Supplement, dated May 7, 2008, to Remarketing Circular,
dated May 6, 2008, relating to:

COMMONWEALTH OF PUERTO RICO
Public Improvement Refunding Bonds

$50,000,000 Series 2007A-6	**$50,000,000 Series 2007A-8**
$50,000,000 Series 2007A-7	**$50,000,000 Series 2007A-9**

(General Obligation Bonds)

Base CUSIP 74514L

Please note the following changes to the Remarketing Circular, dated May 6, 2008, relating to the above bonds (all terms used below have the same meanings given to them in said Remarketing Circular, dated May 6, 2008):

1. The second sentence of the third paragraph under the heading "*Introductory Statement* - Letters of Credit, Remarketing Agents and Interest Rate Swaps" is deleted and in its place the following sentences are added to read as follows:

> One such swap (with Morgan Stanley as swap provider) will remain in place following the applicable Conversion Date, but on an uninsured basis. Another such swap (with Lehman Brothers Special Financing as swap provider) will be terminated and replaced with a new swap on an uninsured basis with UBS AG, Stamford Branch as the swap provider. The Commonwealth will make a termination payment in connection with the termination of the Lehman swap.

2. The second sentence of the first paragraph under the heading "*Purpose of Variable Rate Bonds* - Interest Rate Swaps" is deleted and in its place the following sentences are added to read as follows:

> One such swap (with Morgan Stanley as swap provider) will remain in place following the applicable Conversion Date, but on an uninsured basis. Another such swap (with Lehman Brothers Special Financing as swap provider) will be terminated and replaced with a new swap on an uninsured basis with UBS AG, Stamford Branch as the swap provider. The Commonwealth will make a termination payment in connection with the termination of the Lehman swap.

3. Clause (a) of the first sentence of the third paragraph under the heading "*The Variable Rate Bonds* - Letters of Credit and Reimbursement Agreements - Letters of Credit" is deleted and in its place the following language is added to read as follows:

> (a) the stated expiration date (May 12, 2010, with respect to the Series 2007A-6 Bonds, May 7, 2010, with respect to the Series 2007A-7 Bonds, May 7, 2011, with respect to the Series 2007A-8 Bonds, and May 6, 2011, with respect to the Series 2007A-9 Bonds, unless renewed or extended);

This Supplement will be filed with each NRMSIR and with the MSRB.

COMMONWEALTH OF PUERTO RICO

By: /s/ José Guillermo Dávila
Secretary of the Treasury

Dated: May 7, 2008

REMARKETING – NOT A
NEW ISSUE - BOOK-ENTRY ONLY
See "Book-Entry Only System" under *The Variable Rate Bonds*

On October 16, 2007, Squire, Sanders & Dempsey L.L.P. delivered its approving opinion which concluded that under existing law (i) assuming continuing compliance with certain covenants and the accuracy of certain representations, interest on the Variable Rate Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations, and (ii) the Variable Rate Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation. The approving opinion further concluded that interest on the Variable Rate Bonds may be subject to certain federal taxes imposed only on certain corporations, including the corporate alternative minimum tax on a portion of that interest. On the respective Conversion Dates of the Variable Rate Bonds, Sidley Austin LLP will deliver an opinion to the effect that such conversion is permitted under the Bond Resolution and will not in and of itself impair or affect the exclusion of interest on said Variable Rate Bonds from gross income for purposes of federal income taxation. Sidley Austin LLP will not express an opinion regarding the current status of such interest for federal income tax purposes. For a more complete discussion of the tax aspects of the Variable Rate Bonds, see "Tax Matters" herein.

COMMONWEALTH OF PUERTO RICO
Public Improvement Refunding Bonds

$50,000,000 Series 2007A-6
$50,000,000 Series 2007A-7
$50,000,000 Series 2007A-8
$50,000,000 Series 2007A-9

(General Obligation Bonds)

Original Issue Date: October 16, 2007
Conversion Date: As shown on the inside cover **Due: July 1, as shown on the inside cover**

