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 Bond Counsel, under existing law and assuming compliance with the tax covenants described herein, and the accuracy of certain representations and certifications made by the Commonwealth of Puerto Rico (the "Commonwealth") described herein, 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"). Bond Counsel is also of the opinion that such interest is not treated as a preference item in calculating the alternative minimum tax imposed under the Code with respect to individuals and corporations. Interest on the Notes is, however, included in the adjusted current earnings of certain corporations for purposes of computing the alternative minimum tax imposed on such corporations. Bond Counsel is further of the opinion that, under existing statutes, interest on the Notes is exempt from state, Commonwealth and local income taxation. See "Tax Matters" herein regarding certain other tax considerations.

$1,042,500,000
COMMONWEALTH OF PUERTO RICO
Tax and Revenue Anticipation Notes
Series 2006

Dated: Date of Delivery
Due: July 28, 2006

Yield: 3.23%
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 an irrevocable direct-pay letter of credit (the "Letter of Credit") issued on a several and not joint basis by a syndicate of seven (7) banks (the "Banks") in the amounts and the percentages set forth in the following table.

Name of Bank	Maximum Amount of Principal	Several Obligation
THE BANK OF NOVA SCOTIA	$238,909,725	22.917%
CITIBANK N.A.	173,753,475	16.667
BNP PARIBAS	173,753,475	16.667
DEXIA CREDIT LOCAL	173,753,475	16.667
FORTIS BANK S.A./N.V.	130,312,500	12.500
ROYAL BANK OF CANADA	86,861,100	8.332
STATE STREET BANK AND TRUST COMPANY	65,156,250	6.250
	$1,042,500,000	**100.000%**

Interest on the principal outstanding will accrue for 209 days and such interest will be supported by the Letter of Credit. See "Payment of and Security for the Notes" under *The Notes* and Appendix III.

Principal of and interest on the Notes are payable (i) first from amounts drawn under the Letter of Credit, and (ii) in the event one or more Banks fail to honor their obligations under the Letter of Credit, from the Special Fund for the Redemption of Tax and Revenue Anticipation Notes (the "Note Fund"). Banco Popular de Puerto Rico, on behalf of the Commonwealth, is the Paying Agent and will deliver payment of principal of and interest on the Notes at maturity. 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 for the payment of principal of or interest on the Notes, the GDB TRANs Note or amounts drawn under the Letter of Credit. See "Payment of and Security for the Notes" under *The Notes.*

The Notes are offered when, as and if issued and accepted by the Underwriters, subject to the approval of legality by Nixon Peabody LLP, New York, New York, Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the Underwriters by Quiñones Sánchez & Guzmán PSC, San Juan, Puerto Rico and for the Banks by Chapman and Cutler LLP, Chicago, Illinois. It is expected that settlement for the Notes, in immediately available funds, will occur in Puerto Rico, on or about December 29, 2005.

GOLDMAN, SACHS & CO.
BANC OF AMERICA SECURITIES LLC
CITIGROUP
JP MORGAN
LEHMAN BROTHERS

MORGAN STANLEY
MERRILL LYNCH & CO.
RAYMOND JAMES & ASSOCIATES, INC.
SAMUEL A. RAMIREZ & CO.
WACHOVIA BANK, NATIONAL ASSOCIATION

December 22, 2005

Commonwealth of Puerto Rico

Governor

ANÍBAL ACEVEDO VILÁ

Members of the Cabinet

ANÍBAL JOSÉ TORRES
Chief of Staff

FERNANDO BONILLA
Secretary of State

ROBERTO JOSÉ SÁNCHEZ RAMOS
Secretary of Justice

JUAN CARLOS MÉNDEZ TORRES
Secretary of the Treasury

RAFAEL ARAGUNDE TORRES
Secretary of Education

ROMÁN M. VELASCO GONZÁLEZ
Secretary of Labor and Human Resources

ROSA PÉREZ PERDOMO
Secretary of Health

JOSÉ ORLANDO FABRE LABOY
Secretary of Agriculture

GABRIEL ALCARAZ EMMANUELLI
Secretary of Transportation and Public Works

JORGE SILVA PURAS
Secretary of Economic Development and Commerce

YOLANDA ZAYAS
Secretary of Family Affairs

JORGE RIVERA JIMÉNEZ
Secretary of Housing

JAVIER VÉLEZ AROCHO
Secretary of Natural and Environmental Resources

ALEJANDRO GARCÍA PADILLA
Secretary of Consumer Affairs

DAVID E. BERNIER RIVERA
Secretary of Sports and Recreation

MIGUEL A. PEREIRA CASTILLO
Secretary of Corrections and Rehabilitation

Legislative Officers

KENNETH DAVISON MCCLINTOCK HERNÁNDEZ
President, Senate

JOSÉ FERNANDO APONTE HERNÁNDEZ
Speaker, House of Representatives

Fiscal Officers

ILEANA ISABEL FAS PACHECO
Director, Office of Management and Budget

ALFREDO SALAZAR
Acting President, Government 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 circumstances, 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 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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Tax and Revenue Anticipation Notes
Series 2006

INTRODUCTORY STATEMENT

This Official Statement sets forth certain information about the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico") and the $1,042,500,000 Tax and Revenue Anticipation Notes of the Commonwealth of Puerto Rico, Series 2006 (the "Notes").

The Notes are being issued under Act No. 1 of the Commonwealth, as amended by Act No. 139 of the Commonwealth (as amended, the "Act"), and pursuant to a resolution adopted by the Secretary of the Treasury on December 22, 2005 and approved by the Governor of Puerto Rico (the "Note Resolution"), for the purpose of: (i) repaying amounts borrowed by the Commonwealth under a line of credit provided by Government Development Bank for Puerto Rico ("Government Development Bank" or "GDB") under the Act in advance of the issuance of the Notes, which line has funded cash flow requirements of the General Fund (as defined herein) in fiscal year 2006, which requirements result from timing differences between expected disbursements and receipts of taxes and revenues, and (ii) paying certain of the costs of issuance of the Notes (including certain fees associated with the Letter of Credit (as defined below)).

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 $1.12 billion in March 2006. For a breakdown of the fiscal year 2006 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 2005 and Fiscal Year 2006" under *The Notes*.

The Notes are secured by an irrevocable direct-pay letter of credit (the "Letter of Credit") issued on a several and not joint basis by a syndicate of seven (7) banks (the "Banks") pursuant to a Reimbursement Agreement dated as of December 1, 2005 among The Bank of Nova Scotia, acting through its New York Agency, as Lead Arranger and Administrative Agent (The Bank of Nova Scotia, acting through its Hato Rey Branch, is issuing The Bank of Nova Scotia's several portion of the Letter of Credit); Citibank N.A., as Arranger and Documentation Agent; BNP Paribas, acting through its San Francisco Branch, and Dexia Credit Local, acting through its New York Branch, as Co-Agents, the Banks and the Commonwealth (the "Reimbursement Agreement"). None of the Banks under the Letter of Credit shall be substituted unless (i) receipt of prior written confirmation from Moody's Investors Service Inc. ("Moody's") and Standard & Poor's Rating Services, a division of The McGraw-Hill Companies, Inc. ("S&P"), that the then-current ratings on the Notes will not be suspended, withdrawn or lowered solely as a result of such substitution and (ii) fifteen (15) days prior written notice is provided to the Noteholders of such substitution. 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*.

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

The Commonwealth also has outstanding that certain GDB TRANs Note (as defined in "Purpose of the Notes" under *The Notes*), issued pursuant to the Act and evidencing the unpaid amounts drawn under a line of credit with Government Development Bank (the "GDB TRANs Line of Credit"). As provided in the GDB TRANs Line of Credit, the amount available to be drawn thereunder is (i) the maximum amount authorized under the Act, which is 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 amounts drawn thereunder as of the date of the issuance of the Notes will be partially repaid from proceeds of the Notes. The unpaid drawn amount under the GDB TRANs Line of Credit after partial payment from proceeds of the Notes, and any additional amounts that the Commonwealth may draw thereunder on or before June 30, 2006 are evidenced by the GDB TRANs Note. The GDB TRANs Note matures on July 28, 2006, is not prepayable prior to maturity, and at maturity will be repaid from moneys available to the Commonwealth from fiscal year 2006 tax collection (other than those deposited in the Redemption Fund) to be deposited in the Note Fund on a pari passu basis with the Notes. The Secretary of the Treasury covenants in the Note Resolution not to issue any other parity notes. See "Debt Limitation with Respect to Additional Parity Notes" under *The Notes.*

This Official Statement incorporates (i) the Commonwealth of Puerto Rico Financial Information and Operating Data Report dated as of December 1, 2005 (the "Commonwealth Report") attached hereto as Appendix I, (ii) the proposed Bond Counsel Opinion attached hereto as Appendix II, (iii) a description of each of the Banks issuing the Letter of Credit attached hereto as Appendix III, and (iv) the Comprehensive Annual Financial Report of the Commonwealth for the fiscal year ended June 30, 2004, prepared by the Department of the Treasury of the Commonwealth (the "Commonwealth's Annual Financial Report"), which is incorporated by reference herein. The Commonwealth's Annual Financial Report includes the basic financial statements of the Commonwealth for the fiscal year ended June 30, 2004, together with the independent auditor's report thereon dated April 8, 2005, 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 2005 budget, the fiscal year 2006 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") on May 17, 2005.

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's Annual Financial Report, the Note Resolution, the Letter of Credit 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 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, 2005, including its audited general purpose financial statements for such fiscal year, will be available to investors during the first quarter of calendar year 2006. 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

The following is a summary of certain information regarding the Commonwealth contained in the Commonwealth Report. This summary does not purport to be complete and is qualified in its entirety by reference to the more detailed information appearing in the Commonwealth Report, which should be read in its entirety.

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 (3,911,299 in 2005 according to a Census Bureau estimate). 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 (50) 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.

Fiscal Management

Section 7 of Article VI of the Constitution of Puerto Rico provides that "The appropriations made for any fiscal year shall not exceed the total revenues, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided by law." Such fiscal responsibility for the Commonwealth is shared among the Department of the Treasury, the Office of Management and Budget ("OMB") and 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 has the responsibility for monitoring expenditures. Government Development Bank is the fiscal agent and financial advisor to the Commonwealth and its agencies, public corporations and municipalities and coordinates the management of public finances.

The basic financial statements of the Commonwealth for fiscal 2005 are being audited by KPMG LLP. These financial statements are expected to be released during the first quarter of calendar year 2006. Preparation of the basic financial statements of the Commonwealth involves the collection and inclusion of audited financial statements from the Public Buildings Authority capital project fund (a major fund) and certain activities, funds and component units audited by other auditors and furnished to the Department of Treasury. For a summary of the Commonwealth's significant accounting policies, see Note 1 to the Commonwealth's basic financial statements included in the Commonwealth's Annual Financial Report.

Debt Management

The Constitution of Puerto Rico limits the amount of general obligation debt that can be issued and provides that public debt of the Commonwealth will constitute a first claim on available Commonwealth revenues. 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. See "Debt Limitation with Respect to Full Faith and Credit Obligations" under *The Notes*.

Rating of the Commonwealth and the Notes

In May 2005, Moody's and S&P each announced downgrades to the Commonwealth's general obligation debt rating. Moody's and S&P lowered their respective ratings on the Commonwealth's general obligation debt from "Baa1" to "Baa2" and from "A-" to "BBB." The reasons given by the rating agencies for the reduction in the ratings were, among others, the concern over the Commonwealth's financial performance, particularly the current structural imbalance in its budget, the low funding ratio of the Employees Retirement System of the Commonwealth and its instrumentalities (the "Employees Retirement System"), the uncertainty surrounding the approval of a budget for fiscal year 2006 and the availability of additional recurring revenue sources. See "Commonwealth's Budget Structural Imbalance" under *Puerto Rico Taxes, Other Revenues, and Exemptions,* and *Retirement Systems* and *Budget of the Commonwealth of Puerto Rico* in Appendix I. For more information relating to the rating downgrades please refer to www.moodys.com and www.standardandpoors.com.

The Notes have been rated by Moody's and S&P taking into account the security provided by the Letter of Credit. See *Ratings*.

RECENT DEVELOPMENTS

This section highlights certain important information about the Commonwealth's current fiscal situation. This summary, however, does not purport to be complete and is qualified in its entirety by reference to the more detailed information and descriptions about the Commonwealth's fiscal situation included in the Commonwealth Financial and Operating Data Report, dated December 1, 2005, attached hereto as Appendix I (the "Commonwealth Report"), which should be read in its entirety.

Recent Developments Relating to the Commonwealth's Fiscal Year 2006 Budget and Efforts to Resolve its Budgetary Structural Imbalance

In response to General Fund deficits over the last few fiscal years and an anticipated deficit for fiscal year 2006, the Commonwealth has recently taken legislative and executive actions intended to eliminate such deficits through a comprehensive tax and fiscal spending reform. See "Summary and Management's Discussion of General Fund Results – Commonwealth's Budget Structural Imbalance" under *Puerto Rico Taxes, Other Revenues, and Expenditures* in Appendix I. The combination of these actions, designed to increase recurring revenues and control government spending, is intended to eliminate the Commonwealth's structural budget deficit by fiscal year 2008. See "2006 Budget Approval Process" under *Budget of the Commonwealth of Puerto Rico* in Appendix I.

The discussion below provides details as to the actions being taken by the Commonwealth to address its budget imbalance and other fiscal challenges it currently faces.

House Joint Resolution and the Governor's Executive Order. On November 21, 2005, as a result of a joint effort by the two principal political parties to address the Commonwealth's structural budget imbalance and its other fiscal difficulties, the Legislative Assembly approved, and the Governor signed, Joint Resolution No. 321 (the "Joint Resolution"). On the same day, the Governor issued an Executive Order implementing the fiscal measures defined in the Joint Resolution (the "Fiscal Reform Executive Order"). The Joint Resolution and the Fiscal Reform Executive Order impose government-wide expenditure controls and set forth the basic principles and parameters that will govern the reform of the Commonwealth's tax system and fiscal policy and practices. The proposed tax reform is aimed at increasing revenues by expanding the tax base through the implementation of a broad-based tax on the retail sale of articles of use and consumption (the "consumption tax").

The Joint Resolution and the Fiscal Reform Executive Order come in the wake of expenditure controls previously implemented during fiscal year 2006 by the Governor, such as a reduction of appointed government positions, a limitation on the creation of new temporary employee positions, a hiring freeze, and a voluntary work week reduction program, as well as limitations on central government vehicle fleets and other expenses. If the proposed tax reform and expenditure controls are successfully implemented, the structural imbalance could be corrected by the end of fiscal year 2008. There is no assurance, however, that the structural imbalance will be corrected by such date.

Proposed Tax Reform. Generally, the proposed tax reform will follow three basic principles: (i) broaden the tax base through the implementation of the consumption tax, (ii) reduce individual income tax rates, and (iii) simplify administration of the tax system.

The proposed tax reform will (i) replace the Commonwealth's current excise tax with the consumption tax, (ii) include compensatory income tax credits in order to address any regressive effect the proposed consumption tax may have, (iii) eliminate the marriage penalty, (iv) establish an earned income tax credit, (v) increase the deduction for charitable contributions, (vi) restructure the estate tax system, (vii) provide incentives for investments in technological infrastructure and research and development activities, and (viii) adopt additional measures to foster individual savings.

Legislation with respect to the tax reform proposed by the Joint Resolution was introduced in the House of Representatives with a proposed effective date of July 1, 2006. Although the final structure of the tax reform, including the consumption tax, is under discussion, the Secretary of the Treasury expects that the tax reform will provide a net increase in the General Fund's annual revenues, after taking into consideration projected reductions in income taxes, in an amount sufficient to reduce and eventually eliminate the structural imbalance. See "Summary and Management's

Discussion of General Fund Results – Commonwealth's Budget Structural Imbalance" under *Puerto Rico Taxes, Other Revenues, and Expenditures* in Appendix I.

Proposed Fiscal Reform. The Joint Resolution includes a long-term plan to reduce and improve the management of the Commonwealth's public debt. Upon the elimination of the structural budget imbalance, which elimination must be certified to the Legislative Assembly and the Governor by the Secretary of the Treasury, the Director of OMB and the President of GDB, the Commonwealth's operating budget will include an annual contribution to the public improvement fund equal to two percent (2%) of the total amount of the public improvement bonds authorized for that fiscal year. The annual contribution to the public improvement fund will increase by an additional two percent (2%) of the then-current authorization for each fiscal year thereafter, up to a maximum of twenty percent (20%) of the current year's authorized public improvement bond issuance. This contribution is intended to reduce proportionally each year the amount of the Commonwealth's public improvement bond issues.

The Joint Resolution and the Fiscal Reform Executive Order also set forth guiding principles and parameters and impose certain expenditure controls as part of fiscal reform. The Joint Resolution and the Fiscal Reform Executive Order restrict layoffs of government employees as a means to reduce government expenditures, and impose a hiring freeze in government until the structural budget deficit has been eliminated. Fiscal discipline will be promoted by requiring each central government agency to implement a seven-year expense reduction plan, adopting a new public policy that distinguishes between unnecessary and indispensable expenses, proposing to enact certain limitations on the use of the Budgetary Fund, and providing that the budget may only be balanced through the use of recurring revenues. The proposed fiscal reform also mandates the reduction of advertising and travel expenses, promotes the use of electronic communications and document delivery, caps the purchase price of each government vehicle, and limits other non-payroll expenditures. Furthermore, the Legislative Assembly must approve any borrowings by the Secretary of the Treasury in order to finance any Commonwealth budget deficit with debt securities that are not repaid during the same fiscal year in which they are issued.

In an effort to address other fiscal challenges faced by the Commonwealth, the Joint Resolution and the Fiscal Reform Executive Order promote the adoption of certain measures to alleviate the significant unfunded liabilities of the various government retirement systems. See *Retirement Systems* in Appendix I. These measures include the transfer to the two main government retirement systems of Commonwealth assets and additional General Fund contributions from the revenues of the proposed tax reform in excess of the Commonwealth's current expenditures. Furthermore, the Joint Resolution and the Fiscal Reform Executive Order limit the implementation of early retirement programs for government employees by conditioning their implementation on receipt of an opinion from an independent actuary confirming that the retirement systems will not be adversely affected by such early retirement program.

The measures and efforts set forth in the Joint Resolution and the Fiscal Reform Executive Order and the Tax Reform proposal are broad in scope and have been designed to address and correct the Commonwealth's structural imbalance and other fiscal challenges that are described below.

Fiscal Year 2006 Budget. On March 16, 2005, the Governor of Puerto Rico, Aníbal Acevedo-Vilá, submitted to the Legislative Assembly of the Commonwealth a proposed balanced budget of revenues and expenditures for fiscal year 2006 providing for General Fund resources and expenditures of $9.684 billion, representing an increase of $476 million, or 5.2%, over estimated actual expenditures for fiscal year 2005 estimated at $9.208 billion. The proposed budget package included several new revenue-raising measures sufficient to cover budgeted expenditures, most of which required legislative approval. However, as mentioned below, the Legislative Assembly did not approve the budget proposed by the Governor.

On June 30, 2005, the Legislative Assembly, which is controlled by the principal opposition political party, approved a budget resolution for fiscal year 2006 that provided for General Fund expenditures of $9.258 billion. Governor Acevedo-Vilá vetoed this budget resolution because the revenue measures contained therein, as estimated by the Secretary of Treasury, were insufficient to cover the budgeted expenditures as required by the Constitution. He did, however, sign into law certain revenue-raising measures approved by the Legislative Assembly estimated to generate approximately $130 million in new revenues. Although the revenue-raising provisions contained language conditioning their effectiveness on the approval by the Governor of the $9.258 billion budget resolution, according to the Secretary of Justice, these revenue-raising measures are enforceable regardless of such language. Although no legal action has been initiated thus far, no assurance can be given that the effectiveness of such revenue measures will not be challenged.

As a result of the Governor's veto, and in accordance with the Commonwealth's Constitution, the budget for fiscal year 2005 (with certain adjustments) carried over and will continue in effect for fiscal year 2006 unless another budget for fiscal year 2006 is approved by the Legislative Assembly and the Governor. At this time, it is not anticipated that a new budget for fiscal year 2006 will be approved prior to the end of the fiscal year, although it is possible that other appropriations for special purposes may be approved from time to time. For more details about the budget approval process for fiscal year 2006 and the content of the budget, see "2006 Budget Approval Process" under *Budget of the Commonwealth of Puerto Rico* in Appendix I.

On August 30, 2005, the Governor adopted Executive Order 2005-58 (the "Budget 2006 Executive Order"), in which he made certain additional adjustments to the budget in order to bring the total expenditures in line with the Secretary of Treasury's estimate of total revenues for fiscal year 2006 of $8.945 billion, as required by Commonwealth law. These adjustments included, among others, a $384 million reduction related to a portion of debt service for general obligation bonds due during fiscal year 2006 (the "Excluded Debt Service") which is being paid from a GDB line of credit already in place and may be paid ultimately from the proceeds of a Commonwealth bond issue.

Projected Budget Deficit for Fiscal Year 2006. Based on the spending rate experienced during the first two months of fiscal year 2006, total expenditures for the year are currently estimated to reach $9.319 billion. Without considering any additional revenues, certain additional expenditures defined below, the Excluded Debt Service, or any other expenditures during fiscal year 2006, the difference between the aforementioned spending rate of $9.319 billion and estimated revenues of $8.945 billion is $374 million. The Fiscal Reform Executive Order requires all central government agencies to operate within their assigned budgets for the remainder of fiscal year 2006. Accordingly, agencies must present a report to OMB outlining plans to avoid additional expenditures and finish the year within budget, no later than 30 days after the effectiveness of such Fiscal Reform Executive Order. This action is designed to reduce the $374 million difference and other additional expenditures which are currently estimated to total approximately $311 million (the "Additional Expenditures"). The reports required by the Fiscal Reform Executive Order must also be presented to the respective Presidents of the Senate and the House, and the House Ways and Means Committee and the House Budget Committee, who may determine, based on such reports, whether any additional revenue measures are warranted. In the event expenditures were still to exceed revenues, the Commonwealth estimates it would have available $221 million from an Emergency Fund created by the Act. No. 91 of June 21, 1966, as amended (the "Emergency Fund"), a Budgetary Fund created by Act No. 147 of June 18, 1980, as amended (the "Budgetary Fund"), and other non-recurring resources. For more details about the Additional Expenditures, see "Summary and Management's Discussion of General Fund Results" under *Puerto Rico Taxes, Other Revenues, and Expenditures* and "2006 Budget Approval Process" under *Budget of the Commonwealth of Puerto Rico* in Appendix I.

Although the Commonwealth is using its best efforts in order to maximize revenues and reduce expenditures, there is no assurance that revenues will be greater than the budgeted $8.945 billion or that expenditures will not exceed the anticipated level of $9.319 billion.

Commonwealth's Budget Structural Imbalance. The budget imbalance in fiscal year 2006 comes in the wake of several recent years during which the Commonwealth had insufficient recurring revenues to cover its expenditures. These imbalances have been covered in the past with loans from GDB, financing transactions (including long-term bond issues payable from the General Fund) and other non-recurring resources. During fiscal year 2005, the amount by which the Commonwealth's operating expenditures exceeded its recurring revenues (the so-called structural imbalance) was $989 million. The Commonwealth estimates that during fiscal year 2006, the structural imbalance will be reduced to approximately $858 million. This amount represents the difference between expenditures of $9.319 billion (at the spending rate of the first two months of fiscal year 2006), plus the Excluded Debt Service ($384 million), for a total of $9.703 billion, less recurring revenues of $8.845 billion (which excludes $100 million expected to be generated by an interest rate swap transaction). The Commonwealth expects to reduce this imbalance by financing the Excluded Debt Service ($384 million), withdrawing from reserve funds and utilizing other non-recurring revenues ($221 million), entering into an interest rate swap transaction ($100 million), and implementing the Fiscal Reform Executive Order to reduce expenditures. See "2006 Budget Approval Process" under *Budget of the Commonwealth of Puerto Rico* in Appendix I. In addition to the Additional Expenditures, estimated amounts required to cover maintenance expenses incurred by Public Buildings Authority ("PBA") (approximately $75 million) may further increase the structural imbalance should the Commonwealth have to cover such cash flow shortfall for PBA, however, such estimated amounts will be covered by a line of credit from GDB to PBA collateralized by real estate properties and accounts receivable, and payment to GDB is expected from the sale of such real estate and/or the collection of the receivables pledged to GDB. As discussed above, the Commonwealth has recently taken action to address this budgetary structural imbalance.

Other Fiscal Challenges. The Commonwealth faces other fiscal challenges besides its current budgetary issues. The principal one involves resolving the increasing unfunded pension liability of the Employees Retirement System and the Puerto Rico System of Annuities and Pensions for Teachers (the "Teachers Retirement System"). The Commonwealth expects to reduce the unfunded liability of the Employees Retirement System based on proposed legislation which provides for increased employer and employee contributions and the issuance of up to $2 billion of pension obligation bonds, which would be payable from the Commonwealth's General Fund. The Employees Retirement System and the Teachers Retirement System are also seeking reimbursement from the Commonwealth for certain special retirement benefits paid by them in prior fiscal years under legislation providing such retirement benefits. Part of these claims by the Teachers Retirement System ($119 million) is not recognized by OMB as a Commonwealth liability and the difference is currently under inter-agency arbitration. Others ($78 million for fiscal year 2005 and prior years and $43 million for fiscal year 2006) are under consideration by OMB to determine the final amount that may be owed by the Commonwealth to the Employees Retirement Systems. For more details, see *Retirement Systems* in Appendix I.

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, the Letter of Credit and the Reimbursement Agreement, copies of which are on file at Government Development Bank's offices in San Juan, Puerto Rico and New York, New York.

General

The Notes are dated their date of delivery, mature on July 28, 2006 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 nominee as may be requested by an authorized representative of DTC. One fully-registered Note certificate will be issued for the Notes in the aggregate principal amount of such issue, and 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 million issuers of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments from over 85 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, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, GSCC, MBSCC, and EMCC are 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 Rules applicable to DTC and its Direct and Indirect Participants are on file with the U.S. Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

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, but Beneficial Owners are 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. 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 Government Development Bank, 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 Series 2006 Notes will be payable at maturity in lawful money of the United States of America upon presentation and surrender of Series 2006 Notes at the principal office of the Trustee in New York, New York.

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, GDB, as financial advisor and fiscal agent to the Commonwealth (see "Government Development Bank for Puerto Rico" under *Public Corporations* in the Commonwealth Report (Appendix I)), 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 GDB under the Act in advance of the issuance of the Notes, which line has funded cash flow requirements of the General Fund in fiscal year 2006, which requirements result from timing differences between expected disbursements and receipts of taxes and revenues, and (ii) pay certain of the costs of issuance of the Notes (including certain fees associated with the Letter of Credit).

GDB has advanced to the Commonwealth funds to cover cash requirements in anticipation of the issuance of the Notes pursuant to the GDB TRANs Line of Credit, also authorized under the Act and evidenced by a note maturing on July 28, 2006 and issued under a resolution approved by the Secretary of the Treasury and the Governor on July 1, 2005 and amended and supplemented on November 22, 2005 (the "GDB TRANs Note") and to be further amended and restated as of December 29, 2005 to conform it to the issuance of the Notes and the terms and conditions of the Reimbursement Agreement. The amount available to be drawn under the GDB TRANs Line of Credit is (i) the maximum permitted under the Act (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 sum of (x) the outstanding principal amount of the Notes and (y) the outstanding principal amount of the GDB TRANs Note. From and after the date the Notes are issued, amounts drawn under the GDB TRANs Line of Credit may not be prepaid prior to the maturity date of the GDB TRANs Note. A portion of the amounts outstanding under the GDB TRANs Line of Credit as of the date of issuance of the Notes will be repaid from proceeds of the Notes.

Payment of and Security for the Notes

Letter of Credit

The Notes are secured by and payable from the irrevocable Letter of Credit issued on a several and not joint basis by the Banks pursuant to the Reimbursement Agreement. None of the Banks under the Letter of Credit shall be substituted unless (i) receipt of prior written confirmation from Moody's and S&P that the then-current ratings on the Notes will not be suspended, withdrawn or lowered solely as a result of such substitution and (ii) fifteen (15) days prior written notice is provided to the Noteholders of such substitution. See Appendix III for a description of each of the Banks issuing the Letter of Credit. Each of the 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.

The following table sets forth each of the Banks issuing the Letter of Credit, the maximum amount of the principal amount of the Notes attributable to each such Bank pursuant to its respective several obligation under the Letter of Credit and the Reimbursement Agreement, the corresponding amount of interest that will accrue on such principal amounts (based on an interest rate of 4.50% accruing over a period of 209 days) and the percentage several obligation of each of the Banks.

Name of Bank	Maximum Amount of Principal	Interest to Accrue on Principal	Maximum Amount of Principal and Interest	Several Obligation
THE BANK OF NOVA SCOTIA	$238,909,725	$6,241,517	$245,151,242	22.917%
CITIBANK N.A.	173,753,475	4,539,310	178,292,785	16.667
BNP PARIBAS	173,753,475	4,539,310	178,292,785	16.667
DEXIA CREDIT LOCAL	173,753,475	4,539,310	178,292,785	16.667
FORTIS BANK S.A./N.V.	130,312,500	3,404,414	133,716,914	12.500
ROYAL BANK OF CANADA	86,861,100	2,269,245	89,130,345	8.332
STATE STREET BANK AND TRUST COMPANY	65,156,250	1,702,207	66,858,457	6.250
	$1,042,500,000	**$27,235,313**	**$1,069,735,313**	**100.000%**

Banco Popular de Puerto Rico (the "Paying Agent"), upon compliance with the terms of the Letter of Credit, is authorized and directed to draw on July 28, 2006, up to (i) an amount sufficient to pay the principal amount of the Notes outstanding on July 28, 2006, plus (ii) an amount not to exceed 209 days of accrued interest on the Notes (assuming a December 29, 2005 issuance date for the Notes) at the rate of 4.50% per annum based upon a year of 360 days (the "Drawn Amount").

