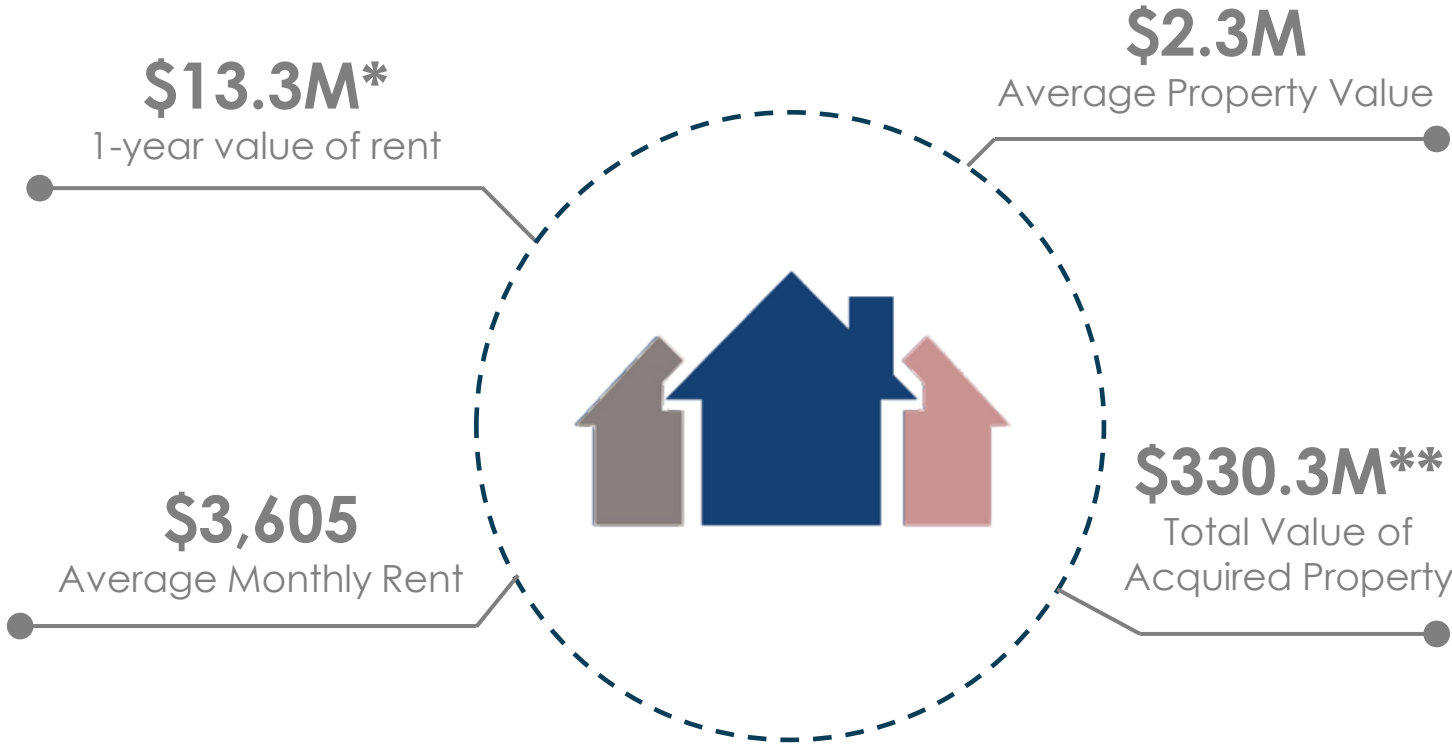
Performance in the Local Economy

(2016 annual report)

For 2016 reported Total Assets in Puerto Rico of
\$461,483,079



Effect in Real Estate Market (cumulative)



