

NEW ISSUE
Full-Book-Entry

RATINGS
Moody's: MIG 1
S&P: SP-1+

(See "Book-Entry Only System" under *The Notes*)

In the opinion of Squire, Sanders & Dempsey L.L.P., Bond Counsel, under existing law (i) assuming continuing compliance with certain covenants and the accuracy of certain representations, interest on the Notes is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations, and (ii) the Notes and the interest thereon are exempt from state, Commonwealth and local income taxation. Interest on the Notes may be subject to certain federal taxes imposed only on certain corporations, including the corporate alternative minimum tax on a portion of that interest. For a more complete discussion of the tax aspects, see "TAX MATTERS" herein.

\$875,000,000
COMMONWEALTH OF PUERTO RICO
Tax and Revenue Anticipation Notes
Series 2007

Dated: Date of Delivery
Due: July 30, 2007

Yield: 3.50%
Coupon Rate: 4.50%

The Notes bear interest at the annual rate shown above, computed on the basis of twelve 30-day months and a 360-day year. Principal of and interest on the Notes are payable in immediately available funds at maturity. The Notes are not subject to redemption prior to maturity. The Notes are issuable in fully registered form in denominations of \$5,000 and any integral multiple thereof.

Payment of the principal of and interest on the Notes are secured by and payable from an irrevocable direct pay letter of credit issued on a several and not joint basis by a syndicate of six (6) banks as set forth in the table below (the "Letter of Credit Banks") in the amounts and the percentages set forth therein (the "Letter of Credit"):

Name of Bank	Maximum Amount of Principal*	Several Obligation
THE BANK OF NOVA SCOTIA	\$306,250,000	35%
BNP PARIBAS	166,250,000	19%
DEXIA CREDIT LOCAL	166,250,000	19%
FORTIS BANK,S.A./N.V.	131,250,000	15%
BANCO BILBAO VIZCAYA ARGENTARIA S.A.	78,750,000	9%
BANCO SANTANDER CENTRAL HISPANO, S.A.	<u>26,250,000</u>	<u>3%</u>
	\$875,000,000	100%

Principal of and interest on the Notes are payable (i) from amounts drawn under the Letter of Credit, and (ii) in the event one or more Letter of Credit Banks fail to honor their several portions under the Letter of Credit, from the Special Fund for the Redemption of Tax and Revenue Anticipation Notes as further described herein (the "Note Fund"). Banco Popular de Puerto Rico, on behalf of the Commonwealth, is the Paying Agent and will deliver payment of the principal of and interest on the Notes at maturity from a drawing on the Letter of Credit. The Note Fund is funded solely from taxes and revenues in the General Fund collected after the date of the issuance of the Notes, and on or prior to June 30, 2007, as described herein. During the term of the Notes, the Commonwealth may also borrow funds pursuant to a Revolving Credit Agreement, as further described herein. Amounts in the Note Fund will be used to repay the Letter of Credit Note and the Revolving Credit Note, and the Notes to the extent one or more Letter of Credit Banks fail to honor their several portions under the Letter of Credit, as further described herein. See "Payment of and Security for the Notes" under *The Notes*.

The Notes do not constitute direct obligations of the Commonwealth of Puerto Rico for the payment of which the full faith, credit and taxing power of the Commonwealth of Puerto Rico, nor that of any of its political subdivisions, are pledged.

The Notes are offered when, as and if issued and accepted by the Underwriters, subject to the approval of legality by Squire, Sanders & Dempsey L.L.P., Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the Underwriters by McConnell Valdés, and for the Letter of Credit Banks by Chapman and Cutler LLP. It is expected that settlement for the Notes, in immediately available funds, will occur in Puerto Rico, on or about October 26, 2006.

Banc of America Securities LLC	MERRILL LYNCH & CO.	Goldman, Sachs & Co.
JPMorgan	Citigroup	Morgan Stanley
Popular Securities	Lehman Brothers	Samuel A. Ramirez & Co.
UBS Investment Bank	Raymond James & Associates, Inc.	Wachovia Bank, National Association

October 19, 2006

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Secretary of State

ROBERTO JOSÉ SÁNCHEZ
RAMOS
Secretary of Justice

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Development
Bank for Puerto Rico

No dealer, broker, sales representative or other person has been authorized by the Commonwealth of Puerto Rico 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 of Puerto Rico or the Underwriters. 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 Notes 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 of Puerto Rico and other official sources that are believed to be reliable, but is not guaranteed as to accuracy or completeness and is not to be construed as a representation by any Underwriter. 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 circumstance, create any implication that there has been no change in the affairs of the Commonwealth of Puerto Rico since the date hereof. This Official Statement is submitted in connection with the sale of the Notes referred to herein and may not be reproduced or used, in whole or in part, for any other purpose. The Underwriters have provided the following sentence 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. Each of the Letter of Credit Banks has supplied the information relating to it and included in Appendix III. Neither the Commonwealth nor the Underwriters make any representation as to the accuracy or completeness of the information contained in Appendix III.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE NOTES AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

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\$875,000,000
COMMONWEALTH OF PUERTO RICO
Tax and Revenue Anticipation Notes
Series 2007

INTRODUCTORY STATEMENT

This Official Statement sets forth certain information about the Commonwealth of Puerto Rico (the “Commonwealth” or “Puerto Rico”) and the \$875,000,000 Tax and Revenue Anticipation Notes of the Commonwealth of Puerto Rico, Series 2007 (the “Notes”).

The Notes are being issued under Act No. 1 of June 26, 1987 of the Commonwealth, as amended by Act No. 139 of November 9, 2005 (as amended, the “Act”), and pursuant to a resolution adopted by the Secretary of the Treasury and approved by the Governor of Puerto Rico on October 19, 2006 (the “Note Resolution”), for the purpose of: (i) repaying amounts borrowed by the Commonwealth under a line of credit provided by the Revolving Credit Banks (as defined below) and related note issued pursuant to the Act in advance of the issuance of the Notes, (ii) paying certain of the costs of issuance of the Notes (including certain fees associated with the Letter of Credit), and (iii) providing funds to pay the appropriations made for fiscal 2007 in anticipation of the receipt of taxes and revenues required to be deposited in the Commonwealth’s General Fund and estimated in the budget of the Commonwealth to be realized in cash during fiscal year 2007.

Without the issuance of the Notes, the Commonwealth estimates that the General Fund would incur monthly cash deficits which would reach a cumulative maximum deficit of approximately \$822 million in March 2007. For a breakdown of the fiscal year 2007 General Fund cash flow projections, before and after taking into account the issuance of the Notes, see “General Fund Monthly Cash Flow for Fiscal Year 2006 and Fiscal Year 2007” under *The Notes*.

The Notes are secured by an irrevocable direct pay letter of credit issued on a several and not joint basis by the Letter of Credit Banks pursuant to a Reimbursement Agreement dated as of October 1, 2006 among The Bank of Nova Scotia, acting through its New York Agency, as Lead Arranger and Administrative Agent, and as a Letter of Credit Bank through its Hato Rey Branch, BNP Paribas, acting through its San Francisco Branch, and Dexia Credit Local, acting through its New York Branch as Co-Agents, Fortis Bank S.A./N.V., acting through its Connecticut Branch, Banco Santander Central Hispano, S.A., acting through its New York Branch, Banco Bilbao Vizcaya Argentaria S.A., acting through its New York Branch, and the Commonwealth (the “Reimbursement Agreement”). For a discussion of the payment source and the security for the Notes, including the Letter of Credit and the Reimbursement Agreement, see “Payment of and Security for the Notes” under *The Notes*.

This Official Statement incorporates (i) the Commonwealth of Puerto Rico Financial Information and Operating Data Report dated as of July 1, 2006 (the “Commonwealth Report”), which is incorporated herein by this reference, (ii) the proposed Bond Counsel Opinion, attached hereto as Appendix II, (iii) a description of each of the Letter of Credit Banks, attached hereto as Appendix III, and (iv) the Comprehensive Annual Financial Report of the Commonwealth for the fiscal year ended June 30, 2005, prepared by the Department of the Treasury of the Commonwealth (the “Commonwealth’s Annual Financial Report”), which is incorporated herein by this reference. The Commonwealth’s Annual Financial Report includes the basic financial statements of the Commonwealth for the fiscal year ended June 30, 2005, together with the independent auditor’s report thereon dated March 14, 2006, of KPMG LLP, certified public accountants. 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 separately identified in their report. Those financial statements were audited by other auditors whose reports have been furnished to KPMG LLP, and their 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, is based solely on the reports of the other auditors.

The Commonwealth Report includes important information about the Commonwealth, including information about its economy, historical revenues and expenditures of the Commonwealth’s General Fund, the year-end results for the fiscal year 2006 budget, the fiscal year 2007 budget, and the debt of the Commonwealth’s public sector, and should

be read in its entirety. The Commonwealth's Annual Financial Report was filed by the Commonwealth with each nationally recognized municipal securities information repository ("NRMSIR") as Appendix I to the Official Statement for the offering of the Commonwealth's Public Improvement Bonds, Series 2006 A and Public Improvement Refunding Bonds, Series 2006 B (the "2006 GO Official Statement").

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 ("MSRB"), or any new or revised Commonwealth Report or Commonwealth 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 Notes, 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 or in the Commonwealth 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.

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 Report, the Commonwealth's Annual Financial Report, the Note Resolution and the Reimbursement Agreement. Requests should be directed to Director-New York Office, Government Development Bank for Puerto Rico, 666 Fifth Avenue, 15th Floor, New York, New York 10103-1599, 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 2006 GO Official Statement, which contains the Commonwealth Report, and 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. The Commonwealth expects that its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2006, including its audited general purpose financial statements for such fiscal year, will be available to investors during the first quarter of calendar year 2007. Promptly after its release, said report will be filed with and available from each NRMSIR.

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 2005 (which ended on

June 30, 2005), the Commonwealth's gross national product (preliminary, in current dollars) was \$53.4 billion, and personal income per capita (preliminary, in current dollars) was \$12,502.

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 ("OMB") 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. OMB prepares the Commonwealth's budget and is responsible for monitoring and approving 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, including information about the economy, historical revenues and expenditures of the Commonwealth's General Fund, the estimated year-end results of fiscal year 2006, the budget for fiscal year 2007, and the debt of the Commonwealth's public sector. The Commonwealth Report should be read in its entirety.

RECENT DEVELOPMENTS

This section summarizes and updates certain information about the Commonwealth's current fiscal situation appearing in the Commonwealth Report. This section should be read in conjunction with the information included in the Commonwealth Report, which shall be deemed modified to the extent the information provided therein is different from that appearing below.

Excise Tax Repeal

On October 17, 2006, the Governor signed into law Act No. 229 of 2006 ("Act 229"), which repealed the 5% general excise tax as of such date. Based on actual revenue receipts between July and September 2006 and expected business-to-business transactions, the Commonwealth believes that the anticipated \$50 million reduction in excise tax revenue projections based on the earlier effective date is not expected to occur and consequently, the cash revenue projections for fiscal year 2007 will not be impacted by this reduction.

Possible Judicial Challenge to Sales Tax

On October 18, 2006, former Governor Carlos Romero-Barceló announced that a group of retirees and merchants, including himself, will challenge in the Commonwealth courts the implementation of the Sales Tax (as defined below). See "*Tax and Fiscal Reform and Government Reorganization Plan*" below. Mr. Romero-Barceló stated that the group will file a petition for declaratory judgment seeking to establish that the Sales Tax approved in Act 117 (as defined below) is 5.5 percent, comprised of a 4 percent general use and sales tax and a 1.5 percent general use and sales tax authorized to the municipalities, and not the 7.0 percent as interpreted by the Executive Branch, comprised of a 5.5 percent general use and sales tax and a 1.5 percent general use and sales tax authorized to the municipalities. Mr. Romero-Barceló stated that the petition will be filed no later than the week of October 23rd. During the same announcement, the President of the House of Representatives, who previously has indicated he and other House members may file a similar lawsuit, stated that he was not planning to do so for the time being, but may decide to do so after the implementation of the Sales Tax begins by November 15. The Secretary of Justice has previously opined that any such challenge to the Sales Tax would be without merit.

The Commonwealth's Budget Deficit for Fiscal Year 2006, Its Structural Budget Imbalance and Other Fiscal Challenges

Estimated Budget Deficit for Fiscal Year 2006. The Secretary of the Treasury's estimate of total revenues for fiscal year 2006 is \$8.645 billion (including \$100 million of proceeds generated by the issuance of the Commonwealth's Public Improvement Refunding Bonds, Series 2006 A, which were privately placed), which is

\$350 million less than the amount originally budgeted of \$8.995 billion. This reduction in revenues is attributable primarily to the current economic slowdown, caused mainly by the current price of oil and its derivatives being at a historically high level, the government's fiscal crisis, which resulted in a two-week shutdown of non-essential government services in May 2006, and the uncertainty that prevailed during the later part of fiscal year 2006 regarding the enactment of proposed tax and fiscal reform measures designed to resolve the fiscal crisis. The Commonwealth expects this reduction in revenues to be temporary in nature and does not expect it to recur during fiscal year 2007.