On October 16, 2007, the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico") issued its Public Improvement Refunding Bonds, Series 2007A, in the original aggregate principal amount of $926,570,000 (the "Bonds"), pursuant to the provisions of Act No. 2 of the Legislature of Puerto Rico, approved October 10, 1985, and Joint Resolution No. 57 of the Legislature of Puerto Rico, approved July 12, 1995, and pursuant to a resolution adopted by the Secretary of the Treasury of the Commonwealth (the "Secretary") and approved by the Governor of Puerto Rico on October 3, 2007, as amended and supplemented (the "Bond Resolution"). Certain of said Bonds with subseries designation "Series 2007A-6" in the principal amount of $50,000,000 (the "Series 2007A-6 Bonds"), subseries designation "Series 2007A-7" in the principal amount of $50,000,000 (the "Series 2007A-7 Bonds"), subseries designation "Series 2007A-8" in the principal amount of $50,000,000 (the "Series 2007A-8 Bonds") and subseries designation "Series 2007A-9" in the principal amount of $50,000,000 (the "Series 2007A-9 Bonds" and, together with the Series 2007A-6 Bonds, the Series 2007A-7 Bonds and the Series 2007A-8 Bonds, the "Variable Rate Bonds") were originally issued as auction rate securities.

Pursuant to the terms of the Bond Resolution, the Secretary has elected to convert the Variable Rate Bonds from ARS Rate Periods to new Interest Rate Periods permitted under the Bond Resolution. The Series 2007A-6 Bonds will convert to a Daily Interest Rate Period on May 13, 2008, the Series 2007A-7 Bonds will convert to a Weekly Interest Rate Period on May 9, 2008, the Series 2007A-8 Bonds will convert to a Weekly Interest Rate Period on May 8, 2008, and the Series 2007A-9 Bonds will convert to a Weekly Interest Rate Period on May 7, 2008, as further described herein. The Variable Rate Bonds are subject to redemption prior to maturity as set forth herein.

The Variable Rate Bonds were originally issued and are being remarketed as registered bonds without coupons registered only in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"), which acts as securities depository for the Variable Rate Bonds. The Variable Rate Bonds offered for remarketing hereby will be available to purchasers in denominations of $100,000 and multiples of $5,000 in excess of that amount only under said DTC book-entry system. **Purchasers will not receive delivery of the Variable Rate Bonds. So long as any purchaser is the beneficial owner of a Variable Rate Bond, he must maintain an account with a broker or dealer who is, or acts through, a DTC Participant to receive payment of principal and interest on such Variable Rate Bond.** See "Book-Entry Only System" under *The Variable Rate Bonds*.

THE VARIABLE RATE BONDS ARE GENERAL OBLIGATIONS OF THE COMMONWEALTH. THE GOOD FAITH, CREDIT AND TAXING POWER OF THE COMMONWEALTH ARE IRREVOCABLY PLEDGED FOR THE PROMPT PAYMENT OF THE PRINCIPAL OF AND INTEREST ON THE VARIABLE RATE BONDS. THE CONSTITUTION OF PUERTO RICO PROVIDES THAT PUBLIC DEBT OF THE COMMONWEALTH, WHICH INCLUDES THE VARIABLE RATE BONDS, CONSTITUTES A FIRST CLAIM ON AVAILABLE COMMONWEALTH RESOURCES.

The Commonwealth will obtain irrevocable, transferable, direct-pay letters of credit (collectively, the "Letters of Credit" and individually, a "Letter of Credit") from UBS AG, Stamford Branch (with respect to the Series 2007A-6 Bonds and the Series 2007A-7 Bonds) and Wachovia Bank, National Association (with respect to the Series 2007A-8 Bonds and Series 2007A-9 Bonds), concurrently with the conversion and remarketing of such Bonds. The scheduled payment of principal of and interest on the Variable Rate Bonds will be payable from draws upon the Letters of Credit. In addition, the Tender Agent will be entitled to draw upon the Letters of Credit to pay the Tender Price of Variable Rate Bonds that are tendered and not remarketed. The Letters of Credit will expire, subject to earlier termination under certain circumstances or extension, prior to the final maturity of the Variable Rate Bonds.

UBS Securities LLC will serve as Remarketing Agent for the Series 2007A-6 Bonds and the Series 2007A-7 Bonds. Wachovia Bank, National Association will serve as Remarketing Agent for the Series 2007A-8 Bonds and the Series 2007A-9 Bonds.

