NEW ISSUE - BOOK-ENTRY
See "Book-Entry Only System" under *The Bonds*

In the opinion of Bond Counsel, under the provisions of the Acts of Congress now in force, (i) subject to continuing compliance with certain tax covenants, interest on the Bonds will not be includable in gross income for federal income tax purposes and (ii) the Bonds and interest thereon will be exempt from state, Commonwealth and local income taxation under existing law. However, see "Tax Exemption" for a description of alternative minimum tax consequences with respect to interest on the Bonds and other tax considerations.

$727,115,000
COMMONWEALTH OF PUERTO RICO
$279,240,000 Public Improvement Refunding Bonds, Series 2004 A
$447,875,000 Public Improvement Refunding Bonds, Series 2004 B
(General Obligation Bonds)

Dated: Date of Delivery **Due: July 1, as shown on the inside cover**

The Series 2004 A Bonds and Series 2004 B Bonds will be issued as registered bonds without coupons in denominations of $5,000 and $25,000, respectively, or any multiple thereof.

The Series 2004 A Bonds will bear interest at the rates shown on the inside cover until July 1, 2012 (the "Mandatory Tender Date"). The Series 2004 A Bonds are subject to mandatory tender, payable as to the principal portion solely from the remarketing of the Series 2004 A Bonds, on the Mandatory Tender Date at a price equal to the principal amount thereof plus accrued interest, if any, to such date. Holders of the Series 2004 A Bonds will have no right to retain the Series 2004 A Bonds after the Mandatory Tender Date. After the Mandatory Tender Date, the Commonwealth may from time to time change the method of determining the interest on the Series 2004 A Bonds, as provided in the Bond Resolution. See "Mandatory Tender for Purchase of Series 2004 A Bonds" under *The Bonds*.

The Series 2004 B Bonds will be issued initially as bonds that bear interest at ARS Rates (as defined herein), and may be converted at the option of the Commonwealth, subject to certain restrictions, to bonds that bear interest at different rates, including Daily Interest Rates, Weekly Interest Rates, Commercial Paper Rates, Fixed Interest Rates or Term Interest Rates. The Series 2004 B Bonds will bear interest from their date of delivery for the Initial Periods set forth on the inside front cover at the rates established by Lehman Brothers for Sub-Series 2004 B-1 through B-4 and by Goldman, Sachs & Co. for Sub-Series 2004 B-5 through B-8 and thereafter at the applicable ARS Rates determined for each of the Auction Periods set forth on the inside front cover pursuant to the Auction Procedures described herein. These Auction Periods may, at the option of the Commonwealth, be converted to daily, seven-day, twenty-eight day, thirty-five day, three month, six month or Special Auction Periods. Upon conversion from an ARS Rate Period to a Daily Rate Period, a Weekly Rate Period, a Commercial Paper Period, a Term Rate Period or a Fixed Rate Period, the Series 2004 B Bonds will be subject to mandatory tender, payable as to the principal portion solely from the remarketing of the Series 2004 B Bonds to be converted, on the conversion date at a price equal to the principal amount thereof plus accrued interest, if any, to such date. See "ARS Provisions of Series 2004 B Bonds" under *The Bonds* and "*Appendix II*-ARS Provisions."

The scheduled payment of principal of and interest on some of the Series 2004 A Bonds will be insured by Financial Guaranty Insurance Company, Financial Security Assurance Inc. and MBIA Insurance Corporation, as indicated on the inside cover of this Official Statement, and the scheduled payment of principal of and interest on all of the Series 2004 B Bonds will be insured by CDC IXIS Financial Guaranty North America, Inc., Financial Guaranty Insurance Company and Financial Security Assurance Inc., as indicated on the inside cover of this Official Statement.

The Bonds are general obligations of the Commonwealth. The good faith, credit and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal of and interest on the Bonds. The Constitution of Puerto Rico provides that public debt of the Commonwealth, including the Bonds, constitutes a first claim on available Commonwealth revenues.

The Bonds are offered for delivery when, as and if issued and accepted by the Underwriters subject to the approval of legality by Sidley Austin Brown & Wood LLP, New York, New York, Bond Counsel, and certain other conditions. Not all of the firms listed below will be acting as underwriters for the Series 2004 B Bonds. See *Underwriting* herein for information on the Underwriters purchasing the Series 2004 A Bonds and those purchasing the Series 2004 B Bonds. Certain legal matters will be passed upon for the Underwriters by Pietrantoni Méndez & Alvarez LLP, San Juan, Puerto Rico. It is expected that settlement for the Bonds will occur in New York, New York, on or about May 18, 2004.

GOLDMAN, SACHS & CO. BANC OF AMERICA SECURITIES LLC CITIGROUP

JP MORGAN LEHMAN BROTHERS MERRILL LYNCH & CO.

MORGAN STANLEY RAYMOND JAMES & ASSOCIATES, INC.

SAMUEL A. RAMÍREZ & CO., INC. UBS FINANCIAL SERVICES INC.

WACHOVIA BANK, NATIONAL ASSOCIATION

April 30, 2004

$727,115,000
COMMONWEALTH OF PUERTO RICO
$279,240,000 Public Improvement Refunding Bonds, Series 2004 A
$447,875,000 Public Improvement Refunding Bonds, Series 2004 B
(General Obligation Bonds)

$279,240,000 Public Improvement Refunding Bonds, Series 2004 A

$187,760,000	5% Term Bonds due July 1, 2030 - Yield- 4.20%**
$29,165,000‡	5% Term Bonds due July 1, 2031 - Yield- 3.83%**
$40,000,000±	5% Term Bonds due July 1, 2031 - Yield- 3.83%**
$22,315,000†	4% Term Bonds due July 1, 2031 - Yield- 3.83%**

$447,875,000 Public Improvement Refunding Bonds, Series 2004 B consisting of:

Sub-Series	Principal Amount	Final Maturity (July 1)
2004 B-1‡	$55,925,000	2021
2004 B-2‡	$56,000,000	2024
2004 B-3‡	$56,000,000	2027
2004 B-4‡	$55,975,000	2028
2004 B-5*	$50,000,000	2029
2004 B-6*	$50,000,000	2029
2004 B-7†	$61,975,000	2031
2004 B-8†	$62,000,000	2032

Sub-Series	Initial Auction Date	Last Day of Initial Period	Initial Interest Payment Date	Auction Period	Auction Generally Held On	CUSIP No.
2004 B-1	06/09/04	06/09/04	07/01/04	35-Day	Wednesday	745145 8R 6
2004 B-2	06/16/04	06/16/04	07/01/04	35-Day	Wednesday	745145 8S 4
2004 B-3	05/24/04	05/24/04	05/25/04	7-Day	Monday	745145 8T 2
2004 B-4	05/26/04	05/26/04	05/27/04	7-Day	Wednesday	745145 8U 9
2004 B-5	05/25/04	05/25/04	05/26/04	7-Day	Tuesday	745145 8H 8
2004 B-6	05/27/04	05/27/04	05/28/04	7-Day	Thursday	745145 8J 4
2004 B-7	05/28/04	05/31/04	06/01/04	7-Day	Friday	745145 8K 1
2004 B-8	05/19/04	05/19/04	06/01/04	Daily	Daily	745145 8L 9

The Bank of New York will serve as Auction Agent. Lehman Brothers will serve as broker-dealer on the Sub-Series 2004 B-1 Bonds through the Sub-Series 2004 B-4 Bonds and Goldman, Sachs & Co. will serve as broker-dealer on the Sub-Series 2004 B-5 Bonds through the Sub-Series 2004 B-8 Bonds.

---

*Insured by CDC IXIS Financial Guaranty North America, Inc.
†Insured by Financial Guaranty Insurance Company.
‡Insured by Financial Security Assurance Inc.
±Insured by MBIA Insurance Corporation.
** Yield to July 1, 2012, the Mandatory Tender Date.

Commonwealth of Puerto Rico

Governor

SILA M. CALDERÓN

Members of the Cabinet

CÉSAR MIRANDA
Chief of Staff

JOSÉ M. IZQUIERDO
Secretary of State

ANABELLE RODRÍGUEZ
Secretary of Justice

JUAN A. FLORES GALARZA
Secretary of the Treasury

CÉSAR A. REY
Secretary of Education

FRANK ZORRILLA MALDONADO
Secretary of Labor and Human Resources

JOHNNY V. RULLÁN
Secretary of Health

LUIS RIVERO CUBANO
Secretary of Agriculture

FERNANDO E. FAGUNDO
Secretary of Transportation and Public Works

MILTON SEGARRA
Secretary of Economic Development and Commerce

YOLANDA ZAYAS SANTANA
Secretary of Family Affairs

ILEANA ECHEGOYEN
Secretary of Housing

LUIS E. RODRÍGUEZ
Secretary of Natural and Environmental Resources

FERNANDO TORRES RAMIREZ
Interim Secretary of Consumer Affairs

JORGE L. ROSARIO
Secretary of Sports and Recreation

MIGUEL A. PEREIRA
Secretary of Corrections and Rehabilitation

Legislative Officers

ANTONIO FAS ALZAMORA
President, Senate

CARLOS VIZCARRONDO
Speaker, House of Representatives

Fiscal Officers

MELBA ACOSTA
Director, Office of Management and Budget

ANTONIO FARÍA
President, Government Development Bank for Puerto Rico

No dealer, broker, sales representative or other person has been authorized by the Commonwealth or the Underwriters to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the Commonwealth or any Underwriter. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the Bonds, by any person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale. The information set forth herein has been obtained from the Commonwealth and other official sources that are believed to be reliable. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Commonwealth since the date hereof. The Underwriters have provided the following sentence and paragraph for inclusion in this Official Statement. The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their respective responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE BONDS AND THE COMMONWEALTH'S OUTSTANDING GENERAL OBLIGATION BONDS AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

Other than with respect to information concerning CDC IXIS Financial Guaranty North America, Inc. ("CIFG NA"), Financial Guaranty Insurance Company ("FGIC"), Financial Security Assurance Inc. ("FSA") and MBIA Insurance Corporation ("MBIA") contained under the caption *Bond Insurance* and the insurance policy specimens appearing in *Appendices IV* through *VII* herein, none of the information in this Official Statement has been supplied or verified by CIFG NA, FGIC, FSA and MBIA, respectively, and CIFG NA, FGIC, FSA and MBIA make no representation or warranty, express or implied, as to (i) the accuracy or completeness of such information, (ii) the validity of the Bonds, or (iii) the tax exempt status of the interest on the Bonds.

TABLE OF CONTENTS

$727,115,000
Commonwealth of Puerto Rico
$279,240,000 Public Improvement Refunding Bonds, Series 2004 A
$447,875,000 Public Improvement Refunding Bonds, Series 2004 B
(General Obligation Bonds)

INTRODUCTORY STATEMENT

This Official Statement of the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico"), which includes the cover page, the inside cover page, the appendices hereto and the report incorporated by reference below, provides certain information in connection with the sale of $279,240,000 Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 2004 A (the "Series 2004 A Bonds") and $447,875,000 Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 2004 B (the "Series 2004 B Bonds" and together with the Series 2004 A Bonds, the "Bonds").

The Bonds are being issued under the provisions of Act No. 2 of the Legislature of Puerto Rico, approved October 10, 1985, and Joint Resolution No. 57 of the Legislature of Puerto Rico, approved July 12, 1993 (collectively, the "Act"), and pursuant to a resolution authorizing the issuance of the Bonds (the "Bond Resolution") adopted by the Secretary of the Treasury and approved by the Governor of Puerto Rico on April 30, 2004.

The Series 2004 A Bonds maturing on July 1, 2031, in the aggregate principal amount of $40,000,000 and bearing interest at a rate of 5.0% (the "MBIA Insured Bonds"), will be insured by a municipal bond insurance policy (the "MBIA Insurance Policy") issued by MBIA Insurance Corporation ("MBIA"). The Series 2004 A Bonds maturing on July 1, 2031, in the aggregate principal amount of $29,165,000 and bearing interest at a rate of 5.0% (the "FSA Series 2004 A Insured Bonds"), will be insured by a municipal bond insurance policy (the "FSA Series 2004 A Insurance Policy") issued by Financial Security Assurance Inc. ("FSA"). The Series 2004 A Bonds maturing on July 1, 2031, bearing interest at a rate of 4.0% (the "FGIC Series 2004 A Insured Bonds"), will be insured by a municipal bond insurance policy (the "FGIC Series 2004 A Insurance Policy") issued by Financial Guaranty Insurance Company ("FGIC").

The Sub-Series 2004 B-1 Bonds, the Sub-Series 2004 B-2 Bonds, the Sub-Series 2004 B-3 Bonds and the Sub-Series 2004 B-4 Bonds (the "FSA Series 2004 B Insured Bonds" and, together with the FSA Series 2004 A Insured Bonds, the "FSA Insured Bonds"), will be insured by a municipal bond insurance policy issued by FSA (the "FSA Series 2004 B Insurance Policy" and, together with the FSA Series 2004 A Insurance Policy, the "FSA Insurance Policy"). The Sub-Series 2004 B-5 Bonds and the Sub-Series 2004 B-6 Bonds (the "CIFG NA Insured Bonds"), will be insured by a municipal bond insurance policy (the "CIFG NA Insurance Policy") issued by CDC IXIS Financial Guaranty North America, Inc. ("CIFG NA"). The Sub-Series 2004 B-7 Bonds and the Sub-Series 2004 B-8 Bonds (the "FGIC Series 2004 B Insured Bonds" and, together with the FGIC Series 2004 A Insured Bonds, the "FGIC Insured Bonds" and, together with the FSA Insured Bonds, the MBIA Insured Bonds and the CIFG NA Insured Bonds, collectively, the "Insured Bonds"), will be insured by a municipal bond insurance policy issued by FGIC (the "FGIC Series 2004 B Insurance Policy" and, together with the FGIC Series 2004 A Insurance Policy, the "FGIC Insurance Policy" and, together with the CIFG NA Insurance Policy, the FSA Insurance Policy, and the MBIA Insurance Policy, collectively, the "Insurance Policies"). CIFG NA, FGIC, FSA and MBIA are each a "Bond Insurer" and, collectively, the "Bond Insurers."

Under the Act, the good faith, credit and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal of and interest on the Bonds. The Constitution of Puerto Rico provides that public debt of the Commonwealth, including the Bonds, constitutes a first claim on available Commonwealth revenues.

This Official Statement includes the cover page, the inside cover page, the Commonwealth of Puerto Rico Financial Information and Operating Data Report dated April 1, 2004 (the "Commonwealth Report") attached hereto as *Appendix I*, the description of the ARS Provisions attached hereto as *Appendix II* and the Comprehensive Annual Financial Report of the Commonwealth for the fiscal year ended June 30, 2002, prepared by the Department of the Treasury of the Commonwealth (the "Commonwealth's Annual Financial Report"), which is incorporated by reference herein. It is expected that the financial statements of the Commonwealth for fiscal year 2003 will be available during the second calendar quarter of 2004.

The Commonwealth Report attached hereto as *Appendix I* includes important information about the Commonwealth, including information about the economy, historical revenues and expenditures of the Commonwealth's General Fund, the year-end results of the fiscal 2003 budget, the approved budget for fiscal year 2004, the proposed budget for fiscal year 2005, and the debt of the Commonwealth's public sector, and should be read in its entirety.

The Commonwealth's Annual Financial Report includes the basic financial statements of the Commonwealth for the fiscal year ended June 30, 2002, together with the independent auditor's report thereon, dated April 30, 2003, of KPMG LLP, certified public accountants. The Commonwealth's Annual Financial Report has been filed by the Commonwealth with each nationally recognized municipal securities information repository ("NRMSIR"). KPMG LLP did not audit the financial statements of the Public Buildings Authority's capital project fund (a major fund), and certain activities, funds and component units separately identified in their report. Those financial statements were audited by other auditors whose reports have been furnished to KPMG LLP, and their opinion as to the basic financial statements, insofar as it relates to the amounts included in the basic financial statements pertaining to such activities, funds and component units, is based solely on the reports of the other auditors.

Any appendix of an Official Statement of the Commonwealth or of any instrumentality of the Commonwealth containing any revision to the Commonwealth Report or to the Commonwealth's Annual Financial Report that is filed with each NRMSIR and the Municipal Securities Rulemaking Board, or any new or revised Commonwealth Report or Commonwealth's Annual Financial Report or other document containing information that modifies or supersedes the information contained in the Commonwealth Report or in the Commonwealth's Annual Financial Report, that is filed with each NRMSIR, in each case after the date hereof and prior to the termination of the offering of the Bonds, shall be deemed to be incorporated by reference into this Official Statement and to be part of this Official Statement from the date of filing of such document. Any statement contained in the Commonwealth's Annual Financial Report shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any such subsequently filed document modifies or supersedes such statement. Any statement contained in the Commonwealth Report or elsewhere herein shall also be deemed to be modified or superseded to the extent that a statement contained in any such subsequently filed document modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Commonwealth will provide without charge to any person to whom this Official Statement is delivered, on the written or oral request of such person, a copy of the Commonwealth's Annual Financial Report incorporated herein by reference. Requests should be directed to Director-New York Office, Government Development Bank for Puerto Rico, 140 Broadway, 38th Floor, New York, New York

10005, telephone number (212) 422-6420, or to Director-General Obligations Division, Government Development Bank for Puerto Rico, P.O. Box 42001, San Juan, Puerto Rico 00940, telephone number (787) 722-7060.

A copy of the Commonwealth's Annual Financial Report may also be obtained by contacting a NRMSIR. The address of each NRMSIR is set forth in *Continuing Disclosure* below.

This Official Statement, including information incorporated in this Official Statement by reference, contains certain "forward-looking statements" concerning the Commonwealth's operations and financial condition. These statements are based upon a number of assumptions and estimates which are subject to significant uncertainties, many of which are beyond the control of the Commonwealth. The words "may," "would," "could," "will," "expect," "anticipate," "believe," "intend," "plan," "estimate" and similar expressions are meant to identify these forward-looking statements. Actual results may differ materially from those expressed or implied by these forward-looking statements.

OVERVIEW

Puerto Rico is located approximately 1,600 miles southeast of New York City. According to the United States Census Bureau, its population was 3,808,610 in 2000. Puerto Rico's political status is that of a commonwealth. The United States and the Commonwealth share a common defense, market, currency and citizenship. The Commonwealth government exercises virtually the same control over its internal affairs as is exercised by the state governments of each of the fifty states over their respective internal affairs, with similar separation of powers among the executive, legislative and judicial branches. It differs from the states, however, in its relationship with the federal government. The people of Puerto Rico are citizens of the United States but do not vote in national elections. They are represented in Congress by a Resident Commissioner who has a voice in the House of Representatives, but no vote. Most federal taxes, except those such as Social Security taxes, which are imposed by mutual consent, are not levied in Puerto Rico. No federal income tax is collected from Puerto Rico residents on income earned in Puerto Rico, except for certain federal employees who are subject to taxes on their salaries. The official languages of Puerto Rico are Spanish and English.

Puerto Rico has a diversified economy with manufacturing and services comprising its principal sectors. Puerto Rico's economy is closely linked to the United States economy. In fiscal year 2003 (which ended on June 30, 2003), the Commonwealth's gross product (preliminary, in current dollars) was \$47.4 billion and personal income per capita (preliminary, in current dollars) was \$11,279.

The Constitution of Puerto Rico limits the amount of general obligation debt that the Commonwealth can issue. The Commonwealth's policy has been and continues to be to maintain the level of such debt within a prudent range below the constitutional limitation.

Fiscal responsibility for the Commonwealth is shared among the Department of the Treasury, the Office of Management and Budget and Government Development Bank for Puerto Rico ("Government Development Bank"). The Department of the Treasury is responsible for collecting most of the Commonwealth's revenues, overseeing preparation of its financial statements and contributing to the preparation of the budget. The Office of Management and Budget prepares the Commonwealth's budget and is responsible for monitoring expenditures. Government Development Bank is the fiscal agent and financial advisor to the Commonwealth and its agencies, public corporations and municipalities and coordinates the management of public finances.

Additional information about the Commonwealth can be found in the Commonwealth Report attached hereto as *Appendix I*.

PLAN OF FINANCING

The Bonds are being issued for the purpose of refunding the following general obligation bonds of the Commonwealth (the "Refunded Bonds"):

Refunded Bonds	Principal Amount to be Refunded	Interest Rate	Maturity Date July 1,	Redemption Date July 1,	Redemption Price (% of Par)
Public Improvement Refunding Bonds, Series 1999	$11,035,000*[(1)]	5.000%	07/01/2005	—	—
Public Improvement Refunding Bonds, Series 1999	35,400,000[(2)]	5.000	07/01/2005	—	—
Public Improvement Bonds of 2001, Series B	3,890,000	5.050	07/01/2020	07/01/2011	100
Public Improvement Bonds of 2001, Series B	8,125,000	5.000	07/01/2021	07/01/2011	100
Public Improvement Bonds of 2001, Series B	5,625,000	5.050	07/01/2021	07/01/2011	100
Public Improvement Bonds of 2001, Series B	8,630,000	5.125	07/01/2023	07/01/2011	100
Public Improvement Bonds of 2001, Series B	19,575,000	5.000	07/01/2023	07/01/2011	100
Public Improvement Refunding Bonds, Series 2001	21,635,000	5.000	07/01/2024	07/01/2011	100
Public Improvement Refunding Bonds, Series 2001	81,130,000	5.250	07/01/2027	07/01/2011	100
Public Improvement Refunding Bonds, Series 2001	104,455,000	5.125	07/01/2030	07/01/2011	100
Public Improvement Bonds of 2002, Series A	17,140,000	5.375	07/01/2028	07/01/2011	100
Public Improvement Bonds of 2002, Series A	102,045,000	5.125	07/01/2031	07/01/2011	100
Public Improvement Bonds of 2003, Series A	13,000,000	4.800	07/01/2032	07/01/2012	100
Public Improvement Bonds of 2003, Series A	130,290,000	5.000	07/01/2032	07/01/2012	100
Public Improvement Bonds of 2003, Series A	112,270,000	5.000	07/01/2027	07/01/2012	100
Public Improvement Bonds of 2004, Series A	140,000	2.000	07/01/2004	—	—
Public Improvement Bonds of 2004, Series A	690,000	4.000	07/01/2006	—	—
Public Improvement Bonds of 2004, Series A	710,000	4.000	07/01/2007	—	—
Public Improvement Bonds of 2004, Series A	740,000	5.000	07/01/2008	—	—
Public Improvement Bonds of 2004, Series A	770,000	5.000	07/01/2009	—	—
Public Improvement Bonds of 2004, Series A	815,000	5.000	07/01/2010	—	—
Public Improvement Bonds of 2004, Series A	855,000	5.000	07/01/2011	—	—
Public Improvement Bonds of 2004, Series A	895,000	5.000	07/01/2012	—	—

* Expected amount. Principal amount refunded may be higher or lower depending upon the precise portfolio of Government Obligations (defined below) purchased with the proceeds of the Bonds and deposited into the Escrow Fund (also defined below). The Commonwealth expects to place a final purchase order for such Government Obligations shortly before the delivery of the Bonds. The portfolio of Government Obligations may be further adjusted upon the delivery of certain bonds to be issued by Public Buildings Authority as described in the second paragraph below this table and in *Tax Exemption* below.

(1) Originally issued in the principal amount of $62,730,000.

(2) Originally issued in the principal amount of $50,000,000.

The Secretary of the Treasury will deposit the net proceeds of the Bonds and certain other available moneys into an escrow fund (the "Escrow Fund") with Banco Popular de Puerto Rico (the "Escrow Agent"). The net proceeds of the Bonds and such other available moneys will be invested in noncallable direct obligations of the United States ("Government Obligations"), the principal of and interest on which, will be sufficient to pay the principal of and premium on the Refunded Bonds on the redemption date mentioned above, which redemption date will be irrevocably designated by the Secretary of the Treasury, and to pay the interest thereon to such redemption date.

Upon the deposit with the Escrow Agent referred to above (and in the case of the Public Improvement Refunding Bonds, Series 1999, identified in footnote * in the table above, after the delivery of certain bonds to be issued by the Public Buildings Authority on June 10, 2004, at which date, the precise principal amount of such Series 1999 Bonds to be refunded will be known), the Refunded Bonds will cease to be outstanding under the terms of their respective authorizing resolutions. Under the Act, once the above deposit of Government Obligations has been made, all the Refunded Bonds will be deemed not to be outstanding for the purpose of applying the debt limitation under Section 2 of Article VI of the Commonwealth's Constitution.

The sufficiency of the amount so deposited, with investment earnings thereon, to accomplish the refunding of the Refunded Bonds referred to above, will be verified by Samuel Klein & Co., Certified Public Accountants (the "Verification Agent").

Sources and Uses of Funds

Sources:

Principal amount of the Bonds	$727,115,000.00
Net original issue premium	16,094,767.65
Total sources	$743,209,767.65

Uses:

Deposit into the Escrow Fund for Refunded Bonds	$719,457,698.88[1]
Underwriting discount, bond insurance premium and legal, printing, and other financing expenses	23,752,068.77
Total uses	$743,209,767.65

[1] In addition, approximately $12.7 million currently on deposit in the Redemption Fund is expected to be deposited into the Escrow Fund upon delivery of the Bonds.

Interest Rate Swap Agreements

On April 13, 2004, in anticipation of the issuance of the Series 2004 B Bonds, Government Development Bank, on behalf of the Commonwealth, entered into interest rate exchange agreements (the "Interest Rate Agreements") with Goldman Sachs Mitsui Marine Derivative Products, L.P., which is an affiliate of Goldman, Sachs & Co. (an underwriter of the Bonds), rated "Aaa" and "AA+" by Moody's Investors Service ("Moody's) and Standard & Poor's, a division of The McGraw-Hill Companies ("S&P"), respectively, and with Lehman Brothers Special Financing, Inc. ("LBSF"), which is an affiliate of Lehman Brothers Inc. (an underwriter of the Bonds) (upon transfer of the Interest Rate Agreements to the Commonwealth, as described below, LBSF will be substituted as counterparty by Lehman Brothers Derivative Products, Inc., which is rated "Aaa" and "AAA" by Moody's and S&P, respectively) (collectively, the "Counterparties"). The purpose of the Interest Rate Agreements was to hedge the Commonwealth's variable rate debt exposure and the interest rate risks associated therewith in relation to the Series 2004 B Bonds.

Pursuant to the terms of the Interest Rate Agreements, upon issuance of the Series 2004 B Bonds, Government Development Bank will, on the date of delivery of the Bonds, begin paying a fixed interest rate and begin receiving a variable interest rate equal to a predetermined percentage of LIBOR plus a spread (which variable interest rate is expected to correspond closely to the variable interest rate to be paid by the Commonwealth on the Series 2004 B Bonds), based on an aggregate notional amount initially equal to $447,875,000 and declining throughout the term of the Interest Rate Agreements in tandem with reductions in the outstanding principal amount of the Series 2004 B Bonds. In addition, upon enactment of proposed legislation that will expressly authorize the Commonwealth to enter into agreements of the nature of the Interest Rate Agreements and, among other things, to pledge the good faith, credit and taxing power of the Commonwealth to all payments to be made by it thereunder, Government Development Bank expects to transfer its obligations under the Interest Rate Agreements to the Commonwealth. The Interest Rate Agreements will terminate on the final maturity date of the Series 2004 B Bonds.

The obligation of Government Development Bank to make scheduled payments under the Interest Rate Agreements prior to their transfer to the Commonwealth, as well as certain payments due upon the termination of the Interest Rate Agreements prior to the stated termination date thereof and similarly prior to such transfer, will be an unsecured general obligation of Government Development Bank payable from any lawfully available funds.

THE BONDS

Description of the Series 2004 A Bonds

This description of the Series 2004 A Bonds relates only to the terms and provisions which are applicable during the period from their date of delivery through July 1, 2012 (the "Mandatory Tender Date").

The Series 2004 A Bonds will be dated the date of their delivery and will bear interest from that date. The Series 2004 A Bonds will be initially issued in book-entry only form and will mature, subject to prior redemption, on the dates set forth on the inside cover of this Official Statement. The Series 2004 A Bonds will be issuable as fully registered bonds without coupons in denominations of $5,000 or any multiple thereof.

The Series 2004 A Bonds initially will bear interest at the rates set forth on the inside cover hereof during the period ending on the Mandatory Tender Date. During that period, interest will be payable semiannually on each January 1 and July 1, commencing July 1, 2004, and will be computed on the basis of a 360-day year of twelve 30-day months.

The Series 2004 A Bonds are subject to mandatory tender, payable solely from the remarketing of the Series 2004 A Bonds, on the Mandatory Tender Date at a price equal to 100% of the principal amount thereof plus accrued interest, if any, to such Date. Holders of the Series 2004 A Bonds will have no right to retain the Series 2004 A Bonds after such Mandatory Tender Date. Prior to the Mandatory Tender Date, the Series 2004 A Bonds may not be tendered and may not be converted to bear interest at any rate other than the rates set forth on the inside cover hereof, as provided in the Bond Resolution. See "Mandatory Tender for Purchase of Series 2004 A Bonds," below.

Description of the Series 2004 B Bonds

The Series 2004 B Bonds will be issued initially as bonds that bear interest at ARS Rates (as defined below in "ARS Provisions of Series 2004 B Bonds") but may be converted at the option of the Commonwealth, subject to certain restrictions, to bonds that bear interest at different rates including Daily Interest Rates, Weekly Interest Rates, Commercial Paper Rates, Term Interest Rates, or Fixed Interest Rates. The Series 2004 B Bonds will be dated the date of their delivery, and will bear interest from that date for the applicable Initial Period set forth on the inside front cover of this Official Statement at the rates established by Lehman Brothers for the Sub-Series 2004 B-1 Bonds through the Sub-Series 2004 B-4 Bonds and by Goldman, Sachs & Co. for the Sub-Series 2004 B-5 Bonds through the Sub-Series 2004 B-8 Bonds and thereafter at the ARS Rate determined pursuant to the Auction Procedures (as hereinafter defined). Following the Initial Period, the Series 2004 B Bonds will initially bear interest for the Auction Periods set forth on the inside front cover of the Official Statement but can be converted to a daily, seven-day, 28-day, 35-day, three-month, six-month or a Special Auction Periods. A Special Auction Period is any period of 182 days or less which is divisible by seven and which is not another Auction Period or any period of more than 182 days which ends not later than the final maturity of the Series 2004 B Bonds. Upon conversion from an ARS Rate Period to a Daily Rate Period, a Weekly Rate Period, a Commercial Paper Rate Period, a Term Rate Period or a Fixed Rate Period, the Series 2004 B Bonds will be subject to mandatory tender, payable as to the principal portion solely from the proceeds of the remarketing of the Series 2004 B Bonds to be converted, on the conversion date at a price equal to 100% of the principal amount thereof plus accrued interest, if any, to such date. Interest on the Series 2004 B Bonds in a daily, seven-day, 28-day, 35-day, a three-month or a Special Auction Period of 180 days or less will be computed on the basis of a 360-day year for the actual number of days elapsed. Interest on the Series

2004 B Bonds in a six-month Auction Period or a Special Auction Period of more than 180 days will be computed on the basis of a 360-day year of twelve 30-day months. See "ARS Provisions of Series 2004 B Bonds" below and "*Appendix II*-ARS Provisions."

The Series 2004 B Bonds will be dated the date of their delivery and will bear interest from that date. The Series 2004 B Bonds will be initially issued in book-entry only form and will mature, subject to prior redemption, on the dates set forth on the inside front cover of this Official Statement. The Series 2004 B Bonds will be issuable as fully registered bonds without coupons in denominations of $25,000 or any multiple thereof. The final maturity for the Series 2004 B Bonds is 2032.

Book-Entry Only System

The following information concerning The Depository Trust Company ("DTC") and DTC's book entry system has been obtained from DTC and neither the Commonwealth nor the Underwriters take any responsibility for the accuracy thereof.

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully registered bonds registered in the name of Cede & Co. (DTC's partnership nominee) or such other nominee as may be requested by an authorized representative of DTC. One fully registered Bond will be issued for each maturity of each of the Series 2004 A Bonds and the Series 2004 B Bonds, each in the aggregate principal amount of such maturity, and will be deposited with or for the benefit of DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 85 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Bonds Clearing Corporation, Government Bonds Clearing Corporation, NBS Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, GSCC, MBSCC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has S&P's highest rating: "AAA." The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com

Purchases of the Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of a Bond ("Beneficial Owner") will in turn be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive any confirmation from DTC of their purchases. Beneficial Owners are, however, expected to receive written confirmations providing details of their transactions, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the

Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive definitive Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co, or such other nominee as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee does not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the Registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Bonds within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Commonwealth as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on such record date (identified in a listing attached to the Omnibus Proxy).

Principal, redemption premium, if any, and interest payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Commonwealth, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, its nominee, or the Commonwealth, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, redemption premium, if any, and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Commonwealth, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the Commonwealth or the Registrar. Under such circumstances, in the event that a successor securities depository is not obtained, definitive Bonds will be printed and delivered.

The Commonwealth may decide to discontinue use of the system of book-entry transfers through DTC (or a successor depository). In that event, definitive Bonds will be printed and delivered.

Payments and Transfers

No assurance can be given by the Commonwealth that DTC will make prompt transfer of payments to the Participants or that Participants will make prompt transfer of payments to Beneficial Owners. The Commonwealth is not responsible or liable for payment by DTC or Participants or for sending transaction statements or for maintaining, supervising or reviewing records maintained by DTC or Participants.

For every transfer and exchange of the Bonds, the Beneficial Owners may be charged a sum sufficient to cover any tax, fee or other charge that may be imposed in relation thereto.

Discontinuance of the Book-Entry Only System

In the event that the book-entry only system is discontinued, the following provisions will apply: principal of and redemption premium, if any, on the Bonds shall be payable in lawful money of the United States of America at the principal office of Banco Popular de Puerto Rico, acting as Registrar (the "Registrar"), in San Juan, Puerto Rico. Interest on the Bonds will be payable by check mailed to the respective addresses of the registered owners determined as of the record date thereof provided in the Bond Resolution as shown on the registration books of the Commonwealth maintained by the Registrar. The Series 2004 A Bonds will be issued only as registered Bonds without coupons in denominations of $5,000 or any multiple thereof. The Series 2004 B Bonds will be issued only as registered Bonds without coupons in denominations of $25,000 or any multiple thereof. The transfer of the Bonds will be registrable and they may be exchanged at the corporate trust office of the Registrar in San Juan, Puerto Rico, upon the payment of any taxes or other governmental charges required to be paid with respect to such transfer or exchange.

Mandatory Tender for Purchase of Series 2004 A Bonds

The Series 2004 A Bonds are subject to mandatory tender for purchase, payable as to their principal portion solely from the remarketing thereof, at a purchase price equal to the principal amount of such bonds (the "Tender Purchase Price") on the Mandatory Tender Date, with no right of the owners of such bonds to retain them. On the Mandatory Tender Date, the Series 2004 A Bonds must be tendered for purchase by the holders thereof to the Registrar. Goldman, Sachs & Co. (the "Remarketing Agent") will act as remarketing agent of the Series 2004 A Bonds pursuant to a remarketing agreement with the Commonwealth acting through the Secretary of the Treasury.

Prior to the Mandatory Tender Date, the Secretary of the Treasury will determine the initial interest rate mode or modes that will be applicable to such bonds from and after the Mandatory Tender Date. The interest rate or rates to be borne by such bonds immediately after the Mandatory Tender Date will be determined by the Remarketing Agent and will be equal to the lowest rate or rates that, in the opinion of the Remarketing Agent, will permit the remarketing of such bonds at par. The interest rate or rates to be determined by the Remarketing Agent may be a fixed or variable rate, and the Series 2004 A Bonds may be subject to subsequent remarketings. If the Secretary of the Treasury determines that the interest rate mode applicable immediately after the Mandatory Tender Date will be a Fixed Rate Mode (in which the interest rate on the Series 2004 A Bonds will be fixed to their maturity) or a Term Rate Mode (in which the interest rate on the Series 2004 A Bonds will be fixed for one year or longer), the Series 2004 A Bonds may be remarketed at an aggregate price exceeding par, but the tendering holders will only receive the Tender Purchase Price. The Secretary of the Treasury in conjunction with any such remarketing may establish amortization requirements for such bonds that will result in the mandatory redemption of such bonds prior to maturity.

As of the date of this Official Statement, the Commonwealth has not provided and does not intend to provide any liquidity facility for the payment of the purchase price payable upon the mandatory tender of the Series 2004 A Bonds on the Mandatory Tender Date, nor is there any requirement that such liquidity facility be obtained. The Tender Purchase Price for such bonds is expected to be obtained from the remarketing thereof.

The Remarketing Agent will use its best efforts to remarket the Series 2004 A Bonds on the Mandatory Tender Date. On the Mandatory Tender Date, the Series 2004 A Bonds shall be deemed to have been tendered on such date for purchase and, if on such date moneys sufficient to pay the Tender Purchase Price thereof shall be on deposit with the Registrar, acting as Tender Agent, interest on such bonds shall cease to accrue. The remarketing of the Series 2004 A Bonds on the Mandatory Tender Date is subject, in all of the cases described above, to the condition that the Secretary of the Treasury receives on the Mandatory Tender Date an opinion of Bond Counsel to the effect that the action proposed to be taken will not have an adverse effect on the tax exemption of the Bonds (an "Opinion of Bond Counsel").

Any Series 2004 A Bonds not purchased on the Mandatory Tender Date, including on account of a failure of the Secretary of the Treasury to receive an Opinion of Bond Counsel, (i) will be returned to their holders, remain outstanding and bear interest at the rate of 8% per annum (or such higher rate as the Secretary of the Treasury, upon receipt of an Opinion of Bond Counsel, may determine) and (ii) will be purchased upon the availability of funds to purchase such Bonds and the receipt of an Opinion of Bond Counsel. The Commonwealth has agreed that it will cause the Series 2004 A Bonds to be remarketed (in such rate mode or modes) on the Mandatory Tender Date or on the first date thereafter at which such Opinion of Bond Counsel is delivered and they can be sold at par (or above par in the two exceptions described above) at a rate not exceeding the maximum legal rate (currently 12% per annum).

Notice of the mandatory tender for purchase of the Series 2004 A Bonds will be given not less than 30 days prior to the Mandatory Tender Date by first-class mail, postage prepaid, to DTC (or if the book-entry only system has been discontinued as described above, to the registered owners of the Series 2004 A Bonds, at their addresses appearing upon the registration books maintained by the Registrar). Failure to mail such notice to the registered owner of any Series 2004 A Bond will not affect the tender, purchase or remarketing of such bond.

ARS Provisions of Series 2004 B Bonds

The following is a summary of certain provisions regarding the Series 2004 B Bonds and should be read in conjunction with the more detailed information set forth in "*Appendix II*-ARS Provisions," which contains a more detailed discussion of the ARS Provisions and the Auction Procedures regarding the Series 2004 B Bonds.

Certain Definitions

"ARS Rate" means, with respect to each sub-series of the Series 2004 B Bonds while the Series 2004 B Bonds bear interest at an ARS Rate, the rate of interest to be borne by such sub-series during each Auction Period, which (other than for the Initial Period) will equal the Auction Rate for such Auction Period; provided, however, that, if the Auction Agent fails to calculate or, for any reason, fails to provide the Auction Rate for any Auction Period, (a) if the preceding Auction Period was a period of 35 days or less, the new Auction Period will be the same as the preceding Auction Period and the ARS Rate for the new Auction Period will be the same as the ARS Rate for the preceding Auction Period, and (b) if the preceding Auction Period was a period of greater than 35 days, the preceding Auction Period will be extended to the seventh day following the day that would have been the last day of such Auction Period had it not been extended (or if such seventh day is not followed by a Business Day then to the next succeeding day which is followed by a Business Day) and the ARS Rate in effect for the preceding Auction Period will continue in effect for the Auction Period as so extended, and, in the event the Auction Period is extended as set forth in clause (b), an Auction will be held on the last Business Day of the Auction Period as so extended to take effect for an Auction Period beginning on the Business Day immediately following the last day of the Auction Period as extended, which Auction Period will end on the date it would otherwise have ended on had the prior Auction Period not been extended; provided, further, that in no event will the ARS Rate exceed the Maximum Interest Rate; and; provided, further, in the event of a failed conversion from an ARS Rate to a Daily Rate, a Weekly Rate, a Commercial Paper Rate, a Term Rate or a Fixed Rate or the conversion from one Auction Period to another Auction Period, the affected sub-series will continue to bear interest at the ARS Rate with a seven-day Auction Period and bear interest at the Maximum Interest Rate for the next Auction Period.

"Auction Date" means, with respect to each sub-series of the Series 2004 B Bonds, (a) if such Series 2004 B Bonds are in a daily Auction Period, each Business Day, and (b) if such Series 2004 B Bonds are in any other Auction Period, the last Business Day of such Auction Period if it is followed by another Auction Period (whether or not an Auction shall be conducted on such date). On the Business Day preceding the conversion from a daily Auction Period to another Auction Period, there will be two Auctions, one for the last daily Auction Period and one for the first Auction Period following the conversion.