Total expenditures for fiscal year 2006 were \$9.683 billion, or approximately \$1.0 billion above the estimate of total revenues for fiscal year 2006. Taking into account certain additional cash requirements in the amount of \$368 million of the General Fund that were covered by alternative financing mechanisms, the fiscal year 2006 budget deficit totals approximately \$1.4 billion. See "Commonwealth's Structural Budget Imbalance" below.

The excess expenditures experienced during fiscal year 2006 (totaling \$1.0 billion) were partially covered with funds from the Emergency and Budgetary Funds (\$64 million) and a Government Development Bank loan (\$741 million). The remaining shortfall, totaling \$233 million, did not have a cash impact during fiscal year 2006 as a result of various cash management mechanisms, including the postponement of certain payments to third party vendors. This shortfall has had an impact on the Commonwealth's cash flow during fiscal year 2007.

The excess expenditures of \$1.0 billion do not include other expenditures related to fiscal year 2006 which had been excluded from the fiscal 2006 budget, such as certain vendor debts of \$268 million from prior fiscal years and \$368 million of debt service due during fiscal year 2006 on the Commonwealth's general obligation bonds, which was paid from the proceeds of a Government Development Bank loan and refunded with the proceeds of the Commonwealth Public Improvement Refunding Bonds, Series 2006 B and C (the "Financed Debt Service"). These excluded expenditures are referred to as the "Additional Expenditures."

Commonwealth's Structural Budget Imbalance. The budget imbalance in fiscal year 2006 comes in the wake of several recent fiscal years during which the Commonwealth's recurring expenditures exceeded its recurring revenues. These budget imbalances were covered in the past with loans from Government Development Bank, financing transactions (including long-term bond issues payable from the General Fund) and other non-recurring resources. The Commonwealth's recurring operating expenditures during fiscal year 2006 exceeded recurring revenues (the so-called structural imbalance) by approximately \$1.2 billion, compared to \$1 billion for fiscal year 2005. The \$1.2 billion structural imbalance for fiscal year 2006 is the difference between expenditures of \$9.683 billion plus the Financed Debt Service, for a total of \$10.05 billion, less budgeted recurring revenues of \$8.895 billion. The calculation of the \$1.2 billion structural imbalance excludes (i) the \$350 million reduction in revenues during fiscal year 2006 discussed above because the government does not consider it a permanent reduction in recurring revenues and (ii) net proceeds of \$100 million received in fiscal year 2006 from the issuance of the Commonwealth's Public Improvement Refunding Bonds, Series 2006 A, which is non-recurring. The amount of estimated expenditures also does not take into account certain Additional Expenditures discussed above, which, if considered recurrent, would increase the structural budget imbalance. The Commonwealth covered the fiscal year 2006 structural imbalance by financing the Financed Debt Service, issuing the Commonwealth's Public Improvement Refunding Bonds, Series 2006 A (\$100 million), transferring approximately \$64 million from the Emergency and Budgetary Funds and financing most of the remaining portion of the Commonwealth's fiscal year 2006 structural budget imbalance with a GDB loan of \$741 million.

In addition to the aforementioned vendor debts and the Financed Debt Service, there are certain other expenditures not included in the amount of actual preliminary expenditures for fiscal year 2006 that may increase the structural imbalance. These include estimated amounts required to cover maintenance expenses incurred by Public Buildings Authority ("PBA") (approximately \$75 million) and subsidy and operational expenses incurred by the Agricultural Services and Development Administration ("ASDA") (approximately \$75 million). These last two items are covered by lines of credit from Government Development Bank collateralized by real estate of ASDA and PBA and accounts receivable of PBA, with payment expected from the sale of such pledged real estate and/or the collection of such pledged receivables. For more information, see "2006 Budget Approval Process" under *Budget of the Commonwealth of Puerto Rico* in the Commonwealth Report.

Other Fiscal Challenges. Other than its current budgetary shortfalls, the principal challenge facing the Commonwealth involves resolving the increasing unfunded pension liability of the Employees Retirement System

and the Teachers Retirement System, which were \$9.2 billion as of June 30, 2003 and \$2.3 billion as of June 30, 2004, respectively. The Commonwealth expects to reduce the unfunded liability of the Employees Retirement System through passage of proposed legislation which provides for increased employer and employee contributions, the issuance of up to \$2 billion of pension obligation bonds, which would be payable from the Commonwealth's General Fund, and, subject to regulatory approval and other conditions, the sale of its remaining Puerto Rico Telephone Company ("PRTC") stock for approximately \$500 million, which the Employees Retirement System expects to invest in higher-yielding assets.

The Employees Retirement System and the Teachers Retirement System are seeking reimbursement from the Commonwealth for certain special retirement benefits paid by them in prior fiscal years under legislation providing such retirement benefits. The Employees Retirement System is seeking reimbursement from the Commonwealth in the amount of \$77.4 million for cumulative benefits paid to beneficiaries through June 30, 2005. The Employees Retirement System projects an additional shortfall of \$39.4 million for fiscal year 2006 in connection with payments pursuant to special benefit laws. OMB believes that the basis of the claims from the Employees Retirement System is valid but that the amounts claimed remain to be verified and reconciled. Recently, the Employees Retirement System received a \$42.9 million payment from OMB to cover shortfalls related to payments made in connection with special benefits laws. OMB does not recognize as a Commonwealth liability part of the claims by the Teachers Retirement System (\$119 million). OMB and the Teachers Retirement System are currently under inter-agency arbitration in an effort to resolve their differences.

For more information about the retirement systems and their finances, see *Retirement Systems* in the Commonwealth Report.

Tax and Fiscal Reform and Government Reorganization Plan

In an effort to address the Commonwealth's structural budget imbalance and its other fiscal difficulties, the Executive Branch and the Legislative Assembly enacted and the Governor signed legislation providing for tax reform and fiscal reforms. The tax reform legislation is aimed at increasing revenues by expanding the tax base through the implementation of a broad-based sales tax. The fiscal reform legislation is aimed at limiting expenditures in relation to past spending rates and stabilizing expenditure growth at a level below that of recurring revenues.

Tax Reform. Act No. 117 of July 4, 2006 ("Act 117") amends the Puerto Rico Internal Revenue Code of 1994 (the "PR Code") to provide, among other things, for a general sales and use tax of 5.5% to be imposed by the central government (the "Central Government Sales Tax"). Act 117 also authorizes each municipal government to impose a municipal sales and use tax of 1.5% (the "Municipal Sales Tax" and, together with the Central Government Sales Tax, the "Sales Tax"). In general, the Municipal Sales Tax has the same tax base, exemptions (except for unprocessed foods) and limitations as those provided for the Central Government Sales Tax. Act 117 also provides certain income tax reductions to address the regressive effect of the Sales Tax on taxpayers in lower income tax brackets.

The Sales Tax is imposed on the sale, use, consumption and storage of taxable items, which include tangible personal property, taxable services, admission rights and certain other types of transactions covering separable and identifiable taxable items which are sold for a single price, subject to certain exceptions and limitations provided therein. The Sales Tax will not be imposed on, among other things: (i) taxable items acquired by merchants for resale, (ii) taxable items acquired by manufacturing plants, (iii) taxable items acquired for use and consumption outside of Puerto Rico, (iv) certain food products that do not need to be heated before their sale, (v) prescription drugs, (vi) the rental payments received by a lessor of real property which is used for residential or commercial purposes, (vii) services provided by designated professionals, (viii) cash, cash equivalents, stocks, bonds, notes, mortgage loans, insurance, securities and interest derived for the use or forbearance of money, (ix) sales of real property, and (x) leases in which the Industrial Development Company is the owner of the property.

Act 117 repeals the 5% general excise tax imposed on imported goods and on goods manufactured in Puerto Rico. Certain items, such as fuel, crude oil and petroleum products, and vehicles, however, remain subject to the excise tax previously applicable to such items and will not be subject to the Sales Tax. The effective date of the repeal of the 5% general excise tax was October 17, 2006 pursuant to Act 229.

The Sales Tax will be effective on November 15, 2006. Municipalities, however, were authorized to implement the Municipal Sales Tax starting on July 1, 2006, and some have already done so. The revenues derived from the Sales Tax will be distributed as follows: (i) municipal governments will retain 1.3% of the Sales Tax, (ii) the Financial Assistance Fund, created by Act No. 91 of May 13, 2006, will receive 1 % of the Sales Tax, and (iii) the General Fund will receive 4.7% of the Sales Tax. The Secretary of the Treasury projects that each percentage point of the Sales Tax will generate annually approximately \$191 million of gross revenues and that the Sales Tax will generate total annual gross revenues of approximately \$1.337 billion. The revenues to be generated by the Sales Tax will be partly offset by the partial elimination of the 5% general excise tax and the effect of the income tax reduction measures included in Act 117.

Act 117 also provides for special income tax rates with respect to certain transactions occurring on and between July 1, 2006 and December 31, 2006. These special tax rates will apply to eligible dividends declared by domestic corporations or partnerships and “built-in” gains associated with capital assets held for periods in excess of six months, as well as certain withdrawals from retirement accounts. These special tax rates are only available for transactions in connection with capital assets consisting of stock or participations of domestic and foreign corporations and partnerships, and real property located in Puerto Rico. In the case of resident corporations and partnerships, these special tax rates apply only to real property located in Puerto Rico.

The Secretary of the Treasury expects the aforementioned provisions of Act 117 to generate approximately \$264 million by December 31, 2006. The Legislative Assembly authorized, but later withdrew its authorization by recalling the approved bill, an increase of the Sales Tax by up to 1% by executive order of the Governor if these Act 117 provisions did not generate \$1 billion by December 31, 2006. It is uncertain whether new legislation to grant such authorization to the Governor will be approved.

Members of the House of Representatives have indicated that they may challenge the validity of the Sales Tax because the House of Representatives intended to enact a 5.5% aggregate sales and use tax which includes the portion attributable to the municipalities. The Secretary of Justice, however, has opined that any potential challenge to the Sales Tax rate would be without merit.

Fiscal Reform. On May 25, 2006, the Governor signed legislation providing for a fiscal reform of the Commonwealth government (the “Fiscal Reform Legislation”). The legislation applies to every instrumentality and entity of the Executive Branch funded, in whole or in part, from the General Fund and sets forth as the public policy of the Commonwealth the reduction of government spending, the elimination or consolidation of redundant agencies, the reduction of government payroll without causing the layoff of regular employees or increasing the actuarial liability of the retirement systems, the limitation of unnecessary, extravagant or excessive spending, and the limitation of public relations and other similar expenses. For more information on the Fiscal Reform Legislation, see “Fiscal Reform” under *Budget of the Commonwealth of Puerto Rico* in the Commonwealth Report.

Despite his approval of the Fiscal Reform Legislation, the Governor has stated that certain of its provisions may be unconstitutional because they infringe on Executive Branch prerogatives. As such, the Governor has informed the Legislative Assembly that certain provisions of the Fiscal Reform Legislation will be implemented at the Executive Branch’s discretion and through the use of the Executive Branch’s prerogatives. There is no assurance that the Fiscal Reform Legislation will generate the expected savings or that it will be implemented as enacted.

Government Reorganization Plan. The Commonwealth has launched the Government Efficiency Project (the “Project”) as part of its efforts to implement a thorough fiscal reform. The main objective of the Project is to review and analyze the functions, financial situation, and performance of every government agency and public corporation. This review and analysis will permit the Commonwealth to implement a comprehensive reorganization via the restructuring, consolidation, and/or elimination of public entities. The Project’s aim is to refocus the Commonwealth’s resources in a more efficient and effective manner, geared towards implementing a “customer service” culture in public service. The Project’s purpose is to establish the parameters, objectives, and goals of the Commonwealth’s restructuring efforts in order to provide a cohesive and integrated action plan for its implementation.

Fiscal Year 2007 Budget

On July 10, 2006, the Governor signed a General Fund budget for fiscal year 2007 of \$9.488 billion, or approximately \$195 million less than the expenditures for fiscal year 2006 of \$9.683 billion (excluding the Additional Expenditures). This reduction of approximately \$195 million is attributable principally to decreases in the amount allocated to the Department of Education and certain health related expenditures. Currently, the Department of Education is working on an internal restructuring to reduce its expenditures so as to remain within its reduced operating budget. The Commonwealth expects to cover certain of its health related expenditures with a loan from the State Insurance Fund of \$180 million.