The Variable Rate Bonds are offered for delivery when, as and if remarketed by the Remarketing Agents subject to the delivery of a Favorable Opinion of Bond Counsel by Sidley Austin LLP, New York, New York, as required by the Bond Resolution, and certain other conditions. Certain legal matters will be passed upon for the Remarketing Agent by Squire, Sanders & Dempsey L.L.P., Miami, Florida. It is expected that the Variable Rate Bonds will be available for delivery through the facilities of DTC upon conversion and remarketing on May 13, 2008 with respect to the Series 2007A-6 Bonds, May 9, 2008 with respect to the Series 2007A-7 Bonds, May 8, 2008 with respect to the Series 2007A-8 Bonds, and May 7, 2008 with respect to the Series 2007A-9 Bonds.

UBS Investment Bank **Wachovia Bank, National Association**

SUBSERIES DESIGNATIONS, MATURITIES, AMOUNTS, INTEREST RATES, PRICES OR YIELDS AND CUSIP NUMBERS

Subseries	Conversion Date	Maturity July 1,	Amount	Interest Rate Period	Price	CUSIP
2007A-6(1)	05/13/08	2033	$50,000,000	Daily	100%	74514LUB1
2007A-7(2)	05/09/08	2033	50,000,000	Weekly	100	74514LUC9
2007A-8(3)	05/08/08	2034	50,000,000	Weekly	100	74514LUE5
2007A-9(4)	05/07/08	2034	50,000,000	Weekly	100	74514LUF2

(1) Secured by Letter of Credit issued by UBS AG, Stamford Branch; UBS Securities LLC, Remarketing Agent.
(2) Secured by Letter of Credit issued by UBS AG, Stamford Branch; UBS Securities LLC, Remarketing Agent.
(3) Secured by Letter of Credit issued by Wachovia Bank, National Association; Wachovia Bank, National Association, Remarketing Agent.
(4) Secured by Letter of Credit issued by Wachovia Bank, National Association; Wachovia Bank, National Association, Remarketing Agent.

The interest rate on the Series 2007A-6 Bonds will be determined on May 12, 2008 and will be effective as of May 13, 2008 for the period ending May 13, 2008, and thereafter, while bearing interest at a Daily Interest Rate, will be determined as described under *The Variable Rate Bonds*. The interest rate on the Series 2007A-7 Bonds will be determined on May 8, 2008 and will be effective as of May 9, 2008 for the period ending May 14, 2008, and thereafter, while bearing interest at a Weekly Interest Rate, will be determined as described under *The Variable Rate Bonds*. The interest rate on the Series 2007A-8 Bonds will be determined on May 7, 2008 and will be effective as of May 8, 2008 for the period ending May 14, 2008, and thereafter, while bearing interest at a Weekly Interest Rate, will be determined as described under *The Variable Rate Bonds*. The interest rate on the Series 2007A-9 Bonds will be determined on May 6, 2008 and will be effective as of May 7, 2008 for the period ending May 7, 2008, and thereafter, while bearing interest at a Weekly Interest Rate, will be determined as described under *The Variable Rate Bonds*.

Commonwealth of Puerto Rico

Governor

Aníbal Acevedo Vilá

Members of the Cabinet

Jorge P. Silva-Puras
Chief of Staff

Fernando J. Bonilla
Secretary of State

Roberto J. Sánchez Ramos
Secretary of Justice

José Guillermo Dávila
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

Gabriel Figueroa Herrera
Secretary of Agriculture

Carlos González Miranda
Secretary of Transportation and Public Works

bartolomé gamundi cestero
Secretary of Economic Development and Commerce

Félix Matos
Secretary of Family Affairs

Jorge Rivera Jiménez
Secretary of Housing

Javier Vélez Arocho
Secretary of Natural and Environmental Resources

Víctor A. Suárez
Secretary of Consumer Affairs

David E. Bernier Rivera
Secretary of Sports and Recreation

Miguel A. Pereira
Secretary of Corrections and Rehabilitation

Legislative Officers

Kenneth D. McClintock
President, Senate

José F. Aponte
Speaker, House of Representatives

Fiscal Officers

Armando A. Valdez
Director, Office of Management and Budget

Jorge Irizarry Herráns
President, Government Development Bank for Puerto Rico

No dealer, broker, sales representative or other person has been authorized by the Commonwealth 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. This Remarketing Circular does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the Variable Rate Bonds, by any person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale. The information set forth herein has been obtained from the Commonwealth and other official sources that are believed to be reliable. The information set forth herein regarding each Provider has been obtained from such Provider. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Remarketing Circular nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Commonwealth since the date hereof. The Remarketing Agents have reviewed the information in this Remarketing Circular 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 Remarketing Agents do not guarantee the accuracy or completeness of such information.