"Auction Period" means, with respect to each sub-series of the Series 2004 B Bonds:

(a) a Special Auction Period;

(b) in a daily Auction Period, a period beginning on each Business Day and extending to but not including the next succeeding Business Day;

(c) in a seven-day Auction Period and with Auctions generally conducted on (i) Fridays, a period of generally seven days beginning on a Monday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Sunday) and ending on the Sunday thereafter (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) Mondays, a period of generally seven days beginning on a Tuesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Monday) and ending on the Monday thereafter (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iii) Tuesdays, a period of generally seven days beginning on a Wednesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Tuesday) and ending on the Tuesday thereafter (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iv) Wednesdays, a period of generally seven days beginning on a

Thursday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Wednesday) and ending on the Wednesday thereafter (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), and (v) Thursdays, a period of generally seven days beginning on a Friday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Thursday) and ending on the Thursday thereafter (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day);

(d) in a 28-day Auction Period and with Auctions generally conducted on (i) Fridays, a period of generally 28 days beginning on a Monday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Sunday) and ending on the fourth Sunday thereafter (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) Mondays, a period of generally 28 days beginning on a Tuesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Monday) and ending on the fourth Monday thereafter (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iii) Tuesdays, a period of generally 28 days beginning on a Wednesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Tuesday) and ending on the fourth Tuesday thereafter (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iv) Wednesdays, a period of generally 28 days beginning on a Thursday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Wednesday) and ending on the fourth Wednesday thereafter (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), and (v) Thursdays, a period of generally 28 days beginning on a Friday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Thursday) and ending on the fourth Thursday thereafter (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day);

(e) in a 35-day Auction Period and with Auctions generally conducted on (i) Fridays, a period of generally 35 days beginning on a Monday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on Sunday) and ending on the fifth Sunday thereafter (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) Mondays, a period of generally 35 days beginning on a Tuesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on Monday) and ending on the fifth Monday thereafter (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iii) Tuesdays, a period of generally 35 days beginning on a Wednesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on Tuesday) and ending on the fifth Tuesday thereafter (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iv) Wednesdays, a period of generally 35 days beginning on a Thursday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on Wednesday) and ending on the fifth Wednesday thereafter (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), and (v) Thursdays, a period of generally 35 days beginning on a Friday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on Thursday) and ending on the fifth Thursday thereafter (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day);

(f) in a three-month Auction Period, a period of generally three months (or shorter period upon a conversion from another Auction Period) beginning on the day following the last day of the prior Auction Period and ending on the first day of the month that is the third calendar month following the beginning date of such Auction Period (unless such first day of the month is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day); and

(g) in a six-month Auction Period, a period of generally six months (or shorter period upon a conversion from another Auction Period) beginning on the day following the last day of the prior Auction Period and ending on the next succeeding June 30 or December 31;

provided, however, that

(1) if there is a conversion of a sub-series of the Series 2004 B Bonds with Auctions generally conducted on Fridays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the next succeeding Sunday (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the Sunday (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period or in the case of the Sub-Series 2004 B-1 Bonds and the Sub-Series 2004 B-2 Bonds on the Business Day immediately following the last day of the prior Auction Period) and will end on the Sunday (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion;

(2) if there is a conversion of a sub-series of the Series 2004 B Bonds with Auctions generally conducted on Mondays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the next succeeding Monday (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the Monday (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period or in the case of the Sub-Series 2004 B-1 Bonds and the Sub-Series 2004 B-2 Bonds on the Business Day immediately following the last day of the prior Auction Period) and will end on the Monday (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion;

(3) if there is a conversion of a sub-series of the Series 2004 B Bonds with Auctions generally conducted on Tuesdays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the next succeeding Tuesday (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the Tuesday (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period will

begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period or in the case of the Sub-Series 2004 B-1 Bonds and the Sub-Series 2004 B-2 Bonds on the Business Day immediately following the last day of the prior Auction Period) and will end on the Tuesday (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion;

(4) if there is a conversion of a sub-series of the Series 2004 B Bonds with Auctions generally conducted on Wednesdays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the next succeeding Wednesday (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the Wednesday (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period or in the case of the Sub-Series 2004 B-1 Bonds and the Sub-Series 2004 B-2 Bonds on the Business Day immediately following the last day of the prior Auction Period) and will end on the Wednesday (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion; and

(5) if there is a conversion of a sub-series of the Series 2004 B Bonds with Auctions generally conducted on Thursdays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the next succeeding Thursday (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the Thursday (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period or in the case of the Sub-Series 2004 B-1 Bonds and the Sub-Series 2004 B-2 Bonds on the Business Day immediately following the last day of the prior Auction Period) and will end on the Thursday (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion.

"Auction Rate" means for each sub-series of the Series 2004 B Bonds for each Auction Period, (a) if Sufficient Clearing Bids exist, the Winning Bid Rate or if all of such Series 2004 B Bonds are the subject of Submitted Hold Orders, the applicable All Hold Rate and (b) if Sufficient Clearing Bids do not exist, the Maximum Interest Rate.

"Interest Payment Date" means, with respect to each sub-series of Series 2004 B Bonds, the initial Interest Payment Dates set forth on the inside cover of this Official Statement, and thereafter: (a) when used with respect to any Auction Period other than a daily Auction Period or a Special Auction Period, the Business Day immediately following such Auction Period; (b) when used with respect to a daily Auction Period, the first Business Day of the month immediately succeeding such Auction Period; and (c) when used with respect to a Special Auction Period of (i) seven or more but fewer than 183 days, the Business Day immediately following such Special Auction Period, or (ii) more than 182 days, each January 1 and July 1 and on the Business Day immediately following such Special Interest Period, except that with respect to the Sub-Series 2004 B-1 Bonds and the Sub-Series 2004 B-2 Bonds in a 35-day Auction Period, Interest Payment Date means each January 1 and July 1 and if any such January 1 or July 1 is not a Business Day, then the next succeeding Business Day.

"Maximum Interest Rate" means the lesser of 12% and the maximum interest rate permitted by law, which on the Closing Date is equal to 12%.

Auction Agent

The Registrar will enter into the Auction Agreement initially with The Bank of New York, pursuant to which The Bank of New York shall perform the duties of Auction Agent. The Auction Agreement will provide, among other things, that the Auction Agent will determine the Auction Rate for each Auction in accordance with the Auction Procedures.

Auction Date

An Auction to determine the interest rate with respect to each sub-series of Series 2004 B Bonds for its next succeeding Auction Period will be held on each Business Day while such Series 2004 B Bonds are in a daily Auction Period and on the last Business Day of the Auction Period while such Series 2004 B Bonds are in any other Auction Period (whether or not an Auction shall be conducted on such date). The first Auction for each sub-series of the Series 2004 B Bonds will take place on the respective dates set forth on the inside front cover of this Official Statement.

Order Procedure for Existing Owners and Potential Owners

The procedure for submitting orders prior to the Submission Deadline on each Auction Date is described in *Appendix II* – ARS Provisions, as are the particulars with regard to the determination of the Auction Rate and the allocation of the Series 2004 B Bonds bearing interest at ARS Rates (collectively, the "Auction Procedures").

Amendment of Auction Procedures

The provisions of the Bond Resolution concerning the Auction Procedures, including, without limitation, the definitions of All Hold Rate, Maximum Interest Rate, ARS Index, Interest Payment Date, and ARS Rate, may be amended by obtaining the consent of the owners of all affected Series 2004 B Bonds. All owners will be deemed to have consented if on the first Auction Date occurring at least 20 days after the Auction Agent mailed notice to such owners the ARS Rate determined for such date is the Winning Bid Rate.

Conversion of Series 2004 B Bonds to Another Rate Period

At the option of the Commonwealth, all of a sub-series of the Series 2004 B Bonds may be converted to bear interest at a Daily Interest Rate, a Weekly Interest Rate, a Commercial Paper Rate, a Term Interest Rate or a Fixed Interest Rate. On the Conversion Date, the Series 2004 B Bonds of such sub-series are subject to mandatory tender at a purchase price equal to 100% of the principal amount thereof, plus accrued interest. The principal portion of the purchase price of the Series 2004 B Bonds so tendered is payable solely from the proceeds of the remarketing of such Series 2004 B Bonds. In the event that the conditions of a conversion are not satisfied, including the failure to remarket all applicable Series 2004 B Bonds on a mandatory tender date, the Series 2004 B Bonds will not be subject to mandatory tender, will be returned to their owners, will automatically convert to a seven-day Auction Period and will bear interest at the Maximum Interest Rate. It is currently anticipated that, should any of the Series 2004 B Bonds be converted to bear interest at a Daily Interest Rate, a Weekly Interest Rate, a Commercial Paper Rate, a Term Interest Rate or a Fixed Interest Rate, a remarketing memorandum or remarketing circular will be distributed describing the Series 2004 B Bonds to be converted to such Rate Period.

Conversion from One Auction Period to Another

On the conversion date from one Auction Period to another, any Series 2004 B Bond of the sub-series to be converted which is not the subject of a specific Hold Order or Bid will be deemed to be subject to a Sell Order. In the event of a failed conversion to another Auction Period due to the lack of Sufficient Clearing Bids, such Series 2004 B Bond will automatically convert to a seven-day Auction Period and will bear interest at the Maximum Interest Rate. In connection with a conversion from one Auction Period to another, written notice of such conversion will be given in accordance with the Auction Procedures; however, the Series 2004 B Bonds to be converted will not be subject to mandatory tender on such conversion date.

Mandatory Conversion

The Bond Resolution provides that, if any sub-series of Series 2004 B Bonds, as a result of the implementation of the Auction Procedures, bears interest at the Maximum Interest Rate for (a) two consecutive Auction Periods and (b) sixty consecutive days, such sub-series will be converted to the Fixed Rate Mode; provided, that the applicable Bond Insurer shall have consented, in writing, to such mandatory conversion.

Special Considerations

The Bond Resolution and the Auction Agreement provide that the Auction Agent may resign from its duties as Auction Agent by giving at least 90 days notice, or 30 days notice if it has not been paid, to the Commonwealth and the Registrar and does not require, as a condition to the effectiveness of such resignation, that a replacement Auction Agent be in place if its fee has not been paid. The Broker-Dealer Agreement provides that the Broker-Dealer thereunder may resign upon five business days' notice or immediately, in certain circumstances, and similarly does not require, as a condition to the effectiveness of such resignation, that a replacement Broker-Dealer be in place. For any Auction Period during which there is no duly appointed Auction Agent, or during which there is no duly appointed Broker-Dealer, it will not be possible to hold Auctions, with the result that the interest rate on the Series 2004 B Bonds will be determined as set forth in the definition of "ARS Rate" above.

The Broker-Dealer Agreement will provide that a Broker-Dealer may submit an Order in Auctions for its own account. If a Broker-Dealer submits an Order for its own account in any Auction, it might have an advantage over other Bidders in that it would have knowledge of orders placed through it in that Auction; such Broker-Dealer, however, would not have knowledge of Orders submitted by other Broker-Dealers (if any) in that Auction. In the Broker-Dealer Agreements, each Broker-Dealer will agree to handle customer orders in accordance with their respective duties under applicable securities laws and rules.

During an ARS Rate Period a beneficial owner of a Series 2004 B Bond may sell, transfer or dispose of a Series 2004 B Bond only pursuant to a Bid or Sell Order in accordance with the Auction Procedures or through a Broker-Dealer. See *Appendix II*-ARS Provisions. The ability to sell a Series 2004 B Bond in an Auction may be adversely affected if there are not sufficient buyers willing to purchase all the Series 2004 B Bonds at a rate equal to or less than the Maximum Interest Rate. Goldman, Sachs & Co. and Lehman Brothers have advised the Commonwealth that they intend to make a market in the Series 2004 B Bonds between Auctions; however, neither Goldman, Sachs & Co. nor Lehman Brothers is obligated to make such markets, and no assurance can be given that secondary markets therefor will develop.

Changes to the Auction Periods and Auction Dates do not require the amendment of the Auction Procedures or any consents.

Redemption Provisions

Optional Redemption of the Series 2004 A Bonds. At the option of the Secretary of the Treasury and upon at least 30 days' notice, the Series 2004 A Bonds are subject to redemption, from any moneys that may be available for that purpose (other than moneys set aside in respect of an amortization requirement), either in whole or in part, and if in part, in such order of maturity as directed by the Secretary of the Treasury, on the Mandatory Tender Date, at the principal amount of the Series 2004 A Bonds to be redeemed, together with the interest accrued thereon to the Mandatory Tender Date.

Optional Redemption of the Series 2004 B Bonds. During an ARS Rate Period, the Series 2004 B Bonds may be redeemed, from any moneys that may be available for that purpose (other than moneys set aside in respect of an amortization requirement), either in whole or in part, (and if in part, in such order of maturity as directed by the Secretary of the Treasury), on the Business Day immediately following an Auction Period, at the principal amount of the Series 2004 B Bonds to be redeemed plus accrued interest, if any, but without premium; provided, however, in the event of a partial redemption of a sub-series of the Series 2004 B Bonds bearing interest at an ARS Rate, the aggregate principal amount of any sub-series of Series 2004 B Bonds remaining outstanding in the Auction Rate Mode after such partial redemption is at least $10,000,000 unless otherwise consented to by all Broker-Dealers.

Mandatory Redemption of the Series 2004 B Bonds. The Series 2004 B Bonds of each sub-series identified below are subject to redemption to the extent of the respective amortization requirements therefor set forth below (less the amount applied to the purchase of any such sub-series and otherwise subject to adjustment as described below), upon at least 30 days' notice, on July 1 of each year set forth below at a redemption price of par plus accrued interest to the dates fixed for redemption:

Amortization Requirements for the Series 2004 B Bonds

July 1,	Sub-Series 2004 B-1	Sub-Series 2004 B-2	Sub-Series 2004 B-3	Sub-Series 2004 B-4
2006	$ 2,125,000			
2007	2,200,000			
2008	2,275,000			
2009	2,375,000			
2010	2,450,000			
2011	2,550,000			
2012	2,625,000			
2013	2,725,000			
2014	2,825,000			
2015	2,925,000			
2016	3,025,000			
2017	3,125,000			
2018	3,250,000			
2019	3,350,000			
2020	7,375,000			
2021	10,725,000*	$ 6,625,000		
2022		17,950,000		
2023		18,650,000		
2024		12,775,000*	$ 6,575,000	
2025			20,075,000	
2026			26,175,000	
2027			3,175,000*	$ 34,300,000
2028				21,675,000*

July 1,	Sub-Series 2004 B-5	Sub-Series 2004 B-6	Sub-Series 2004 B-7	Sub-Series 2004 B-8
2028	$43,175,000			
2029	6,825,000*	$50,000,000*	$10,525,000	
2030			50,900,000	
2031			550,000*	$30,150,000
2032				31,850,000*

* Maturity

Notwithstanding the foregoing, while the Series 2004 B Bonds bear interest at an ARS Rate, in any Auction Period other than a daily Auction Period, if such July 1 is not an Interest Payment Date, the redemption shall occur on the Interest Payment Date immediately preceding such July 1.

If the amount of Series 2004 B Bonds of any sub-series purchased or redeemed in a fiscal year exceeds the amount of the amortization requirement for the Series 2004 B Bonds of any such sub-series for such fiscal year, the amortization requirement for the Series 2004 B Bonds of such sub-series may be decreased for such subsequent fiscal years and in such amounts aggregating the amount of such excess as the Secretary of the Treasury shall determine.

Notice of Redemption; Effect of Redemption

Any redemption of the Bonds, either in whole or in part, shall be made upon at least thirty days' prior notice by mail to DTC or, if the book-entry only system described above has been discontinued, by first class mail, postage prepaid, to all registered owners of the Bonds to be redeemed in the manner and under the terms and conditions provided in the Bond Resolution. On the date designated for redemption, notice having been given as provided in the Bond Resolution and moneys for payment of the principal of and accrued interest on the Bonds or portions thereof so called for redemption being held by the Registrar, interest on the Bonds or portions thereof so called for redemption shall cease to accrue.

Each notice of redemption shall contain, among other things, the particular Bonds (or portions thereof) being called for redemption, the redemption date and price and the address at which such Bonds are to be surrendered for payment of the redemption price. Any defect in such notice or the failure to mail any such notice to DTC in respect of, or the registered owner of, any Bond will not affect the validity of the proceedings for the redemption of any other Bond.

If less than all the Bonds of any series and maturity are called for redemption, the particular Bonds so called for redemption shall be selected by the Registrar by such method as it deems fair and appropriate, except that so long as the book-entry only system shall remain in effect, in the event of any such partial redemption, DTC shall reduce the credit balances of the applicable DTC Participants in respect of the Bonds and such DTC Participants shall in turn select those Beneficial Owners whose ownership interests are to be extinguished by such partial redemption, each by such method as DTC or such DTC Participant, as the case may be, in its sole discretion, deems fair and appropriate.

Authorization

Section 2 of Article VI of the Constitution of the Commonwealth provides that the power of the Commonwealth to contract and to authorize the contracting of debts shall be exercised as determined by the Legislature. Pursuant to this power, the Legislature enacted the Act, which authorizes the issuance of the Bonds.

Security

Provision for Payment of Public Debt

The Act provides that the good faith, credit and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal of and interest on the Bonds issued under the provisions of the Act. The Secretary of the Treasury is authorized and directed under the Act to pay the principal of and interest on the Bonds as the same become due and payable from any funds available for such purpose with the Department of the Treasury in the fiscal year in which such payment is due. The Act provides that the provisions contained therein with respect to the payment of the principal of and interest on the Bonds shall be considered to be a continuous appropriation for the Secretary of the Treasury to make such payments, even though no specific appropriations are made for such purposes. Such payments are required to be made pursuant to the provisions of the laws of the Commonwealth that regulate the disbursement of public funds.

The Constitution of Puerto Rico provides that public debt of the Commonwealth will constitute a first claim on available Commonwealth revenues. Public debt includes general obligation bonds and notes of the Commonwealth and any payments required to be made by the Commonwealth under its guarantees of bonds and notes issued by its public instrumentalities.

The Commonwealth has allocated certain motor vehicle fuel taxes, crude oil and derivative products excise taxes and license fees to Puerto Rico Highway and Transportation Authority (the "Highway Authority"). The amounts so allocated, however, are subject to first being applied to payment of the principal of and interest on the Commonwealth public debt, but only if and to the extent that all other available revenues of the Commonwealth are insufficient for that purpose. The Commonwealth has never applied such amounts to the payment of its public debt.

Since fiscal year 1989, the Commonwealth has pledged to Puerto Rico Infrastructure Financing Authority certain federal excise taxes imposed on alcoholic beverages and tobacco products produced in Puerto Rico and sold in the United States, which taxes are returned to the Commonwealth. The amounts so pledged, however, are subject to first being applied to payment of the principal of and interest on the Commonwealth public debt, but only if and to the extent that all other available revenues of the Commonwealth are insufficient for that purpose. The Commonwealth has never applied such amounts to the payment of its public debt.

The Constitution expressly empowers a holder of bonds and notes evidencing public debt to bring suit against the Secretary of the Treasury to require application of available revenues, including surplus, to the payment of principal of and interest on public debt when due.

Special Fund for General Obligation Debt Service

Act No. 83 of the Legislature of Puerto Rico, approved August 30, 1991, as amended, provides for the levy of an annual special tax of 1.03% of the assessed value of all real and personal property not exempt from taxation. The proceeds of said tax are credited to the Special Fund for the Amortization and Redemption of General Obligations Evidenced by Bonds and Promissory Notes (the "Redemption Fund"), for application to the payment of general obligation bonds and notes of the Commonwealth.

Act No. 39 of the Legislature of Puerto Rico, approved May 13, 1976, as amended ("Act No. 9"), requires the Secretary of the Treasury to transfer each month from available funds of the Commonwealth to the Redemption Fund such amounts which together with certain funds otherwise deposited therein will be equal to the sum of one-sixth of the interest to be paid in the next six months and one-twelfth of the principal to be paid or required to be amortized within the next twelve months on all bonds and notes of the Commonwealth for which its full faith and credit are pledged as the same become due and all bonds and notes of the Commonwealth for which the guaranty of the Commonwealth has been exercised. Moneys in the Redemption Fund are held in trust by Government Development Bank. Act No. 39 provides that the obligation of the Secretary of the Treasury to make the above transfers is cumulative, and the amount of any deficiency in any month shall be added to the amount of transfers required in future months until such deficiency has been fully paid. On April 20, 2004, the amount on deposit in the Redemption Fund was $199.5 million, which was the required amount.

Act No. 39 expressly relates to direct obligations of the Commonwealth. It may also apply to the payment of Commonwealth guaranteed obligations of public corporations outstanding prior to the date of its adoption but not to the payment of bonds and other obligations of such public corporations guaranteed by the Commonwealth issued after the date of its adoption.

Payment Record

The Commonwealth has never defaulted on the payment of principal of or interest on any of its debt.

Debt Limitation

Section 2 of Article VI of the Constitution of Puerto Rico provides that direct obligations of the Commonwealth evidenced by full faith and credit bonds or notes shall not be issued if the amount of the principal of and interest on such bonds and notes and on all such bonds and notes theretofore issued which is payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceeds 15% of the average annual revenues raised under the provisions of Commonwealth legislation and covered into the Treasury of Puerto Rico (hereinafter "internal revenues") in the two fiscal years preceding the then current fiscal year. Section 2 of Article VI does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded. Internal revenues consist principally of income taxes, property taxes and excise taxes. Certain revenues, such as federal excise taxes on offshore shipments of alcoholic beverages and tobacco products and customs duties, which are collected by the United States Government and returned to the Treasury of Puerto Rico, and motor vehicle fuel taxes, crude oil and derivative products excise taxes and license fees, which are allocated to the Highway Authority, are not included as internal revenues for the purpose of calculating the debt limit, although they may be available for the payment of debt service.

On December 21, 1995, Puerto Rico Aqueduct and Sewer Authority ("PRASA") issued $400,340,000 Puerto Rico Aqueduct and Sewer Authority Refunding Bonds, guaranteed by the Commonwealth (the "PRASA Guaranteed Bonds"). On January 1, 1997, the Commonwealth began to make payments of debt service on the PRASA Guaranteed Bonds under the full faith and credit guarantee of the Commonwealth. The amount paid by the Commonwealth under the PRASA Guaranteed Bonds is taken into account for purposes of computing the above described 15% constitutional debt limitation.

All or a portion of the proceeds of certain refunding bonds issued by the Commonwealth were invested in guaranteed investment contracts or federal agency securities (in each case rated in the highest rating category by Moody's and S&P), none of which is eligible to be used for legal defeasance under Puerto Rico law ("non-eligible investments"). Since bonds refunded with proceeds invested in non-eligible investments are not legally defeased, such bonds are treated as outstanding for purposes of the 15% constitutional debt limitation.

After giving effect to the issuance of the Bonds and the refunding of the Refunded Bonds, future maximum annual debt service for the Commonwealth's outstanding general obligation debt is $676,817,577.92 in the fiscal year ending June 30, 2006 (based on the assumption that the Series 2004 A Bonds after the Mandatory Tender Date and the Series 2004 B Bonds bear interest at 12% per annum). Debt service for the PRASA Guaranteed Bonds paid by the Commonwealth during fiscal year 2003 (including for this purpose debt service payments due July 1, 2003) was $32,745,157.50. See "Debt Service Requirements for Commonwealth General Obligation Bonds and Certain Guaranteed Debt" under *Public Sector Debt of the Commonwealth*, below. The sum of those amounts ($709,562,735.42) is equal to 9.88% of $7,185,660,000, which is the average of the adjusted internal revenues for the two fiscal years ended June 30, 2002 and June 30, 2003. If Commonwealth general obligation bonds refunded with non-eligible investments were treated as not being outstanding, the percentage previously referred to in the preceding sentence would be 9.11%. Upon the enactment of legislation currently pending that will expressly authorize the Commonwealth to enter into agreements of the nature of the Interest Rate Agreements (see "Interest Rate Swap Agreements" under *Plan of Financing*), the Commonwealth will be permitted to calculate the constitutional debt limitation in connection with variable rate bonds, such as the Bonds, using the fixed rate it is required to pay under any interest rate exchange agreement entered into by the Commonwealth in connection with such bonds and using the lesser of (i) the maximum interest rate allowed by law, and (ii) the maximum interest rate set forth in the resolution approving the bonds, if any, for variable rate bonds for which no such agreement has been executed. If the fixed rate paid by the Commonwealth under the Interest Rate Agreements described in "Interest Rate Swap Agreements" under *Plan of Financing* above was used to calculate the constitutional debt limitation, the first percentage referred to above would be 9.35%.

Maturity Limitation

The Constitution provides that no bonds or notes of the Commonwealth shall mature later than 30 years from their date of issue, except bonds or notes for housing facilities, which shall mature in no more than 40 years.

Interest Rate Swap Risk

As described in "Interest Rate Swap Agreements" under *Plan of Financing*, Government Development Bank has entered into Interest Rate Agreements with respect to the Series 2004 B Bonds. The Counterparties may terminate the Interest Rate Agreements (i) upon nonpayment by Government Development Bank (or by the Commonwealth after their transfer by Government Development Bank) (and failure by any of the Bond Insurers to make payments pursuant to their respective financial guaranty policies guaranteeing the Commonwealth's payments under such Agreements (the "Swap Policies")), (ii) in the event of the downgrading of any of the Bond Insurers by the rating agencies below certain specified levels (unless the Commonwealth provides substitute credit support meeting specified criteria), or (iii) in the event of the bankruptcy of any of the Bond Insurers. The Counterparties may also terminate the Interest Rate Agreements upon the occurrence of certain other "Termination Events" or "Events of Default," as defined in said Agreements, but only with the consent of the applicable Bond Insurers (if not then in payment default under their respective Swap Policies). Government Development Bank (or after said transfer, the Commonwealth) may terminate the Interest Rate Agreements at any time.

Termination of the Interest Rate Agreements may result in the payment of a termination amount by one party that attempts to compensate the other party to the Interest Rate Agreements for its economic losses. Which party would pay the cost of termination would depend, in major part, on then current interest rate levels, and if such levels were then lower than the fixed interest rate swap rate paid by Government Development Bank (or after said transfer, the Commonwealth), the cost of termination to Government Development Bank (or the Commonwealth) could be substantial.

The Interest Rate Agreements expose Government Development Bank (and after said transfer, the Commonwealth) to basis risk because the interest rate on the Series 2004 B Bonds generally tracks The Bond Market Association index, whereas the floating rate payments to be made by the Counterparties under the Interest Rate Agreements are determined pursuant to a formula based primarily on a percentage of LIBOR (the "LIBOR Based Formula"). The LIBOR Based Formula was derived in part from the historical trading relationship between LIBOR and The Bond Market Association index. If the relationship between LIBOR and The Bond Market Association index changes, Government Development Bank (and after said transfer, the Commonwealth) may be exposed to basis risk, and the amounts received from the Counterparties under the Interest Rate Agreements may be less than the interest cost on the Series 2004 B Bonds. No determination can be made at this time as to the potential exposure to Government Development Bank (and after said transfer, the Commonwealth) relating to the aforementioned difference in variable rate payments under the Interest Rate Agreements. The Counterparties swap payments are not pledged to the payment of the principal of and interest on the Bonds.

In addition, to the extent the amounts received by Government Development Bank (and after said transfer, the Commonwealth) from the Counterparties exceed the interest cost on the Series 2004 B bonds, the Commonwealth may be required to take certain actions to preserve the tax-exempt status of the Series 2004 B Bonds.

BOND INSURANCE

The CIFG NA Bond Insurance Policy

The following information has been furnished by CIFG NA for use in this Official Statement. Reference is made to *Appendix IV* for a specimen of CIFG NA's policy.

Concurrently with the issuance of the Bonds, CIFG NA will issue the CIFG NA Insurance Policy for the CIFG NA Insured Bonds. CIFG NA is a monoline financial guaranty insurance company incorporated under the laws of the State of New York, with its principal place of business in New York City.

The claims-paying ability (also referred to as its financial strength) of CIFG NA is rated "AAA" by Fitch Ratings ("Fitch"), "Aaa" by Moody's, and "AAA" by S&P, the highest rating assigned by each such rating agency. Each rating of CIFG NA should be evaluated independently. The ratings reflect the respective rating agency's current assessment of the creditworthiness of CIFG NA and its ability to pay claims on its policies of insurance based upon, among other factors, the adequacy of the net worth maintenance and reinsurance agreements provided by CIFG described below under "*Capitalization.*" Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency. The above ratings are not recommendations to buy, sell or hold the CIFG NA Insured Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the CIFG NA Insured Bonds. CIFG NA does not guarantee the market price of the CIFG NA Insured Bonds nor does it guaranty that the ratings on the CIFG NA Insured Bonds will not be revised or withdrawn.

CIFG NA is licensed and subject to regulation as a financial guaranty insurance corporation under the laws of the State of New York, its state of domicile, and is licensed to do business in multiple jurisdictions. CIFG NA is subject to Article 69 of the New York Insurance Law which, among other things, limits the business of such insurers to financial guaranty insurance and related lines, requires that each such insurer maintain a minimum surplus to policyholders, establishes contingency, loss and unearned premium reserve requirements for each such insurer, and limits the size of individual transactions ("single risks") and the volume of transactions ("aggregate risks") that may be underwritten by such insurers. Other provisions of the New York Insurance Law applicable to non-life insurance companies such as CIFG NA regulate, among other things, permitted investments, payment of dividends, transactions with affiliates, mergers, consolidations, acquisitions or sales of assets and incurrence of liabilities for borrowings. CIFG NA is required to file quarterly and annual statutory financial statements with the New York State Insurance Department ("NYSID"), and is subject to statutory restrictions concerning the types and quality of its investments and the filing and use of policy forms and premium rates. Additionally, CIFG NA's accounts and operations are subject to periodic examination by the NYSID.

THE INSURANCE PROVIDED BY THE CIFG NA FINANCIAL GUARANTY INSURANCE POLICY (THE "CIFG NA INSURANCE POLICY") IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED BY THE INSURANCE LAWS OF THE STATE OF NEW YORK.

Capitalization. In addition to capital and surplus, set forth below, CIFG NA is supported by a net worth maintenance agreement from its indirect parent, CDC IXIS Financial Guaranty, a French reinsurance corporation ("CIFG"). The net worth maintenance agreement provides that CIFG will maintain CIFG NA's U.S. statutory capital and surplus at no less than $80 million. In addition, through a facultative reinsurance agreement, CIFG NA may cede up to 90% of its exposure on each transaction to CIFG; however, the facultative reinsurance agreement does not require that CIFG reinsure its exposure under any transaction. CIFG's claims paying ability is rated "Aaa" by Moody's, "AAA" by S&P and "AAA" by Fitch, the highest rating assigned by each such rating agency. *Notwithstanding these net worth maintenance and reinsurance agreements, the holders of the CIFG NA Insured Bonds will have direct recourse against CIFG NA only, and neither CIFG nor any other affiliate of CIFG NA will be directly liable to the holders of the CIFG NA Insured Bonds.*

The following table sets forth the capitalization of CIFG NA as of December 31, 2003, on the basis of accounting principles prescribed or permitted by the NYSID (in thousands):

Common capital stock	$ 19,700
Gross paid in and contributed surplus	110,925
Unassigned funds (retained deficit)	(31,574)
Surplus as regards policyholders	$ 99,051

There has been no material adverse change in the capitalization of CIFG NA from December 31, 2003 to the date of this Official Statement.

CIFG NA has prepared audited annual financial statements as of December 31, 2003 in accordance with statutory accounting principles applicable to insurance companies. Copies of such financial statements may be obtained at www.cifg.com, or by writing to CIFG NA at 825 Third Avenue, 6th Floor, New York, New York 10022, Attention: Finance Department. The toll-free telephone number of CIFG NA is (866) CIFG 212.

The CIFG NA Insurance Policy does not protect investors against changes in market value of the CIFG NA Insured Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. CIFG NA makes no representation regarding the CIFG NA Insured Bonds or the advisability of investing in the CIFG NA Insured Bonds. CIFG NA makes no representation regarding this Official Statement, nor has it participated in the preparation thereof, except that CIFG NA has provided to the Commonwealth the information presented under this caption for inclusion in this Official Statement.

The FGIC Bond Insurance Policy

The following information has been furnished by FGIC for use in this Official Statement. Reference is made to *Appendix V* for a specimen of FGIC's policy.

Concurrently with the issuance of the FGIC Insured Bonds, FGIC will issue its FGIC Insurance Policy for the FGIC Insured Bonds. The FGIC Insurance Policy unconditionally guarantees the payment of that portion of the principal or accreted value (if applicable) of and interest on the FGIC Insured Bonds which has become due for payment, but shall be unpaid by reason of nonpayment by the Commonwealth. FGIC will make such payments to U.S. Bank Trust National Association, or its successor as its agent (the "Fiscal Agent"), on the later of the date on which such principal, accreted value or interest (as applicable) is due or on the business day next following the day on which FGIC shall have received notice (in accordance with the terms of the FGIC Insurance Policy) from an owner of FGIC Insured Bonds or the Registrar of the nonpayment of such amount by the Commonwealth. The Fiscal Agent will disburse such amount due on any FGIC Insured Bond to its owner upon receipt by the Fiscal Agent of evidence satisfactory to the Fiscal Agent of the owner's right to receive payment of the principal, accreted value or interest (as applicable) due for payment and evidence, including any appropriate instruments of assignment, that all of such owner's rights to payment of such principal, accreted value or interest (as applicable) shall be vested in FGIC. The term "nonpayment" in respect of a FGIC Insured Bond includes any payment of principal, accreted value or interest (as applicable) made to an owner of a FGIC Insured Bond which has been recovered from such owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction.

Once issued, the FGIC Insurance Policy is non-cancellable by FGIC. The FGIC Insurance Policy covers failure to pay principal (or accreted value, if applicable) of the FGIC Insured Bonds on their stated maturity dates and their mandatory sinking fund redemption dates, and not on any other date on which the FGIC Insured Bonds may have been otherwise called for redemption, accelerated or advanced in maturity. The FGIC Insurance Policy also covers the failure to pay interest on the stated date for its payment. Upon such payment, FGIC will become the owner of the applicable FGIC Insured Bonds or right to payment of principal or interest on such FGIC Insured Bonds and will be fully subrogated to all of the Bondholders' rights thereunder.

The FGIC Insurance Policy does not insure any risk other than Nonpayment by the Commonwealth, as defined in the FGIC Insurance Policy. Specifically, the FGIC Insurance Policy does not cover: (i) payment on acceleration, as a result of a call for redemption (other than mandatory sinking fund redemption) or as a result of any other advancement of maturity; (ii) payment of any redemption, prepayment or acceleration premium; (iii) the purchase price of tendered bonds; or (iv) nonpayment of principal (or accreted value, if applicable) or interest caused by the insolvency or negligence or any other act or omission of the Registrar.

As a condition of its commitment to insure FGIC Insured Bonds, FGIC may be granted certain rights under the Bond Resolution. See "Concerning the Insurance Policies of the Bond Insurers" below..

The FGIC Insurance Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

Financial Guaranty Insurance Company. FGIC, a New York stock insurance corporation, is a direct, wholly-owned subsidiary of FGIC Corporation, and provides financial guaranty insurance for public finance and structured finance obligations. FGIC is licensed to engage in financial guaranty insurance in all 50 states, the District of Columbia and the Commonwealth and, through a branch, in the United Kingdom. FGIC is a wholly-owned subsidiary of FGIC Corporation, a Delaware corporation.

On December 18, 2003, an investor group consisting of The PMI Group, Inc. ("PMI"), affiliates of The Blackstone Group L.P. ("Blackstone"), affiliates of The Cypress Group L.L.C. ("Cypress") and affiliates of CIVC Partners L.P. ("CIVC") acquired FGIC Corporation (the "FGIC Acquisition") from a subsidiary of General Electric Capital Corporation ("GE Capital"). PMI, Blackstone, Cypress and CIVC acquired approximately 42%, 23%, 23% and 7%, respectively, of FGIC Corporation's common stock. GE Capital retained approximately $234.6 million in liquidation preference of FGIC Corporation's convertible participating preferred stock and approximately 5% of FGIC Corporation's common stock. Neither FGIC Corporation nor any of its shareholders is obligated to pay any debts of FGIC or any claims under any insurance policy, including the FGIC Insurance Policy, issued by FGIC.

FGIC is subject to the insurance laws and regulations of the State of New York, where it is domiciled, including Article 69 of the New York Insurance Law ("Article 69"), a comprehensive financial guaranty insurance statute. FGIC is also subject to the insurance laws and regulations of all other jurisdictions in which it is licensed to transact insurance business. The insurance laws and regulations, as well as the level of supervisory authority that may be exercised by the various insurance regulators, vary by jurisdiction, but generally require insurance companies to maintain minimum standards of business conduct and solvency, to meet certain financial tests, to comply with requirements concerning permitted investments and the use of policy forms and premium rates and to file quarterly and annual financial statements on the basis of statutory accounting principles ("SAP") and other reports. In addition, Article 69, among other things, limits the business of each financial guaranty insurer, including FGIC, to financial guaranty insurance and certain related lines.

For the years ended December 31, 2003 and December 31, 2002, FGIC had written directly or assumed through reinsurance, guaranties of approximately $42.4 billion and $47.9 billion par value of securities, respectively (of which approximately 79% and 81%, respectively, constituted guaranties of municipal bonds), for which it had collected gross premiums of approximately $260.3 million and $232.6 million, respectively. For the year ended December 31, 2003, FGIC had reinsured, through facultative arrangements, approximately 2.0% of the risks it had underwritten.

As of December 31, 2003, FGIC had net admitted assets of approximately $2.741 billion, total liabilities of approximately $1.587 billion, and total capital and surplus of approximately $1.153 billion, determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

The audited financial statements of FGIC as of December 31, 2003 and 2002, which have been filed with the Nationally Recognized Municipal Securities Information Repositories ("NRMSIRs"), are hereby included by specific reference in this Official Statement. Any statement contained herein under the heading "The FGIC Bond Insurance Policy," or in any documents included by specific reference herein, shall be modified or superseded to the extent required by any statement in any document subsequently filed by FGIC with such NRMSIRs, and shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement. All financial statements of FGIC (if any) included in documents filed by the Commonwealth with the NRMSIRs subsequent to the date of this Official Statement and prior to the termination of the offering of the FGIC Insured Bonds shall be deemed to be included by specific reference into this Official Statement and to be a part hereof from the respective dates of filing of such documents. For contact information of the NRMSIRs, see *Continuing Disclosure* below.

FGIC also prepares quarterly and annual financial statements on the basis of generally accepted accounting principles ("GAAP"). Copies of FGIC's most recent GAAP and SAP financial statements are available upon request to: Financial Guaranty Insurance Company, 125 Park Avenue, New York, NY 10017, Attention: Corporate Communications Department. Financial Guaranty's telephone number is (212) 312-3000.

Financial Guaranty's Credit Ratings. The financial strength of FGIC is rated "AAA" by S&P, "Aaa" by Moody's, and "AAA" by Fitch. Each rating of FGIC should be evaluated independently. The ratings reflect the respective ratings agencies' current assessments of the insurance financial strength of FGIC. Further explanations of any rating may be obtained only from the applicable rating agency. These ratings are not recommendations to buy, sell or hold the FGIC Insured Bonds, and are subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market prices of the FGIC Insured Bonds. FGIC does not guarantee the market prices or investment value of the FGIC Insured Bonds, nor does it guarantee that the ratings on the FGIC Insured Bonds will not be revised or withdrawn.

Neither FGIC nor any of its affiliates accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure that is provided to potential purchasers of the FGIC Insured Bonds, or omitted from such disclosure, other than with respect to the accuracy of information with respect to FGIC and the FGIC Insurance Policy under the heading "The FGIC Bond Insurance Policy." In addition, FGIC makes no representation regarding the FGIC Insured Bonds or the advisability of investing in the FGIC Insured Bonds.

The FSA Bond Insurance Policy

The following information has been furnished by FSA for use in this Official Statement. Reference is made to *Appendix VI* for a specimen of FSA's policy.

Concurrently with the issuance of the Bonds, FSA will issue the FSA Insurance Policy for the FSA Insured Bonds. The FSA Insurance Policy guarantees the scheduled payment of principal of and interest on the FSA Insured Bonds when due as set forth in the form of the FSA Insurance Policy included as an exhibit to this Official Statement.

The FSA Insurance Policy is not covered by any insurance security or guaranty fund established under New York, California, Connecticut or Florida insurance law.