The Letter of Credit shall expire at 5:00 p.m., New York City time, on the date which is the earlier of (i) August 1, 2006, and (ii) the date of payment of the principal of and interest on the Notes drawn from the Letter of Credit.

The Notes are secured by and payable from (i) first, the Drawn Amount, and (ii) second, in the event one or more Banks fail to honor their several portion of the Drawn Amount under the Letter of Credit, from the Note Fund. The Commonwealth's payment obligations relating to the Drawn Amount shall be evidenced by a note of the Commonwealth issued pursuant to the Act and designated TRANs Bank Note of the Commonwealth of Puerto Rico, Series 2006 (the "TRANs Bank Note"). The TRANs Bank Note shall be issued to the Administrative Agent on the date of issuance of the Notes and shall mature on July 28, 2006. The TRANs Bank 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.

The TRANs Bank Note is neither secured by nor payable from the Letter of Credit. The payment obligations under the TRANs Bank 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, 2006 and deposited in the Note Fund as more fully described herein. 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 TRANs Bank Note and the GDB TRANs Note on or after the maturity date of the Notes 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 TRANs Bank Note and the GDB TRANs 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, 2006, will withdraw from the General Fund all taxes and revenues required to be deposited therein from April 1, 2006 through June 30, 2006, 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 in the months indicated below equals the following percentages of the sum of the principal of and interest on the Notes and the GDB TRANs Note due at maturity (such sum being herein called the "Note Fund Requirement"):

2006	**Percentage of Note Fund Requirement**
April	33⅓%
May	66⅔%
June	100%

The Secretary of the Treasury covenants in the Note Resolution to compute on a cash basis on or before the tenth (10^{th}) day of each month, commencing on January 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 2006. 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, 2006 through June 30, 2006 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 or the TRANs Bank Note or the GDB TRANs 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 November 30, 2005, the amount on deposit in the Redemption Fund was approximately $243.9 million, which was the required amount. Fiscal year 2006 deposits from the General Fund to the Redemption Fund to fund the projected debt service through July 1, 2006, exclusive of debt service on any general obligation bonds that may be issued in fiscal year 2006, are expected to total $485 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 2006 is expected to total $77 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 entered 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. For additional information regarding the Commonwealth debt, see *Debt* in the Commonwealth Report in Appendix I.

On December 21, 1995, Puerto Rico Aqueduct and Sewer Authority ("PRASA") issued $400,340,000 Puerto Rico Aqueduct and Sewer Authority Refunding Bonds guaranteed by the Commonwealth (the "PRASA Guaranteed Bonds") of which approximately $292 million are currently outstanding. On January 2, 1997, the Commonwealth began to make payments of debt service on the PRASA Guaranteed Bonds under the full faith and credit guarantee of the Commonwealth. Although beginning with the debt service payment due January 1, 2006 the Commonwealth will stop making such debt service payments, the amount paid by the Commonwealth under the PRASA Guaranteed Bonds will be taken into account for purposes of computing the above described 15% constitutional debt limitation. See "Other Public Corporations - Aqueduct and Sewer Authority" under *Public Corporations* in Commonwealth Report in Appendix I.

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

After the enactment of Joint Resolution No. 2104 dated September 30, 2004 expressly authorizing 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, the Commonwealth is permitted 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. The Commonwealth has entered into two interest rate exchange agreements with respect to the Series 2004 B Bonds. Accordingly, in determining its compliance with the constitutional debt limitation, the Commonwealth is calculating its debt outstanding with respect to the Series 2004 B Bonds using the fixed rate under such interest rate exchange agreements.

With regard to the Series 2004 A Bonds, such bonds bear interest at their actual rate per annum through July 1, 2012 and thereafter at 12% per annum. Debt service for the PRASA Guaranteed Bonds paid by the Commonwealth during fiscal year 2005 (including for this purpose debt service payments due and paid on July 1, 2005) was $30,127,367.50. The sum of the amount of debt outstanding for purposes of calculating the 15% constitutional debt limitation is equal to 9.45% of $7,781,435,000, which is the average of the adjusted internal revenues for the fiscal year ended June 30, 2005. If bonds refunded with non-eligible investments described above were treated as not being outstanding, the percentage referred to in the preceding sentence would be 8.82%. Neither of the 9.45% nor the 8.82% referred to above take into account debt service relating to the Commonwealth's $675,000,000 Public Improvements Bonds of 2006, Series A ("the 2006 GO Bonds"), which the Commonwealth intends to issue early in calendar year 2006. The debt service of the 2006 GO Bonds could increase such percentages, although the Commonwealth believes that in no event would the percentages reach the 15% constitutional 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 2006 (consisting of taxes and revenues projected to be collected after the issuance of the Notes and prior to June 30, 2006, minus required deposits to the Redemption Fund) will be approximately $4.7 billion. For fiscal year 2005, taxes and revenues which would have been available for deposit in the Note Fund were approximately $6.2 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 2005 amounted to $8.307 billion, such that the aggregate principal amount of notes issued under the Act during fiscal year 2006 shall not exceed $1.495 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.

During fiscal year 2006, the GDB TRANs Line of Credit was authorized under the Act and evidenced by the GDB TRANs Note, a note issued under the Act. A portion of the amount outstanding under the GDB TRANs Line of Credit as of the date of issuance of the Notes will be repaid from proceeds of the Notes. The unpaid amount under the GDB TRANs Line of Credit after the partial payment from proceeds of the Notes will remain outstanding and will be evidenced by the GDB TRANs Note. The GDB TRANs Note will also evidence any additional amounts that the Commonwealth may draw thereafter under the GDB Line of Credit. The GDB TRANs Note matures on July 28, 2006 and is not prepayable prior to maturity. The GDB TRANs Note will be repaid from moneys deposited in the Note Fund on a pari passu basis with the Notes, including the TRANs Bank Note.

Under the Note Resolution, the Secretary of the Treasury covenants not to issue any other additional obligations payable on a parity with the Notes (including the TRANs Bank Note) and the GDB TRANs Note.

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 2005 and Fiscal Year 2006

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 and excise taxes. Revenues from non-Puerto Rico sources are derived from federal excise taxes and customs duties returned to the Commonwealth. The primary expenditures of the Commonwealth through the General Fund are for grants and subsidies, and personal and other services. 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 2002 through 2004, a discussion of the preliminary fiscal year 2005 results and a comparison of the fiscal year 2006 budget with the preliminary fiscal year 2005 results, appears under *Puerto Rico Taxes, Other Revenues, and Expenditures* in the Commonwealth Report in Appendix I and should be read in its entirety.

The tables which follow set forth the actual monthly cash flow for the Commonwealth General Fund for fiscal year 2005 and the estimated monthly cash flow for fiscal year 2006. The monthly cash flow for fiscal 2005 is preliminary and does not take into account any audit adjustments.

The monthly cash flow estimates for fiscal year 2006 are based upon the constitutionally-mandated budget for fiscal year 2006 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.

Commonwealth of Puerto Rico
Preliminary General Fund Cash Flows
Fiscal Year 2005
(in thousands)

	July	August	September	October	November	December	January	February	March	April	May	June	Total
Beginning Cash Balance	$ 108,512 [P]	$ (71,701)	$(103,984)	$ 1,071,015	$ 443,499	$ 661,928	$331,277	$454,593	$ 531,244	$ 723,800	$ 684,170	$ 287,052	$ 108,512
Receipts:													
Income taxes	339,795	292,211	512,704	357,238	298,365	608,601	472,252	263,306	463,260	1,012,421	353,769	550,217	5,524,139
Commonwealth excise taxes	126,647	133,645	138,564	143,924	154,162	169,261	148,963	133,729	155,307	172,649	148,307	159,069	1,784,227
Inheritance and gift taxes	461	572	192	1,314	1,108	143	91	250	124	1,308	55	1,511	7,129
Licenses	4,366	5,394	11,477	24,630	7,919	3,774	5,220	4,871	6,369	4,419	6,031	2,946	87,416
Other internal sources	42,212	28,780	60,830	42,226	36,125	75,272	23,066	43,979	50,078	42,028	37,100	56,263	537,959
Non-Commonwealth sources	18,206	20,793	46,927	15,661	10,728	37,909	34,994	25,409	19,200	34,901	66,108	35,294	366,130
Proceeds from Special Funds	-	-	-	-	-	-	-	-	-	-	-	-	-
Subtotal receipts	531,687	481,395	770,694	584,993	508,407	894,960	684,586	471,544	694,338	1,267,726	611,370	805,300	8,307,000
Other income (refunds) [1]	23,055	22,990	27,619	29,308	27,809	32,266	37,814	12,171	(63,846)	(118,980)	(10,603)	(75,012)	(55,409)
(Transfer) Refunding to Redemption Fund [2]	(30,832)	(30,832)	(30,832)	(30,832)	(30,832)	(30,832)	(30,832)	(30,832)	(30,832)	(30,832)	(30,832)	(30,833)	(369,985)
Proceeds of notes and other borrowings [3]	470,000	314,000	1,272,695	65,000	537,000	311,500	246,000	290,000	342,500	219,900	46,000	811,000	4,925,595
Repayment of notes and other borrowings [4]	(255,000)	(115,000)	(265,000)	(679,000)	(100,000)	(355,000)	(85,000)	(60,000)	(110,000)	(528,178)	(293,178)	(1,064,078)	(3,909,434)
Total available cash from operations	738,910	672,553	1,775,176	(30,531)	942,384	852,894	852,568	682,883	832,160	809,636	322,757	446,377	8,897,767
Disbursements:													
Grant and subsidies	462,530	288,990	175,432	186,061	228,176	632,942	334,777	214,339	282,295	301,633	258,105	252,106	3,617,386
Personal services	405,731	366,125	373,228	374,343	426,861	477,303	353,222	341,445	326,587	502,910	420,459	415,353	4,783,567
Other services	35,450	41,071	40,140	29,665	25,537	35,229	36,990	43,521	16,272	33,423	33,117	18,931	389,346
Materials and supplies	4,521	7,814	8,455	6,496	4,222	7,372	3,791	6,013	4,044	10,395	7,965	1,323	72,411
Equipment purchases	10,891	836	2,554	301	1,128	699	472	867	405	905	198	1,451	20,707
Other debt service and capital outlays	-	-	368	119	38,031	30,000	-	47	10,001	-	31	1	78,598
PY Other disbursements	-	-	-	-	-	-	-	-	-	-	-	-	-
Total disbursements	919,123	704,836	600,177	596,985	723,955	1,183,545	729,252	606,232	639,604	849,266	719,875	689,165	8,962,015
Total available cash less transfers and disbursements	(180,213)	(32,283)	1,174,999	(627,516)	218,429	(330,651)	123,316	76,651	192,556	(39,630)	(397,118)	(242,788)	(64,248)
Ending Cash Balance	**$ (71,701)**	**$(103,984)**	**$ 1,071,015**	**$ 443,499**	**$ 661,928**	**$ 331,277**	**$ 454,593**	**$ 531,244**	**$ 723,800**	**$ 684,170**	**$ 287,052**	**$ 44,264**	**$ 44,264**
Ending cash balance without considering TRANS	**$ (71,701)**	**$(103,984)**	**$ 263,320**	**$ (364,196)**	**$ (145,767)**	**$ (476,418)**	**$(353,102)**	**$(276,451)**	**$ (83,895)**	**$ 149,653**	**$ 25,714**	**$ 56,103**	

(P) Preliminary.
(1) Consists of reimbursement of certain advances to agencies to cover expenses, revenue from General Fund's non-budgetary funds plus a reserve for future tax refunds reduced by estimated tax refunds.
(2) 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.
(3) Consists of proceeds of borrowing from Government Development Bank and proceeds from Commonwealth's Tax and Revenue Anticipation Notes, including $478 million of refinancing measures provided by GDB.
(4) Consists of amount of repayments of borrowing from Government Development Bank and repayments of Commonwealth's Tax and Revenue Anticipation Notes.

Commonwealth of Puerto Rico
Preliminary 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	$ 44,264	$ 423,051	$ 287,529	$ 231,381	$ 226,322	$ 425,996	$ 756,799	$ 717,200	$ 550,091	$ 513,603	$ 673,595	$ 203,647	$ 44,264
Receipts:													
Income taxes	409,700	445,500	560,100	400,700	315,644	608,400	424,400	310,100	482,200	1,126,200	356,900	529,156	5,969,000
Commonwealth excise taxes	114,400	142,600	139,100	136,500	157,600	173,000	162,000	143,800	169,100	182,200	160,100	199,600	1,880,000
Inheritance and gift taxes	200	100	100	100	100	100	100	200	200	100	200	500	2,000
Licenses	3,800	5,300	10,700	20,400	10,200	7,000	7,900	7,700	8,400	7,400	7,800	13,400	110,000
Other internal sources	36,900	34,100	43,500	30,500	30,400	61,300	30,900	32,400	36,500	54,200	38,500	78,800	508,000
Non-Commonwealth sources	37,100	39,700	25,200	30,500	29,900	38,700	30,800	27,300	25,800	29,400	33,500	28,100	376,000
Other sources	-	-	-	-	-	100,000[(6)]	-	-	-	-	-	-	100,000
Subtotal receipts	602,100	667,300	778,700	618,700	543,844	988,500	656,100	521,500	722,200	1,399,500	597,000	849,556	8,945,000
Other income (refunds) [(1)]	28,368	22,596	32,713	35,670	38,020	40,000	40,000	22,388	(52,003)	(51,833)	(4,411)	(194,140)	(42,632)
(Transfer) Refunding to Redemption Fund [(2)]	(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[(3)]	833,000	165,000	120,000	225,000	440,000	1,285,675[(8)]	40,000	40,000	40,000	40,000	40,000	261,000 [(5)]	3,529,675
Repayment of notes and other borrowings[(4)]	(100,000)	(173,000)	(100,000)	(90,000)	(50,000)	(1,040,675)	-	-	-	(457,000)	(457,000)	(457,000)	(2,924,675)
Total available cash from operations	1,323,067	641,495	791,012	748,969	931,463	1,233,099	695,699	543,487	669,796	890,266	135,188	419,015	9,022,556
Disbursements:													
Grant and subsidies	515,624	361,952	305,895	184,358	239,842	219,915	177,607	139,297	130,616	171,510	121,772	148,256	2,716,644
Personal services	403,729	372,799	450,057	493,521	445,277	625,133	491,973	450,385	515,387	505,997	426,128	417,246	5,597,632
Other services	21,611	36,333	74,933	50,438	31,182	36,138	50,108	101,410	41,325	34,831	39,502	40,128	557,939
Materials and supplies	2,568	3,981	13,436	18,465	13,148	13,919	11,218	15,825	15,298	15,046	15,891	8,732	147,527
Equipment purchases	748	1,952	2,839	7,246	2,340	7,191	4,392	3,679	3,658	2,890	1,843	6,668	45,446
Other debt service and capital outlays	-	-	-	-	-	-	-	-	-	-	-	-	-
PY Other disbursements	-	-	-	-	-	-	-	-	-	-	-	-	-
Total disbursements	944,280	777,017	847,160	754,028	731,789	902,296	735,298	710,596	706,284	730,274	605,136	621,030	9,065,188
Total available cash less transfers and disbursements	378,787	(135,522)	(56,148)	(5,059)	199,624	330,803	(39,599)	(167,109)	(36,488)	159,992	(469,948)	(202,015)	(42,632)
Ending Cash Balance	**$ 423,051**	**$ 287,529**	**$ 231,381**	**$ 226,322**	**$ 425,996**	**$ 756,799**	**$ 717,200**	**$ 550,091**	**$ 513,603**	**$ 673,595**	**$ 203,647**	**$ 1,632**	**$ 1,632**
Ending cash balance without considering TRANS[(7)]	**$(309,949)**	**$(437,471)**	**$(513,619)**	**$(653,678)**	**$(844,004)**	**$(758,201)**	**$(837,800)**	**$(1,044,909)**	**$(1,121,397)**	**$(544,405)**	**$(597,353)**	**$(382,368)**	

(1) 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.
(2) 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.
(3) Consists of proceeds of borrowing from Government Development Bank and proceeds from Commonwealth's Tax and Revenue Anticipation Notes.
(4) Consists of amount of repayments of borrowing from Government Development Bank and repayments of Commonwealth's Tax and Revenue Anticipation Notes.
(5) Includes $221 million from the Budgetary Fund, Emergency Fund and other sources.
(6) Represents an interest rate swap transaction.
(7) Balance also excludes Government Development Bank loans and repayments.
(8) Amount is net of costs 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 in Appendix I, which should be read in its entirety.

As of September 30, 2005, funds aggregating approximately $197.3 million under the custody of the Secretary of the Treasury were available for inter-fund borrowings, if necessary.

In addition, the GDB TRANs Line of Credit unused authorized balance, may also be available to pay the Notes in the event one or more Banks fail to honor their obligations under the Letter of Credit and there are insufficient funds in the Note Fund to pay the Notes.

TAX MATTERS

Federal Income Taxes

The Internal Revenue Code of 1986, as amended (the "Code"), imposes certain requirements that must be met subsequent to the issuance and delivery of the Notes for interest thereon to be and remain excluded from gross income for Federal income tax purposes. Noncompliance with such requirements could cause the interest on the Notes to be included in gross income for Federal income tax purposes retroactive to the date of issue of the Notes. The Commonwealth has covenanted to comply with the applicable requirements of the Code in order to maintain the exclusion of the interest on the Notes from gross income for Federal income tax purposes pursuant to Section 103 of the Code. In addition, the Commonwealth has made certain representations and certifications in the Tax Certificate as to Arbitrage and the Provisions of Sections 103 and 141-150 of the Internal Revenue Code of 1986 relating to the Notes. Bond Counsel will not independently verify the accuracy of those certifications and representations.

In the opinion of Nixon Peabody LLP, Bond Counsel, under existing law and assuming compliance with the aforementioned covenant, and the accuracy of certain representations and certifications made by the Commonwealth described above, interest on the Notes is excluded from gross income for Federal income tax purposes under Section 103 of the Code. Bond Counsel is also of the opinion that such interest is not treated as a preference item in calculating the alternative minimum tax imposed under the Code with respect to individuals and corporations. Interest on the Notes is, however, included in the adjusted current earnings of certain corporations for purposes of computing the alternative minimum tax imposed on such corporations.

Bond Counsel is also of the opinion that, under existing statutes, interest on the Notes is exempt from state, Commonwealth and local income taxation.

Original Issue Premium

The Notes are expected to be offered at prices in excess of their principal amounts. An initial purchaser with an initial adjusted basis in a Note in excess of its principal amount will have amortizable bond premium which is not deductible from gross income for federal income tax purposes. The amount of amortizable bond premium for a taxable year is determined actuarially on a constant interest rate basis over the term of each Note based on the purchaser's yield to maturity. For purposes of determining gain or loss on the sale or other disposition of a Note, an initial purchaser who acquires such obligation with an amortizable bond premium is required to decrease such purchaser's adjusted basis in such Note annually by the amount of amortizable bond premium for the taxable year. The amortization of bond premium may be taken into account as a reduction in the amount of tax-exempt income for purposes of determining various other tax consequences of owning such Notes. Owners of the Notes are advised that they should consult with their own advisors with respect to the state, Commonwealth and local tax consequences of owning such Notes.

Ancillary Tax Matters

Ownership of the Notes may result in other Federal tax consequences to certain taxpayers, including, without limitation, certain S corporations, foreign corporations with branches in the United States, property and casualty insurance companies, individuals receiving Social Security or Railroad Retirement benefits, individuals seeking to claim the earned income credit, and taxpayers (including banks, thrift institutions and other financial institutions) who may be deemed to have incurred or continued indebtedness to purchase or to carry the Notes. Bond Counsel is not rendering any opinion as to any Federal tax matters other than those described under the caption "Tax Matters". Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the Federal tax consequences of owning and disposing of the Notes, as well as any tax consequences arising under the laws of any state or other taxing jurisdiction.

Changes in Federal Tax Law and Post-Issuance Events

From time to time proposals are introduced in Congress that, if enacted into law, could have an adverse impact on the potential benefits of the exclusion from gross income for Federal income tax purposes of the interest on the Notes, and thus on the economic value of the Notes. This could result from reductions in Federal income tax rates, changes in the structure of the Federal income tax rates, changes in the structure of the Federal income tax or its replacement with another type of tax, repeal of the exclusion of the interest on the Notes from gross income for such purposes, or otherwise. It is not possible to predict whether any legislation having an adverse impact on the tax treatment of holders of the Notes may be proposed or enacted.

Bond Counsel has not undertaken to advise in the future whether any events after the date of issuance and delivery of the Notes may affect the tax status of interest on the Notes. Bond Counsel expresses no opinion as to any Federal, state, Commonwealth or local tax law consequences with respect to the Notes, or the interest thereon, if any action is taken with respect to the Notes or the proceeds thereof upon the advice or approval of other counsel.

LEGAL MATTERS

The proposed form of opinion of Nixon Peabody LLP, New York, New York, Bond Counsel, is set forth in Appendix II to this Official Statement. Certain legal matters will be passed upon for the Underwriters by Quiñones Sánchez & Guzmán PSC, San Juan, Puerto Rico. Certain legal matters will be passed on by the 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 $1,340,177 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.

Goldman, Sachs & Co. ("Goldman Sachs"), lead Underwriter of the Notes, had previously entered into an agreement with FirstBank of Puerto Rico ("FirstBank"), pursuant to which FirstBank had agreed to cooperate with Goldman Sachs in connection with Goldman Sachs' provision of underwriting and investment banking services to the Commonwealth with respect to the Notes. Pursuant to this agreement, which was disclosed to Government Development

Bank, FirstBank will be entitled to receive a portion of Goldman Sachs' actual net profits, if any, in connection with the underwriting of the Notes, as permitted by Rule G-38 of the Municipal Securities Rulemaking Board (the "MSRB"). In accordance with amendments to Rule G-38 of the MSRB that were enacted earlier this year, the agreement between Goldman Sachs and FirstBank was terminated as of August 29, 2005.

Morgan Stanley & Co. Incorporated ("Morgan Stanley") had a similar agreement with Popular Securities, Inc. ("Popular Securities"), pursuant to which Popular Securities had agreed to cooperate with Morgan Stanley in connection with Morgan Stanley's provision of underwriting and investment banking services to the Commonwealth with respect to the Notes. In accordance with the amendments to Rule G-38 of the MSRB, this agreement has also been terminated.

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, as specifically stated herein below, has covenanted for the benefit of the Underwriters and Beneficial Owners (generally the tax owners of the Notes):

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:

(i) principal and interest payment delinquencies;

(ii) non-payment related defaults;

(iii) unscheduled draws on debt service reserves reflecting financial difficulties;

(iv) unscheduled draws on credit enhancements reflecting financial difficulties;

(v) substitution of credit or liquidity providers, or their failure to perform;

(vi) adverse opinions or events affecting the tax-exempt status of Notes;

(vii) modifications to rights of the holders (including Beneficial Owners) of the Notes;

(viii) note calls;

(ix) defeasances;

(x) release, substitution, or sale of property securing repayment of the Notes; and

(xi) rating changes.

Event (iii) may not be applicable, since the terms of the Notes do not provide for "debt service reserves." For a description of the Notes, see *The Notes*. In addition, with respect to the following events:

Events (iv) and (v). 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 (vi). For information on the tax status of the Notes, see *Tax Matters*.

Events (viii and ix). Events (viii) and (ix) may not be applicable since the terms of the Notes and the Note Resolution do not contain any "call" or "defeasance" provisions. See *The Notes*.

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, 45^{th} Floor, New York, New York 10041; FT Interactive Data, Attn: NRMSIR, 100 William Street, New York, New York 10038; and DPC Data Inc., One Executive Drive, Fort Lee, New Jersey 07024.

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

The Commonwealth acknowledges that its 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. Moreover, proceedings filed by Beneficial Owners against the Obligated Person 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. The Commonwealth have further agreed that the annual financial information containing any amended operating data or financial information will explain, in narrative form, the reasons for the amendment and the impact of the change in the type of operating data or financial information being provided.

Any assertion of beneficial ownership must be filed, with full documentary support, as part of the written request described above. These 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 and the summaries of or references to the various acts and provisions contained in each of the Commonwealth Report, the Letter of Credit and Reimbursement Agreement 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 Commonwealth Report (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 and the information appearing in Underwriting, was supplied by certain officials of the Commonwealth or certain of its agencies or instrumentalities, in their respective official capacities, or was obtained from publications of the Commonwealth or certain of its agencies or instrumentalities, and is included or incorporated by reference in this Official Statement on the authority of such officials or the authority of such publications as public official documents. The information pertaining to DTC was supplied by DTC.

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

APPENDIX I

COMMONWEALTH OF PUERTO RICO
Financial Information and Operating Data Report
December 1, 2005

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COMMONWEALTH OF PUERTO RICO

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INTRODUCTION

Geographic Location and Demography

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

According to the United States Census Bureau, the population of Puerto Rico was 3,808,610 in 2000 (3,911,299 in 2005 according to a Census Bureau estimate), compared to 3,522,000 in 1990. As of 2000, the population of San Juan, the island's capital and largest city, was 434,375.

Relationship with the United States

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

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

The United States and the Commonwealth of Puerto Rico (the "Commonwealth") share a common defense, market, and currency. The Commonwealth exercises virtually the same control over its internal affairs as do the 50 states. It differs from the states, however, in its relationship with the federal government. The people of Puerto Rico are citizens of the United States but do not vote in national elections. They are represented in Congress by a Resident Commissioner who has a voice in the House of Representatives but no vote. Most federal taxes, except those such as Social Security taxes which are imposed by mutual consent, are not levied in Puerto Rico. No federal income tax is collected from Puerto Rico residents on income earned in Puerto Rico, except for certain federal employees who are subject to taxes on their salaries.

The official languages of Puerto Rico are Spanish and English.

Governmental Structure

The Constitution of the Commonwealth provides for the separation of powers of the executive, legislative, and judicial branches of government. The Governor is elected every four years. The Legislative Assembly consists of a Senate and a House of Representatives, the members of which are elected for four-year terms. The highest court within the local jurisdiction is the Supreme Court of Puerto Rico. Puerto Rico constitutes a District in the Federal Judiciary and has its own United States District Court. Decisions of this court may be appealed to the United States Court of Appeals for the First Circuit and from there to the Supreme Court of the United States.

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

Aníbal Acevedo Vilá was sworn in as Governor of Puerto Rico on January 2, 2005. He is a graduate of the University of Puerto Rico, where he obtained a Bachelor's degree in Political Science and a Juris Doctor degree. He obtained an LL.M. from Harvard Law School and served as law clerk for Puerto Rico Supreme Court Judge Federico Hernández Denton and for U.S. First Circuit Court of Appeals Judge Levin Campbell. He also served in the public sector as legislative adviser to the Governor of Puerto Rico. From 1993 to 2001, he served as an elected member of the Puerto Rico House of Representatives. From 2001 until assuming his position as Governor, he served as the elected Resident Commissioner of the Commonwealth in the U.S. House of Representatives.

Juan C. Méndez, Secretary of the Department of the Treasury (the "Treasury"), took office in January 2005. He is a certified public accountant and a graduate of the University of Puerto Rico, where he obtained a Bachelor's degree in Accounting and a Juris Doctor degree. He obtained an LL.M. in tax law from Georgetown University Law Center. From 2002 to mid-2004, he worked as a technical advisor to the Secretary of the Treasury. Prior to 2002, he worked as a tax attorney at a large law firm in Puerto Rico.

Ileana F. Fas Pacheco, Director of the Office of Management and Budget ("OMB"), took office in January 2005. She is a graduate of the University of Puerto Rico, where she obtained a Bachelor's degree in Science with a major in Electrical Engineering. She obtained a Master's degree in Business Administration in International Management from Thunderbird, the American Graduate School of International Management. From 2001 until assuming her current position, she worked in the public sector as Special Assistant to the Puerto Rico Secretary of State, legislative assistant to the Resident Commissioner, and Director of the Office of Federal Affairs of the Puerto Rico Department of Education. Prior to 2001, she worked as an electrical engineer at an electronics company.

Alfredo Salazar Conde became Acting President of Government Development Bank for Puerto Rico ("GDB") effective on August 19, 2005. Mr. Salazar is a private investor with over 30 years of experience in commercial banking. Mr. Salazar served as President of GDB from 1975 to 1976 and as Executive Director of Puerto Rico Industrial Development Company during 1990. Mr. Salazar has a Bachelor's degree in economics from Villanova University and pursued post graduate studies in finance at New York University and Harvard Business School.

Political Trends

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

	1988	**1992**	**1996**	**2000**	**2004**
Popular Democratic Party	48.7%	45.9%	44.5%	48.6%	48.4%
New Progressive Party	45.8%	49.9%	51.1%	45.7%	48.2%
Puerto Rico Independence Party	5.4%	4.2%	3.8%	5.2%	2.7%
Others	0.1%	--	0.6%	0.5%	0.6%

With the results of the 2004 election, control of the executive branch continued under the Popular Democratic Party while the legislative branch is now controlled by the New Progressive Party. The composition of the Senate and House of Representatives by political party is as follows:

	Senate	House
Popular Democratic Party	9	18
New Progressive Party	17	32
Puerto Rico Independence Party	1	1
	27	51

The next general election (gubernatorial, municipal, and legislative) in Puerto Rico will be held in November 2008. Voter participation in Puerto Rico is substantially higher than in the United States, averaging 82% since 1972.

THE ECONOMY

General

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

Puerto Rico has enjoyed more than two decades of almost continuous economic expansion. Virtually every sector of the economy has participated in this expansion, and record levels of employment have been achieved. Factors contributing to this expansion include government-sponsored economic development programs, increases in the level of federal transfer payments, and the relatively low cost of borrowing. In prior years, these factors were aided by a significant expansion in construction investment driven by infrastructure projects, private investment, primarily in housing, and relatively low oil prices.