IN CONNECTION WITH THE REMARKETING OF THE VARIABLE RATE BONDS, THE REMARKETING AGENTS MAY EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE VARIABLE RATE BONDS, AS WELL AS THE OUTSTANDING GENERAL OBLIGATION BONDS OF THE COMMONWEALTH, AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

CERTAIN STATEMENTS CONTAINED IN THIS REMARKETING CIRCULAR REFLECT NOT HISTORICAL FACTS BUT FORECASTS AND “FORWARD-LOOKING STATEMENTS”. THESE STATEMENTS ARE BASED UPON A NUMBER OF ASSUMPTIONS AND ESTIMATES THAT ARE SUBJECT TO SIGNIFICANT UNCERTAINTIES, MANY OF WHICH ARE BEYOND THE CONTROL OF THE COMMONWEALTH OF PUERTO RICO. IN THIS RESPECT, THE WORDS “ESTIMATES”, “PROJECTS”, “ANTICIPATES”, “EXPECTS”, “INTENDS”, “BELIEVES” AND SIMILAR EXPRESSIONS ARE INTENDED TO IDENTIFY FORWARD-LOOKING STATEMENTS. ALL PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINIONS, ESTIMATES AND OTHER FORWARD-LOOKING STATEMENTS ARE EXPRESSLY QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT: ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE EXPRESSED OR IMPLIED BY FORWARD-LOOKING STATEMENTS.

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COMMONWEALTH OF PUERTO RICO
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$50,000,000 Series 2007A-6	**$50,000,000 Series 2007A-8**
$50,000,000 Series 2007A-7	**$50,000,000 Series 2007A-9**

(General Obligation Bonds)

INTRODUCTORY STATEMENT

This Remarketing Circular of the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico"), which includes the cover page, the inside cover page, the table of contents and the appendices, provides certain information in connection with the conversion and remarketing of certain subseries of the $926,570,000 aggregate principal amount of Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 2007A (the "Bonds"), to wit: $50,000,000 aggregate principal amount of the Bonds with subseries designation "Series 2007A-6" (the "Series 2007A-6 Bonds"), $50,000,000 aggregate principal amount of the Bonds with subseries designation "Series 2007A-7" (the "Series 2007A-7 Bonds"), $50,000,000 aggregate principal amount of the Bonds with subseries designation "Series 2007A-8" (the "Series 2007A-8 Bonds") and $50,000,000 aggregate principal amount of the Bonds with subseries designation "Series 2007A-9" (the "Series 2007A-9 Bonds" and, together with the Series 2007A-6 Bonds, the Series 2007A-7 Bonds and the Series 2007A-8 Bonds, the "Variable Rate Bonds").

The Variable Rate Bonds were originally issued and are being converted and remarketed under the provisions of Act No. 2 of the Legislature of Puerto Rico, approved October 10, 1985, and Joint Resolution No. 57 of the Legislature of Puerto Rico, approved July 12, 1993 (collectively, the "Act"), and pursuant to a resolution authorizing the issuance of the Bonds adopted in accordance with the Act by the Secretary of the Treasury of the Commonwealth of Puerto Rico (the "Secretary" or the "Secretary of the Treasury") and approved by the Governor of Puerto Rico on October 3, 2007, as amended and supplemented (the "Bond Resolution"). Concurrently with the original issuance of the Bonds, the Commonwealth issued its $60,545,000 aggregate principal amount of Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 2007B under the provisions of the Act. On or about the dates of conversion of the Variable Rate Bonds, the Commonwealth is issuing its $735,015,000 aggregate principal amount of Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 2008 A (the "Series 2008 A Bonds"), $173,975,000 aggregate principal amount of Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 2008 B (the "Series 2008 B Bonds"), and $190,135,000 aggregate principal amount of Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 2008 C (the "Series 2008 C Bonds").