FSA. FSA is a New York domiciled financial guaranty insurance company and a wholly owned subsidiary of Financial Security Assurance Holdings Ltd. ("Holdings"). Holdings is an indirect subsidiary of Dexia, S.A., a publicly held Belgian corporation, and of Dexia Credit Local, a direct wholly-owned subsidiary of Dexia, S.A. Dexia, S.A., through its bank subsidiaries, is primarily engaged in the business of public finance, banking and asset management in France, Belgium and other European countries. No shareholder of Holdings or FSA is liable for the obligations of FSA.

At December 31, 2003, FSA's total policyholders' surplus and contingency reserves were approximately \$2,104,257,000 and its total unearned premium reserve was approximately \$1,356,385,000 in accordance with statutory accounting practices. At December 31, 2003, FSA's total shareholders' equity was approximately \$2,307,646,000 and its total net unearned premium reserve was approximately \$1,166,562,000 in accordance with generally accepted accounting principles.

The financial statements included as exhibits to the annual and quarterly reports filed by Holdings with the Securities and Exchange Commission are hereby incorporated herein by reference. Also incorporated herein by reference are any such financial statements so filed from the date of this Official Statement until the termination of the offering of the FSA Insured Bonds. Copies of materials incorporated by reference will be provided upon request to Financial Security Assurance Inc.: 350 Park Avenue, New York, New York 10022, Attention: Communications Department (telephone (212) 826-0100).

The FSA Insurance Policy does not protect investors against changes in market value of the FSA Insured Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. FSA makes no representation regarding the FSA Insured Bonds or the advisability of investing in the FSA Insured Bonds. FSA makes no representation regarding the Official Statement, nor has it participated in the preparation thereof, except that FSA has provided to the Commonwealth the information presented under this caption for inclusion in the Official Statement.

The MBIA Bond Insurance Policy

The following information has been furnished by MBIA for use in this Official Statement. Reference is made to *Appendix VII* for a specimen of MBIA's policy.

MBIA's policy unconditionally and irrevocably guarantees the full and complete payment required to be made by or on behalf of the Commonwealth to the Registrar or its successor of an amount equal to (i) the principal of (either at the stated maturity or by an advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the MBIA Insured Bonds as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed by the MBIA Insurance Policy shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner of the MBIA Insured Bonds pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law (a "Preference").

The MBIA Insurance Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any MBIA Insured Bonds. MBIA's policy does not, under any circumstance, insure against loss relating to: (i) optional or mandatory redemptions (other than mandatory sinking fund redemptions); (ii) any payments to be made on an accelerated basis; (iii) payments of the purchase price of MBIA Insured Bonds upon tender by an owner thereof; or (iv) any Preference relating to (i) through (iii) above. The MBIA Insurance Policy also does not insure against nonpayment of principal of or interest on the MBIA Insured Bonds resulting from the insolvency, negligence or any other act or omission of the Registrar or any other registrar for the MBIA Insured Bonds.

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by MBIA from the Registrar or any owner of a MBIA Insured Bond the payment of an insured amount for which is then due, that such required payment has not been made, MBIA on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such insured amounts which are then due. Upon presentment and surrender of such MBIA Insured Bonds or presentment of such other proof of ownership of the MBIA Insured Bonds, together with any appropriate instruments of assignment to evidence the assignment of the insured amounts due on the MBIA Insured Bonds as are paid by MBIA, and appropriate instruments to effect the appointment of MBIA as agent for such owners of the MBIA Insured Bonds in any legal proceeding related to payment of insured amounts on the MBIA Insured Bonds, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners or the Registrar payment of the insured amounts due on such MBIA Insured Bonds, less any amount held by the Registrar for the payment of such insured amounts and legally available therefor.

MBIA. MBIA Insurance Corporation ("MBIA") is the principal operating subsidiary of MBIA Inc., a New York Stock Exchange listed company (the "Company"). The Company is not obligated to pay the debts of or claims against MBIA. MBIA is domiciled in the State of New York and licensed to do business in and subject to regulation under the laws of all 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, the Virgin Islands of the United States and the Territory of Guam. MBIA has three branches, one in the Republic of France, one in the Republic of Singapore and one in the Kingdom of Spain. New York has laws prescribing minimum capital requirements, limiting classes and concentrations of investments and requiring the approval of policy rates and forms. State laws also regulate the amount of both the aggregate and individual risks that may be insured, the payment of dividends by MBIA, changes in control and transactions among affiliates. Additionally, MBIA is required to maintain contingency reserves on its liabilities in certain amounts and for certain periods of time.

MBIA does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding the policy and MBIA set forth under the heading "MBIA Bond Insurance Policy" under *Bond Insurance*. Additionally, MBIA makes no representation regarding the MBIA Insured Bonds or the advisability of investing in the MBIA Insured Bonds.

The Financial Guarantee Insurance Policies are not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

MBIA Information. The following document filed by the Company with the Securities and Exchange Commission (the "SEC") is incorporated herein by reference:

The Company's Annual Report on Form 10-K for the year ended December 31, 2003.

Any documents filed by the Company pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act of 1934, as amended, after the date of this Official Statement and prior to the termination of the offering of the MBIA Insured Bonds offered hereby shall be deemed to be incorporated by reference in this Official Statement and to be a part hereof. Any statement contained in a document incorporated or deemed to be incorporated by reference herein, or contained in this Official Statement, shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Company files annual, quarterly and special reports, information statements and other information with the SEC under File No. 1-9583. Copies of the SEC filings (including (1) the Company's Annual Report on Form 10-K for the year ended December 31, 2003, and (2) the Company's Quarterly Reports on Form 10-Q for the quarters ended March 31, 2003, June 30, 2003 and September 30, 2003) are available (i) over the Internet at the SEC's web site at http://www.sec.gov; (ii) at the SEC's public reference room in Washington D.C.; (iii) over the Internet at the Company's web site at http://www.mbia.com; and (iv) at no cost, upon request to MBIA Insurance Corporation, 113 King Street, Armonk, New York 10504. The telephone number of MBIA is (914) 273-4545.

As of December 31, 2002, MBIA had admitted assets of $9.2 billion (audited), total liabilities of $6.0 billion (audited), and total capital and surplus of $3.2 billion (audited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of December 31, 2003, MBIA had admitted assets of $9.9 billion (unaudited), total liabilities of $6.2 billion (unaudited), and total capital and surplus of $3.7 billion (unaudited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

Financial Strength Ratings of MBIA. Moody's rates the financial strength of MBIA "Aaa."

S&P rates the financial strength of MBIA "AAA."

Fitch rates the financial strength of MBIA "AAA."

Each rating of MBIA should be evaluated independently. The ratings reflect the respective rating agency's current assessment of the creditworthiness of MBIA and its ability to pay claims on its policies of insurance. Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency.

The above ratings are not recommendations to buy, sell or hold the MBIA Insured Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the MBIA Insured Bonds. MBIA does not guaranty the market price of the MBIA Insured Bonds nor does it guaranty that the ratings on the MBIA Insured Bonds will not be revised or withdrawn.

Concerning the Insurance Policies of the Bond Insurers

As provided in the Bond Resolution, the Bond Insurers shall be deemed to be the owners of the Insured Bonds in lieu of the Beneficial Owners, as long as the Bond Insurers shall not then be in default of their obligations under their respective Insurance Policies, for the purposes of the giving of consents to the adoption of any resolution supplemental to the Bond Resolution.

PUBLIC SECTOR DEBT OF THE COMMONWEALTH

Pro Forma Public Sector Debt

The following table presents a summary of public sector debt as of December 31, 2003. The table also shows the public sector debt as adjusted by the inclusion of the Bonds and the exclusion of the Refunded Bonds. Excluded from the table is debt not primarily payable from either Commonwealth or municipal taxes, Commonwealth appropriations or rates charged by public corporations for services or products. Also excluded from the table is debt the inclusion in which would reflect double counting, including, but not limited to, $1.323 billion of outstanding bonds issued by the Municipal Finance Agency to finance its purchase of bonds of Puerto Rico municipalities, and $1.026 billion of obligations of Government Development Bank issued to purchase certain Commonwealth public sector debt and for other purposes, of which $267 million is guaranteed by the Commonwealth. The table should be read in conjunction with the information set forth under *Debt* in *Appendix I*.

Commonwealth of Puerto Rico
Public Sector Debt *
(in thousands)

	December 31, 2003	As Adjusted by the Issuance of the Bonds(1)
Puerto Rico direct debt (2)	$ 8,515,633	$ 8,562,888(3)
Municipal debt	1,935,028	1,935,028
Public corporations debt		
Puerto Rico guaranteed debt	643,295	643,295
Debt supported by Puerto Rico appropriations or taxes	13,527,718	13,527,718
Other non-guaranteed debt	7,694,201	7,694,201
Total public corporations debt	$21,865,214	$21,865,214
Total public sector debt	$32,315,875	$32,363,130(3)

* For a complete recital of all notes to this table, see "Public Sector Debt" under "Debt" in *Appendix I*.
(1) Adjusted to include the issuance of the Bonds and to exclude the Refunded Bonds.
(2) This amount excludes any Commonwealth general obligation bonds that have been refunded with proceeds that were invested in non-eligible investments, even though such bonds will be considered outstanding under their respective authorizing resolutions and for purposes of calculating the Commonwealth's constitutional debt limitation.
(3) If the principal amount of certain of the Refunded Bonds is adjusted for the reasons specified in footnote * appearing under the table of Refunded Bonds in *Plan of Financing*, the amount of Puerto Rico direct debt, as shown under the column "As Adjusted by the Issuance of the Bonds," will change correspondingly. Should the principal amount of the Refunded Bonds decrease after such adjustment, the amount shown under such column will increase by an amount equal to the amount of the foregoing decrease and vice versa.

Source: Government Development Bank

Debt Service Requirements for Commonwealth General Obligation Bonds and Certain Guaranteed Debt

The following table presents the debt service requirements for (i) Commonwealth general obligation bonds and PRASA bonds for which debt service payments are being made under the Commonwealth guaranty, in each case outstanding on December 31, 2003 (adjusted to exclude debt service on the Refunded Bonds); (ii) debt service on the Bonds; and (iii) total debt service adjusted for the issuance of the Bonds, and the refunding of the Refunded Bonds. The table excludes debt service on Commonwealth general obligation bonds that have been refunded with the proceeds of refunding bonds invested in non-eligible investments, notwithstanding that such bonds will be considered to be outstanding for purposes of calculating the Commonwealth's constitutional debt limitation. With respect to other debt of PRASA, see *Public Corporations* in *Appendix I*. Debt service requirements for each fiscal year, as shown in the following table, include principal and interest due on July 1 immediately following the close of such fiscal year.

Puerto Rico
Debt Service Requirements*
(In thousands)

			The Bonds		
Fiscal Year Ending June 30	**Outstanding Bonds Total Debt Service[(1)]**	**Outstanding PRASA Guaranteed Bonds Debt Service**	**Principal**	**Interest[(2)]**	**Grand Total[(3)]**
2004	305,347	30,125	0	3,530	339,003
2005	447,096	30,127	0	29,551	506,774
2006	495,641	30,121	2,125	29,548	557,434
2007	495,516	30,126	2,200	29,475	557,317
2008	505,248	30,131	2,275	29,405	567,060
2009	500,898	30,123	2,375	29,327	562,723
2010	501,080	29,984	2,450	29,253	562,767
2011	498,686	29,928	2,550	29,168	560,332
2012	498,542	30,127	2,625	29,088	560,382
2013	499,529	30,128	3,945	26,844	560,446
2014	501,616	30,125	4,100	26,698	562,539
2015	501,869	30,126	4,255	26,555	562,805
2016	502,134	30,121	4,410	26,396	563,061
2017	502,510	30,122	4,570	26,243	563,444
2018	503,880	30,126	4,755	26,073	564,834
2019	504,521	30,125	4,920	25,907	565,473
2020	531,071	0	9,015	25,716	565,802
2021	369,479	0	19,060	25,364	413,903
2022	278,220	0	21,095	24,736	324,051
2023	214,068	0	42,255	23,930	280,253
2024	190,725	0	43,960	22,286	256,970
2025	191,000	0	45,735	20,540	257,275
2026	176,740	0	53,440	18,734	248,914
2027	165,660	0	66,880	16,638	249,178
2028	148,713	0	86,720	14,024	249,456
2029	163,690	0	75,265	10,770	249,725
2030	146,084	0	95,770	8,043	249,897
2031	157,061	0	88,515	4,438	250,014
2032	38,438	0	31,850	1,118	71,405
2033	38,435	0	0	0	38,435
	$ 10,573,498	$ 481,665	$ 727,115	$ 639,396	$ 12,421,674

* Totals may not add due to rounding.

(1) Debt service requirements on all general obligation bonds outstanding on December 31, 2003, adjusted to exclude debt service on any general obligation bonds refunded with proceeds invested in non-eligible investments (even though such bonds are considered to be outstanding for purposes of calculating the Commonwealth's constitutional debt limitation).

(2) Interest on the Series 2004 A Bonds is calculated at their actual rate per annum through the Mandatory Tender Date and thereafter at 4.28% per annum for the Series 2004 A Bonds due on July 1, 2030, and 3.88% per annum for the Series 2004 A Bonds due on July 1, 2031. Interest on the Series 2004 B Bonds is calculated using the respective fixed interest rates to be paid by the Commonwealth under the Interest Rate Agreements. If the maximum rate permitted by Puerto Rico law of 12% was used instead, maximum annual principal and interest requirements on the Bonds of $676,817,577.92 would occur in the fiscal year ending June 30, 2006.

(3) Debt service requirements on all general obligation bonds outstanding adjusted as discussed in footnotes 1 and 2 above and further adjusted to include the issuance of the Bonds and the refunding of the Refunded Bonds. If the principal of certain of the Refunded Bonds is adjusted for the reasons specified in *Plan of Financing*, the amount shown under "Outstanding Bonds Total Debt Service" in the above table for the fiscal year ending June 30, 2005 may be higher or lower depending on the actual principal amount of such Refunded Bonds that are defeased.

Sources: Government Development Bank and Department of the Treasury

TAX EXEMPTION

The Internal Revenue Code of 1986, as amended (the "Code"), includes requirements regarding the use, expenditure and investment of bond proceeds and the timely payment of certain investment earnings to the Treasury of the United States, if required, which must continue to be satisfied after the issuance of the Bonds in order that interest on the Bonds not be included in gross income for federal income tax purposes. The failure to meet these requirements may cause interest on the Bonds to be included in gross income for federal income tax purposes retroactive to their date of issuance.

The Commonwealth has entered into a bond purchase agreement with respect to the Series 2004 A Bonds on April 30, 2004. The bond purchase agreement with respect to the Series 2004 B Bonds is expected to be entered into on May 12, 2004. It is anticipated that Puerto Rico Public Buildings Authority (the "Authority") will also enter into a bond purchase agreement on May 12, 2004 with respect to certain bonds the interest on which will not be includable in gross income for federal income tax purposes. In the event that the bond purchase agreements with respect to the Bonds are entered into within fifteen days of the date that a bond purchase agreement with respect the Authority's tax-exempt bonds is entered into, the Bonds and such Authority tax-exempt bonds will be a single issue of bonds for federal income tax purposes (the "Combined Bond Issue"). In the event that there is a Combined Bond Issue, both the Commonwealth and the Authority must comply with the above requirements under the Code with respect to the Combined Bond Issue. A failure to satisfy such requirements by either the Commonwealth or the Authority may cause interest on the Bonds to be included in gross income for federal income tax purposes retroactive to their date of issuance. The Commonwealth has covenanted to comply, to the extent permitted by the Constitution and the laws of the Commonwealth, with the requirements of the Code in order to maintain the exclusion from gross income for federal income tax purposes of interest on the Bonds. The Authority will covenant in the event of a Combined Bond Issue to comply, to the extent permitted by the Constitution and the laws of the Commonwealth, with the requirements of the Code in order to maintain the exclusion from gross income for federal income tax purposes of interest on the Bonds. Bond Counsel is not aware of any provision of the Constitution or laws of the Commonwealth which would prevent the Commonwealth or the Authority from complying with the requirements of the Code.

In the opinion of Bond Counsel, subject to continuing compliance by the Commonwealth, and the Authority under the circumstances described in the preceding paragraph, with the tax covenant referred to above, under the provisions of the Acts of Congress now in force and under existing regulations, rulings and court decisions, interest on the Bonds will not be includable in gross income for federal income tax purposes. Interest on the Bonds will not be an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. Interest on the Bonds will, however, be includable in the computation of the alternative minimum tax on corporations imposed by the Code. In the event that one or more of the bond purchase agreements described in the preceding paragraph is not signed within fifteen days of April 30, 2004, the opinion of Bond Counsel in *Appendix III* will be appropriately modified to exclude from the definition of Combined Bond Issue all of the bonds to which any later signed bond purchase agreement relates. Bond Counsel is rendering no opinion on the effect of any action taken or not taken after the date of its opinion without its approval (except for such action or omission to act as is provided for in the documents pertaining to the Bonds) or in reliance upon the advice of counsel other than such firm on the exclusion from gross income of the interest on the Bonds for federal income tax purposes. Bond Counsel is further of the opinion that under the provisions of the Acts of Congress now in force, the Bonds and the interest thereon will be exempt from state, Commonwealth and local income taxation.

Ownership of tax-exempt obligations may result in collateral federal income tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, certain foreign corporations, certain S Corporations with excess passive income, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations and taxpayers who may be eligible for the earned income tax credit.

Ownership of tax-exempt obligations may also result in collateral income tax consequences under Puerto Rico law to financial institutions doing business in Puerto Rico.

Prospective purchasers of the Bonds should consult their tax advisors as to the applicability and impact of any collateral consequences.

Legislation affecting municipal securities is constantly being considered by the United States Congress. There can be no assurance that legislation enacted after the date of issuance of the Bonds will not have an adverse effect on the tax-exempt status of the Bonds. Legislative or regulatory actions and proposals may also affect the economic value of tax exemption or the market prices of the Bonds.

Premium Bonds

The excess, if any, of the tax basis of a Bond to a purchaser (other than a purchaser who holds such Bonds as inventory, stock in trade or for sale to customers in the ordinary course of business) over the amount payable at maturity of that Bond is "Bond Premium." Bond Premium is amortized over the term of such Bond for federal income tax purposes (in the case of a Bond with Bond Premium callable prior to its stated maturity, the amortization period and yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on such Bond). No deduction is allowed for such amortization of Bond Premium. Bond Premium is, however, treated as an offset to qualified stated interest received on the Bonds. An owner of such Bond is required to decrease his adjusted basis in such Bond by the amount of amortizable bond premium attributable to each taxable year such Bond is held. An owner of such Bond should consult his tax advisor with respect to the precise determination for federal income tax purposes of the treatment of Bond Premium upon sale, redemption or other disposition of such Bond and with respect to Commonwealth, state, and local income tax consequences of owning and disposing of such Bond.

LEGAL MATTERS

The proposed form of opinion of Sidley Austin Brown & Wood LLP, New York, New York, Bond Counsel, is set forth in *Appendix III* to this Official Statement. Certain legal matters will be passed upon for the Underwriters by Pietrantoni Méndez & Alvarez LLP, San Juan, Puerto Rico.

LEGAL INVESTMENT

The Bonds will be eligible for deposit by banks in Puerto Rico to secure public funds and will be approved investments for insurance companies to qualify them to do business in Puerto Rico, as required by law.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

The Verification Agent will verify, from the information provided to them, the mathematical accuracy as of the date of the closing of the Bonds of the computations contained in the provided schedules to determine that the anticipated receipts from the securities listed in such schedules, to be held in escrow, will be sufficient to pay, when due, the principal, interest and call premium payment requirements of the Refunded Bonds. See *Plan of Financing*. The Verification Agent will express no opinion on the assumptions provided to them, nor as to the exclusion from gross income for Federal income tax purposes of the interest on the Bonds.

UNDERWRITING

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Series 2004 A Bonds from the Commonwealth at an aggregate discount of $1,617,032.07 from the initial offering prices of the Series 2004 A Bonds set forth or derived from information set forth on the inside cover of this Official Statement. The obligations of the Underwriters are subject to certain conditions precedent, and they will be obligated to purchase all the Series 2004 A Bonds, if any such bonds are purchased. The Underwriters may offer to sell the Series 2004 A Bonds to certain dealers and others at prices lower than the initial public offering prices. The offering prices may be changed, from time to time, by the Underwriters.

Goldman, Sachs & Co. and Lehman Brothers Inc., will jointly and severally agree, subject to certain conditions, to purchase the Series 2004 B Bonds from the Commonwealth at an aggregate discount of $1,953,041.02 from the initial offering prices of the Series 2004 B Bonds set forth or derived from information set forth on the inside cover of this Official Statement. Goldman, Sachs & Co. will purchase the Series 2004 B Bonds, on behalf of itself and Lehman Brothers Inc., and Lehman Brothers Inc. will then purchase from Goldman, Sachs & Co. the Sub-Series 2004 B-1 through Sub-Series 2004 B-4 Bonds. The obligation of Goldman, Sachs & Co. and Lehman Brothers Inc. is subject to certain conditions precedent, and they will be obligated to purchase all of the Series 2004 B Bonds, if any such bonds are purchased. Goldman, Sachs & Co. and Lehman Brothers Inc. may offer to sell the Series 2004 B Bonds to certain dealers and others at prices lower than the initial public offering prices. The offering prices may be changed, from time to time, by Goldman, Sachs & Co. and Lehman Brothers Inc.

Goldman, Sachs & Co., a managing underwriter, has entered into a written agreement with FirstBank Puerto Rico, pursuant to which FirstBank Puerto Rico has agreed to provide investment banking services to Goldman, Sachs & Co. in connection with Goldman, Sachs & Co.'s provision of underwriting and investment banking services to the Commonwealth with respect to the Bonds. Pursuant to this agreement, the existence of which has been disclosed to the Commonwealth and Government Development Bank, FirstBank Puerto Rico will be entitled to receive a portion of Goldman, Sachs & Co.'s actual net profits, if any, in connection with the underwriting of the Bonds. Other Underwriters have entered into similar agreements with respect to the sharing of underwriting net profits and disclosed such arrangements to the Commonwealth and Government Development Bank.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

As required by Act No. 272 of the Legislature of Puerto Rico, approved May 15, 1945, as amended, Government Development Bank has acted as financial advisor to the Commonwealth in connection with the Bonds offered hereby. As financial advisor, Government Development Bank participated in the selection of the Underwriters of the Bonds. Certain of the Underwriters have been selected by Government Development Bank to serve from time to time as underwriters of its obligations and the obligations of the Commonwealth, its instrumentalities and public corporations. Certain of the Underwriters or their affiliates participate in other financial transactions with Government Development Bank.

RATINGS

Moody's and S&P have given the Bonds ratings of "Baa1" and "A-", respectively. These ratings do not reflect the Insurance Policies. Moody's and S&P are expected to give the Insured Bonds ratings of "Aaa" and "AAA," respectively, based on the expected issuance by the respective Bond Insurers of their Insurance Policies. Ratings reflect only the respective views of the rating agencies and an explanation of the significance of each rating may be obtained only from the respective rating agency.

Such rating agencies were provided with materials relating to the Commonwealth and the Bonds and other relevant information, and no application has been made to any other rating agency for the purpose of obtaining a rating on the Bonds.

There is no assurance that such ratings will remain in effect for any given period of time or that they will not be revised downward or withdrawn entirely by either or both of such rating agencies, if in the judgment of either or both, circumstances so warrant. Any such downward revision or withdrawal of such ratings, or either of them, may have an adverse effect on the market prices of the Bonds.

CONTINUING DISCLOSURE

In accordance with the requirements of Rule 15c2-12, as amended (the "Rule"), promulgated by the Securities and Exchange Commission (the "SEC"), the Commonwealth has covenanted in the Bond Resolutions for the benefit of the Beneficial Owners (as defined in the Bond Resolutions):

1. to file, within 305 days after the end of each fiscal year commencing with the fiscal year ending June 30, 2004, with each NRMSIR and with any Commonwealth state information depository ("SID"), core financial information and operating data for the prior fiscal year, including (i) the Commonwealth's audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time, and (ii) material historical quantitative data (including financial information and operating data) on the Commonwealth and its revenues, expenditures, financial operations and indebtedness, in each case generally found in this Official Statement; and

2. to file, in a timely manner, with each NRMSIR or with the Municipal Securities Rulemaking Board and with each Commonwealth SID, notice of any failure of the Commonwealth to comply with paragraph 1 above and of the occurrence of any of the following events with respect to the Bonds, if material:

    a. principal and interest payment delinquencies;
    b. non-payment related defaults;
    c. unscheduled draws on debt service reserves reflecting financial difficulties;
    d. unscheduled draws on credit enhancements reflecting financial difficulties;
    e. substitution of credit or liquidity providers, or their failure to perform;
    f. adverse opinions or events affecting the tax-exempt status of the Bonds;
    g. modifications to rights of the holders (including Beneficial Owners) of the Bonds;
    h. Bond calls;
    i. defeasances;
    j. release, substitution, or sale of property securing repayment of the Bonds; and
    k. rating changes.

Event (c) and (e) are included pursuant to a letter from the SEC staff to the National Association of Bond Lawyers, dated September 19, 1995. However, events (c) and (e) may not be applicable, since the terms of the Bonds do not provide for "debt service reserves" or "liquidity providers." In addition, with respect to the following events:

Events (d) and (e). The Commonwealth does not undertake to provide any notice with respect to credit enhancement added after the primary offering of the Bonds, unless the Commonwealth applies for or participates in obtaining the enhancement.

Event (f). For information on the tax status of the Bonds, see *Tax Matters*.

Event (h). The Commonwealth does not undertake to provide the above-described event notice of a mandatory scheduled redemption, not otherwise contingent upon the occurrence of an event, if the terms, dates and amounts of redemption are set forth in detail in this Official Statement under "*The Bonds* — Redemption," the only open issue is which Bonds will be redeemed in the case of a partial redemption, notice of redemption is given to the Bondholders as required under the terms of the Bonds, and public notice of the redemption is given pursuant to Securities Exchange Act of 1934 Release No. 34-23856 of the SEC, even if the originally scheduled amounts are reduced by prior optional redemptions or Bond purchases.

The Commonwealth expects to provide the information described in paragraph 1(ii) above by filing its first bond official statement that includes such information for the preceding fiscal year or, if no such official statement is issued by the 305-day deadline, by filing a separate document containing such information.

The Commonwealth has made similar continuing disclosure covenants in connection with prior bond issuances, and has complied with all such covenants, except as hereinafter noted. The Commonwealth's audited financial statements for the fiscal year ended June 30, 2002 were filed after the Commonwealth's filing deadline of May 1, 2003, because of delays in finalizing such financial statements resulting from the implementation of Governmental Accounting Standards Board Statement No. 34 ("GASB 34"). The Commonwealth's audited financial statements for the fiscal year ended June 30, 2003 were not filed on or prior to the Commonwealth's filing deadline of April 30, 2004, because of delays in finalizing the financial statements of certain of the Commonwealth's reporting units due to the implementation of GASB 34. The Commonwealth expects such financial statements will be available and filed during the second calendar quarter of 2004.

As of the date of this Official Statement, there is no Commonwealth SID, and the NRMSIRs are: Bloomberg Municipal Repository, 100 Business Park Drive, Skillman, New Jersey 08558; Standard & Poor's J.J. Kenny, 55 Water Street, 45th Floor, New York, New York 10041; FT Interactive Data, Attn: NRMSIR, 100 William Street, New York, New York 10038; and DPC Data Inc., One Executive Drive, Fort Lee, New Jersey 07024.

The Commonwealth may from time to time choose to provide notice of the occurrence of certain other events in addition to those listed above if, in the judgment of the Commonwealth, such other events are material with respect to the Bonds, but the Commonwealth does not undertake to provide any such notice of the occurrence of any material event except those events listed above.

The Commonwealth acknowledges that its undertaking pursuant to the Rule described above is intended to be for the benefit of the Beneficial Owners of the Bonds, and shall be enforceable by any such Beneficial Owners; provided that the right to enforce the provisions of its undertaking shall be limited to a right to obtain specific enforcement of the Commonwealth's obligations thereunder.

No Beneficial Owner may institute any suit, action or proceeding at law or in equity ("Proceeding") for the enforcement of the foregoing covenants (the "Covenants") or for any remedy for breach thereof, unless such Beneficial Owner shall have filed with the Commonwealth written notice of any request to cure such breach, and the Commonwealth shall have refused to comply within a reasonable time. All Proceedings shall be instituted only in a Commonwealth court located in the Municipality of San Juan, Puerto Rico for the equal benefit of all Beneficial Owners of the outstanding Bonds benefited by the Covenants, and no remedy shall be sought or granted other than specific performance of any of the Covenants at issue. Moreover, Proceedings filed by Beneficial Owners against the Commonwealth may be subject to the sovereign immunity provisions of Section 2 of Act No. 104, approved June 29, 1955, as amended, which governs the scope of legal actions against the Commonwealth, substantially limits the amount of monetary damages that may be awarded against the Commonwealth and provides certain notice provisions, the failure to comply with which may further limit any recovery.

The Covenants may only be amended if:

(1) the amendment is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the Commonwealth, or type of business conducted; the Covenants, as amended, would have complied with the requirements of the Rule at the time of award of the Bonds, after taking into account any amendments or change in circumstances; and the amendment does not materially impair the interest of Beneficial Owners, as determined by persons unaffiliated with the Commonwealth; or

(2) all or any part of the Rule, as interpreted by the staff of the SEC at the date of the adoption of such Rule, ceases to be in effect for any reason, and the Commonwealth elects that the Covenants shall be deemed amended accordingly.

The Commonwealth has further agreed that the annual financial information containing any amended operating data or financial information will explain, in narrative form, the reasons for the amendment and the impact of the change in the type of operating data or financial information being provided.

Any assertion of beneficial ownership must be filed, with full documentary support, as part of the written request described above.

The Covenants have been made in order to assist the Underwriters in complying with the Rule.

MISCELLANEOUS

The foregoing summaries of or references to the Act, the Bonds, the Bond Resolution and the summaries of or references to the various acts contained in the Commonwealth Report, are made subject to all the detailed provisions thereof to which reference is hereby made for further information and do not purport to be complete statements of any or all of such provisions.

Appended to and constituting a part of this Official Statement are the Commonwealth Report (*Appendix I*), a description of the ARS Provisions (*Appendix II*), the proposed form of opinion of Bond Counsel (*Appendix III*), a specimen of the CIFG NA Insurance Policy (*Appendix IV*), a specimen of the FGIC Insurance Policy (*Appendix V*), a specimen of the FSA Insurance Policy (*Appendix VI*), and a specimen of the MBIA Insurance Policy (*Appendix VII*).

The information set forth in this Official Statement and incorporated herein by reference, except for information pertaining to DTC, the Bond Insurers and the information appearing in *Underwriting*, was supplied by certain officials of the Commonwealth or certain of its agencies or instrumentalities, in their respective official capacities, or was obtained from publications of the Commonwealth or certain of its agencies or instrumentalities, and is included or incorporated by reference in this Official Statement on the authority of such officials or the authority of such publications as public official documents. The information pertaining to DTC was supplied by DTC. The information in "The CIFG NA Bond Insurance Policy" under *Bond Insurance* and in *Appendix IV* was supplied by CIFG NA. The information in "The FGIC Bond Insurance Policy" under *Bond Insurance* and in *Appendix V* was supplied by FGIC. The information in "The FSA Bond Insurance Policy" under *Bond Insurance* and in *Appendix VI* was supplied by FSA. The information in "The MBIA Bond Insurance Policy" under *Bond Insurance* and in *Appendix VII* was supplied by MBIA.

This Official Statement will be filed with each NRMSIR and with the MSRB.

COMMONWEALTH OF PUERTO RICO

By: /s/ Juan A. Flores Galarza
Secretary of the Treasury

APPENDIX I

COMMONWEALTH OF PUERTO RICO
Financial Information and Operating Data Report
April 1, 2004

TABLE OF CONTENTS

Page

COMMONWEALTH OF PUERTO RICO

Financial Information and Operating Data Report
April 1, 2004

INTRODUCTION

Geographic Location and Demography

Puerto Rico, the fourth largest of the Caribbean islands, is located approximately 1,600 miles southeast of New York City. It is approximately 100 miles long and 35 miles wide.

According to the United States Census Bureau, the population of Puerto Rico was 3,808,610 in 2000, compared to 3,522,000 in 1990. As of 2000, the population of San Juan, the island's capital and largest city, was 434,375.

Relationship with the United States

Puerto Rico was discovered by Columbus in 1493, and shortly thereafter the island was conquered and settled by the Spaniards. It remained a Spanish possession for four centuries.

Puerto Rico came under United States sovereignty pursuant to the Treaty of Paris, signed on December 10, 1898, which ended the Spanish-American War. Puerto Ricans have been citizens of the United States since 1917. In 1950, after a long evolution toward greater self-government for Puerto Rico, the Congress of the United States enacted Public Law 600, which is "in the nature of a compact" and which became effective upon its acceptance by the electorate of Puerto Rico. It provides that those sections of existing law which defined the political, economic, and fiscal relationship between Puerto Rico and the United States would remain in full force. It also authorized the people of Puerto Rico to draft and adopt their own Constitution. The Constitution was drafted by a popularly elected constitutional convention, overwhelmingly approved in a special referendum by the people of Puerto Rico and approved by the United States Congress and the President of the United States, becoming effective upon proclamation of the Governor of Puerto Rico on July 25, 1952. Puerto Rico's relationship with the United States is referred to herein as commonwealth status.

The United States and the Commonwealth of Puerto Rico (the "Commonwealth") share a common defense, market, and currency. The Commonwealth exercises virtually the same control over its internal affairs as do the fifty states. It differs from the states, however, in its relationship with the federal government. The people of Puerto Rico are citizens of the United States but do not vote in national elections. They are represented in Congress by a Resident Commissioner who has a voice in the House of Representatives but no vote. Most federal taxes, except those such as Social Security taxes which are imposed by mutual consent, are not levied in Puerto Rico. No federal income tax is collected from Puerto Rico residents on income earned in Puerto Rico, except for certain federal employees who are subject to taxes on their salaries.

The official languages of Puerto Rico are Spanish and English.

Governmental Structure

The Constitution of the Commonwealth provides for the separation of powers of the executive, legislative, and judicial branches of government. The Governor is elected every four years. The Legislature consists of a Senate and a House of Representatives, the members of which are elected for four-year terms. The highest court within the local jurisdiction is the Supreme Court of Puerto Rico.

Puerto Rico constitutes a District in the Federal Judiciary and has its own United States District Court. Decisions of this court may be appealed to the United States Court of Appeals for the First Circuit and from there to the Supreme Court of the United States.

Governmental responsibilities assumed by the central government of the Commonwealth are similar in nature to those of the various state governments. In addition, the central government assumes responsibility for local police and fire protection, education, public health and welfare programs, and economic development.

Sila M. Calderón was sworn in as Governor of Puerto Rico on January 2, 2001. She obtained a Bachelor's degree in Political Science from Manhattanville College in New York and undertook graduate studies at the School of Public Administration of the University of Puerto Rico. Since 1973, she has worked in the public sector as Executive Assistant to the Secretary of Labor, Special Assistant to the Governor of Puerto Rico, Chief of Staff of the Governor of Puerto Rico and Secretary of State. In the private sector, she was an executive in charge of Business Development for Citibank, N.A., President of Commonwealth Investment Company Inc., and a member of the Board of Directors of BanPonce, Banco Popular de Puerto Rico and Pueblo International, Inc. From 1997 until taking office as Governor, she served as elected Mayor of the municipality of San Juan.

Juan A. Flores Galarza, Secretary of the Treasury, took office on January 2, 2001. He is a certified public accountant and a graduate of the University of Puerto Rico, Mayagüez Campus, where he obtained a Bachelor's degree in Business Administration. Prior to his appointment as Secretary of the Treasury, he worked in a manufacturing company and as an auditor for a large accounting firm.

Melba Acosta, Director of the Office of Management and Budget, took office on January 2, 2001. She is a graduate of the University of Puerto Rico, where she obtained a Bachelor's degree in Business Administration and a Juris Doctor degree. She obtained a Master's degree in Business Administration from the Harvard Graduate School of Business. She is a certified public accountant and has six years of experience as a tax consultant and corporate attorney in the private sector. Prior to her appointment as head of the Office of Management and Budget, she served for four years in the public sector as Chief of Staff of the Municipality of San Juan.

Antonio Faría-Soto was appointed President of Government Development Bank in November 2003. He obtained a Bachelor's degree in Business Administration from Catholic University of Puerto Rico and a Master's degree in Business Administration from InterAmerican University. At the time of his appointment, he was President of the Economic Development Bank for Puerto Rico. Prior to his appointment as President of the Economic Development Bank for Puerto Rico, he served as Commissioner of Financial Institutions for the Commonwealth. Mr. Faría has over 30 years of experience in the commercial and investment banking industry, having worked at PaineWebber, Banco Santander, Banco Central Hispano, Banco Central y Economías and Citibank, N.A.

Political Trends

For many years there have been two major views in Puerto Rico with respect to the island's relationship with the United States: one favoring commonwealth status, represented by the Popular Democratic Party, and the other favoring statehood, represented by the New Progressive Party. The following table shows the percentages of the total vote received by the gubernatorial candidates of the various parties in the last five elections by voter preference with respect to commonwealth status, statehood, and independence. While the electoral choices of Puerto Rico's voters are not based solely on preferences regarding the island's relationship with the United States, candidates who support a continuing relationship between Puerto Rico and the United States have prevailed in elections for many years.

	1984	1988	1992	1996	2000
Popular Democratic Party	48.5%	48.7%	45.9%	44.5%	48.6%
New Progressive Party	45.5	45.8	49.9	51.1	45.7
Puerto Rico Independence Party	3.9	5.4	4.2	3.8	5.2
Others	2.1	0.1	--	0.6	0.5

With the results of the 2000 election, control of the executive and legislative branches is now under the Popular Democratic Party. The composition of the Senate and House of Representatives by political party is as follows:

	Senate	House
Popular Democratic Party	20	29
New Progressive Party	8	21
Puerto Rico Independence Party	1	1
	29	51

The next general election (gubernatorial, municipal, and legislative) in Puerto Rico will be held in November 2004. Voter participation in Puerto Rico is substantially higher than in the United States, averaging 83% since 1972.

THE ECONOMY

General

The Commonwealth has established policies and programs directed principally at developing the manufacturing and services sectors of the economy and expanding and modernizing the Commonwealth's infrastructure. Domestic and foreign investments have been stimulated by selective tax exemptions, development loans, and other financial and tax incentives. Infrastructure expansion and modernization have been to a large extent financed by bonds and notes issued by the Commonwealth, its public corporations, and municipalities. Economic progress has been aided by significant increases in the levels of education and occupational skills of the island's population.

Puerto Rico has enjoyed two decades of almost continuous economic expansion. Almost every sector of the economy has participated in this expansion, and record levels of employment have been achieved. Factors contributing to this expansion included government-sponsored economic development programs, increases in the level of federal transfer payments, a significant expansion in construction investment driven by infrastructure projects and private investment, primarily in housing, the relatively low cost of borrowing, and low oil prices in many years during this period.

Personal income, both aggregate and per capita, has increased consistently each fiscal year from 1985 to 2003. In fiscal year 2003, aggregate personal income was $43.6 billion ($41.7 billion in 2000 prices) and personal income per capita was $11,279 ($10,784 in 2000 prices).* Personal income includes transfer payments to individuals in Puerto Rico under various social programs. Total federal payments to Puerto Rico, which include transfers to local government entities and expenditures of federal agencies in Puerto Rico, in addition to federal transfer payments to individuals, are lower on a per capita basis in

*Different price deflators are used for gross product and personal income statistics. The year 2000 is used as a basis for comparison because that is the year used by the U.S. Department of Commerce.

Puerto Rico than in any state of the United States. Transfer payments to individuals in fiscal year 2003 were $9.6 billion, of which $7.4 billion, or 76.6%, represented entitlements to individuals who had previously performed services or made contributions under programs such as Social Security, Veterans' Benefits, Medicare and U.S. Civil Service retirement pensions.

Total average employment (as measured by the Department of Labor and Human Resources Household Employment Survey) has also increased. For example, from fiscal year 1999 to fiscal year 2003, average employment increased from 1,146,700 to 1,210,800.

The dominant sectors of the Puerto Rico economy are manufacturing and services. The manufacturing sector has undergone fundamental changes over the years as a result of increased emphasis on higher wage, high technology industries, such as pharmaceuticals, biotechnology, electronics, computers, microprocessors, professional and scientific instruments, and certain high technology machinery and equipment. The services sector, including finance, insurance, real estate, wholesale and retail trade, and tourism, also plays a major role in the economy. It ranks second only to manufacturing in contribution to the gross domestic product and leads all sectors in providing employment.

The following table shows the gross product for the five fiscal years ended June 30, 2003.