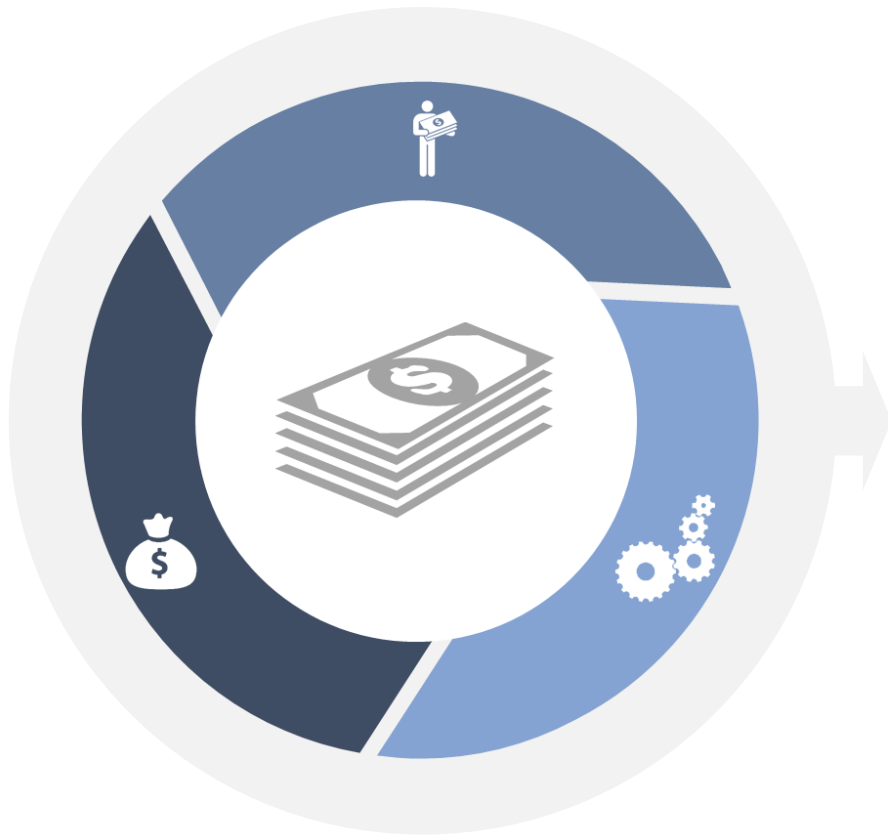
*The annualized reported value of rent could include data from business activity within Puerto Rico (not exclusive residential).

**Figures do not include some potential outliers of \$310M observed in the data.

Act 22

Grantees Spending in the Local Economy

(cumulative)



For 2016 43.5% of Grantees reported making contributions to non-profit organizations

\$261.5M
Planned Capital Investments

\$105.M
Money spent in the local economy from decree holders

42%
of participants have a business established in Puerto Rico

2,600
Potential employment generated from these **businesses**

(excludes Act 20 businesses and domestic work)

Expected Trend in Act 22 Decreases, by Scenario

(cumulative)

Year	Baseline	Optimistic	Pessimistic
2016	880	880	880
2017	1,148	1,209	1,109
2018	1,416	1,539	1,338
2019	1,684	1,868	1,567
2020	1,952	2,197	1,796
2021	2,220	2,527	2,025
2022	2,488	2,856	2,254
2023	2,757	3,186	2,483
2024	3,025	3,515	2,712
2025	3,293	3,844	2,941

Total Economic Impact by 2025

(cumulative)

GRANTEES

By 2025 one should expect close to **3,293** Act 22 grantees



INVESTMENT

Total investment in real estate by 2025 will add up to **\$1.2 Billion**



EMPLOYMENT

Total new employment **9,022**



EXPENDITURES

Total individual expenditures within the Island will reach over **\$1.5 Billion**





ACT 20

Main Effects of Act 20

- Misconception – usually equated with Act 22
- New economic activity generated from exports
- Level playing field for local and foreign companies
- Increase participation in the global economy
- Promotes innovation beyond domestic demand
- Promotes relocation of companies to Puerto Rico as to capitalize from our export platform capability



Profile of Act 20 Companies

by Service Type

Service Type	Share
Consulting Services	41.6%
Other Service	12.5%
Investment Banking	8.4%
Centralized Management Services	7.5%
Advertising and Public Relations	7.1%
Professional Services	6.1%
Architect & Engineering	4.3%
Development of Computer Programs	4.1%
Marketing and Call Centers	2.4%
Trading Companies	2.2%
Education Training Services	1.2%
Centers for Electronic data processing	1.0%
Research and Development	0.8%
Creative Industries	0.4%
Hospital and Lab Services	0.4%
Assembly and Bottling Packaging	0.2%
Total	100.0%



Most businesses are concentrated in **highly specialized services.**

Consulting Services are concentrated in the areas of Business management and Finance. Other Services include: real estate, business and economic advisory, information technology, insurance, telecommunications, among others.

These provide the greatest opportunity for technology transfer and other spillover effects in the local economy.