Personal income, both aggregate and per capita, has increased consistently each fiscal year from 1985 to 2004. In fiscal year 2004, aggregate personal income was $46.8 billion ($43.8 billion in 2000 prices) and personal income per capita was $12,031 ($11,260 in 2000 prices).[1] Personal income includes transfer payments to individuals in Puerto Rico under various social programs. Total federal payments to Puerto Rico, which include transfers to local government entities and expenditures of federal agencies in Puerto Rico, in addition to federal transfer payments to individuals, are lower on a per capita basis in Puerto Rico than in any state of the United States. Transfer payments to individuals in fiscal year 2004 were $9.7 billion, of which $7.5 billion, or 77%, represented entitlements to individuals who had previously performed services or made contributions to programs such as Social Security, Veterans' Benefits, Medicare, and U.S. Civil Service retirement pensions.

Total average annual employment (as measured by the Department of Labor and Human Resources Household Employment Survey) has also increased. From fiscal year 2000 to fiscal year 2005, annual employment increased from 1,150,291 to 1,237,593, an increase of 7.6%.

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

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

The following table shows the gross national product for the five fiscal years ended June 30, 2004.

Commonwealth of Puerto Rico
Gross National Product

	Fiscal Years Ended June 30				
	2000	**2001**	**2002**	**2003**	**2004**[1]
Gross national product - $ millions[2]	$41,419	$44,047	$45,071	$47,439	$50,320
Real gross national product - $ millions (2000 prices)	41,419	42,044	41,901	42,756	43,937
Annual percentage increase in real gross national product (2000 prices)	3.0%	1.5%	(0.3%)	2.0%	2.8%
U.S. annual percentage increase in real gross national product (2000 prices)	4.6%	2.1%	0.7%	2.3%	4.6%

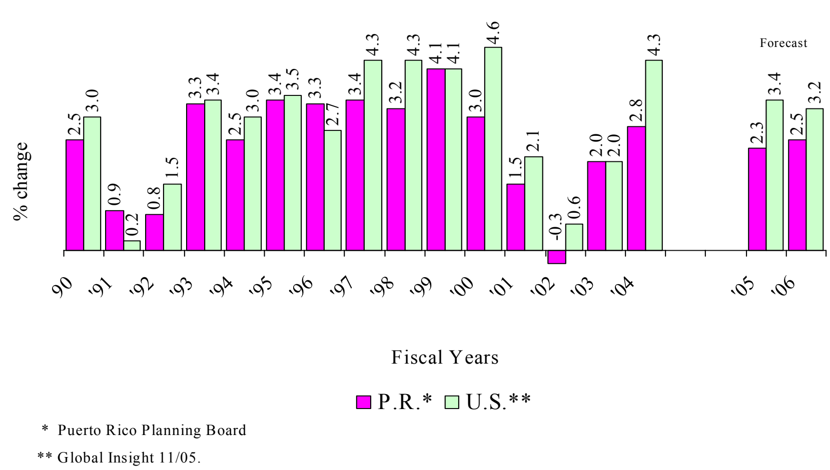
(1) Preliminary. Puerto Rico Planning Board expects to certify these numbers by February 2006. Fiscal year 2004 data are the most recent available statistics.
(2) In current dollars.

Sources: Puerto Rico Planning Board and Global Insight Inc.

The economy of Puerto Rico is closely linked to the United States economy. During fiscal year 2004 (from July 1, 2003 to June 30, 2004) approximately 82% of Puerto Rico's exports went to the United States mainland, which was also the source of approximately 45% of Puerto Rico's imports. Factors affecting the United States economy usually have a significant impact on the performance of the Puerto Rico economy. These include exports, direct investment, the amount of federal transfer payments, the level of interest rates, the level of oil prices, the rate of inflation, and tourist expenditures. Consequently, the economic slowdown in the United States in 2001 and 2002, and the subsequent recovery have also been reflected in the Puerto Rico economy, although to a lesser degree.

The following graph compares the growth rate of real gross national product for the Puerto Rico and United States economies since fiscal year 1990, and the forecast of the growth rate for fiscal years 2005 and 2006.

Real GNP Growth Rate



Since the 1950s, the Puerto Rico Planning Board (the "Planning Board") has prepared a complete set of macroeconomic measures like those prepared for the United States by the Bureau of Economic Analysis ("BEA") of the Department of Commerce. In contrast with the BEA, which computes the economic accounts on a quarterly basis, the Planning Board computes the economic accounts on an annual basis. Like the BEA, the Planning Board revises the macroeconomic numbers on a regular basis. The Planning Board has always classified the latest annual numbers as preliminary until they are revised and made final in conjunction with the release of new data each year. At present, all macroeconomic accounts for fiscal year 2004 are preliminary until the revised figures are released.

Forecast for Fiscal Year 2006

The Planning Board's current real gross national product forecast for fiscal year 2006, released in February 2005, projects an increase of 2.5%. The most important short-term factors that could have an adverse effect on the economy include the persistent high level of oil prices, the upward trend in short-term interest rates, the depreciation of the United States dollar, which affects the value of imports to Puerto Rico, and the possibility of a deceleration of public investment due to the Commonwealth's fiscal difficulties, which could reduce activity in construction and other sectors. The continued upward trend of interest rates may also contribute to a possible economic slowdown in general. The increase in oil prices coupled with other price increases, also serve to reduce disposable income and, therefore, overall economic activity. The Commonwealth is dependent on oil for approximately 70% of its power generation. Therefore, the increases in oil prices are expected to negatively affect the Commonwealth's economy. On the other hand, it is expected that the implementation of the tax reform will positively affect economic activity of the Commonwealth. Although the current administration is working to maintain public investment, no assurance can be given that the Commonwealth will succeed in these efforts. For a discussion of the Commonwealth's fiscal difficulties, see "Fiscal Year 2005 Budget," and Budget for Fiscal Year 2006" under *Budget of the Commonwealth of Puerto Rico*.

Fiscal Year 2005

According to the Department of Labor and Human Resources Household Employment Survey (the "Household Survey"), total employment for fiscal year 2005 averaged 1,237,600, an increase of 2.7% compared to 1,205,600 for fiscal year 2004. The unemployment rate for fiscal year 2005 was 10.6%, a decrease from 11.4% for fiscal year 2004. As in the past, the economy of Puerto Rico followed the performance of the United States economy.

The Planning Board's current real gross national product forecast for fiscal year 2005, released in February 2005, projected an increase of 2.3%. The major short-term factors that could have an adverse effect on the economy of Puerto Rico include the persistent high level of oil prices, the continued upward trend in short-term interest rates, and the devaluation of the United States dollar, which affects the value of imports to Puerto Rico.

Fiscal Year 2004

The Planning Board's preliminary reports of the performance of the Puerto Rico economy during fiscal year 2004 indicate that the economy registered an increase of 2.8% in real gross national product. Nominal gross national product was $50.3 billion in fiscal year 2004 ($43.9 billion in 2000 prices), compared to $47.4 billion in fiscal year 2003 ($42.8 billion in 2000 prices). This represents an increase in nominal gross national product of 6.1%. Aggregate personal income increased from $44.7 billion in fiscal year 2003 ($42.4 billion in 2000 prices), to $46.8 billion in fiscal year 2004 ($43.8 billion in 2000 prices), and personal income per capita increased from $11,566 in fiscal year 2003 ($10,962 in 2000 prices), to $12,031 in fiscal year 2004 ($11,260 in 2000 prices). According to the Household Survey, total annual employment averaged 1,205,600 in fiscal year 2004 compared to 1,188,015 in fiscal year 2003, an increase of 1.5%. Concurrently, the unemployment rate also decreased from 12.1% during fiscal year 2003 to 11.4% during fiscal year 2004.

Economic Development Program for the Private Sector

The Commonwealth's economic development program for the private sector is now focused on initiatives aimed at producing a more diversified and sustainable economic development. The three principal elements of these initiatives are the following: (i) the promotion of foreign investment focused on life sciences and communications and information technology; (ii) the promotion of local entrepreneurial investment that builds upon the Commonwealth's competitive advantages in, among other areas, life sciences, tourism, commerce, and services; and (iii) investment in infrastructure and human capital to complement the promotion of foreign and local investment and focus on the current and future needs for human capital.

The Commonwealth has formulated a strategic plan to enhance its competitiveness in knowledge-based economic sectors, such as research and development of science and technology products. Four major components of this strategic plan are: (i) building on the strong presence in Puerto Rico of multinational companies in the science and technology sectors; (ii) building on Puerto Rico's skilled workforce to promote the expansion of research and development facilities by companies currently operating in Puerto Rico; (iii) attracting new companies in such sectors; and (iv) providing incentives for companies and entrepreneurs to engage in the process of innovation and commercialization of new products and to establish research and development facilities in Puerto Rico. The last initiative includes the creation of the Puerto Rico Science & Technology Trust, a government-sponsored trust, that will provide grants and financing to companies, entrepreneurs, and universities that engage in these activities.

The Commonwealth is also providing incentives to promote the establishment of distribution and call centers, the acquisition and development of patents, and the development of a local entrepreneurial class. Distribution and call centers located in the Commonwealth will benefit from special incentives such as: (i) an excise tax exemption on machinery and equipment acquired by a call center; and (ii) a preferential tax rate of 4% for call centers located in Puerto Rico if they offer services to Latin America and a preferential tax rate of 2% if they offer hemisphere or worldwide services. The Commonwealth has decided to focus on this type of industry because it is labor intensive, presents no environmental concerns, and is generally able to start operations quickly.

With respect to the acquisition and development of patents, under newly enacted legislation, the Secretary of the Treasury may (i) negotiate the payment of taxes on patent royalties; and (ii) reduce the tax rate on patent royalties to a rate as low as 2%. These incentives are in addition to those already enacted for research and development carried out in the Commonwealth. To further develop a local entrepreneurial class, the Commonwealth has enacted legislation providing local entrepreneurs with the following benefits: (i) tax incentives to retailers that use their distribution channels to sell products made in Puerto Rico in other jurisdictions; (ii) require that at least 15% of products and services purchased by public agencies be locally manufactured or provided; and (iii) the use of government-sponsored financing, marketing and/or training to promote the production of economically feasible products or services for Puerto Rico markets.

Puerto Rico Tax Incentives

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

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

The 1998 Tax Incentives Act was also amended to allow a credit against the Puerto Rico tax liability of investors that acquire the majority of the stock, partnership interests or operational assets of an exempted business that is in the process of closing operations in Puerto Rico. A credit against Puerto Rico tax liability is also provided to investors that contribute cash to such exempted business for the construction or improvement of its physical plant and the purchase of machinery and equipment. The amount of the credit is equal to 50% of the cash invested for such purposes, not to exceed $5,000,000 per exempted business. The credits are subject to approval by the Secretary of the Treasury, and the maximum amount of such credits for any fiscal year is $15,000,000.

For fiscal year 2005, the Commonwealth enacted a "sunset provision" that lowered all long-term capital gains tax rates by 50%. In particular, gains realized from July 1, 2004 to June 30, 2005 from the sale or exchange of a capital asset by resident individuals, if held for more than six months, are taxed at a rate of 5% (6.25% in the case of corporate taxpayers) if located in Puerto Rico and at a rate of 10% (12.5% in the case of corporate taxpayers) if located outside Puerto Rico. As part of the package of legislative measures proposed to increase General Fund revenues for fiscal years 2006 and 2007, however, the preferential long-term capital gains rates have been eliminated, and all long-term capital gains realized during taxable years that commenced after June 30, 2005 will be taxed at a rate of 12.5%, in the case of individuals, estates and trusts; and 20% in the case of corporations and partnerships. See "Summary and Management's Discussion of General Fund Results" under *Puerto Rico Taxes, Other Revenues, and Expenditures*.

The 1998 Tax Incentives Act permits income tax rates lower than 2% for companies that establish operations in Puerto Rico in "core pioneer industries" which utilize innovative technology not used in Puerto Rico prior to January 1, 2000; (ii) granting tax credits with respect to eligible investments made in the construction or substantial rehabilitation of housing units to be rented to low income families; (iii) reducing to 7% the capital gains rate applicable to gains realized in taxable years that started on or before June 30, 2005 from the sale of the stock of Puerto Rico corporations acquired in an initial public offering made after June 30, 1997, or acquired in public offerings made prior to December 31, 2007; (iv) granting income tax exemption to the fees and interest income received by financial institutions in connection with loans or guarantees of loans made to finance tourism development projects; (v) granting an exemption to qualified associations administering timesharing rights or vacation clubs and to owners' associations of areas designated as tourism enhancement districts; (vi) granting income tax exemption to financial institutions for charges collected on obligations issued for the financing of tourism projects; (vii) granting tax exemption for investments in infrastructure made by housing developers; (viii) granting tax credits to Puerto Rico businesses that acquire products manufactured in Puerto Rico for exportation; and (ix) rehabilitating urban centers through the development of housing projects, community areas, commercial areas, parks and recreational spaces, construction and renovation of structures, and the development of undeveloped or under-developed sites.

Reduction of the Costs of Doing Business

The Commonwealth believes that, to make Puerto Rico more competitive and foster investment, it needs to reduce the cost of doing business in Puerto Rico. In order to accomplish this, the Commonwealth proposes to (i) promote the creation of more cogeneration power plants to diversify energy fuel sources and reduce oil imports for electric power generation; (ii) streamline the permitting process to accelerate and reduce the cost of investment in Puerto Rico; and (iii) create a multi-agency task force to expedite critical projects in the life sciences sector.

The Commonwealth is in the process of diversifying its energy fuel sources. Two cogeneration power plants, one of which is fueled by coal and the other by liquefied natural gas, have reduced Puerto Rico's dependence on oil imports for the generation of electricity by approximately 25%, from 99% to 74%. Currently, as part of the Electric Power Authority's capital improvement plan, the Authority is considering building an additional cogeneration power plant fueled by liquefied natural gas in the municipality of Mayagüez.

Federal Tax Incentives

In connection with the phase-out of Sections 30A and 936 of the U.S. Internal Revenue Code of 1986, as amended (the "U.S. Code") (see "Tax Incentives – Incentives Under the U.S. Code" below), the United States Senate requested the Joint Commission on Taxation ("JCT") and the General Accounting Office ("GAO") to study the economic impact of such phase-out and present recommendations on alternative tax incentives for U.S.-based companies operating in Puerto Rico. In anticipation of the final phase-out of Sections 30A and 936 of the U.S. Code, most U.S.-based companies operating under Sections 30A and 936 of the U.S. Code have converted from United States corporations to Controlled Foreign Corporations ("CFCs"), thus lessening the impact of the phase-out of those sections. Currently, the United States Congress is considering legislation that would extend to production activities that take place in Puerto Rico section 199 of the U.S. Code, which provides a three-point reduction in the federal income tax rate, phased-in over five years (from 35% to 31.85% after 2009). The Commonwealth is also seeking the extension of additional sections of the U.S. Code that provide a dividends received deduction for a percentage of profits generated in Puerto Rico by CFCs, as well as deductions that would encourage investments in research and development activities.

Employment and Unemployment

The number of persons employed in Puerto Rico during fiscal year 2005 averaged 1,237,600, a 2.7% increase from 1,205,600 in fiscal year 2004. Unemployment, although at relatively low historical levels, remains above the United States average. The average unemployment rate decreased from 11.4% in fiscal year 2004 to 10.6% in fiscal year 2005.

The following table presents annual statistics of employment and unemployment for fiscal year 2000 through fiscal year 2005. These employment figures are based on the Household Survey, which includes self-employed individuals, instead of the non-farm payroll employment survey (the "Payroll Survey"), which does not. The number of self-employed individuals represents around 17% of civilian employment in Puerto Rico, more than double the level in the United States.

Commonwealth of Puerto Rico
Employment and Unemployment(1)
(persons age 16 and over)
(in thousands)

Fiscal Years Ended June 30	Labor Force	Employed	Unemployed	Unemployment Rate(2)
		(Annual Average)		
2000	1,292	1,150	142	11.0%
2001	1,277	1,144	134	10.5%
2002	1,309	1,152	158	12.1%
2003	1,352	1,188	164	12.1%
2004	1,360	1,206	155	11.4%
2005	1,385	1,238	147	10.6%

(1) Totals may not add due to rounding.
(2) Unemployed as percentage of labor force.

Source: Department of Labor and Human Resources - Household Survey

Economic Performance by Sector

From fiscal year 2000 to fiscal year 2004, the manufacturing and services sectors generated the largest portion of gross domestic product. The three sectors of the economy that provide the most employment are manufacturing, services and government.

The following table presents annual statistics of gross domestic product by sector and gross national product for the five fiscal years ended June 30, 2000 through 2004.

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

	Fiscal Years Ended June 30				
	2000	**2001[1]**	**2002[1]**	**2003**	**2004[2]**
Manufacturing	$24,079	$29,037	$31,243	$32,501	$34,078
Services[3]	24,920	26,615	26,913	28,688	30,505
Government[4]	5,478	5,992	6,303	7,006	7,389
Transportation, communication and public utilities	4,237	4,698	4,948	5,205	5,350
Agriculture, forestry and fisheries	529	348	277	314	435
Construction[5]	1,875	1,802	1,648	1,614	1,741
Statistical discrepancy	585	717	292	(493)	(654)
Total gross domestic product[6]	$61,702	$69,208	$71,624	$74,834	$78,842
Less: net payment abroad	(20,283)	(25,162)	(26,552)	(27,396)	(28,522)
Total gross national product[6]	$41,419	$44,046	$45,071	$47,439	$50,320

(1) Calendar years 2001 and 2002 are under revision by the Bureau of Labor Statistics of the Department of Labor and Human Resources.
(2) Preliminary. Puerto Rico Planning Board expects to certify these numbers by February 2006. Fiscal year 2004 data are the most recent available statistics.
(3) Includes wholesale and retail trade, finance, insurance and real estate, tourism, and other services.
(4) Includes the Commonwealth, its municipalities and certain public corporations, and the federal government. Excludes certain other public corporations, like the Electric Power Authority and the Aqueduct and Sewer Authority.
(5) Includes mining.
(6) Totals may not add due to rounding.

Source: Planning Board

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

The following table presents annual statistics of average employment based on the North American Industry Classification System (NAICS) for fiscal years 2000 to 2005.

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

	Fiscal Years Ended June 30					
	2000	**2001**	**2002**	**2003**	**2004**	**2005(2)**
Natural Resources and Construction	74,917	75,184	70,499	67,673	69,124	67,516
Manufacturing						
Durable Goods	57,383	56,249	49,348	49,032	50,991	51,616
Non-Durable Goods	85,550	82,236	72,595	68,236	67,606	65,626
Sub Total	217,850	213,669	192,442	184,941	187,721	184,758
Trade, Transportation, Warehouse & Utilities						
Wholesale Trade	32,000	32,327	31,489	31,783	33,261	33,725
Retail Trade	131,817	133,821	127,716	128,567	131,624	131,055
Transportation, Warehouse & Utilities	19,458	19,285	17,603	17,112	17,153	18,464
Sub Total	183,275	185,433	176,808	177,462	182,037	183,245
Information	21,108	20,597	21,943	21,332	22,067	23,343
Finance	45,583	44,974	43,963	44,103	46,402	46,309
Professional & Business	96,750	97,164	95,223	97,266	102,102	102,155
Educational & Health	80,692	84,202	84,452	91,318	97,951	98,889
Leisure & Hospitality	65,942	66,435	64,273	67,073	70,512	70,979
Other Services	17,408	17,330	16,602	18,588	20,643	22,137
Government	286,133	282,723	288,679	297,709	303,137	309,594
Total Non-Farm	1,014,742	1,012,528	984,385	999,790	1,032,573	1,041,407

(1) The figures presented in this table are based on the Payroll Survey prepared by the Bureau of Labor Statistics of the Department of Labor and Human Resources. There are numerous conceptual and methodological differences between the Household Survey and the Payroll Survey. The Payroll Survey reflects information collected from payroll records of a sample of business establishments, while the Household Survey is based on responses to a series of questions by persons in a sample of households. The Payroll Survey excludes the self-employed and agricultural employment. Totals may not add due to rounding. Calendar years 2001 and 2002 are under revision by the Bureau of Labor Statistics of the Department of Labor and Human Resources.
(2) Preliminary.

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

Manufacturing

Manufacturing is the largest sector of the Puerto Rico economy in terms of gross domestic product. The Planning Board estimates that in fiscal year 2004 manufacturing generated $34.1 billion or 43.2% of gross domestic product. During fiscal year 2005, payroll employment for the manufacturing sector was 117,242, a decrease of 1.1% compared with fiscal year 2004, with most of the job losses occurring in labor-intensive industries. Most of the island's manufacturing output is shipped to the United States mainland, which is also the principal source of semi-finished manufactured articles on which further manufacturing operations are performed in Puerto Rico. The United States minimum wage laws are applicable in Puerto Rico. As of June 2005, the average hourly manufacturing wage rate in Puerto Rico was 65.8% of the average mainland United States rate.

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

The following table sets forth gross domestic product by manufacturing sector for the five fiscal years ended June 30, 2000 through June 30, 2004.

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

	2000	2001	2002	2003	2004[1]
Pharmaceuticals	$13,580	$16,620	$18,681	$19,072	$20,138
Machinery and metal products:					
Machinery, except electrical	2,031	3,376	3,845	3,528	3,499
Electrical machinery	1,525	1,874	1,757	1,915	1,821
Professional and scientific instruments	1,758	2,100	2,191	3,026	3,325
Other machinery and metal products	341	316	312	291	313
Food products	1,912	1,974	2,092	2,289	2,332
Other chemical and allied products	777	765	578	496	475
Apparel	610	569	530	466	620
Other[2]	1,543	1,444	1,258	1,418	1,555
Total gross domestic product of manufacturing sector[3]	$24,079	$29,037	$31,243	$32,501	$34,078

(1) Preliminary. Puerto Rico Planning Board expects to certify these numbers by February 2006. Fiscal year 2004 data are the most recent available statistics.
(2) Includes petroleum products; petrochemicals; tobacco products; stone, clay and glass products; textiles and others.
(3) Totals may not add due to rounding.

Source: Planning Board

The following table presents annual statistics of average manufacturing employment by industry based on the North American Industry Classification System (NAICS) for fiscal years 2000 to 2005.

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

	Fiscal Years Ended June 30					
Industry Group	**2000**	**2001(1)**	**2002(1)**	**2003**	**2004**	**2005(2)**
Durable Goods						
Nonmetallic Mineral Products Manufacturing	4,833	4,726	4,429	4,385	4,692	4,606
Fabricated Metal Products	7,267	7,218	6,379	6,127	6,519	6,569
Computer and Electronic	14,958	14,316	11,464	11,483	10,761	11,094
Electrical Equipment	8,917	8,225	7,064	7,331	7,753	7,529
Miscellaneous Manufacturing	11,725	12,046	11,757	12,149	13,037	13,920
Other Durable Goods Manufacturing	9,683	9,718	8,255	7,557	8,229	7,898
Total – Durable Goods	57,383	56,249	49,348	49,032	50,991	51,616
Non-Durable Goods						
Food Manufacturing	17,417	17,109	14,515	13,466	13,232	12,428
Beverage and Tobacco Products	3,425	3,571	3,403	3,112	3,078	3,307
Apparel Manufacturing	17,517	16,265	11,715	8,870	8,099	6,966
Chemical Manufacturing	29,450	29,124	30,363	30,792	30,448	30,317
Plastics and Rubber Products	4,108	3,820	3,393	3,293	3,208	2,958
Other Non-Durable Goods Manufacturing	13,633	12,347	9,206	703	9,541	9,650
Total – Non-Durable Goods	85,550	82,236	72,595	60,236	67,606	65,626
Total Manufacturing Employment	142,933	138,485	121,943	109,268	118,597	117,242

* Totals may not add due to rounding.
(1) Calendar years 2001 and 2002 are under revision by the Bureau of Labor Statistics of the Department of Labor and Human Resources.
(2) Preliminary.

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

Total employment in the manufacturing sector decreased by 25,691 from fiscal year 2000 to fiscal year 2005. This reduction in manufacturing employment was coupled with a significant increase in manufacturing productivity and investment as shown by the expansion in real manufacturing output and in the growth of exports. Most of the decrease in employment has been concentrated in labor intensive industries, particularly apparel, textiles, tuna canning, and leather products.

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

Employment 2,500 and over	**Product**
Abbot Laboratories	Pharmaceuticals
Baxter International, Inc.	Medical Devices
Johnson and Johnson	Surgical Products
Pfizer Pharmaceuticals LLC	Pharmaceuticals
Wyeth	Pharmaceuticals
Zimmer Holdings, Inc.	Pharmaceuticals

Employment 1,000 to 2,499	**Product**
Altadis	Cigars
Amgen, Inc.	Pharmaceuticals
Atento Teleservicios	Communications
Eaton Corporation	Electronic Instruments
Edwards Lifesciences LLC	Surgical Instruments
Eli Lilly and Company	Pharmaceuticals
General Electric Industrial Systems	Electronic Instruments
Glaxo Smithkline	Pharmaceuticals
Atento Teleservicios	Transportation
Hewlett-Packard Co.	Computers
Medtronic Europe SA	Surgical Instruments
Merck & Co., Inc.	Pharmaceuticals
Propper International Company	Apparel
Sara Lee Corp	Apparel
Schering Plough Corporation	Pharmaceuticals
The Cooper Companies	Ophthalmic Products
Tyco International	Surgical Products

Employment 500 to 999	**Product**
Advanced Medical Optics, Inc.	Ophthalmic Products
Astra Zeneca PLC	Pharmaceuticals
Becton-Dickinson & Co.	Surgical Instruments
Bumble Bee Seafoods	Food
Cardinal Health, Inc.	Surgical Instruments
Grupo Gloria	Food
Guidant Corp.	Medical Instruments
Hamilton Sundstrand Corp.	Electrical Instruments
Hubbel Incorporated	Electrical Instruments
Ingersoll-Rand Co.	Electrical Instruments
Ivax Pharmaceutical	Pharmaceuticals
Pall Corporation	Ophthalmic Filters
Patheon Inc.	Pharmaceuticals
Procter & Gamble Co.	Pharmaceuticals
Stryker Corp.	Surgical Instruments
Unilever PLC	Consumer Products
Warner-Lambert Company	Pharmaceuticals
Wellco Enterprises, Inc.	Footwear

Employment 200 to 499	**Product**
Alcan Finance (BDA) LTC	Plastics
Atlantron Inc.	Computers
Atento Teleservicios	Transportation
Bacardí Limited	Food
Biovail Corporation International	Pharmaceuticals
CEMEX	Cement
Centennial Communication	Communications
Checkpoint Systems Inc.	Electronic Instruments
Coca Cola Company	Food
Colgate-Palmolive Company	Consumer Products
C.R. Bard	Surgical Instruments
Curtis Instruments Inc.	Electrical Instruments
Davis Creek Managing Partners	Metal Products
E.I. DuPont de Nemours & Co.	Chemicals
Eastern Canvas Products	Textile Products
Espace Europee de Lenterprise	Pharmaceuticals
Essilor International	Ophthalmic Products
Garguilo	Transportation
Hershey Foods Corp.	Food
ICN Pharmaceuticals Inc.	Pharmaceuticals
IDT Dutch Holding, BV	Communications
Loctite Corporation	Chemicals
Lutron Electronics Co. Inc.	Electronic Instruments
Millipore Corporation	Surgical Instruments
Mylan Laboratories, Inc.	Chemicals
Northrop Grumman Corporation	Electrical Instruments
Novartis Holding AG	Ophthalmic Products
Nypro International	Medical Devices
Owens Illinois Inc.	Glass and Plastics
Packaging Coordinators Inc.	Packaging Products
PepsiCo, Inc.	Food
Pilgrim's Pride Corporation	Food
Positronic Industries, Inc.	Electronics
Rocky Shoes & Boots	Footwear
Siemens AG	Electrical Instruments
Sitnasuak Native Corporation	Apparel
Solectron Corporation	Electronic Instruments
St. Jude Medical, Inc.	Surgical Instruments
Standard Motor Products Inc.	Motor Vehicle Parts
Storage Technology Corp.	Electronics
SwissAir Services Corp.	Transportation
Symmetricom Inc.	Electronic Equipment
Thomas & Betts Corporation	Electrical Instruments
Timberland Company	Leather
Warner Chilcott	Pharmaceuticals
Watson Pharmaceutical, Inc.	Pharmaceuticals

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

Source: PRIDCO; Economic Analysis and Strategic Planning Area

Services

Puerto Rico has experienced significant growth in the services sector, which includes finance, insurance, real estate, wholesale and retail trade, tourism and other services, in terms of both income and employment over the past decade, showing a favorable trend as compared with certain other industrialized economies. During the period between fiscal years 2000 and 2004, the gross domestic product in this sector, in nominal terms, increased at an average annual rate of 5.2%, while payroll employment in this sector increased at an average annual rate of 1.1%. It should also be noted that in the Puerto Rico labor market, self-employment, which is not accounted for in the Payroll Survey, represents approximately 17% of total employment according to the Household Survey. Most of the self-employment is concentrated in the service and construction sectors. For example, in fiscal year 2003, the number of self-employed individuals was 180,464, out of which 46.0% were in the service sector and 10.5% were in the construction sector. The development of the services sector has been positively affected by demand generated by other sectors of the economy, such as manufacturing, construction and agriculture. The services sector in Puerto Rico has a diversified base.

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

The services sector ranks second to manufacturing in its contribution to gross domestic product, and it is the sector with the greatest employment. In fiscal year 2004, services generated $30.5 billion of gross domestic product, or 38.7% of the total. Services employment grew from 510,758 in fiscal year 2000 to 547,057 in fiscal year 2005 (representing 52.5% of total non-farm payroll employment). This represents a cumulative increase of 6% during such period. Wholesale and retail trade, finance, insurance and real estate experienced significant growth in fiscal years 2000 to 2004, as measured by gross domestic product. From fiscal year 2000 to 2004, gross domestic product increased in wholesale and retail trade from $8.3 billion to $9.6 billion, and in finance, insurance, and real estate from $10.0 billion to $13.0 billion. There are sixteen commercial banks and trust companies currently operating in Puerto Rico. Total assets of these institutions as of June 30, 2005 were $100.0 billion. As of June 30, 2005, there were approximately thirty-five international banking entities operating in Puerto Rico licensed to conduct offshore banking transactions with total assets of $72.8 billion.