Commonwealth of Puerto Rico
Gross Product

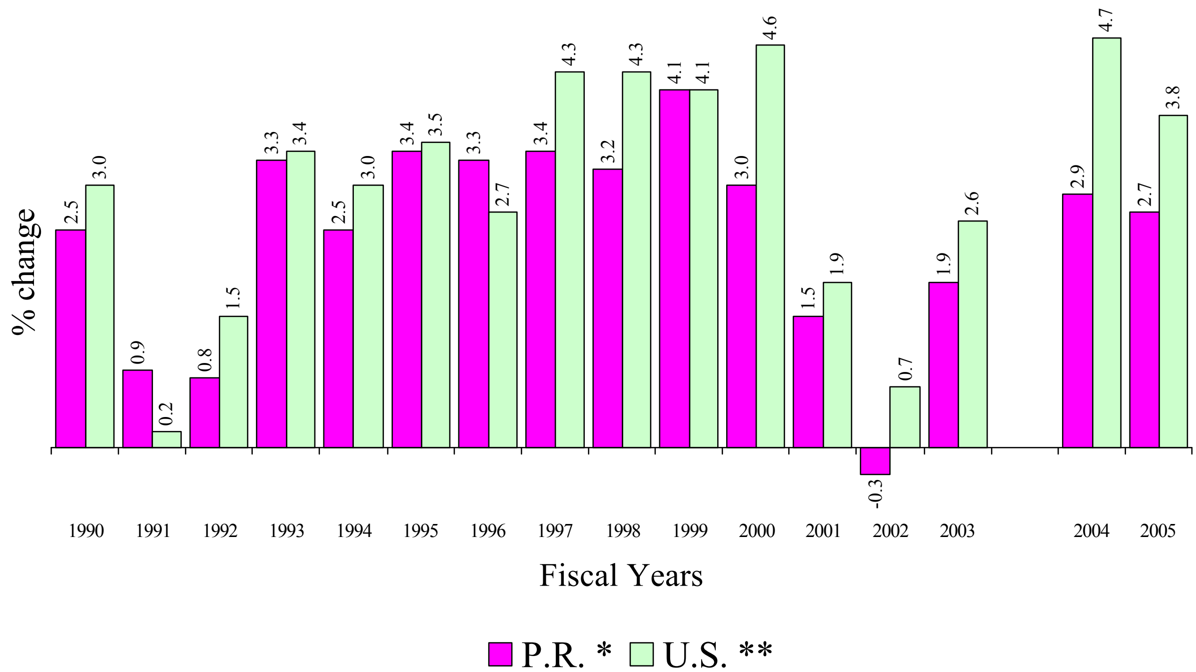
	Fiscal Years Ended June 30				
	1999	**2000**	**2001**	**2002**	**2003**(1)
Gross product - $ millions(2)	$ 38,281	$ 41,419	$ 44,047	$ 45,008	$ 47,354
Real gross product - $ millions (2000 prices)	40,225	41,419	42,044	41,910	42,689
Annual percentage increase in real gross product (2000 prices)	4.1%	3.0%	1.5%	(0.3%)	1.9%
U.S. annual percentage increase in real gross product (2000 prices)	4.1%	4.6%	1.9%	0.7%	2.6%

(1) Preliminary.
(2) In current dollars.

Sources: P.R. Planning Board and Global Insight Inc.

The economy of Puerto Rico is closely linked to the United States economy. Factors affecting the United States economy usually have a significant impact on the performance of the Puerto Rico economy. These include exports, direct investment, the amount of federal transfer payments, the level of interest rates, the level of oil prices, the rate of inflation, and tourist expenditures. Consequently, the economic slowdown in the United States in 2001 and 2002 and the subsequent recovery in 2003, which continues in 2004, have also been reflected in the Puerto Rico economy. During fiscal year 2003 (July 2002 through June 2003), approximately 86% of Puerto Rico's exports went to the United States mainland, which was also the source of approximately 49% of Puerto Rico's imports. In fiscal year 2003, Puerto Rico experienced a $21.4 billion positive merchandise trade balance. The graph on the following page compares the growth rate of real gross national product for the Puerto Rico and United States economies since fiscal 1990, and the projection of the growth rate for fiscal years 2004 and 2005.

Real GNP Growth Rate



* P.R. Planning Board

** Global Insight 04/04.

Since the 1950s, the Puerto Rico Planning Board (the "Planning Board") has prepared a complete set of macroeconomic measures like those prepared for the United States by the Bureau of Economic Analysis ("BEA") of the Department of Commerce. In contrast with the BEA, which computes the economic accounts on a quarterly basis, the Planning Board computes the economic accounts on an annual basis. Like the BEA, the Planning Board revises the macroeconomic numbers on a regular basis. The Planning Board has always classified the latest annual numbers as preliminary until they are revised and made final in conjunction with the release of new data each year. At present, all macroeconomic accounts for fiscal year 2003 are preliminary until the revised figures are released.

Fiscal Year 2003

The Planning Board's preliminary reports of the performance of the Puerto Rico economy during fiscal year 2003 indicate that the economy registered an increase of 1.9% in real gross product. Gross product was $47.4 billion in fiscal year 2003 ($42.7 billion in 2000 prices) compared to $45.0 billion in fiscal year 2002 ($41.9 billion in 2000 prices). This represents an increase in nominal gross product of 5.2%. Aggregate personal income increased from $42.2 billion in fiscal year 2002 ($40.8 billion in 2000 prices) to $43.6 billion in fiscal year 2003 ($41.7 billion in 2000 prices), and personal income per capita increased from $10,969 in fiscal year 2002 ($10,603 in 2000 prices) to $11,279 in fiscal year 2003 ($10,784 in 2000 prices). According to the Department of Labor and Human Resources Household Employment Survey (the "Household Survey"), total monthly employment averaged 1,210,800 in fiscal year 2003 compared to 1,169,600 in fiscal year 2002, an increase of 3.5%. Notwithstanding this increase in average monthly employment, the unemployment rate increased from 12.0% during fiscal year 2002 to

12.1% during fiscal year 2003 due to a higher labor participation rate and a significant increase in the civilian population aged 16 years and over.

Fiscal Year 2004

The Planning Board's current real gross product forecast for fiscal years 2004 and 2005, released in February 2004, projects an increase of 2.9% and 2.7%, respectively. According to the Household Survey, total monthly seasonally adjusted employment for the period from July 2003 to March 2004 averaged 1,232,100, an increase of 2.3% compared to 1,204,700 for the same period during fiscal year 2003. The seasonally adjusted unemployment rate for the first nine months of fiscal year 2004 was 11.2%, a decrease from 12.1% for the same period in fiscal year 2003. As in the past, the economy of Puerto Rico is expected to follow the performance of the United States economy. Construction activity is expected to be a driving force for economic growth in the short and medium-term. The Planning Board's forecast for construction investment, both public and private, for fiscal year 2004 is $6.7 billion, in nominal terms, which represents a real growth of 4.6% when compared to fiscal year 2003.

Economic Development Program for the Private Sector

During the past three years, the Commonwealth's economic development program for the private sector has focused on initiatives which it believes will lead to sustainable economic development. The principal initiatives have been: (i) the enactment of laws in Puerto Rico providing tax benefits that will promote foreign and local investment and increased economic activity; (ii) the acceleration and simplification of the local permitting process; (iii) the reduction of the costs of doing business in Puerto Rico; and (iv) the promotion of new federal income tax benefits that enhance the attractiveness of establishing operations in Puerto Rico. Recognizing a shift in its post-industrial economy, the Commonwealth recently formulated a strategic plan to enhance its competitiveness in knowledge-based economic sectors, such as research and development of science and technology products. Two major components of this strategic plan are: (i) to build on the strong presence in Puerto Rico of multinational companies in the science and technology sectors and Puerto Rico's skilled workforce to promote the expansion of research and development facilities by companies currently operating in Puerto Rico and to attract new leaders in such sectors, and (ii) to provide incentives for companies and entrepreneurs to engage in the process of innovation and commercialization of new products and establish research and development facilities in Puerto Rico. The latter initiative includes the proposed creation of a government-sponsored trust to provide grants and financing to companies and entrepreneurs that engage in these activities. Legislation for the creation of the trust is expected to be submitted to the Legislature during the second quarter of 2004.

Puerto Rico Tax Incentives

One of the benefits enjoyed by the Commonwealth is that corporations operating in Puerto Rico (other than corporations organized in the United States) and individuals residing in Puerto Rico generally are not subject to federal income taxes. This enables the Commonwealth to utilize local tax legislation as a tool for stimulating economic development in Puerto Rico. See "Tax Incentives" below.

In this regard, the Commonwealth has enacted legislation extending certain benefits of its most recent tax incentive law, Act No. 135 of December 2, 1997, as amended (the "1998 Tax Incentives Act"), to all eligible businesses operating under previous tax incentives laws. These benefits include a 200% deduction for research and development expenses and worker training expenses, the ability to deduct as a current expense investments in machinery and equipment, and the ability to claim a tax credit equal to 25% of the purchase price of a product manufactured in the Commonwealth (in excess of a base amount) or 35% of the purchase price of a locally manufactured recycled product.

The 1998 Tax Incentives Act was also amended to allow a credit against the Puerto Rico income tax liability of investors that acquire the majority of the stock, partnership interests or operational assets of an exempted business that is in the process of closing operations in Puerto Rico. A credit against the Puerto Rico income tax liability is also provided to investors that contribute cash to such exempted business for the construction or improvement of its physical facilities and the purchase of machinery and equipment. The amount of the credit is equal to 50% of the cash invested for such purposes.

The Commonwealth has also enacted legislation which (i) reduces the capital gains tax from 20% to 10% in the case of individuals and estates and trusts, and from 25% to 12.5% in the case of corporations and partnerships organized under the laws of the Commonwealth or engaged in trade or business in the Commonwealth, for gains from the sale of eligible Commonwealth investments; and (ii) allows income tax credits for extraordinary investment in housing infrastructure. In addition, legislation was recently enacted that reduces the tax payable on interest on certain qualifying debt obligations issued by Puerto Rico corporations and certain qualifying foreign corporations and paid to resident individuals, trusts and estates to 10% under certain circumstances.

In addition, legislation has been enacted: (i) amending the 1998 Tax Incentives Act to provide special income tax rates ranging from 0% to 2% to companies that establish operations in Puerto Rico in "core pioneer industries" which utilize innovative technology not previously used in Puerto Rico; (ii) granting tax credits with respect to eligible investments made in the construction or substantial rehabilitation of housing units to be rented to low income families; (iii) reducing to 7% the capital gains rate applicable to gains realized on the sale of the stock of Puerto Rico corporations sold in an initial public offering made prior to December 31, 2007, or acquired in public offerings made prior to December 31, 2007; (iv) granting income tax exemption to the fees and interest income received by financial institutions in connection with loans or guarantees of loans made to finance tourism development projects; (v) granting an exemption to qualified associations administering timesharing rights or vacation clubs and to owners' associations of areas designated as tourism enhancement districts; (vi) granting income tax exemption to financial institutions for charges collected on obligations issued for the financing of tourism projects; (vii) granting tax exemption for investments in infrastructure made by housing developers; (viii) granting tax credits to Puerto Rico businesses that acquire products manufactured in Puerto Rico for exportation; and (ix) rehabilitating urban centers through the development of housing projects, community areas, commercial areas, parks and recreational spaces, construction and renovation of structures and the development of undeveloped or under-developed sites.

Acceleration and Simplification of Local Permitting Process

Another government initiative to promote sustainable economic activity involves the simplification of the permitting process. As part of this initiative, the Commonwealth established a multi-agency center that handles, in a coordinated manner, the permitting process. Furthermore, the government developed a procedure that will allow agencies to conduct simultaneous public hearings in those instances when two or more agencies require them.

Reduction of the Costs of Doing Business

The Commonwealth believes that to make Puerto Rico more competitive and foster investment it needs to reduce the cost of doing business in Puerto Rico. As part of this initiative, Puerto Rico Industrial Development Company ("PRIDCO") is conducting a thorough evaluation of the cost of doing business in Puerto Rico in order to develop new proposals to reduce those costs.

One of the costs of doing business in Puerto Rico that is high, particularly for the manufacturing industry, relative to competing jurisdictions, is the cost of electricity. Puerto Rico is heavily dependent on oil imports for the production of electricity. As a result of the construction of two cogeneration plants, however, one of which is fueled by liquefied natural gas and the other by coal, Puerto Rico's dependence on oil imports for the production of electricity has been reduced from 99% to 72%. The Electric Power Authority now estimates that these plants could provide up to 33% of its electric energy requirements.

Federal Tax Incentives

In order to enhance the attractiveness for United States companies of establishing operations in Puerto Rico, the Commonwealth has been seeking to provide for a new and permanent tax regime applicable to U.S.-based businesses that have operations in the Commonwealth or other U.S. possessions. During the past three years, the Commonwealth has been pursuing an amendment to Section 956 of the United States Internal Revenue Code of 1986, as amended (the "Code"), that would establish a regime based on the tax rules generally applied to U.S. companies with international operations, but with certain modifications intended to promote employment both in the Commonwealth and the United States. The U.S. Congress, however, has not acted upon the proposed amendment to Section 956 of the Code. Also, due to the phase-out of Sections 30A and 936 of the Code (see "Tax Incentives – Incentives Under the Code" below), the U.S. Senate designated a special commission through the General Accounting Office to study the economic impact of said phase-out and to present recommendations on alternative tax incentives for U.S.-based companies operating in Puerto Rico. In the meantime, as discussed below, most U.S.-based companies operating under Sections 30A and 936 of the Code have converted from United States corporations to Puerto Rico or foreign corporations, which has lessened the impact of the phase-out of those sections.

Employment and Unemployment

The number of persons employed in Puerto Rico during fiscal year 2003 averaged 1,210,800. Unemployment, although at relatively low historical levels, remains above the United States average. The average unemployment rate decreased from 12.5% in fiscal year 1999 to 12.1% in fiscal year 2003, and to 11.2% in March 2004.

The following table presents annual statistics of employment and unemployment for fiscal year 1999 through fiscal year 2003 and monthly statistics for July 2003 to March 2004. These employment figures are based on the Household Survey, which 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 civilian employment in Puerto Rico, more than double the level in the United States.

Commonwealth of Puerto Rico
Employment and Unemployment (1)

Fiscal Years Ended June 30	Labor Force	Employed	Unemployed	Unemployment Rate(2)
		(Annual Average)		
1999	1,310	1,147	163	12.5%
2000	1,303	1,159	143	11.0
2001	1,293	1,158	135	10.5
2002	1,330	1,170	160	12.0
2003	1,378	1,211	167	12.1
Fiscal Year 2004		(Seasonally Adjusted)		
July	1,408	1,231	176	12.5%
August	1,390	1,233	158	11.4
September	1,376	1,213	162	11.8
October	1,391	1,234	157	11.3
November	1,390	1,213	177	12.7
December	1,400	1,238	162	11.6
January	1,382	1,222	160	11.6
February	1,373	1,234	138	10.1
March	1,431	1,271	160	11.2

(1) Thousands of persons 16 years of age and over. Totals may not add due to rounding.
(2) Unemployed as percentage of labor force.

Source: Department of Labor and Human Resources - Household Survey

Economic Performance by Sector

During the period between fiscal year 1999 and 2003, the manufacturing and services 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 following table presents annual statistics of gross domestic product by sector and gross product for the five fiscal years ended June 30, 2003.

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

	Fiscal Years Ended June 30				
	1999	**2000**	**2001**	**2002**	**2003[1]**
Manufacturing	$23,312	$24,079	$29,037	$30,527	$31,297
Services[2]	22,435	24,920	26,615	27,168	28,745
Government[3]	5,530	5,478	5,992	6,303	7,147
Transportation, communication and public utilities	4,032	4,237	4,698	4,934	5,145
Agriculture, forestry and fisheries	336	529	348	228	203
Construction[4]	1,668	1,875	1,802	1,814	1,760
Statistical discrepancy	529	585	717	333	66
Total gross domestic product[5]	$57,841	$61,702	$69,208	$71,306	$74,363
Less: net payment abroad	(19,560)	(20,283)	(25,162)	(26,298)	(27,009)
Total gross product[5]	$38,281	$41,419	$44,047	$45,008	$47,354

(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.
(4) Includes mining.
(5) Totals may not add due to rounding.

Source: Planning Board

The data for employment by sector or industries presented here, like in the United States, is based on the Payroll Survey, which is designed to measure employment by sector. The Payroll Survey excludes agricultural employment and self-employed persons.

The following table presents annual statistics of average employment based on the North American Industry Classification System (NAICS) for fiscal years 1999 - 2003.

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

	Fiscal Years Ended June 30				
	1999	**2000**	**2001**	**2002**	**2003[(2)]**
Natural Resources and Mining	1,408	1,425	1,455	1,292	1,173
Construction	67,325	73,492	73,729	69,208	68,701
Manufacturing					
Durable Goods	56,917	57,383	56,249	49,348	47,534
Non-Durable Goods	88,783	85,550	82,236	72,595	69,319
Sub Total	145,700	142,933	138,485	121,943	116,854
Trade, Transportation, Warehouse & Utilities					
Wholesale Trade	30,342	32,000	32,327	31,489	31,218
Retail Trade	126,067	131,817	133,821	127,716	128,189
Transportation, Warehouse & Utilities	18,765	19,458	19,285	17,603	17,124
Sub Total	175,084	183,275	185,433	176,808	176,530
Information	20,683	21,108	20,597	21,943	21,216
Finance	44,575	45,583	44,974	43,963	42,128
Professional & Business	91,008	96,750	97,164	95,223	96,938
Educational & Health	75,350	80,692	84,202	84,452	87,590
Leisure & Hospitality	61,333	65,942	66,435	64,273	66,200
Other Services	17,208	17,408	17,330	16,602	16,338
Government	302,183	286,133	282,723	288,679	298,751
Total Non-Farm[(3)]	1,001,858	1,014,742	1,012,528	984,385	992,418

(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. In Puerto Rico, self-employment represents around 15% of total employment, while representing approximately 7% of total employment in the United States.
(2) Preliminary.
(3) Totals may not add due to rounding.

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

Manufacturing

Manufacturing is the largest sector of the Puerto Rico economy in terms of gross domestic product. The Planning Board estimates that in fiscal year 2003 manufacturing generated $31.3 billion, or 42.1%, of gross domestic product. During fiscal year 2003, payroll employment for the manufacturing sector was 116,854, a decrease of 4.2% compared with fiscal year 2002, with most of the job losses occurring in labor-intensive industries. Most of the island's manufacturing output is shipped to the United States mainland, which is also the principal source of semi-finished manufactured articles on which further manufacturing operations are performed in Puerto Rico. The United States minimum wage laws are applicable in Puerto Rico. As of February 2004, the average hourly manufacturing wage rate in Puerto Rico was 66.2% of the average mainland United States rate.

Manufacturing in Puerto Rico is now more diversified than during the earlier phases of its industrial development and includes several industries less prone to business cycles. In the last three decades, industrial development has tended to be more capital intensive and more dependent on skilled labor. This gradual shift in emphasis is best exemplified by the large investment over the last decade in the pharmaceutical, scientific instruments, computers and electrical products industries in Puerto Rico. One of the factors assisting the development of the manufacturing sector has been the tax incentives offered by the federal and Puerto Rico governments. Federal legislation enacted in 1996, however, which amended Section 936 of the Internal Revenue Code of 1986, as amended, phases out the federal tax incentives during a ten-year period. See "Tax Incentives - Incentives Under the Code" under *The Economy.*

The following table sets forth gross domestic product by manufacturing sector for the five fiscal years ended June 30, 2003.

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

	Fiscal Years Ended June 30				
	1999	2000	2001	2002	2003(1)
Pharmaceuticals	$12,913	$13,580	$16,620	$17,958	$19,239
Machinery and metal products:					
Machinery, except electrical	1,847	2,031	3,376	3,751	3,607
Electrical machinery	1,410	1,525	1,874	1,759	1,629
Professional and scientific instruments	1,697	1,758	2,100	2,276	2,306
Other machinery and metal products	377	341	316	323	372
Food products	1,910	1,912	1,974	2,080	2,051
Other chemical and allied products	898	777	765	619	591
Apparel	609	610	569	521	367
Other(2)	1,651	1,543	1,444	1,239	1,136
Total gross domestic product of manufacturing sector(3)	$23,312	$24,079	$29,037	$30,527	$31,297

(1) Preliminary.
(2) Includes petroleum products; petrochemicals; tobacco products; stone, clay and glass products; textiles and others.
(3) Totals may not add due to rounding.

Source: Planning Board

The following table presents annual statistics of average manufacturing employment by industry based on the North American Industry Classification System (NAICS) for fiscal years 1999 to 2003.

Commonwealth of Puerto Rico
Non-Farm Payroll Manufacturing Employment by Industry Group[(1)]
(persons age 16 years and over)

Industry Group	Fiscal Years Ended June 30				
	1999	2000	2001	2002	2003[(2)]
Durable Goods					
Nonmetallic Mineral Products Manufacturing	4,275	4,833	4,726	4,447	4,255
Cement and Concrete Products Manufacturing	3,217	3,700	3,723	3,494	3,373
Fabricated Metal Product	6,817	7,267	7,218	6,403	6,054
Computer and Electronic	15,983	14,958	14,316	11,471	11,549
Navigational, Measuring	4,808	4,617	4,330	4,661	4,186
Electrical Equipment	8,725	8,917	8,225	7,064	6,927
Electrical Equipment Manufacturing	4,767	4,992	4,564	4,030	3,630
Miscellaneous Manufacturing	11,708	11,725	12,046	11,299	12,147
Medical Equipment and Supplies Manufacturing	10,258	10,300	10,784	10,110	11,187
Other Durable Goods Manufacturing	9,409	9,683	9,718	8,255	6,602
Total – Durable Goods	56,917	57,383	56,249	49,348	47,534
Non-Durable Goods					
Food Manufacturing	18,733	17,417	17,109	14,469	13,213
Beverage and Tobacco Products Manufacturing	3,658	3,425	3,571	3,423	3,352
Apparel Manufacturing	19,275	17,517	16,265	11,872	8,935
Cut and Sew Apparel Manufacturing	17,392	16,358	15,162	11,174	8,914
Chemical Manufacturing	28,625	29,450	29,124	30,265	31,621
Pharmaceutical and Medicine Manufacturing	23,425	24,300	24,275	25,707	27,337
Plastics and Rubber Products	4,308	4,108	3,820	3,399	3,154
Plastics Product Manufacturing	3,783	3,675	3,412	3,105	2,875
Other Non-Durable Goods Manufacturing	14,184	13,633	12,347	9,206	9,044
Total – Non-Durable Goods	88,783	85,550	82,236	72,595	69,319
Total Manufacturing Employment	145,700	142,933	138,485	121,943	116,853

(1) Totals may not add due to rounding.
(2) Preliminary.

Sources: Department of Labor and Human Resources, Current Employment Statistic Survey (Establishment Survey – NAICS Codes)

While total employment in the manufacturing sector decreased by 28,847 from fiscal year 1999 to fiscal year 2003, other indicators of the manufacturing sector suggest that manufacturing production increased. Average weekly hours worked increased from 40.6 in the first eight months of fiscal year 1999 to 41.3 for the same period in fiscal year 2004. The reduction in manufacturing employment occurred during a period of significant expansion in real manufacturing output, as reflected in the growth of exports. This trend suggests a significant increase in manufacturing investment and productivity. Most of the decrease in employment has been concentrated in labor intensive industries, particularly apparel, textiles, tuna canning, and leather products.

Leading United States and Foreign Companies with Manufacturing Operations in Puerto Rico[1]

Employment 2,500 and over	Product
Baxter International, Inc.	Surgical Instruments
Eaton Corporation	Electronic Instruments
Johnson and Johnson	Pharmaceuticals
Pfizer Inc.	Pharmaceuticals
Sara Lee Corp.	Apparel
Wyeth	Pharmaceuticals

Employment 1,000 to 2,499	Product
Abbott Laboratories Inc.	Pharmaceuticals
Bristol-Myers Squibb Company	Pharmaceuticals
Edwards Lifesciences LLC	Surgical Instruments
Eli Lilly and Company	Pharmaceuticals
GE Power Systems	Electrical Instruments
Hewlett-Packard Co.	Computers
Hubell Incorporated	Electrical Instruments
MacAndrews & Forbes Holdings	Tobacco Products
Medtronics, Inc.	Surgical Instruments
Merck & Co., Inc.	Pharmaceuticals
Nypro Inc.	Medical Devices
Pharmacia	Pharmaceuticals
Propper International Co.	Apparel
Schering Plough Corporation	Pharmaceuticals
Solectron Corp.	Electronic Instruments
Tyco Int.	Communications
Unilever PLC	Consumer Products

Employment 500 to 999	Product
Advanced Medical Optics	Ophthalmic Products
Amgen Manufacturing	Pharmaceuticals
Astra Zeneca PLC	Pharmaceuticals
B. Braun Medical	Medical Equipment
Becton-Dickinson & Co.	Scientific Instruments
Bumble Bee Seafoods	Food
Cardinal Health, Inc.	Pharmaceuticals
Consolidated Container Co.	Packaging Products
Garguilo Inc.	Transportation
Guidant Corp.	Medical Instruments
Hamilton Sundstrand	Electrical Instruments
Ingersoll-Rand Co.	Electrical Instruments
Ivax Pharmaceutical	Pharmaceuticals
Novartis-Holding AG	Ophthalmic Products
Ocular Science	Ophthalmic Products
Pall Corporation	Filters
Pharmacia Up-John Co.	Pharmaceuticals
Pilgrim Pride Co.	Food

Employment 200 to 499	Product
Agropecuaria Krisma C.A.	Food
Bacardí	Food
Bard Shannon LTD.	Scientific Instruments
Biovail Laboratories	Pharmaceuticals
Carolina Underwear Co.	Apparel
Checkpoint Systems Inc.	Electronic Instruments
Coca Cola Company	Food
Colgate-Palmolive Company	Consumer Products
Curtis Instruments Inc.	Electrical Instruments
E.I. DuPont de Nemours & Co.	Chemicals
Eastern Canvas Products	Textile Products
Emerson Electric Co.	Electronic Instruments
Espace Europee de Lenterprise	Pharmaceuticals
Essilor International	Ophthalmic Products
Hershey Foods	Food
ICN Pharmaceuticals Inc.	Pharmaceuticals
Lawson Mardon Wheaton	Glass and Plastics
Loctite Corporation	Chemicals
Lutron Electronics Co. Inc.	Electronic Instruments
Micro Technology	Electronic Instruments
Millipore Corporation	Surgical Instruments
Molex Inc.	Electrical Instruments
Mylan Laboratories	Chemicals
Northrop Grumman	Electrical Instruments
Owens Illinois Inc.	Glass and Plastics
Packaging Coordinators Inc.	Packaging Products
PepsiCo	Food
Procter & Gamble Co.	Pharmaceuticals
Rocky Shoes & Boots	Footwear
Siemens AG	Electrical Instruments
Standard Motor Products Inc.	Motor Vehicle Parts
Storage Technology Corp.	Electronics
Surgical Specialties Corp.	Surgical Instruments
Symmetricom Inc.	Electronic Equipment
Thomas & Betts	Electrical Instruments
Timberland Company	Leather
Watson Phamaceutical, Inc.	Pharmaceuticals
Wellco Enterprises, Inc.	Leather

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

Source: PRIDCO, Office of Economic Research

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 1999 and 2003, the gross domestic product in this sector, in nominal terms, increased at an average annual rate of 6.4%, while payroll employment in this sector increased at an average annual rate of 1.1%. It should also be noted that in the Puerto Rico 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 employment is concentrated in the service and construction sectors. For example, in fiscal year 2003, the number of self-employed individuals was 180,464, out of which 46.0% were in the service sector and 10.5% were in the construction sector. 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.

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 2003, services generated $28.7 billion of gross domestic product, or 38.7%, of the total. Services employment grew from 485,241 in fiscal year 1999 to 506,941 in fiscal year 2003 (representing 51.1% of total employment). This represents a cumulative increase of 4.5%. Wholesale and retail trade, finance, insurance and real estate experienced significant growth in fiscal years 1999 to 2003, as measured by gross domestic product. From fiscal year 1999 to 2003, gross domestic product increased in wholesale and retail trade from $8.1 billion to $8.6 billion and in finance, insurance, and real estate from $8.2 billion to $12.7 billion. There are sixteen commercial banks and trust companies currently operating in Puerto Rico. Total assets of these institutions as of December 31, 2003 were $61.0 billion. As of December 31, 2003, there were thirty-five international banking entities operating in Puerto Rico licensed to conduct offshore banking transactions with total assets of $56.5 billion.

The following tables set forth gross domestic product and employment for the services sector for the five fiscal years ended June 30, 2003.

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

	Fiscal Years Ended June 30				
	1999	**2000**	**2001**	**2002**	**2003**(1)
Wholesale and retail trade	$ 8,112	$ 8,340	$ 8,338	$ 8,409	$ 8,623
Finance, insurance and real estate	8,183	9,977	11,294	11,590	12,732
Other services(2)	6,140	6,603	6,982	7,169	7,391
Total(3)	$22,435	$24,920	$26,615	$27,168	$28,745

(1) Preliminary.
(2) Includes tourism.
(3) Totals may not add due to rounding.

Source: Planning Board

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

	Fiscal Years Ended June 30				
	1999	**2000**	**2001**	**2002**	**2003**(1)
Trade, Transportation, Warehouse & Utilities	175,084	183,275	185,433	176,808	176,531
Wholesale Trade	30,342	32,000	32,327	31,489	31,218
Retail Trade	126,067	131,817	133,821	127,716	128,189
Transportation, Warehouse & Utilities	18,675	19,458	19,285	17,603	17,124
Information	20,683	21,108	20,597	21,943	21,216
Finance	44,575	45,583	44,974	43,963	42,128
Professional and Business	91,008	96,750	97,164	95,223	96,938
Educational & Health	75,350	80,692	84,202	84,452	87,590
Leisure & Hospitality	61,333	65,942	66,435	64,273	66,200
Other Services	17,208	17,408	17,330	16,602	16,338
Total	485,241	510,758	516,135	503,264	506,941

(1) Preliminary

Source: Department of Labor and Human Resources, Benchmark on Employment, Hours and Earnings

Hotels and Related Services - Tourism

During fiscal year 2003, the number of persons registered in tourist hotels was 1,733,300, an increase of 8.6% over the number of persons registered during fiscal year 2002, when tourism in Puerto Rico was adversely affected in the immediate aftermath of the terrorist attacks of September 11, 2001. The average occupancy rate in tourist hotels during fiscal year 2003 was 68.0% compared to 64.4% in fiscal year 2002. The average number of rooms rented in tourist hotels increased 9.1% during fiscal year 2003 compared with fiscal year 2002. The average number of rooms available in tourist hotels increased 3.5% during fiscal year 2003 compared with fiscal year 2002, representing openings of new hotels and hotel expansions. During fiscal year 2003, hotels comprising 870 new hotel rooms opened and, as of January 2004, several hotels, representing more than 4,000 additional rooms, are under various stages of development or construction.

In the first seven months of fiscal year 2004, the number of persons registered in tourist hotels was 1,000,000, an increase of 2.9% over the number of persons registered during the same period of fiscal year 2003. The number of non-resident tourists registered in tourist hotels during the first seven months of fiscal year 2004 increased 4.3% in comparison with the same period of fiscal year 2003. The average occupancy rate in tourist hotels during the first seven months of fiscal year 2004 was 69.5% compared to 64.9% in the same period of fiscal year 2003. The average number of rooms rented in tourist hotels increased 4.5% during the first seven months of fiscal year 2004 compared with the same period of fiscal year 2003.

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, 2003.

Commonwealth of Puerto Rico
Tourism Data

	Number of Visitors				
Fiscal Years Ended June 30	**Tourist Hotels(1)**	**Cruise Ship**	**Other(2)**	**Total**	**Total Visitors' Expenditures (in millions)**
1999	1,042,000	1,197,200	1,982,100	4,221,300	$2,138.5
2000	1,050,100	1,224,600	2,291,300	4,566,000	2,387.9
2001	1,186,800	1,356,600	2,364,400	4,907,800	2,728.1
2002	1,147,800	1,277,000	1,939,300	4,364,100	2,486.4
2003(3)	1,239,200	1,163,900	1,999,200	4,402,300	2,676.6

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

Sources: Puerto Rico Tourism Company and the Planning Board

Government

The government sector of Puerto Rico plays an important role in the economy. In fiscal year 2003, government accounted for $7.1 billion of Puerto Rico's gross domestic product, or 9.6%, of the total. The government is also a significant employer, providing jobs for 298,751 workers, or 30.1%, of total non-farm payroll employment in fiscal year 2003. The government's (including the central government, the public corporations and the municipalities, but excluding the federal government) share of non-farm payroll employment, measured according to the payroll survey, has decreased from 34.9% in fiscal year 1980, to 33.6% in fiscal year 1990, and to 26.4% in fiscal year 2000.

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

Transportation

Thirty-four shipping lines offer regular ocean freight service to eighty United States and foreign ports. San Juan is the island's leading seaport, but there are also seaport facilities at other locations on the island including Arecibo, Culebra, Fajardo, Guayama, Guayanilla, Mayagüez, Ponce, Vieques, and Yabucoa.

Luis Muñoz Marín International Airport is currently served by twenty-five United States and international airlines. At present, there is daily direct service between San Juan and Atlanta, Boston, Chicago, Dallas, Miami, New York, Philadelphia, and numerous other destinations within the United States. There is also regularly scheduled service between Puerto Rico and other Caribbean islands and certain Latin American and European cities. A major United States airline uses San Juan as a hub for its intra-Caribbean airline service. Several smaller airports serve intra-island traffic.

The island's major cities are connected by a modern highway system, which, as of December 31, 2003, totaled approximately 4,591 miles. The highway system comprises 379 miles of primary system highways, 230 miles of primary urban system highways, 955 miles of secondary system highways and 3,027 miles of tertiary highways and roads.

The Commonwealth is conducting a request for proposal process to select a private company to develop, construct, operate and maintain a world-class container facility on the south coast of Puerto Rico, to be called the Port of the Americas. The Port of the Americas Authority, created by legislation, will select and negotiate with the developer and operator of the project. To date, approximately $17.7 million has been invested in the development of the project. Construction is expected to begin in 2004, and partial operation of the Port of the Americas could begin as early as 2006.

Construction

Although the construction industry represents a relatively small segment of the economy compared to other sectors, it has made significant contributions to the growth of economic activity. However, during the period from fiscal year 1999 through fiscal year 2003, real construction investment decreased 3.1%. This decline is relatively small when compared to the relatively high levels of construction activity.

The total value of construction permits increased 70.3% for the same five-year period. Public investment has been an important component of construction investment. During fiscal year 2003, approximately 42% of the total investment in construction was related to public projects. During fiscal year 2003, the total value of construction permits increased 22.0% compared with fiscal year 2002. Total sales of cement, including imports, increased 3.2% during fiscal year 2003 in comparison with fiscal year 2002. Average payroll employment in the construction sector during fiscal year 2003 was 68,700, a decrease of 0.7% from fiscal year 2002.

During the first seven months of fiscal year 2004, the total value of construction permits increased 3.6% compared with the same period of fiscal year 2003. During the first nine months of fiscal year 2004, however, total sales of cement, including imports, decreased 3.1% compared with the same period of fiscal year 2003. This decrease in total sales of cement was attributable to heavy rains that affected the island in November 2003, causing a 31% decrease in sales as compared to November 2002. Excluding November 2003, total sales of cement for the first nine months of fiscal year 2004 show a slight increase of 0.5%. Notwithstanding the decline of November 2003, total sales of cement for fiscal year 2004 are expected to exceed 40 million bags, which indicates a relatively high level of investment in construction when compared to historical figures for Puerto Rico. Total imports of iron and steel products increased 36.2% during fiscal year 2003.

The Planning Board's forecast for construction investment, both public and private, for fiscal year 2004 is $6.7 billion, in nominal terms, which represents a real growth of 4.6% when compared to fiscal year 2003. For fiscal year 2004, approximately $3.1 billion are expected to be invested in public improvements. Public investment will be primarily in housing, new schools (and school reconstruction programs), water projects and other infrastructure projects to be undertaken by the Aqueduct and Sewer Authority, Convention Center District Authority, Electric Power Authority, Highway and Transportation Authority, Infrastructure Financing Authority, Ports Authority, Public Buildings Authority, Special Communities Perpetual Trust, and the University of Puerto Rico.

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 2003, gross income from agriculture was $756.2 million, an increase of 1.7% compared with fiscal year 2002. Agriculture gross income consists of the total value of production in the principal agricultural sectors, which include traditional crops, livestock and poultry, grains, vegetables, fruits, and other products. During fiscal year 2003, non-traditional crops, fruits, starchy and other vegetables, and ornamental plants have contributed a higher percentage of the sector's income.

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. Act No. 225, approved on December 1, 1995, increased the tax benefits available to bona fide farmers. The Act 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 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.

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, college attendance and college attendance as a percentage of the college age population continued to increase.

The following table presents comparative trend data for Puerto Rico and the United States with respect to college age population and the percentage of such population attending institutions of higher learning.

Commonwealth of Puerto Rico
Trend in College Enrollment

	Commonwealth of Puerto Rico			Mainland United States		
Academic Year	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(2)	57,340	16.8%	23,714,000(2)	8,580,887	36.2%
1980	397,839(2)	130,105	32.7	30,022,000(2)	12,096,895	40.3
1990	417,636(2)	156,147	37.4	26,961,000(2)	13,621,000	50.5
2000	428,892(2)	176,015	41.0	27,143,455(2)	15,312,000	56.4
2001	425,519(3)	185,015	43.5	27,831,000(3)	15,873,000	57.0
2002	422,549(3)	190,776	45.1	28,342,000(3)	15,608,000	55.1
2003	418,390(3)	199,842	47.8	28,899,571(4)	15,756,000(4)	54.5

(1) Number of persons of all ages enrolled in institutions of higher education as percent of population 18-24 years of age.
(2) Based on census population as of April 1.
(3) Estimated population (reference date July 1).
(4) Projected.

Sources: 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

The University of Puerto Rico, the only public university in Puerto Rico, has eleven campuses located throughout the island. The University's total enrollment for academic year 2002-2003 was 69,555 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 revenue from internal sources for each of the two fiscal years immediately preceding the current fiscal year.

In addition to the University of Puerto Rico, there are 43 public and private institutions of higher education located in Puerto Rico. Such institutions have a current enrollment in excess of 130,285 students and provide programs of study in liberal arts, education, business, natural sciences, technology, secretarial and computer sciences, nursing, medicine, and law. Degrees are offered by these institutions at the associate, bachelor, master, and doctoral levels.

Tax Incentives

One of the factors that has promoted and continues to promote the development of the manufacturing sector in Puerto Rico has been the various local and federal tax incentives available, particularly those under Puerto Rico's Industrial Incentives Program and, until recently, Sections 30A and 936 of the Code. Tax and other incentives have also been established to promote the development of the tourism industry. These incentives are summarized below.

Industrial Incentives Program

Since 1948, Puerto Rico has had various industrial incentives laws designed to stimulate industrial investment in the island. Under these laws, companies engaged in manufacturing and certain other designated activities were eligible to receive full or partial exemption from income, property, and other local taxes. The most recent of these industrial incentives laws is the 1998 Tax Incentives Act, a law aimed at promoting investment in Puerto Rico.

The benefits provided by the 1998 Tax Incentives Act are available to new companies as well as companies currently conducting tax exempt operations in Puerto Rico that choose to renegotiate their existing tax exemption grant. The activities eligible for tax exemption include manufacturing, certain designated services performed for markets outside Puerto Rico, the production of energy from local renewable sources for consumption in Puerto Rico and laboratories for scientific and industrial research. For companies qualifying thereunder, the 1998 Tax Incentives Act imposes income tax rates ranging from 2% to 7% for periods ranging from 10 to 25 years. In addition, it grants 90% exemption from property taxes, 100% exemption from municipal license taxes during the first three semesters of operations and between 80% and 60% thereafter, and 100% exemption from excise taxes with respect to raw materials and certain machinery and equipment used in the exempt activities. The 1998 Tax Incentives Act also provides various special deductions designed to stimulate employment and productivity, research and development and capital investment in Puerto Rico.

Under the 1998 Tax Incentives Act, companies can repatriate or distribute their profits free of Puerto Rico dividend taxes. In addition, passive income derived from the investment of eligible funds in Puerto Rico financial institutions, obligations of the Commonwealth and other designated investments are fully exempt from income and municipal license taxes. Individual shareholders of an exempted business are allowed a credit against their Puerto Rico income taxes equal to 30% of their proportionate share of the exempted business's income tax liability. Gain from the sale or exchange of shares of an exempted business by its shareholders during the exemption period is subject to a 4% income tax rate.