Act 20 Performance 2016

Almost 30% of grantees reported having a business in Puerto Rico prior to obtaining the decree

Potential local ownership

Within the U.S. the states of Texas, California and Florida had the biggest shares

Actuals and Averages of expected 3-year investment schedules, by concept

Number of Employees	3,534
Eligible	1,992
Non-Eligible	1,542
Payroll	\$165,509,280
Eligible	\$80,316,805
Non-Eligible	\$85,192,475
Investment	\$496,387,549
Real Estate	\$38,462,153
Machinery & Equipment	\$21,812,203
Other Assets	\$436,113,193

Actuals and averages of expected 3-year operational schedules

Total Revenues	\$1,426,761,745
Eligible	\$1,229,868,713
Non-Eligible	\$196,893,032
Total Expenses	\$891,541,483
Eligible	\$680,872,939
Non-Eligible	\$210,668,543
Net Income	\$494,664,008
Eligible	\$512,797,397
Non-Eligible	-\$18,133,388

Act 20 Performance 2016

Act 20 Employment, Total Payroll and Average Payroll by Type of Eligible Economic Activity

Type of Activity	Eligible Activities			Non Eligible			Total		
	Employment	Total Payroll	Payroll / Employment	Employment	Total Payroll	Payroll / Employment	Employment	Total Payroll	Payroll / Employment
Advertising and Public Relations	102	\$2,819,028	\$27,638	14	\$158,350	\$11,311	116	\$2,977,378	\$25,667
Assembly and Bottling Packaging	3	\$6,047	\$2,016	0	\$0	-	3	\$6,047	\$2,016
Architect & Engineering	104	\$1,897,344	\$18,244	44	\$2,176,214	\$49,459	148	\$4,073,558	\$27,524
Call Centers	335	\$3,201,148	\$9,556	20	\$0	\$0	355	\$3,201,148	\$9,017
Centers for Electronic data processing	6	\$246,405	\$41,068	0	\$0	-	6	\$246,405	\$41,068
Centralized Management Services	184	\$8,422,564	\$45,775	9	\$427,497	\$47,500	193	\$8,850,061	\$45,855
Consulting Services	614	\$36,084,357	\$58,769	635	\$26,166,393	\$41,207	1,249	\$62,250,750	\$49,840
Creative Industries	6	\$286,354	\$47,726	3	\$13,115	\$4,372	9	\$299,469	\$33,274
Development of Computer Programs	75	\$2,873,790	\$38,317	78	\$3,447,634	\$44,200	153	\$6,321,424	\$41,316
Education Training Services	11	\$484,030	\$44,003	1	\$9,200	\$9,200	12	\$493,230	\$41,103
Hospital and Lab Services	8	\$1,019,145	\$127,393	0	\$0	-	8	\$1,019,145	\$127,393
Investment Banking	112	\$5,883,544	\$52,532	41	\$2,152,617	\$52,503	153	\$8,036,161	\$52,524
Other Service	195	\$4,750,810	\$24,363	241	\$8,848,070	\$36,714	436	\$13,598,880	\$31,190
Professional Services	151	\$9,058,811	\$59,992	449	\$41,576,469	\$92,598	600	\$50,635,280	\$84,392
Research and Development	11	\$454,591	\$41,326	0	\$0	-	11	\$454,591	\$41,326
Trading Companies	38	\$1,975,284	\$51,981	6	\$166,667	\$27,778	44	\$2,141,951	\$48,681
Other and Unknown	37	\$853,553	\$23,069	1	\$50,249	\$50,249	38	\$903,802	\$23,784
Total	1,992	\$80,316,805	\$40,320	1,542	\$85,192,475	\$55,248	3,534	\$165,509,280	\$46,833

Source: Data provided by the PR Department of Economic Development (2016). *Imputed based on the application, as the only firm in this sector reported 0 payroll in the annual report. This imputation was not considered for the total estimates.

Act 20 Performance 2016

Estimated Individual Income Tax Payable by Employees in Eligible and Non-Eligible Activities

Type of Activity	Tax Payable in Eligible	Tax Payable in Non-Eligible	Total Individual Income Tax Payable
Advertising and Public Relations	\$91,928	\$0	\$91,928
Architect & Engineering	\$0	\$203,689	\$203,689
Centers for Electronic data processing	\$18,209	\$0	\$18,209
Centralized Management Services	\$722,975	\$38,312	\$761,288
Consulting Services	\$4,251,537	\$1,943,935	\$6,195,472
Creative Industries	\$25,799	\$0	\$25,799
Development of Computer Programs	\$188,420	\$283,146	\$471,567
Education Training Services	\$39,518	\$0	\$39,518
Hospital and Lab Services	\$231,934	\$0	\$231,934
Investment Banking	\$600,870	\$219,666	\$820,536
Other Service	\$86,353	\$532,045	\$618,399
Professional Services	\$1,091,735	\$7,861,683	\$8,953,418
Research and Development	\$33,924	\$0	\$33,924
Trading Companies	\$198,637	\$5,525	\$204,162
Other and Unknown	\$9,681	\$4,794	\$14,476
Total	\$7,591,521	\$11,092,796	\$18,684,317