The following tables set forth service sector gross domestic product for fiscal years 2000 to 2004 and employment for the services sector for fiscal years 2000 to 2005.

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

	Fiscal Years Ended June 30				
	2000	**2001**	**2002**	**2003**	**2004(1)**
Wholesale and retail trade	$ 8,340	$ 8,338	$ 8,623	$ 9,005	$ 9,582
Finance, insurance and real estate	9,977	11,294	11,212	12,425	13,024
Other services(2)	6,603	6,982	7,078	7,257	7,899
Total	$24,920	$26,615	$26,913	$28,688	$30,505

* Totals may not add due to rounding.

(1) Preliminary. Puerto Rico Planning Board expects to certify these numbers by February 2006. Fiscal year 2004 data are the most recent available statistics.

(2) Includes tourism.

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

	Fiscal Years Ended June 30					
	2000	**2001(1)**	**2002(1)**	**2003**	**2004**	**2005(2)**
Wholesale Trade	32,000	32,327	31,489	31,783	33,261	33,725
Retail Trade	131,817	133,821	127,716	128,567	131,624	131,055
Transportation, Warehouse & Utilities	19,458	19,285	17,603	17,112	17,153	18,464
Trade, Transportation, Warehouse & Utilities	183,275	185,433	176,808	177,461	182,037	183,245
Information	21,108	20,597	21,943	21,332	22,067	23,343
Finance	45,583	44,974	43,963	44,103	46,402	46,309
Professional and Business	96,750	97,164	95,223	97,266	102,102	102,155
Educational & Health	80,692	84,202	84,452	91,318	97,951	98,889
Leisure & Hospitality	65,942	66,435	64,273	67,073	70,512	70,979
Other Services	17,408	17,330	16,602	18,588	20,643	22,137
Total	510,758	516,135	503,264	517,141	541,714	547,057

* Totals may not add due to rounding.
(1) Calendar years 2001 and 2002 are under revision by the Bureau of Labor Statistics of the Department of Labor and Human Resources.
(2) Preliminary.
Source: Department of Labor and Human Resources, Benchmark on Employment, Hours and Earnings

Hotels and Related Services - Tourism

During fiscal year 2005, the number of persons registered in tourist hotels, including residents of Puerto Rico and tourists staying in more than one hotel during their visit, was 1,842,400, an increase of 3.1% over the number of persons registered during the same period in fiscal year 2004. The number of non-resident tourists registered in tourist hotels during fiscal year 2005 increased 2.8% compared to fiscal year 2004 due to new hotel rooms from tourist developments opened in 2005. Hotel rooms available during fiscal year 2005 increased 5.3% compared to fiscal year 2004. The average number of rooms rented in tourist hotels increased 3.1% during fiscal year 2005 compared to fiscal year 2004. The average occupancy rate in tourist hotels during fiscal year 2005 was 70.8% compared to 72.4% for fiscal year 2004. The decrease in the occupancy rate in tourist hotels during fiscal year 2005 was due to the addition of new hotel rooms.

During fiscal year 2004, the number of persons registered in tourist hotels, including residents of Puerto Rico and tourists staying in more than one hotel during their visit, was 1,787,300, an increase of 3.2% over the number of persons registered during fiscal year 2003. The average occupancy rate in tourist hotels during fiscal year 2004 was 72.4% compared to 68.0% in fiscal year 2003. The average number of rooms rented in tourist hotels increased 4.9% during fiscal year 2004 compared with fiscal year 2003. The average number of rooms available in tourist hotels decreased 1.6% during fiscal year 2004 compared to fiscal year 2003.

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

The following table presents data relating to visitors to Puerto Rico and tourist expenditures for the five fiscal years ended June 30, 2004.

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

Fiscal Years Ended June 30	Tourist Hotels(2)	Cruise Ship	Other(3)	Total	Total Visitors' Expenditures (in millions)
2000	1,050,100	1,224,600	2,291,300	4,566,000	$2,387.90
2001	1,186,800	1,356,600	2,364,400	4,907,800	2,728.10
2002	1,147,800	1,277,000	1,939,300	4,364,100	2,486.40
2003	1,239,200	1,163,900	1,999,200	4,402,300	2,676.60
2004	1,307,000	1,348,200	2,234,000	4,889,200	3,024.00

(1) Only includes information about non-resident tourists registering in tourist hotels. They are counted once even if registered in more than one hotel.
(2) Includes visitors in guesthouses.
(3) Includes visitors in homes of relatives, friends, and in hotel apartments.

Sources: Puerto Rico Tourism Company and the Planning Board

The Commonwealth, through the Convention Center District Authority, is in the process of finishing the development of the largest convention center in the Caribbean, and the centerpiece of a 100-acre private development, including hotels, restaurants, cinemas, office space and housing. The convention center district is being developed at a total cost of $1.3 billion to improve Puerto Rico's competitive position in the convention and group travel segments. The convention center opened on November 17, 2005, and 17 conventions have already been booked for the first year of operations.

The Convention Center District Authority also owns a multi-purpose coliseum located in San Juan, Puerto Rico. The coliseum, known as the Jose Miguel Agrelot Coliseum, was inaugurated in 2004 and has been host to various successful artistic and other events.

Government

The government sector of Puerto Rico plays an important role in the economy. In fiscal year 2004, the government accounted for $7.4 billion of Puerto Rico's gross domestic product, or 9.4% of the total. The government is also a significant employer, providing jobs for 309,594 workers, or 29.7% of total non-farm payroll employment in fiscal year 2005.

On February 25, 1998, legislation was enacted permitting the unionization of employees of the central government (excluding municipal employees). Under this law, government employees are given collective bargaining rights subject to a number of limitations. Among those limitations are: employees are prohibited from striking; salary increases are contingent on the availability of budgeted revenues; employees cannot be required to become union members and pay union dues; and collective bargaining negotiations cannot occur in an election year. During fiscal year 2006, the Commonwealth and its instrumentalities have begun to negotiate the economic and non-economic terms of at least forty collective bargaining agreements, which could have a material impact on the General Fund.

On August 3, 2005, the Governor issued an Executive Order requiring most Executive Branch agencies to establish a voluntary employee hourly reduction program. The purpose of the program is to reduce salary expenditures by the government. The program establishes two hourly alternatives with different pay incentives: (1) one day per week work reduction (approximately 7.5 hours or 20% of the work week) with a 15% reduction in salary and (2) 50% reduction in the regular hourly work week with a 35% reduction in salary (for those employees with 5 years or less before retirement, the second option will only entail a 25% reduction in salary). Participation in this voluntary program will not result in any payroll contribution reductions to the Government Employees Retirement System. See "Budget for Fiscal Year 2006" under *Budget of the Commonwealth of Puerto Rico*.

Transportation

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

Luis Muñoz Marín International Airport is currently served by 25 United States and international airlines. At present, there is daily direct service between San Juan and Atlanta, Boston, Chicago, Dallas, Miami, New York, Philadelphia, and numerous other destinations within the United States. There is also regularly scheduled service between Aguadilla and Ponce and New York and between Puerto Rico and other Caribbean islands and certain Latin American and European cities. A major United States airline uses San Juan as a hub for its intra-Caribbean airline service. Several smaller airports serve intra-island traffic.

The island's major cities are connected by a modern highway system, which, as of December 31, 2004, totaled approximately 4,608 miles. The highway system comprises 379 miles of primary system highways, which are the more important interregional traffic routes and include the PR-52, the PR-22, PR-53 and PR-20 toll highways, 230 miles of primary urban system highways, 959 miles of secondary system highways serving the needs of intra-regional traffic and 3,041 miles of tertiary highways and roads serving local, intra-regional traffic.

The first phase of a new mass transit system, known as Tren Urbano, has been completed. Tren Urbano serves a portion of metropolitan San Juan and is expected eventually to serve the municipalities of Carolina and Caguas as well.

The Port of the Americas Authority ("PAA") is responsible for the development and operation of the Port of the Americas, a deep draft port on the south coast of Puerto Rico. The first phase of the Port of the Americas was completed in fiscal year 2004. This initial phase included the improvement of piers 4, 5 and 6 of the Port and the acquisition of heavy equipment at a cost of $40 million. During calendar year 2005, the PAA began its second phase of the Port which is expected to be completed by the end of calendar year 2007. Completion of this second phase will provide capacity to handle up to 250,000 Twenty-Foot Equivalent Units ("TEU"). This second phase includes (i) dredging the entrance channel and adjacent areas of the Port to a depth of 50 feet; (ii) reconstruction of container terminals; (iii) commencement of certain required environmental risk mitigation procedures; and (iv) preparation of final construction schematics. With respect to these tasks, dredging is 28% complete, the final design contract has been awarded, acquisition of environmental risk mitigation land is underway, and the contract for reconstruction at the container terminal is expected to be awarded during the first quarter 2006.

PAA has borrowed a total of $250 million, including a $70 million line of credit from GDB, for the Port which is expected to be capable of providing capacity for up to 700,000 TEUs when the third phase is completed. This debt is payable from annual legislative appropriations until the PAA starts generating revenues sufficient to cover debt service. Partial operation of the Port of the Americas, at a capacity of up to 250,000 TEUs per year, could begin early 2008.

Construction

Although the construction industry represents a relatively small segment of the economy compared to other sectors, it has made significant contributions to the growth of economic activity. However, during the period from fiscal year 2000 through fiscal year 2004, real construction investment decreased 3.3%. This decline is relatively small when compared to the high levels of construction activity previously recorded.

The total value of construction permits increased 21.2% for the same 5-year period. Public investment has been an important component of construction investment. During fiscal year 2004, approximately 41% of the total investment in construction was related to public projects. During fiscal year 2005, the total value of construction permits increased 0.1% compared with fiscal year 2004. Average payroll employment in the construction sector during fiscal year 2005 was 67,516, a decrease of 2.3% from fiscal year 2004.

During fiscal year 2005, total sales of cement, including imports, decreased 0.1% compared with fiscal year 2004.

Total construction investment for fiscal year 2004 increased (in real terms) by 1.5%, which was the first increase in 3 years. For fiscal years 2005 and 2006, the Planning Board forecasts construction investment increases (in real terms) of 1.3% for each year. Public investment will be primarily in housing, new schools (and school reconstruction programs), water projects, and other public infrastructure projects. However, public investment in construction could be negatively affected by the Commonwealth's fiscal difficulties.

Agriculture

The Department of Agriculture and related agencies have directed their efforts at increasing and improving local agricultural production, increasing efficiency and the quality of produce, and stimulating the consumption of locally produced agricultural products. During fiscal year 2004, gross income from agriculture was $780.7 million, an increase of 2.8% compared with fiscal year 2003. Agriculture gross income consists of the total value of production in the principal agricultural sectors, which include traditional crops, livestock and poultry, grains, vegetables, fruits, and other products. During fiscal year 2004, traditional crops, livestock products, starchy vegetables, ornamental plants and other products contributed a higher percentage of the sector's income than in the previous fiscal year.

The Commonwealth supports agricultural activities through incentives, subsidies, and technical and support services, in addition to income tax exemptions for qualified income derived by bona fide farmers. Act No. 225 of 1995 provides a 90% income tax exemption for income derived from agricultural operations, an investment tax credit equal to 50% of the investment in qualified agricultural projects, and a 100% exemption from excise taxes, real and personal property taxes, municipal license taxes and tariff payments. It also provides full income tax exemption for interest income from bonds, notes and other debt instruments issued by financial institutions to provide financing to agricultural businesses. Subsequent legislation imposed an aggregate annual limit of $15 million on the investment tax credits available under Act No. 225.

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

Higher Education

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

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

Commonwealth of Puerto Rico
Trend in College Enrollment

	Commonwealth of Puerto Rico			Mainland United States		
Academic Year	Population 18-24 Years of Age	Higher Education Enrollment	Percent[(1)]	Population 18-24 Years of Age	Higher Education Enrollment	Percent[(1)]
1970	341,448[(2)]	57,340	16.8%	23,714,000[(2)]	8,580,887	36.2%
1980	397,839[(2)]	130,105	32.7%	30,022,000[(2)]	12,096,895	40.3%
1990	417,636[(2)]	156,147	37.4%	26,961,000[(2)]	13,621,000	50.5%
2000	428,892[(2)]	176,015	41.0%	27,143,455[(2)]	15,312,000	56.4%
2001	426,194[(3)]	185,015	43.4%	27,968,162[(3)]	15,928,000	56.7%
2002	423,852[(3)]	190,776	45.0%	28,442,293[(3)]	16,612,000	58.4%
2003	420,295[(3)]	199,842	47.6%	28,923,731[(3)]	16,910,000	58.5%
2004	416,020[(3)]	206,791	49.7%	29,245,102	17,095,000	58.4%

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

Sources: United States Census Bureau (Mainland United States Population), United States National Center for Education Statistics, Planning Board (Puerto Rico Population) and Council on Higher Education of Puerto Rico

The University of Puerto Rico, the only public university in Puerto Rico, has eleven campuses located throughout the island. The University's total enrollment for academic year 2003-2004 was approximately 68,000 students. Statistics for academic year 2004-2005 are still not available. The Commonwealth is legally bound to appropriate annually for the University of Puerto Rico an amount equal to 9.60% of the average annual revenue from internal sources for each of the two fiscal years immediately preceding the current fiscal year.

In addition to the University of Puerto Rico, there are 40 public and private institutions of higher education located in Puerto Rico. Such institutions have a current enrollment of approximately 138,700 students and provide programs of study in liberal arts, education, business, natural sciences, technology, secretarial and computer sciences, nursing, medicine, and law. Degrees are offered by these institutions at the associate, bachelor, master, and doctoral levels.

Tax Incentives

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

Industrial Incentives Program

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

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

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

Tourism Incentives Program

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

As part of the incentives to promote the tourism industry, the Commonwealth established the Tourism Development Fund as a subsidiary of GDB with the authority to (i) make investments in or provide financing to entities that contribute to the development of the tourism industry and (ii) provide financial guarantees and direct loans for financing hotel development projects. To date, the Fund has provided direct loans and financial guarantees for loans made or bonds issued to finance the development of seventeen hotel projects representing over 3,800 new hotel rooms.

Incentives under the U.S. Code

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

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

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

Section 30A. The 1996 Amendments added Section 30A to the U.S. Code. Section 30A permits a "qualifying domestic corporation" ("QDC") that meets certain gross income tests to claim a credit (the "Section 30A Credit") against the federal income tax imposed on taxable income derived from sources outside the United States from the active conduct of a trade or business in Puerto Rico or from the sale of substantially all the assets used in such business ("possession income"). The Section 30A Credit will not be available for taxable years commencing on or after January 1, 2006.

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

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

Section 936. Under Section 936 of the U.S. Code, as amended by the 1996 Amendments, United States corporations that meet certain requirements and elect its application ("Section 936 Corporations") are entitled to credit against their United States corporate income tax the portion of such tax attributable to income derived from the active conduct of a trade or business within Puerto Rico ("active business income") and from the sale or exchange of substantially all assets used in the active conduct of such trade or business.

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

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

In the case of taxable years beginning on or after 1998, the possession income subject to the Section 936 credit is subject to a cap based on the Section 936 Corporation's possession income for an average adjusted base period ending on October 14, 1995. The Section 936 credit is eliminated for taxable years commencing on or after January 1, 2006.

Controlled Foreign Corporations

Because of the credit limitations and impending phase out of Sections 30A and 936 of the U.S. Code, many corporations previously operating thereunder have reorganized their operations in Puerto Rico to become controlled foreign corporations ("CFCs"). A CFC is a corporation that is organized outside the United States and is controlled by United States shareholders. In general, a CFC may defer the payment of federal income taxes on its trade or business income until such income is repatriated to the United States in the form of dividends or through investments in certain United States properties. The Puerto Rico Office of Industrial Tax Exemption has received notification from over 120 corporations that have converted part or all of their operations to CFCs. These include most of the major pharmaceutical, instrument and electronics companies manufacturing in Puerto Rico.

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

DEBT

Public Sector Debt

Public sector debt comprises bonds and notes of the Commonwealth, its municipalities, and public corporations ("notes" as used in this section refers to certain types of non-bonded debt regardless of maturity), subject to the exclusions described below. 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 deposited into the Treasury (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, and motor vehicle fuel taxes and license fees, which are allocated to the Highway and Transportation 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. Future maximum annual debt service for the Commonwealth's outstanding general obligation debt is $705,522,695 in the fiscal year ending June 30, 2006 (based on the assumption that the Public Improvement Refunding Bonds, Series 2004 A bear interest at their actual rate per annum through July 1, 2012 and thereafter at 12% per annum, and the Public Improvement Refunding Bonds, Series 2004 B bear interest at 12% per annum). Debt service for the PRASA guaranteed bonds paid by the Commonwealth during fiscal year 2005 (including, for this purpose, debt service payments due and paid on July 1, 2005) was $30,127,367.50. The sum of those amounts ($735,650,063) is equal to 9.45% of $7,781,435,000, which is the average of the adjusted internal revenues for the fiscal year ended June 30, 2004 and the currently estimated adjusted internal revenues for the fiscal year ended June 30, 2005. If bonds refunded with non-eligible investments described in the preceding sentence were treated as not being outstanding, and the interest on the Public Improvement Refunding Bonds, Series 2004 B was calculated using the effective fixed interest rate payable by the Commonwealth under the interest rate exchange agreements entered into in respect thereof, the percentage referred to in the preceding sentence would be 8.82%. The Commonwealth's policy has been and continues to be to maintain the amount of such debt prudently below the constitutional limitation. Debt of municipalities, other than bond anticipation notes, is supported by real and personal property taxes and municipal license taxes. Debt of public corporations, other than bond anticipation notes, is generally supported by the revenues of such corporations from rates charged for services or products. See *Public Corporations.* However, certain debt of public corporations is supported, in whole or in part, directly or indirectly, by Commonwealth appropriations or taxes.

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

The following table presents a summary of public sector debt as of September 30, 2005. Excluded from the table is debt not primarily payable from either Commonwealth or municipal taxes, Commonwealth appropriations or rates charged by public corporations for services or products, some of which debt is set forth in footnote 4 below. Also excluded from the table is debt the inclusion of which would reflect double counting including, but not limited to, $1.1 billion of outstanding bonds (as of September 30, 2005) issued by the Municipal Finance Agency to finance its purchase of bonds of Puerto Rico municipalities, and $2.6 billion of obligations of the Public Finance Corporation issued to purchase certain Commonwealth public sector debt.

Commonwealth of Puerto Rico
Public Sector Debt
(in thousands)

	September 30, 2005
Puerto Rico direct debt[(1)]	$ 9,631,658
Municipal debt	2,119,995
Public corporations debt	
Puerto Rico guaranteed debt[(2)]	666,921
Debt supported by Puerto Rico appropriations or taxes[(3)]	16,807,326
Other non-guaranteed debt[(4)]	7,964,106
Total public corporations debt	25,438,353
Total public sector debt	$37,190,006

(1) Includes general obligation bonds, tax and revenue anticipation notes, and lines of credit provided by GDB. Excludes certain Commonwealth general obligation bonds that have been refunded with proceeds that were invested in guaranteed investment contracts or other securities not eligible to effect a legal defeasance, even though such bonds will be considered outstanding under their respective authorizing resolutions and for purposes of calculating the Commonwealth's constitutional debt limitation.

(2) Consists of $508.2 million of bonds issued by the Aqueduct and Sewer Authority and $158.7 million of State Revolving Fund Loans, incurred under various federal water laws. Excludes Public Buildings Authority bonds in the principal amount of $2.9 billion as of June 30, 2005 and $267 million of GDB bonds payable from available moneys of GDB.

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

(4) Excludes the following: $1.1 billion of Infrastructure Financing Authority bonds, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company; $1.2 billion of Children's Trust bonds which are payable solely from the payments to be received pursuant to the tobacco litigation settlement; $663 million of Housing Finance Authority bonds, which are payable from Puerto Rico Housing Administration's annual allocation of Public Housing Capital Funds from the United States Department of Housing and Urban Development; $153 million of Special Facilities Revenue Bonds issued by the Highway and Transportation Authority, which are payable from net toll revenues collected from the Teodoro Moscoso Bridge; $155 million of Special Facilities Bonds issued by the Ports Authority, which are solely payable from by the pledge of certain payments made by a private corporation under a special facilities agreement; $97 million of Qualified Zone Academy Bonds issued by the Public Finance Corporation, which are payable from securities purchased with funds assigned by the Children's Trust to the Department of Education; $87 million of Educational Facilities Revenue Bonds, 2000 Series A (University Plaza Project) issued by the Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority, which are payable from rent payments made by the University of Puerto Rico; and approximately $113.4 million of bonds issued by the Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority to finance the construction of various government infrastructure projects, which are payable from rent payments made by various government entities. References collectively to the bonds listed in this footnote are subsequently called the "Excluded Bonds." If the principal amounts of the Excluded Bonds were included in the above table, total public corporations debt would be $28,341,753,000 and total public sector debt would be $40,093,406,000.

Source: Government Development Bank for Puerto Rico

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

Debt Service Requirements for Commonwealth General Obligation Bonds

The following table presents the debt service requirements for Commonwealth general obligation bonds outstanding as of June 30, 2005.

The table excludes debt service on certain general obligation bonds refunded with refunding bonds the proceeds of which, pending the redemption of the refunded bonds, were invested in guaranteed investment contracts or other securities not eligible to effect a legal defeasance. Such refunded bonds will be considered to be outstanding under their respective authorizing resolutions and for purposes of calculating the Commonwealth's constitutional debt limitation described above. In addition, the interest in the table is calculated in respect of certain variable rate general obligation bonds as to which the Commonwealth has entered into interest rate exchange agreements by using the respective fixed rates of interest that the Commonwealth is paying under said agreements. Had such economically (but not legally) defeased bonds been included in the table and the interest in respect of such variable rate bonds been calculated by treating them as bearing interest at the maximum rate permitted by law (currently an effective rate of 12% per annum), maximum annual principal and interest on all outstanding general obligation bonds during the fiscal year ending June 30, 2006 would equal $705,522,695. Debt service requirements for each fiscal year, as shown in the following table, include principal and interest due on July 1 immediately following the close of such fiscal year.

Puerto Rico
Debt Service Requirements*
(in thousands)

	Outstanding Bonds		
Fiscal Year Ending June 30	**Principal**	**Interest**	**Total Debt Service[(1)]**
2006[(2)]	$ 174,484	$ 387,535	$ 562,019
2007	161,722	400,175	561,897
2008	200,027	371,611	571,638
2009	238,840	328,465	567,304
2010	252,795	314,693	567,488
2011	264,197	300,913	565,110
2012	283,795	281,166	564,961
2013	301,335	263,690	565,025
2014	299,023	268,096	567,119
2015	313,125	254,313	567,437
2016	328,230	239,472	567,702
2017	343,802	224,283	568,084
2018	361,120	208,346	569,466
2019	394,356	175,751	570,107
2020	452,165	148,395	600,560
2021	322,480	126,181	448,661
2022	247,400	111,409	358,809
2023	214,650	100,363	315,013
2024	200,845	90,886	291,731
2025	209,670	82,365	292,035
2026	209,880	73,792	283,672
2027	219,380	64,555	283,935
2028	229,265	54,947	284,212
2029	239,770	44,716	284,486
2030	251,355	33,301	284,656
2031	263,020	21,752	284,772
2032	96,645	9,518	106,163
2033	68,080	5,111	73,191
2034	33,105	1,655	34,760
	$7,174,559	$4,987,455	$12,162,014

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* Totals may not add due to rounding. Excludes the debt service on certain economically (but not legally) defeased general obligation bonds and includes the effective fixed rate on certain variable rate general obligation bonds as to which the Commonwealth has entered into interest rate exchange agreements.

(1) Since fiscal year 1997, the Commonwealth has been paying approximately $30 million annual debt service on PRASA bonds guaranteed by the Commonwealth. Beginning with the debt service payment due January 1, 2006, the Commonwealth will stop making such payments since PRASA will resume making all payments due on and after such date from anticipated increased revenues received from its rate increase. See “Other Public Corporations - Aqueduct and Sewer Authority” under *Public Corporations* below.

(2) This amount is contemplated to be refinanced to lower the debt service payments due from the Commonwealth on outstanding general obligation bonds for fiscal year 2006. See “Commonwealth’s Budget Structural Imbalance” under *Puerto Rico Taxes, Other Revenues, and Expenditures* and “2006 Budget Approval Process” under *Budget of the Commonwealth of Puerto Rico.*

Sources: Government Development Bank for Puerto Rico and Department of the Treasury

In May 2005, Moody's Investors Service ("Moody's") and Standard & Poor's Rating Services, a division of The McGraw-Hill Companies, Inc. ("S&P"), each announced downgrades to the Commonwealth's general obligation debt rating. Moody's and S&P lowered their respective ratings on the Commonwealth's general obligation debt from "Baa1" to "Baa2" and from "A-" to "BBB." Among the reasons given by the rating agencies for the reduction in the ratings were, among others, the concern over the Commonwealth's financial performance, particularly the current structural imbalance in its budget, the low funding ratio of the Employees Retirement System of the Commonwealth and its instrumentalities (the "Employees Retirement System"), the uncertainty surrounding the approval of a budget for fiscal year 2006 and the availability of additional recurring revenue sources. See "Commonwealth's Budget Structural Imbalance" under *Puerto Rico Taxes, Other Revenues, and Exemptions*. See also *Retirement Systems* and *Budget of the Commonwealth of Puerto Rico.* For more information relating to the rating downgrades please refer to www.moodys.com and www.standardandpoors.com.

On October 21, 2005, S&P further lowered GDB's long-term counterparty credit rating to "BBB" from "BBB+" and affirmed its short-term, counterparty rating of "A-2." S&P's rating reduction of GDB was made in order to further align GDB's rating to that of the Commonwealth given GDB's high balance of public sector loans on its balance sheet. See "Government Development Bank" below.

The Commonwealth and GDB have each been assigned a negative ratings outlook by the rating agencies.

The Commonwealth is currently addressing the structural imbalance referenced above through the simultaneous control of expenses and generation of other resources. See *Budget of the Commonwealth of Puerto Rico*. The rating agencies have requested that the Commonwealth develop a multi-year fiscal plan that demonstrates the achieving of financial stability. The Commonwealth is preparing such plan. Until the successful implementation of such plan, the rating agencies may further downgrade their respective ratings of the Commonwealth's debt.

Commonwealth Guaranteed Debt

As of September 30, 2005, $2.9 billion of Commonwealth guaranteed bonds of the Public Buildings Authority were outstanding. Maximum annual debt service on these bonds is $219.5 million in fiscal year ending June 30, 2011, with their final maturity being July 1, 2036. No payments under the Commonwealth guaranty have been required to date for bonds of the Public Buildings Authority.

As of September 30, 2005, $267 million of Commonwealth guaranteed obligations of GDB were outstanding. No payments under the Commonwealth guaranty have been required for any obligations of GDB to date.

As of September 30, 2005, the aggregate outstanding principal amount of obligations of PRASA guaranteed by the Commonwealth was $292 million. On January 2, 1997, the Commonwealth began to make debt service payments under the Commonwealth guaranty and continuously made payments through fiscal year 2005. Beginning with the debt service payment due January 1, 2006, the Commonwealth will stop making debt service payments required on these revenue bonds. PRASA will resume payment of this debt from increased revenues it expects to receive as part of its newly revised tariff structure. See "Other Public Corporations - Aqueduct and Sewer Authority" under *Public Corporations* below.

As of September 30, 2005, the principal amount outstanding on the bonds issued by PRASA to the United States Department of Agriculture, Rural Development, also guaranteed by the Commonwealth, was $216.2 million and the principal amount outstanding of the loans by the State Revolving Funds for the benefit of PRASA was $158.7 million.

Trends of Public Sector Debt

The following table shows the growth rate of short-term and long-term public sector debt and the growth rate of Gross National Product (in current dollars) for the five fiscal years ended June 30, 2005 and the first three months of fiscal year 2006. As of September 30, 2005, outstanding short-term debt, relative to total debt, was 7.7%.

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

	Public Sector Debt					Gross National Product[(1)]	
June 30	**Long Term[(2)]**	**Short Term[(3)]**	**Short Term as % of Total**	**Total**	**Rate of Increase**	**Amount**	**Rate of Increase**
2001	$22,345	$2,870[(4)]	11.4%	$25,215	5.8%	$44,047	6.3%
2002	26,737	1,250[(5)]	4.5%	27,987	11.0%	45,071	2.3%
2003	28,102	1,605[(5)]	5.4%	29,707	6.1%	47,439	5.3%
2004	31,767	2,175[(5)]	6.4%	33,942	14.3%	50,320	6.1%
2005	34,789	1,914[(5)]	5.2%	36,703	8.1%	N/A	N/A
September 30, 2005 ..	34,341	2,849	7.7%	37,190	1.3%	N/A	N/A

* Totals may not add due to rounding.

(1) In current dollars.

(2) Does not include the Excluded Bonds identified in footnote 4 of the table above entitled "Commonwealth of Puerto Rico -- Public Sector Debt," which would have been issued and outstanding at the time, all of which would be considered long-term debt.

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

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

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

Source: Government Development Bank for Puerto Rico

The following table shows the trend of public sector debt by major category for the five fiscal years ended June 30, 2005 and the first three months of fiscal year 2006.