Tourism Incentives Program

For many years Puerto Rico has also had incentives laws designed to stimulate investment in hotel operations on the island. The most recent of these laws, the Tourism Incentives Act of 1993, provides partial exemptions from income, property, and municipal license taxes for a period of up to ten years. The Tourism Incentives Act also provides certain tax credits for qualifying investments in hotel development projects. Recently enacted legislation provides further tourism incentives by granting certain tax exemptions on interest income received from permanent or interim financing of tourism development projects and fees derived from credit enhancements provided to the financing of such projects.

As part of the incentives to promote the tourism industry, the Commonwealth established the Tourism Development Fund as a subsidiary of Government Development Bank for Puerto Rico ("GDB") with the authority to (i) make investments in or provide financing to entities that contribute to the development of the tourism industry and (ii) provide financial guarantees for financing hotel development projects. To date, the Fund has provided financial guarantees for loans made or bonds issued to finance the development of fifteen hotel projects representing over 3,600 new hotel rooms.

Incentives under the Code

United States corporations operating in Puerto Rico have been subject to special tax provisions since the Revenue Act of 1921. Prior to enactment of the Tax Reform Act of 1976, under Section 931 of the Code, United States corporations operating in Puerto Rico (and meeting certain source of income tests) were taxed only on income arising from sources within the United States.

The Tax Reform Act of 1976 created Section 936 of the Code, which revised the tax treatment of United States corporations operating in Puerto Rico by taxing such corporations on their worldwide income in a manner similar to that applicable to any other United States corporation but providing such corporations a full credit for the federal tax on their business and qualified investment income in Puerto Rico. The credit provided an effective 100% federal tax exemption for operating and qualifying investment income from Puerto Rico sources.

As a result of amendments to Section 936 made in 1996 (the "1996 Amendments"), the tax credit is being phased out over a ten-year period for companies that were operating in Puerto Rico in 1995 and is no longer available for corporations that establish operations in Puerto Rico after October 13, 1995. The 1996 Amendments also eliminated the credit previously available for income derived from certain qualified investments in Puerto Rico.

<u>*Section 30A*</u>. The 1996 Amendments added Section 30A to the Code. Section 30A permits a "qualifying domestic corporation" ("QDC") that meets certain gross income tests to claim a credit (the "Section 30A Credit") against the federal income tax imposed on taxable income derived from sources outside the United States from the active conduct of a trade or business in Puerto Rico or from the sale of substantially all the assets used in such business ("possession income"). The Section 30A Credit will not be available for taxable years commencing after 2005.

The Section 30A Credit is limited to the sum of (i) 60% of qualified possession wages as defined in the Code, which includes wages up to 85% of the maximum earnings subject to the OASDI portion of Social Security taxes plus an allowance for fringe benefits of 15% of qualified possession wages, (ii) a specified percentage of depreciation deductions ranging between 15% and 65%, based on the class life of tangible property, and (iii) a portion of Puerto Rico income taxes paid by the QDC, up to a 9% effective tax rate (but only if the QDC does not elect the profit-split method for allocating income from intangible property).

In the case of taxable years beginning after December 31, 2001, the amount of possession income that qualifies for the Section 30A Credit is subject to a cap based on the QDC's possession income for an average adjusted base period ending before October 14, 1995 (the "income cap").

<u>*Section 936*</u>. Under Section 936 of the Code, as amended by the 1996 Amendments, United States corporations that meet certain requirements and elect its application ("Section 936 Corporations") are entitled to credit against their United States corporate income tax the portion of such tax attributable

to income derived from the active conduct of a trade or business within Puerto Rico ("active business income") and from the sale or exchange of substantially all assets used in the active conduct of such trade or business.

Under Section 936, a Section 936 Corporation may elect to compute its active business income, eligible for the Section 936 credit, under one of three formulas: (i) a cost-sharing formula, whereby it is allowed to claim all profits attributable to manufacturing intangibles and other functions carried out in Puerto Rico provided it makes a cost sharing payment in the amount required under Section 936; (ii) a profit-split formula, whereby it is allowed to claim 50% of the combined net income of its affiliated group from the sale of products manufactured in Puerto Rico; or (iii) a cost-plus formula, whereby it is allowed to claim a reasonable profit on the manufacturing costs incurred in Puerto Rico.

The Section 936 credit is now only available to companies that were operating in Puerto Rico on October 13, 1995, and had elected the percentage of income credit provided by Section 936. Such percentage of income credit is equal to 40% of the federal income tax otherwise imposable on the Puerto Rico active business income or derived from the sale or exchange of substantially all assets used in such business.

In the case of taxable years beginning on or after 1998, the possession income subject to the Section 936 credit is subject to a cap based on the Section 936 Corporation's possession income for an average adjusted base period ending on October 14, 1995. The Section 936 credit is eliminated for taxable years commencing after 2005.

Controlled Foreign Corporations

Because of the credit limitations and impending phase out of Sections 30A and 936, many corporations previously operating thereunder have reorganized their operations in Puerto Rico to become controlled foreign corporations ("CFCs"). A CFC is a corporation which is organized outside the United States and is controlled by United States shareholders. In general, a CFC may defer the payment of federal income taxes on its trade or business income until such income is repatriated to the United States in the form of dividends or through investments in certain United States properties. The Puerto Rico Office of Industrial Tax Exemption has received notification from over eighty corporations that have converted part or all of their operations to CFCs. These include most of the major pharmaceutical, instrument and electronics companies manufacturing in Puerto Rico.

CFCs operate under transfer pricing rules for intangible income that are different from those applicable to corporations operating under Sections 936 and 30A. In many cases, they are allowed to attribute a larger share of this income to their Puerto Rico operation, but must make a royalty payment "commensurate with income" to their U.S. affiliates. Section 936 companies were exempted from Puerto Rico withholding taxes on any cost sharing payments they might have opted to make, but CFCs are subject to a ten percent Puerto Rico withholding tax on royalty payments.

DEBT

Public Sector Debt

Public sector debt comprises bonds and notes of the Commonwealth, its municipalities, and public corporations ("notes" as used in this section refers to certain types of non-bonded debt regardless of maturity), subject to the exclusions described below. The Constitution of Puerto Rico limits the amount of general obligation (full faith and credit) debt that can be issued or guaranteed by the Commonwealth. The Commonwealth's policy has been and continues to be to maintain the amount of such debt prudently below the constitutional limitation. Direct debt of the Commonwealth is supported by Commonwealth taxes. Debt of municipalities, other than bond anticipation notes, is supported by real and personal property taxes and municipal license taxes. Debt of public corporations, other than bond anticipation notes, is generally supported by the revenues of such corporations from rates charged for services or products. See *Public Corporations.* However, certain debt of public corporations is supported, in whole or in part, directly or indirectly, by Commonwealth appropriations or taxes.

Direct debt of the Commonwealth is issued pursuant to specific legislation approved in each particular case. Debt of the municipalities is issued pursuant to resolutions adopted by the respective municipal assemblies. Debt of public corporations is issued pursuant to resolutions adopted by the governing bodies of the public corporations in accordance with their enabling statutes. GDB, as fiscal agent of the Commonwealth and its municipalities and public corporations, must approve the specific terms of each issuance.

The following table presents a summary of public sector debt as of December 31, 2003. Excluded from the table is debt not primarily payable from either Commonwealth or municipal taxes, Commonwealth appropriations or rates charged by public corporations for services or products. Also excluded from the table is debt the inclusion of which would reflect double counting, including but not limited to $1.323 billion of outstanding bonds issued by the Municipal Finance Agency to finance its purchase of bonds of Puerto Rico municipalities, and $1.026 billion of obligations of GDB issued to purchase certain Commonwealth public sector debt and for other purposes, of which $267 million is guaranteed by the Commonwealth.

Commonwealth of Puerto Rico
Public Sector Debt
(in thousands)

	December 31, 2003
Puerto Rico direct debt[1]	$8,515,633
Municipal debt	1,935,028
Public corporations debt	
Puerto Rico guaranteed debt[2]	643,295
Debt supported by Puerto Rico appropriations or taxes[3]	13,527,718
Other non-guaranteed debt[4]	7,694,201
Total public corporations debt	21,865,214
Total public sector debt	$32,315,875

(1) Includes general obligation bonds, tax and revenues anticipation notes, and lines of credit provided by GDB. Includes $10 million of certain indebtedness originally issued by the Urban Renewal and Housing Corporation that was transferred to the Commonwealth by virtue of Act No. 134 of the Legislature of Puerto Rico, approved on December 13, 1994 ("Act No. 134") (such indebtedness is referred to as "Transferred CRUV Debt"). This amount excludes certain Commonwealth general obligation bonds that have been refunded with proceeds that were invested in guaranteed investment contracts or other securities not eligible to effect a legal defeasance, even though such bonds will be considered outstanding under their respective authorizing resolutions and for purposes of calculating the Commonwealth's constitutional debt limitation.

(2) Consists of $501.5 million of bonds issued by the Aqueduct and Sewer Authority and $141.8 million of State Revolving Fund Loans, incurred under various federal water laws. Excludes Public Buildings Authority bonds in the principal amount of $2.053 billion as of December 31, 2003 and $267 million of GDB bonds payable from available moneys of GDB.

(3) Represents, among others, bonds and notes issued by the Aqueduct and Sewer Authority, the Highway and Transportation Authority, the Housing Finance Authority, the Infrastructure Financing Authority, the Public Buildings Authority and the Public Finance Corporation.

(4) Excludes $1.066 billion of Infrastructure Financing Authority bonds, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company. Excludes $1.155 billion of Children's Trust bonds which are payable solely from the payments to be received pursuant to the tobacco litigation settlement.

Source: Government Development Bank

No deductions have been made in the above table for debt service funds and debt service reserve funds. The table above and the amounts shown throughout this section as representing outstanding debt include outstanding capital appreciation bonds at their respective original principal amounts and do not include any accretion thereon.

Debt Service Requirements for Commonwealth General Obligation Bonds and Certain Guaranteed Debt

The following table presents the debt service requirements for Commonwealth general obligation bonds outstanding as of December 31, 2003 and bonds of the Aqueduct and Sewer Authority for which debt service payments are being made under the Commonwealth guaranty.

The table excludes debt service on certain general obligation bonds refunded with refunding bonds the proceeds of which, pending the redemption of the refunded bonds, were invested in guaranteed investment contracts or other securities not eligible to effect a legal defeasance. Such refunded bonds will be considered to be outstanding under their respective authorizing resolutions and for purposes of calculating the Commonwealth's constitutional debt limitation. With respect to other debt of the Aqueduct and Sewer Authority, see *Public Corporations*. Debt service requirements for each fiscal year, as shown in the following table, include principal and interest due on July 1 immediately following the close of such fiscal year.

Commonwealth of Puerto Rico
Debt Service Requirements
(in thousands)*

Fiscal Years Ending June 30	Outstanding Bonds Principal	Interest	Total Debt Service	PRASA Bonds Debt Service	Grand Total
2004	$105,938	$366,443	$472,381	$30,125	$502,507
2005	183,455	344,563	528,018	30,127	558,145
2006	163,724	364,772	528,496	30,121	558,617
2007	150,682	377,682	528,364	30,126	558,490
2008	188,667	349,430	538,097	30,131	568,228
2009	227,105	306,635	533,740	30,123	563,863
2010	240,675	293,254	533,929	29,984	563,913
2011	251,617	279,916	531,534	29,928	561,462
2012	270,745	260,642	531,387	30,127	561,514
2013	285,600	245,834	531,434	30,128	561,562
2014	282,628	250,894	533,521	30,125	563,646
2015	295,925	237,850	533,774	30,126	563,900
2016	310,225	223,814	534,039	30,121	564,160
2017	324,957	209,459	534,415	30,122	564,537
2018	341,380	194,406	535,785	30,126	565,911
2019	373,701	162,726	536,427	30,125	566,551
2020	430,480	136,386	566,866	0	566,866
2021	299,740	115,198	414,938	0	414,938
2022	223,765	101,279	325,044	0	325,044
2023	190,000	91,211	281,211	0	281,211
2024	175,335	82,536	257,871	0	257,871
2025	183,300	74,838	258,138	0	258,138
2026	182,675	67,057	249,732	0	249,732
2027	191,375	58,542	249,917	0	249,917
2028	200,600	49,511	250,111	0	250,111
2029	210,680	39,517	250,197	0	250,197
2030	221,735	28,463	250,198	0	250,198
2031	233,065	17,130	250,195	0	250,195
2032	66,290	5,218	71,508	0	71,508
2033	36,555	1,880	38,435	0	38,435
Total	$6,842,617	$5,337,086	$12,179,703	$481,665	$12,661,368

*Totals may not add due to rounding.

Sources: Government Development Bank and Department of the Treasury

Commonwealth Guaranteed Debt

As of December 31, 2003, $2.053 billion of Commonwealth guaranteed bonds of the Public Buildings Authority were outstanding. Maximum annual debt service on these bonds is $176.8 million in fiscal year ending June 30, 2011, with their final maturity being July 1, 2036. No payments under the Commonwealth guaranty have been required to date for bonds of the Public Buildings Authority.

As of December 31, 2003, $267 million of Commonwealth guaranteed obligations of GDB were outstanding. No payments under the Commonwealth guaranty have been required for any obligations of GDB to date.

As of December 31, 2003, the Commonwealth had guaranteed the Series 1995 revenue bonds of the Aqueduct and Sewer Authority in the aggregate outstanding principal amount of $318.1 million. On January 2, 1997, the Commonwealth began to make debt service payments under the Commonwealth guaranty and expects to make all debt service payments required on these revenue bonds.

In addition, in April 2000, the Commonwealth extended its guaranty to all of the outstanding bonds issued by the Aqueduct and Sewer Authority to the United States Department of Agriculture, Rural Development, and to all of the outstanding loans by the State Revolving Funds for the benefit of the Aqueduct and Sewer Authority. The guaranty will also cover any additional bonds and loans that may be issued until June 30, 2005. It is expected that this guaranty will be extended through new legislation to cover debt obligations issued until 2010. As of December 31, 2003, the principal amount outstanding on these bonds was $183.4 million and the principal amount outstanding of these loans was $141.8 million.

Trends of Public Sector Debt

The following table shows the growth rate of short-term and long-term public sector debt and the growth rate of gross product (in current dollars) for the five fiscal years ended June 30, 2003 and the first six months of fiscal year 2004. As of December 31, 2003, outstanding short-term debt, relative to total debt, was 8.5%.

Commonwealth of Puerto Rico
Public Sector Debt and Gross Product
(dollars in millions)*

	Public Sector Debt					Gross Product[(1)]	
June 30	Long Term	Short Term[(2)]	Short Term as % of Total	Total	Rate of Increase	Amount	Rate of Increase
1999………………..	$20,905	$1,773[(3)]	7.8%	$22,678	1.6%	$38,281	9.0%
2000………………..	21,620	2,202[(3)]	9.2	23,822	5.0	41,419	8.2
2001[(4)]……………..	22,345	2,870[(5)]	11.4	25,215	5.8	44,047	6.3
2002[(6)]……………..	26,737	1,250[(3)]	4.5	27,987	11.0	45,008	2.2
2003[(7)]……………..	28,102	1,605[(3)]	5.4	29,707	6.1	47,354	5.2
December 31, 2003[(8)]	29,554	2,762	8.5	32,316	8.8	N/A	N/A

*Totals may not add due to rounding.

(1) In current dollars.

(2) Obligations (other than bonds) issued with an original maturity of three years or less and lines of credit with a remaining maturity of three years or less are considered short-term debt.

(3) Does not include the tax and revenue anticipation notes that were outstanding at the close of the indicated fiscal years because prior to the end of said fiscal years sufficient funds had been set aside for the payment of such notes in full.

(4) Excludes $397.0 million of bonds of Children's Trust outstanding on this date. If these bonds had been included, the rate of growth of public sector debt for fiscal year 2001 would have been 12.1%. Excludes $1.093 billion of bonds of Infrastructure Financing Authority outstanding on this date, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.

(5) Includes a $164 million line of credit from GDB to the Secretary of the Treasury the proceeds of which were applied to pay debt service on general obligation bonds in lieu of funds available therefor in the General Fund.

(6) Excludes $390.1 million of bonds of Children's Trust outstanding on this date. Excludes $1.082 billion of bonds of Infrastructure Financing Authority outstanding on this date, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.

(7) Excludes $1.171 billion of bonds of Children's Trust outstanding on this date. Excludes $1.074 billion of bonds of Infrastructure Financing Authority outstanding on this date, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.

(8) Excludes $1.155 billion of bonds of Children's Trust outstanding on this date. Excludes $1.066 billion of bonds of Infrastructure Financing Authority outstanding on this date, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.

Source: Government Development Bank

The following table shows the trend of public sector debt by major category for the five fiscal years ended June 30, 2003 and for the first six months of fiscal year 2004.

Commonwealth of Puerto Rico
Public Sector Debt by Major Category
(dollars in millions)[*]

	Commonwealth			Municipalities			Public Corporations[(1)]			Total		Grand Total[(4)]
June 30	Long Term[(4)]	Short Term[(2)]	Total	Long Term	Short Term[(2)]	Total	Long Term	Short Term[(2)]	Total	Long Term	Short Term[(2)]	
1999	$5,097	$0[(3)]	$5,097	$1,215	$60	$1,275	$14,593	$1,713	$16,306	$20,905	$1,773	$22,678
2000	5,349	0[(3)]	5,349	1,396	68	1,464	14,875	2,134	17,008	21,620	2,202	23,822
2001	5,674	164[(5)]	5,838	1,469	163	1,632	15,201[(6)]	2,543	17,744	22,345	2,870	25,215
2002	6,025	91[(3)]	6,116	1,618	177	1,795	19,094[(7)]	982	20,076	26,737	1,250	27,987
2003	6,709	177[(3)]	6,886	1,754	201	1,955	19,639[(8)]	1,227	20,866	28,102	1,605	29,707
Dec. 31, 2003	7,312	1,204	8,516	1,739	196	1,935	20,503[(9)]	1,362	21,865	29,554	2,762	32,316

*Totals may not add due to rounding.

(1) Includes Commonwealth guaranteed debt.
(2) Obligations (other than bonds) issued with an original maturity of three years or less and lines of credit with a remaining maturity of three years or less are considered short-term debt.
(3) Does not include the tax and revenue anticipation notes which were outstanding at the close of the indicated fiscal years because prior to the end of said fiscal years sufficient funds had been set aside for the payment of such notes in full.
(4) Includes the Transferred CRUV Debt.
(5) Includes a $164 million line of credit from GDB to the Secretary of the Treasury the proceeds of which were applied to pay debt service on general obligation bonds in lieu of funds available therefor in the General Fund.
(6) Excludes $397.0 million original principal amount of bonds issued by Children's Trust. Excludes $1.093 billion original principal amount of bonds issued by Infrastructure Financing Authority, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.
(7) Excludes $390.1 million of bonds of Children's Trust outstanding on this date. Excludes $1.082 billion of bonds of Infrastructure Financing Authority outstanding on this date, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.
(8) Excludes $1.171 billion original principal amount of bonds of Children's Trust. Excludes $1.074 billion of bonds of Infrastructure Financing Authority outstanding on this date, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.
(9) Excludes $1.155 billion original principal amount of bonds of Children's Trust. Excludes $1.066 billion of bonds of Infrastructure Financing Authority outstanding on this date, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.

Source: Government Development Bank

PUBLIC CORPORATIONS

In Puerto Rico, many governmental or quasi-governmental functions are performed by public corporations. These are governmental entities created by the Legislature with varying degrees of independence from the central government. Public corporations are generally created to perform a single function or a limited number of related functions. Most public corporations obtain revenues from rates charged for services or products, but many are subsidized to some extent by the central government. Most public corporations are governed by boards appointed by the Governor with the advice and consent of the Senate, but some public corporations are subsidiaries of departments of the central government. Capital improvements of most of the larger public corporations are financed by revenue bonds under trust agreements or bond resolutions or notes under loan agreements. The following table presents the outstanding bonds and notes of certain of the public corporations as of December 31, 2003 ("notes" as used in this section refers primarily to certain types of non-bonded debt regardless of maturity). Debt of certain other public corporations is excluded from this table because such debt is payable primarily from funds or grants provided by the Federal government or is payable from sources other than Commonwealth appropriations or taxes or revenues of public corporations, or is payable from revenues derived from private sector services or products, such as industrial development bonds. Also excluded from this table is debt of certain public corporations the inclusion of which would reflect double counting. No deductions have been made in the table for debt service funds and debt service reserve funds. More detailed information about the major public corporations is presented in the following sections.

Commonwealth of Puerto Rico
Outstanding Debt of Public Corporations
December 31, 2003
(in thousands)

	Bonds			Notes			Total Bonds and Notes		
	With Guaranty	Without Guaranty	Total	With Guaranty	Without Guaranty	Total	With Guaranty	Without Guaranty	Total
Aqueduct and Sewer Authority	$ 501,479	$0	$ 501,479	$141,816	$ 11,711[(1)]	$ 153,527	$ 643,295	$ 11,711[(1)]	$ 655,006
Electric Power Authority	0	5,033,219	5,033,219	0	163,809	163,809	0	5,197,028	5,197,028
Highway and Transportation Authority	0	5,263,014	5,263,014	0	28,114	28,114	0	5,291,128	5,291,128
Housing Finance Authority	0	685,567	685,567	0	135,807	135,807	0	821,374	821,374
Industrial Development Company	0	301,845	301,845	0	32,966	32,966	0	334,811	334,811
Infrastructure Financing Authority	0	927,990[(2)]	927,990	0	8,664	8,664	0	936,654	936,654
Public Buildings Authority	2,053,453	0	2,053,453	0	294,839	294,839	2,053,453	294,839	2,348,292
Public Finance Corporation	0	4,237,781[(3)]	4,237,781		0	0	0	4,237,781[(3)]	4,237,781
Ports Authority	0	78,955	78,955	0	299,898	299,898	0	378,853	378,853
University of Puerto Rico	0	430,278	430,278	0	517	517	0	430,795	430,795
Others	0	0	0	0	1,23,492	1,233,492	0	1,233,492	1,233,492
Total[(4)]	$2,554,932	$16,958,649	$19,513,581	$141,816	$2,209,817	$2,351,633	$2,696,748	$19,168,466	$21,865,214

(1) Principal of and interest on this debt is reimbursed from Commonwealth appropriations.
(2) Excludes $1.066 billion of outstanding bonds of Infrastructure Financing Authority, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.
(3) Payable primarily from Commonwealth appropriations.
(4) Excludes accretion of interest from the respective issuance dates on capital appreciation bonds. Also excludes $1.155 billion original principal amount of Children's Trust Tobacco Settlement Asset-Backed Bonds, Series 2002, issued on October 10, 2002, which will be repaid from payments made by certain tobacco companies under a master settlement agreement. See "Other Public Corporations" below.

Source: Government Development Bank

Government Development Bank for Puerto Rico

The principal functions of GDB are to act as financial advisor to and fiscal agent for the Commonwealth, its municipalities and public corporations in connection with the issuance of bonds and notes, to make loans and advances to public corporations and municipalities, and to make loans to private enterprises to aid in the economic development of Puerto Rico.

As of December 31, 2003, $1.725 billion of bonds and notes of GDB were outstanding. As of said date, GDB also had $3.101 billion in loans to the central government of the Commonwealth and its public corporations and municipalities. Act No. 12 of May 9, 1975, as amended, provides that the payment of principal of and interest on specified notes and other obligations of GDB, not exceeding $550 million may be guaranteed by the Commonwealth, of which $267 million were outstanding as of December 31, 2003.

Act No. 271 of November 21, 2002, requires GDB to provide the Special Communities Perpetual Trust with a $500 million line of credit and to make a capital contribution to the Trust of $500 million. This contribution shall be withdrawn from GDB's equity capital and disbursed gradually to the Trust after full disbursement of the line of credit. See "Other Public Corporations – Special Communities Perpetual Trust" below. GDB expects to replenish its equity capital with future operating net income. To date, the Trust has drawn approximately $7 million on the line of credit.

Act No. 82 of June 16, 2002, authorizes GDB to transfer every year to the Commonwealth's General Fund up to 10% of its audited net income or $10,000,000, whichever is greater.

GDB has the following principal subsidiaries:

Housing Finance Authority (formerly known as Housing Finance Corporation) was originally created in November 1977 to provide needed rental-housing units and stimulate the construction industry under federally subsidized programs. Effective February 8, 2002, the Housing Finance Corporation became the Housing Finance Authority and the Housing Bank and Finance Agency was dissolved and its powers transferred to the Authority. The Authority is engaged in insuring and servicing mortgages originated by the Urban Renewal and Housing Corporation. It also provides financing for rental housing units, stimulates the construction industry under federally subsidized programs and provides interim financing for low-income housing projects and single-family homeownership programs. Housing Finance Corporation had issued tax-exempt revenue bonds and notes to finance the construction of housing units approved for federal rental subsidies and to finance home ownership of single family housing units, which bonds and notes are now limited obligations of the Housing Finance Authority payable solely from revenues collected in respect to such housing units. The Federal Housing Administration has insured mortgages on certain of the housing units. As of December 31, 2003, $1.518 billion of Housing Finance Authority bonds were outstanding.

As of December 31, 2003, the Authority also had outstanding $684.8 million of bonds issued to (i) pay obligations of the Commonwealth under law, (ii) fund certain payments of the Commonwealth under its mortgage subsidy program for low and moderate income families, (iii) guarantee certain insurance obligations of the Housing Bank and Finance Agency under certain programs.

Tourism Development Fund was created in November 1993 to promote Puerto Rico's hotel and tourism industry, primarily by making available guarantees to secure the payment of private financing used for new hotel development projects. The Tourism Development Fund is also authorized to make capital investments and provide direct financing to tourism related projects. As of December 31, 2003, the Tourism Development Fund had outstanding loans and guarantees with respect to the financing of fifteen hotel projects in an aggregate amount in excess of $580 million.

As of December 31, 2003, the Tourism Development Fund has made and continues to make disbursements under its guarantees relating to certain hotel projects, including disbursements of $83.8 million, $75.3 million, and $9.3 million made in September 2002, August 2003, and December 2003, respectively, to repay the bonds of three projects, which bonds had been declared due and payable at the direction of Tourism Development Fund due to the failure of the borrowers of such projects to comply with their obligations under the related reimbursement agreements. The unaudited capital of Tourism Development Fund as of December 31, 2003, was $96.3 million and its unaudited allowance for losses on guarantees and letters of credit was approximately $30.9 million.

Development Fund was created in 1977 to provide an alternate source of financing to private enterprises in Puerto Rico that have difficulties in obtaining financing from traditional sources. The Development Fund may also guarantee obligations of these enterprises and invest in their equity securities.

Capital Fund was created in November 1993 for trading in debt obligations and publicly traded shares of domestic and foreign corporations.

Public Finance Corporation was created in December 1984 to provide agencies and instrumentalities of Puerto Rico with alternate means of meeting their financing requirements. As of December 31, 2003, the Corporation had $4.238 billion aggregate principal amount of bonds outstanding, substantially all of which have been issued to purchase debt of agencies and instrumentalities of the Commonwealth, and are payable from Commonwealth appropriations.

A description of certain other affiliates of GDB is provided in "Other Public Corporations" below.

Other Public Corporations

Aqueduct and Sewer Authority. Puerto Rico Aqueduct and Sewer Authority ("PRASA") owns and operates a system of public water supply and sanitary sewer facilities.

PRASA needs to make a substantial investment in infrastructure and a major overhaul of its operations to maintain the viability of the existing system and to finance its expansion for new users. Funds for this investment are expected to be provided through a combination of revenues from PRASA, bond issues, legislative appropriations, and federal grants. Debt service on revenue bonds is payable from net revenues of the system after payment of current expenses. Due to PRASA's financial difficulties (discussed below) and its inability to access the bond market, Act No. 45 was enacted in July 1994 to provide a Commonwealth guaranty of the principal and interest payments to the bondholders of all outstanding revenue bonds issued by PRASA. In addition, Act No. 45 was amended in 2000 to extend the Commonwealth payment guaranty to all outstanding bonds issued by PRASA to the United States Department of Agriculture, Rural Development, and loans granted by the Clean Water and Drinking Water State Revolving Funds for the benefit of PRASA. The guaranty will cover additional debt obligations issued by PRASA prior to July 1, 2005. It is expected that this guaranty will be extended through new legislation to include debt obligations issued until 2010.

PRASA has reported net losses of $100.7 million, $0.5 million, $191.8 million and $185.8 million during fiscal years 2000, 2001, 2002 and 2003, respectively. The net losses reported for fiscal years after 2000 are not comparable to the losses reported in prior fiscal years due to the implementation of a change in government accounting rules which allows governmental grants to be treated as revenues instead of as capital contributions. Without such favorable treatment of government grants, PRASA's net loss would have been $169.6 million in fiscal year 2001, $349 million in fiscal year 2002 and $189.3 million in fiscal year 2003. These losses reflect the continuing financial and operating difficulties that PRASA has experienced in recent years. The total debt of PRASA, including outstanding loans of $153.5 million, was $655 million as of December 31, 2003.

From May 1995 until March 2004, the operation, management, repair, and maintenance of PRASA's systems were in the hands of private companies. The most recent agreement for the private management of PRASA's systems was entered into in May 2002 with Ondeo Puerto Rico, Inc. ("Ondeo"), an affiliate of Suez. However, in January 2004, Ondeo and PRASA agreed to terminate their agreement and in April 2004, the operation, management, repair, and maintenance of the PRASA systems returned to PRASA. Ondeo will continue to provide operating support to PRASA until mid-2004.

As part of the plan for the return of the operation and management of the PRASA systems to PRASA, legislation was enacted in March 2004 to restructure PRASA and provide further powers to improve its operational and financial management. The main areas of this restructuring included (i) decentralizing the administration of PRASA by creating five regions to provide greater efficiency in, and financial control of, the day to day administration and operational decision making process and execution; (ii) creating the positions of five Executive Regional Directors and an Executive Director for Infrastructure, who will, respectively, manage each region and manage capital improvement projects; and (iii) providing for six-year appointments for each of the Executive Regional Directors, Executive Director for Infrastructure and Executive President aiming to give continuity to top management in order to better implement, supervise and revise as needed the ten-year plan and goals identified for PRASA in 2002 and included in the management contract with Ondeo. Further powers granted include the authority to make certain determinations and take certain actions with respect to compliance of the water and sewer system with various Federal environmental laws.

Children's Trust is a not-for-profit corporate entity created in 1999 as a public instrumentality of the Commonwealth. The Commonwealth has transferred to Children's Trust all of its rights, title and interest under the tobacco litigation Master Settlement Agreement, including the Commonwealth's right to receive initial, annual and strategic contribution payments to be made by the participating cigarette manufacturers under the Master Settlement Agreement.

Children's Trust issued $1.171 billion aggregate principal amount of Tobacco Settlement Asset-Backed Bonds in October 2002. As of December 31, 2003, the outstanding principal amount of the bonds was $1.155 billion. These bonds and any other additional senior bonds issued by Children's Trust are secured by a statutory pledge of the payments made and to be made by participating manufacturers under the Master Settlement Agreement. To date, all payments required to be made under the Master Settlement Agreement have been made on a timely basis and Puerto Rico's share thereof has been received by Children's Trust.

Convention Center District Authority was created on September 2, 2000 to own, develop, finance, plan, design, build, operate, maintain, administrate and promote the Convention Center and designated private parcels located within the Convention Center District in San Juan. The Authority currently has lines of credit with GDB totaling $221 million, of which $154.3 million was outstanding as of December 31, 2003.

Electric Power Authority owns and operates the island's electric system. The capital improvement program for the five-year period ending June 30, 2008, is estimated to cost approximately $2.1 billion and will be financed primarily by borrowed funds, supplemented by internally generated funds. The Authority's bonded debt consists of Power Revenue Bonds, secured by a lien on net revenues of the electric system. As of December 31, 2003, the Authority's total debt was $5.197 billion, including $5.033 billion of bonds outstanding (not including accretion of interest from the respective issuance date on capital appreciation bonds). As a means of reducing its dependency on oil, the Authority has entered into long-term power purchase contracts with the operators of two cogeneration plants that use fuels other than oil. These two cogeneration projects consist of EcoElectrica LP's 507 megawatts liquefied natural gas plant at Guayanilla and a 454 megawatts clean coal facility at Guayama operated by an affiliate of Applied Energy Systems ("AES"). EcoElectrica's and AES's plants started commercial operations in March 2000 and November 2002, respectively. It is expected that these two cogeneration plants will initially provide approximately one-third of the Authority's energy needs.

Health Insurance Administration was created in 1993 to implement the health reform by negotiating and contracting for the provision of comprehensive health insurance coverage for qualifying (generally low income) Puerto Rico residents. Under this system, the government selects, through a bidding system, one private health insurance company in each of several designated regions of the island and pays such insurance company the insurance premium for each eligible beneficiary within such region. The health insurance system covers all of the municipalities, and approximately 1.5 million persons were covered by the system during fiscal year 2004.

The total cost of the health insurance program for fiscal year 2004 is expected to be $1.326 billion, compared to $1.248 billion for fiscal year 2003 and $1.271 billion for fiscal year 2002. For fiscal year 2004, the General Fund is expected to cover $970 million of the total cost of the health insurance program, while the remaining $357 million is expected to be paid from other federal and municipal sources. The fiscal year 2005 budget estimates the cost of the health insurance program to be $1.360 billion, of which the General Fund is estimated to cover $990 million, while the remaining $370 million is estimated to be paid from other federal and municipal sources.

Highway and Transportation Authority is responsible for highway construction in Puerto Rico. Such construction is financed by debt (interim notes and revenue bonds), revenues of the Authority, and federal and Commonwealth grants. Debt service on the Authority's revenue bonds constitutes a first lien on its gross revenues, which consist currently of all the proceeds of the gasoline tax; one-half of the proceeds of the tax on gas oil or diesel oil; all the proceeds of the excise taxes on crude oil, unfinished oil and derivative products, up to $120 million per fiscal year; highway toll revenues; and the gross receipts of $15.00 per vehicle per year from certain motor vehicle license fees. Such revenues (except for toll revenues) may be applied first to the payment of debt service on general obligation bonds and notes of the Commonwealth and payments required to be made by the Commonwealth under its guarantees of bonds and notes to the extent that no other revenues are available for such purpose. The Commonwealth has never applied such revenues for such payment. As of December 31, 2003, the Authority's total debt was $5.291 billion, including $28.1 million in loans.

The Authority has under construction the first phase of a new mass transit system, known as Tren Urbano, to serve a portion of metropolitan San Juan. The first phase of Tren Urbano is being constructed under several design/build contracts, including a design/build/operate contract covering the design and construction of the system and the operation of Tren Urbano for five years with an additional five-year option at the Authority's election. The cost of the first phase is estimated to be $2.3 billion, which cost is being financed by Federal Transit Administration grants, other federal funding sources and the Authority's own resources, including bond financings.

The Authority is a party to a concession agreement under which a private company designed, constructed and currently is operating a toll bridge spanning the San José Lagoon. The toll bridge was financed with special facility revenue bonds of the Authority, the outstanding principal balance of which was $153.2 million as of December 31, 2003, payable by the private operator of the bridge principally from toll revenues. The concession is for a term of 35 years, subject to earlier termination or extension. The bridge opened for traffic in February 1994. In certain circumstances as described in the concession agreement, including where toll revenues are insufficient to generate certain rates of return to the private operator, the private operator may require the Authority, among other things, to assume the operator's obligations with respect to the special facility revenue bonds. Some of those circumstances, including low toll revenues, exist at this time, but the Authority does not currently anticipate that the operator will exercise its remedy against the Authority.

Puerto Rico Industrial Development Company participates in the Commonwealth-sponsored economic development program by providing physical facilities, general assistance, and special incentive grants to manufacturers. The Company was merged with the Economic Development Administration in January 1998. Rentals derived from the leasing of specified facilities of the Company are pledged to the payment of the Company's revenue bonds. As of December 31, 2003, the Company's total debt was $334.8 million, including $32.9 million in loans.

Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority ("AFICA") was created in June 1977. The Authority has issued revenue bonds to finance industrial, tourist, environmental control, medical, and educational facilities in Puerto Rico for the use of private companies, non-profit entities, or government agencies. The bonds are payable solely from payments to be made to the Authority by such private companies, non-profit entities, or government agencies, and do not constitute a debt of the Commonwealth or any of its other public corporations or municipalities. As of December 31, 2003, approximately $2.3 billion of the Authority's bonds were outstanding. The Authority has financed the construction of a multi-purpose coliseum in San Juan with a line of credit provided by GDB, which line had an outstanding balance of $119.9 million as of December 31, 2003. The coliseum is near completion. It is expected that, upon completion, the coliseum will be transferred to the Tourism Company.

Infrastructure Financing Authority was created in June 1988 to provide financial, administrative, consulting, technical, advisory, and other types of assistance to other public corporations and governmental instrumentalities of Puerto Rico authorized to develop infrastructure facilities and to establish alternate means for financing infrastructure facilities. The Authority is authorized to issue bonds and provide loans, grants and other financial assistance for the construction, acquisition, repair, maintenance and reconstruction of infrastructure projects by public corporations and instrumentalities of the Commonwealth. The Authority's enabling act also established the Puerto Rico Infrastructure Fund, funded with annual fixed amounts from the first proceeds of federal excise taxes imposed on rum and other articles produced in Puerto Rico and sold in the United States which are transferred to Puerto Rico pursuant to the United States Internal Revenue Code of 1986, as amended. Currently, this amount is $70 million, and it will increase to $90 million for fiscal years 2007 to 2052. The Authority is using these amounts to provide financial support to water and sewer projects. As of December 31, 2003, the Authority's total debt was $936.7 million, including $8.7 million in loans.

The Authority is providing assistance to Puerto Rico Aqueduct and Sewer Authority covering (i) the design and construction of various strategic regional water and sewer projects intended to provide improved services to targeted regions throughout the island, (ii) the implementation of an action plan to address a number of small water and sewer rehabilitation projects, (iii) the achievement of compliance with certain environmental laws, and (iv) the establishment of a prioritized capital program.

In June 1998, the Authority's enabling act was amended to establish the Infrastructure Development Fund, a permanent trust fund to be utilized by the Authority for the purpose of financing infrastructure projects. The Infrastructure Development Fund was initially funded in March 1999 with $1.2 billion of proceeds received by the Telephone Authority from the sale of a controlling interest in Puerto Rico Telephone Company. This initial amount will remain permanently deposited in a segregated, perpetual account, denominated the "corpus account," and must be invested exclusively in U.S. government or U.S. government-backed obligations. The income from such investment may only be used to finance infrastructure projects related to the Commonwealth's water and sewer systems. Other moneys in the Infrastructure Development Fund not attributable to the corpus account or the investment income thereon may be used for other infrastructure projects. The Authority is the custodian and administrator of the Infrastructure Development Fund. In October 2000, the Authority issued $1.093 billion of bonds payable from and secured by a pledge of the interest received by the Authority from the investments of the Infrastructure Development Fund. The proceeds of this bond issue are being used to finance certain aqueduct and sewer infrastructure development projects.

Maritime Shipping Authority commenced operations in 1974 upon the acquisition of three shipping lines serving Puerto Rico and the United States mainland. In 1995, the assets and operations of the Maritime Shipping Authority were sold to a private investor group. The remaining debt of the Authority was refinanced through the issuance of bonds by Public Finance Corporation, a subsidiary of

GDB. The aggregate principal amount of such bonds outstanding as of December 31, 2003, was $312.2 million (not including accreted values of capital appreciation bonds outstanding). The bonds are payable from funds to be appropriated annually by the Legislature of Puerto Rico.

Municipal Finance Agency was created in 1972 as a municipal "bond bank" for Puerto Rico. The Agency is authorized to issue bonds to purchase general obligation bonds and notes of Puerto Rico municipalities and to fund a debt service reserve. Debt service on the Agency's bonds is payable from debt service payments on municipal bonds held by the Agency and from the debt service reserve, including investment income thereon. The Commonwealth has agreed to pay such amounts to the debt service reserve as may be necessary to maintain it at its required level, subject to appropriation by the Legislature, which appropriation is authorized but not legally required to be made. To date no such payments have been required. As of December 31, 2003, the Agency had $1.323 billion of bonds outstanding.

Ports Authority owns and operates the major airport and seaport facilities in Puerto Rico. The Authority derives revenues from a variety of sources, including charges on airplane fuel sales, air terminal space rentals, landing fees, wharfage, dockage and harbor fees, and rentals for the lease of seaport equipment and property. Act No. 1 of January 1, 2000, authorized the transfer of the Authority's unprofitable maritime ferry operations to Puerto Rico Maritime Transportation Authority, a newly created government agency. As of December 31, 2003, the Authority had $378.9 million in debt, including $299.9 million in loans.