The revenue projection for fiscal year 2007 is \$9.163 billion, an increase of \$618 million, or 7.2%, from preliminary net revenue collections for fiscal year 2006 of \$8.545 billion. The Secretary of the Treasury's revenue projection for fiscal year 2007 consists of \$8.899 billion, a 4.1% increase over fiscal year 2006, and \$264 million to be generated by certain non-recurring tax measures. See "Tax and Fiscal Reform and Government Reorganization Plan - Tax Reform" above. The revenue projections for fiscal year 2007 have been adjusted to take into account (i) the Planning Board's downward revision of its forecast for real growth in gross national product from 2.5% to 0.6%, (ii) the substitution of the Sales Tax for the 5% general excise tax, which is projected to raise \$643 million during such period (4.7% of which Sales Tax is allocated to the General Fund) starting on November 15, 2006 through June 30, 2007, and (iii) certain income tax rate reductions included in the tax reform legislation. For more information, see "Summary and Management's Discussion of General Fund Results - Fiscal Year 2007 Projected Revenues" under *Puerto Rico Taxes, Other Revenues, and Expenditures* in the Commonwealth Report.

The Commonwealth's budgeted expenditures for fiscal year 2007 of \$9.488 billion exceed projected revenues of \$9.163 billion by approximately \$325 million. In addition, the Commonwealth must cover a \$233 million cash shortfall relating to fiscal year 2006 and a \$51 million cash shortfall relating to fiscal year 2007 consisting of (i) certain payments excluded from the fiscal year 2007 budget and (ii) temporary differences in cash flow during fiscal year 2007. The Commonwealth expects to reduce the budget deficit and cash shortfall of \$619 million through the implementation of additional expenditure reducing measures, a possible increase in tax revenues resulting from the reduction of the uncertainty surrounding the government's fiscal crisis, and cash management mechanisms. Among such measures, OMB has established a ten percent reserve from the budgeted amounts of certain agencies totaling \$540 million. Funds from these reserves may be used by the agencies only with OMB approval. The possible increase in tax revenues may be tempered by a number of factors, including without limitation, the adverse economic impact resulting from increases in the price of oil and the implementation of the Sales Tax.

The Commonwealth has also excluded from the fiscal year 2007 budget approximately \$522 million of debt service payments on its outstanding appropriation debt. Of this amount, Government Development Bank ("GDB") advanced and, on July 15, 2006, deposited with the trustee \$303 million corresponding to debt service of the Public Finance Corporation. The remaining \$219 million of debt service payments is owed by the Commonwealth to GDB. Additional debt service requirements for fiscal year 2007 will be covered with amounts to be deposited in the Financial Assistance Fund, a special fund created by Act No. 91 of May 13, 2006. The Financial Assistance Fund will be funded mainly with 1% of the Sales Tax, which is expected to generate annually approximately \$191 million. However, due to the implementation of the Sales Tax on November 15, 2006, the 1% Sales Tax is expected to generate approximately \$136.8 million for the seven and a half months in fiscal year 2007 for which it will be in effect. The Commonwealth is currently evaluating various restructuring alternatives for its outstanding appropriation debt, some of which may require legislative approval, in order to cover these debt service payments with the expected revenues of the Financial Assistance Fund. Amounts not covered by the Financial Assistance Fund, if any, would have to be covered by additional legislative appropriations from the Commonwealth's General Fund.

Rating Action Involving the Commonwealth

Recent Rating Action. On July 20, 2006, Standard & Poor's Rating Services, a division of The McGraw-Hill Companies, Inc. ("S&P"), confirmed its "BBB" and "BBB-" rating on the Commonwealth's general obligation debt and appropriation debt, respectively, and removed the rating from CreditWatch with negative implications, where it had been placed on March 22, 2006. S&P's ratings outlook, however, remains negative.

On July 21, 2006, Moody's Investors Service ("Moody's") confirmed its "Baa3" and "Bal" rating on the Commonwealth's general obligation debt and appropriation debt, respectively, and removed the ratings from Watchlist with negative implications, where it had been placed on February 24, 2006. Moody's ratings outlook, however, also remains negative.

Previous Rating Action. On March 22, 2006, S&P placed the Commonwealth's rating on CreditWatch with negative implications as a result of the Commonwealth's anticipated budget deficit for fiscal year 2006, slow progress on tax and fiscal reform and the apparent political impasse regarding these measures. This action had been preceded in May 2005 by a reduction in S&P's rating of the Commonwealth's general obligation debt and appropriation debt rating from "A-" to "BBB" and from "BBB" to "BBB-," respectively.

On May 8, 2006, Moody's downgraded the Commonwealth's general obligation and appropriation bond ratings from "Baa2" to "Baa3" and from "Baa3" to "Bal," respectively, and kept the ratings on Watchlist for possible further downgrade. Moody's action reflected the Commonwealth's strained financial condition, ongoing political conflict and lack of agreement regarding the measures necessary to end the government's multi-year trend of financial deterioration. For a discussion of previous rating actions affecting the Commonwealth, see "Rating of Commonwealth General Obligation Bonds" under *Debt* in the Commonwealth Report.

THE NOTES

Set forth below is a narrative description of certain legislative and contractual provisions relating to the authorization of sources of payment and security for the Notes. These provisions have been summarized and this description does not purport to be complete. Reference should be made to the Act, the Note Resolution and the Reimbursement Agreement, copies of which are available to potential purchasers of the Notes. See Introductory Statement.

General

The Notes are dated their date of delivery, mature on July 30, 2007 and bear interest at the rate of 4.50%. Interest is computed on the basis of twelve 30-day months and a 360-day year. The Notes are issuable in fully registered form in denominations of \$5,000 and any integral multiple thereof. The Notes are not subject to redemption prior to maturity. Principal of and interest on the Notes are payable in immediately available funds at maturity.

Book-Entry Only System

The Depository Trust Company ("DTC"), New York, New York, will act as securities depository for the Notes. The Notes will be issued as fully-registered Notes registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. Because the aggregate principal amount of the Notes exceeds \$500 million, one fully-registered Note certificate will be issued for the Notes in the aggregate principal amount of \$500 million, and an additional certificate will be issued with respect to any principal amount in excess of \$500 million, and each will be deposited with 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, as amended. DTC holds and provides asset servicing for over 2.2 million issuers of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC 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 certificates. 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 Securities Clearing Corporation, Fixed Income Clearing Corporation, and

Emerging Markets Clearing Corporation (NSCC, FICC, 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, and www.dtc.org.

Purchases of Notes under the DTC system must be made by or through Direct Participants, which will receive a credit for the Notes on DTC’s records. The ownership interest of each actual purchaser of each Note (a “Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, 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 Notes are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Notes, except in the event that use of the book-entry system for the Notes is discontinued.

To facilitate subsequent transfers, all Notes deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of Notes with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Notes; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Notes 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.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Notes 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 Notes are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and dividend payments on the Notes 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 Banco Popular de Puerto Rico, as paying agent (the “Paying Agent”), 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, nor its nominee, the Paying Agent, or the Commonwealth, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Commonwealth or the Paying Agent, 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 Notes at any time by giving reasonable notice to the Commonwealth or the Paying Agent. Under such circumstances, in the event that a successor securities depository is not obtained, Note certificates are required to be printed and delivered.

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

In the event that such book-entry only system is discontinued, the following provisions will apply: principal of and interest on the Notes will be payable at maturity in lawful money of the United States of America upon presentation and surrender of Notes at the principal office of the Paying Agent in Hato Rey, Puerto Rico.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the Commonwealth believes to be reliable, but the Commonwealth takes no responsibility for the accuracy thereof.

Authorization of Notes

Section 2 of Article VI of the Constitution of Puerto Rico 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 Notes. The Notes are issued pursuant to the Act and the Note Resolution adopted by the Secretary of the Treasury and approved by the Governor. As part of the authorization process for the Notes, Government Development Bank, as financial advisor and fiscal agent to the Commonwealth, has reviewed and made its favorable recommendations as to the Notes.

Purpose of the Notes

The Notes are being issued to (i) repay amounts borrowed by the Commonwealth under a line of credit provided by the Revolving Credit Banks pursuant to the Act in advance of the issuance of the Notes, (ii) pay certain of the costs of issuance of the Notes (including certain fees associated with the Letter of Credit), and (iii) provide funds to pay the appropriations made for fiscal 2007 in anticipation of the receipt of taxes and revenues required to be deposited in the Commonwealth's General Fund and estimated in the budget of the Commonwealth to be realized in cash during fiscal year 2007.

Payment of and Security for the Notes

Letter of Credit

The Notes are secured by and payable from the irrevocable direct pay letter of credit issued by the Letter of Credit Banks, on a several and not joint basis, in the amount of the principal of and interest due on the Notes at maturity, pursuant to the Reimbursement Agreement. The Letter of Credit is attached as Appendix I hereto. A description of each of the Letter of Credit Banks is attached as Appendix III hereto. Each of the Letter of Credit Banks has supplied the information relating to it included in Appendix III. Neither the Commonwealth nor the Underwriters make any representation as to the accuracy or completeness of the information contained in Appendix III. The Letter of Credit Banks may not assign their obligations under the Reimbursement Agreement without (i) receipt of prior written confirmation from Moody's and S&P that the ratings on the Notes will not be suspended, withdrawn or lowered solely as a result of such assignment, (ii) the prior written consent of the Commonwealth, the Administrative Agent and each Letter of Credit Bank, and (iii) twenty (20) days prior written notice provided by the Paying Agent to the Noteholders of said Assignment.

The following table sets forth the names of the Letter of Credit Banks, the maximum amount of their several payment obligations under the Letter of Credit, the corresponding amount of interest that will accrue on such amounts until the Notes' maturity date (based on an interest rate of 4.50% accruing over a period of 275 days) and the percentage of their several payment obligations under the Letter of Credit:

Name of Bank	Maximum Amount of Principal Secured	Interest to Accrue on Principal Secured	Maximum Amount of Principal and Interest Secured	Several Obligation
THE BANK OF NOVA SCOTIA	\$306,250,000	\$10,527,343.75	\$316,777,343.75	35%
BNP PARIBAS	166,250,000	5,714,843.75	171,964,843.75	19%
DEXIA CREDIT LOCAL	166,250,000	5,714,843.75	171,964,843.75	19%
FORTIS BANK S.A./N.V.	131,250,000	4,511,718.75	135,761,718.75	15%
BANCO BILBAO VIZCAYA ARGENTARIA S.A.	78,750,000	2,707,031.25	81,457,031.25	9%
BANCO SANTANDER CENTRAL HISPANO, S.A.	26,250,000	902,343.75	27,152,343.75	3%
	\$875,000,000	\$30,078,125.00	\$905,078,125.00	100%

Pursuant to the Letter of Credit, the Paying Agent is authorized and expected to present a draw on July 27, 2007, for payment on July 30, 2007, up to the principal amount of the Notes, together with any accrued and unpaid interest thereon (the "Drawing"), to be deposited in a payment fund to be held by the Paying Agent solely for the benefit of the Noteholders. The Letter of Credit shall expire at 5:00 p.m., New York time, on the date which is the earliest of: (i) August 1, 2007, (ii) the date of payment of the Drawing by the Administrative Agent, on behalf of the Letter of Credit Banks, to the Paying Agent, (iii) the Administrative Agent's, on behalf of the Letter of Credit Banks, receipt of a cancellation certificate signed by a duly authorized officer of the Paying Agent, or (iv) the date when the Paying Agent surrenders the original of this Letter of Credit to the Administrative Agent on behalf of the Letter of Credit Banks, for cancellation.

The Notes are secured by and payable from (i) the Drawing pursuant to the Letter of Credit, and (ii) in the event one or more Letter of Credit Banks fail to honor their several portions of the Drawing Amount under the Letter of Credit, from the Note Fund. The Commonwealth's payment obligations relating to the Drawing shall be evidenced by a note of the Commonwealth issued pursuant to the Act and designated "Tax and Revenue Anticipation Note of the Commonwealth of Puerto Rico (Letter of Credit), Series 2007" (the "Letter of Credit Note"). The Letter of Credit Note shall be issued to The Bank of Nova Scotia, as the Administrative Agent for the Letter of Credit Banks, under the Reimbursement Agreement on the date of issuance of the Notes, and shall mature on the Notes' maturity date. The Letter of Credit Note, which is authorized by and shall be considered a note under the Act, will be a replacement note of the issued and outstanding Notes and not a duplicate of such obligations.