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

	Commonwealth			Municipalities			Public Corporation(1)			Total		
June 30	Long Term(2)	Short Term(3)	Total	Long Term	Short Term(3)	Total	Long Term	Short Term(3)	Total	Long Term	Short Term(3)	Total
2001	$5,674	$164(4)	$5,838	$1,469	$163	$1,632	$15,201	$2,543	$17,744	$22,345	$2,870	$25,215
2002	6,025	91(5)	6,116	1,618	177	1,795	19,094	982	20,076	26,737	1,250	27,987
2003	6,709	177(5)	6,886	1,754	201	1,955	19,639	1,227	20,866	28,102	1,605	29,707
2004	7,758	761(5)	8,519	1,820	226	2,046	22,190	1,187	23,377	31,768	2,174	33,942
2005	8,761	257(5)	9,018	1,927	254	2,181	24,101	1,403	25,504	34,789	1,914	36,703
September 30, 2005	8,682	950	9,632	1,882	238	2,120	23,777	1,661	25,438	34,341	2,849	37,190

* Totals may not add due to rounding.
(1) Includes Commonwealth guaranteed debt; does not include the Excluded Bonds.
(2) Includes the Transferred Debt from Urban Renewal and Housing Corporation ("CRUV").
(3) Obligations (other than bonds) issued with an original maturity of three years or less and lines of credit with a remaining maturity of three years or less are considered short-term debt.
(4) Consists of a line of credit from GDB to the Secretary of the Treasury the proceeds of which were applied to pay debt service on general obligation bonds in lieu of funds available therefor in the General Fund.
(5) Does not include the tax and revenue anticipation notes which were outstanding at the close of the indicated fiscal years because prior to the end of said fiscal years sufficient funds had been set aside for the payment of such notes in full.

Source: Government Development Bank for Puerto Rico

PUBLIC CORPORATIONS

In Puerto Rico, many governmental or quasi-governmental functions are performed by public corporations. These are governmental entities created by the Legislative Assembly with varying degrees of independence from the central government. Public corporations are generally created to perform a single function or a limited number of related functions. Most public corporations obtain revenues from rates charged for services or products, but many are subsidized to some extent by the central government. Most public corporations are governed by boards appointed by the Governor with the advice and consent of the Senate, but some public corporations are subsidiaries of departments of the central government. Capital improvements of most of the larger public corporations are financed by revenue bonds under trust agreements or bond resolutions or notes under loan agreements. The following table presents the outstanding bonds and notes of certain of the public corporations as of September 30, 2005 ("notes" as used in this section refers primarily to certain types of non-bonded debt regardless of maturity). Debt of certain other public corporations is excluded from this table because such debt is payable primarily from funds or grants provided by the federal government or is payable from sources other than Commonwealth appropriations or taxes or revenues of public corporations, or is payable from revenues derived from private sector services or products, such as industrial development bonds. Also excluded from this table is debt of certain public corporations the inclusion of which would reflect double counting. No deductions have been made in the table for debt service funds and debt service reserve funds. More detailed information about the major public corporations is presented in the following sections.

Commonwealth of Puerto Rico
Outstanding Debt of Public Corporations
September 30, 2005
(in thousands)

	Bonds			Notes			Total Bonds and Notes		
	With Guaranty	Without Guaranty	Total	With Guaranty	Without Guaranty	Total	With Guaranty	Without Guaranty	Total
Aqueduct and Sewer Authority	$ 507,669	$ -	$ 507,669	$158,696	$ 366,135[1]	$ 524,831	$ 666,365	$ 366,135[1]	$ 1,032,500
Electric Power Authority	-	5,246,707	5,246,707	-	263,546	263,546	-	5,510,253	5,510,253
Highway and Transportation Authority	-	5,689,439[2]	5,689,439	-	453,000	453,000	-	6,142,439	6,142,439
Housing Finance Authority[3]	-	603,383	603,383	-	88,237	88,237	-	691,620	691,620
Industrial Development Company	-	285,234	285,234	-	38,931	38,931	-	324,165	324,165
Infrastructure Financing Authority	-	1,450,418[4]	1,450,418	-	10,371	10,371	-	1,460,789	1,460,789
Public Buildings Authority	2,884,487	-	2,884,487	-	15,417	15,417	2,884,487	15,417	2,899,904
Public Finance Corporation	-	4,230,942[5]	4,230,942	-	-	-	-	4,230,942	4,230,942
Ports Authority	-	70,735[6]	70,735	-	420,547	420,547	-	491,282	491,282
University of Puerto Rico	-	391,853[7]	391,853	-	54,145	54,145	-	445,998	445,998
Others	-	-	-	-	2,273,928	2,273,928	-	2,273,928	2,273,928
Total[8]	$3,392,156	$17,968,711	$21,360,867	$158,696	$3,918,790	$4,077,486	$3,550,852	$21,887,501	$25,438,353

(1) Principal of and interest on this debt is reimbursed from Commonwealth appropriations.

(2) Excludes $153 million of Special Facilities Revenue Bonds issued by the Highway and Transportation Authority, which are payable from net toll revenues collected from the Teodoro Moscoso Bridge.

(3) Excludes the $663 million of Housing Finance Authority bonds, which are payable solely from Puerto Rico Public Housing Administration's annual allocation of Public Housing Capital Funds from the United States Department of Housing and Urban Development.

(4) Excludes $1.1 billion of outstanding bonds of Infrastructure Financing Authority, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.

(5) Payable primarily from Commonwealth appropriations. Excludes $97 million of Qualified Zone Academy Bonds issued by the Public Finance Corporation, which are payable from securities purchased with funds assigned by the Children's Trust to the Department of Education.

(6) Excludes $155 million of Special Facilities Bonds issued by the Ports Authority, which are solely payable from by the pledge of certain payments made by a private corporation under a special facilities agreement.

(7) Excludes $87 million of Educational Facilities Revenue Bonds, 2000 Series A (University Plaza Project) issued by the Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority, which are payable from rent payments made by the University of Puerto Rico.

(8) Excludes accretion of interest from the respective issuance dates on capital appreciation bonds. Also excludes $1.2 billion original principal amount of Children's Trust Tobacco Settlement Asset-Backed Bonds, Series 2002, issued on October 10, 2002, which will be repaid from payments made by certain tobacco companies under a master settlement agreement. See "Other Public Corporations" below.

Source: Government Development Bank for Puerto Rico.

Government Development Bank for Puerto Rico

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

As of September 30, 2005, $1.704 billion of bonds and notes of GDB were outstanding, consisting of $267 million in Commonwealth guaranteed GDB bonds and $1.437 billion of GDB commercial paper. Act No. 12 of May 9, 1975, as amended, provides that the payment of principal of and interest on specified notes and other obligations of GDB, not exceeding $550 million, may be guaranteed by the Commonwealth, of which $267 million were outstanding as of September 30, 2005. As of said date, GDB also had $6.6 billion in loans outstanding to the central government of the Commonwealth and its public corporations and municipalities.

Act No. 82 of 2002 ("Act No. 82") amended GDB's Charter to authorize GDB to transfer annually to the General Fund, beginning with fiscal year 2001, up to 10% of its audited net income or $10,000,000, whichever is greater. GDB is not required by Act No. 82 to transfer any funds. GDB made payments to the General Fund of $11.6 million for fiscal year 2003 and $18.3 million for fiscal year 2004. GDB did not make a payment to the General Fund under Act No. 82 for fiscal year 2005, and none is expected to be made in fiscal year 2006.

Act No. 271 of November 21, 2002, requires GDB to make a special capital contribution to the Special Communities Trust of $500 million and to provide the Trust with a $500 million non-revolving line of credit. In December 2004, GDB transferred to the Trust the required $500 million capital contribution and an additional $270.7 million, which represented the remaining undisbursed balance of the $500 million line of credit. The amounts transferred to the Trust were deposited in two investment accounts held by GDB for the benefit of the Trust. As of June 30, 2005, the Trust had repaid $73 million of its line of credit and had an outstanding balance of $427 million. The line of credit is payable from legislative appropriations.

GDB has several subsidiaries which perform various functions. The principal subsidiaries and their functions are listed below:

Housing Finance Authority. Housing Finance Authority (formerly known as Housing Finance Corporation) was created to provide needed rental-housing units and stimulate the construction industry under federally subsidized programs. Effective February 8, 2002, Housing Finance Corporation became Housing Finance Authority and the Housing Bank and Finance Agency was dissolved and its powers transferred to the Housing Finance Authority. Housing Finance Authority provides financing for rental housing units, stimulates the construction industry under federally subsidized programs and provides interim financing for low-income housing projects and single-family homeownership programs. It is also engaged in insuring and servicing mortgages originated by the former Housing Bank and Finance Agency. As of September 30, 2005, Housing Finance Authority's total outstanding loans to the private sector for development of housing projects targeted to low-and moderate-income families were $70.1 million. The Authority's mortgage loans to low and moderate income homeowners represented an additional $87.8 million as of the same date.

Housing Finance Authority has outstanding tax-exempt revenue bonds and notes that were issued to finance the construction of housing units approved for federal rental subsidies and to finance home ownership of single family housing units. Such bonds and notes are limited obligations of the Housing Finance Authority payable solely from revenues collected in respect of such housing units. As of September 30, 2005, $673 million of Housing Finance Authority bonds and notes were outstanding (excluding bonds payable solely from securities pledged to the payment of such bonds and bonds payable solely from federal funds).

As of September 30, 2005, the Authority also had outstanding $612 million of bonds issued to fund certain payments of the Commonwealth under its mortgage subsidy program for low and moderate income families, and to guarantee certain insurance obligations of the former Housing Bank and Finance Agency.

As of September 30, 2005, the Authority had total notes and bonds outstanding of $1.4 billion (including $141 million of debt outstanding under GDB lines of credit) and total unrestricted net assets of $463 million (unaudited).

Tourism Development Fund. Tourism Development Fund was created in November 1993 to promote Puerto Rico's hotel and tourism industry by making available direct loans and guarantees to secure the payment of private financing used for new hotel development projects. Tourism Development Fund is also authorized to make capital investments in tourism related projects. As of September 30, 2005, Tourism Development Fund had outstanding direct loans in an aggregate principal amount of $259.9 million and guarantees issued in the outstanding amount of $167.5 million to finance hotels and tourism-related projects.

Tourism Development Fund has made payments under its guarantees and letters of credit in the aggregate amount of approximately $313.4 million with respect to several projects, including $282 million disbursed to pay in full the bonds issued to finance three projects, which bonds had been declared due and payable at the direction of Tourism Development Fund due to the failure of the borrowers of such projects to comply with their obligations under the related reimbursement agreements. Of the total amount disbursed, Tourism Development Fund has been able to recover approximately $199.7 million from the borrowers. After taking these payments and all related recoveries into consideration, the unrestricted net assets of Tourism Development Fund as of September 30, 2005 were approximately $99.3 million (unaudited), and its allowance for loan losses on guarantees, loans, other real estate owned and letters of credit was approximately $36.8 million (unaudited).

Capital Fund. GDB Capital Fund (the "Capital Fund") was created in November 1992 for the purpose of investing and trading in debt obligations and publicly traded shares of domestic and foreign corporations separate from GDB's general investment operations. As of September 30, 2005, the Capital Fund had assets of $73.1 million, which were all invested in an equity index fund that invests mainly in growth stocks.

Development Fund. Puerto Rico Development Fund (the "Development Fund") was established to provide an alternate source of financing to private enterprises in Puerto Rico that have difficulties in obtaining financing from traditional sources. The Development Fund is also authorized to guarantee obligations of these enterprises and invest in their equity securities. As of September 30, 2005, the Development Fund had $17 million in such investments.

Public Finance Corporation. Puerto Rico Public Finance Corporation ("Public Finance Corporation") was established to provide agencies and instrumentalities of the Commonwealth with alternate means of meeting their financing requirements. The Public Finance Corporation currently holds notes payable by the Commonwealth, the Maritime Shipping Authority, the Office for the Improvement of Public Schools, the Department of Health, and the Aqueduct and Sewer Authority, among others. As of September 30, 2005, the Public Finance Corporation had $4.2 billion aggregate principal amount of bonds outstanding. All such bonds are limited non-recourse obligations of the Public Finance Corporation payable solely from Commonwealth appropriations made to pay the notes held by the Public Finance Corporation.

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

Other Public Corporations

Aqueduct and Sewer Authority. PRASA owns and operates a system of public water supply and sanitary sewer facilities.

PRASA needs to make a substantial investment in infrastructure and a major overhaul of its operations to maintain the viability of the existing system and to finance its expansion for new users. Funds for this investment are expected to be provided through a combination of revenues from PRASA, bond issues, legislative appropriations, and federal grants. PRASA issues revenue bonds payable from net revenues of the system after payment of current expenses. Due to PRASA's financial difficulties (discussed below) and its inability to access the bond market, the Commonwealth currently guarantees the principal and interest payments to the bondholders of all outstanding revenue bonds issued by PRASA, all outstanding bonds issued by PRASA to the United States Department of Agriculture, Rural Development, and all loans granted by the Clean Water and Drinking Water State Revolving Funds for the benefit of PRASA. The guaranty covers additional debt obligations issued by PRASA until 2010. The total debt of PRASA was $1.03 billion as of September 30, 2005.

From May 1995 until March 2004, the operation, management, repair, and maintenance of PRASA's systems were undertaken by private companies under operation and management contracts. The most recent agreement for the private management of PRASA's systems was entered into in May 2002 with Ondeo Puerto Rico, Inc. ("Ondeo"). In January 2004, Ondeo and PRASA agreed to terminate their agreement and in April 2004, the operation, management, repair, and maintenance of the PRASA systems returned to PRASA's operation and management.

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

PRASA has reported operational deficits of $209.7 million and $282.5 million during fiscal years 2003 and 2004, respectively. In fiscal year 2005, it is expected that PRASA will have incurred another significant operational loss. PRASA has covered these operational deficits with legislative appropriations from the Commonwealth General Fund. Beginning in fiscal year 2006, the Commonwealth will cease to provide financial assistance to PRASA. As a first significant step towards acquiring fiscal independence from the Commonwealth, in October 2005, PRASA approved a new tariff structure which provides for rate increases for virtually all customers in two phases: effective October 2005 and in July 2006. Rate increases in the first phase will average 65% depending on the type of client (residential, commercial/government or industrial) and on the consumption bracket of the client for the invoiced period. In the second phase, rate increases will average 35% based on these same factors. The new structure also includes changes from bi-monthly to monthly invoicing of residential customers. During the implementation of this first phase, GDB will provide financial assistance to PRASA with a $100 million line of credit payable from future PRASA revenues. In order to achieve full fiscal independence, however, PRASA will have to implement various other changes, such as (i) significant cost savings programs; and (ii) a new and aggressive enforcement policy to identify and process delinquent customers. Although PRASA will require GDB financial assistance until these measures are fully implemented, the measures are intended to allow PRASA to become financially independent in the future.

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

Children's Trust issued $1.2 billion aggregate principal amount of Tobacco Settlement Asset-Backed Bonds in October 2002. The bond proceeds were used, among other things, to pay the cost of certain capital expenses of the Commonwealth and certain capital and working capital expenses of PRASA. On June 30, 2005, the Children's Trust issued its $108.2 million Tobacco Settlement Asset-Backed Bonds, Series 2005-A and 2005-B, to pay working capital expenses of the Commonwealth. As of September 30, 2005, the outstanding principal amount of the Trust's bonds was $1.2 billion. These bonds and any other additional senior bonds issued by Children's Trust are secured by a statutory pledge of the payments made and to be made by participating manufacturers under the Master Settlement Agreement. To date, all payments required to be made under the Master Settlement Agreement have been made on a timely basis, and Puerto Rico's share thereof has been received by Children's Trust.

Convention Center District Authority ("CCD Authority") was created to own, develop, finance, plan, design, build, operate, maintain, administrate and promote the Convention Center and designated private parcels located within the Convention Center District in San Juan. The Convention Center opened on November 17, 2005. The CCD Authority currently has lines of credit with GDB totaling $415.7 million, of which $310.9 million was outstanding as of September 30, 2005 payable from a portion of the tax imposed on hotel stays earmarked to the CCD Authority.

The Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority ("AFICA") financed the construction of a multi-purpose coliseum in San Juan, known as the Jose Miguel Agrelot Coliseum, with a line of credit provided by GDB. The Jose Miguel Agrelot Coliseum was completed and transferred to the CCD Authority on August 2004. Pursuant to Act No. 185 of August 3, 2004, AFICA also transferred the line of credit to the CCD Authority. As of September 30, 2005, the line of credit had an outstanding balance of $153.1 million. It is anticipated that this line of credit and the CCD Authority line of credit for the Convention Center will be refinanced in fiscal year 2006. The source of repayment for Coliseum debt will be revenues from Coliseum activities and appropriations for the Coliseum refinancing. The source of repayment for all other CCD Authority debt will consist of a portion of the tax imposed on hotel stays earmarked to the CCD Authority.

Electric Power Authority owns and operates the island's electric system. The capital improvement program for the five-year period ending June 30, 2010, is estimated to cost approximately $2.1 billion and will be financed primarily by borrowed funds, supplemented by internally generated funds. The Authority's bonded debt consists of Power Revenue Bonds, secured by a lien on net revenues of the electric system. As of September 30, 2005, the Authority's total debt was $5.5 billion, including $5.2 billion of bonds outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds). As a means of reducing its dependency on oil, the Authority has entered into long-term power purchase contracts with the operators of two cogeneration plants that use fuels other than oil. Currently, these two cogeneration plants provide approximately 26% of the Authority's energy needs.

Health Insurance Administration was created in 1993 to implement the health reform by negotiating and contracting for the provision of comprehensive health insurance coverage for qualifying (generally low income) Puerto Rico residents. Under this system, the government selects, through a bidding system, one private health insurance company in each of eight designated regions of the island and pays such insurance company the insurance premium for each eligible beneficiary within such region. The Administration is currently negotiating new contracts with the insurance companies. These negotiations could result in an increase in premiums in excess of the amounts budgeted for fiscal year 2006. The health insurance system covers all of the municipalities, and approximately 1.5 million persons were covered by the system during fiscal year 2005.

The total cost of the health insurance program for fiscal year 2006 is estimated at $1.5 billion, compared to $1.455 billion for fiscal year 2005 and $1.37 billion for fiscal year 2004. For fiscal year 2005, the General Fund covered $984 million of the total cost of the health insurance program, while the remaining $471 million was paid from federal, municipal and other sources. For fiscal year 2006, it is expected that $984 million of the cost of the health insurance program will again be covered from the General Fund, with the remainder expected to be paid from federal, municipal and other sources. See *Budget of the Commonwealth of Puerto Rico*.

Highway and Transportation Authority is responsible for highway construction in Puerto Rico. Such construction is financed by debt (interim notes and revenue bonds), revenues of the Authority, and federal and Commonwealth grants. Debt service on the Authority's revenue bonds constitutes a first lien on its gross revenues, which consist currently of all the proceeds of the gasoline tax; one-half of the proceeds of the tax on gas oil or diesel oil; all the proceeds of the excise taxes on crude oil, unfinished oil and derivative products, up to $120 million per fiscal year; highway toll revenues; and the gross receipts of $15.00 per vehicle per year from certain motor vehicle license fees. Such revenues (except for toll revenues) may be applied first to the payment of debt service on general obligation bonds and notes of the Commonwealth and payments required to be made by the Commonwealth under its guarantees of bonds and notes to the extent that no other revenues are available for such purpose. The Commonwealth has never applied such revenues for such payment. In April 2004, the Authority issued approximately $140 million of bonds secured solely by Federal Highway Aid grant revenues. In September 2005, the Authority issued bonds in an amount of $1.5 billion to finance various highway projects and refund certain of the Authority's revenue bonds. As of September 30, 2005, the Authority's total debt was $6.1 billion, including $5.7 billion of bonds outstanding.

The Authority has completed the first phase of a new mass transit system, known as Tren Urbano, to serve a portion of metropolitan San Juan. The first phase of Tren Urbano was constructed under several design/build contracts, including a design/build/operate contract covering the design and construction of the system and the operation of Tren Urbano for five years with an additional five-year option at the Authority's election. The cost of the first phase was $2.25 billion, which cost was financed by Federal Transit Administration grants, other federal funding sources and the Authority's own resources, including bond financings. Tren Urbano commenced operations in June 2005. This project is now fully operational on a regular basis. Tren Urbano is expected eventually to serve the municipalities of Carolina and Caguas as well.

The Authority is a party to a concession agreement under which a private company designed, constructed and currently is operating a toll bridge spanning the San José Lagoon. The toll bridge was financed with special facility revenue bonds of the Authority, the outstanding principal balance of which was $153.2 million as of September 30, 2005, payable by the private operator of the bridge principally from toll revenues. The concession is for a term of 35 years, subject to earlier termination or extension. The bridge opened for traffic in February 1994. In certain circumstances as described in the concession agreement, including where toll revenues are insufficient to generate certain rates of return to the private operator, the private operator may require the Authority, among other things, to assume the operator's obligations with respect to the special facility revenue bonds. Some of those circumstances, including low toll revenues, exist at this time, but the Authority does not currently anticipate that the operator will exercise its remedy against the Authority.

The Authority raised its highway tolls by approximately 43% in September 2005.

Puerto Rico Industrial Development Company participates in the Commonwealth-sponsored economic development program by providing physical facilities, general assistance, and special incentive grants to manufacturers. The Company was merged with the Economic Development Administration in January 1998. Rentals derived from the leasing of specified facilities of the Company are pledged to the payment of the Company's revenue bonds. As of September 30, 2005, the Company's total debt was $324 million. The Company is currently restructuring its operations in order to allow it to react more quickly to changing business situations. Part of this restructuring includes a significant reduction in its employees.

Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority was created in June 1977. The Authority has issued revenue bonds to finance industrial, tourist, educational, medical, and environmental control facilities in Puerto Rico for the use of private companies, non-profit entities, or government agencies. The bonds are payable solely from payments to be made to the Authority by such private companies, non-profit entities, or government agencies, and do not constitute a debt of the Commonwealth or any of its other public corporations or municipalities. As of September 30, 2005, approximately $2.1 billion of the Authority's bonds were outstanding.

Infrastructure Financing Authority was created in June 1988 to provide financial, administrative, consulting, technical, advisory, and other types of assistance to other public corporations, governmental instrumentalities, political subdivisions and municipalities (collectively, "Benefited Entities") authorized to develop infrastructure facilities and to establish alternate means for financing infrastructure facilities. The Authority is authorized to issue bonds and provide loans, grants and other financial assistance for the construction, acquisition, repair, maintenance and reconstruction of infrastructure projects by Benefited Entities. The Authority's enabling act also established the Puerto Rico Infrastructure Fund, funded with annual fixed amounts from the first proceeds of federal excise taxes imposed on rum and other articles produced in Puerto Rico and sold in the United States which are transferred to Puerto Rico pursuant to the United States Internal Revenue Code of 1986, as amended. Currently, this amount is $70 million, and it will increase to $90 million for fiscal years 2007 to 2052. Rum is the only article currently produced in Puerto Rico subject to federal excise taxes, the proceeds of which are required to be returned to the Treasury. The Authority is using these amounts to provide financial support for various infrastructure and other projects. As of September 30, 2005, the Authority's total debt was $1.5 billion.

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

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

Maritime Shipping Authority commenced operations in 1974 upon the acquisition of three shipping lines serving Puerto Rico and the United States mainland. In 1995, the assets and operations of the Maritime Shipping Authority were sold to a private investor group. The remaining debt of the Authority was refinanced through the issuance of bonds by Public Finance Corporation, a subsidiary of GDB. The aggregate principal amount of such bonds outstanding as of September 30, 2005, was $328.5 million (not including accreted values of capital appreciation bonds outstanding). The bonds are payable from funds to be appropriated annually by the Legislative Assembly of Puerto Rico.

Municipal Finance Agency was created in 1972 as a municipal "bond bank" for Puerto Rico. The Agency is authorized to issue bonds to purchase general obligation bonds and notes of Puerto Rico municipalities and to fund a debt service reserve. Debt service on the Agency's bonds is payable from debt service payments on municipal bonds held by the Agency and from the debt service reserve, including investment income thereon. The Commonwealth has agreed to pay such amounts to the debt service reserve as may be necessary to maintain it at its required level, subject to appropriation by the Legislative Assembly, which appropriation is authorized but not legally required to be made. To date no such payments have been required. As of September 30, 2005, the Agency had $1.1 billion of bonds outstanding.

Ports Authority owns and operates the major airport and seaport facilities in Puerto Rico. The Authority derives revenues from a variety of sources, including charges on airplane fuel sales, air terminal space rentals, landing fees, wharfage, dockage and harbor fees, and rentals for the lease of seaport equipment and property. As of September 30, 2005, the Authority had $491.3 million in debt, including $302.9 million under a line of credit with GDB.

Public Buildings Authority is authorized to construct, purchase or lease office, school, health, correctional and other facilities for lease to departments, public corporations, and instrumentalities of the Commonwealth. Bonds that have been issued by the Authority to finance such facilities (through retirement of interim notes or otherwise) are payable from lease payments, which are largely derived from legislative appropriations and are further secured by the Commonwealth's guaranty. The Authority is authorized by law to have outstanding at any one time up to $3.325 billion of bonds guaranteed by the Commonwealth. As of September 30, 2005, $2.884 billion of such bonds of the Authority was outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds). As of September 30, 2005, PBA's line of credit with GDB had an outstanding balance of $15.4 million.

Special Communities Perpetual Trust is an irrevocable and permanent trust created in November 2002 as a public corporation. The Trust's principal purpose is to fund development projects which address the infrastructure and housing needs of underprivileged communities. Act No. 271 of November 21, 2002, requires GDB to provide the Trust with a $500 million line of credit and to make a capital contribution to the Trust of $500 million. In December 2004, GDB transferred to the Trust the $500 million capital contribution as required by law and $270.7 million, the amount remaining in the GDB $500 million line of credit. The amounts transferred to the Trust were deposited in two investment accounts held by GDB for the benefit of the Trust, of which $320 million had been disbursed to the Trust as of September 30, 2005. As of September 30, 2005, the Trust's line of credit with GDB had an outstanding balance of $425.1 million.

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

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

University of Puerto Rico (the "University"), with approximately 68,000 students in academic year 2003-2004, is by far the largest institution of higher education on the island. Government appropriations are the principal source of University revenues, but additional revenues are derived from tuition, student fees, auxiliary enterprises, interest income, federal grants, and other sources. University capital improvements have been financed mainly by revenue bonds. As of September 30, 2005, the University's total debt was $446 million.

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

Other public corporations (not described above) have outstanding debt in the aggregate amount of $1.1 billion as of September 30, 2005. Debt service on $587.7 million of such outstanding debt is being paid from legislative appropriations. However, the Commonwealth is not obligated to make any such appropriations. Additional legislative appropriations are made to enable certain of such corporations to pay their operating expenses.

INSURANCE MATTERS

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

RETIREMENT SYSTEMS

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

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

The Teachers Retirement System covers public school teachers and certain private school teachers as well as teachers working in administrative positions. Act No. 91 of March 29, 2004 established that (i) all new teachers hired from that date and thereafter are covered by the Teachers Retirement System; and (ii) current employees of the Teachers Retirement System as of that date may elect to participate in the Teachers Retirement System or in the Employees Retirement System. The Judiciary Retirement System covers judges, and the Employees Retirement System covers all other employees of the Commonwealth, its municipalities and instrumentalities. As of September 30, 2005, the total number of active members of the three systems was as follows: Employees Retirement System, 284,690; Teachers Retirement System, 78,500; and Judiciary Retirement System, 690. The three systems are financed by contributions made by employers (the Commonwealth, public corporations, and municipalities) and employees, and investment income. The central government is responsible for approximately 67% of total employer contributions to the Employees Retirement System, and the other 33% is the responsibility of public corporations and municipalities. The central government is also responsible for 100% and 99% of total employer contributions to the Judiciary and Teachers Retirement Systems, respectively. Retirement and related benefits provided by the systems and required contributions to the systems by employers and employees are determined by law rather than by actuarial requirements. For the Employees Retirement System, required employer contributions consist of approximately 9.275% of applicable payroll. Required employee contributions for the Employees Retirement System vary according to salary and how the individual employee's retirement benefits are coordinated with social security benefits. For the Judiciary Retirement System, required contributions consist of 20% of applicable payroll for the employer and 8% for the employees. For the Teachers Retirement System, required contributions consist of 8.5% of applicable payroll for the employer and 9.0% for the employees.

According to the most recent actuarial valuation of the Employees Retirement System and Judiciary Retirement System submitted by a firm of independent consulting actuaries, as of June 30, 2003, the total pension benefit obligation for the Employees Retirement System and Judiciary Retirement System was $11.2 billion and $166.7 million, respectively. The unfunded pension benefit obligation of the Employees Retirement System and Judiciary Retirement System for the same period was $9.2 billion and $105 million, respectively, representing a funding ratio of 17.4% and 37.1%, respectively. Any amounts receivable from the Commonwealth with respect to benefits under special benefits laws (discussed below) are considered in the actuarial evaluation process to determine the unfunded liability of the Employees Retirement System to the extent receivables are recognized as such by the Employees Retirement System. The June 30, 2003 actuarial valuation was completed in accordance with the "Projected Unit Credit" method and assumed an investment return of 8.5% per year and a salary increase of 5% per year. Insofar as the statutorily mandated annual deposit to the Employees Retirement System and Judiciary Retirement System is insufficient to cover the actuarial pension liability, the unfunded pension benefit obligation will continue to increase in the short term, and additional funding from the Commonwealth may ultimately be necessary to cover such unfunded liability.