Public Buildings Authority is authorized to construct, purchase or lease office, school, health, correctional and other facilities for lease to departments, public corporations, and instrumentalities of the Commonwealth. Bonds that have been issued by the Authority to finance such facilities (through retirement of interim notes or otherwise) are payable from lease payments, which are largely derived from legislative appropriations and are further secured by the Commonwealth's guaranty. The Authority is authorized by law to have outstanding at any one time up to $3.325 billion of bonds guaranteed by the Commonwealth. As of December 31, 2003, $2.053 billion of such bonds of the Authority was outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds). Also, as of December 31, 2003, the Authority had a $400 million GDB line of credit with an outstanding balance of $294.8 million.

Special Communities Perpetual Trust is an irrevocable and permanent trust created in November 2002 as a public corporation. The Trust's principal purpose is to fund development projects which address the infrastructure and housing needs of underprivileged communities. The Trust's capital will consist of moneys drawn under a $500 million GDB line of credit, which is currently in use by the Trust, and a $500 million grant from GDB to be disbursed over time after the line of credit has been fully disbursed. As of December 31, 2003, the Trust's GDB line of credit had an outstanding balance of $7.2 million.

Telephone Authority was created in July 1974 when the Commonwealth purchased the Puerto Rico Telephone Company ("PRTC") from International Telephone and Telegraph Corporation. PRTC operates the principal telephone system in Puerto Rico.

In March 1999, the Telephone Authority sold a controlling interest in PRTC to a consortium led by GTE International Telecommunications Incorporated, which was acquired by Verizon Communications, Inc. The net proceeds of the sale received at closing were applied to defease outstanding bonds of the Authority in the principal amount of $756 million, to make a $1.2 billion deposit to the Infrastructure Development Fund held by the Infrastructure Financing Authority and to pay certain benefits to PRTC employees. In January 2002, Verizon exercised its option to purchase an additional 15% of PRTC stock for $172 million. The Commonwealth retains a 28% stock participation in PRTC.

The proceeds from the Verizon stock option exercise and the remaining 28% ownership interest were transferred to the Employees Retirement System of the Commonwealth and its instrumentalities.

University of Puerto Rico (the "University"), with 69,555 students in academic year 2002-2003, is by far the largest institution of higher education on the island. Government appropriations are the principal source of University revenues, but additional revenues are derived from tuition, student fees, auxiliary enterprises, interest income, federal grants, and other sources. University capital improvements have been financed mainly by revenue bonds. As of December 31, 2003, the University's total debt was $430.8 million, including $500,000 in loans.

On December 21, 2000, AFICA issued its $86,735,000 Educational Facilities Revenue Bonds, 2000 Series A (University Plaza Project) for the purpose of financing the construction of additional student housing and parking and office space for the University. The project is being built and will be operated by Desarrollos Universitarios, Inc., a Puerto Rico not-for-profit corporation, and will be leased to the University for a term equal to the term of the bonds with lease payments being in sufficient amounts to pay debt service on said bonds as they become due.

Other public corporations have outstanding debt in the aggregate amount of $863.4 million as of December 31, 2003. Debt service on $292.8 million of such outstanding debt is being paid from legislative appropriations. However, the Commonwealth is not obligated to make any such appropriations. Additional legislative appropriations are made to enable certain of such corporations to pay their operating expenses.

INSURANCE MATTERS

Government-owned property is insured through policies obtained by the Secretary of the Treasury and through self-insurance, except for property owned by the Electric Power Authority and the Aqueduct and Sewer Authority, which is insured through arrangements and policies obtained by the respective Authorities. Personal injury awards against the Commonwealth are limited by law to $150,000 per occurrence.

RETIREMENT SYSTEMS

Public employees of the Commonwealth and its instrumentalities are covered by five retirement systems: the Employees Retirement System of the Commonwealth and its instrumentalities (the "Employees Retirement System"), the Annuity and Pension System for the Teachers of Puerto Rico (the "Teachers Retirement System"), the Commonwealth Judiciary Retirement System (the "Judiciary Retirement System"), the Retirement System of the University of Puerto Rico (the "University Retirement System"), and the Employees Retirement System of Puerto Rico Electric Power Authority (the "Electric Power Authority Retirement System").

The University Retirement System and the Electric Power Authority Retirement System apply to employees of the University of Puerto Rico and Electric Power Authority, respectively. The Commonwealth is not required to contribute directly to those two systems, although a large portion of University revenues is derived from legislative appropriations.

The Teachers Retirement System covers primarily public school teachers, the Judiciary Retirement System covers judges, and the Employees Retirement System covers all other employees of the Commonwealth, its municipalities and instrumentalities. As of June 30, 2003, the total number of active members of the three systems was as follows: Employees Retirement System, 166,914; Teachers Retirement System, 49,046; and Judiciary Retirement System, 338. The three systems are financed by contributions made by employers (the Commonwealth, public corporations, and municipalities) and employees, and investment income. The central government is responsible for approximately 67% of total employer contributions to the Employees Retirement System, and the other 33% is the responsibility of public corporations and municipalities. The central government is also responsible for 100% and 99% of total employer contributions to the Judiciary and Teachers Retirement Systems, respectively. Retirement and related benefits provided by the systems and required contributions to the systems by employees are determined by law. Required employers' contributions to the systems are determined by law and are not actuarially determined. For the Employees Retirement System, required employer contributions consist of 9.275% of applicable payroll in the case of municipalities, central government and public corporations. Required employee contributions for the Employees Retirement System vary according to salary and how the individual employee's retirement benefits are coordinated with social security benefits. For the Judiciary Retirement System, required contributions consist of 20% of applicable payroll for the employer and 8% for the employees.

According to the most recent actuarial valuation of the Employees Retirement System and Judiciary Retirement System submitted by a firm of independent consulting actuaries, as of June 30, 2001, the total pension benefit obligation for the Employees Retirement System and Judiciary Retirement System was $9.881 billion and $162.2 million, respectively. The unfunded pension benefit obligation of the Employees Retirement System and Judiciary Retirement System for the same period was $7.453 billion and $92.1 million, respectively, representing a funding ratio of 25% and 43%, respectively. This funding ratio does not take into account the reduction in the value of their respective equity portfolios resulting from the decline in the equities market since fiscal year 2001. It is estimated that as of June 30, 2002, the total pension benefit obligation for the Employees Retirement System is $10.540 billion and the unfunded pension benefit obligation is $8.560 billion, representing a funding ratio of 19%.

The most recent actuarial valuation was completed in accordance with the "Projected Unit Credit" method. An investment return of 8.5% per year, a salary increase of 5% per year, and a post-retirement benefit increase of 3% every third year were assumed. In the case of the Employees Retirement System, Act No. 10 of May 21, 1992 provided three benefit increases of 3% each. The first 3% increase was granted to retirees who had been receiving their annuities for three or more years as of that date. The second 3% increase was granted to retirees who had been receiving their annuities for three or more years as of January 1, 1995. This increase is being financed by additional contributions from the employers. The third 3% increase was granted to retirees who had been receiving their annuities for three or more years as of January 1, 1998. This third increase is being partially funded with additional contributions from some of the employers. In June 2001, the Legislature approved a law providing a fourth 3% increase, effective as of January 1, 2001, in post-retirement annuity payments granted on or prior to January 1, 1998. This increase will be funded by the General Fund for retirees who were employees of the central government and by municipalities and public corporations for retirees who were their employees. In June 2003, the Legislature approved a law providing a fifth increase of 3% in post retirement benefits effective January 1, 2004. This increase will also be funded by the General Fund for retirees who were employees of the central government and by municipalities and public corporations for retirees who were their employees. Subsequent increases will depend upon the explicit approval of the System's Board of Trustees and the Legislature, and must provide a funding source. In the case of the Judiciary Retirement System, Act No. 41 of June 13, 2001 provides a 3% increase in annuity payments, commencing on January 1, 2002 and every three years thereafter, to retirees who have been receiving their annuities for three or more years as of that date. This increase will be funded by the General Fund.

In 1990, the organic act of the Employees Retirement System was amended to reduce the future pension liabilities of the Employees Retirement System. Among other provisions, the legislation increased the level of contribution to the System and limited the retirement benefits for new employees by increasing the length of time for the vesting of certain benefits and reducing the level of benefits in the case of early retirement. The legislation also reduced the level of occupational disability benefits and death benefits received by new employees.

In 1999, the organic act of the Employees Retirement System was further amended to change it, prospectively, from a defined benefit system to a defined contribution system. This amendment provides for the establishment of an individual account for each employee hired by the Commonwealth after December 31, 1999 and for those current employees who elect to transfer from the existing defined benefit system. The individual account of each current employee is credited initially with an amount equal to his aggregate contributions to the Employees Retirement System, plus interest. Current employees who did not elect to transfer to the new defined contribution system will continue accruing benefits under the current defined benefit system. The individual account of each participant of the new defined contribution system is credited monthly with the participant's contribution and is credited semiannually with a rate of return based on either of two notional investment returns. Such accounts are not credited with any contribution by the employer. Instead, employer contributions will now be used completely to reduce the accumulated unfunded pension liability of the Employees Retirement System.

The law approving the sale of a controlling interest in PRTC to a consortium led by GTE International Telecommunications Incorporated (subsequently acquired by Verizon Communications Inc.) provides that any future proceeds received by the government from the sale of its then remaining 43% stock ownership in PRTC will be transferred to the Employees Retirement System to reduce its accumulated unfunded pension benefit obligation. In January 2002, Verizon exercised its option to purchase an additional 15% of the stock of PRTC for $172 million. The proceeds of the sale were transferred to the Employees Retirement System.

The Employees Retirement System's disbursements of benefits during fiscal years 2002 and 2003 exceeded contributions and investment income for those years. This cash shortfall was covered with a portion of the proceeds from the sale to Verizon of the 15% stock ownership in PRTC.

The Employees Retirement System anticipates that its future cash flow needs for disbursement of benefits to participants may exceed the sum of the employer and employee contributions received and its investment and other recurring income. The Employees Retirement System expects to cover this cash flow imbalance in the next few fiscal years with the proceeds from the sale of the remaining shares of PRTC stock. The Employees Retirement System is currently evaluating other measures to increase its revenues.

According to the most recent actuarial valuation of the Teachers Retirement System submitted by a firm of independent consulting actuaries, as of June 30, 2001, the accrued actuarial liability of the system was $3.684 billion and the value of assets amounted to $2.284 billion, representing a funding ratio of 62%, and the resulting unfunded accrued liability was $1.400 billion. This funding ratio does not take into account the recent significant decline in the equities market and the resulting reduction in the value of the equity portfolio. As of June 30, 2000, the remaining amortization period for the unfunded liability was 19 years. The actuarial valuation assumed an investment return of 8% per year and salary increases of 5% per year. Act No. 45 of January 27, 2000 increased the amount of the employee contribution from 7% to 9%, effective immediately. This will result in an increase of employee contributions of $1.5 million per month.

The following table presents, in summary form, the income and expenses of the retirement systems for the fiscal years ended June 30, 2001, June 30, 2002, and June 30, 2003. The investment income figures presented in the table include unrealized gains and losses.

Commonwealth of Puerto Rico
Retirement Systems
Income and Expenses
(in thousands)

	Employees Retirement System	Judiciary Retirement System	Teachers Retirement System
Fiscal Year Ended June 30, 2003			
Income:			
Employers' contributions	$330,404	$ 5,536	$ 140,264
Employee contributions	276,347	2,479	104,403
Investment income	57,132	4,131	51,998
Total	$663,883	$ 12,146	$ 296,665
Expenses:			
Benefit payments	667,390	9,330	$ 298,529
Administrative and other expenses	28,768	1,473	22,565
Total	696,158	10,803	$ 321,094
Net Income (Loss)	$(32,275)	$ 1,343	($ 24,429)
Fiscal Year Ended June 30, 2002			
Income:			
Employers' contributions	$308,228	$ 5,412	$ 124,152
Employee contributions	259,203	2,448	99,454
Investment income	(306,008)	(7,791)	(41,068)
Total	$261,423	$ 69	$ 182,538
Expenses:			
Benefit payments	$683,106	$8,462	$ 278,168
Administrative and other expenses	27,304	1,072	20,833
Total	$710,410	$9,714	$ 299,001
Net Income (Loss)	($448,987)	($9,645)	($ 116,463)
Fiscal Year Ending June 30, 2001			
Income:			
Employers' contributions	$302,234	$5,394	$ 116,134
Employee contributions	245,221	2,240	94,295
Special Contribution-PRTC Stock	701,000[(1)]	N/A	N/A
Investment income	(232,479)	(11,048)	(173,097)
Total	$1,015,976	($3,414)	$ 37,332
Expenses:			
Benefit payments	$600,674	$8,262	$ 240,761
Administrative and other expenses	28,404	1,049	22,507
Total	$629,078	$9,311	$ 263,268
Net Income (Loss)	$386,898	($12,725)	($ 225,936)

(1) Value of 28% stock ownership interest in PRTC based on an appraisal made by an independent firm. As of December 31, 2002, the shares of PRTC held by the Employee Retirement System after the sale of certain optioned shares to Verizon were valued at $362.7 million.

Sources: Employees Retirement System, Judiciary Retirement System, and Teachers Retirement System

COMMONWEALTH FINANCIAL STATEMENTS

For fiscal year 2002, the financial statements of the Commonwealth were audited by KPMG LLP. KPMG LLP did not audit the financial statements of the Public Buildings Authority capital project fund (a major fund), and certain activities, funds and component units identified separately in their report. Those financial statements were audited by other auditors whose reports were furnished to KPMG LLP, and its opinion on the basic financial statements, insofar as it relates to the amounts included in the basic financial statements pertaining to such activities, funds and component units, was based solely on the reports of the other auditors.

It is expected that the financial statements of the Commonwealth for fiscal year 2003 will be available during the second quarter of fiscal year 2004. Preparation of the financial statements of the Commonwealth involved the collection and combination of audited financial statements from approximately fifty separate reporting entities.

PUERTO RICO TAXES, OTHER REVENUES AND EXPENDITURES

The Secretary of the Treasury has custody of the funds of the central government and is responsible for the accounting, disbursement and investment of such funds. Central government funds are grouped into three major categories or "types" of funds, as follows: (i) Governmental Fund Types, which include the General, Special Revenue, Debt Service (also referred to herein as Redemption), and Capital Project Funds; (ii) Proprietary Fund Types, which include the Enterprise and Internal Service Funds; and (iii) Fiduciary Fund Types, which include the Trust and Agency Funds. These funds do not include funds of the municipalities, because the municipalities are governmental entities with independent treasuries. The Special Revenue Fund is incorporated into the General Fund for financial reporting purposes (but not for budgetary purposes).

The General Fund is the primary operating fund of the Commonwealth. General Fund revenues are broadly based and include revenues raised internally as well as those from non-Puerto Rico sources. Internal revenues consist principally of income taxes and excise taxes. Revenues from non-Puerto Rico sources are derived from federal excise taxes and customs duties returned to the Commonwealth. The primary expenditures of the Commonwealth through the General Fund are for grants and subsidies, and personal and other services.

Summary and Management's Discussion of General Fund Results

The following table presents the revenues and expenditures of the General Fund on a cash basis for fiscal year 2000 through fiscal year 2003 and the budgeted revenues and expenditures for fiscal year 2004. The information through fiscal year 2003 is based on actual fiscal year-end results. (The information relating to fiscal year 2003 is preliminary and subject to audit adjustments.) The information relating to fiscal year 2004 is based on the current budget of revenues and expenditures for fiscal year 2004.

The amounts shown on the table as expenditures may be different than those reflected in the budget or in the Commonwealth's financial statements because the table shows only cash disbursements, while the budget includes all authorized expenditures, regardless of when the related cash is actually disbursed. In addition, transfers to the Redemption Fund (used to pay debt service on the Commonwealth's bonds), which are included in the budget under "debt service," are shown as a deduction from total revenues in calculating "adjusted revenues" in the table and are not included under "expenditures." Finally, certain expenditures incurred in excess of budgeted amounts may not be reflected in the table as expenditures to the extent they are paid from reserve funds, such as moneys in the

Budgetary Fund. For example, in fiscal year 2003, there were approximately $150 million of such expenditures that are not reflected in the table. A discussion of the budget for fiscal year 2004 appears below under "Budget of the Commonwealth of Puerto Rico."

Amounts listed under "Other Income" represent recurring General Fund revenues not appropriately attributable to other revenue line items, such as repayment of General Fund advances to municipalities and government agencies and funds. "Other Expenditures" represent recurring General Fund expenditures not appropriately attributable to other expenditures line items, such as advances to government agencies and municipalities, which advances are to be reimbursed to the General Fund by law. Amounts listed under "Capital Outlays and Other Debt Service" represent debt service on obligations and capital expenditures for which the Legislature has by resolution agreed to appropriate funds. "Transfers to Agencies" represents moneys appropriated for the operation of the Health Facilities and Services Administration or, after the dissolution of that Administration, the Department of Health. General Fund revenues, expenditures and transfers as presented in the table differ from the General Fund revenues, expenditures and transfers as presented in the financial statements of the Commonwealth, as the latter statements reflect an expanded General Fund entity in accordance with generally accepted accounting principles.

Commonwealth of Puerto Rico
General Fund Revenues, Expenditures, and Changes in Cash Balance
(in thousands)

	2000	2001	2002	2003(p)	2004(c)
Beginning cash balance	$ 474,759	$ 287,055	$ 125,154	$ 350,284	$ 179,058
Revenues from internal sources:					
Income Taxes:					
Individuals	2,352,066	2,259,090	2,471,782	2,517,678	2,816,000
Corporations	1,781,862	1,696,766	1,584,719	1,776,985	1,826,000
Partnerships	2,339	3,026	2,670	2,101	2,000
Withheld from non-residents	557,276	696,835	583,256	517,141	560,000
Tollgate taxes	111,130	49,511	59,515	45,321	22,000
Interest	11,674	14,782	14,310	11,278	13,000
Dividends	39,664	58,580	62,548	49,790	47,000
Total income taxes	4,856,011	4,778,590	4,778,800	4,920,294	5,286,000
Commonwealth excise taxes:					
Alcoholic beverages	236,374	237,512	249,705	299,582	313,000
Cigarettes	115,157	119,135	116,055	149,487	159,000
Motor vehicles	389,995	406,252	418,024	499,252	543,000
Other excise taxes	668,820	579,050	674,762	703,029	738,000
Total Commonwealth excise taxes	1,410,346	1,341,949	1,458,546	1,651,350	1,753,000
Property taxes	1,131	287	-	-	-
Inheritance and gift taxes	3,109	7,475	1,962	2,825	3,000
Licenses	73,801	76,338	82,575	85,876	87,000
Other:					
Lottery	63,779	57,482	61,358	67,621	66,000
Electronic Lottery	70,209	70,211	57,897	89,443	88,000
Miscellaneous non-tax revenues	169,246	299,758	668,226(1)	438,457	292,000
Total Other	303,234	427,451	787,481	595,521	446,000
Total revenues from internal sources	6,647,632	6,632,090	7,109,364	7,255,866	7,575,000
Revenues from non-Commonwealth sources:					
Federal excise taxes	245,750	286,890	314,253	309,958	330,000
Customs	50,231	43,154	30,595	25,918	20,000
Total revenues from non-Commonwealth sources	295,981	330,044	344,848	335,876	350,000
Total revenues	6,943,613	6,962,134	7,454,212	7,591,742	7,925,000
Other Income (refunds)(2)	64,325	84,878	111,411	(78,927)	305,468
Transfers to Redemption Fund(3)	(410,046)	(245,814)	(274,773)	(331,925)	(407,948)
Proceeds of notes and other borrowings(4)	778,863	825,703	1,161,856	2,259,775	1,568,397
Repayment of notes and other borrowings(5)	(787,155)	(686,024)	(1,201,084)	(2,021,832)	(1,574,634)
Adjusted revenues	6,589,600	6,940,877	7,251,622	7,418,833	7,816,283
Expenditures:					
Grants and subsidies	2,864,215	3,078,505	2,862,288	3,773,579	2,626,738
Personal services	2,737,159	2,779,989	2,884,636	3,119,476	4,718,184
Other services	745,194	778,236	764,655	583,343	344,406
Materials and supplies	109,081	106,072	106,294	80,491	146,036
Equipment purchases	56,404	48,326	20,397	33,170	21,187
Capital outlays and other debt service	101,178	33,235	73,806	-	-
Transfers to agencies	164,073	280,415	314,416	-	-
Prior year disbursements	-	-	-	-	88,432
Total expenditures	6,777,304	7,102,778	7,026,492	7,590,059	7,944,984
Adjusted revenues less expenditures	(187,704)	(161,901)	225,130	(171,226)	(128,701)
Ending cash balance	$ 287,055	$ 125,154	$ 350,284	$ 179,058	$ 50,357

(p) Preliminary
(c) Current budget.
(1) Includes certain non-recurring revenues totaling $244.1 million.
(2) Consists of net revenue from General Fund's non budgetary funds plus a reserve for future tax refunds reduced by estimated tax refunds.
(3) Consists of amounts to pay principal of and interest on general obligation bonds and notes of the Commonwealth. Does not include amounts deposited directly to the Redemption Fund from non-General Fund revenues.
(4) Consists of proceeds of Commonwealth tax and revenue anticipation notes and borrowings from Government Development Bank.
(5) Consists of repayment of Commonwealth tax and revenue anticipation notes and borrowings from Government Development Bank.

Source: Department of the Treasury

Budgeted Fiscal Year 2004 Compared to Preliminary Fiscal Year 2003

The General Fund budget for fiscal year 2004, which commenced on July 1, 2003, provides for total resources and appropriations of $8.295 billion, which represents an increase of $452 million, or 5.8%, over the fiscal year 2003 budget. Total resources include $7.925 billion of total revenues and $370 million of other sources, which are included as part of "Other Income (refunds)." General Fund total budgeted and actual resources for fiscal year 2003, which ended on June 30, 2003, were $7.842 billion. This amount includes total revenues of $7.592 billion and $250 million reported as part of "Proceeds of notes and other borrowings." The $250 million represents a loan from GDB. The loan has a term of five years, and may be repaid sooner to the extent that sufficient revenues are available for such purpose.

The major changes in revenues from fiscal year 2003 are expected to be: (i) projected increases in total income taxes of $366 million; (ii) projected increases in total excise taxes of $102 million; and (iii) projected decreases in other revenues of $150 million. The budgeted General Fund revenues for fiscal year 2004 assumes a 6.1% nominal and 2.9% real growth in gross product, and additional revenues of $225 million from new legislative measures.

For the first nine months of fiscal year 2004, General Fund revenues were $5.363 billion, which is $411 million, or 8.3%, higher than General Fund revenues during the first nine months of fiscal year 2003, and $9.9 million, or 0.2%, higher than budgeted revenues for this period.

Total cash expenditures for fiscal year 2004 are budgeted to increase to $7.945 billion, which amount includes $88 million in disbursements related to fiscal year 2003. After considering (i) $408 million in debt service payments (separately identified on the table as "Transfers to Redemption Fund"), (ii) net repayments of $6 million to GDB and (iii) $306 million in other sources from the General Fund's non-budgetary funds and a reserve for future tax refunds reduced by estimated tax refunds (separately identified on the table as "Other Income (refunds)"), the ending cash balance of the General Fund would be reduced from $179 million at the end of fiscal year 2003 to $64 million at the end of fiscal year 2004.

Preliminary Fiscal Year 2003 Compared to Fiscal Year 2002

Preliminary General Fund total revenues for fiscal year 2003 were $7.592 billion, representing an increase of $138 million, or 1.8%, from actual fiscal year 2002 revenues. This amount excludes proceeds of a loan of $250 million obtained from GDB, mentioned above, which is included as part of "Proceeds of notes and other borrowings." The major changes from fiscal year 2002 were: (i) increases in income taxes from individuals of $46 million and in corporate income taxes of $192 million; (ii) increases in excise taxes on alcoholic beverages and cigarettes of $83 million, and increases in motor vehicle excise taxes of $81 million; (iii) an increase in electronic lottery revenues of $32 million; and (iv) a decrease in miscellaneous non-tax revenues of $230 million and in income taxes withheld from non-residents of $66 million. The decrease in miscellaneous non-tax revenues relates to certain special administrative measures that had been implemented by the Secretary of the Treasury in fiscal year 2002 and that do not apply to fiscal year 2003.

Preliminary total cash expenditures for fiscal year 2003 were $7.590 billion, which amount excludes certain amounts related to fiscal year 2003 but disbursed or to be disbursed in fiscal year 2004. This amount also excludes $150 million of additional expenditures that were not originally budgeted and were covered with reserve funds, federal fiscal relief funds and other sources. The principal reason for these higher expenditures was higher than anticipated education costs. After considering (i) $332 million in debt service payments (separately identified on the table as "Transfers to Redemption Fund"), (ii) $238 million in net borrowings from GDB (which includes the $250 million loan mentioned above) and other sources, and (iii) $79 million in reserves for future tax refunds reduced by estimated tax refunds (separately identified on the table as "Other Income (refunds)"), the ending cash balance of the General

Fund was reduced from $350 million at the end of fiscal year 2002 to $179 million at the end of fiscal year 2003.

Fiscal Year 2002 Compared to Fiscal Year 2001

General Fund total revenues for fiscal year 2002 were $7.454 billion, representing an increase of $492 million, or 7.1%, from fiscal year 2001 revenues. The major changes from fiscal year 2001 were: (i) an increase in income taxes from individuals of $213 million; (ii) increases in Commonwealth excise taxes of $117 million; (iii) an increase in miscellaneous non-tax revenues of $368 million; (iv) a decrease in income taxes from corporations of $112 million; and (v) a decrease in income taxes withheld from non-residents, tollgate taxes and dividend taxes totaling $100 million.

The increase in miscellaneous non-tax revenues relates to certain special revenue raising measures adopted by the Secretary of the Treasury in fiscal year 2002. Such measures included the transfer to the General Fund of funds on deposit in a contingency fund related to the sale of PRTC stock and of certain compulsory insurance premiums, the sale of certain tax receivables to GDB, and savings generated by the refinancing of certain Commonwealth bonds.

Total cash expenditures for fiscal year 2002 were $7.026 billion. After considering (i) $275 million in debt service payments (separately identified on the table as "Transfers to Redemption Fund"), (ii) net repayments of $39 million to GDB and other sources, and (iii) $111 million in other sources from the General Fund's non-budgetary funds, the ending cash balance of the General Fund increased from $125 million at the end of fiscal year 2001 to $350 million at the end of fiscal year 2002.

Fiscal Year 2001 Compared to Fiscal Year 2000

General Fund total revenues for fiscal year 2001 were $6.962 billion, an increase of $19 million from fiscal year 2000. The major changes from fiscal year 2000 were (i) a decrease of $85 million in corporate income taxes; (ii) a decrease of $93 million in individual income taxes; (iii) a decrease of $62 million in tollgate taxes; (iv) a decrease of $90 million in other excise taxes; (v) an increase in income tax withheld from non-residents of $140 million; and (vi) an increase in federal excise taxes of $41 million.

Total cash expenditures for fiscal year 2001 were $7.103 billion. After considering (i) $246 million in debt service payments (separately identified on the table as "Transfers to Redemption Fund"), (ii) $140 million in net borrowings from GDB and other sources, and (iii) $85 million in other sources from the General Fund's non-budgetary funds, the ending cash balance of the General Fund decreased from $287 million at the end of fiscal year 2000 to $125 million at the end of fiscal year 2001.

Major Sources of General Fund Revenues

Income Taxes

The Commonwealth's income tax law, the Internal Revenue Code of 1994, as amended (the "PR Code"), imposes a tax on the income of individual residents of Puerto Rico, trusts, estates, and domestic and foreign (if engaged in a trade or business in Puerto Rico) corporations and partnerships. A withholding tax is imposed on certain payments made to non-residents of Puerto Rico.

Individuals. Resident individuals are subject to tax on their taxable income from all sources. Prior to January 1, 2000, the PR Code had five tax brackets for individuals with tax rates of 8%, 12%, 18%, 31% and 33%. As a result of legislation enacted in 1999 and thereafter, the first four brackets have been reduced to 7.5%, 11%, 16.5% and 29.5% for the taxable year commencing on January 1, 2000, to

7%, 10%, 15% and 28% for taxable years commencing after December 31, 2000. Dividend income from Puerto Rico corporations and certain qualifying foreign corporations is taxed at a rate of 10%.

Gain realized from the sale or exchange of a capital asset by resident individuals, if held for more than six months, is taxed at a rate of 20%. It is taxed at a rate of 10% if the capital asset consists of certain property located or deemed located in Puerto Rico. Gains realized by Puerto Rico resident individuals, trusts and estates from the sale of stock of certain Puerto Rico corporations in an initial public offering made prior to January 1, 2008 are subject to a special capital gains rate of 7%.

Interest income in excess of $2,000 on deposits with Puerto Rico financial institutions is taxed at a rate of 17%; the first $2,000 of interest income from such institutions is exempt from taxation. Interest income on certain qualifying debt obligations issued by Puerto Rico corporations and certain qualifying foreign corporations and paid to resident individuals, trusts and estates qualifies for a special 17% tax rate. Legislation has recently been enacted that will reduce this 17% tax rate to 10% under certain circumstances.

Corporations and Partnerships. Puerto Rico corporations and partnerships are subject to tax on income from all sources; foreign corporations and partnerships that are engaged in a trade or business in Puerto Rico are subject to tax on their income from Puerto Rico sources and on income from sources outside Puerto Rico that is effectively connected with the conduct of their trade or business in Puerto Rico. Unless a corporation or partnership qualifies for partial exemption from corporate income and other taxes under the industrial incentives program (see "Tax Incentives" under *The Economy* above), it is subject to tax at graduated rates.

The PR Code provides for six income tax brackets for corporations and partnerships, with the highest rate (39%) applicable to net taxable income in excess of $300,000. Gains realized from the sale or exchange of a capital asset, if held for more than six months, are taxed at a maximum rate of 25% or 12.5% if the capital asset consists of certain property located or deemed located in Puerto Rico sold or exchanged after December 31, 2000. Dividends received by Puerto Rico corporations and partnerships of foreign corporations and partnerships engaged in trade or business in Puerto Rico are subject to general income tax rates. A dividends received credit may be available. A special tax rate of 17% is applicable to dividend distributions of REITs received by corporations.

Certain corporations and partnerships covered by the tax incentives acts continue to be subject to a maximum tax rate of 45% on their taxable income. Corporations and partnerships covered by the Puerto Rico Tourism Incentives Act of 1993, as amended, are subject to a maximum tax rate of 42% on their taxable income. The PR Code also provides for an alternative minimum tax of 22%. Corporations and partnerships operating under a new grant of tax exemption issued under the 1998 Tax Incentives Act are subject to a maximum income tax rate of 7% during their basic exemption period.

The PR Code imposes a branch profits tax on resident foreign corporations less than 80% of whose gross income qualifies as income effectively connected with a Puerto Rico trade or business. The branch profits tax is 10% of an annual dividend equivalent amount, and it applies without regard to the Puerto Rico source of income rules.

Interest from Puerto Rico sources paid to non-resident non-affiliated corporate recipients is not subject to any income or withholding tax. Interest paid to certain related non-resident recipients is subject to a withholding tax of 29%. Dividends paid to non-resident corporate recipients are subject to a withholding tax of 10%. Dividends distributed by corporations (including Section 936 Corporations) operating under new grants of tax exemption issued under the 1998 Tax Incentives Act are not subject to Puerto Rico income tax. However, royalty payments made by such corporations to non-resident recipients are subject to a 10% withholding tax. The basic tax on dividends paid to foreign corporate shareholders of Section 936 Corporations operating under grants of tax exemption issued under prior incentives laws is 10% but is subject to reduction if a percentage of the profits are invested in certain eligible instruments for specified periods of time.

Subject to certain exceptions, payments in excess of $1,500 during a calendar year made by the Commonwealth and persons engaged in a trade or business in Puerto Rico in consideration of the receipt of services rendered in Puerto Rico are subject to a 7% withholding tax.

The Treasury Department is presently evaluating a plan to reform the Commonwealth's tax system. The objective of this reform would be to reduce the income tax rates for individuals while expanding the tax base by taxing persons not currently participating in the income tax system and simplifying the tax system in order to make its administration more effective. The tax reform is expected to be implemented beginning on January 1, 2006. The Treasury Department expects that the tax reform will produce additional General Fund revenues.

Excise Taxes

The PR Code imposes a tax on articles and commodities that are imported into or manufactured in Puerto Rico for consumption in Puerto Rico and a tax on certain transactions, such as hotel occupancy, public shows, and horse racing. The excise tax on certain articles and commodities, such as cigarettes, alcohol and petroleum products, is based upon the quantity of goods imported. The excise tax on motor vehicles is based on its suggested retail price. The PR Code imposes a tax at an effective rate of 6.6% of the F.O.B. factory price for imported goods and 3.6% of the sales price of goods manufactured in Puerto Rico, except sugar, cement, cigarettes, motor vehicles and certain petroleum products, which are taxed at different rates. Goods to be used by the government, except for motor vehicles and construction equipment, are not exempt. Exemptions apply to certain articles, such as food and medicines, and to articles designated for certain users.

Other Taxes and Revenues

Motor vehicle license plate and registration fees comprise the major portion of license tax receipts.

Non-tax revenues consist principally of lottery proceeds, documentary stamps, permits, fees and forfeits, proceeds of land sales and receipts from public corporations in lieu of taxes.

Revenues from non-Commonwealth sources include customs duties collected in Puerto Rico and excise taxes on shipments of rum from the island to the United States mainland. The customs duties and excise taxes on shipments are imposed and collected by the United States and returned to the Commonwealth. The excise tax on shipments of rum from Puerto Rico and other rum producing countries is $13.50 per gallon. Of this amount, $13.25 per gallon was returned to the Treasury of Puerto Rico during the period from July 1, 1999 to December 31, 2003. Effective January 1, 2004, the amount returned was reduced to $10.50 per gallon. However, legislation is currently pending in both houses of the United States Congress that would extend the period during which the tax returned to Puerto Rico remains at $13.25 per gallon to June or December 2004, depending on which version is enacted.

Property Taxes

Personal property, which accounts for approximately 53% of total collections of taxable property, is self-assessed. Real property taxes are assessed based on 1958 property values. No real property reassessment has been made since 1958, and construction taking place after that year has been assessed on the basis of what the value of the property would have been in 1958. Accordingly, the overall assessed valuation of real property for taxation purposes is substantially lower than the actual market value. Also, an exemption on the first $15,000 of assessed valuation in owner-occupied residences is available.

Property taxes are assessed, determined and collected for the benefit of the municipalities by the Municipal Revenues Collection Center ("CRIM"), a government instrumentality of the Commonwealth. However, a special 1.03% tax on the assessed value of all property (other than exempted property) imposed by the Commonwealth for purposes of paying the Commonwealth's general obligation debt is deposited in the Commonwealth's Redemption Fund.

The following table presents the assessed valuations and real and personal property taxes collected for the fiscal years ending June 30, 1999 through 2003.

Commonwealth of Puerto Rico
Assessed Valuations and Real and Personal Property Taxes
(Commonwealth and Municipalities Combined)
(in thousands)

Fiscal Years Ended June 30	Assessed Valuations(1)	Taxes Levied	Collections of Current Year	Collections of Previous Years	Total
1999	$20,042,738	$642,555	$523,886	$47,309	$571,195
2000	20,514,014	704,568	594,151	64,812	658,963
2001	21,575,063	736,667	614,411	70,496	684,907
2002	22,743,568	792,799	645,117	60,677	705,794
2003	23,138,903	824,933	671,163	79,421	750,584

(1) Valuation set as of July 1 of each fiscal year.

Source: Municipal Revenues Collection Center

Collections of Income and Excise Taxes

The Department of the Treasury has continued its program for improving tax collections, which began in fiscal year 1986. The program has consisted, in part, of taking the initiative in sponsoring and implementing tax reform, particularly in the areas of excise taxes and income taxes, in order to decrease the incidences of nonpayment of taxes and to expand the taxpayer base. The program has also included (i) improving the methods by which delinquent taxpayers are identified, primarily through the use of computer analyses, (ii) computerizing the processing of tax returns, and (iii) identifying and eliminating taxpayer evasion.

Transfers to General Obligation Redemption Fund

These consist of transfers from the General Fund to the Redemption Fund for the amortization of the principal of and interest on general obligation bonds and notes of the Commonwealth.

Components of General Fund Expenditures

Grants and Subsidies

This category includes grants and contributions to municipalities, public corporations with independent treasuries, and charitable institutions. It also includes items for or included in court awards, damage awards for personal injury or property damage, and payment of taxes and payments in lieu of taxes.

Personal Services

This category includes compensation paid for personal services rendered to the Commonwealth and its public instrumentalities by individuals or firms in the form of salaries, wages, *per diems*, fees, commissions, or other forms of compensation.

Other Services

This category includes compensation for services other than the services referred to above, including advertising, printing, communications, legal expenses, utilities, building and equipment rental and maintenance expenses, insurance premiums and miscellaneous services.

Materials and Supplies

This category includes all articles that ordinarily have a short life and durability, lose their characteristic identity in the process of use, have only nominal value ($25 or less), or are not otherwise chargeable as equipment.

Equipment Purchases

This category includes items that have three special characteristics distinguishing them from materials: durability, long useful life, and high unit cost. In addition, these items are subject to centralized inventory control as fixed assets.

Capital Outlays and Other Debt Service

Capital outlays are made primarily for land acquisition or interests in land, construction of buildings, roads, bridges and other structures, and permanent improvements and additions. Other debt service includes payments on notes held by GDB to be paid from the General Fund and payments for the amortization of the principal of and interest on non-general obligations payable from Commonwealth appropriations.

Transfers to Agencies

These transfers include the repayment of loans and advances to other funds, certain refunds, advances from other funds and other receipts, repayment of advances from other funds, grants and contributions to other funds under the custody of the Secretary of the Treasury and other items. The major portion of grants and contributions in recent fiscal years has consisted of transfers to cover the costs of health reform and advances to the municipalities.

Other Expenditures

This category represents recurring General Fund expenditures not appropriately attributable to other expenditure line items, such as advances to government agencies and municipalities, which advances are to be reimbursed to the General Fund by law.

Federal Grants

Puerto Rico receives grants under numerous federal programs. Federal grants to the agencies and instrumentalities of the Commonwealth government, including public corporations, are estimated to be $4.768 billion for fiscal year 2005, a decrease of $33 million, or 0.7%, from fiscal year 2004. The following table presents revenues from federal grants by broad program areas, which are accounted in the central accounting system of the Department of the Treasury. The figures for fiscal years 2001 and 2002 are actual figures. The preliminary figures for fiscal year 2003 and the estimated figures for fiscal years 2004 and 2005 are based on the information submitted by each agency to the Office of Management and Budget.

Commonwealth of Puerto Rico
Federal Grants[1]
(in thousands)

	2001	2002	2003[2]	2004[3]	2005[3]
Education	$ 642,082	$ 734,917	$ 828,992	$1,046,443	$1,064,964
Social Services	1,665,248	1,711,360	1,849,000	1,769,246	1,771,417
Health	297,865	333,154	367,916	391,521	424,011
Labor and Human Resources[4]	339,772	376,119	334,350	222,070	235,230
Crime	16,965	15,689	32,479	38,794	28,928
Housing[5]	336,175	385,592	321,870	385,408	402,904
Drug and Justice	17,524	9,822	17,802	31,677	12,463
Agriculture and Natural Resources	6,265	13,119	7,883	10,216	8,170
Contributions to Municipalities	56,809	59,191	59,191	59,002	56,371
Other	7,256	13,538	11,071	19,172	18,061
TOTAL	$3,385,961	$3,652,501	$3,830,554	$3,973,549	$4,022,519

(1) Federal grants to public corporations, including the Highway and Transportation Authority, are not included in this table. Public corporations are estimated to receive 746 million in federal grants during fiscal year 2005.
(2) Preliminary.
(3) Estimated.
(4) Amounts include grants to the Right to Work Administration, the Occupational Development, and Human Resources Council.
(5) Amounts include grants to the Public Housing Administration.

Source: Office of Management and Budget

BUDGET OF THE COMMONWEALTH OF PUERTO RICO

Office of Management and Budget

The Office of Management and Budget's ("OMB") predominant mission is to assist the Governor in overseeing the preparation of the budget of the Commonwealth and supervise its administration in the agencies of the Executive Branch. In helping to formulate the Governor's budget, OMB evaluates the effectiveness of agency programs, policies, and procedures, assesses competing funding demands among agencies, and sets funding priorities.

In addition, OMB oversees and coordinates the Administration's initiatives in financial management, information technology, general management and organizational structure, and supervises the agencies' compliance with the Governor's program and regulatory policies. In each of these areas, OMB's role is to help improve administrative management, develop better performance measures and coordinating mechanisms, and promote efficiency in the use of public funds.