Remarketing. The Variable Rate Bonds were originally issued in ARS Rate Periods. Pursuant to an election by the Secretary to convert the Variable Rate Bonds to the new Interest Rate Periods described on the inside cover page, the Variable Rate Bonds are subject to mandatory tender and are being converted to new Interest Rate Periods and remarketed. The Series 2007A-6 Bonds will convert to a Daily Interest Rate Period on May 13, 2008, the Series 2007A-7 Bonds will convert to a Weekly Interest Rate Period on May 9, 2008, the Series 2007A-8 Bonds will convert to a Weekly Interest Rate Period on May 8, 2008, and the Series 2007A-9 Bonds will convert to a Weekly Interest Rate Period on May 7, 2008 (each such date of conversion is hereinafter referred to as a "Conversion Date" and collectively, as the "Conversion

Dates"). The Variable Rate Bonds will bear interest from their respective Conversion Dates in the Interest Rate Periods set forth on the inside cover page.

Letters of Credit, Remarketing Agents and Interest Rate Swaps. The Commonwealth will enter into separate reimbursement agreements (individually, a "Reimbursement Agreement" and collectively, the "Reimbursement Agreements") with UBS AG, Stamford Branch ("UBS AG"), in connection with the Series 2007A-6 Bonds and the Series 2007A-7 Bonds, and with Wachovia Bank, National Association ("Wachovia" and together with UBS AG, the "Providers" and individually, a "Provider"), in connection with the Series 2007A-8 Bonds and the Series 2007A-9 Bonds, pursuant to which the Providers will issue separate irrevocable, transferable, direct-pay letters of credit (collectively, the "Letters of Credit" and individually, a "Letter of Credit"), for the payment of the principal of and interest on, and Tender Price of, the Variable Rate Bonds to which each Letter of Credit relates.

UBS Securities LLC and Wachovia Bank, National Association (individually, a "Remarketing Agent" and, collectively, the "Remarketing Agents") will serve as remarketing agents for the Variable Rate Bonds under separate remarketing agreements with the Commonwealth (collectively, the "Remarketing Agreements").

Concurrently with the original issuance of the Variable Rate Bonds, the Commonwealth entered into interest rate exchange transactions (the "swaps") with qualifying financial institutions (the "swap providers") in order to effectively fix the interest cost to the Commonwealth of the Variable Rate Bonds. The swaps will remain in place following the Conversion Dates, but with a new counterparty (UBS AG, Stamford Branch instead of the original counterparties) on an uninsured basis.

Reference is made to the Bond Resolution for the complete terms of the Variable Rate Bonds. Terms used in this Remarketing Circular and not defined herein have the respective meanings given to them in the Bond Resolution, copies of which may be obtained by contacting Executive Vice President, Government Development Bank for Puerto Rico, 135 West 50th Street, 22nd Floor, New York, New York 10020, telephone number (212) 333-0364, or to Executive Vice President – General Obligations Division, Government Development Bank for Puerto Rico, P.O. Box 42001, San Juan, Puerto Rico 00940, telephone number (787) 722-7060.

Cancellation of Bond Insurance. Upon the original delivery of the Variable Rate Bonds, Assured Guaranty Corp. ("Assured Guaranty") issued a financial guaranty insurance policy guaranteeing, in respect of certain specified obligations including the Variable Rate Bonds, the payment of the portion of principal and interest that became due for payment but remained unpaid by reason of nonpayment (the "Original Policy"). Upon the mandatory tender and the conversion of the Variable Rate Bonds to new Interest Rate Periods, as described herein, Assured Guaranty is amending the Original Policy at the request of the Commonwealth to provide that the Variable Rate Bonds will no longer constitute insured obligations. Accordingly, the holders of the Variable Rate Bonds in the new Interest Rate Periods will not have the benefit of the Original Policy or any credit support other than the applicable Letter of Credit.

Security. Under the Act, the good faith, credit and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal of and interest on the Variable

Rate Bonds. The Constitution of Puerto Rico provides that public debt of the Commonwealth, which includes the Variable Rate Bonds, constitutes a first claim on available Commonwealth resources.