Various special benefits laws enacted in previous years provided for additional benefits for the Employees Retirement System, Teachers Retirement System, and Judiciary Retirement System. More specifically, in the case of the Employees Retirement System, Act No. 10 of May 21, 1992 provided for special benefit increases of 3% every three years. The first 3% increase was granted to retirees who had been receiving their annuities for three or more years as of that date. The second 3% increase was granted to retirees who had been receiving their annuities for three or more years as of January 1, 1995. This increase is being financed by additional contributions from the employers. The third 3% increase was granted to retirees who had been receiving their annuities for three or more years as of January 1, 1998. This third increase is being partially funded with additional contributions from some of the employers. In June 2001, the Legislative Assembly approved a law providing a fourth 3% increase, effective as of January 1, 2001, in post-retirement annuity payments granted on or prior to January 1, 1998. This increase will be funded by the General Fund for retirees who were employees of the central government and by municipalities and public corporations for retirees who were their employees. In June 2003, the Legislative Assembly approved a law providing a fifth increase of 3% in post retirement benefits effective January 1, 2004. This increase will also be funded by the General Fund for retirees who were employees of the central government and by municipalities and public corporations for retirees who were their employees. Subsequent increases will depend upon the express approval of the System's Board of Trustees and the Legislative Assembly, and must provide a funding source. In the case of the Judiciary Retirement System, Act No. 41 of June 13, 2001 provided a 3% special benefit increase in annuity payments, commencing on January 1, 2002 and every three years thereafter, to retirees who have been receiving their annuities for three or more years as of that date. This increase will be funded by the General Fund.

In connection with the special benefit laws applicable to the Teachers Retirement System, it is seeking reimbursement from the Commonwealth in the amount of $119 million for special benefits paid by the System to its beneficiaries for previous fiscal years through 2005. OMB disputes the Teachers Retirement System's interpretation of these special benefit laws as requiring the Commonwealth's reimbursement of such special benefits paid, and this claim is currently under inter-agency arbitration proceedings. The Employees Retirement System is also seeking reimbursement from the Commonwealth (in connection with other special benefits laws applicable to its beneficiaries) in the amount of $57.8 million, representing cumulative benefits paid to beneficiaries through June 30, 2004. The Employees Retirement System projects additional shortfalls of $20 million for fiscal year 2005 (currently under audit) and $43 million for fiscal year 2006, in connection with special benefits law payments. OMB believes that the basis of the claims from the Employees Retirement System is valid but that the amounts claimed still remain to be verified and reconciled. With respect to the shortfall for fiscal year 2006, OMB is also evaluating the requested amount by the Employees Retirement System needed to cover its shortfall over the budgeted amounts for fiscal year 2006. See "Fiscal Year 2006 Budget" under *Budget of the Commonwealth of Puerto Rico*.

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

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

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

The Employees Retirement System's disbursements of benefits during fiscal years 2003, 2004, and 2005 exceeded contributions and investment income for those years. The cash shortfall for fiscal year 2003 was covered with a portion of the proceeds from the sale to Verizon of the 15% stock ownership in PRTC and a loan received from the Treasury. The cash shortfall for fiscal year 2004 was covered with a loan received from the Treasury. Balances owed to the Treasury and other pending working capital needs through fiscal year 2005 were refinanced through a repurchase agreement with a financial institution in an amount of $138 million collateralized with the Employees Retirement System assets. A cash shortfall, which will be covered either by a sale of assets, a loan received from the Treasury, or other financial market transactions, is also expected for fiscal year 2006.

The Employees Retirement System anticipates that its future cash flow needs for disbursement of benefits to participants is likely to exceed the sum of the employer and employee contributions received and its investment and other recurring income. Also under evaluation by the Employees Retirement System is the sale of the remaining shares of PRTC stock. The proceeds to be generated by this transaction may be used to fund any cash flow imbalance, or portion thereof, in the next few years. The Employees Retirement System is also evaluating other measures to improve its cash flows and funding ratio. Some of these measures include, but are not limited to, the establishment of a maximum salary to calculate pension benefits, aggressive collection efforts with respect to employer contributions owed by the Commonwealth, the municipalities and public corporations, the transfer to the Employees Retirement System of any amounts remaining in the Children's Trust after payment of all the outstanding bonds, and the assignment to the Employees Retirement System of a percentage of General Fund revenues and/or excess proceeds derived from the proposed tax reform being considered by the Commonwealth. See "Proposed Tax Reform" under *Puerto Rico Taxes, Other Revenues, and Expenditures*.

In addition, legislation has been submitted that, if enacted, will authorize the issuance of pension obligation bonds ("POBs"). The POBs will contribute approximately $2 billion in assets to the Employees Retirement System and will be payable solely from the Commonwealth's General Fund. While the POBs are outstanding and the Commonwealth is paying debt service, General Fund transfers to the Employees Retirement System in any fiscal year will be reduced by an amount equal to the lesser of $100 million and the debt service on the POBs payable in such fiscal year. The proposed legislation also includes a measure that would increase employee and employer contributions to the Employees Retirement System from 8.275% and 9.275%, respectively, to 10% each. The Employees Retirement System projects that current contributions, together with investment and other recurring income, earnings on the $2 billion that would be raised by the issuance of the POBs, and the proposed increase in employee and employer contributions will allow it to improve its funding ratio. It is uncertain, however, if and when the legislation submitted will be considered and approved.

According to the most recent actuarial valuation of the Teachers Retirement System submitted by a firm of independent consulting actuaries, as of June 30, 2004 the accrued actuarial liability of the system was $4.7 billion and the value of its assets amounted to $2.4 billion, representing a funding ratio of 51%, and the resulting unfunded accrued liability was $2.3 billion. This funding ratio takes into account the recent turn-around in the equities market and the restructuring of the portfolio's asset composition. The actuarial valuation assumed an investment return of 8%, yearly salary increases of 5%, employee and employer contributions of 9% and 8.5%, respectively, and a remaining amortization period of 16 years for the unfunded accrued liability. The actuarial accrued liability does not include benefits paid under special benefits laws (described above) and will not include the obligation with respect to the prospective payments under special benefits laws because these are not obligations of the Teachers Retirement Fund, and the funding for such benefits will originate from the Commonwealth's General Fund. Insofar as the statutorily mandated annual deposit to the Teachers Retirement System is insufficient to cover the actuarial pension liability, the unfunded pension benefit obligation will continue to increase in the short term, and additional funding from the Commonwealth may ultimately be necessary to cover such unfunded liability.

The following tables present the Statement of Plan Net Assets and Statement of Changes in Plan Net Assets of the Employees Retirement System, the Judiciary Retirement System, and the Teachers Retirement System for fiscal years 2003, 2004, and 2005.

The Commonwealth of Puerto Rico
Employees Retirement System
Statement of Plan Net Assets*
As of June 30, 2005, 2004 and 2003

	2005(1)	2004	2003
ASSETS			
Cash and Investments:			
Cash and Cash Equivalents:			
Deposits at commercial banks	$ 24,585,761	$ 12,672,927	$ 35,038,118
Deposited with GDB:			
Unrestricted	13,196,092	31,852,889	28,112,466
Restricted	1,577,829	1,139,837	652,637
Total Cash	39,359,683	45,665,654	63,803,223
Marketable Securities:			
Notes and Bonds	20,786,293	106,440,889	218,092,563
Stocks	1,200,131,525	1,162,761,632	944,904,356
Master Repo	145,186,563	-	-
Alternative investments	41,243,583	41,632,679	34,089,407
Total Cash and Investments	**1,407,347,965**	**1,310,835,201**	**1,197,086,327**
LOANS TO PLAN MEMBERS:			
Mortgage	82,769,119	72,375,251	65,435,904
Personal	367,732,209	281,231,806	203,082,715
Cultural Trips	20,589,836	15,596,225	13,277,170
Total Loans to Plan Members	**471,091,165**	**369,203,283**	**281,795,789**
Investment in PRTA Holdings	486,080,000	404,390,000	362,670,000
Total cash, investments and loans to plan members	**2,403,878,814**	**2,130,094,138**	**1,905,355,340**
RECEIVABLES:			
Employer	34,655,581	32,655,770	31,256,878
General Fund of the Commonwealth	21,483,869	11,013,923	10,967,574
The Commonwealth of PR Judiciary	1,376,260	3,471,665	2,178,758
Investment Sales	2,090,012	605,886	572,683
Accrued Interest	1,303,273	2,288,387	4,051,724
Other	27,725,288	36,662,026	17,567,254
Total Receivables	88,634,287	88,697,659	66,594,873
PROPERTY:	8,410,789	8,330,293	7,583,372
OTHER ASSETS:	7,764,040	7,824,497	9,811,479
Total Assets	**2,508,687,932**	**2,234,946,589**	**1,989,345,064**
LIABILITIES			
Book overdraft	-	58,028,695	-
Short Term Obligations	138,000,000	-	-
Escrow Funds to plan Members and Guarantee Insurance	20,502,138	19,886,502	18,231,988
Investment Purchases	2,078,940	1,202,112	1,348,888
Other Liabilities	15,112,796	14,387,381	22,362,558
Total Liabilities	**175,693,875**	**93,504,691**	**41,943,435**
Net Assets Held in Trust for Pension Benefits	**$2,332,994,056**	**$2,141,441,898**	**$1,947,401,629**

* Totals may not add due to rounding.
(1) Financial information for fiscal year 2005 is unaudited.

The Commonwealth of Puerto Rico
Employees Retirement System
Statement of Changes in Plan Net Assets*
As of June 30, 2005, 2004 and 2003

	2005[(1)]	2004	2003
ADDITIONS:			
Contributions:			
Employer	$ 374,661,488	$ 330,335,460	$ 312,472,902
Employees	332,236,585	294,013,459	276,346,849
Special	14,730,754	14,553,107	17,930,529
Total Contributions	**721,628,828**	**638,902,028**	**606,750,281**
Investment Income:			
Realized Gain or Loss	35,170,888	22,990,043	(209,864,923)
Unrealized Gain or Loss	151,623,890	235,712,185	173,426,231
Dividend Income	19,111,464	6,692,664	42,561,011
Interest Income	49,011,603	43,795,352	43,309,670
Total	**254,917,847**	**309,190,244**	**49,430,990**
Less Investment Expense	(3,297,066)	(3,058,129)	(3,425,599)
Other Income	13,769,263	6,860,191	11,126,916
Net Investment Income	**265,390,044**	**312,992,306**	**57,132,307**
Total Additions	**987,018,872**	**951,894,334**	**663,882,588**
DEDUCTIONS:			
Annuities	714,454,966	672,578,372	614,500,062
Special	14,730,754	14,553,107	17,930,529
Death Benefits	10,894,649	11,098,998	12,371,185
Refunds:			
Employer	1,734,048	1,220,244	2,727,922
Employees	17,782,305	18,768,598	19,861,204
Administrative Expenses	35,869,989	31,527,570	28,768,227
Net Adjustment in the conversion to a new loan application	-	8,107,173	-
Total Deductions	**795,466,714**	**757,854,066**	**696,159,131**
Net Increase	**191,552,158**	**194,040,268**	**(32,276,542)**
Net Assets Held in Trust for Pension Benefits:			
Beginning of the Year	2,141,441,898	1,947,401,629	1,979,678,171
End of Year	**$2,332,994,056**	**$2,141,441,898**	**$1,947,401,629**

* Totals may not add due to rounding.
(1) Financial information for fiscal year 2005 is unaudited.

The Commonwealth of Puerto Rico
Judiciary Retirement System
Statement of Plan Net Assets*
As of June 30, 2005, 2004 and 2003

	2005[1]	2004	2003
ASSETS			
Cash and Investments:			
Cash and Cash Equivalents	$ 1,803,777	$ 1,028,749	$2,555,092
Cash Deposited with GDB			
Unrestricted	921,430	222,120	990,357
Restricted	871	762	-
Total Cash	2,726,079	1,251,632	3,545,449
Receivables:			
Accrued Interest	252,862	304,442	349,600
Investment Sales	102,365	27,036	32,451
Other	48,657	45,230	46,004
Total Receivables	**403,885**	**376,709**	**428,056**
Marketable Securities:			
Notes and Bonds	20,031,133	20,781,506	19,772,751
Stock	49,360,624	48,943,697	40,057,519
Total Marketable Securities	**69,391,458**	**69,725,203**	**59,830,271**
LOANS TO PLAN MEMBERS			
Mortgage	435,247	48,344	31,219
Personal	173,292	119,990	306,908
Cultural Trips	34,453	43,495	51,191
Total Loans to Plan Members	**251,269**	**211,831**	**389,319**
Total cash, investments and loans to plan members	**72,772,692**	**71,565,376**	**64,193,096**
LIABILITIES			
Book overdraft	827,661	3,471,665	2,178,758
Due to the Employees Retirement System of the Government of Puerto Rico	1,376,260	129,282	125,630
Escrow Funds to Plan Members and Guarantee Insurance	130,022	129,282	125,630
Investment Purchases	123,315	65,300	59,197
Other Liabilities	47,639	48,880	48,762
Total Liabilities	**2,504,899**	**3,715,128**	**2,412,348**
Net Assets Held in Trust for Pension Benefits	**$70,267,792**	**$67,850,247**	**$61,780,747**

* Totals may not add due to rounding.
(1) Financial information for fiscal year 2005 is unaudited.

The Commonwealth of Puerto Rico
Judiciary Retirement System
Statement of Changes in Plan Net Assets*
As of June 30, 2005, 2004 and 2003

	2005(1)	**2004**	**2003**
ADDITIONS:			
Contributions:			
Employer	$ 6,469,432	$ 5,556,053	$ 5,536,328
Employees	2,775,268	2,577,924	2,478,483
Total Contributions	**9,244,701**	**8,133,978**	**8,014,811**
Investment Income:			
Realized Gain or Loss	1,997,588	1,160,917	2,414,484
Unrealized Gain or Loss	2,247,722	6,931,720	-
Dividend Income	206,323	158,457	168,083
Interest Income	1,158,023	1,177,090	1,803,760
Total	**5,609,657**	**9,428,185**	**4,386,327**
Less Investment Expense	(190,134)	-	(255,737)
Other Income	3,645	579	-
Net Investment Income	**5,423,169**	**9,428,765**	**4,130,590**
Total Additions	**14,667,871**	**17,562,743**	**12,145,401**
DEDUCTIONS:			
Annuities	10,758,894	9,927,398	9,330,594
Refunds:			
Employer	135,074	-	-
Employees	124,296	-	-
Administrative Expenses	1,232,060	1,348,717	1,474,138
Net Adjustment in the conversion to a new loan application	-	217,127	-
Total Deductions	**12,250,325**	**11,493,243**	**10,804,732**
Net Increase	**2,417,545**	**6,069,499**	**1,340,668**
Net Assets Held in Trust for Pension Benefits:			
Beginning of the Year	67,850,247	61,780,747	60,440,079
End of the Year	**$70,267,792**	**$67,850,247**	**$61,780,747**

* Totals may not add due to rounding.
(1) Financial information for fiscal year 2005 is unaudited.

The Commonwealth of Puerto Rico
Annuities and Pension for Teachers
Statement of Plan Net Assets*
As of June 30, 2005, 2004 and 2003
(in thousands)

	2005	2004	2003
ASSETS			
Cash:			
Cash and cash equivalents	$ 79,017	$ 67,113	$ 204,886
Cash with fiscal agent	2,853	-	-
Cash restricted	1,595	2,396	2,236
Cash deposited with GDB	3,536	3,717	4,199
Total Cash	87,001	73,226	211,321
Investments, at fair value:			
Bonds and notes	257,030	280,747	737,913
Stocks	1,833,168	1,678,679	971,014
Total investment at fair value	2,090,198	1,959,426	1,708,927
Other investments:			
Mortgage notes acquired from third parties	-	-	7
Private equity investments	44,747	43,660	34,728
Total investments	**2,134,945**	**2,003,086**	**1,743,662**
Loan to plan members:			
Mortgage	109,605	110,293	113,116
Personal	234,335	233,342	235,118
Cultural trips	1,338	1,148	1,210
Total loans to plan members	345,278	344,783	349,444
Total investments and loans	**2,567,224**	**2,421,095**	**2,304,427**
Accounts receivable:			
Receivable for investments sold	10,516	5,535	124,400
Accrued interest and dividends receivable	4,449	5,380	9,705
Other	2,593	2,500	1,845
Total accounts receivable	17,558	13,415	135,950
Property and equipment, net	26,206	24,332	24,964
Other assets	600	619	597
Total Assets	**2,611,588**	**2,459,461**	**2,465,938**
LIABILITIES			
Investments purchased	14,262	10,567	238,883
Cash overdraft in cash with fiscal agent	-	7,812	42,210
Accounts payable	3,768	2,570	2,296
Obligation under capital lease	78	96	-
Accrued expenses	4	3,071	2,785
Line of credit	4,314	240	-
Escrow fund of mortgage loans and guarantee insurance reserve for loans to plan members	6,069	9,911	11,311
Bonds payable	21,285	22,090	22,943
Other liabilities	669	109	2,848
Total liabilities	**50,449**	**56,466**	**323,276**
Net Assets Held in Trust for Pension Benefits	**$2,561,139**	**$2,402,995**	**$2,142,662**

* Totals may not add due to rounding.

The Commonwealth of Puerto Rico
Annuities and Pensions for Teachers
Statement of Changes in Plan Net Assets*
As of June 30, 2005, 2004 and 2003
(in thousands)

	2005	2004	2003
ADDITIONS:			
Contributions:			
Employees	$ 131,481	$ 118,743	$ 112,774
Employer	120,887	110,548	104,403
Special	60,853	40,409	27,490
Total contributions	**313,221**	**269,700**	**244,667**
Investment Income:			
Interest income	47,577	55,878	82,210
Dividend Income	20,339	17,264	16,513
Net appreciation in fair value of investments	161,685	240,732	(42,227)
	229,601	313,874	56,496
Less investment expense	4,986	4,986	5,508
Net investment income	224,615	308,916	50,988
Other income	1,167	32,397	1,010
Total additions	**539,003**	**611,013**	**296,665**
DEDUCTIONS:			
Benefit paid to participants:			
Annuities and death benefits	313,551	292,401	276,096
Special benefits	38,592	32,210	22,433
Refunds of contributions	2,912	3,432	3,021
Administrative expenses	25,804	22,637	19,544
Total deductions	**380,859**	**350,680**	**321,094**
Net increase in net assets held in trust for pension benefits	158,144	260,333	(24,429)
Net assets held in trust for pension benefits			
Beginning of year	2,402,995	2,142,662	2,167,091
End of year	**$2,561,139**	**$2,402,995**	**$2,142,662**

* Totals may not add due to rounding.

COMMONWEALTH FINANCIAL STATEMENTS

For fiscal year 2004, the financial statements of the Commonwealth were audited by KPMG LLP. KPMG LLP did not audit the financial statements of the Public Buildings Authority capital project fund (a major fund), and certain activities, funds and component units identified separately in their report. Those financial statements were audited by other independent auditors whose reports were furnished to KPMG LLP, and its opinion on the basic financial statements, insofar as it relates to the amounts included in the basic financial statements pertaining to such activities, funds and component units, was based solely on the reports of the other auditors.

The Comprehensive Annual Financial Report of the Commonwealth ("CAFR") for fiscal year 2004, which includes the basic financial statements of the Commonwealth for fiscal year 2004, was filed by the Commonwealth with each nationally recognized municipal securities information repository on May 17, 2005. The CAFR for fiscal year 2005 is expected to be released during the first quarter of calendar year 2006.

PUERTO RICO TAXES, OTHER REVENUES, AND EXPENDITURES

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

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

Summary and Management's Discussion of General Fund Results

The following table presents the actual revenues and expenditures of the General Fund on a cash basis for fiscal year 2002 through fiscal year 2004, the preliminary revenues and expenditures for fiscal year 2005, and the budgeted revenues and expenditures for fiscal year 2006, which, with certain exceptions, were capped at fiscal year 2005 levels as discussed under *Budget of the Commonwealth of Puerto Rico*. The information relating to fiscal year 2005 is based on the preliminary figures of revenues and expenditures for such fiscal year. The information relating to fiscal year 2006 reflects the revenues projected by the Treasury and the expenditures included in the fiscal year 2005 budget, which carried over to fiscal year 2006 as a result of the failure to enact a new budget by June 30, 2005 as mandated by the Constitution of the Commonwealth, as such expenditures were adjusted pursuant to an Executive Order of the Governor, dated August 30, 2005, and other actions. For a discussion of the expenditures included in the budget for fiscal year 2006, the adjustments made by the Governor, and the anticipated budget imbalance for fiscal year 2006, see "Budget for Fiscal Year 2006" under *Budget of the Commonwealth of Puerto Rico*.

The amounts shown in the following table as expenditures may be different than those reflected in the budget or in the Commonwealth's financial statements because the table shows only cash disbursements, while the budget includes all authorized expenditures, regardless of when the related cash is actually disbursed. In addition, transfers to the Redemption Fund (used to pay debt service on the Commonwealth's bonds), which are included in the budget under "debt service," are shown as a deduction from total revenues in calculating "adjusted revenues" in the table and are not included under "expenditures." Finally, certain expenditures incurred in excess of budgeted amounts may not be reflected in the table as expenditures to the extent they are paid from reserve funds, such as moneys in the Budgetary Fund. For example, in fiscal years 2003, 2004, and 2005, there were approximately $150 million, $85 million, and $80 million, respectively, of such expenditures that are not reflected in the table. A discussion of the budget for fiscal year 2005 and the budget for fiscal year 2006 appears below under *Budget of the Commonwealth of Puerto Rico*.

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

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

	2002	2003	2004	2005[(p)]	2006[(c)]
Beginning cash balance	$ 125,154	$ 350,284	$ 179,058	$ 108,512	$ 44,264
Revenues from internal sources:					
Income Taxes:					
Individuals	2,449,982	2,517,678	2,720,920	2,919,198	3,093,000
Corporations	1,706,137	1,776,985	1,831,027	1,871,919	2,143,000
Partnerships	2,670	2,101	3,005	3,245	3,000
Withheld from non-residents	583,256	517,141	631,100	612,006	628,000
Tollgate taxes	59,515	45,321	31,579	22,973	17,000
Interest	14,310	11,278	10,108	10,490	11,000
Dividends	62,548	49,790	70,192	80,398	74,000
Total income taxes	4,878,418	5,170,294	5,297,931	5,520,229	5,969,000
Commonwealth excise taxes:					
Alcoholic beverages	249,705	299,582	296,302	298,235	316,000
Cigarettes	116,055	149,487	144,733	146,527	152,000
Motor vehicles	418,024	499,252	551,181	606,662	614,000
Other excise taxes	681,344	703,029	701,129	732,803	798,000
Total Commonwealth excise taxes	1,465,128	1,651,350	1,693,345	1,784,227	1,880,000
Property taxes	-	-	-	3,910	-
Inheritance and gift taxes	1,962	2,825	15,691	7,129	2,000
Licenses	82,575	85,876	84,231	87,416	110,000
Other:					
Lottery	61,358	67,621	65,387	49,633	63,000
Electronic Lottery	57,897	89,443	86,115	68,011	83,000
Miscellaneous non-tax revenues	562,213[(1)]	438,457	379,501	420,315	462,000[(8)]
Total Other	681,468	595,521	531,003	537,959	608,000
Total revenues from internal sources	7,109,551	7,255,866	7,622,201	7,940,870	8,569,000
Revenues from non-Commonwealth sources:					
Federal excise taxes[(2)]	314,253	309,958	328,921	341,093	350,000
Customs	30,595	25,918	34,266	25,037	26,000
Total revenues from non-Commonwealth sources	344,848	335,876	363,187	366,130	376,000
Total net revenues	7,454,399	7,841,742	7,985,388	8,307,000	8,945,000
Other Income (refunds)[(3)]	111,411	(78,927)	62,789	(55,409)	(42,632)
Transfers to Redemption Fund[(4)]	(274,773)	(331,925)	(341,538)	(369,985)	(484,812)
Proceeds of notes and other borrowings[(5)]	1,161,856	2,259,775	3,940,397	4,925,595	2,951,000[(9)]
Repayment of notes and other borrowings[(6)]	(1,201,084)	(2,021,832)	(3,713,634)	(3,909,434)	(2,346,000)
Adjusted revenues	7,251,622	7,418,833	7,933,402	8,897,767	9,022,556
Expenditures:					
Grants and subsidies	2,862,288	3,773,579	3,468,531	3,617,386	2,716,644
Personal services	2,884,636	3,119,476	3,951,387	4,783,567	5,597,632

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

	2002	2003	2004	2005(p)	2006(c)
Other services	764,655	583,343	400,594	389,346	557,939(10)
Materials and supplies	106,294	80,491	73,757	72,411	147,527
Equipment purchases	20,397	33,170	20,572	20,707	45,446
Capital outlays and other debt service	73,806	-	675	78,598	-
Transfers to agencies(7)	314,416	-	-	-	-
Prior year disbursements	-	-	88,432	-	-
Total expenditures	7,026,492	7,590,059	8,003,948	8,962,015	9,065,188
Adjusted revenues less expenditures	225,130	(171,226)	(70,546)	(64,248)	(42,632)
Ending cash balance	$ 350,284	$ 179,058	$ 108,512	$ 44,264	$ 1,632

(p) Preliminary.
(c) Current Budget.
(1) Includes certain non-recurring revenues totaling $244.1 million.
(2) Excludes transfers by the Commonwealth to the Conservation Trust Fund and amounts deposited by the Secretary of the Treasury into a separate account for the promotion of Puerto Rico rums in foreign markets.
(3) Consists of net revenues from the General Fund's non budgetary funds plus a reserve for future tax refunds reduced by estimated tax refunds.
(4) Consists of amounts to pay principal of and interest on general obligation bonds and notes of the Commonwealth. Does not include amounts deposited directly to the Redemption Fund from non-General Fund revenues.
(5) Consists of proceeds of Commonwealth tax and revenue anticipation notes and borrowings from GDB.
(6) Consists of repayment of Commonwealth tax and revenue anticipation notes and borrowings from GDB.
(7) "Transfers to Agencies" represents moneys appropriated for the operation of the Health Facilities and Services Administration or, after the dissolution of that Administration, the Department of Health.
(8) Includes revenues from an interest rate swap transaction amounting to $100 million.
(9) Includes $221 million from the Budgetary Fund, Emergency Fund, and other sources.
(10) Does not include possible payments relating to previous years' debt with vendors, estimated at $268 million.

Source: Department of the Treasury

Fiscal Year 2006

General Fund total revenues for fiscal year 2006 are projected to be $8.945 billion, which represents an increase of $638 million from fiscal year 2005 net revenues. Projected increased revenues for fiscal year 2006 include: (i) increases in income taxes from individuals of $173.8 million; (ii) increases in income taxes from corporations of $271.1 million; and (iii) increases in total excise taxes of $95.8 million. The $8.945 billion amount includes $100 million from an interest rate swap transaction that the Commonwealth anticipates undertaking during fiscal year 2006.

The projection of General Fund revenues for fiscal year 2006 is based on a projected nominal growth in gross national product of 5.9% and additional revenues of $130 million from the following new transitional legislation: (i) an increase in income taxes applicable to regular corporations ($68 million); (ii) an increase in license fees for luxury cars ($17 million); (iii) a surtax on insurance companies ($16 million); and (iv) an increase in capital gains rates ($29 million). These tax increases are scheduled to expire during fiscal year 2008 after the changes in the tax reform proposal currently being discussed are fully implemented. See "Proposed Tax Reform" below. The projected revenues also assume the receipt of $95 million from the following administrative measures: (i) an intensification of efforts to detect excise tax evasion using recently acquired x-ray machines to monitor ship containers at ports of entry; (ii) the implementation of a program to improve all tax collections; and (iii) heightened scrutiny on the payment of excise taxes on crude oil and its derivatives.

General Fund estimated total revenues for the first quarter of fiscal year 2006 were $2.1 billion, which exceeded the amount originally budgeted by $56 million. The quarterly increase is attributable to an increase in income taxes from individuals ($48 million), withholding tax revenues from non-residents ($48 million) and external revenues ($3 million), coupled with decreases in income taxes from corporations ($16 million), excise taxes ($19 million) and non-tax revenues ($8 million). Also, total revenues for this first quarter showed an increase of $264.4 million or 14% when compared to the same period in fiscal year 2005. This increase, in comparison with fiscal year 2005, was attributable to increases in income taxes from individuals ($69.6 million), corporations ($41.3 million), taxes withheld from non-residents ($158.8 million) and external revenues ($16.1 million), together with decreases in excise taxes ($2.7 million), and non-tax revenues ($18.7 million). The increase in revenues from individual income taxes is mainly attributable to administrative measures. The increase in the withholding tax on non-residents for this first quarter in fiscal year 2006, included an extraordinary $125 million payment from one taxpayer, which payment had been taken into consideration in the revenue projections for fiscal year 2006.

Budgeted expenditures for fiscal year 2006 are $8.945 billion. Estimated expenditures for fiscal year 2006 amount to $9.319 billion. For a discussion of the difference between the budgeted expenditures, estimated expenditures and the measures that the Commonwealth has identified to cover the estimated budget imbalance, see "Budget for Fiscal Year 2006" and "2006 Budget Approval Process" under *Budget of the Commonwealth of Puerto Rico.*

Fiscal Year 2005 (Preliminary)

General Fund final total net revenues for fiscal year 2005 were $8.307 billion, representing an increase of $322 million or 4%, from fiscal year 2004 net revenues. This amount excludes proceeds of a loan of $550 million obtained from GDB, which is included as part of "Proceeds of notes and other borrowings." The major changes in revenues from fiscal year 2004 were: (i) increases in total income taxes of $222 million, mainly resulting from increases in income taxes collected from individuals of $198 million and in income taxes collected from corporations of $40 million; (ii) increases in total excise taxes of $90.8 million; and (iii) increases in other revenues of $6.9 million, mainly as a result of an increase in miscellaneous non-tax revenues of $40.8 million.

Preliminary total cash expenditures for fiscal year 2005 are estimated at $9.208 billion, which exceeded budgeted expenditures by $354 million, attributed mainly to increases in the area of education ($303 million), public safety and protection ($23 million), health ($15 million), welfare ($10 million), and economic development ($3 million). This amount also excludes approximately $80 million of additional expenditures that were not originally budgeted. Various financing transactions were entered into to cover this imbalance. For more detailed information, see "Fiscal Year 2005 Budget" under *Budget of the Commonwealth of Puerto Rico*.