Budgetary Process

The fiscal year of the Commonwealth begins each July 1. The Governor is constitutionally required to submit to the Legislature an annual balanced budget of capital improvements and operating expenses of the central government for the ensuing fiscal year. The annual budget is prepared by OMB, in coordination with the Planning Board, the Department of the Treasury, and other government offices and agencies. Section 7 of Article VI of the Constitution provides that "The appropriations made for any fiscal year shall not exceed the total revenues, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided by law."

The annual budget, which is developed utilizing elements of program budgeting, includes an estimate of revenues and other resources for the ensuing fiscal year under (i) laws existing at the time the budget is submitted, and (ii) legislative measures proposed by the Governor and submitted with the proposed budget, as well as the Governor's recommendations as to appropriations that in her judgment are necessary, convenient, and in conformity with the four-year investment plan prepared by the Planning Board.

The Legislature may amend the budget submitted by the Governor but may not increase any items so as to cause a deficit without imposing taxes to cover such deficit. Upon passage by the Legislature, the budget is referred to the Governor, who may decrease or eliminate any item but may not increase or insert any new item in the budget. The Governor may also veto the budget in its entirety and return it to the Legislature with the Governor's objections. The Legislature, by a two-thirds majority in each house, may override the Governor's veto. If a budget is not adopted prior to the end of the fiscal year, the annual budget for the preceding fiscal year as originally approved by the Legislature and the Governor is automatically renewed for the ensuing fiscal year until a new budget is approved by the Legislature and the Governor. This permits the Commonwealth to continue making payments of its operating and other expenses until a new budget is approved.

Financial Control and Adjustment Procedures

Revenue estimates for budgetary purposes are prepared by the Department of the Treasury, except for estimates of federal grants, which are prepared by OMB based on information received from the various departments and other recipients of such grants. Revenue and federal grant estimates are under continuous review and, if necessary, are revised at least quarterly during the fiscal year. Fiscal control over expenditures is exercised by the Governor, through the Director of OMB, and the Secretary of the Treasury. Monthly reviews and expenditure cut-off procedures are followed to prevent expenditure in excess of appropriations.

During any fiscal year in which the resources available to the Commonwealth are insufficient to cover the appropriations approved for such year, the Governor may take administrative measures to reduce expenses and submit to both houses of the Legislature a detailed report of any adjustment necessary to balance the budget, or make recommendations to the Legislature for new taxes or authorize borrowings under provisions of existing legislation or take any other necessary action to meet the estimated deficiency. Any such proposed adjustments shall give effect to the "priority norms" established by law for the disbursement of public funds in the following order of priority; first the payment of the interest on and amortization requirements for public debt (Commonwealth general obligations and guaranteed debt for which the Commonwealth's guarantee has been exercised); second, the fulfillment of obligations arising out of legally binding contracts, court decisions on eminent domain, and other unavoidable obligations to protect the name, credit and good faith of the Commonwealth; third, current expenditures in the areas of health, protection of persons and property, education, welfare and retirement systems; and fourth, all other purposes.

A Budgetary Fund was created by Act No. 147 of June 18, 1980, as amended (the "Budgetary Fund"), to cover the appropriations approved in any fiscal year in which the revenues available for such fiscal year are insufficient, to secure the payment of public debt, and to provide for unforeseen circumstances in the provision of public service. Currently, an amount equal to one percent of the General Fund net revenues of the preceding fiscal year is deposited annually into the Fund. In addition, other income (not classified as revenues) that is not assigned by law to a specific purpose is also required to be deposited in the Budgetary Fund. The maximum balance of the Budgetary Fund may not exceed

6% of the total appropriations included in the budget for the preceding fiscal year. As of February 29, 2004, the balance in the Budgetary Fund was $57.6 million.

An Emergency Fund was created by Act No. 91 of June 21, 1966, as amended (the "Emergency Fund"), to cover unexpected public needs caused by calamities, such as wars, hurricanes, earthquakes, droughts, floods and plagues, and to protect people's lives and property and the public sector credit. The Emergency Fund is capitalized annually with an amount totaling no less than one percent of the General Fund net revenues of the preceding fiscal year. The Governor or, by designation, the Director of OMB, may order the deposit of funds from any source into the Emergency Fund in an amount greater than the amount fixed in Act No. 91 when deemed convenient. When said funds are ordered deposited into the Emergency Fund, however, the balance thereof cannot exceed five percent of the budget approved for the fiscal year in which such deposit is ordered. As part of the fiscal year 2004 budget process, Act No. 91 was amended to set an upper limit to the Emergency Fund of $150 million. As of February 29, 2004, the balance in the Emergency Fund was $112.7 million.

Appropriations

Appropriations in the central government budget of Puerto Rico consist of the following:

(i) General Fund appropriations for recurring ordinary operating expenses of the central government and for contributions to public corporations, municipalities, and private organizations. Such appropriations are made by a single annual law known as the Joint Resolution of the General Budget.

(ii) General Fund appropriations for special operating expenses and for capital expenditures. Such appropriations are authorized by separate law for one or more years for special programs or activities, which may be permanent or transitory.

(iii) Disbursements of Special Funds for operating purposes and for capital improvements. For the most part, such disbursements do not require annual legislative authorization, because they are authorized by previous legislation or by the United States Congress. Federal grants constitute the major part of the resources of the Special Funds.

(iv) Bond Fund appropriations for capital expenditures financed by bonds. Such expenditures occur in one or more years.

In Puerto Rico, the central government has many functions, which in the fifty states are the responsibility of local government, such as providing public education, police and fire protection. The central government provides significant annual grants to the Aqueduct and Sewer Authority, the University of Puerto Rico and to the municipalities. In the summaries of the central government budgets presented below, grants to the University of Puerto Rico are included in current expenses for education and debt service on general obligation bonds is included in current expenses for debt service. Debt service on Sugar Corporation notes paid by the Commonwealth is included in current expenses for economic development, and debt service on Urban Renewal and Housing Corporation bonds and notes and on Housing Finance Authority mortgage subsidy bonds paid by the Commonwealth is included in current expenses for housing.

Approximately 30% of the General Fund is committed for payment of fixed charges such as municipal subsidies, grants to the University of Puerto Rico, contributions to the Aqueduct and Sewer Authority, funding for the judiciary branch, rental payments to the Public Buildings Authority, among others, and debt service on direct debt of the Commonwealth. In the case of the judiciary branch, legislation approved in December of 2002 provides that, commencing with fiscal year 2004, the Commonwealth will appropriate annually to the judiciary branch an amount initially equal to 3.3% of the average annual revenue from internal sources for each of the two preceding fiscal years. This percentage will increase until it reaches 4% in fiscal year 2008, and may be further increased upon review, with scheduled reviews every five years.

Fiscal Year 2004 Budget

The consolidated budget for fiscal year 2004 totaled $23.782 billion. Of this amount, $13.577 billion is assigned to the central government. This includes General Fund total resources and appropriations of $8.295 billion, which represents an increase of $452 million, or 5.8%, over budgeted amounts for fiscal year 2003. These total resources include $7.925 billion of total revenues and $370 million of other sources. The following table presents a summary of the Commonwealth's central government budget for the fiscal year ending June 30, 2004.

Commonwealth of Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ending June 30, 2004
(in thousands)

	General Fund[1]	Bond Fund	Special Funds		Total
Revenues from internal sources:					
Property taxes	$ 0	-	$ 103,524		$ 103,524
Personal income taxes	2,816,000	-	-		2,816,000
Retained non-resident income tax	560,000	-	-		560,000
Corporate income taxes	1,826,000	-	-		1,826,000
Partnership income taxes	2,000	-	-		2,000
Tollgate taxes	22,000	-	-		22,000
17% withholding tax on interest	13,000	-	-		13,000
10% withholding tax on dividends	47,000	-	-		47,000
Inheritance and gift taxes	3,000	-	-		3,000
Excise taxes:					
Alcoholic beverages	313,000	-	-		313,000
Motor vehicles and accessories	543,000	-	-		543,000
Cigarettes	159,000	-	-		159,000
Special excise tax on certain petroleum products	22,000	-			22,000
General 5% excise tax	543,000	-			543,000
Other	173,000	-	57,900		230,900
Licenses	87,000	-	-		87,000
Miscellaneous non-tax revenues:					
Contributions from lottery fund	66,000	-	-		66,000
Electronic lottery	88,000	-	-		88,000
Registration and document certification fees	171,000	-	-		171,000
Other	121,000	-	259,032		380,032
Total revenues from internal sources	7,575,000	-	420,456		7,995,456
Revenues from non-Commonwealth sources:					
Federal excise taxes on off-shore shipments	330,000	-	-		330,000
Federal grants	0	-	3,973,549	(2)	3,973,549
Customs	20,000	-	-		20,000
Total revenues from non-Commonwealth sources	350,000	-	3,973,549		4,323,549
Total revenues	$7,925,000	-	$4,394,005		$12,319,005
Other:					
Other Income	369,995	-	-		369,995
Balance from previous year	-	-	347,902		347,902
Bonds authorized	-	540,000	-		540,000
Total other sources	369,995	540,000	347,902		1,257,897
Total resources	$ 8,294,995	$ 540,000	$4,741,907		$13,576,902
Appropriations:					
Current expenses:					
General government	803,036	-	54,069		857,105
Education	2,552,438	-	977,036		3,529,474
Health	1,403,772	-	419,118		1,822,890
Welfare	404,015	-	2,099,589		2,503,604
Economic development	182,973	-	63,204		246,177
Public safety and protection	1,394,746	-	87,608		1,482,354
Transportation and communications	83,549	-	44,857		128,406
Housing	24,802	-	205,965		230,767
Contributions to municipalities	362,857	-	2,091		364,948
Special pension contributions	187,173	-	0		187,173
Debt service	407,948	-	103,524		511,472
Other debt service	487,686	-	25,300		512,986
Total appropriations-current expenses	8,294,995	-	4,082,361		12,377,356

	General Fund(1)	Bond Fund	Special Funds	Total
Capital improvements	0	540,000	258,538	798,538
Total appropriations	8,294,995	540,000	4,340,899	13,175,894
Year-end balance	0	-	401,008	401,008
Total appropriations and year-end balance	$8,294,995	$540,000	$4,741,907	$13,576,902

(1) Law No. 93 of August 20, 1997 establishes that resources that do not represent revenues, become part of the Budgetary Fund.
(2) Does not include grants received by agencies whose accounting systems are not centralized in the Department of Treasury.

Sources: Department of the Treasury and Office of Management and Budget.

In the fiscal year 2004 budget, revenues and other resources of all budgetary funds total $12.689 billion, excluding balances from the previous fiscal year and general obligation bonds authorized. The net increase in General Fund revenues in the fiscal year 2004 budget, as compared to fiscal year 2003 preliminary results, is accounted mainly by increases in corporate income taxes (up $49 million), personal income taxes (up $298 million), excise taxes on motor vehicles and accessories (up $44 million), retained non-resident income tax (up $43 million), federal excise taxes on offshore shipments (up $20 million), excise taxes on alcoholic beverages (up $14 million), excise taxes on cigarettes (up $10 million) and decreases in customs (down $6 million) and tollgate taxes (down $23 million).

Current expenses and capital improvements of all budgetary funds total $13.176 billion, an increase of $575 million from fiscal year 2003. The major changes in General Fund expenditures by program in fiscal year 2004 are: health (up $127.9 million), education (up $106.5 million), debt service on Commonwealth's general obligation and guaranteed debt (up $33.8 million), other debt service, consisting principally of Commonwealth appropriation debt (up $63.2 million), special pension contributions (up $56.6 million), contributions to municipalities (up $7.8 million), transportation and communications (up $6.5 million), public safety and protection (up $5.6 million), welfare (up $3.6 million), housing (up $1.9 million), general government (up $43.2 million) and a decrease in economic development (down $4 million).

Although General Fund expenditures were budgeted at $8.295 billion, actual expenditures are projected to be $8.546 billion, or $251 million higher than originally budgeted. The higher expenditures are expected to be mainly in the areas of education, public safety and protection and health. The government expects, however, to cover any shortfall in the budget from expected reimbursements of certain Federal funds relating to education, transfers to the General Fund from the Budgetary Fund and through a series of other initiatives, among which are measures taken by OMB to reduce expenditures and the refinancing and restructuring of debt of the Commonwealth at lower interest rates.

The general obligation bond authorization for the fiscal year 2004 budget is $540 million.

Fiscal Year 2005 Proposed Budget

On February 25, 2004, the Governor of Puerto Rico submitted a proposed budget for fiscal year 2005 to the Legislature of Puerto Rico. This budget is expected to be approved before June 30, 2005. The following table presents a summary of the Commonwealth's proposed central government budget for the fiscal year ending June 30, 2005.

Commonwealth of Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ending June 30, 2005
(in thousands)

	General Fund	Bond Fund	Special Funds	Total
Revenues from internal sources:				
Property taxes	$ 0	-	$ 109,849	$ 109,849
Personal income taxes	2,865,000	-	-	2,865,000
Retained non-resident income tax	560,000	-	-	560,000
Corporate income taxes	1,935,000	-	-	1,935,000
Partnership income taxes	2,000	-	-	2,000
Tollgate taxes	30,000	-	-	30,000
17% withholding tax on interest	15,000	-	-	15,000
10% withholding tax on dividends	53,000	-	-	53,000
Inheritance and gift taxes	3,000	-	-	3,000
Excise taxes:				
Alcoholic beverages	304,000	-	-	304,000
Motor vehicles and accessories	560,000	-	0	560,000
Cigarettes	150,000	-	-	150,000
Special excise tax on certain products	10,000	-		10,000
General 5% excise tax	598,000	-		598,000
Other	197,000	-	61,400	258,400
Licenses	90,000	-	-	90,000
Miscellaneous non-tax revenues:				
Contributions from lottery fund	70,000	-	-	70,000
Electronic lottery	90,000	-	-	90,000
Registration and document certification fees	208,000	-	-	208,000
Other	130,000	-	279,058	409,058
Total revenues from internal sources	7,870,000	-	450,307	8,320,307
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	350,000	-	-	350,000
Federal grants	0	-	4,022,519	4,022,519
Customs	30,000	-	-	30,000
Total revenues from non-Commonwealth sources	380,000	-	4,022,519	4,402,519
Total revenues	$8,250,000	-	$4,472,826	$12,319,005
Other:				
Other Income	550,000	-	-	550,000
Balance from previous year	-	-	401,008	401,008
Bonds authorized	-	550,000	-	550,000
Total other sources	550,000	550,000	401,008	1,501,008
Total resources	$8,800,000	550,000	$4,873,834	$14,223,834
Appropriations:				
Current expenses:				
General government	800,432	-	51,992	852,424
Education	2,823,242	-	1,097,358	3,920,600
Health	1,431,205	-	456,266	1,887,471
Welfare	427,893	-	2,103,780	2,531,673
Economic development	193,341	-	66,603	259,944
Public safety and protection	1,552,204	-	86,102	1,638,306
Transportation and communications	92,136	-	51,303	143,439
Housing	26,539	-	206,259	232,798
Contributions to municipalities	358,951	-	2,031	360,982
Special pension contributions	239,158	-	0	239,158
Debt service	369,985	-	109,849	479,834
Other debt service	484,914	-	25,000	509,914
Total appropriations-current expenses	8,800,000	-	4,256,543	13,056,543

	General Fund	Bond Fund	Special Funds	Total
Capital improvements	0	550,000	243,199	793,199
Total appropriations	8,800,000	550,000	4,499,742	13,849,742
Year-end balance	0	-	374,092	374,092
Total appropriations and year-end balance	$8,800,000	$550,000	$4,873,834	$14,223,834

(1) Does not include grants received by agencies whose accounting systems are not centralized in the Department of Treasury.

Sources: Department of the Treasury and Office of Management and Budget.

In the proposed fiscal year 2005 budget, revenues and other resources of all funds total $13.273 billion, excluding balances from the previous fiscal year and general obligation bonds authorized. The proposed fiscal year 2005 budget provides for total General Fund resources and appropriations of $8.8 billion, which represents an increase of $505 million, or 6.1%, over fiscal year 2004 budgeted resources of $8.295 billion. Total resources include $8.250 billion of total revenues, which represents an increase of $325 million, or 4.1%, over the fiscal year 2004 estimated revenues of $7.925 billion, and $550 million of additional resources relating to the conversion into cash (through a sale or other transaction with GDB) of certain tax receivables held by the Puerto Rico Treasury Department. The budgeted General Fund revenues for fiscal year 2005 assume a 5.7% nominal growth, or 2.7% real growth, in gross product, and additional revenues of $120 million from proposed tax measures, including a 50% reduction in capital gains rates for fiscal year 2005, a 10% withholding tax on jackpot winnings on casino slot machines, and a withholding tax on interest paid on commercial loans to non-resident lenders. Said measures require the enactment of legislation.

The net increase in General Fund revenues in the fiscal year 2005 proposed budget, as compared to the fiscal year 2004 budgeted revenues, are accounted mainly by corporation income taxes (up $109 million), general 5% excise taxes (up $55 million), personal income taxes (up $49 million), motor vehicles and accessories (up $17 million), federal excise taxes on off-shore shipments (up $20 million), and customs (up $10 million) and decreases in cigarettes (down $9 million) and alcoholic beverages (down $9 million).

Current expenses and capital improvements of all funds total $13.850 billion, an increase of $673.8 million from fiscal year 2004. The major changes in General Fund expenditures by program in fiscal year 2005 are: education (up $270.8 million), public safety and protection (up $157.5 million), special pension contributions (up $52 million), health (up $27.4 million), welfare (up $23.9 million), transportation and communications (up $8.6 million), and housing (up $1.7 million) and decreases in general governmental (down $2.6 million), other debt service (down $2.8 million), contributions to municipalities (down $3.9 million), and debt service (down $38 million).

The general obligation bond authorization for the proposed fiscal year 2005 budget is $550 million.

Differences between Budget and Basic Financial Statements

Revenue and expenditures, as reported by the Department of the Treasury in its Basic Financial Statements, may differ substantially from resources and appropriations in the annual budget for a number of reasons, including the following:

(i) The budgetary accounts are on a cash basis, while financial statements prepared by the Department of the Treasury include accruals and other adjustments as required by government accounting standards.

(ii) Expenditures for current purposes in a particular fiscal year may include amounts appropriated for earlier periods but not previously expended and, conversely, may exclude amounts appropriated for such fiscal year but not expended until later periods.

(iii) Bonds are authorized by the Commonwealth in accordance with a four-year capital improvement program. Since bond sales are determined by bond market conditions and other factors, the amounts of bonds sold for these improvements are financed by advances from the General Fund to the Capital Projects Fund, which are later reimbursed from proceeds of bond or notes sales.

LITIGATION

The Commonwealth is a defendant in numerous legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Act No. 104 of the Legislature of Puerto Rico, approved on June 25, 1955, as amended ("Act No. 104"), persons are authorized to sue the Commonwealth only for causes of actions specified in said Act. The Commonwealth may be liable under Act No. 104 for damages up to a maximum amount of $75,000 or $150,000 if the suit involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Act No. 9 of the Legislature of Puerto Rico, approved on November 26, 1975, as amended ("Act No. 9"), the Commonwealth may provide its officers and employees, including directors of public corporations and government instrumentalities and mayors of the municipalities of the Commonwealth, with legal representation, as well as assume the payment of any judgment that may be entered against them. There is no limitation on the amount of the judgment that may be paid under Act No. 9.

With respect to pending and threatened litigation, as of June 30, 2003, the Commonwealth will include in its financial statements reported liabilities of approximately $70 million for awarded and anticipated unfavorable judgments. This amount represented the amount estimated at the time as a probable liability or a liability with a fixed or expected due date, which would require future available financial resources for its payment. The Commonwealth believes that the ultimate liability in excess of amounts provided in the financial statements, if any, would not be significant.

The Commonwealth is a defendant in two lawsuits filed in local and federal district court by an association of insurance companies seeking to recover from the Commonwealth approximately $74 million of compulsory insurance premiums allegedly belonging to the insurance companies or their policyholders which were transferred by the Secretary of the Treasury to the General Fund. The Commonwealth believes that its ultimate liability, if any, would not be significant.

The Commonwealth is a defendant in a lawsuit alleging violations of civil rights. The amounts claimed approximate $23 million; however, the ultimate liability cannot be presently determined. No provision for any liability that may result upon adjudication of this lawsuit has been recognized in the financial statements by the Commonwealth. The Commonwealth believes that the ultimate liability, if any, would not be significant.

Several officers of the Commonwealth are defendants in a class action lawsuit filed in 1979 in the United States District Court for the District of Puerto Rico by various inmates who alleged that their constitutional rights were being violated because of overcrowding and lack of adequate healthcare in the island's correctional system. In 1980, the United States District Court issued a preliminary injunction and required the defendants to provide additional capacity for the cells of the correctional facilities and to improve the healthcare services available to inmates. Fines in the amount of $280 million have been assessed against the defendants in order to assure compliance with the space and healthcare requirements imposed by the United States District Court. Of the fines imposed, $150 million have already been paid by the Commonwealth.

APPENDIX II

ARS PROVISIONS

Definitions

In addition to the words and terms elsewhere defined in this Official Statement, the following words and terms as used in this Appendix II and elsewhere in this Official Statement have the following meanings with respect to the Series 2004 B Bonds in an ARS Rate Period unless the context or use indicates another or different meaning or intent:

"Agent Member" means a member of, or participant in, the Securities Depository who will act on behalf of a Bidder.

"All Hold Rate" means, as of any Auction Date, 55% of the ARS Index in effect on such Auction Date.

"ARS" means the Series 2004 B Bonds while they bear interest at the ARS Rate.

"ARS Index" has the meaning specified under "ARS Index" of this Appendix II.

"ARS Rate" means for each sub-series of ARS, the rate of interest during each Auction Period determined in accordance with the Bond Resolution as summarized under "Determination of ARS Rate" of this Appendix II; provided, however, in no event may the ARS Rate exceed the Maximum Interest Rate.

"ARS Rate Conversion Date" means with respect to any sub-series of ARS, the date on which the Series 2004 B Bonds of such sub-series convert from an interest rate period other than an ARS Rate Period and begin to bear interest at an ARS Rate.

"ARS Rate Period" means after the Initial Period, any period of time commencing on the day following the Initial Period to but not including a Conversion Date and the period from and including an ARS Rate Conversion Date to but excluding the next Conversion Date.

"Auction" means each periodic implementation of the Auction Procedures.

"Auction Agent" means the auctioneer appointed in accordance with the provisions of the Bond Resolution and will initially be The Bank of New York.

"Auction Agreement" means an agreement between the Auction Agent and the Registrar pursuant to which the Auction Agent agrees to follow the procedures specified in the Bond Resolution with respect to ARS, as such agreement may from time to time be amended or supplemented.

"Auction Date" means, with respect to any sub-series of ARS, (a) if such ARS are in a daily Auction Period, each Business Day, and (b) if such ARS are in any other Auction Period, the last Business Day of such Auction Period, if its is followed by another Auction Period (whether or not an Auction will be conducted on such date). The last Business Day of a Special Auction Period will be the Auction Date for the Auction Period which begins on the next succeeding Business Day, if any. On the Business Day preceding the conversion from a daily Auction Period to another Auction Period, there will be two Auctions, one for the last daily Auction Period and one for the first Auction Period following the conversion. The first Auction Dates for the ARS are set forth on the inside cover page of this Official Statement.

"Auction Period" means with respect to each sub-series of ARS Bonds:

(a) a Special Auction Period;

(b) in a daily Auction Period, a period beginning on each Business Day and extending to but not including the next succeeding Business Day;

(c) in a seven day Auction Period and with Auctions generally conducted on (i) Fridays, a period of generally seven days beginning on a Monday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Sunday) and ending on the Sunday thereafter (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) Mondays, a period of generally seven days beginning on a Tuesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Monday) and ending on the Monday thereafter (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iii) Tuesdays, a period of generally seven days beginning on a Wednesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Tuesday) and ending on the Tuesday thereafter (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iv) Wednesdays, a period of generally seven days beginning on a Thursday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Wednesday) and ending on the Wednesday thereafter (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), and (v) Thursdays, a period of generally seven days beginning on a Friday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Thursday) and ending on the Thursday thereafter (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day);

(d) in a 28-day Auction Period and with Auctions generally conducted on (i) Fridays, a period of generally 28 days beginning on a Monday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Sunday) and ending on the fourth Sunday thereafter (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) Mondays, a period of generally 28 days beginning on a Tuesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Monday) and ending on the fourth Monday thereafter (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iii) Tuesdays, a period of generally 28 days beginning on a Wednesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Tuesday) and ending on the fourth Tuesday thereafter (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iv) Wednesdays, a period of generally 28 days beginning on a Thursday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Wednesday) and ending on the fourth Wednesday thereafter (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), and (v) Thursdays, a period of generally 28 days beginning on a Friday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Thursday) and ending on the fourth Thursday thereafter (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day);

(e) in a 35-day Auction Period and with Auctions generally conducted on (i) Fridays, a period of generally 35 days beginning on a Monday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on Sunday) and ending on the fifth Sunday thereafter (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) Mondays, a period of generally 35 days beginning on a Tuesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on Monday) and ending on the fifth Monday thereafter (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iii) Tuesdays, a period of generally 35 days beginning on a Wednesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on Tuesday) and ending on the fifth Tuesday thereafter (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iv) Wednesdays, a period of generally 35 days beginning on a Thursday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on

Wednesday) and ending on the fifth Wednesday thereafter (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), and (v) Thursdays, a period of generally 35 days beginning on a Friday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on Thursday) and ending on the fifth Thursday thereafter (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day);

(f) in a three-month Auction Period, a period of generally three months (or shorter period upon a conversion from another Auction Period) beginning on the day following the last day of the prior Auction Period and ending on the first day of the month that is the third calendar month following the beginning date of such Auction Period (unless such first day of the month is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day); and

(g) in a six-month Auction Period, a period of generally six months (or shorter period upon a conversion from another Auction Period) beginning on the day following the last day of the prior Auction Period and ending on the next succeeding June 30 or December 31;

provided, however, that

(a) if there is a conversion of a sub-series of ARS with Auctions generally conducted on Fridays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the next succeeding Sunday (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the Sunday (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period or in the case of Series 2004 B-1 Bonds and Series 2004 B-2 Bonds the Business Day immediately following the last day of the prior Auction Period) and will end on the Sunday (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion;

(b) if there is a conversion of a sub-series of ARS with Auctions generally conducted on Mondays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the next succeeding Monday (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the Monday (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period or in the case of Series 2004 B-1 Bonds and Series 2004 B-2 Bonds the Business Day immediately following the last day of the prior Auction Period) and will end on the Monday (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion;

(c) if there is a conversion of a sub-series of ARS with Auctions generally conducted on Tuesdays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the next succeeding Tuesday (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the Tuesday (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period or in the case of Series 2004 B-1 Bonds and Series 2004 B-2 Bonds the Business Day immediately following the last day of the prior Auction Period) and will end on the Tuesday (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion;

(d) if there is a conversion of a sub-series of ARS with Auctions generally conducted on Wednesdays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the next succeeding Wednesday (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the Wednesday (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period or in the case of Series 2004 B-1 Bonds and Series 2004 B-2 Bonds the Business Day immediately following the last day of the prior Auction Period) and will end on the Wednesday (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion; and

(e) if there is a conversion of a sub-series of ARS with Auctions generally conducted on Thursdays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the next succeeding Thursday (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period) and will end on the Thursday (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period will begin on the date of the conversion (i.e., the Interest Payment Date for the prior Auction Period or in the case of Series 2004 B-1 Bonds and Series 2004 B-2 Bonds the Business Day immediately following the last day of the prior Auction Period) and will end on the Thursday (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion.

"Auction Procedures" means the procedures for conducting Auctions during an ARS Rate Period set forth in the Bond Resolution and summarized in this Appendix II.

"Auction Rate" means for each sub-series of ARS for each Auction Period, (a) if Sufficient Clearing Bids exist, the Winning Bid Rate, provided, however, if all of such ARS are the subject of Submitted Hold Orders, the All Hold Rate with respect thereto and (b) if Sufficient Clearing Bids do not exist, the Maximum Interest Rate with respect thereto.

"Available Bonds" means for each sub-series of ARS on each Auction Date, the aggregate principal amount of ARS that are not the subject of Submitted Hold Orders.

"Bid" has the meaning specified in subsection (a) of "Orders by Existing Owners and Potential Owners" of this Appendix II.

"Bidder" means each Existing Owner and Potential Owner who places an Order.

"Broker-Dealer" means any entity that is permitted by law to perform the function required of a Broker-Dealer described in the Bond Resolution that is a member of, or a direct participant in, the Securities Depository, that has been selected by the Commonwealth and that is a party to a Broker-Dealer Agreement with the Auction Agent.

“Broker-Dealer Agreement” means an agreement among the Auction Agent, the Commonwealth and a Broker-Dealer pursuant to which such Broker-Dealer agrees to follow the procedures described in the Bond Resolution, as such agreement may from to time be amended or supplemented.

“Conversion Date” means the date on which a sub-series of ARS convert from one interest rate period to another interest rate period.

“Existing Owner” means a Person who is listed as the owner of ARS in the records of the Auction Agent.

“Hold Order” has the meaning specified in subsection (a) of “Orders by Existing Owners and Potential Owners” of this Appendix II.

“Initial Period” means for each sub-series of ARS the period from the Closing Date to but not including the respective initial Interest Payment Date set forth on the inside front cover of their Official Statement.

“Interest Payment Date” with respect to each sub-series of ARS, means the initial Interest Payment Dates set forth on the inside cover of this Official Statement, and thereafter (a) when used with respect to any Auction Period other than a daily Auction Period or a Special Auction Period, the Business Day immediately following such Auction Period, (b) when used with respect to a daily Auction Period, the first Business Day of the month immediately succeeding such Auction Period, and (c) when used with respect to a Special Auction Period of (i) seven or more but fewer than 183 days, the Business Day immediately following such Special Auction Period, or (ii) more than 182 days, each January 1 and July 1 and on the Business Day immediately following such Special Auction Period, except that with respect to Series 2004 B-1 Bonds and Series 2004 B-2 Bonds in a 35-day Auction Period, Interest Payment Date means each January 1 and July 1 and if any such January 1 or July 1 is not a Business Day, then the next succeeding Business Day.

“LIBOR” means on any date of determination for an Auction Period, the offered rate (rounded up to the next highest one one-thousandth of one percent (0.001%) for deposits in U.S. dollars for a one-month period which appears on the Telerate page 3750 at approximately 11:00 A.M., London time, on such date, or if such date is not a date on which dealings in U.S. dollars are transacted in the London interbank market then on the next preceding day on which such dealings were transacted in such market.

“Maximum Interest Rate” means the lesser of twelve percent (12%) and the maximum rate permitted by applicable law, which on the Closing Date is equal to twelve percent (12%).

“Order” means a Hold Order, Bid or Sell Order.

“Potential Owner” means any Person, including any Existing Owner, who may be interested in acquiring a beneficial interest in ARS in addition to ARS currently owned by such Person, if any.

“Principal Office” means, with respect to the Auction Agent, the office thereof designated in writing to the Commonwealth, the Registrar and each Broker-Dealer.

“Securities Depository” means The Depository Trust Company and its successors and assigns or any other securities depository selected by the Commonwealth which agrees to follow the procedures required to be followed by such securities depository in connection with ARS.

“Sell Order” has the meaning specified in “Orders by Existing Owners and Potential Owners” of this Appendix II.

“Special Auction Period” means, with respect to a sub-series of ARS, (a) any period of 182 days or less which is divisible by seven and begins on an Interest Payment Date or in the case of Series 2004 B-1 Bonds and

Series 2004 B-2 Bonds the Business Day immediately following the last day of the prior Auction Period and ends (i) in the case of any sub-series of ARS with Auctions generally conducted on Fridays, on a Sunday unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day, (ii) in the case of any sub-series of ARS with Auctions generally conducted on Mondays, on a Monday unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day, (iii) in the case of any sub-series of ARS with Auctions generally conducted on Tuesdays, on a Tuesday unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day, (iv) in the case of any sub-series of ARS with Auctions generally conducted on Wednesdays, on a Wednesday unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day, and (v) in the case of any sub-series of ARS with Auctions generally conducted on Thursdays, on a Thursday unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day and (b) any period which is longer than 182 days, which begins on an Interest Payment Date or in the case of Series 2004 B-1 Bonds and Series 2004 B-2 Bonds the Business Day immediately following the last day of the prior Auction Period and ends not later than the final scheduled maturity date of such sub-series of ARS.

"Submission Deadline" means 1:00 p.m., New York City time, on each Auction Date for a sub-series of ARS not in a daily Auction Period and 11:00 a.m., New York City time, on each Auction Date for a sub-series of ARS in a daily Auction Period, or such other time on such date as will be specified from time to time by the Auction Agent pursuant to the Auction Agreement as the time by which Broker-Dealers are required to submit Orders to the Auction Agent.

"Submitted Bid" has the meaning specified in "Determination of ARS Rate" of this Appendix II.

"Submitted Hold Order" has the meaning specified in "Determination of ARS Rate" of this Appendix II.

"Submitted Order" has the meaning specified in "Determination of ARS Rate" of this Appendix II.

"Submitted Sell Order" has the meaning specified in "Determination of ARS Rate" of this Appendix II.

"Sufficient Clearing Bids" means with respect to a sub-series of ARS, an Auction for which the aggregate principal amount of ARS of such sub-series that are the subject of Submitted Bids by Potential Owners in an Auction specifying one or more rates not higher than the Maximum Interest Rate is not less than the aggregate principal amount of ARS of such sub-series that are the subject of Submitted Sell Orders and of Submitted Bids by Existing Owners specifying rates higher than the Maximum Interest Rate.

"Winning Bid Rate" means with respect to a sub-series of ARS, the lowest rate specified in any Submitted Bid for such sub-series which if selected by the Auction Agent in an Auction as the ARS Rate would cause the aggregate principal amount of ARS of such sub-series that are the subject of Submitted Bids specifying a rate not greater than such rate to be not less than the aggregate principal amount of Available Bonds of such sub-series.

Auction Procedures

Orders by Existing Owners and Potential Owners.

(a) Prior to the Submission Deadline on each Auction Date:

(i) each Existing Owner may submit to a Broker-Dealer, in writing or by such other method as will be reasonably acceptable to such Broker-Dealer, information as to:

(A) the principal amount of ARS, if any, held by such Existing Owner which such Existing Owner irrevocably commits to continue to hold for the next succeeding Auction Period without regard to the rate determined by the Auction Procedures for such Auction Period;

(B) the principal amount of ARS, if any, held by such Existing Owner which such Existing Owner irrevocably commits to continue to hold for the next succeeding Auction Period if the rate determined by the Auction Procedures for such Auction Period will not be less than the rate per annum then specified by such Existing Owner (and which such Existing Owner irrevocably offers to sell on the Business Day next succeeding the next Auction Date (or the same day in the case of a daily Auction Period) if the rate determined by the Auction Procedures for the next succeeding Auction Period will be less than the rate per annum then specified by such Existing Owner); and/or

(C) the principal amount of ARS, if any, held by such Existing Owner which such Existing Owner irrevocably offers to sell on the Business Day next succeeding the next Auction Date (or on the same day in the case of a daily Auction Period) without regard to the rate determined by the Auction Procedures for the next succeeding Auction Period.

(ii) for the purpose of implementing the Auctions and thereby to achieve the lowest possible interest rate on ARS, the Broker-Dealers will contact Potential Owners, including Persons that are Existing Owners, to determine the principal amount of ARS, if any, which each such Potential Owner irrevocably offers to purchase if the rate determined by the Auction Procedures for the next succeeding Auction Period is not less than the rate per annum then specified by such Potential Owner.

For the purposes hereof, an Order containing the information referred to in clause (i)(A) above is herein referred to as a "Hold Order," an Order containing the information referred to in clause (i)(B) or (ii) above is herein referred to as a "Bid," and an Order containing the information referred to in clause (i)(C) above is herein referred to as a "Sell Order."

(b)(i) A Bid by an Existing Owner will constitute an irrevocable offer to sell:

(A) the principal amount of ARS specified in such Bid if the rate determined by the Auction Procedures on such Auction Date will be less than the rate specified therein; or

(B) such principal amount or a lesser principal amount of ARS to be determined as described in subsection (a)(v) of the section below entitled "Allocation of ARS" if the rate determined by the Auction Procedures on such Auction Date will be equal to such specified rate; or

(C) a lesser principal amount of ARS to be determined as described in subsection (b)(iv) of the section below entitled "Allocation of ARS" if such specified rate will be higher than the Maximum Interest Rate and Sufficient Clearing Bids do not exist.

(ii) A Sell Order by an Existing Owner will constitute an irrevocable offer to sell:

(A) the principal amount of ARS specified in such Sell Order; or

(B) such principal amount or a lesser principal amount of ARS as described in subsection (b)(iv) of the section below entitled "Allocation of ARS" if Sufficient Clearing Bids do not exist.

(iii) A Bid by a Potential Owner will constitute an irrevocable offer to purchase:

(A) the principal amount of ARS specified in such Bid if the rate determined by the Auction Procedures on such Auction Date will be higher than the rate specified therein; or

(B) such principal amount or a lesser principal amount of ARS as described in subsection (a)(vi) of the section below entitled "Allocation of ARS" if the rate determined by the Auction Procedures on such Auction Date will be equal to such specified rate.

(c) Anything herein to the contrary notwithstanding:

(i) for purposes of any Auction, any Order which specifies ARS to be held, purchased or sold in a principal amount which is not $25,000 or an integral multiple thereof will be rounded down to the nearest $25,000, and the Auction Agent will conduct the Auction Procedures as if such Order had been submitted in such lower amount;

(ii) for purposes of any Auction other than during a daily Auction Period, any portion of an Order of an Existing Owner which relates to an ARS which has been called for redemption on or prior to the Business Day immediately succeeding the Auction Date next succeeding such Auction will be invalid with respect to such portion and the Auction Agent will conduct the Auction Procedures as if such portion of such Order had not been submitted; and

(iii) for purposes of any Auction other than during a daily Auction Period, no portion of an ARS which has been called for redemption on or prior to the Business Day immediately succeeding the Auction Date next succeeding such Auction will be included in the calculation of Available Bonds for such Auction.

Submission of Orders by Broker-Dealers to Auction Agent.

(a) Each Broker-Dealer will submit to the Auction Agent in writing or by such other method as will be reasonably acceptable to the Auction Agent, including such electronic communication acceptable to the parties, prior to the Submission Deadline on each Auction Date, all Orders obtained by such Broker-Dealer and, if requested, specifying with respect to each Order:

(i) the name of the Bidder placing such Order;

(ii) the aggregate principal amount of ARS of each sub-series, if any, that are the subject of such Order;

(iii) to the extent that such Bidder is an Existing Owner:

(A) the principal amount of ARS of each sub-series, if any, subject to any Hold Order placed by such Existing Owner;

(B) the principal amount of ARS of each sub-series, if any, subject to any Bid placed by such Existing Owner and the rate specified in such Bid; and

(C) the principal amount of ARS of each sub-series, if any, subject to any Sell Order placed by such Existing Owner.

(iv) to the extent such Bidder is a Potential Owner, the rate specified in such Bid.

(b) If any rate specified in any Bid contains more than three figures to the right of the decimal point, the Auction Agent will round such rate up to the next highest one thousandth of one percent (0.001%).

(c) If an Order or Orders covering all of the ARS of a particular sub-series held by an Existing Owner is not submitted to the Auction Agent prior to the Submission Deadline, the Auction Agent will deem a Hold Order to have been submitted on behalf of such Existing Owner covering the principal amount of ARS of such sub-series held by such Existing Owner and not subject to Orders submitted to the Auction Agent; provided, however, that if there is a conversion from one Auction Period to another Auction Period and Orders have not been submitted to the Auction Agent prior to the Submission Deadline covering the aggregate principal amount of ARS of such sub-series to be converted held by such Existing Owner, the Auction Agent will deem a Sell Order to have been submitted on behalf of such Existing Owner covering the principal amount of ARS of such sub-series to be converted held by such Existing Owner not subject to Orders submitted to the Auction Agent.

(d) If one or more Orders covering in the aggregate more than the principal amount of Outstanding ARS of a sub-series held by any Existing Owner are submitted to the Auction Agent, such Orders will be considered valid as follows:

(i) all Hold Orders will be considered Hold Orders, but only up to and including in the aggregate the principal amount of ARS of such sub-series held by such Existing Owner;

(ii) (A) any Bid of an Existing Owner will be considered valid as a Bid of an Existing Owner up to and including the excess of the principal amount of ARS of such sub-series held by such Existing Owner over the principal amount of ARS of such sub-series subject to Hold Orders referred to in paragraph (i) above;

(B) subject to clause (A) above, all Bids of an Existing Owner with the same rate will be aggregated and considered a single Bid of an Existing Owner up to and including the excess of the principal amount of ARS of such sub-series held by such Existing Owner over the principal amount of ARS of such sub-series held by such Existing Owner subject to Hold Orders referred to in paragraph (i) above;

(C) subject to clause (A) above, if more than one Bid with different rates is submitted on behalf of such Existing Owner, such Bids will be considered Bids of an Existing Owner in the ascending order of their respective rates up to the amount of the excess of the principal amount of ARS of such sub-series held by such Existing Owner over the principal amount of ARS of such sub-series held by such Existing Owner subject to Hold Orders referred to in paragraph (i) above; and

(D) the principal amount, if any, of such ARS of such sub-series subject to Bids not considered to be Bids of an Existing Owner under this paragraph (ii) will be treated as the subject of a Bid by a Potential Owner.