Pursuant to the terms of a Revolving Credit and Term Loan Agreement dated as of July 1, 2006, as amended, The Bank of Nova Scotia, acting through its Hato Rey Branch; BNP Paribas, acting through its San Francisco Branch; Dexia Credit Local, acting through its New York Branch; Fortis Bank S.A./N.V., acting through its Connecticut Branch; Banco Popular de Puerto Rico; KBC Bank N.V., acting through its New York Branch; Deutsche Bank AG, acting through its New York Branch ("DB"); Scotiabank de Puerto Rico; Banco Bilbao Vizcaya Argentaria S.A., acting through its New York Branch; and Banco Bilbao Vizcaya Argentaria, Puerto Rico (collectively, the "Revolving Credit Banks") advanced to the Commonwealth funds to cover cash requirements in anticipation of the issuance of the Notes evidenced by a note maturing on December 31, 2006. The outstanding principal amount of \$600 million under the Revolving Credit and Term Loan Agreement and related note will be repaid in full with proceeds from the sale of the Notes.

The Revolving Credit and Term Loan Agreement will be further amended and restated as of October 1, 2006, on the date of delivery of the Notes (the "Revolving Credit Agreement") to remove DB as a Revolving Credit Bank and to add Banco Santander Puerto Rico as a Revolving Credit Bank, and to allow the Commonwealth to borrow from the Revolving Credit Banks up to an amount equal to (i) the maximum permitted under the Act (being the lesser of (A) \$1.5 billion and (B) eighteen percent (18%) of the net revenues of the General Fund for the previous fiscal year) less (ii) the outstanding principal amount of the Notes. The Commonwealth may borrow under the Revolving Credit Agreement through and including June 30, 2007, and all amounts due and owing thereunder shall be paid in full no later than August 1, 2007. Amounts borrowed under the Revolving Credit Agreement will be evidenced by a substitute Revolving Credit Note issued under the Act and the Note Resolution; provided, however, that after the issuance of the Notes, the principal amount of the Revolving Credit Note, together with the principal amount of the Notes, may not exceed the maximum permitted under the Act. The amounts due under the Revolving Credit Note will be paid from moneys set aside in the Note Fund (as described below), after any required transfers

from the General Fund to the Redemption Fund as required by law, from which principal of and interest on the Letter of Credit Note is also to be paid.

The Note Fund

The payment obligations under the Notes, the Letter of Credit Note and the Revolving Credit Note are payable solely from the taxes and revenues in the General Fund collected by the Secretary of the Treasury after the date of issuance of the Notes and on or prior to June 30, 2007 and deposited in the Note Fund as more fully described below. All moneys in the Note Fund required for such purpose shall be used on a *pari passu* basis to pay the amounts due under the Notes, Letter of Credit Note and the Revolving Credit Note, and shall be used for no other purpose; provided, however, that pursuant to certain constitutional and statutory authorizations, payments on general obligation bonds and notes of the Commonwealth and, on bonds and notes of its public corporations guaranteed by the Commonwealth, have a claim on Commonwealth taxes and revenues, including amounts on deposit in the Note Fund, prior to the claim thereon of the Notes, the Letter of Credit Note and the Revolving Credit Note.

After any required transfers from the General Fund to the Special Fund for the Amortization of General Obligations Evidenced by Bonds and Promissory Notes (the “Redemption Fund”), the Secretary of the Treasury, beginning on April 1, 2007, will withdraw from the General Fund all taxes and revenues required to be deposited therein from April 1, 2007 through June 30, 2007, together with any taxes and revenues collected after the issuance of the Notes and then on deposit in the General Fund. Such taxes and revenues will be deposited in the Note Fund until the amount on deposit in the Note Fund by the last calendar day of the months indicated below equals the following percentages of the sum of (1) the principal of and interest on the Notes to be paid at maturity and (2) the outstanding principal balance of the Revolving Credit Note and accrued interest thereon to be paid from time to time as the same becomes due and payable (such sum being herein called the “Note Fund Requirement”):

<u>2007</u>	<u>Percentage of Note Fund Requirement</u>
April	33 $\frac{1}{3}$ %
May	66 $\frac{2}{3}$ %
June	100%

The Secretary of the Treasury covenants in the Note Resolution to compute on a cash basis on or before the tenth (10th) day of each month, commencing on November 10, 2006, projected taxes and revenues expected to be deposited in, expenditures from, and fund balances of the General Fund for each month remaining in fiscal year 2007. If, on the basis of such computations, the Secretary of the Treasury determines that the Note Fund Requirement less any amount then on deposit in the Note Fund equals or exceeds 85% of the sum of all taxes and revenues expected to be deposited in the General Fund from the later of the date of such determination and April 1, 2007 through June 30, 2007 after accounting for any required transfers from the General Fund to the Redemption Fund, the Secretary of the Treasury shall immediately withdraw sufficient amounts of taxes and revenues as received from the General Fund, shall make any required transfers to the Redemption Fund, and thereafter shall transfer to the Note Fund sufficient amounts of such taxes and revenues as received as will cause the amount on deposit in the Note Fund to equal the Note Fund Requirement.

Neither the full faith, credit and taxing power of the Commonwealth nor that of any of its political subdivisions are pledged for the payment of principal of or interest on the Notes, the Letter of Credit Note or the Revolving Credit Note.

Provision for Prior Payment of Full Faith and Credit Obligations of the Commonwealth

The Constitution of Puerto Rico provides that public debt of the Commonwealth constitutes a first lien on available Commonwealth taxes and revenues. Public debt includes bonds and notes of the Commonwealth to which the full faith, credit and taxing power of the Commonwealth are pledged and, according to opinions heretofore rendered by the Secretary of Justice of Puerto Rico, any payments which are required to be made by the Commonwealth under its guarantees of bonds and notes issued by its public corporations. The Notes do not constitute public debt.

Under the provisions of Act No. 39 of the Commonwealth, approved May 13, 1976, as amended, the Secretary of the Treasury is obligated to fund annual debt service on general obligation bonds and notes of the Commonwealth by monthly deposits into the Redemption Fund. As of October 5, 2006, the amount on deposit in the Redemption Fund was approximately \$141.8 million, which was the required amount. Fiscal year 2007 deposits from the General Fund to the Redemption Fund to fund the projected debt service through July 1, 2007, exclusive of debt service on any general obligation bonds that may be issued in fiscal year 2007, are expected to total \$517.9 million. In addition to moneys from the General Fund, the Redemption Fund receives a certain portion of moneys collected by the municipalities from property tax collections which portion for fiscal year 2007 is expected to total \$111.1 million.

Moneys in the Redemption Fund are not available to pay the Notes.

Debt Limitation with Respect to Full Faith and Credit Obligations

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 and license fees, which are allocated to the Puerto Rico 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.

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.

Joint Resolution No. 2104 of September 30, 2004 ("Joint Resolution No. 2104"), authorized the Commonwealth to enter into interest rate exchange agreements with respect to the Commonwealth's \$447,875,000 Public Improvement Refunding Bonds, Series 2004 B (the "Series 2004 B Bonds"), which were issued as variable rate bonds. Joint Resolution No. 2104 allows the Commonwealth to calculate the constitutional debt limitation using (i) the fixed rate it is required to pay under any interest rate exchange agreements entered into by the Commonwealth in connection with the Series 2004 B Bonds, and (ii) the lesser of (A) the maximum interest rate allowed by law and (B) the maximum interest rate set forth in the resolution approving the bonds, if any, in connection with the Commonwealth's \$279,240,000 Public Improvement Refunding Bonds, Series 2004 A (the "Series 2004 A Bonds") and any Series 2004 B Bonds for which no interest rate exchange agreement is executed. In November 2004, the Commonwealth entered into two interest rate exchange agreements with respect to the Series 2004 B Bonds.

Future maximum annual debt service for the Commonwealth's outstanding general obligation debt is \$768,843,249.58 in the fiscal year ending June 30, 2020 (based on the assumption that (i) the bonds refunded with non-eligible investment are treated as being outstanding, (ii) the Series 2004 A Bonds bear interest at their actual rate per annum through July 1, 2012 and thereafter at 12% per annum, and (iii) the Series 2004 B Bonds and the variable rate bonds issued as part of the Public Improvement Bonds of 2006, Series A (the "CPI Bonds"), bear interest at 12% per annum). The sum of those amounts \$768,843,250 is equal to 9.48% of \$8,113,386,000, which is the average of the adjusted internal revenues for the fiscal year ended June 30, 2005 and the currently estimated adjusted internal revenues for the fiscal year ended June 30, 2006. If the bonds refunded with noneligible investments were treated as not being outstanding, and the interest on the Series 2004 B Bonds and the CPI Bonds is calculated using the fixed rate paid by the Commonwealth under the interest rate exchange agreements executed in connection with such bonds, the percentage referred to in the preceding sentence would be 8.38%.

Debt service for the Puerto Rico Aqueduct and Sewer Authority (“PRASA”) guaranteed bonds of \$30,120,768 was paid by PRASA during fiscal year 2006 (including, for this purpose, debt service payments due and paid on July 1, 2006) and, thus, is not included in the calculation of the 15% debt limitation. See “Other Public Corporations - Aqueduct and Sewer Authority” under *Public Corporations* in the Commonwealth Report. In the event PRASA is unable to make any portion of the future debt service payments on its guaranteed bonds, the Commonwealth would be required to make such payments under its guarantee from the General Fund and such debt service would be included in the calculation of the 15% debt limitation.

The Notes are not subject to the above described constitutional debt limitation.

Estimated Note Revenues

The Commonwealth estimates that the taxes and revenues available for deposit in the Note Fund for fiscal year 2007 (consisting of taxes and revenues projected to be collected after the issuance of the Notes and prior to June 30, 2007, minus required deposits to the Redemption Fund) will be approximately \$6.162 billion. For fiscal year 2006, taxes and revenues which would have been available for deposit in the Note Fund were approximately \$4.432 billion.

Debt Limitation with Respect to Additional Parity Notes

The aggregate principal amount of notes issued under the Act with respect to any fiscal year and outstanding at any time shall not exceed, at the date such notes are issued, the lesser of (i) \$1.5 billion and (ii) eighteen percent (18%) of the net revenues of the General Fund for the previous fiscal year. Preliminary net revenues for fiscal year 2006 amounted to \$8.545 billion, such that the aggregate principal amount of notes issued under the Act during fiscal year 2007 shall not exceed \$1.538 billion. The Act provides that any notes issued thereunder shall mature on such date or dates not exceeding thirty (30) days after the close of the fiscal year in which such notes are issued. The Commonwealth has issued notes under the Act for prior fiscal years, which notes have since matured and been paid in full. Under the Note Resolution, the Commonwealth covenants not to create or suffer to be created any lien or charge upon the revenues in the Note Fund ranking equally or prior to the Notes, the Letter of Credit Note and the Revolving Credit Note. The aggregate principal amount of the Notes and the Revolving Credit Note shall not exceed the maximum permitted under the Act.

Payment Record

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

General Fund Monthly Cash Flow for Fiscal Year 2006 and Fiscal Year 2007

The Secretary of the Treasury has custody of the funds of the Commonwealth’s central government and is responsible for the accounting, disbursement and investment of such funds. 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, excise taxes and, beginning on November 15, 2006, Sale Taxes in substitution of 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. A detailed description of the Commonwealth’s major sources of General Fund revenues and components of General Fund expenditures, along with a Summary and Management’s Discussion of the General Fund Results for fiscal years 2003 through 2005, a discussion of the preliminary fiscal year 2006 results and a comparison of the fiscal year 2007 budget with the preliminary fiscal year 2006 results, appears under *Puerto Rico Taxes, Other Revenues, and Expenditures* in the Commonwealth Report.

The tables which follow set forth the actual monthly cash flow for the Commonwealth General Fund for fiscal year 2006 and the estimated monthly cash flow for fiscal year 2007. The monthly cash flow for fiscal 2006 is preliminary and does not take into account any audit adjustments.

The monthly cash flow estimates for fiscal year 2007 are based upon the constitutionally-mandated budget for fiscal year 2007 and upon historical experience as adjusted to reflect economic conditions, statutory and administrative

changes and anticipated payment dates for grants and subsidies, personal and other services, materials and supplies, equipment, capital outlays, debt service and transfers. These estimates are based on present circumstances and currently available information and are believed to be reasonable. Such estimates may be affected by numerous factors, including the continuing validity of the assumptions underlying the estimates, and there can be no assurance that such estimates will be achieved.