Sources: Data provided by the PR Department of Economic Development (2016). PR Treasury Department (2016). Income Tax 2014 Instructions,

Act 20 Performance 2016

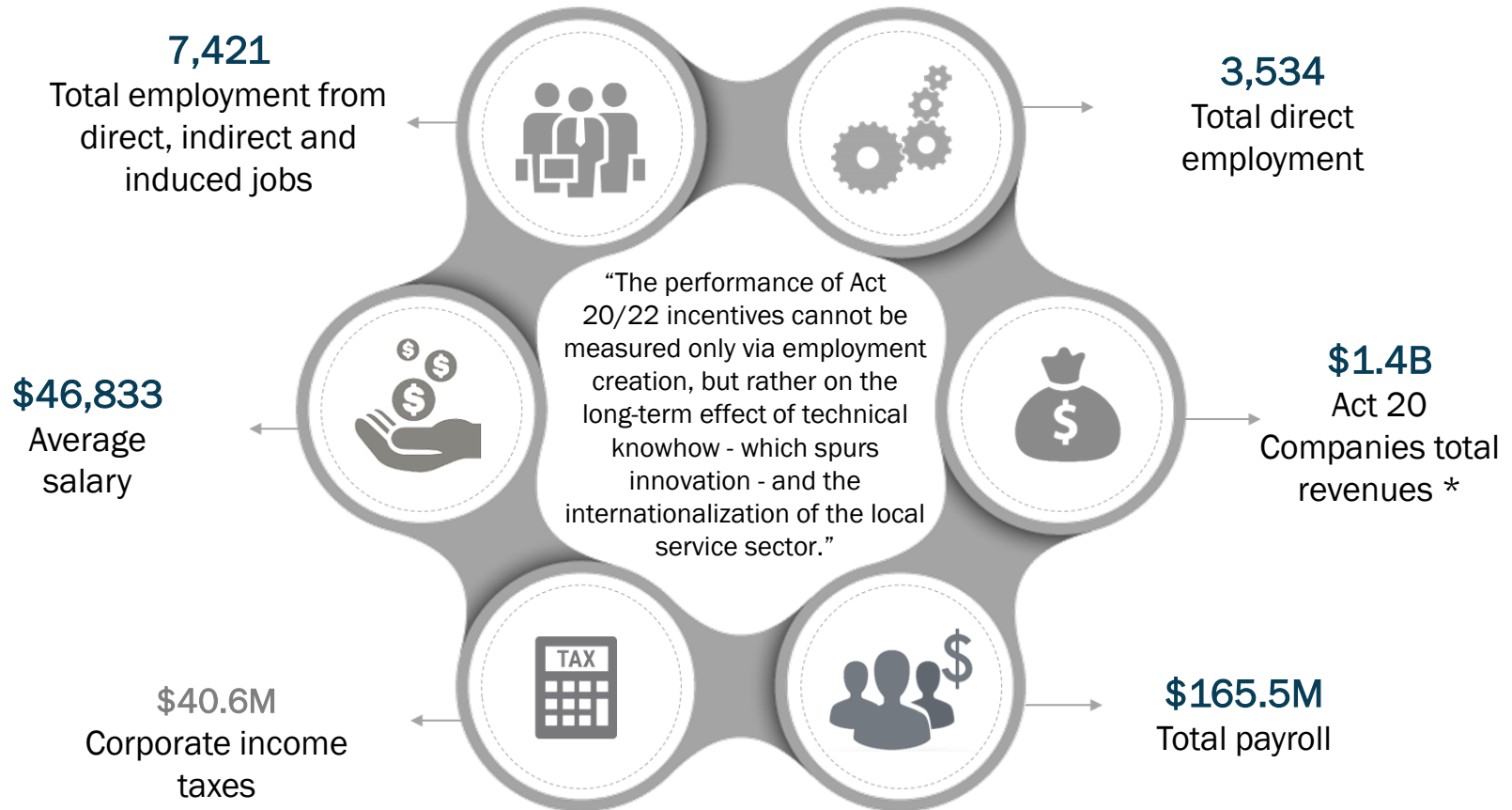
Estimated Sales and Use Tax Payable by Employees in Eligible and Non-Eligible Activities