Additional Documents. This Remarketing Circular includes the Commonwealth's Financial Information and Operating Data Report, dated January 2, 2008 (the "Commonwealth Report"), attached hereto as *Appendix I*, and incorporates by reference the Commonwealth's Comprehensive Annual Financial Report for the fiscal year ended June 30, 2006, as amended, prepared by the Department of the Treasury of the Commonwealth (the "Commonwealth's Annual Financial Report"). The Commonwealth Report attached hereto as *Appendix I* includes important operating and financial information about the Commonwealth, including information about its economy, historical revenues and expenditures of its General Fund, the estimated year-end results of fiscal year 2007, the budget for fiscal years 2007 and 2008, and the debt of the Commonwealth's public sector, and should be read in its entirety and in conjunction with the *Recent Developments* herein. The Commonwealth's Annual Financial Report includes the basic financial statements of the Commonwealth as of and for the fiscal year ended June 30, 2006, which have been audited by KPMG LLP, independent auditors, as stated in their report dated August 1, 2007, accompanying such financial statements. KPMG LLP did not audit the financial statements of the Public Buildings Authority capital project fund or the Children's Trust special revenue funds (major funds), and certain activities, funds and component units separately identified in its report. Those financial statements were audited by other auditors whose reports have been furnished to KPMG LLP, and its opinions, insofar as they relate to the amounts included for activities, funds and component units, separately identified in its report, are based solely on the reports of the other auditors. The report of KPMG LLP contains an explanatory paragraph referring to the Commonwealth's adoption of Governmental Accounting Standards Board ("GASB") Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, as of June 30, 2006. The Commonwealth's Annual Financial Report has been filed by the Commonwealth with each nationally recognized municipal securities information repository ("NRMSIR").

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

Under its existing continuing disclosure agreements, the Commonwealth is obligated to file on or before May 1 in each year updates of its financial and demographic information through the end of the prior fiscal year, including the Commonwealth's Annual Financial Report. In the recent past, the Commonwealth has been unable, due to accounting rules changes and other reasons (mostly related to delays in receipt of component units' audited financial statements), to file the Commonwealth's Annual Financial Report by the May 1 continuing disclosure update filing deadline. The Commonwealth's Annual Financial Report for the fiscal year ended June 30, 2006 was filed with each NRMSIR on August 16, 2007 and an amended and restated version thereof was filed with each NRMSIR on September 13, 2007. The Commonwealth's audited financial statements for fiscal year ended June 30, 2007 are expected to be filed after the current filing deadline of May 1, 2008, because various component units did not submit their audited financial statements to the central government's external auditors on time.

The Commonwealth will provide without charge to any person to whom this Remarketing Circular is delivered, on the written or oral request of such person, a copy of the Commonwealth's Annual Financial Report incorporated herein by reference. Requests should be directed to Executive Vice President, Government Development Bank for Puerto Rico, 135 West 50th Street, 22nd Floor, New York, New York 10020, telephone number (212) 333-0364, or to Executive Vice President – 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.

OVERVIEW

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

Puerto Rico has a diversified economy with manufacturing and services comprising its principal sectors. Puerto Rico's economy is closely linked to the United States economy. In fiscal year 2007 (which ended on June 30, 2007), the Commonwealth's gross product (preliminary, in current dollars) was $58.712 billion, and personal income per capita (preliminary, in current dollars) was $13,491.

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

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

Additional information about the Commonwealth can be found in the Commonwealth Report attached hereto as *Appendix I*, including information about the economy, historical revenues and expenditures of the Commonwealth's General Fund, the year-end results of fiscal year 2006, the estimated year-end results for fiscal year 2007 and the approved budget for fiscal year 2008, and the debt of the Commonwealth's public sector. The Commonwealth Report should be read in its entirety.

RECENT DEVELOPMENTS

This section supplements the information appearing in the Commonwealth Report and should be read in conjunction therewith.