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Commonwealth of Puerto Rico
General Fund Cash Flows*
Fiscal Year 2006
(in thousands)

	July	August	September	October	November	December	January	February	March	April	May	June	Total
Beginning cash balance	\$ 42,933	\$ 417,669	\$ 271,910	\$ 401,765	\$ 483,369	\$ 509,890	\$ 856,362	\$ 780,599	\$ 511,090	\$ 417,562	\$ 427,600	\$ 176,285	\$ 42,933
Receipts:													
Income taxes	409,595	445,466	560,097	400,657	337,699	581,497	552,236	287,884	485,610	1,000,377	390,978	544,757	5,996,853
Commonwealth excise taxes	114,413	142,642	139,055	136,550	154,687	160,699	132,862	107,774	145,288	149,686	124,216	137,927	1,645,799
Inheritance and gift taxes	226	145	108	100	256	5,347	101	43	2,132	116	683	212	9,469
Licenses	3,816	5,284	10,692	20,360	9,994	6,570	5,703	4,392	7,624	5,143	4,492	6,746	90,816
Other internal sources	36,934	34,110	43,540	30,498	27,280	64,691	29,029	23,697	52,062	23,017	32,212	49,193	446,263
Non-Commonwealth sources	32,578	39,691	25,231	30,524	31,001	34,643	35,156	28,232	26,058	21,836	32,120	18,754	355,824
Other sources	-	-	-	-	-	-	-	-	-	-	-	100,000 ^(e)	100,000
Subtotal receipts	597,562	667,338	778,723	618,689	560,917	853,447	755,087	452,022	718,774	1,200,175	584,701	857,589	8,645,024
Other income (refunds) ^(a)	29,195	21,266	30,117	40,806	31,385	38,317	38,723	30,326	(12,112)	1,085	45,045	(218,068)	76,085
(Transfer) Refunding to Redemption Fund ^(b)	(40,401)	(40,401)	(40,401)	(40,401)	(40,401)	(40,401)	(40,401)	(40,401)	(40,401)	(40,401)	(40,401)	(40,401)	(484,812)
Proceeds of notes and other borrowings ^(c)	833,000	165,000	126,025	231,025	446,025	1,339,722 ^(d)	46,025	46,025	46,025	46,025	371,000	420,000 ^(f)	4,115,897
Repayment of notes and other borrowings ^(d)	(100,000)	(173,000)	(100,000)	(90,000)	(50,000)	(1,095,416)	-	-	-	(500,000)	(440,000)	(457,422)	(3,005,838)
Total available cash from operations	1,319,356	640,203	794,464	760,119	947,926	1,095,669	799,434	487,972	712,286	706,884	520,345	561,698	9,346,356
Disbursements:													
Grants and subsidies	515,231	362,413	267,500	210,779	335,170	283,161	352,589	294,862	344,858	284,035	364,543	331,209	3,946,349
Personal services	404,373	380,471	363,423	391,628	514,736	413,634	419,031	399,458	415,034	382,007	361,646	352,441	4,797,882
Other services	21,698	36,826	21,534	74,539	67,707	46,659	76,163	51,645	31,541	18,595	39,002	39,754	525,663
Materials and supplies	2,570	4,276	7,087	377	2,606	4,369	3,813	8,922	5,768	1,584	5,715	3,140	50,227
Equipment purchases	748	1,976	3,565	1,192	1,185	1,374	1,263	2,095	2,112	452	740	2,677	19,378
Other debt service and capital outlays	-	-	1,500	-	-	-	22,338	499	6,501	10,173	15	8,762	49,789
PY Other disbursements	-	-	-	-	-	-	-	-	-	-	-	-	-
Total disbursements	944,620	785,962	664,609	678,515	921,404	749,197	875,197	757,481	805,814	696,846	771,661	737,983	9,389,289
Total available cash less transfers and disbursements	374,736	(145,759)	129,855	81,604	26,522	346,472	(75,763)	(269,509)	(93,528)	10,038	(251,315)	(176,285)	(42,933)
Ending Cash Balance	\$ 417,669	\$ 271,910	\$ 401,765	\$ 483,369	\$ 509,890	\$ 856,362	\$ 780,599	\$ 511,090	\$ 417,562	\$ 427,600	\$ 176,285	\$ 0	\$ 0

* Preliminary
(a) Consists of net revenue from General Fund's non budgetary funds plus a reserve for future tax refunds reduced by actual and estimated tax refunds.
(b) Consists of amounts to pay principal of and interest on general obligation bonds of the Commonwealth. Does not include amounts deposited directly to the Redemption Fund from non-General Fund revenues.
(c) Consists of proceeds of borrowing from the Government Development Bank and proceeds from Commonwealth's Tax and Revenue Anticipation Notes, including \$741 million loan authorized by the Legislature.
(d) Consists of repayments of borrowing from the Government Development Bank and repayments of Commonwealth's tax and revenue anticipation notes.
(e) Represent an interest rate swap transaction.
(f) Includes \$50 million from the Emergency Fund used for operating expenses.
(g) Amount is net of costs of issuance of the Commonwealth's Tax and Revenue Anticipation Notes, Series 2006.

Commonwealth of Puerto Rico
General Fund Cash Flows*
Fiscal Year 2007
(in thousand)

	July	August	September	October	November	December	January	February	March	April	May	June	Total
Beginning cash balance	\$ -	\$ 264,257	\$ 100,105	\$ 124,628	\$ 445,430	\$ 515,888	\$ 651,540	\$ 623,169	\$ 498,547	\$ 456,986	\$ 559,655	\$ 84,082	\$ -
Receipts:													
Income taxes	482,600	385,200	574,400	374,700	355,000	579,800	483,300	349,800	467,200	1,067,100	406,400	471,500	5,997,000
Commonwealth excise taxes	111,200	121,200	128,800	142,500	130,800	109,900	93,000	80,200	104,000	107,100	90,600	116,700	1,336,000
Inheritance and gift taxes	1,000	200	500	300	300	400	300	300	300	100	200	100	4,000
Sales and use tax	-	-	-	-	-	40,000	110,400	84,600	98,100	101,400	100,900	107,600	643,000
Licenses	5,200	5,200	11,000	28,800	8,100	7,900	7,300	6,100	6,400	6,200	5,600	7,200	105,000
Other internal sources	24,500	33,200	35,000	31,400	29,700	58,800	30,000	29,100	40,600	32,400	38,000	56,300	439,000
Non-Commonwealth sources	18,700	31,600	31,700	26,400	30,700	40,700	34,300	33,800	26,900	31,200	35,400	33,600	375,000
Subtotal receipts	643,200	576,600	781,400	604,100	554,600	837,500	758,600	583,900	743,500	1,345,500	677,100	793,000	8,899,000
Other income (refunds) (a)	(24,000)	60,000	60,000	60,000	60,000	234,000	42,000	35,098	(24,507)	(5,854)	35,565	(334,301)	198,000
(Transfer) Refunding to Redemption Fund (b)	(42,683)	(42,683)	(42,683)	(42,683)	(42,683)	(42,683)	(42,683)	(42,683)	(42,683)	(42,683)	(42,683)	(42,683)	(512,197)
Proceeds of notes and other borrowings (c)	600,000	-	-	1,000,000 (f)	300,000	-	-	-	-	-	-	-	1,900,000
Repayment of notes and other borrowings (d)	-	(3,720)	(3,300)	(604,000)	(600)	(2,345)	(2,345)	(2,345)	(2,345)	(445,803)	(445,803)	(445,803)	(1,958,409)
Total available cash from operations	1,176,517	590,197	795,417	1,017,417	871,317	1,026,472	755,572	573,970	673,965	851,160	224,179	(29,788)	8,526,394
Disbursements:													
Grants and subsidies	305,390	188,437	221,638	148,616	184,789	258,355	213,454	165,851	188,586	180,450	185,463	176,228	2,417,257
Personal services	478,567	435,212	429,016	460,749	529,687	541,593	464,276	440,016	459,905	505,409	447,806	437,932	5,630,170
Other services	46,072	52,323	34,330	70,806	57,738	52,010	72,010	67,281	36,179	35,298	46,564	38,423	609,034
Materials and supplies	10,329	15,173	20,138	13,362	8,465	15,187	11,460	21,682	15,206	16,645	18,587	7,771	174,005
Equipment purchases	12,936	4,239	5,212	3,002	2,156	3,485	2,699	3,283	3,084	1,560	1,296	4,816	47,767
Other debt service and capital outlays	-	-	1,594	80	18,024	20,189	20,044	479	12,564	9,128	34	7,863	90,000
PY Other disbursements	58,966	58,966	58,967	-	-	-	-	-	-	-	-	-	176,899
Total disbursements	912,260	754,349	770,894	696,616	800,859	890,820	783,943	698,592	715,525	748,491	699,752	673,031	9,145,132
Total available cash less transfers and disbursements	264,257	(164,152)	24,524	320,801	70,458	135,652	(28,371)	(124,622)	(41,561)	102,669	(475,573)	(702,820)	(618,738)
Ending Cash Balance	\$ 264,257	\$ 100,105	\$ 124,628	\$ 445,430	\$ 515,888	\$ 651,540	\$ 623,169	\$ 498,547	\$ 456,986	\$ 559,655	\$ 84,082	\$ (618,738)	\$ (618,738)
Ending cash balance without considering TRANS (h)	\$ (335,743)	\$ (496,175)	\$ (468,352)	\$ (543,550)	\$ (772,492)	\$ (634,495)	\$ (660,521)	\$ (782,798)	\$ (822,014)	\$ (273,542)	\$ (303,313)	\$ (560,329)	\$ (618,738)

* As per approved Commonwealth budget.
(a) Consists of net revenue from General Fund's non budgetary funds plus a reserve for future tax refunds reduced by actual and estimated tax refunds.
(b) Consists of amounts to pay principal of and interest on general obligation bonds of the Commonwealth. Does not include amounts deposited directly to the Redemption Fund from non-General Fund revenues.
(c) Consists of proceeds of borrowing from the private bank line of credit syndicate and proceeds from Commonwealth's Tax and Revenue Anticipation Notes, Series 2007.
(d) Consists of repayments of borrowing from the private bank line of credit syndicate and repayments of Commonwealth's Tax and Revenue Anticipation Notes, Series 2007.
(e) Includes \$264M of non recurring tax measures.
(f) Proceeds from the Commonwealth's Tax and Revenue Anticipation Notes, Series 2007, net of costs of issuance, and proceeds of borrowing from the private bank line of credit syndicate.
(g) See "Recent Developments, Fiscal Year 2007 Budget" above for an explanation of the measures the Commonwealth expects to take to reduce this deficit.
(h) Amount net of cost of issuance.

Inter-Fund Borrowings

The Commonwealth historically has used inter-fund borrowings to meet temporary imbalances of receipts and disbursements in the General Fund. Act No. 147 of the Commonwealth, approved on June 18, 1980, provides that in any fiscal year where revenues of the General Fund are not sufficient to meet approved appropriations for such year, the Governor may authorize the Secretary of the Treasury to borrow funds from Government Development Bank and, if necessary, from any funds of the Commonwealth under his custody, on such terms and conditions as the Secretary of the Treasury deems advisable. Funds available for this purpose do not include public pension funds and funds of public employees' associations. No moneys are currently borrowed from Government Development Bank under this Act 147. Moneys so borrowed must be repaid as soon as there is sufficient money in the General Fund to do so. Moneys borrowed and repaid by the General Fund are accounted for as "Operating Transfers In" and "Operating Transfers Out," respectively, in the financial statements of the Commonwealth and included in certain revenue and expenditure line items in the table entitled "General Fund Revenues, Expenditures, and Changes in Cash Balance" in "Summary and Management's Discussion of General Fund Results" under *Puerto Rico Taxes, Other Revenues, and Expenditures* in the Commonwealth Report.

As of September 30, 2006, funds aggregating approximately \$378.8 million under the custody of the Secretary of the Treasury were available for inter-fund borrowings, if necessary.

TAX MATTERS

In the opinion of Squire, Sanders & Dempsey L.L.P., Bond Counsel, under existing law: (i) interest on the Notes is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; and (ii) the Notes and the interest thereon are exempt from state, Commonwealth and local income taxation. Bond Counsel expresses no opinion as to any other tax consequences regarding the Notes.

The opinion on tax matters will be based on and will assume the accuracy of certain representations and certifications, and continuing compliance with certain covenants, of the Commonwealth contained in the transcript of proceedings and that are intended to evidence and assure the foregoing, including that the Notes are and will remain obligations the interest on which is excluded from gross income for federal income tax purposes. Bond Counsel will not independently verify the accuracy of the Commonwealth's certifications and representations or the continuing compliance with the Commonwealth's covenants.

The opinion of Bond Counsel is based on current legal authority and covers certain matters not directly addressed by such authority. It represents Bond Counsel's legal judgment as to exclusion of interest on the Notes from gross income for federal income tax purposes but is not a guaranty of that conclusion. The opinion is not binding on the Internal Revenue Service ("IRS") or any court. Bond Counsel expresses no opinion about (i) the effect of future changes in the Code and the applicable regulations under the Code or (ii) the interpretation and the enforcement of the Code or those regulations by the IRS.