Fiscal Year 2004

General Fund total net revenues for fiscal year 2004 were $7.985 billion, representing an increase of $143 million, or 1.8%, from fiscal year 2003 net revenues. This amount excludes proceeds of a loan of $233 million obtained from GDB, which is included as part of "Proceeds of notes and other borrowings." This amount also excludes $88 million of additional non-recurring revenues. The major changes in revenues from fiscal year 2003 were: (i) increases in total income taxes of $128 million, mainly resulting from increases in income taxes from individuals of $203 million and in income taxes withheld from non-residents of $114 million; (ii) increases in total excise taxes of $42 million; and (iii) decreases in other revenues of $65 million, mainly as a result of a decrease in miscellaneous non-tax revenues of $59 million. Approximately $170 million of the increase in total income taxes for fiscal year 2004 relates to the collection of past taxes as a result of an incentives plan implemented by the Treasury.

Total cash expenditures for fiscal year 2004 were $8.004 billion, which amount excludes certain amounts related to fiscal year 2004 but disbursed in fiscal year 2005. This amount also excludes approximately $293 million of additional expenditures that were not originally budgeted and were covered with reserve funds ($50 million), the reimbursement of certain federal education funds ($141 million), and other sources. After considering (i) debt service payments (separately identified in the table as "Transfers to Redemption Fund"), (ii) $227 million in net borrowings from GDB and other sources, and (iii) $63 million in other income from the General Fund's non-budgetary funds, the ending cash balance of the General Fund decreased from $179 million at the end of fiscal year 2003 to $109 million at the end of fiscal year 2004.

Fiscal Year 2003

General Fund total revenues for fiscal year 2003 were $7.841 billion, representing an increase of $387 million, or 5.2%, from actual fiscal year 2002 revenues. This amount excludes proceeds of a loan of $250 million obtained from GDB, which is included as part of "Proceeds of notes and other borrowings." The major changes from fiscal year 2002 were: (i) increases in income taxes from individuals of $67 million and in corporate income taxes of $71 million; (ii) increases in excise taxes on alcoholic beverages and cigarettes of $83 million, and an increase in motor vehicles excise taxes of $81 million; (iii) an increase in electronic lottery revenues of $32 million; and (iv) a decrease in miscellaneous non-tax revenues of $124 million and in income taxes withheld from non-residents of $66 million. The decrease in miscellaneous non-tax revenues relates to certain special administrative measures that had been implemented by the Secretary of the Treasury in fiscal year 2002 and that did not apply to fiscal year 2003.

Total cash expenditures for fiscal year 2003 were $7.590 billion, which amount excludes certain amounts related to fiscal year 2003 but disbursed in fiscal year 2004. This amount also excludes $150 million of additional expenditures that were not originally budgeted and were covered with reserve funds, federal fiscal relief funds and other sources. The principal reason for these higher expenditures was higher than anticipated education costs. After considering (i) $332 million in debt service payments (separately identified on the table as "Transfers to Redemption Fund"), (ii) $238 million in net borrowings from GDB (which includes the $250 million loan mentioned above) and other sources, and (iii) $79 million in reserve for future tax refunds reduced by estimated tax refunds (separately identified on the table as "Other Income (refunds)"), the ending cash balance of the General Fund was reduced from $350 million at the end of fiscal year 2002 to $179 million at the end of fiscal year 2003.

Commonwealth's Budget Structural Imbalance

The Commonwealth is currently experiencing a budget imbalance in fiscal year 2006 which comes in the wake of several recent fiscal years during which the Commonwealth had insufficient recurring revenues to cover its expenditures. These imbalances have been covered in the past with loans from GDB, financing transactions (including long-term bond issues) and other non-recurring resources. During fiscal year 2005, the amount by which the Commonwealth's operating expenditures exceeded its recurring revenues (the so-called structural imbalance) was $989 million. The Commonwealth estimates that during fiscal year 2006, the structural imbalance will be $858 million. This amount represents the difference between (A) recurring revenues of $8.845 billion (which excludes the $100 million expected to be generated by the interest rate swap transaction mentioned below); and (B) $9.703 billion, which is comprised of the sum of (i) anticipated expenditures of $9.319 billion; and (ii) the mandated appropriation of $384 million of Excluded Debt Service (as defined in "2006 Budget Approval Process" under *Budget of the Commonwealth of Puerto Rico*) related to a portion of the debt service due during fiscal year 2006 on the Commonwealth's general obligation bonds, which is being paid from a GDB line of credit already in place and ultimately will be paid from the proceeds of a Commonwealth bond issuance. See "2006 Budget Approval Process" under *Budget of the Commonwealth of Puerto Rico*. As discussed in further detail below, the Commonwealth expects to cover the fiscal year 2006 structural imbalance by financing the Excluded Debt Service ($384 million), implementing procedures to reduce expenditures, withdrawing funds from the Budgetary and Emergency Funds and utilizing other non-recurring revenues ($221 million), and entering into an interest rate swap transaction ($100 million). Although the Commonwealth is using its best efforts in order to fully implement these cost reducing measures, there is no assurance that it will be able to do so.

There are certain expenditures not included in the amount of estimated expenditures for fiscal year 2006 ($9.319 billion), however, that may increase the structural imbalance. These expenditures consist of the following items, among others, (i) possible increases (in excess of the amount already budgeted) in health insurance premiums payable by the Commonwealth in fiscal year 2006 under its health reform program, which premiums are currently being negotiated (approximately $102 million); (ii) increases in the budget of the Legislative Assembly, the State Elections Commission, and the Office of the Ombudsman, whose budget reductions are being challenged in court, were such challenges to be successful (approximately $30 million); (iii) amounts required to be contributed by the Commonwealth to the Employees Retirement System relating to the costs of providing special benefits to retired employees, which amounts are not included in the fiscal year 2006 budget (approximately $43 million); (iv) potential additional expenditures in connection with the Medical Services Administration (approximately $30 million); (v) other potential additional operational expenditures (non-payroll related) (approximately $106 million); and (vi) previous years' debts with vendors (such items collectively, the "Additional Expenditures"). In addition to the Additional Expenditures, estimated amounts required to cover maintenance expenses incurred by Public Buildings Authority ("PBA") (approximately $75 million) may further increase the structural imbalance should the Commonwealth have to cover such maintenance expenses for PBA. Such estimated amounts are expected to be covered by a line of credit from GDB to PBA collateralized by real estate properties and accounts receivable, with payment to GDB expected from the sale of such real estate and/or the collection of such receivables pledged to GDB. See "2006 Budget Approval Process" under *Budget of the Commonwealth of Puerto Rico*.

The Commonwealth is also considering new revenue sources to address the structural imbalance beyond fiscal year 2006. In this regard, the Commonwealth is proposing to implement a new consumption tax and reductions in recurring expenditures as part of a comprehensive tax and fiscal reform, as discussed below. See "Proposed Tax Reform" and "Appropriations" under *Budget of the Commonwealth of Puerto Rico*.

Major Sources of General Fund Revenues

Income Taxes

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

Individuals. Resident individuals are subject to tax on their taxable income from all sources. The P.R. Code has five tax brackets for individuals with tax rates of 7%, 10%, 15%, 28%, and 33%. Dividend income from Puerto Rico corporations and certain qualifying foreign corporations is taxed at a rate of 10%.

Gain realized from the sale or exchange of a capital asset by resident individuals, if held for more than six months, is taxed at a rate of 20%. It is taxed at a rate of 10% if the capital asset consists of certain property located or deemed located in Puerto Rico. Gains realized on or before December 31, 2005 by Puerto Rico resident individuals, trusts and estates from the sale of stock of certain Puerto Rico corporations that was acquired in an initial public offering made after June 30, 1997 are subject to a special capital gains rate of 7%. Act No. 40 of August 1, 2005 ("Act No. 40"), however, was enacted to change to 12.5% the tax applicable to long-term capital gains for taxable years starting after June 30, 2005.

On August 22, 2004, the Governor signed into law Act No. 226 to provide a temporary reduction in the long-term capital gains tax rate that was applicable before the enactment of Act No. 40. Act No. 226 reduced the long-term capital gains tax rates by 50% for transactions that take place from July 1, 2004 through June 30, 2005, provided that the net long-term capital gain was reinvested in Puerto Rico.

Interest income in excess of $2,000 on deposit with Puerto Rico financial institutions is taxed at a rate of 17%; the first $2,000 of interest income from such institutions is exempt from taxation. Interest income on certain qualifying debt obligations issued by Puerto Rico corporations and certain qualifying foreign corporations and paid to resident individuals, trusts, and estates qualifies for a special 10% tax rate.

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

The P.R. Code provides for six income tax brackets for corporations and partnerships, with the highest rate (39%) applicable to net taxable income in excess of $300,000. Also, Act No. 41 of August 1, 2005 was enacted to impose a temporary additional tax of 2.5% on corporations and partnerships with a net taxable income of $20,000 or more. Gains realized from the sale or exchange of a capital asset, if held for more than six months, are taxed at a maximum rate of 25% or 12.5% if the capital asset consists of certain property located or deemed located in Puerto Rico. However, Act No. 40 was enacted to change to 20% the tax rate on long-term capital gains for taxable years starting after June 30, 2005. Dividends received by Puerto Rico corporations and partnerships of foreign corporations and partnerships engaged in trade or business in Puerto Rico are subject to general income tax rates. A dividends received credit may be available when the corporation or partnership making the distribution is organized in Puerto Rico. A special tax rate of 17% is applicable to dividend distributions of REITs received by corporations. Interest income on certain qualifying debt obligations issued by Puerto Rico corporations and certain qualifying foreign corporations and paid to resident corporations and partnerships qualifies for a special tax rate of 10%.

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

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

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

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

Excise Taxes

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

Other Taxes and Revenues

Motor vehicle license plate and registration fees comprise the major portion of license tax receipts. Recent legislation was enacted to increase license fees on luxury vehicles.

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

Revenues from non-Commonwealth sources include customs duties collected in Puerto Rico and excise taxes on shipments of rum from the island to the United States mainland. The customs duties and excise taxes on shipments are imposed and collected by the United States and returned to the Commonwealth. The excise tax on shipments of rum from Puerto Rico and other rum producing countries is $13.50 per gallon. Of this amount, $13.25 per proof gallon has been or will be returned to the Treasury during the period from July 1, 1999 to December 31, 2005. Effective January 1, 2006, the amount returned will be reduced to the lesser of $10.50 per proof gallon and the actual excise tax imposed. Legislation is currently pending in both houses of the United States Congress, however, that would increase the amount of federal excise taxes per proof gallon transferred to the Commonwealth to $13.50 after December 31, 2005 and before January 1, 2007. This legislation would also allocate $0.50 of the total tax so returned to the Conservation Trust Fund, a charitable trust established in 1968 pursuant to a Memorandum of Understanding between the United States Department of the Interior and the Commonwealth whose mission is to protect natural resources in Puerto Rico.

Property Taxes

Personal property, which accounts for approximately 49% of total collections of taxable property, is self-assessed. Real property taxes are assessed based on 1958 property values. No real property reassessment has been made since 1958, and construction taking place after that year has been assessed on the basis of what the value of the property would have been in 1958. Accordingly, the overall assessed valuation of real property for taxation purposes is substantially lower than the actual market value. Also, an exemption on the first $15,000 of assessed valuation in owner-occupied residences is available.

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

The following table presents the assessed valuations and real and personal property taxes collected for fiscal years ending June 30, 2000 through June 30, 2005.

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

Fiscal Years Ended June 30,	Assessed Valuations(1)	Taxes Levied	Collections of Current Year	Collections of Previous Years	Total Collections(2)
2000	$20,514,014	$704,568	$594,151	$64,812	$658,963
2001	21,575,063	736,667	614,411	70,496	684,907
2002	22,743,568	792,799	645,117	60,677	705,794
2003	23,138,903	824,933	671,163	79,421	750,584
2004	23,540,237	836,734	706,677	79,772	786,449
2005	25,877,795	899,893	738,074	50,751	788,825

(1) Valuation set as of July 1 of each fiscal year.
(2) During fiscal year 2004 a property tax amnesty was approved by the Legislative Assembly and implemented by CRIM. In addition to the amounts shown, under the amnesty program a total of $105.3 million was collected in fiscal year 2004 and $21.1 million in fiscal year 2005.

Source: Municipal Revenues Collection Center

Collections of Income and Excise Taxes

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

Proposed Tax Reform

On November 21, 2005, as a result of a joint effort by the two principal political parties to address the Commonwealth's structural budget imbalance and its other fiscal difficulties, the Legislative Assembly approved, and the Governor signed, Joint Resolution No. 321 (the "Joint Resolution"). On the same day, the Governor issued an executive order implementing the fiscal measures defined in the Joint Resolution (the "Fiscal Reform Executive Order"). The Joint Resolution and Fiscal Reform Executive Order impose government-wide expenditure controls and set forth the basic principles and parameters that will govern the reform of the Commonwealth's tax system and fiscal policy and practices. The proposed tax reform is aimed at increasing revenues by expanding the tax base through the implementation of a broad-based tax on the retail sale of articles of use and consumption (the "consumption tax").

The Joint Resolution and Fiscal Reform Executive Order come in the wake of expenditure controls previously implemented during fiscal year 2006 by the Governor, such as a reduction of appointed government positions, a limitation on the creation of new temporary employee positions, a hiring freeze, and a voluntary work week reduction program, as well as limitations on central government vehicle fleets and other expenses. If the proposed tax reform and expenditure controls are successfully implemented, the structural imbalance could be corrected by the end of fiscal year 2008. There is no assurance, however, that the structural imbalance will be corrected by such date.

Generally, the proposed tax reform will follow three basic principles: (i) broaden the tax base through the implementation of the consumption tax, (ii) reduce individual income tax rates, and (iii) simplify the administration of the tax system.

The proposed tax reform will (i) replace the Commonwealth's current excise tax with the consumption tax, (ii) include compensatory income tax credits in order to address any regressive effect the proposed consumption tax may have, (iii) eliminate the marriage penalty, (iv) establish an earned income tax credit, (v) increase the deduction for charitable contributions, (vi) restructure the estate tax system, (vii) provide incentives for investment in technological infrastructure and research and development activities, and (viii) adopt additional measures to foster individual savings.

Legislation with respect to the tax reform proposed by the Joint Resolution was introduced in the House of Representatives with a proposed effective date of July 1, 2006. Although the final structure of the tax reform, including the consumption tax, is under discussion, the Secretary of the Treasury expects that the tax reform will provide a net increase in the General Fund's annual revenues, after taking into consideration projected reductions in income taxes, in an amount sufficient to reduce and eventually eliminate the structural imbalance. See "Summary and Management's Discussion of General Fund Results – Commonwealth's Budget Structural Imbalance" above.

The Joint Resolution includes a long-term plan to reduce and improve the management of the Commonwealth's public debt. Upon the elimination of the structural budget imbalance, which elimination must be certified to the Legislative Assembly and the Governor by the Secretary of the Treasury, the Director of the OMB and the President of GDB, the Commonwealth's operating budget will include an annual contribution to the public improvement fund equal to two percent (2%) of the total amount of the public improvement bonds authorized for that fiscal year. The annual contribution to the public improvement fund will increase by an additional two percent (2%) of the then current authorization for each fiscal year thereafter, up to a maximum of twenty percent (20%) of the current year's authorized public improvement bond issuance. This contribution is intended to reduce proportionally each year the amount of the Commonwealth's public improvement bond issues.

The Joint Resolution and the Fiscal Reform Executive Order also set forth guiding principles and parameters and impose certain expenditure controls as part of fiscal reform. The Joint Resolution and the Fiscal Reform Executive Order restrict layoffs of government employees as a means to reduce government expenditures, and impose a hiring freeze in government until the structural budget deficit has been eliminated. Fiscal discipline will be promoted by requiring each central government agency to implement a seven-year expense reduction plan, adopting a new public policy that distinguishes between unnecessary and indispensable expenses, imposing certain limitations on the use of the Budgetary Fund, and providing that the budget may only be balanced through the use of recurring revenues. The proposed fiscal reform also mandates the reduction of advertising and travel expenses, promotes the use of electronic communications and document delivery, caps the purchase price of each government vehicle, and limits other non-payroll expenditures. Furthermore, the Legislative Assembly must approve any borrowings by the Secretary of the Treasury in order to finance any Commonwealth budget deficit with debt securities that are not repaid during the same fiscal year in which they are issued.

In an effort to address other fiscal challenges faced by the Commonwealth, the Joint Resolution and the Fiscal Reform Executive Order promote the adoption of certain measures to alleviate the significant unfunded liabilities of the various government retirement systems. See *Retirement Systems* above. These measures include the transfer to the two main government retirement systems of Commonwealth assets and additional General Fund contributions from the revenues of the proposed tax reform in excess of the Commonwealth's current expenditures. Furthermore, the Joint Resolution and the Fiscal Reform Executive Order limit the implementation of early retirement programs for government employees by conditioning their implementation on receipt of an opinion from an independent actuary confirming that the retirement systems will not be adversely affected by such early retirement program.

The measures and efforts set forth in the Joint Resolution, the Fiscal Reform Executive Order and the Tax Reform proposal are broad in scope and have been designed to address and correct the Commonwealth's structural imbalance and other fiscal challenges that are described below.

Transfers to General Obligation Redemption Fund

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

Components of General Fund Expenditures

Grants and Subsidies

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

Personal Services

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

Other Services

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

Materials and Supplies

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

Equipment Purchases

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

Capital Outlays and Other Debt Service

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

Transfers to Agencies

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

Other Expenditures

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

Federal Grants

Puerto Rico receives grants under numerous federal programs. Federal grants to the agencies and instrumentalities of the Commonwealth government, including public corporations, are estimated to be $5.279 billion for fiscal year 2006, an increase of $83.5 million, or 1.6%, from fiscal year 2005. The following table presents revenues from federal grants by broad program areas, which are accounted in the central accounting system of the Treasury. The figures for fiscal years 2002, 2003, and 2004 are actual figures. The estimated figures for fiscal years 2005 and 2006 are based on the information submitted by each agency to OMB.

Commonwealth of Puerto Rico
Federal Grants
(in thousands)

	2002	2003	2004	2005(1)	2006(1)
Education	$ 734,917	$ 828,992	$1,081,236	$ 992,658	$1,046,439
Social Services	1,711,360	1,848,910	1,792,203	1,884,298	1,878,945
Health	333,154	367,916	444,348	478,068	489,556
Labor and Human Resources(2)	376,119	334,350	204,679	214,679	208,973
Crime	15,689	32,479	37,988	29,313	29,593
Housing(3)	385,592	312,869	366,408	383,219	629,228
Drug and Justice	9,822	11,995	31,349	13,071	32,811
Agriculture and Natural Resources	13,119	7,883	10,378	8,183	10,115
Contributions to Municipalities	59,191	59,191	59,002	56,371	53,744
Other	13,538	25,874	39,879	33,168	40,721
TOTAL	$3,652,501	$3,830,459	$4,067,470	$4,091,328	$4,420,125

(1) Estimated.

(2) Amounts include grants to the Right to Work Administration and the Occupational Development and Human Resources Council.

(3) Amounts include grants to the Public Housing Administration.

Source: Office of Management and Budget

BUDGET OF THE COMMONWEALTH OF PUERTO RICO

Office of Management and Budget

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

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

Budgetary Process

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

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

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

Financial Control and Adjustment Procedures

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

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

A Budgetary Fund was created by Act No. 147 of June 18, 1980, as amended (the "Budgetary Fund"), to cover the appropriations approved in any fiscal year in which the revenues available for such fiscal year are insufficient, to secure the payment of public debt, and to provide for unforeseen circumstances in the provision of public service. Currently, an amount equal to one percent of the General Fund net revenues of the preceding fiscal year is deposited annually into the Fund. In addition, other income (not classified as revenues) that is not assigned by law to a specific purpose is also required to be deposited in the Budgetary Fund. The maximum balance of the Budgetary Fund may not exceed 6% of the total appropriations included in the budget for the preceding fiscal year. As of July 1, 2005, the balance in the Budgetary Fund was \$182.6 million. As of June 30, 2006, the Budgetary Fund is projected to have a balance of \$98 million.

An Emergency Fund was created by Act No. 91 of June 21, 1966, as amended (the "Emergency Fund"), to cover unexpected public needs caused by calamities, such as wars, hurricanes, earthquakes, droughts, floods and plagues, and to protect people's lives and property and the public sector credit. The Emergency Fund is capitalized annually with an amount totaling no less than one percent of the General Fund net revenues of the preceding fiscal year. Act No. 91 was amended on August 28, 2003, to set an upper limit to the Emergency Fund of \$150 million at the beginning of the fiscal year and was further amended in 2005 to authorize the disbursement of funds from the Emergency Fund to cover certain General Fund expenditures and operational costs of the State Emergency Management Agency. The 2005 amendment also authorizes GDB to lend to the Commonwealth up to \$150 million to replenish the Emergency Fund to provide funding for emergency and disaster needs. As of July 1, 2005, prior to the aforementioned 2005 amendment, the balance in the Emergency Fund was \$134.5 million.

Appropriations

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

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

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

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

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

In Puerto Rico, the central government performs many functions, which in the fifty states are the responsibility of local governments, such as providing public education, police and fire protection. The central government also provides significant annual grants to the University of Puerto Rico and to the municipalities.

In the summaries of the central government budgets presented below, grants to the University of Puerto Rico are included in current expenditures for education and the debt service on general obligation bonds is included in current expenses for debt service. Debt service on Sugar Corporation notes paid by the Commonwealth is included in current disbursements for economic development, and debt service on Urban Renewal and Housing Corporation bonds and notes and on Housing Finance Authority mortgage subsidy bonds paid by the Commonwealth is included in current expenses for housing.

For fiscal year 2005, approximately 56% of the General Fund was committed for payment of the central government payroll. In addition, approximately 27% of the General Fund was committed to the payment of fixed charges such as municipal subsidies, grants to the University of Puerto Rico, funding for the judicial branch, rental payments to the Public Buildings Authority, among others, and debt service on the direct debt of the Commonwealth. For fiscal year 2006, it is proposed that approximately 55% and 7% of the General Fund be committed for payment of the central government payroll and debt service on the direct debt of the Commonwealth, respectively. In the case of the judicial branch, legislation approved in December of 2002 provides that, commencing with fiscal year 2004, the Commonwealth will appropriate annually to the judicial branch an amount initially equal to 3.3% of the average annual revenue from internal sources for each of the two preceding fiscal years. This percentage will increase until it reaches 4% in fiscal year 2008, and may be further increased upon review, with scheduled reviews every five years.

Fiscal Year 2005 Budget (Preliminary)

The consolidated budget for fiscal year 2005 totaled $24.8 billion. Of this amount, $14.5 billion is assigned to the central government. This amount included General Fund total resources and appropriations of $8.9 billion, which represent an increase of $641 million, or 7.7%, over budgeted amounts for fiscal year 2004. These total resources budgeted included $8.3 billion of total revenues and $550 million of additional resources from a GDB loan secured by tax receivables. The budget for fiscal year 2005 was approved July 1, 2004.

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

	General Fund	Bond Fund	Special Funds	Total
Revenues from internal sources:				
Property taxes	$ 3,910	-	$ 112,977	$ 116,887
Personal income taxes	2,919,198	-	-	2,919,198
Retained non-resident income tax	612,006	-	-	612,006
Corporate income taxes	1,871,919	-	-	1,871,919
Partnership income taxes	3,245	-	-	3,245
Tollgate taxes	22,973	-	-	22,973
17% withholding tax on interest	10,490	-	-	10,490
10% withholding tax on dividends	80,398	-	-	80,398
Inheritance and gift taxes	7,129	-	-	7,129
Excise taxes:				
Alcoholic beverages	298,235	-	-	298,235
Motor vehicles and accessories	606,662	-	-	606,662
Cigarettes	146,527	-	-	146,527
Special excise tax on certain petroleum products	-	-	-	-
General 5% excise tax	557,369	-	-	557,369
Other (excise taxes)	175,434	-	47,100	222,534
Licenses	87,416	-	-	87,416
Miscellaneous non-tax revenues:				
Contributions from lottery fund	49,602	-	-	49,602
Electronic lottery	68,011	-	-	68,011
Registration and document certification fees	230,341	-	-	230,341
Other	189,974	-	296,907	486,881
Total revenues from internal sources	7,940,839	-	456,984	8,397,823
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	341,093	-	-	341,093
Federal grants	-	-	4,093,028(1)	4,093,028
Customs	25,037	-	-	25,037
Total revenues from non-Commonwealth sources	366,130	-	4,093,028(2)	4,459,158
Total revenues	8,306,969	-	4,550,012	12,856,981
Other:				
Other Income	550,000	-	-	550,000
Balance from previous year	-	-	497,811	497,811
Bonds authorized	-	550,000	-	550,000
Total other sources	550,000	550,000	497,811	1,597,811
Total resources	8,856,969	550,000	5,047,823	14,454,792
Appropriations:				
Current expenses:				
General government	828,449	-	51,224	879,673
Education	2,839,044	-	1,191,151	4,030,195
Health	1,429,230	-	512,622	1,941,852
Welfare	434,370	-	2,101,620	2,535,990
Economic development	198,925	-	66,478	265,403
Public safety and protection	1,557,482	-	89,497	1,646,979
Transportation and communications	92,636	-	51,342	143,978
Housing	26,539	-	206,341	232,880
Contributions to municipalities	369,829	-	2,031	371,860

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

	General Fund	Bond Fund	Special Funds	Total
Special pension contributions	239,285	-	-	239,285
Debt service	379,856	-	112,977	492,833
Other debt service (appropriations)	457,939	-	25,000	482,939
Total appropriations-current expenses	8,853,584	-	4,410,283	13,263,867
Capital improvements	-	550,000	242,632	792,632
Total appropriations	8,853,584	550,000	4,652,915	14,056,499
Year-end balance	3,385	-	394,908	398,293
Total appropriations and year-end balance	**$8,856,969**	**$550,000**	**$5,047,823**	**$14,454,792**

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

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

In the fiscal year 2005 budget, revenues and other budgetary funds total $13.4 billion, excluding balances from the previous fiscal year and authorized general obligation bonds. The net increase in General Fund revenues in the fiscal year 2005 budget, as compared to fiscal year 2004 results, is due to increases in personal income taxes (up $198 million), corporate income taxes (up $41 million), various excise taxes (up $189 million), and decreases in tollgate taxes (down $19 million), customs (down $9 million), electronic lottery transfers (down $18 million), contributions from the lottery fund (down $16 million), and retained non-resident income taxes (down $19 million).

Current expenses and capital improvements of all budgetary funds total $14.1 billion, an increase of $1 billion from fiscal year 2004. The major changes in General Fund expenditures by program in fiscal year 2005 were: education (up $287 million), public safety and protection (up $163 million), special pension contributions (up $52 million), debt service on Commonwealth's general obligation and guaranteed debt (up $35.8 million), welfare (up $30 million), health (up $25 million), economic development (up $16 million), transportation and communications (up $9 million), contributions to municipalities (up $7 million), housing (up $2 million), and a decrease in other debt service, consisting principally of Commonwealth appropriation debt (down $30 million), and general government debt (down $40 million).

Actual expenditures for fiscal year 2005 are currently estimated at $9.2 billion, which amount exceeds the General Fund budget by $354 million and are attributed mainly to increases in the areas of education ($303 million), public safety and protection ($23 million), health ($15 million), welfare ($10 million), and economic development ($3 million). This amount also excludes approximately $80 million of additional expenditures that were not originally budgeted. The government covered this budget imbalance with several financing transactions, among them, (i) the use of a portion of the proceeds of a bond issue by Infrastructure Financing Authority to replace a General Fund budgetary allocation to the University of Puerto Rico ($317 million); (ii) the use of a portion of the proceeds of a bond issue by Children's Trust to cover other General Fund appropriations ($100 million); (iii) income generated through debt service deposit (forward delivery) agreements ($83 million); and (iv) the release of excess funds held by AFICA ($30 million), all of which totaled $530 million. The remaining $98 million of this amount was carried forward to budgetary reserves for future use. The $354 million amount does not include expenditures for the Health Insurance Administration, the Medical Services Administration, the Police Department, previous fiscal years' debt with vendors, and additional contributions to the Government Employees Retirement System, the latter of which is estimated to be $20 million. See *Retirement Systems* above.

The general obligation bond authorization for the fiscal year 2005 budget was $550 million, all of which bonds have been issued.

Budget for Fiscal Year 2006

The consolidated budget for fiscal year 2006 totals $24.8 billion. Of this amount, $14.8 billion is assigned to the central government. This includes General Fund total resources and appropriations of $8.9 billion, which represents an increase of $91 million, or 1%, over budgeted amounts for fiscal year 2005. The following table presents a summary of the Commonwealth's current central government budget for the fiscal year ending June 30, 2006.