Fiscal Year 2008 Projected Revenues and Expenditures

As discussed in greater detail in the Commonwealth Report, the General Fund budget for fiscal year 2008 is $9.227 billion. General Fund revenues for the eight-month period ending on February 29, 2008 totaled $5.081 billion, which is $291.5 million less than the Department of the Treasury's estimate for that period. This amount includes $2.662 billion in revenues from individual and corporate income taxes, $658.6 million from non-resident withholding taxes, $553.8 million from excise taxes and $572.7 million of sales tax revenues. During fiscal year 2008, the Commonwealth recovered approximately $287 million more in federal funds than it had budgeted. This federal funds recovery represented reimbursement of amounts advanced by the Commonwealth's Department of Education during fiscal years 2006 and 2007. The Commonwealth currently anticipates that for the full fiscal year 2008, total expenditures will roughly equal the budgeted amounts. However, expenditures relating to the Health Insurance Program could exceed the budgeted amounts. As a result of the foregoing, the Commonwealth currently projects a budget deficit of approximately $119 million for fiscal year 2008 (before giving effect to certain refunding transactions the Commonwealth is currently undertaking). The Commonwealth’s economic team is working together to enforce the spending control measures that have been established to attempt to minimize this budget risk.

Fiscal Year 2009 Projected Revenues and Expenditures

On March 13, 2008, the Governor submitted a proposed General Fund budget for fiscal year 2009 of $9.488 billion, or approximately $261 million more than the estimated expenditures for fiscal year 2008 of $9.227 billion. The fiscal year 2009 budget marks the third consecutive year in which budgeted expenditures are below the fiscal year 2006 level. The increase in expenditures is mainly due to University of Puerto Rico, judiciary and municipal formula increases and salary increases mandated by law or collective bargaining agreements. An additional $42.3 million is budgeted for the State Election Commission. The Secretary's General Fund revenue projection for fiscal year 2009 is $8.488 billion, a decrease of $183 million, or 2.1%, from estimated net revenues for fiscal year 2008 of $8.671 billion. The Commonwealth's budgeted expenditures for fiscal year 2009 of $9.488 billion exceed projected revenues of $8.488 by approximately $1 billion. The Commonwealth's economic team is working together to enforce spending control measures that have been established to attempt to minimize the budget risk. In addition, the Governor has proposed two special measures which are expected to generate close to $1 billion in fiscal year 2009. These measures consist of tax receivable financings and proceeds received from a concession agreement for operation of the electronic lottery. Legislation authorizing these two measures was submitted by the Governor to the Legislature along with the budget. No assurance can be given that either of these measures will be enacted, or that if enacted, they will be in the forms recommended by the Governor.

Indictment of Governor of Puerto Rico

On March 27, 2008, the Governor of Puerto Rico and several other individuals were named in federal grand jury indictments relating to the use of political contributions and campaign funds during the period when the Governor was Resident Commissioner in Washington, D.C. The Governor has denied any wrongdoing and has stated his intention to remain in his position and present his defense. It is not expected that such developments will have any impact on the fiscal affairs of the Commonwealth or on the payment of any obligations issued by the Commonwealth since (i) the good faith, credit and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal and interest on its general obligation bonds, and (ii) the Constitution of Puerto Rico provides that public debt of the Commonwealth, including its general obligation bonds, constitute a first claim on available Commonwealth revenues.

Proposed Sales Tax and Excise Tax Changes

On February 6, 2008, the Governor, in his State of the Commonwealth address, proposed suspending a portion of the current sales and use tax, for a reduction from 7% to 2.5%, and re-instituting a revamped excise tax on goods imported into Puerto Rico to help stimulate the Commonwealth’s economy. The proposal will require passage of legislation to become law, and includes provisions that will continue the earmarking of sales tax revenues equal to 1% of the total sales tax rate to the Dedicated Sales Tax Fund and other mechanisms currently in place to ensure the security for the outstanding bonds of the Puerto Rico Sales Tax Financing Corporation ("COFINA"). See "Tax Reform" under *Puerto Rico Taxes, Other Revenues and Expenditures,* "Government Development Bank for Puerto Rico – Sales Tax Financing Corporation" under *Public Corporations* and "Public Sector Debt" under *Debt* in the Commonwealth Report in *Appendix I*. On February 7, 2008, the Governor stated that any proposal from his administration would not impair the rights of bondholders and that he will veto any counter-proposal from the Legislature of Puerto Rico that would constitute a possible impairment of the rights of bondholders. On February 7, 2008, Standard & Poor's Ratings Service ("S&P") placed the COFINA bonds on CreditWatch Negative and Fitch Ratings Ltd. ("Fitch") placed the same bonds on Rating Watch. On March 14, 2008, the Governor submitted to the Legislature a proposed bill establishing the conditions for suspending the collection of the 4.5% sales and use tax (which is the portion of the total sales and use tax to be collected for the General Fund), establishing and funding a debt service reserve fund for the benefit of COFINA bondholders and re-instituting the revamped excise tax. Said bill has been structured to safeguard the rights of the COFINA bonds and is aimed at preserving the current rating of the COFINA bonds. This action is expected to be revenue neutral for the General Fund. No assurance can be given that the above proposal will be enacted, or that if it is enacted, it will be in the form recommended by the Governor.