The Code prescribes a number of qualifications and conditions for the interest on state and local government obligations to be and to remain excluded from gross income for federal income tax purposes, some of which require future or continued compliance after issuance of the obligations. Noncompliance with these requirements by the Commonwealth may cause loss of such status and result in the interest on the Notes being included in gross income for federal income tax purposes retroactively to the date of issuance of the Notes. The Commonwealth has covenanted to take the actions required of it for the interest on the Notes to be and to remain excluded from gross income for federal income tax purposes, and not to take any actions that would adversely affect that exclusion. After the date of issuance of the Notes, Bond Counsel will not undertake to determine (or to so inform any person) whether any actions taken or not taken, or any events occurring or not occurring, or any other matters coming to Bond Counsel's attention, may adversely affect the exclusion from gross income for federal income tax purposes of interest on the Notes or the market prices of the Notes.

A portion of the interest on the Notes earned by certain corporations may be subject to a federal corporate alternative minimum tax. In addition, interest on the Notes may be subject to a federal branch profits tax imposed on certain foreign corporations doing business in the United States and to a federal tax imposed on excess net passive income of certain S corporations. Under the Code, the exclusion of interest from gross income for federal income tax purposes may have certain adverse federal income tax consequences on items of income, deduction or credit for certain taxpayers, including financial institutions, certain insurance companies, recipients of Social Security and Railroad Retirement benefits, those that are deemed to incur or continue indebtedness to acquire or carry tax-exempt obligations, and individuals otherwise eligible for the earned income tax credit. The applicability and extent of these and other tax consequences will depend upon the particular tax status or other tax items of the owner of the Notes. Bond Counsel will express no opinion regarding those consequences.

Legislation affecting tax-exempt obligations is regularly considered by the United States Congress. There can be no assurance that legislation enacted or proposed, or clarification of the Code, after the date of issuance of the Notes, will not have an adverse effect on the tax status of interest on the Notes or the market prices of the Notes.

Prospective purchasers of the Notes should consult their own tax advisers regarding pending or proposed federal tax legislation, and prospective purchasers of the Notes at other than their original issuance at the price indicated on the cover of this Official Statement should also consult their own tax advisers regarding other tax considerations such as the consequences of market discount, as to all of which Bond Counsel expresses no opinion.

Bond Counsel's engagement with respect to the Notes ends with the issuance of the Notes, and, unless separately engaged, Bond Counsel is not obligated to defend the Commonwealth or the beneficial owners regarding the tax status of interest on the Notes in the event of an audit examination by the IRS. The IRS has a program to audit tax-exempt obligations to determine whether the interest thereon is includible in gross income for federal income tax purposes. If the IRS does audit the Notes, under current IRS procedures, the IRS will treat the Commonwealth as the taxpayer and the beneficial owners of the Notes will have only limited rights, if any, to obtain and participate in judicial review of such audit. Any action of the IRS, including but not limited to selection of the Notes for audit, or the course or result of such audit, or an audit of other obligations presenting similar tax issues, may affect the market prices for the Notes.

Original Issue Premium

The Notes are expected to be offered and sold to the public at a price in excess of their stated redemption price (the principal amount) at maturity. That excess constitutes bond premium. For federal income tax purposes, bond premium is amortized over the period to maturity of a Note, based on the yield to maturity of that Note, compounded semiannually. No portion of that bond premium is deductible by the owner of a Note. For purposes of determining the owner's gain or loss on the sale, redemption (including redemption at maturity) or other disposition of a Note, the owner's tax basis in the Note is reduced by the amount of bond premium that accrues during the period of ownership. As a result, an owner may realize taxable gain for federal income tax purposes from the sale or other disposition of a Note for an amount equal to or less than the amount paid by the owner for that Note. A purchaser of a Note in the initial public offering at the price for that Note stated on the cover of this Official Statement who holds that Note to maturity will realize no gain or loss upon the retirement of that Note.

Owners of Notes should consult their own tax advisers as to the determination for federal income tax purposes of the amount of bond premium properly accruable in any period with respect to the Notes and as to other federal tax consequences and the treatment of bond premium for purposes of state, Commonwealth and local taxes on, or based on, income.

LEGAL MATTERS

The proposed form of opinion of Squire, Sanders & Dempsey L.L.P., Bond Counsel, is set forth in Appendix II to this Official Statement. Certain legal matters will be passed upon for the Underwriters by McConnell Valdés, San Juan, Puerto Rico. Certain legal matters will be passed on for the Letter of Credit Banks by Chapman and Cutler LLP, Chicago, Illinois.

LEGAL INVESTMENT

The Notes 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.

UNDERWRITING

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Notes from the Commonwealth at an aggregate discount of \$1,097,558.89 from the initial offering price of the Notes. The obligations of the Underwriters are subject to certain conditions precedent, and the Underwriters will be obligated to purchase all the Notes, if any Notes are purchased. The Underwriters may offer to sell the Notes to certain dealers (including dealers depositing the Notes into unit investment trusts, certain of which may be sponsored or managed by the Underwriters) and others at prices lower than the initial public offering prices, and such offering price may be changed, from time to time, by the Underwriters.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

As required by Act No. 272 of the Commonwealth, as amended, Government Development Bank has acted as financial advisor to the Commonwealth in connection with the Notes.

As financial advisor, Government Development Bank participated in the selection of the Underwriters of the Notes. 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 Notes ratings of MIG 1 and SP-1+, respectively, after taking into account the security provided by the Letter of Credit. The 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 Notes and other relevant information, and no application has been made to any other rating agency for the purpose of obtaining a rating on the Notes.

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 price of the Notes.

CONTINUING DISCLOSURE

In accordance with the requirements of Rule 15c2-12, as amended (the "Rule"), promulgated by the U.S. Securities and Exchange Commission, the Commonwealth has covenanted for the benefit of the Underwriters and beneficial owners (generally the tax owners of the Notes as follows):

To file in a timely manner, with each NRMSIR or with the MSRB, and with any Commonwealth and state information depository ("SID"), notice of the occurrence of any of the following events with respect to the Notes, 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 Notes;
- (g) modifications to rights of the holders (including beneficial owners) of the Notes;
- (h) Note calls;
- (i) defeasances;
- (j) release, substitution, or sale of property securing repayment of the Notes; and
- (k) rating changes.

Events (c), (d) and (e) are included pursuant to a letter from the SEC staff to the National Association of Bond Lawyers, dated September 19, 1995. Event (c) may not be applicable, since the terms of the Notes do not provide for “debt service reserves”. Events (h) and (i) are not applicable since the terms of the Notes and the Note Resolution do not contain any “call” or “defeasance” provisions. 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 Notes, unless the Commonwealth applies for or participates in obtaining the enhancement.

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

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 Notes, but the Commonwealth does not undertake to provide any such notice of the occurrence of any material event except those events listed above.

On September 7, 2004, the Commission released an interpretive letter (the "Letter") approving the use of www.DisclosureUSA.org ("DisclosureUSA"), created by the Municipal Advisory Council of Texas ("Texas MAC"), as a means by which continuing disclosure filings may be made under the Rule, subject to certain qualifications set forth in the Letter. The Commonwealth may choose to satisfy its obligations to file the information required by the Rule with the repositories by transmitting such filings (the "Filings"), either directly or indirectly through a designated agent, to DisclosureUSA for submission to each NRMSIR and SID (without also separately submitting the Filings to the NRMSIRs and SID by some other means). The Commonwealth intends to monitor the performance of Texas MAC with regard to the submission of the Filings to the NRMSIRs and SID. In the event that Texas MAC fails, with respect to the Filings, to perform the functions or undertake the responsibilities referenced in the Letter, or if for any reason the Commission modifies or revokes its interpretation described in the Letter, such that transmission of the Filings to DisclosureUSA would no longer satisfy the Commonwealth's obligation under this Resolution, the Commonwealth will separately submit the Filings to the NRMSIRs and SID.

The Commonwealth has made similar continuing disclosure covenants in connection with prior securities issuances, and has complied with all such covenants, except as follows. 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 also filed after 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's audited financial statements for the fiscal year ended June 30, 2004 and the Commonwealth Report for such fiscal year were also filed after the Commonwealth's filing deadline of May 1, 2005, because of delays in preparation of such documents.

As of the date of this Official Statement, there is no Commonwealth SID, and the name and address of each NRMSIR is: Bloomberg Municipal Repository, 100 Business Park Drive, Skillman, New Jersey 08558; S&P's: J.J. Kenny Repository, 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 acknowledges that its undertakings pursuant to the Rule described above are intended to be for the benefit of the Beneficial Owners of the Notes, 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 obligations hereunder.

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, for the equal benefit of all beneficial owners of the outstanding Notes benefited by the Covenants, and no remedy shall be sought or granted other than specific performance of the Covenant at issue. 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 (32 L.P.R.A. §§ 3077-3077a), 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 Notes, after taking into account any amendments or change in circumstances; and the amendment does not materially impair the interests of beneficial owners, as determined by parties 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 Covenant shall be deemed amended accordingly.

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 to comply with the Rule.

MISCELLANEOUS

The foregoing summaries of or references to the various acts, the Notes, the Note Resolution, the Letter of Credit, the Revolving Credit Agreement, the Reimbursement Agreement, the Commonwealth Report, and the summaries of or references to the various acts and provisions contained in such documents 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 is the form of Letter of Credit (Appendix I), the proposed form of opinion of Bond Counsel (Appendix II) and Descriptions of the Letter of Credit Banks (Appendix III).

The information included in this Official Statement and incorporated herein by reference, except for information pertaining to DTC, the information appearing in Underwriting and the descriptions of the Letter of Credit Banks, 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.

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

COMMONWEALTH OF PUERTO RICO

By: /s/ Juan Carlos Méndez Torres
Secretary of the Treasury
Commonwealth of Puerto Rico

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FORM OF LETTER OF CREDIT

IRREVOCABLE DIRECT-PAY LETTER OF CREDIT

NO. 92141/80085 (THE BANK OF NOVA SCOTIA, ACTING THROUGH ITS HATO REY BRANCH); DCL0610204 (DEXIA CREDIT LOCAL, ACTING THROUGH ITS NEW YORK BRANCH); 91892514 (BNP PARIBAS, ACTING THROUGH ITS SAN FRANCISCO BRANCH); CT-044818 (FORTIS BANK S.A./N.V., ACTING THROUGH ITS CONNECTICUT BRANCH); NO. SBLC6702284NY (BANCO BILBAO VIZCAYA ARGENTARIA, ACTING THROUGH ITS NEW YORK BRANCH); NO. S027406 (BANCO SANTANDER CENTRAL HISPANO, SA, ACTING THROUGH ITS NEW YORK BRANCH)

October 26, 2006

Banco Popular
de Puerto Rico,
as Paying Agent
Trust Division
153 Ponce de Leon Avenue, Suite 800
Hato Rey, Puerto Rico 00918

Attention: Corporate Trust Department

Ladies and Gentlemen:

1. At the request of the Commonwealth of Puerto Rico (the "*Commonwealth*"), the Banks listed on the signature pages hereto (the "*Banks*") hereby establish in favor of Banco Popular de Puerto Rico, as paying agent (together with its successors and assigns, the "*Paying Agent*"), their Irrevocable Direct-Pay Letter of Credit No. 92141/80085 (The Bank of Nova Scotia, acting through its Hato Rey Branch); DCL0610204 (Dexia Credit Local, acting through its New York Branch); 91892514 (BNP Paribas, acting through its San Francisco Branch); CT-044818 (Fortis Bank S.A./N.V., acting through its Connecticut Branch); No. SBLC6702284NY (Banco Bilbao Vizcaya Argentaria, acting through its New York Branch); No. S027406 (Banco Santander Central Hispano, SA, acting through its New York Branch) (this "*Letter of Credit*") issued pursuant to that certain Reimbursement Agreement dated as of October 1, 2006 (the "*Reimbursement Agreement*"), by and among the Commonwealth, the Banks listed on the signature pages thereof, The Bank of Nova Scotia, acting through its New York Agency, as Lead Arranger and Administrative Agent (referred to in such capacity as the "*Administrative Agent*"), and BNP Paribas, acting through its San Francisco Branch ("*BNP Paribas*"), and Dexia Credit Local, acting through its New York Branch ("*Dexia*"), as Co-Agents (the "*Co-Agents*"), in the initial stated amount of \$905,078,125 in Dollars (as defined in the Reimbursement Agreement) (said initial stated amount equal to the principal amount of the Notes (as defined herein) on the Effective Date (as defined in the Reimbursement Agreement), plus interest thereon at an assumed rate of 4.50% per annum for a period of 275 days based upon a year of 360 days as such amount may be reduced from time to time as herein provided, herein referred to as the "*Stated Amount*"), which may be drawn upon by the Paying Agent to pay the principal of the Commonwealth's Tax and Revenue Anticipation Notes, Series 2007 (the "*Notes*") on the stated maturity thereof together with accrued and unpaid interest thereon. Anything in this Letter of Credit to the contrary notwithstanding, the obligations of the Banks as issuers hereof shall be several and not joint. The obligations of (i) The Bank of Nova Scotia, acting through its Hato Rey Branch ("*Scotiabank*") hereunder shall not exceed \$316,777,343.75, (ii) BNP Paribas hereunder shall not exceed 171,964,843.75, (iii) Dexia hereunder shall not exceed \$171,964,843.75, (iv) Fortis Bank S.A./N.V., acting through its Connecticut Branch ("*Fortis*") hereunder shall not exceed \$135,761,718.75, (v) Banco Bilbao Vizcaya Argentaria S.A., acting through its New York Branch ("*BBVA*") hereunder shall not exceed \$81,457,031.25 and (vi) Banco Santander

Central Hispano, SA, acting through its New York Branch (“BSCH”) hereunder shall not exceed \$27,152,343.75. Subject to the foregoing limitation, the several obligation of Scotiabank hereunder shall equal 35.0% of the Drawing, the several obligation of BNP Paribas hereunder shall equal 19.0% of the Drawing, the several obligation of Dexia hereunder shall equal 19.0% of the Drawing, the several obligation of Fortis hereunder shall equal 15.0% of the Drawing, the several obligation of BBVA hereunder shall equal 9.0% of the Drawing and the several obligation of BSCH hereunder shall equal 3.0% of the Drawing.