(iii) all Sell Orders will be considered Sell Orders, but only up to and including a principal amount of ARS of such sub-series equal to the excess of the principal amount of ARS of such sub-series held by such Existing Owner over the sum of the principal amount of ARS considered to be subject to Hold Orders pursuant to paragraph (i) above and the principal amount of ARS of such sub-series considered to be subject to Bids of such Existing Owner pursuant to paragraph (ii) above.

(e) If more than one Bid is submitted on behalf of any Potential Owner, each Bid submitted with the same rate will be aggregated and considered a single Bid and each Bid submitted with a different rate will be considered a separate Bid with the rate and the principal amount of ARS specified therein.

(f) Neither the Commonwealth, the Registrar nor the Auction Agent will be responsible for the failure of any Broker-Dealer to submit an Order to the Auction Agent on behalf of any Existing Owner or Potential Owner.

Determination of ARS Rate.

(a) Not later than 9:30 a.m., New York City time, on each Auction Date for each sub-series of ARS, the Auction Agent will advise the Broker-Dealers and the Registrar by telephone or other electronic communication acceptable to the parties of the All Hold Rate, the Maximum Interest Rate and the ARS Index for such ARS.

(b) Promptly after the Submission Deadline on each Auction Date for each sub-series of ARS, the Auction Agent will assemble all Orders submitted or deemed submitted to it by the Broker-Dealers (each such Order as submitted or deemed submitted by a Broker-Dealer being hereinafter referred to as a "Submitted Hold Order," a "Submitted Bid" or a "Submitted Sell Order," as the case may be, and collectively as a "Submitted Order") and will determine (i) the Available Bonds, (ii) whether there are Sufficient Clearing Bids, and (iii) the Auction Rate.

(c) Promptly after the Auction Agent has made the determinations pursuant to subsection (b) above, the Auction Agent will advise the Registrar by telephone (promptly confirmed in writing), telex or facsimile transmission or other electronic communication acceptable to the parties of the Auction Rate for the next succeeding Auction Period and the Registrar will promptly notify the Securities Depository of such Auction Rate.

(d) In the event the Auction Agent fails to calculate or, for any reason, fails to provide the Auction Rate for any Auction Period, (i) if the preceding Auction Period was a period of 35 days or less, the new Auction Period will be the same as the preceding Auction Period and the ARS Rate for the new Auction Period will be the same as the ARS Rate for the preceding Auction Period, and (ii) if the preceding Auction Period was a period of greater than 35 days, the preceding Auction Period will be extended to the seventh day following the day that would have been the last day of such Auction Period had it not been extended (or if such seventh day is not followed by a Business Day then to the next succeeding day which is followed by a Business Day) and the ARS Rate in effect for the preceding Auction Period will continue in effect for the Auction Period as so extended. In the event an Auction Period is extended as set forth in clause (ii) of the preceding sentence, an Auction shall be held on the last Business Day of the Auction Period as so extended to take effect for an Auction Period beginning on the Business Day immediately following the last day of the Auction Period as extended which Auction Period will end on the date it would otherwise have ended on had the prior Auction Period not been extended.

(e) In the event of a failed conversion with respect to ARS to a Daily Rate Period, a Weekly Rate Period, a Term Rate Period, a Commercial Paper Rate Period or a Fixed Rate Period, or in the event of a failure to change the length of the current Auction Period due to the lack of Sufficient Clearing Bids at the Auction on the Auction Date for the first new Auction Period, the ARS Rate for the next Auction Period will be the Maximum Interest Rate and the Auction Period will be a seven-day Auction Period.

(f) If the ARS are not rated or if the ARS are no longer maintained in book-entry-only form by the Securities Depository, then the ARS Rate will be the Maximum Interest Rate.

(g) If the fees of any Broker-Dealer are not paid, the Trustee shall notify the Auction Agent of such failure, and the ARS Rate for the next Auction Period will be the Maximum Interest Rate.

Allocation of ARS.

(a) In the event of Sufficient Clearing Bids for a sub-series of ARS, subject to the further provisions of subsections (c) and (d) below, Submitted Orders for such sub-series will be accepted or rejected as follows in the following order of priority:

(i) the Submitted Hold Order of each Existing Owner will be accepted, thus requiring each such Existing Owner to continue to hold the ARS that are the subject of such Submitted Hold Order;

(ii) the Submitted Sell Order of each Existing Owner will be accepted and the Submitted Bid of each Existing Owner specifying any rate that is higher than the Winning Bid Rate will be rejected, thus requiring each such Existing Owner to sell the ARS that are the subject of such Submitted Sell Order or Submitted Bid;

(iii) the Submitted Bid of each Existing Owner specifying any rate that is lower than the Winning Bid Rate will be accepted, thus requiring each such Existing Owner to continue to hold the ARS that are the subject of such Submitted Bid;

(iv) the Submitted Bid of each Potential Owner specifying any rate that is lower than the Winning Bid Rate will be accepted, thus requiring each such Potential Owner to purchase the ARS that are the subject of such Submitted Bid;

(v) the Submitted Bid of each Existing Owner specifying a rate that is equal to the Winning Bid Rate will be accepted, thus requiring each such Existing Owner to continue to hold the ARS that are the subject of such Submitted Bid, but only up to and including the principal amount of ARS obtained by multiplying (A) the aggregate principal amount of Outstanding ARS which are not the subject of Submitted Hold Orders described in paragraph (i) above or of Submitted Bids described in paragraphs (iii) or (iv) above by (B) a fraction the numerator of which will be the principal amount of Outstanding ARS held by such Existing Owner subject to such Submitted Bid and the denominator of which will be the aggregate principal amount of Outstanding ARS subject to such Submitted Bids made by all such Existing Owners that specified a rate equal to the Winning Bid Rate, and the remainder, if any, of such Submitted Bid will be rejected, thus requiring each such Existing Owner to sell any excess amount of ARS;

(vi) the Submitted Bid of each Potential Owner specifying a rate that is equal to the Winning Bid Rate will be accepted, thus requiring each such Potential Owner to purchase the ARS that are the subject of such Submitted Bid, but only in an amount equal to the principal amount of ARS obtained by multiplying (A) the aggregate principal amount of Outstanding ARS which are not the subject of Submitted Hold Orders described in paragraph (i) above or of Submitted Bids described in paragraphs (iii), (iv) or (v) above by (B) a fraction the numerator of which will be the principal amount of Outstanding ARS subject to such Submitted Bid and the denominator of which will be the sum of the aggregate principal amount of Outstanding ARS subject to such Submitted Bids made by all such Potential Owners that specified a rate equal to the Winning Bid Rate, and the remainder of such Submitted Bid will be rejected; and

(vii) the Submitted Bid of each Potential Owner specifying any rate that is higher than the Winning Bid Rate will be rejected.

(b) In the event there are not Sufficient Clearing Bids for a sub-series of ARS, subject to the further provisions of subsections (c) and (d) below, Submitted Orders, for each sub-series of ARS will be accepted or rejected as follows in the following order of priority:

(i) the Submitted Hold Order of each Existing Owner will be accepted, thus requiring each such Existing Owner to continue to hold the ARS that are the subject of such Submitted Hold Order;

(ii) the Submitted Bid of each Existing Owner specifying any rate that is not higher than the Maximum Interest Rate will be accepted, thus requiring each such Existing Owner to continue to hold the ARS that are the subject of such Submitted Bid;

(iii) the Submitted Bid of each Potential Owner specifying any rate that is not higher than the Maximum Interest Rate will be accepted, thus requiring each such Potential Owner to purchase the ARS that are the subject of such Submitted Bid;

(iv) the Submitted Sell Orders of each Existing Owner will be accepted as Submitted Sell Orders and the Submitted Bids of each Existing Owner specifying any rate that is higher than the Maximum Interest Rate will be deemed to be and will be accepted as Submitted Sell Orders, in both cases only up to and including the principal amount of ARS obtained by multiplying (A) the aggregate principal amount of ARS subject to Submitted Bids described in paragraph (iii) of this subsection (b) by (B) a fraction the numerator of which will be the principal amount of Outstanding ARS held by such Existing Owner subject to such Submitted Sell Order or such Submitted Bid deemed to be a Submitted Sell Order and the denominator of which will be the principal amount of Outstanding ARS subject to all such Submitted Sell Orders and such Submitted Bids deemed to be Submitted Sell Orders, and the remainder of each such Submitted Sell Order or Submitted Bid will be deemed to be and will be accepted as a Hold Order and each such Existing Owner will be required to continue to hold such excess amount of ARS; and

(v) the Submitted Bid of each Potential Owner specifying any rate that is higher than the Maximum Interest Rate will be rejected.

(c) If, as a result of the procedures described in subsection (a) or (b) above, any Existing Owner or Potential Owner would be required to purchase or sell an aggregate principal amount of ARS which is not an integral multiple of $25,000 on any Auction Date, the Auction Agent will by lot, in such manner as it will determine in its sole discretion, round up or down the principal amount of ARS to be purchased or sold by any Existing Owner or Potential Owner on such Auction Date so that the aggregate principal amount of ARS purchased or sold by each Existing Owner or Potential Owner on such Auction Date will be an integral multiple of $25,000, even if such allocation results in one or more of such Existing Owners or Potential Owners not purchasing or selling any ARS on such Auction Date.

(d) If, as a result of the procedures described in subsection (a) above, any Potential Owner would be required to purchase less than $25,000 in principal amount of ARS on any Auction Date, the Auction Agent will by lot, in such manner as it will determine in its sole discretion, allocate ARS for purchase among Potential Owners so that the principal amount of ARS purchased on such Auction Date by any Potential Owner will be an integral multiple of $25,000, even if such allocation results in one or more of such Potential Owners not purchasing ARS on such Auction Date.

Notice of ARS Rate.

(a) On each Auction Date, the Auction Agent will notify by telephone or other telecommunication device or other electronic communication acceptable to the parties or in writing each Broker-Dealer that participated in the Auction held on such Auction Date of the following with respect to each sub-series of ARS for which an Auction was held on such Auction Date:

(i) the ARS Rate determined on such Auction Date for the succeeding Auction Period;

(ii) whether Sufficient Clearing Bids existed for the determination of the Winning Bid Rate;

(iii) if such Broker-Dealer submitted a Bid or a Sell Order on behalf of an Existing Owner, whether such Bid or Sell Order was accepted or rejected and the principal amount of ARS, if any, to be sold by such Existing Owner;

(iv) if such Broker-Dealer submitted a Bid on behalf of a Potential Owner, whether such Bid was accepted or rejected and the principal amount of ARS, if any, to be purchased by such Potential Owner;

(v) if the aggregate principal amount of ARS to be sold by all Existing Owners on whose behalf such Broker-Dealer submitted Bids or Sell Orders is different from the aggregate principal amount of ARS to be purchased by all Potential Owners on whose behalf such Broker-Dealer submitted a Bid, the name or names of one or more Broker-Dealers (and the Agent Member, if any, of each such other Broker Dealer) and the principal amount of ARS to be (A) purchased from one or more Existing Owners on whose behalf such other Broker-Dealers submitted Bids or Sell Orders or (B) sold to one or more Potential Owners on whose behalf such Broker-Dealer submitted Bids; and

(vi) the immediately succeeding Auction Date.

(b) On each Auction Date, with respect to each sub-series of ARS for which an Auction was held on such Auction Date, each Broker-Dealer that submitted an Order on behalf of any Existing Owner or Potential Owner will: (i) advise each Existing Owner and Potential Owner on whose behalf such Broker-Dealer submitted an Order as to (A) the ARS Rate determined on such Auction Date, (B) whether any Bid or Sell Order submitted on behalf of each such Owner was accepted or rejected and (C) the immediately succeeding Auction Date; (ii) instruct each Potential Owner on whose behalf such Broker-Dealer submitted a Bid that was accepted, in whole or in part, to instruct such Existing Owner's Agent Member to pay to such Broker-Dealer (or its Agent Member) through the Securities Depository the amount necessary to purchase the principal amount of ARS to be purchased pursuant to such Bid (including, with respect to ARS in a daily Auction Period, and Series 2004 B-1 Bonds and Series 2004 B-2 Bonds in a 35-day Auction Period, accrued interest if the purchase date is not an Interest Payment Date for such Bond) against receipt of such ARS; and (iii) instruct each Existing Owner on whose behalf such Broker-Dealer submitted a Sell Order that was accepted or a Bid that was rejected, in whole or in part, to instruct such Existing Owner's Agent Member to deliver to such Broker-Dealer (or its Agent Member) through the Securities Depository the principal amount of ARS to be sold pursuant to such Bid or Sell Order against payment therefor.

ARS Index.

(a) The ARS Index is LIBOR.

(b) If for any reason on any Auction Date the ARS Index will not be determined as hereinabove provided in this Section, the ARS Index will be the ARS Index for the Auction Period ending on such Auction Date.

(c) The determination of the ARS Index as provided herein will be conclusive and binding upon the Commonwealth, the Registrar, the Broker-Dealers, the Auction Agent and the Owners of ARS.

Miscellaneous Provisions Regarding Auctions.

(a) In this Appendix II, each reference to the purchase, sale or holding of "ARS" will refer to beneficial interests in ARS, unless the context clearly requires otherwise.

(b) During an ARS Rate Period with respect to ARS, the provisions of the Bond Resolution and the definitions contained therein and described in this Appendix II, including without limitation the definitions Maximum Interest Rate, All Hold Rate, ARS Index, Interest Payment Date, and the ARS Rate, may be amended pursuant to the Bond Resolution, by obtaining the consent of the owners of all Outstanding ARS bearing interest at an ARS Rate as follows. If on the first Auction Date occurring at least 20 days after the date on which the Registrar mailed notice of such proposed amendment to the registered owners of the Outstanding ARS as required by the Bond Resolution, (i) the ARS Rate which is determined on such date is the Winning Bid Rate and (ii) there is delivered to the Commonwealth and the Registrar an Opinion of Bond Counsel to the effect that such amendment will not adversely affect the validity of ARS or any exemption from federal income tax to which the interest on ARS would otherwise be entitled, the proposed amendment will be deemed to have been consented to by the owners of all affected Outstanding ARS bearing interest at an ARS Rate of such Series.

(c) If the Securities Depository notifies the Commonwealth that it is unwilling or unable to continue as owner of ARS or if at any time the Securities Depository will no longer be registered or in good standing under the Securities Exchange Act of 1934, as amended, or other applicable statute or regulation and a successor to the Securities Depository is not appointed by the Commonwealth within 90 days after the Commonwealth receives notice or becomes aware of such condition, as the case may be, the Commonwealth will execute and the Registrar will authenticate and deliver certificates representing ARS. Such Series 2004 B Bonds will be registered in such names and authorized denominations as the Securities Depository, pursuant to instructions from the Agent Members or otherwise, will instruct the Commonwealth and the Registrar.

During an ARS Rate Period, so long as the ownership of ARS is maintained in book-entry form by the Securities Depository, an Existing Owner or a beneficial owner may sell, transfer or otherwise dispose of an ARS only pursuant to a Bid or Sell Order in accordance with the Auction Procedures or to or through a Broker-Dealer, provided that (i) in the case of all transfers other than pursuant to Auctions such Existing Owner or its Broker-Dealer or its Agent Member advises the Auction Agent of such transfer and (ii) a sale, transfer or other disposition of the ARS from a customer of a Broker-Dealer who is listed on the records of that Broker-Dealer as the holder of such ARS to that Broker-Dealer or another customer of that Broker-Dealer will not be deemed to be a sale, transfer or other disposition for purposes of this paragraph if such Broker-Dealer remains the Existing Owner of ARS so sold, transferred or disposed of immediately after such sale, transfer or disposition.

Changes in Auction Period or Auction Date.

(a) <u>Changes in Auction Period</u>. (i) During any ARS Rate Period, the Commonwealth may, from time to time on the Business Day immediately following the last day of an Auction Period, change the length of the Auction Period with respect to all of the ARS of any sub-series in an ARS Rate Period to daily, seven days, 28 days, 35 days, three months, six months and a Special Auction Period in order to accommodate economic and financial factors that may affect or be relevant to the length of the Auction Period and the interest rate borne by such ARS; provided, however, in the case of a change from a Special Auction Period, the date of such change will be the Business Day immediately following the last day of such Special Auction Period. The Commonwealth will initiate the change in the length of the Auction Period by giving written notice to the Registrar, the Bond Insurer for such sub-series, the Auction Agent, the Broker-Dealers and the Securities Depository that the Auction Period will change if the conditions described herein are satisfied and the proposed effective date of the change, at least 10 Business Days prior to the Auction Date for such Auction Period.

(ii) Any such changed Auction Period will be for a period of one day, seven days, 28 days, 35 days, three months, six months or a Special Auction Period and will be for all of the ARS of a sub-series in a particular ARS Rate Period.

(iii) The change in the length of the Auction Period for any sub-series of ARS will not be allowed unless Sufficient Clearing Bids existed at both the Auction before the date on which the notice of the proposed change was given as provided in this subsection (a) and the Auction immediately preceding the proposed change.

(iv) The change in length of the Auction Period for any sub-series of ARS will take effect only if (A) the Registrar and the Auction Agent receive, by 11:00 a.m., New York City time, on the Business Day before the Auction Date for the first such Auction Period, a certificate from the Commonwealth consenting to the change in the length of the Auction Period specified in such certificate and (B) Sufficient Clearing Bids exist at the Auction on the Auction Date for such first Auction Period. For purposes of the Auction for such first Auction Period only, each Existing Owner will be deemed to have submitted Sell Orders with respect to all of its ARS except to the extent such Existing Owner submits an Order with respect to such ARS. If the condition referred to in (A) above is not met, the Auction Rate for the next Auction Period will be determined pursuant to the Auction Procedures and the Auction Period will be the Auction Period determined without reference to the proposed change. If the condition referred to in (A) is met but the condition referred to in (B) above is not met, the Auction Rate for the next Auction Period will be the Maximum Interest Rate and the Auction Period will be a seven-day Auction Period.

(v) On the conversion date for ARS selected for conversion from one Auction Period to another, any applicable ARS which are not the subject of a specific Hold Order or Bid will be deemed to be subject to a Sell Order.

(b) Changes in Auction Date. During any ARS Rate Period, the Auction Agent, with the written consent of the Commonwealth, may specify an earlier Auction Date for any sub-series (but in no event more than five Business Days earlier) than the Auction Date that would otherwise be determined in accordance with the definition of "Auction Date" in order to conform with then current market practice with respect to similar securities or to accommodate economic and financial factors that may affect or be relevant to the day of the week constituting an Auction Date and the interest rate borne on such ARS. The Auction Agent will provide notice of its determination to specify an earlier Auction Date for an Auction Period by means of a written notice delivered at least 45 days prior to the proposed changed Auction Date to the Registrar, the Commonwealth, the Broker-Dealers and the Securities Depository. In the event the Auction Agent specifies an earlier Auction Date, the days of the week on which an Auction Period begins and ends, the day of the week on which a Special Auction Period ends and the Interest Payment Date relating to a Special Auction Period will be adjusted accordingly.

Conversions from ARS Rate Periods.

At the option of the Commonwealth, all of a sub-series of ARS may be converted from an ARS Rate Period to a Daily Rate Period, a Weekly Rate Period, a Commercial Paper Rate Period, a Term Rate Period or a Fixed Rate Period, as follows:

(i) The Conversion Date will be the Business Day immediately following the final Auction Period.

(ii) The Commonwealth will give written notice of any such conversion to the Bond Insurer for such sub-series, the Registrar, the Auction Agent, the Remarketing Agent, if any, and the Broker-Dealer not less than seven (7) Business Days prior to the date on which the Registrar is required to notify the Bondholders of the conversion pursuant to subparagraph (iii) below. Such notice will specify the proposed Conversion Date and the new rate period. Together with such notice, the Commonwealth will file with the Bond Insurer for such sub-series and the Registrar an Opinion of Bond Counsel to the effect that the proposed conversion of ARS will not adversely affect the validity of the Series 2004 B Bonds or any exemption from federal income taxation to which interest on the Series 2004 B Bonds would otherwise be entitled. No conversion will become effective unless the Commonwealth will also file with the Bond Insurer for such sub-series and the Registrar, such an Opinion of Bond Counsel dated the Conversion Date.

(iii) Not less than twenty (20) days prior to the Conversion Date, the Registrar will mail a written notice of the conversion to the holders of all ARS to be converted, specifying the Conversion Date and setting forth the matters required to be stated pursuant to the Bond Resolution with respect to purchases of ARS.

(iv) If on a Conversion Date any condition precedent to such conversion required under the Bond Resolution is not satisfied, the Registrar will give written notice by first class mail postage prepaid as soon as practicable and in any event not later than the next succeeding Business Day to the Holders of the applicable ARS, the Commonwealth and the Bond Insurer for such sub-series that such conversion has not occurred, that the ARS will not be purchased on the failed Conversion Date, that the Auction Agent will continue to implement the Auction Procedures on the Auction Dates with respect to the ARS which otherwise would have been converted excluding however, the Auction Date falling on the Business Day next preceding the failed Conversion Date, and that the interest rate will continue to be the ARS Rate; provided, however, that the interest rate borne by the ARS during the Auction Period commencing on such failed Conversion Date will be the Maximum Interest Rate, and the Auction Period will be the seven-day Auction Period.

(v) Except for conversions to a Term Rate Period or a Fixed Rate Period, a Liquidity Facility meeting the requirements of the Bond Resolution is effective.

Auction Agent

Auction Agent.

(a) The Auction Agent will be appointed by the Registrar at the written direction of the Commonwealth, to perform the functions specified in the Bond Resolution. The Auction Agent will designate its Principal Office and signify its acceptance of the duties and obligations imposed upon it under the Bond Resolution by a written instrument, delivered to the Commonwealth, the Registrar and each Broker-Dealer which will set forth such procedural and other matters relating to the implementation of the Auction Procedures as will be satisfactory to the Commonwealth and the Registrar.

(b) Subject to any applicable governmental restrictions, the Auction Agent may be or become the owner of or trade in the ARS with the same rights as if such entity were not the Auction Agent.

Qualifications of Auction Agent; Resignation; Removal. The Auction Agent will be (a) a bank or trust company organized under the laws of the United States or any state or territory thereof having a combined capital stock, surplus and undivided profits of at least $30,000,000, or (b) a member of NASD having a capitalization of at least $30,000,000 and, in either case, authorized by law to perform all the duties imposed upon it by the Bond Resolution and a member of or a participant in, the Securities Depository. The Auction Agent may at any time resign and be discharged of the duties and obligations created by the Bond Resolution by giving at least ninety (90) days notice to the Commonwealth, the Bond Insurers and the Registrar. The Auction Agent may be removed at any time by the Commonwealth by written notice, delivered to the Auction Agent, the Commonwealth, the Bond Insurers and the Registrar. Upon any such resignation or removal, the Registrar will appoint a successor Auction Agent meeting the requirements of this paragraph. In the event of the resignation or removal of the Auction Agent, the Auction Agent will pay over, assign and deliver any moneys and ARS held by it in such capacity to its successor. The Auction Agent will continue to perform its duties until its successor has been appointed by the Registrar. In the event that the Auction Agent has not been compensated for its services, the Auction Agent may resign by giving thirty (30) days notice to the Commonwealth and the Registrar even if a successor Auction Agent has not been appointed.

SIDLEY AUSTIN BROWN & WOOD LLP

787 SEVENTH AVENUE
NEW YORK, NEW YORK 10019
TELEPHONE 212 839 5300
FACSIMILE 212 839 5599
www.sidley.com

FOUNDED 1866

BEIJING
BRUSSELS
CHICAGO
DALLAS
GENEVA
HONG KONG
LONDON

LOS ANGELES
NEW YORK
SAN FRANCISCO
SHANGHAI
SINGAPORE
TOKYO
WASHINGTON, D.C.

May __, 2004

Hon. Juan A. Flores Galarza
Secretary of the Treasury of Puerto Rico
San Juan, Puerto Rico

Dear Sir:

We have examined Act. No. 2 of the Legislature of Puerto Rico, approved October 10, 1985, and Joint Resolution No. 57 of the Legislature of Puerto Rico, approved July 12, 1993 (collectively, the "Act"), and certified copies of the legal proceedings, including a resolution adopted by the Secretary of the Treasury of the Commonwealth of Puerto Rico and approved by the Governor of the Commonwealth of Puerto Rico on April 30, 2004 (the "Resolution"), and other proofs submitted relative to the issuance and sale of the following described bonds (the "Bonds"):

$727,115,000
COMMONWEALTH OF PUERTO RICO

$279,240,000 PUBLIC IMPROVEMENT REFUNDING BONDS, SERIES 2004 A

and

$447,875,000 PUBLIC IMPROVEMENT REFUNDING BONDS, SERIES 2004 B

Dated: Date of Delivery.

Maturing on the dates and in such principal amounts and bearing interest at the rates, all as set forth in the Resolution. The Bonds are issuable as registered Bonds without coupons in the manner and in accordance with the terms and conditions of the Resolution. The Bonds are subject to redemption and tender for purchase as set forth in the Resolution.

We have also examined one of the Bonds as executed and authenticated.

From such examination we are of the opinion that:

1. The Act is valid.

2. Said proceedings have been validly and legally taken.

3. The Act and said proceedings and proofs show lawful authority for the issuance and sale of the Bonds, and the Bonds constitute valid and binding general obligations of the Commonwealth of Puerto Rico for the prompt payment of the principal of and the interest on which the good faith, credit and taxing power of the Commonwealth of Puerto Rico are pledged.

4. Under the provisions of the Acts of Congress now in force and under existing regulations, rulings and court decisions, (i) subject to continuing compliance with the covenants referred to below and requirements of the Internal Revenue Code of 1986, as amended (the "Code"), regarding the use, expenditure and investment of bond proceeds and the timely payment of certain investment earnings to the Treasury of the United States, if required, interest on the Bonds is not includable in gross income for federal income tax purposes; and (ii) the Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation. No opinion is expressed as to the effect of any action taken or not taken after the date of this opinion without our approval (except for such action or omission to act as is provided in the documents pertaining to the Bonds) or in reliance upon advice of counsel other than ourselves on the exclusion from gross income of the interest on said Bonds for federal income tax purposes.

Interest on the Bonds is not a specific item of tax preference for the purposes of the federal alternative minimum tax imposed on individuals and corporations. Interest on the Bonds is, however, includable in the computation of the alternative minimum tax on corporations imposed by the Code. The Code contains other provisions that could result in tax consequences, upon which we express no opinion, as a result of (a) ownership of Bonds or (b) the inclusion in certain computations (including, without limitation, those related to the corporate alternate minimum tax) of interest that is excluded from gross income.

On May 12, 2004, Puerto Rico Public Buildings Authority (the "Authority") entered into a bond purchase agreement with respect to certain bonds the interest on which will not be includable in gross income for federal income tax purposes. The Bonds and such Authority tax-exempt bonds will, if such Authority tax-exempt bonds are delivered to investors, be a single issue of bonds for federal income tax purposes (the "Combined Bond Issue"). In the event that there is a Combined Bond Issue, both the Commonwealth of Puerto Rico and the Authority must comply with the above requirements under the Code with respect to the Combined Bond Issue. A failure to satisfy such requirements by either the Commonwealth of Puerto Rico or the Authority may cause interest on the Bonds to be included in gross income for federal income tax purposes retroactive to their date of issuance. The Commonwealth of Puerto Rico has covenanted to comply, to the extent permitted by the Constitution and the laws of the Commonwealth of Puerto Rico, with the requirements of the Code in order to maintain the exclusion from gross income for federal income tax purposes of interest on the Bonds. The Authority will covenant in the event of a Combined Bond Issue to comply, to the extent permitted by the Constitution and the laws of the Commonwealth of Puerto Rico, with the requirements of the Code in order to maintain the exclusion from gross income for federal income tax purposes of interest on the Bonds. We are not aware of any provisions of the Constitution or laws of the Commonwealth of Puerto Rico which would prevent the Commonwealth of Puerto Rico or the Authority from complying with the requirements of the Code.

Respectfully submitted,

[To be signed, "Sidley Austin Brown & Wood LLP"]

APPENDIX IV

CDC IXIS Financial Guaranty North America, Inc.
825 Third Avenue, Sixth Floor
New York, NY 10022
For information, contact (212) 909-3939
Toll-free (866) 243-4212

FINANCIAL GUARANTY INSURANCE POLICY

ISSUER: Policy No.: CIFGNA-#

CUSIP: Effective Date:

OBLIGATIONS:

CDC IXIS FINANCIAL GUARANTY NORTH AMERICA, INC. ("CIFGNA"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY GUARANTEES to each Policyholder, subject only to the terms and conditions of this Policy (which includes each endorsement hereto), the full and complete payment by or on behalf of the Issuer of Regular Payments of principal of and interest on the Obligations.

For the further protection of each Policyholder, CIFGNA irrevocably and unconditionally guarantees:

(1) payment of any amount required to be paid under this Policy by CIFGNA following CIFGNA's receipt of notice and instruments of assignment as described in Endorsement No. 1 hereto and

(2) payment of the amount of any distribution of principal of and interest on the Obligations made during the Term of this Policy to such Policyholder that is subsequently avoided in whole or in part as a preference payment under applicable law (such payment to be made by CIFGNA in accordance with Endorsement No. 1 hereto).

CIFGNA shall be subrogated to the rights of each Policyholder to receive payments under the Obligations to the extent of any payment by CIFGNA hereunder. Upon disbursement in respect of an Obligation, CIFGNA shall become the owner of the Obligation, appurtenant coupon, if any, and all rights to payment of principal thereof or interest thereon.

The following terms shall have the meanings specified below, subject to and including any modifications set forth in any endorsement hereto, for all purposes of this Policy. "Policyholder" means, if the Obligations are in book-entry form, the registered owner of any Obligation as indicated on the registration books maintained by or on behalf of the Issuer for such purpose or, if the Obligations are in bearer form, the holder of any Obligation; *provided, however, that* any trustee acting on behalf of and for the benefit of such registered owner or holder shall be deemed to be the Policyholder to the extent of such trustee's authority. "Regular Payments" means payments of interest and principal which are agreed to be made during the Term of this Policy in accordance with the original terms of the Obligations when issued and without regard to any amendment or modification of such Obligations thereafter; payments which become due on an accelerated basis as a result of (a) a default by the Issuer or any other person, (b) an election by the Issuer to pay principal or other amounts on an accelerated basis or (c) any other cause, shall not constitute "Regular Payments" unless CIFGNA shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration. "Term of this Policy" shall have the meaning set forth in Endorsement No. 1 hereto.

This Policy sets forth in full the undertaking of CIFGNA, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto or to the Obligations, except a contemporaneous or subsequent agreement or instrument given by CIFGNA or to which CIFGNA has given its written consent, or by the merger, consolidation or dissolution of the Issuer. The premiums paid in respect of this Policy are nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Obligations prior to maturity. This Policy may not be cancelled or revoked during the Term of this Policy, including for nonpayment of premium due to CIFGNA. Payments under this Policy may not be accelerated except at the sole option of CIFGNA.

In witness whereof, CDC IXIS FINANCIAL GUARANTY NORTH AMERICA, INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

CDC IXIS FINANCIAL GUARANTY NORTH AMERICA, INC.

By ______________________________

Authorized Officer

FGIC

Financial Guaranty Insurance Company
125 Park Avenue
New York, NY 10017
T 212·312·3000
T 800·352·0001

Municipal Bond
New Issue Insurance Policy

Issuer:	**Policy Number:**
	Control Number: 0010001
Bonds:	**Premium:**

SPECIMEN

Financial Guaranty Insurance Company ("Financial Guaranty"), a New York stock insurance company, in consideration of the payment of the premium and subject to the terms of this Policy, hereby unconditionally and irrevocably agrees to pay to U.S. Bank Trust National Association or its successor, as its agent (the "Fiscal Agent"), for the benefit of Bondholders, that portion of the principal and interest on the above-described debt obligations (the "Bonds") which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

Financial Guaranty will make such payments to the Fiscal Agent on the date such principal or interest becomes Due for Payment or on the Business Day next following the day on which Financial Guaranty shall have received Notice of Nonpayment, whichever is later. The Fiscal Agent will disburse to the Bondholder the face amount of principal and interest which is then Due for Payment but is unpaid by reason of Nonpayment by the Issuer but only upon receipt by the Fiscal Agent, in form reasonably satisfactory to it, of (i) evidence of the Bondholder's right to receive payment of the principal or interest Due for Payment and (ii) evidence, including any appropriate instruments of assignment, that all of the Bondholder's rights to payment of such principal or interest Due for Payment shall thereupon vest in Financial Guaranty. Upon such disbursement, Financial Guaranty shall become the owner of the Bond, appurtenant coupon or right to payment of principal or interest on such Bond and shall be fully subrogated to all of the Bondholder's rights thereunder, including the Bondholder's right to payment thereof.

This Policy is non-cancellable for any reason. The premium on this Policy is not refundable for any reason, including the payment of the Bonds prior to their maturity. This Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Bond.

As used herein, the term "Bondholder" means, as to a particular Bond, the person other than the Issuer who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof. "Due for Payment" means, when referring to the principal of a Bond, the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity and means, when referring to interest on a Bond, the stated date for payment of interest. "Nonpayment" in respect of a Bond means the failure of the Issuer to have provided sufficient funds to the paying agent for payment in full of all

FGIC

Financial Guaranty Insurance Company
125 Park Avenue
New York, NY 10017
T 212·312·3000
T 800·352·0001

Municipal Bond
New Issue Insurance Policy

---

principal and interest Due for Payment on such Bond. "Notice" means telephonic or telegraphic notice, subsequently confirmed in writing, or written notice by registered or certified mail, from a Bondholder or a paying agent for the Bonds to Financial Guaranty. "Business Day" means any day other than a Saturday, Sunday or a day on which the Fiscal Agent is authorized by law to remain closed.

In Witness Whereof, Financial Guaranty has caused this Policy to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.

President

Effective Date: **Authorized Representative**

U.S. Bank Trust National Association, acknowledges that it has agreed to perform the duties of Fiscal Agent under this Policy.

Authorized Officer

FGIC

Financial Guaranty Insurance Company
125 Park Avenue
New York, NY 10017
T 212·312·3000
T 800·352·0001

Endorsement
To Financial Guaranty Insurance Company Insurance Policy

Policy Number:	**Control Number:** 0010001

SPECIMEN

It is further understood that the term "Nonpayment" in respect of a Bond includes any payment of principal or interest made to a Bondholder by or on behalf of the issuer of such Bond which has been recovered from such Bondholder pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction.

NOTHING HEREIN SHALL BE CONSTRUED TO WAIVE, ALTER, REDUCE OR AMEND COVERAGE IN ANY OTHER SECTION OF THE POLICY. IF FOUND CONTRARY TO THE POLICY LANGUAGE, THE TERMS OF THIS ENDORSEMENT SUPERSEDE THE POLICY LANGUAGE.

In Witness Whereof, Financial Guaranty has caused this Endorsement to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.

Frank Bivona

President

Effective Date: **Authorized Representative**

Acknowledged as of the Effective Date written above:

Authorized Officer
U.S. Bank Trust National Association, as Fiscal Agent

FINANCIAL SECURITY ASSURANCE®

MUNICIPAL BOND INSURANCE POLICY

ISSUER:

BONDS:

Policy No.: -N

Effective Date:

Premium:

FINANCIAL SECURITY ASSURANCE INC. ("Financial Security"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY agrees to pay to the trustee (the "Trustee") or paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the Bonds, for the benefit of the Owners or, at the election of Financial Security, directly to each Owner, subject only to the terms of this Policy (which includes each endorsement hereto), that portion of the principal of and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

On the later of the day on which such principal and interest becomes Due for Payment or the Business Day next following the Business Day on which Financial Security shall have received Notice of Nonpayment, Financial Security will disburse to or for the benefit of each Owner of a Bond the face amount of principal of and interest on the Bond that is then Due for Payment but is then unpaid by reason of Nonpayment by the Issuer, but only upon receipt by Financial Security, in a form reasonably satisfactory to it, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in Financial Security. A Notice of Nonpayment will be deemed received on a given Business Day if it is received prior to 1:00 p.m. (New York time) on such Business Day; otherwise, it will be deemed received on the next Business Day. If any Notice of Nonpayment received by Financial Security is incomplete, it shall be deemed not to have been received by Financial Security for purposes of the preceding sentence and Financial Security shall promptly so advise the Trustee, Paying Agent or Owner, as appropriate, who may submit an amended Notice of Nonpayment. Upon disbursement in respect of a Bond, Financial Security shall become the owner of the Bond, any appurtenant coupon to the Bond or right to receipt of payment of principal of or interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by Financial Security hereunder. Payment by Financial Security to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of Financial Security under this Policy.

Except to the extent expressly modified by an endorsement hereto, the following terms shall have the meanings specified for all purposes of this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment" means (a) when referring to the principal of a Bond, payable on the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity unless Financial Security shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration and (b) when referring to interest on a Bond, payable on the stated date for payment of interest. "Nonpayment" means, in respect of a Bond, the failure of the Issuer to have provided sufficient funds to the Trustee or, if there is no Trustee, to the Paying Agent for payment in full of all principal and interest that is Due for Payment on such Bond. "Nonpayment" shall also include, in respect of a Bond, any payment of principal or interest that is Due for Payment made to an Owner by or on behalf of the Issuer which has been recovered from such Owner pursuant to the

United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to Financial Security which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

Financial Security may appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy by giving written notice to the Trustee and the Paying Agent specifying the name and notice address of the Insurer's Fiscal Agent. From and after the date of receipt of such notice by the Trustee and the Paying Agent, (a) copies of all notices required to be delivered to Financial Security pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to Financial Security and shall not be deemed received until received by both and (b) all payments required to be made by Financial Security under this Policy may be made directly by Financial Security or by the Insurer's Fiscal Agent on behalf of Financial Security. The Insurer's Fiscal Agent is the agent of Financial Security only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of Financial Security to deposit or cause to be deposited sufficient funds to make payments due under this Policy.

To the fullest extent permitted by applicable law, Financial Security agrees not to assert, and hereby waives, only for the benefit of each Owner, all rights (whether by counterclaim, setoff or otherwise) and defenses (including, without limitation, the defense of fraud), whether acquired by subrogation, assignment or otherwise, to the extent that such rights and defenses may be available to Financial Security to avoid payment of its obligations under this Policy in accordance with the express provisions of this Policy.

This Policy sets forth in full the undertaking of Financial Security, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto. Except to the extent expressly modified by an endorsement hereto, (a) any premium paid in respect of this Policy is nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Bonds prior to maturity and (b) this Policy may not be canceled or revoked. THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

In witness whereof, FINANCIAL SECURITY ASSURANCE INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

[Countersignature]

FINANCIAL SECURITY ASSURANCE INC.

By ______________________________

By ______________________________
Authorized Officer

A subsidiary of Financial Security Assurance Holdings Ltd.
350 Park Avenue, New York, N.Y. 10022-6022
(212) 826-0100

Form 500NY (5/90)

APPENDIX VII

FINANCIAL GUARANTY INSURANCE POLICY
MBIA Insurance Corporation
Armonk, New York 10504

[NUMBER]

MBIA Insurance Corporation (the "Insurer"), in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to

or its successor (the "Paying Agent ") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean:

[PAR]
[LEGAL NAME OF ISSUE]

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by the Insurer from the Paying Agent or any owner of an Obligation the payment of an Insured Amount for which is then due, that such required payment has not been made, the Insurer on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners, or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

As used herein, the term "owner" shall mean the registered owner of any Obligation as indicated in the books maintained by the Paying Agent, the Issuer, or any designee of the Issuer for such purpose. The term owner shall not include the Issuer or any party whose agreement with the Issuer constitutes the underlying security for the Obligations.

Any service of process on the Insurer may be made to the Insurer at its offices located at 113 King Street, Armonk, New York 10504 and such service of process shall be valid and binding.

This policy is non-cancellable for any reason. The premium on this policy is not refundable for any reason including the payment prior to maturity of the Obligations.

This policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

IN WITNESS WHEREOF, the Insurer has caused this policy to be executed in facsimile on its behalf by its duly authorized officers, this [DAY] day of [MONTH, YEAR].

MBIA Insurance Corporation

SPECIMEN

President

Attest: ______________________

Assistant Secretary

STD-R-NY-6
4/95