Commonwealth of Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ending June 30, 2006
(in thousands)

	General Fund	Bond Fund	Special Funds	Total
Revenues from internal sources:				
Property taxes	$ -	-	$113,825	$113,825
Personal income taxes	3,093,000	-	-	3,093,000
Retained non-resident income tax	628,000	-	-	628,000
Corporate income taxes	2,143,000	-	-	2,143,000
Partnership income taxes	3,000	-	-	3,000
Tollgate taxes	17,000	-	-	17,000
17% withholding tax on interest	11,000	-	-	11,000
10% withholding tax on dividends	74,000	-	-	74,000
Inheritance and gift taxes	2,000	-	-	2,000
Excise taxes:				
Alcoholic beverages	316,000	-	-	316,000
Motor vehicles and accessories	614,000	-	-	614,000
Cigarettes	152,000	-	-	152,000
Special excise tax on certain petroleum products	30,000	-	-	30,000
General 5% excise tax	634,000	-	-	634,000
Other (excise taxes)	134,000	-	47,100	181,100
Licenses	110,000	-	-	110,000
Miscellaneous non-tax revenues:				
Contributions from lottery fund	63,000	-	-	63,000
Electronic lottery	83,000	-	-	83,000
Registration and document certification fees	231,000	-	-	231,000
Other	131,000	-	309,200	440,200
Total revenues from internal sources	8,469,000	-	470,125	8,939,125
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	350,000	-	-	350,000
Federal grants	-	-	4,420,125 (1)	4,420,125
Customs	26,000	-	-	26,000
Total revenues from non-Commonwealth sources	376,000	-	4,420,125(2)	4,796,125
Total revenues	8,845,000	-	4,890,250	13,735,250
Other:				
Other Income	100,000	-	-	100,000
Balance from previous year	-	-	394,908	394,908
Bonds authorized	-	675,000	-	675,000
Total other sources	100,000	675,000	394,908	1,169,908
Total resources	**8,945,000**	**675,000**	**5,285,158**	**14,905,158**
Appropriations:				

Commonwealth of Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ending June 30, 2006
(in thousands)

	General Fund	Bond Fund	Special Funds	Total
Current expenses:				
General government	$775,022	-	$51,844	$826,866
Education	3,104,967	-	1,315,482	4,420,449
Health	1,460,502	-	508,895	1,969,397
Welfare	441,035	-	2,190,033	2,631,068
Economic development	180,498	-	69,252	249,750
Public safety and protection	1,532,161	-	93,860	1,626,021
Transportation and communications	100,750	-	58,605	159,355
Housing	19,391	-	323,818	343,209
Contributions to municipalities	386,395	-	1,985	388,380
Special pension contributions(3)	239,265	-	-	239,265
Debt service	116,812	-	113,825	230,637
Other debt service (appropriations) (4)	582,202	-	19,000	601,202
Total appropriations-current expenses	8,939,000	-	4,746,599	13,685,599
Capital improvements	6,000	675,000	487,149	1,168,149
Total appropriations	8,945,000	675,000	5,233,748	14,853,748
Year-end balance	-	-	51,410	51,410
Total appropriations and year-end balance	**$8,945,000**	**$675,000**	**$5,285,158**	**$14,905,158**

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

(2) Act No. 93 of August 20, 1997 establishes that resources that do not represent revenues become part of the Budgetary Fund.

(3) Includes $60 million from the Budgetary Fund.

(4) Includes $75 million from the Emergency Fund.

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

In the fiscal year 2006 budget, revenues and other resources of all budgetary funds total $13.8 billion, excluding balances from the previous fiscal year and authorized general obligation bonds. The net increase in General Fund revenues in the fiscal year 2006 budget, as compared to fiscal year 2005 preliminary results, is accounted for mainly by increases in personal income taxes (up $174 million), retained non-resident income taxes (up $16 million), corporate income taxes (up $271 million), various excise taxes (up $137 million), licenses (up $23 million), contributions from the lottery fund (up $13 million), electronic lottery fund (up $15 million), federal excise taxes on offshore shipments (up $9 million), and decreases in tollgate taxes and withholding taxes on dividends (down $6 million each), inheritance and gift taxes (down $5 million), other excise taxes (down $41 million) and other miscellaneous non-tax revenues (down $59 million).

Current expenses and capital improvements of all budgetary funds total $14.9 billion, an increase of approximately $797 million from fiscal year 2005. The major changes in General Fund expenditures by program in fiscal year 2006 are mainly due to increases in education (up $265 million), health (up $31.3 million), welfare (up $6 million), transportation and communications (up $8 million), contributions to municipalities (up $16 million), other debt service, consisting principally of Commonwealth appropriation debt (up $124.3 million), decreases in general government (down $53 million) and economic development (down $18.4 million), and decreases in housing (down $7 million), public safety and protection (down $25 million), and debt service on Commonwealth's general obligation and guaranteed debt (down $263 million).

The general obligation bond authorization for the fiscal year 2006 budget is $675 million.

2006 Budget Approval Process

Executive Order Budget. On March 16, 2005, the Governor of Puerto Rico, Aníbal Acevedo-Vilá, submitted to the Legislative Assembly of the Commonwealth a proposed balanced budget of revenues and expenditures for fiscal year 2006 providing for General Fund resources and expenditures of $9.684 billion, representing an increase of $476 million, or 5.2%, over estimated actual expenditures for fiscal year 2005 ($9.208 billion). The proposed budget package included several new revenue raising measures sufficient to cover budgeted expenditures, most of which required legislative approval. However, as mentioned below, the Legislative Assembly did not approve the budget proposed by the Governor.

On June 30, 2005, the Legislative Assembly, which is controlled by the principal opposition political party, approved a budget resolution for fiscal year 2006 that provided for General Fund expenditures of $9.258 billion. Governor Acevedo-Vilá vetoed this budget resolution because the revenue measures contained therein, as estimated by the Secretary of Treasury, were insufficient to cover the budgeted expenditures as required by the Constitution. The Governor did, however, sign into law certain revenue raising measures approved by the Legislative Assembly estimated to generate approximately $130 million in new revenues. Although the revenue raising measures contained language conditioning their effectiveness on the approval by the Governor of the $9.258 billion budget resolution, according to the Secretary of Justice, these revenue raising measures are enforceable regardless of such language. Although no legal action has been initiated thus far, no assurance can be given that the effectiveness of such revenue measures will not be challenged.

As a result of the Governor's veto, and in accordance with the Commonwealth's Constitution, the budget for fiscal year 2005 (with certain adjustments) carried over and will continue in effect for fiscal year 2006 unless another budget for fiscal year 2006 is approved by the Legislative Assembly and the Governor. At this time, it is not anticipated that a new budget for fiscal year 2006 will be approved prior to the end of the fiscal year, although it is possible that other appropriations for special purposes may be approved from time to time.

According to an opinion from the Secretary of Justice, the fiscal year 2006 budget that went into effect on July 1, 2005 authorized total spending of $9.489 billion, consisting of the amounts provided by (i) the fiscal year 2005 budget resolution, (ii) laws that assigned resources according to formulas or over several years, including fiscal year 2006, and (iii) laws approved during fiscal year 2005 with respect to ordinary government operational expenses. This amount was reduced to $9.284 billion as a result of (i) new appropriations approved after July 1, 2005, (ii) automatic reductions to certain formula-based appropriations pegged to the amount of estimated revenues, and (iii) a special adjustment eliminating the appropriation for $384 million related to a portion of debt service for general obligation bonds due during fiscal year 2006.

On August 30, 2005, the Governor adopted Executive Order 2005-58 (the "Budget 2006 Executive Order"), in which he made certain additional adjustments to the budget in order to bring the total expenditures in line with the Secretary of Treasury's estimate of total revenues for fiscal year 2006 of $8.945 billion, as required by Commonwealth law. These adjustments included a $384 million reduction related to a portion of debt service for general obligation bonds due during fiscal year 2006 (the "Excluded Debt Service") which is being paid from a GDB line of credit already in place and may be paid ultimately from the proceeds of a Commonwealth bond issue.

As a result of the insufficiency of projected revenues for fiscal year 2006 to meet the appropriations made in the fiscal year 2005 budget, and based in part on the opinion by the Secretary of Justice, the Governor made certain modifications to amounts assigned to agencies and instrumentalities under the 2005 budget by reallocating funds to agencies that provide direct services, such as the Department of Education, the Health Department and the police. This reallocation reduced the budget of many other Commonwealth agencies and instrumentalities from the levels provided in the fiscal year 2005 budget. Some of the entities whose budgets were reduced (the House of Representatives, the

Senate, the State Elections Commission, the Superintendent of the Capitol, and the Office of the Ombudsman) filed suit challenging, on statutory grounds, the Governor's reduction of their previous year's budget allocations. Two superior court judges have ruled differently on this matter. These decisions are currently pending resolution before the Puerto Rico Supreme Court. See *Litigation* below.

2006 Budget Imbalance. Notwithstanding the budget reduction implemented by the Fiscal Reform Executive Order, the Commonwealth estimates that its actual expenditures during fiscal year 2006 payable from General Fund revenues will total $9.319 billion. Without taking into account any additional revenues, the Additional Expenditures and the Excluded Debt Service, and assuming no other expenditures during fiscal year 2006, the difference between estimated expenditures of $9.319 billion and estimated revenues of $8.945 billion is $374 million. The Fiscal Reform Executive Order requires all central government agencies to operate within their assigned budgets for the remainder of fiscal year 2006. Accordingly, agencies must present a report to OMB outlining plans to avoid additional expenditures and finish the year within budget, no later than 30 days after the effectiveness of the Fiscal Reform Executive Order. This action is designed to reduce such difference of $374 million and other Additional Expenditures. The reports required by the Fiscal Reform Executive Order must also be presented to the speaker of the House, and the President of the Senate, the House Ways and Means Committee and the House Budget Committee, who may determine, based on such reports, whether any additional revenue measures are warranted. In the event expenditures will still exceed revenues, the Commonwealth estimates it would have available $221 million from the Emergency Fund, the Budgetary Fund, and other non-recurring resources. For more details about the Additional Expenditures, see "Summary and Management's Discussion of General Fund Results" under *Puerto Rico Taxes, Other Revenues, and Expenditures.*

As an initial temporary measure, on August 3, 2005, the Governor issued an Executive Order requiring most Executive Branch agencies to establish a voluntary employee hourly reduction program. The purpose of the program is to reduce salary expenditures by the government. The program established two hourly alternatives with different pay incentives: (1) one day per week work reduction with a 15% reduction in salary; and (2) 50% reduction in the regular hourly work week with a 35% reduction in salary (for those employees with 5 years or less before retirement, the second option will only entail a 25% reduction in salary).

It is possible that the Commonwealth may realize additional revenues and incur additional expenditures not included in the above estimated budget imbalance. As previously stated, revenues for the first quarter of fiscal year 2006 have exceeded budgeted amounts by $56 million. Although the Treasury Department is not in a position to project fiscal year-end revenues before completing the first semester, revenues may exceed the budgeted amount. There is no assurance that such level of revenue collection will continue for the remainder of the fiscal year, or that revenue levels will exceed the budgeted amount of $8.945 billion.

In addition, it is possible that expenditures may exceed the estimated level of $9.319 billion. This amount is based on the expenditure projections provided to OMB by certain key central government agencies taking into account their actual expenditures during the first two months of fiscal year 2006, with such projections having been adjusted to reflect certain recently legislated or otherwise expected expenditure increases. This amount, however, does not take into account the Additional Expenditures, some of which are contingent on negotiations and court decisions and include the following items, among others: (i) possible increases (in excess of the amount already budgeted) in health insurance premiums payable by the Commonwealth in fiscal year 2006 under its health reform program, which premiums are currently being negotiated (approximately $102 million); (ii) increases in the budget of the Legislative Assembly, the State Elections Commission, and the Office of the Ombudsman, whose budget reductions are being challenged in court, were such challenges to be successful (approximately $30 million); (iii) amounts required to be contributed by the Commonwealth to the Employees Retirement System relating to the costs of providing special benefits to retired employees, which amounts are not included in the fiscal year 2006 budget (approximately $43 million); (iv) potential additional expenditures in connection with the Medical Services Administration (approximately $30 million); (v) other potential additional non-payroll operational expenditures (approximately $106 million), and (vi) previous years' debts with vendors.

Although the Commonwealth is using its best efforts in order to maximize revenues and reduce expenditures, there is no assurance that revenues will be greater than the budgeted $8.945 billion or that expenditures will not exceed the estimated level of $9.319 billion. Moreover, though contrary to current public policy, the Commonwealth and its instrumentalities could obtain further extensions of credit by GDB to fund any remaining imbalance in fiscal year 2006 should other measures be insufficient to cover such imbalance.

Differences between Budget and Basic Financial Statements

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

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

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

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

LITIGATION

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

With respect to pending and threatened litigation, as of June 30, 2004, the Commonwealth has included in its financial statements reported liabilities of approximately $219 million for awarded and anticipated unfavorable judgments. This amount represented the amount estimated at the time as a probable liability or a liability with a fixed or expected due date, which would require future available financial resources for its payment. The Commonwealth believes that the ultimate liability in excess of amounts provided in the financial statements, if any, would not be significant.

The Commonwealth is a defendant in two lawsuits filed, one in Commonwealth court and one in the United States District Court for the District of Puerto Rico, by an association of primary care health centers seeking to recover from the Commonwealth $120 million of Medicaid funds retained by the Department of Health since 1997. In June 2004, the Superior Court of the Commonwealth in San Juan determined that the Commonwealth must return those funds. The Commonwealth appealed this decision. As of June 30, 2004, the Commonwealth has accrued $120 million for this legal contingency. With respect to the federal case, a preliminary injunction was issued by the Court against the Commonwealth requiring it to disburse approximately $20 million in six payments beginning in October 2005.

The Commonwealth is a defendant in two lawsuits filed in local and federal district court by an association of insurance companies seeking to recover from the Commonwealth approximately $38 million of compulsory motor vehicle insurance premiums allegedly belonging to the insurance companies or their policyholders, which were transferred by the Secretary of the Treasury to the General Fund. The Commonwealth believes that its ultimate liability, if any, would not be significant.

The Commonwealth is also a defendant in various cases, including a class action presented by parents of special education students alleging deficient services to these students in the areas of education and health care before Commonwealth Courts. One court recently decided in favor of the parents' request to include damage claims in the same class action case. This decision is appealable and thus, not final at this time. The Commonwealth does not anticipate any final determination or damages award, in any case, to be granted in this fiscal year.

The Commonwealth and various component units are defendants in other lawsuits alleging violations of constitutional rights (for example, by municipalities) civil rights, breach of contract, and other damage claims. Preliminary hearings and discovery proceedings are in progress. The amounts claimed exceed $7.8 billion; however, the ultimate liability cannot be presently determined. It is the opinion of the Commonwealth that the claims are excessive. No provision for any liability that may result upon adjudication of these lawsuits has been recognized by the Commonwealth. The Commonwealth believes that the ultimate liability in excess of amounts provided, if any, would not be significant.

The Governor, the Director of OMB and the Secretary of the Treasury are also defendants in various lawsuits by governmental entities whose budgets for fiscal year 2006 were reduced under the Executive Order of August 30, 2005. These claimants are challenging, on constitutional and statutory grounds, the Governor's reallocation of resources see "2006 Budget Approval Process" under *Budget of the Commonwealth of Puerto Rico*. The Commonwealth believes these challenges will not prevail. If all or any of these challenges prevail, however, further adjustments would have to be made to the fiscal year 2006 budget in the form of cuts to other agencies' budgets in the approximate amount of $30 million.

APPENDIX II

FORM OF OPINION OF BOND COUNSEL

437 Madison Avenue
New York, New York 10022-7001
(212) 940-3000

December ___ , 2005

Hon. Juan C. Méndez Torres
Secretary of the Treasury of Puerto Rico
San Juan, Puerto Rico

Dear Sir:

We have acted as bond counsel in connection with the issuance by the Commonwealth of Puerto Rico (the "Commonwealth") of $1,042,500,000 Tax and Revenue Anticipation Notes of the Commonwealth of Puerto Rico, Series 2006 (the "Notes"). The Notes are dated December ___, 2005, mature July 28, 2006, and bear interest at the rate of four point five per centum (4.5%) per annum, payable at maturity. The Notes are issuable as registered notes in denominations of $5,000 and any multiple thereof and are issued under the provisions of Act No. 1 of the Legislature of Puerto Rico, approved June 26, 1987 (the "Act"), as amended, and a resolution of the Secretary of the Treasury of Puerto Rico authorizing the issuance of the Notes (the "Note Resolution").

We have examined the law and such certified proceedings and other papers as we deem necessary to render the following opinions.

In rendering the following opinions we have assumed the genuineness of all signatures, the authenticity of all documents tendered to us as originals and the conformity to original documents of all documents submitted to us as certified or photostatic copies. As to questions of fact material to our opinion, we have relied upon the certified proceedings and other certifications of public officials furnished to us without undertaking to verify the same by independent investigation.

Based upon the foregoing, we are of the opinion, under existing law, as follows:

1. The Act is valid.

2. The proceedings authorizing the issuance of the Notes have been validly and legally taken.

3. The Notes have been duly authorized and issued to fund a portion of the Commonwealth's projected cash requirements for the remainder of the fiscal year ending June 30, 2006, which requirements result from timing differences between expected disbursements and receipts of revenues, are valid and binding obligations of the Commonwealth , and are payable on a parity with all other outstanding Notes heretofore and hereafter issued under the Act and the Note Resolution (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 New York Agency, as Lead Arranger and Administrative Agent, Citibank, N.A., as Arranger and Documentation Agent, BNP Paribas, acting through its San Francisco Branch and Dexia Credit Local, acting through its New York Branch, as Co-Agents, and the several other banks named therein (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," to the credit of which 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, 2006 and on or prior to June 30, 2006 plus

any balance in the General Fund on April 1, 2006 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, 2006), subject to certain prior applications as specified therein, sufficient to pay the principal of and interest on the Notes. The full faith, credit and taxing power of the Commonwealth are not pledged to the payments of the Notes.

4. The Internal Revenue Code of 1986, as amended (the "Code"), sets forth certain requirements which must be met subsequent to the issuance and delivery of the Notes for interest thereon to be and remain excluded from gross income for Federal income tax purposes. Noncompliance with such requirements could cause the interest on the Notes to be included in gross income for Federal income tax purposes retroactively to the date of issue of the Notes. The Commonwealth has covenanted in the Note Resolution to comply, to the extent permitted by the Constitution and laws of the Commonwealth, with the requirements of the Code and the regulations promulgated thereunder to maintain the exclusion from gross income of the interest on the Notes pursuant to Section 103 of the Code. We are not aware of any provisions in said Constitution and laws that would prevent such compliance. In addition, the Commonwealth has made certain representations and certifications relating to the Notes in its "Tax Certificate as to Arbitrage and the Provisions of Sections 103 and 141-150 of the Internal Revenue Code of 1986" of even date herewith.

Under existing law, assuming compliance with the tax covenants described herein and the accuracy of certain representations and certifications made by the Commonwealth described above, interest on the Notes is excluded from gross income for Federal income tax purposes under Section 103 of the Code. We are also of the opinion that such interest is not treated as a preference item in calculating the alternative minimum tax imposed under the Code with respect to individuals and corporations. Interest on the Notes is, however, included in the adjusted current earnings of certain corporations for purposes of computing the alternative minimum tax imposed on such corporations.

5. The interest on the Notes is exempt from state, Commonwealth and local income taxation.

Except as stated in paragraphs 4 and 5 above, we express no opinion as to any other Federal or state, Commonwealth or local tax consequences of the ownership or disposition of the Notes. Furthermore, we express no opinion as to any Federal, state, Commonwealth or local tax law consequences with respect to the Notes, or the interest thereon, if any action is taken with respect to the Notes or the proceeds thereof upon the advice or approval of other bond counsel.

It is to be understood that the rights of the holders of the Notes and the enforceability thereof may be subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights heretofore or hereafter enacted to the extent constitutionally applicable and that their enforcement may also be subject to the exercise of judicial discretion in appropriate cases.

Very truly yours,

APPENDIX III

DESCRIPTION OF LETTER OF CREDIT BANKS

SCOTIABANK

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).

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.

CITIBANK

Citibank N.A. ("Citibank") was originally organized on June 16, 1812, and now is a national banking association organized under the National Bank Act of 1864. Citibank is an indirect wholly-owned subsidiary of Citigroup Inc. ("Citigroup"), a Delaware holding company. As of September 30, 2005, the total assets of Citibank and its consolidated subsidiaries represented approximately 48% of the total assets of Citigroup and its consolidated subsidiaries.

The long term ratings of Citibank and its consolidated subsidiaries are Aa1, AA and AA+ by Moody's, S&P and Fitch, respectively. The short term ratings of Citibank and its consolidated subsidiaries are A-1+, P-1 and F1+ by Moody's, S&P and Fitch, respectively.

Citibank is a commercial bank that, along with its subsidiaries and affiliates, offers a wide range of banking and trust services to its customers throughout the United States and the world. As a national bank, Citibank is a regulated entity permitted to engage only in banking and activities incidental to banking. Citibank is primarily regulated by the Office of the Comptroller of the Currency (the "Comptroller"), which also examines its loan portfolios and reviews the sufficiency of its allowance for credit losses.

Citibank's deposits at its U.S. branches are insured by the Federal Deposit Insurance Corporation (the "FDIC") and are subject to FDIC insurance assessments. The Letter of Credit is not insured by the FDIC or any other regulatory agency of the United States or any other jurisdiction. Citibank may, under certain circumstances, be obligated for the liabilities of its affiliates that are FDIC-insured depository institutions.

Legislation enacted as part of the Omnibus Budget Reconciliation Act of 1993 provides that deposits in U.S. offices and certain claims for administrative expenses and employee compensation against a U.S. insured depository institution which has failed will be afforded a priority over other general unsecured claims, including deposits in non-U.S. offices and claims under non-depository contracts in all offices, against such an institution in the "liquidation or other resolution" of such an institution by any receiver. Such priority creditors (including the FDIC, as the subrogee of insured depositors) of such FDIC-insured depository institution will be entitled to priority over unsecured creditors in the event of a "liquidation or other resolution" of such institution.

For further information regarding Citibank, reference is made to the Annual Report on Form 10-K of Citicorp and its subsidiaries for the year ended December 31, 2004, and the Quarterly Report on Form 10-Q of Citigroup and its subsidiaries for the quarter ended September 30, 2005, filed by Citigroup with the Securities and Exchange Commission (the "SEC"). Further information regarding Citibank subsequent to September 30, 2005, will be included in the Form 10-Qs (quarterly) and Form 10-Ks (annually) subsequently filed by Citigroup with the SEC. Copies of such material may be obtained, upon payment of a duplicating fee, by writing to the SEC at 100 F Street, N.E., Washington, D.C. 20549. In addition, such reports are available at the SEC's web site (http://www.sec.gov).

In addition, Citibank submits quarterly to the Comptroller certain reports called "Consolidated Reports of Condition and Income for a Bank With Domestic and Foreign Offices" ("Call Reports"). The Call Reports, which include income statement and balance sheet information, are on file with and publicly available at the Comptroller's offices at 250 E Street, S.W., Washington, D.C. 20219 and are also available on the web site of the FDIC (http://www.fdic.gov).

Any of the reports referenced above are available upon request, without charge, by writing or calling Citigroup Document Services, 140 58th Street, Brooklyn, New York 11220, (718) 765-6514.

The information contained in this Appendix III relates to and has been obtained from Citibank. The information concerning Citibank contained herein is furnished solely to provide limited introductory information regarding Citibank 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.

BNP PARIBAS

As of December 31st 2004, BNP Paribas (the "Bank") was the Euro zone's largest banking institution in terms of market capitalization. The Bank, together with its consolidated subsidiaries (collectively, the "Group"), is a global provider of financial services; conducting retail, corporate and investment banking, private banking, asset management, insurance and specialized and other financial activities throughout the world. According to rankings published in July 2004 by *The Banker* (based on 2003 figures):

- based on total assets, the Group was the second largest banking group in France, the fifth largest in Europe, and the seventh largest in the world; and
- based on Tier 1 capital, the Group was the second, fourth and tenth largest banking group in France, Europe and the world, respectively.

The 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 throughout the world, in particular in Europe and the western United States.

The Group has offices in more than 85 countries. At December 31, 2004, the Group had consolidated assets of €905.9 billion (compared to €783.1 billion at December 31, 2003), consolidated gross total customer items of €266.9 billion (compared to €231.5 billion at December 31, 2003), consolidated customer deposits (including retail and negotiable certificates of deposit) of €328.3 billion (compared to €282.6 billion at December 31, 2003) and shareholders' equity (Group share including income for the 2004 fiscal year) of €30.2 billion (compared to €28.3 billion at December 31, 2003). Net income, before taxes, non-recurring items and amortization of goodwill for the year ended December 31, 2004 was €7.6 billion (compared to €6.3 billion for the year ended December 31, 2003). Net income, Group share, for the year ended December 31, 2004 was €4.7 billion (compared to €3.8 billion for the year ended December 31, 2003).

The Bank 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 "B."

The Group has three core businesses: Retail Banking; Corporate and Investment Banking; and Asset Management and Services. Operationally, the Group's businesses are organized into five main divisions (French Retail Banking, International Retail Banking and Financial Services, Corporate and Investment Banking, Asset Management and Services and BNP Paribas Capital).

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 19 billion euros as of December 31, 2004, 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 2004 primarily through the issuance of euro and U.S. dollar-denominated bonds. In 2004, total funding raised by Dexia and Dexia Municipal Agency was 11.7 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, 2004, Dexia had total consolidated assets of 206.0 billion euros, outstanding medium and long-term loans to customers of 168.13 billion euros and shareholders' equity of over 4.32 billion euros (Tier I plus Tier II), and for the year then ended had consolidated net income of 705 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, 2004, the exchange rate was 1.0000 euro equals 1.3621 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 36,000 in 2004. 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, 2004 Fortis Bank had total assets of EUR 484.2 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 2004, 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 2004 were prepared in accordance with Belgian accounting standards, which differ from generally accepted accounting principles in use in the United States.

The information in this Appendix 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 Appendix is correct as of any time subsequent to its date.

STATE STREET BANK AND TRUST COMPANY

State Street Bank and Trust Company (the "Bank") is a wholly-owned subsidiary of State Street Corporation (the "Corporation"). The Corporation (NYSE: STT) a leading specialist in providing institutional investors with investment servicing, investment management and investment research and trading. With $9.5 trillion in assets under custody and $1.4 trillion in assets under management, the Corporation operates in 25 countries and more than 100 markets worldwide. The assets of the Bank at December 31, 2004 accounted for approximately 96% of the consolidated assets of the Corporation. At December 31, 2004, the Corporation had total assets of $94.040 billion, total deposits (including deposits in foreign offices) of $55.129 billion, total loans and lease finance assets net of unearned income, allowance and reserve for possible credit losses of approximately $4.611 billion and total equity capital of $6.159 billion.

The Bank's Consolidated Reports of Condition for Insured Commercial and State Chartered Savings Banks FFIEC 031 for December 31, 2004, as submitted to the Federal Reserve Bank of Boston, are incorporated by reference in this Appendix and shall be deemed to be a part hereof.

In addition, all reports filed by the Bank pursuant to 12 U.S.C. §324 after the date of this Official Statement shall be deemed to be incorporated herein by reference and shall be deemed to be a part hereof from the date of filing of any such report.

Additional information, including financial information relating to the Corporation and the Bank is set forth in the Corporation's Annual Report or Form 10-K for the year ended December 31, 2004. The annual report can be found on the Corporation's web site, ***www.statestreet.com***. Such report and all reports filed by the Corporation pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, after the date of this Official Statement are incorporated herein by reference and shall be deemed a part hereof from the date of filing of any such report. The Letter of Credit is an obligation of the Bank and not of the Corporation.

Any statement contained in any document incorporated or deemed to be incorporated by reference herein 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 subsequently filed document that also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Bank hereby undertakes to provide, without charge to each person to whom a copy of this Official Statement has been delivered, on the written request of any such person, a copy of any or all of the documents referred to above which have been or may be incorporated in this Official Statement by reference, other than exhibits to such documents. Written requests for such copies should be directed to Investor Relations, State Street Corporation, One Lincoln Street, Boston, Massachusetts 02111, telephone number 617-786-3000.

Neither the Bank nor its affiliates make any representation as to the contents of this Official Statement (except as to this Appendix to the extent it relates to the Bank), the suitability of the Notes for any investor, the feasibility or performance of any project or compliance with any securities or tax laws or regulations.

ROYAL BANK OF CANADA

Royal Bank of Canada (referred to in this section as the "Bank") is a Schedule I bank under the *Bank Act* (Canada), which constitutes its charter. The Bank's principal executive offices are located at Royal Bank Plaza, 200 Bay Street, Toronto, Ontario, Canada M5J 2J5. The head office is located at 1 Place Ville Marie, Montreal, Quebec, Canada H3C 3A9.

The Bank is Canada's largest bank as measured by assets and market capitalization and one of North America's leading diversified financial services companies. It provides personal and commercial banking, wealth management services, insurance, corporate and investment banking, and transaction processing services on a global basis. The Bank and its subsidiaries employ approximately 60,000 people who serve more than 14 million clients through offices in North America and some 30 countries around the world. The initials RBC are used as a prefix for the business and operating subsidiaries of the Bank, all of which operate under the master brand name of RBC Financial Group.

The Bank had, on a consolidated basis, as at October 31, 2005, total assets of C$469.5 billion (approximately US$397.7 billion*), shareholders' equity of C$19.8 billion (approximately US$16.8 billion*) and total deposits of C$306.9 billion (approximately US$259.9 billion*). The foregoing figures were prepared in accordance with Canadian generally accepted accounting principles and have been derived from, and are qualified by reference to, the Bank's audited consolidated financial statements for the fiscal year ended October 31, 2005 included in the Annual Report on Form 40-F filed with the United States Securities and Exchange Commission on November 30, 2005. Reference is also made to the notes to the audited consolidated financial statements (including note 1, which contains a discussion of the significant accounting policies) to such audited consolidated financial statements.

The long-term unsecured senior debt of the Bank has been assigned ratings of AA- (negative outlook) by Standard & Poor's Ratings Services, Aa2 (stable outlook) by Moody's Investors Service and AA (stable outlook) by FitchRatings. The Bank's common shares are listed on the Toronto Stock Exchange, New York Stock Exchange and Swiss Exchange under the trading symbol “RY.“ Its preferred shares are listed on the Toronto Stock Exchange.

Upon written request, and without charge, the Bank will provide a copy of its most recent publicly filed audited consolidated financial statements and Annual Report on Form 40-F to any person to whom this Official Statement is delivered. Written requests should be directed to: Investor Relations, Royal Bank of Canada, 123 Front Street West, 6th Floor, Toronto, Ontario, Canada M5J 2M2.

The delivery of this Official Statement 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 herein is correct as at any time subsequent to its date.

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* As at October 31, 2005: C$1.00 = US$0.847.