2. This Letter of Credit shall expire at 5:00 p.m., New York City time, on the date (the “*Termination Date*”) which is the earliest of: (i) August 1, 2007 (the “*Stated Expiration Date*”), (ii) the date of payment of the Drawing by the Administrative Agent to the Paying Agent, (iii) the Administrative Agent’s, on behalf of the Banks, receipt of a certificate signed by your duly authorized officer in the form of Annex B attached hereto appropriately completed, or (iv) the date when you surrender the original of this Letter of Credit to the Administrative Agent on behalf of the Banks, for cancellation. You agree to surrender the original of this Letter of Credit to the Administrative Agent on behalf of the Banks, after the Termination Date.

3. Funds under this Letter of Credit are available to you against your presentation of a drawing certificate in the form of Annex A attached hereto (the “*Drawing*”) to the Administrative Agent, on behalf of the Banks, at The Bank of Nova Scotia, New York Agency, One Liberty Plaza, 24th Floor, New York, New York 10006, Attention: Letter of Credit, Telephone: (212) 225-5424, Telecopy: (212) 225-6464, or at such other address and/or number which may be designated by the Administrative Agent by written notice delivered to the Paying Agent. Without limiting the obligations of the Banks under this Letter of Credit, the Administrative Agent, on behalf of the Banks, shall receive the Drawing, determine whether it complies with the terms and conditions hereof and promptly notify each Bank of the Drawing. The Drawing so presented shall have all blanks appropriately filled in and shall be signed by a person who purports to be an authorized officer of the Paying Agent and shall be in the form of a letter on the letterhead of the Paying Agent delivered or telecopied to the Administrative Agent.

4. The Administrative Agent, on behalf of the Banks, hereby agrees that demand for payment made under and in strict compliance with the terms of this Letter of Credit will be duly honored upon receipt of the Drawing request as specified in paragraph 3 hereof and if presented at the aforesaid office on or before the Termination Date. If the Drawing is received by the Administrative Agent at or prior to 10:00 a.m., New York time, on July 27, 2007, and provided that the documents presented in connection therewith strictly conform to the terms and conditions hereof, payment shall be made of the amount specified in immediately available funds, on July 30, 2007 no later than 11:00 a.m. New York time. If the Drawing is received by the Administrative Agent at or prior to 10:00 a.m., New York time, on July 30, 2007 or July 31, 2007, and *provided* that the documents presented in connection therewith strictly conform to the terms and conditions hereof, payment shall be made of the amount specified in immediately available funds, no later than 11:00 a.m., New York time, on the immediately succeeding Business Day. If the Drawing is received hereunder after 10:00 a.m., New York time, on July 27, 2007 or July 30, 2007, payment shall be made of the amount specified in immediately available funds, no later than 11:00 a.m., New York time, on the second Business Day immediately succeeding the date of such Drawing. Payment under this Letter of Credit shall be made by the Banks by wire transfer of immediately available funds of each Bank to the Administrative Agent who shall remit such amounts to the Paying Agent in accordance with the instructions specified by the Paying Agent in the drawing certificate relating to the Drawing hereunder. Such account may be changed only by presentation to the Administrative Agent of a letter in form satisfactory to the Administrative Agent specifying a different account with the Paying Agent and executed by the Paying Agent. As used in this Letter of Credit, “*Business Day*” shall mean a day other than (i) a Saturday or Sunday, (ii) any other day on which banks located in New York, New York or the cities in which the principal office of the Administrative Agent and the Paying Agent are located are authorized by law to close or (iii) a day on which the New York Stock Exchange is closed. The obligations of the Banks under this Letter of Credit shall be several and not joint, and each Bank shall pay in respect of the Drawing presented in accordance with the terms hereof an amount equal to such Bank’s percentage of the amount of the Drawing as specified above. The Administrative Agent will promptly remit such amounts received from the Banks to the Paying Agent. Neither the Administrative Agent nor any Bank shall be responsible or otherwise liable for any other Bank’s failure to perform its obligations under this Letter of Credit, nor shall the failure of any Bank to perform its obligations under this Letter of Credit relieve any other Bank of its obligations hereunder. The Administrative Agent shall not be liable for the failure of any Bank to perform its obligations under this Letter of Credit.

5. Only the Paying Agent may make the Drawing under this Letter of Credit. Upon payment as provided in paragraph 4 of the amount specified in the Drawing drawn hereunder, the Banks shall be fully discharged of their obligation under this Letter of Credit with respect to such Drawing.

6. This Letter of Credit is intended to apply only to the payment of the principal amount of the Notes and accrued interest thereon through and including July 30, 2007.

7. To the extent not inconsistent with the express terms hereof, this Letter of Credit shall be governed by and construed in accordance with the Uniform Customs and Practices for Documentary Credits (1993 Revision), International Chamber of Commerce Publication No. 500 (the "*Uniform Customs*"), except for Article 48(g) thereof, and, as to matters not governed by the Uniform Customs, this Letter of Credit shall be governed by the internal laws of the State of New York, including, without limitation, the Uniform Commercial Code as in effect in the State of New York. Communications with respect to this Letter of Credit shall be in writing and shall be addressed to the Administrative Agent at The Bank of Nova Scotia, New York Agency, One Liberty Plaza, 26th Floor, New York, New York 10006, Attention: Public Finance (or to such other address as the Administrative Agent, on behalf of the Banks, may specify to you in writing), specifically referring thereon to this Letter of Credit by its number.

8. You may transfer your rights under this Letter of Credit in their entirety (but not in part) to any transferee who has succeeded to you as Paying Agent under the Paying Agency Agreement (as defined in the Reimbursement Agreement) and such transferred rights may be successively transferred. Transfer of your rights under this Letter of Credit to any such transferee shall be effected upon the presentation to the Administrative Agent of this Letter of Credit accompanied by a transfer letter in the form attached hereto as Annex C.

10. This Letter of Credit sets forth in full our undertaking, and such undertaking shall not in any way be modified, amended, amplified or limited by reference to any document, instrument or agreement referred to herein (including, without limitation, the Notes), except only the certificates and letters referred to herein; and no such reference shall be deemed to incorporate herein by reference any document, instrument or agreement.

Very truly yours,

THE BANK OF NOVA SCOTIA, acting through its New York Agency, as Administrative Agent

THE BANK OF NOVA SCOTIA, acting through its Hato Rey Branch, as a Letter of Credit Bank

BNP PARIBAS, acting through its San Francisco Branch, as a Letter of Credit Bank

DEXIA CREDIT LOCAL, acting through its New York Branch, as a Letter of Credit Bank

FORTIS BANK S.A./N.V., acting through its Connecticut Branch, as a Letter of Credit Bank

BANCO BILBAO VIZCAYA ARGENTARIA S.A., acting through its New York Branch, as a Letter of Credit Bank

BANCO SANTANDER CENTRAL HISPANO, SA, acting through its New York Branch, as a Letter of Credit Bank

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FORM OF OPINION OF BOND COUNSEL

Upon delivery of the Notes, Squire, Sanders & Dempsey L.L.P. is prepared to render its final opinion with respect to the Notes in substantially the following form:

October __, 2006

Juan Carlos Méndez
Secretary of the Treasury of
Puerto Rico
San Juan, Puerto Rico

Re: \$875,000,000 Tax and Revenue Anticipation Notes of the Commonwealth of Puerto Rico, Series 2007

Dear Sir:

We have served as bond counsel in connection with the issuance by the Commonwealth of Puerto Rico (the "Commonwealth") of its \$875,000,000 aggregate principal amount of Tax and Revenue Anticipation Notes of the Commonwealth of Puerto Rico, Series 2007 (the "Notes"). The Notes are dated their initial date of delivery, mature on July 30, 2007 and bear interest at the rate of 4.50%, payable on July 30, 2007, all as set forth in the Note Resolution referred to hereinbelow. The Notes are issuable as registered notes without coupons in denominations of \$5,000 or any multiple thereof, in the manner and in accordance with the terms and conditions of the Note Resolution. The Notes are not subject to redemption prior to maturity.

In our capacity as bond counsel, we have examined the transcript of the proceedings (the "Transcript") of the Commonwealth relating to the issuance of the Notes, including, without limitation, Act No. 1 of the Legislature of Puerto Rico, approved June 26, 1987, as amended by Act No. 139 of the Legislature of Puerto Rico, approved on November 9, 2005 (collectively, the "Act"), and resolutions adopted on October 19, 2006 by the Secretary of the Treasury of Puerto Rico and approved by the Governor of Puerto Rico (collectively, the "Note Resolution"), and such other documents as we have deemed necessary to render this opinion.

We have also examined a copy of a Note as executed and authenticated. We assume that all other Notes have been similarly 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 Notes have been duly authorized and issued to fund a portion of the projected cash flow requirements of the Commonwealth's General Fund in fiscal 2007, which requirements result from timing differences between expected disbursements and receipts of taxes and revenues, and to repay amounts borrowed by the Commonwealth under a revolving line of credit (the "Line of Credit") obtained in advance of the issuance of the Notes. The Notes are valid and binding obligations of the Commonwealth and are payable (i) first from amounts drawn under an irrevocable direct-pay Letter of Credit of even date hereof (the "Letter of Credit") issued by The

Bank of Nova Scotia, acting through its Hato Rey Branch, BNP Paribas, acting through its San Francisco Branch, Dexia Credit Local, acting through its New York Branch, Fortis Bank S.A./N.V., acting through its Connecticut Branch, Banco Bilbao Vizcaya Argentaria S.A., acting through its New York Branch and Banco Santander Central Hispano, S.A., acting through its New York Branch (collectively, the “Banks”) and (ii) in the event one or more Banks fail to honor their obligations under the Letter of Credit, from the special fund created by the Act designated “Special Fund for the Redemption of Tax and Revenue Anticipation Notes” (the “Note Fund”), to the credit of which Note Fund the Secretary of the Treasury of Puerto Rico is required by and in the manner set forth in the Note Resolution to deposit all taxes and revenues required to be deposited in the General Fund of the Commonwealth received after March 31, 2007 and on or prior to June 30, 2007 plus any balance in the General Fund on April 1, 2007 in respect of taxes and revenues received by the General Fund after the date hereof (and if certain coverage requirements are not met, taxes and revenues so deposited prior to April 1, 2007), subject to certain prior applications as specified in the Act. Amounts in the Note Fund shall also be applied to pay the Letter of Credit Note and the Revolving Credit Note (as such terms are defined in the Note Resolution) as provided in the Note Resolution. The full faith, credit and taxing power of the Commonwealth are not pledged to the payment of the Notes.

4. The interest on the Notes is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended (the “Code”), and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. The Notes and the interest thereon are exempt from state, Commonwealth and local income taxation. We express no opinion as to any other tax consequences regarding the Notes.

Under the Code, a portion of the interest on the Notes earned by certain corporations may be subject to a federal corporate alternative minimum tax and interest on the Notes may be subject to a federal branch profits tax imposed on certain foreign corporations doing business in the United States and to a federal tax imposed on excess net passive income of certain S corporations.

In giving the opinion set forth in numbered paragraph 4. hereof, we have relied upon, and assumed continuing compliance with, the Commonwealth’s covenants and the accuracy, which we have not independently verified, of the representations and certifications of the Commonwealth contained in the Transcript. The accuracy of those representations and certifications, and the Commonwealth’s continuing compliance with those covenants, may be necessary for the interest on the Notes to be and to remain excluded from gross income for federal income tax purposes. Failure to comply with certain of those covenants subsequent to issuance of the Notes may cause interest on the Notes to be included in gross income for federal income tax purposes retroactively to the date of issuance of the Notes. The Commonwealth has covenanted to comply with the requirements of the Code to the extent permitted by the Constitution and laws of the Commonwealth. We are not aware of any provisions of the Constitution or laws of the Commonwealth that would prevent the Commonwealth from complying with the requirements of the Code.