Type of Activity	SUT Payable in Eligible	SUT Payable in Non-Eligible	Total SUT Payable
Advertising and Public Relations	\$136,760	\$7,965	\$144,725
Assembly and Bottling Packaging	\$304	\$0	\$304
Architect & Engineering	\$95,440	\$98,295	\$193,735
Call Centers	\$161,024	\$0	\$161,024
Centers for Electronic data processing	\$11,396	\$0	\$11,396
Centralized Management Services	\$384,013	\$19,402	\$403,416
Consulting Services	\$1,581,899	\$1,209,588	\$2,791,487
Creative Industries	\$12,989	\$660	\$13,649
Development of Computer Programs	\$134,222	\$157,891	\$292,113
Education Training Services	\$22,180	\$463	\$22,643
Hospital and Lab Services	\$38,542	\$0	\$38,542
Investment Banking	\$262,994	\$96,231	\$359,225
Other Service	\$234,238	\$415,891	\$650,129
Professional Services	\$395,790	\$1,660,128	\$2,055,918
Research and Development	\$21,006	\$0	\$21,006
Trading Companies	\$88,465	\$8,081	\$96,545
Other and Unknown	\$42,404	\$2,265	\$44,669
Total	\$3,623,666	\$3,676,860	\$7,300,525

Sources: Data provided by the PR Department of Economic Development (2016). PR Treasury Department (2016). *Value based on imputed payroll from application.

Act 20 Performance 2016

(cumulative)
1% of GNP



*Total revenues include eligible and non-eligible activities. Includes data from applications and annual reports

Expected Trend in Act 20 Decreases, by Scenario

(cumulative)

Year	Baseline	Optimistic	Pessimistic
2016	757	757	757
2017	995	1,073	908
2018	1,233	1,388	1,059
2019	1,473	1,707	1,212
2020	1,711	2,022	1,363
2021	1,956	2,348	1,519
2022	2,204	2,677	1,676
2023	2,436	2,985	1,823
2024	2,671	3,297	1,973
2025	2,909	3,612	2,124

Total Economic Impact by 2025

PARTICIPANTS

By 2025 one should expect close to **2,909** program participants



EMPLOYMENT

Act 20 companies would have generated close to **52,471** new employment opportunities



INCOME

By 2025 export service companies under Act 20 would have generate **\$29.5 billion** in gross income



TAX

Over **\$812 million** in corporate tax



PAYROLL

Total payroll paid by 2025 adds to over **\$3.5 billion**



Conclusions

- By the end of 2016 both programs will have added their highest amount of new decrees since their enactment
- Almost 1,000 decrees for Act 22 and 600 for Act 20
- Contrary to 2015, Act 22 participants have shifted towards property rent, rather than acquisition. Yet, the total value of property acquired, continues to increase
- Due to the uncertainty in the business environment, Act 22 participants have not increased their planned capital investments proportionally to their individual expenditures in the Island
- In accordance with such tendency, a smaller share of participants plan to establish a business in Puerto Rico
- Thus, by 2025 individual expenditures will reach almost \$1.5 billion



Conclusions

- Overall, the accumulated economic impact of Act 20 and Act 22 has continued a positive trend
- Amidst Puerto Rico's fiscal crunch, the promotion efforts of the DDEC have rendered a continuous influx of new investors into the Island
- Act 20 and 22 grantees have enlarged the Island's capital stock via an increased number of decree holders. This has been translated into productive investments in the economy
- Over \$165M in local salaries
- Over 10,021 jobs
- Over \$40M in corporate income taxes alone
- Over \$330M in local real estate investments
- The Act 20/22 programs has created a robust promotion network of private individuals which does not require direct government resources
- The incentives provide an opportunity to expand and manage the Island's openness



Recommendations

- To guarantee the institutional stability of Puerto Rico, both incentives must be maintained
- Moreover, the following years will provide a greater opportunity for Puerto Rico to capitalize on the initial investments promoted under these laws
- The programs could be strengthened to guarantee stronger spillover effects via internal linkages in the local economy
- Programmatic changes could include:
- Reducing entry barriers for local firms
- Gradually increase the requirements for higher performance measures (investment, jobs, value of exports, among others)
- Institutionalize a program evaluation system for both acts