In rendering the opinions set forth herein, we have assumed the accuracy and truthfulness of all public records and of all certifications, documents and other proceedings examined by us that have been executed or certified by public officials acting within the scope of their official capacities and have not verified the accuracy or truthfulness thereof. We have also assumed the genuineness of the signatures appearing upon such public records, certifications, documents and proceedings. As to questions of fact material to our opinion, we have relied on representations of the Commonwealth furnished to us, without undertaking to verify such representations by independent investigation.

It is to be understood that the rights of the holders of the Notes and the enforceability of the Note Resolution and the Notes may be subject to judicial discretion and valid bankruptcy, insolvency, reorganization, moratorium and other laws affecting creditors’ rights generally, and subject to general principles of equity (regardless of whether considered in a proceeding in equity or at law).

Respectfully submitted,

[To be signed “Squire, Sanders & Dempsey L.L.P.”]

DESCRIPTION OF LETTER OF CREDIT BANKS

BANK OF NOVA SCOTIA

The Bank of Nova Scotia (“Scotiabank” or the “Bank”), founded in 1832, is a Canadian chartered bank with its principal office located in Toronto, Ontario. Scotiabank is one of North America’s premier financial institutions and Canada’s most international bank. With 48,000 employees, Scotiabank and its affiliates serve over 10 million customers throughout the world.

Scotiabank provides a full range of personal, commercial, corporate and investment banking services through its network of branches located in all Canadian provinces and territories. Outside Canada, Scotiabank has branches and offices in over 50 countries and provides a wide range of banking and related financial services, both directly and through subsidiary and associated banks, trust companies and other financial firms.

For the fiscal year ended October 31, 2005, Scotiabank recorded total assets of CDN\$314.0 billion (US\$265.8 billion) and total deposits of CDN\$217.4 billion (US\$184.1 billion). Net income for the fiscal year ended October 31, 2005 equaled CDN\$3.209 billion (US\$2.717 billion), compared to CDN\$2.931 billion (US\$2.481 billion) for the prior fiscal year. Amounts above are shown in Canadian dollars and also reflect the United States dollar equivalent as of October 31, 2005 (1.0000 United States dollar equals 1.1812 Canadian dollars).

For the quarter ended July 31, 2006, Scotiabank recorded total assets of CDN\$365.0 billion (US\$322.5 billion) and total deposits of CDN\$255.2 billion (US\$225.5 billion). Net income for the quarter ended July 31, 2006 equaled CDN\$936 million (US\$827 million), compared to CDN\$784 million (US\$693 million) for the same period the prior year. Amounts above are shown in Canadian dollars and also reflect the United States dollar equivalent as of Monday, July 31, 2006 (1.0000 United States dollar equals 1.1316 Canadian dollars).

Scotiabank will provide to anyone, upon written request, a copy of its most recent annual report, as well as a copy of its most recent quarterly financial report. Requests should be directed to: The Bank of Nova Scotia, New York Agency, One Liberty Plaza, 26th Floor, New York, NY, 10006. Attention: Public Finance Department.

The information concerning the Bank contained herein is furnished solely to provide limited introductory information regarding the Bank and does not purport to be comprehensive. Such information is qualified in its entirety by the detailed information appearing in the documents and financial statements referenced above.

The delivery of this disclosure information by the Bank shall not create any implication that there has been no change in the affairs of the Bank since the date hereof, or that the information contained or referred to in this disclosure information is correct as of any time subsequent to its date.

BNP PARIBAS

BNP Paribas, together with its consolidated subsidiaries (the “BNP Paribas Group”) is a global financial services provider, conducting retail, corporate and investment banking, private banking, asset management, insurance and specialized and other financial activities throughout the world. The BNP Paribas Group is a leading European provider of corporate and investment banking products and services and a leading provider of private banking and asset management products and services throughout the world. It provides retail banking and financial services to over 20 million individual customers worldwide, in particular in Europe and the western United States, and has offices in more than 85 countries. According to rankings published in July 2005 by The Banker (based on 2004 figures):

- based on total assets, the BNP Paribas Group was the second largest banking group in France, the fourth largest in Europe and the sixth largest in the world; and

- based on Tier 1 capital, the BNP Paribas Group was the second, fifth and tenth largest banking group in France, Europe and the world, respectively.

At December 31, 2005, the BNP Paribas Group had consolidated assets of €1,258.1 billion (compared to €1,002.5 billion at January 1, 2005), consolidated loans and receivables due from customers of €301.2 billion (compared to €244.2 billion at January 1, 2005), consolidated items due to customers of €247.5 billion (compared to €211.5 billion at January 1, 2005) and shareholders’ equity (BNP Paribas Group share including income for 2005) of €40.7 billion (compared to €32.3 billion at January 1, 2005). Pre-tax net income for the year ended December 31, 2005 was €8.4 billion (compared to €7.1 billion for the year ended December 31, 2004, calculated under 2004 IFRS). Net income, BNP Paribas Group share, for the year ended December 31, 2005 was €5.9 billion (compared to €4.9 billion for the year ended December 31, 2004, calculated under 2004 IFRS).

The BNP Paribas Group currently has long-term senior debt ratings of “Aa2” with stable outlook from Moody’s, “AA” with stable outlook from Standard & Poor’s and “AA” with stable outlook from Fitch Ratings. Moody’s has also assigned the Bank a Bank Financial Strength rating of “B+” and Fitch Ratings has assigned the Bank an individual rating of “A/B”.

The BNP Paribas Group has three divisions: Retail Banking, Asset Management and Services and Corporate and Investment Banking, the latter two of which also constitute “core businesses”. Operationally, the Retail Banking division is itself comprised of two core businesses: French Retail Banking and International Retail Banking and Financial Services.

DEXIA CREDIT LOCAL

Dexia Credit Local (“Dexia”) is a subsidiary of the Dexia Group, which was created in 1996. The Dexia Group is a major European banking organization that is the product of several cross-border mergers. Dexia is an authentically European bank in terms of both its management organization and the scope of its different lines of business. The Dexia Group is listed on the Brussels, Paris and Luxembourg stock exchanges. With a stock market capitalization of over 21 billion euros as of December 31, 2005, the Dexia Group ranks in the top third of the Euronext 100 companies.

Dexia specializes in the Dexia Group’s first line of business – public and project finance and financial services for the public sector. Dexia has recognized expertise in local public sector financing and project finance. It is backed by a network of specialized banks, which employ over 3,000 professionals. Through this network of subsidiaries, affiliates and branches, Dexia is present in almost all of the countries of the European Union as well as Central Europe, the United States of America and Canada. Dexia also has operations in Latin America, the Asian-Pacific Region including Australia, and the countries around the Mediterranean.

Dexia is a bank with its principal office located in Paris, France. In issuing the facility, Dexia will act through its New York Branch, which is licensed by the Banking Department of the State of New York as an unincorporated branch of Dexia Credit Local, Paris. Dexia is the leading local authority lender in Europe, funding its lending activities in 2005 primarily through the issuance of euro and U.S. dollar-denominated bonds. In 2005, total funding raised by Dexia and Dexia Municipal Agency was 13.2 billion euros.

The Dexia Group is the owner of Financial Security Assurance Holdings Ltd. (“FSA Holdings”), the holding company for Financial Security Assurance Inc., a leading financial guaranty insurer.

As of December 31, 2005, Dexia had total consolidated assets of 272 billion euros, outstanding medium and long-term loans to customers of 215.60 billion euros and shareholders’ equity of over 7.48 billion euros (Tier I plus Tier II), and for the year then ended had consolidated net income of 861 million euros. These figures were determined in accordance with generally accepted accounting principles in France. Dexia maintains its records and prepares its financial statements in euros. At December 31, 2005, the exchange rate was 1.0000 euro equals 1.173895 United States dollar. Such exchange rate fluctuates from time to time.

Dexia is rated Aa2 long-term and P-1 short-term by Moody’s, AA long-term and A-1+ short-term by S&P, and AA+ long-term and F1+ short-term by Fitch.

Dexia will provide without charge a copy of its most recent publicly available annual report. Written requests should be directed to: Dexia Credit Local, New York Branch, 445 Park Avenue, 7th Floor, New York, New York 10022, Attention: General Manager. The delivery of this information shall not create any implication that the information contained or referred to herein is correct as of any time subsequent to its date.

FORTIS BANK S.A./N.V.

Fortis Bank S.A./N.V. (“Fortis Bank”) conducts the banking activities of Fortis, an international financial services provider active in the fields of banking, insurance and investment.

Fortis Bank is a wholly-owned indirect subsidiary of Fortis SA/NV and Fortis N.V., whose principal offices are located in Brussels (Belgium) and Utrecht (the Netherlands) respectively.

Fortis Bank is a commercial bank offering a full range of banking and insurance products and services to a wide range of customers. In its home market, the Benelux countries, Fortis Bank occupies a leading position. Fortis is the largest bank in Belgium, the second-largest in Luxembourg, and the fourth-largest in the Netherlands. The bank had full-time staff of over 41,000 in 2005. Outside its home market, Fortis Bank concentrates on selected market segments. Its business is subject to examination and regulation by the Belgian Banking and Finance Commission.

As of December 31, 2005 Fortis Bank had total assets of EUR 639.2 billion.

Fortis Bank's Connecticut branch (the “Connecticut Branch”) has been licensed by the Connecticut Department of Banking (the “Banking Department”) to conduct a wholesale banking business since October 9, 2002. The Connecticut Branch is subject to examination by the Banking Department and the Federal Reserve Bank of New York. In addition, the Connecticut Branch is required to file periodic and other reports containing financial information with the Banking Department and the Federal Reserve Bank of New York.

Additional information, including the Fortis Annual Report for 2005, may be obtained without charge by each person to whom this Official Statement is delivered upon the written request of any such person to Fortis Bank, 301 Tresser Boulevard, Stamford, Connecticut, 06301. This information is also available at www.Fortis.com.

The financial statements appearing in the Fortis Annual Report for 2005 were prepared in accordance with International Financial Reporting Standards as adopted by the European Union, which differ from generally accepted accounting principles in use in the United States.

The information in this page has been obtained from Fortis Bank, which is solely responsible for its content. The delivery of the Official Statement shall not create any implication that there has been no change in the affairs of Fortis Bank since the date hereof, or that the information contained or referred to in this page is correct as of any time subsequent to its date.

BANCO BILBAO VIZCAYA ARGENTARIA

Banco Bilbao Vizcaya Argentaria (BBVA) is a multinational financial services group based on people. Its 7,456 branches and 95,000 employees provide banking and financial services solutions to a global customer base of 35 million customers in 32 countries, including corporate and consumer lending, credit card services, ATMs, telephone and Internet banking. Internationally, BBVA provides investment banking and brokerage services, venture capital, and investment management.

At year-end 2005, BBVA posted a net attributed profit of 3,806 billion euros and total assets were 392,389 billion euros.

The Group's four business areas include:

Retail Banking in Spain and Portugal: this includes the financial services unit, ie, individual customers, small companies and businesses in the domestic market, plus consumer finance provided by Finanzia and Uno-e, mutual and pension fund managers, private banking, the insurance business and BBVA Portugal.

Wholesale Businesses: this area consists of the corporate banking unit, including SMEs, large companies and institutions in the domestic market. Global Businesses covers the global customer unit, investment banking, treasury management and distribution. The area also takes care of business and real estate projects.

Business in Mexico and the United States: this area includes the banking, insurance and pension businesses in Mexico and the United States (including Puerto Rico).

Businesses in South America: this consists of banking, insurance and pension businesses in Argentina, Bolivia, Chile, Colombia, Ecuador, Panama, Paraguay, Peru, Dominican Republic, Uruguay and Venezuela.

For further information log on to www.bbva.com

BANCO SANTANDER CENTRAL HISPANO, S.A.

Banco Santander Central Hispano, S.A. (“BSCH”) was established on March 21, 1857 and incorporated in its present form by a public deed executed in Santander, Spain, on January 14, 1875, recorded in the Mercantile Registry (Finance Section) of the Government of the Province of Santander.

BSCH activities comprise a full range of retail, commercial and corporate banking services, including investment banking, treasury and capital markets and insurance.

As of June 30, 2006 BSCH on a consolidated basis had:

- Assets of 818,096 million Euros.
- Total managed funds of 976,511 million Euros.
- Market capitalization of 71,424 million Euros.
- Shareholders’ equity of 38,411 million Euros.

For further details, please access BSCH’s website at www.gruposantander.com. For the website in the English language, click on the “English” link and access “Information for Shareholders and Investors”.

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