Employees Retirement Systems Funding Improvement

On January 31, 2008, the Employees Retirement System (the "System") issued $1,588,810,799.60 principal amount of its Senior Pension Funding Bonds, Series A (the "Series A Pension Bonds"). The net proceeds of the Series A Pension Bonds have been deposited into the trusteed assets of the System reducing the unfunded accrued actuarial liability of the System. See *Retirement Systems* in the Commonwealth Report in *Appendix I*. The Series A Pension Bonds are secured by a pledge of contributions to be made into the System by all of the participating government employers, including the Commonwealth, its municipalities and certain public corporations. The System anticipates issuing additional Senior Pension Funding Bonds during 2008 for the same purpose and having the same security as the Series A Pension Bonds.

Planning Board Revised Economic Growth Estimates

On February 21, 2008, the Planning Board, as part of its final review of fiscal year 2007 economic statistics indicated that it expected to reduce the 2007 economic growth rate to -1.8% from -1.4% and that the forecast for fiscal years 2008 and 2009 will be lowered on account of the projected length of the current recession. The factors that influenced the Board's fiscal year 2007 indication included reductions in retail sales, private investment (especially in the construction sector) and government investment. Price increases in certain key areas such as energy and raw materials contributed to the Board's numbers as well.

Additional Debt Guaranteed by the Commonwealth

On March 18, 2008, the Puerto Rico Aqueduct and Sewer Authority issued $159,055,000 of Revenue Refunding Bonds, 2008 Series A, and $125,700,000 of Revenue Refunding Bonds, 2008 Series B, Guaranteed by the Commonwealth of Puerto Rico (collectively, the "PRASA

Bonds"). Although these bonds were not issued by the Commonwealth, the payment of principal of and interest on said bonds is guaranteed by the Commonwealth.

PURPOSE OF VARIABLE RATE BONDS

The Variable Rate Bonds, together with the balance of the Bonds and the Series 2007B Bonds, were originally issued for the purpose of refunding certain outstanding public improvement and public improvement refunding bonds of the Commonwealth (the "Refunded Bonds"), for debt service savings. A description of the Refunded Bonds is contained in the Official Statement, dated October 3, 2007, relating to the Bonds, which Official Statement can be obtained from any NRMSIR.

Letters of Credit

The Commonwealth will enter into separate Reimbursement Agreements with each of the Providers, pursuant to which the Providers will issue the Letters of Credit to pay when due the principal of and interest on the Variable Rate Bonds. Unless certain events have occurred, the Letters of Credit may also be drawn to provide funds to the Tender Agent to enable it to purchase Variable Rate Bonds which are optionally or mandatorily tendered by their Owners and are not remarketed, including a draw in connection with a mandatory tender upon the Provider's giving notice to the Tender Agent of the occurrence of an event of default under the Reimbursement Agreements related to and resulting in a termination of the Letters of Credit.

Interest Rate Swaps

Concurrently with the original issuance of the Variable Rate Bonds, the Commonwealth entered into interest rate swaps with certain swap providers in accordance with and meeting the requirements of Act No. 39 of the Legislature of Puerto Rico, approved August 1, 2005 as amended ("Act No. 39 of 2005"), in order to effectively fix the interest rate on the Variable Rate Bonds. The swaps will remain in place following the Conversion Dates, but with a new counterparty (UBS AG, Stamford Branch instead of the original counterparties) on an uninsured basis.

Under the terms of the interest rate swaps, they may be terminated by the Commonwealth at any time at their then current market value(s). The underlying agreements may also be terminated upon the occurrence of certain credit events. If a termination event occurs due to a credit event, the Commonwealth may be obligated to pay to the applicable swap provider an amount based on the terminating swap's market value that may be substantial.

The Commonwealth's obligations under the interest rate swaps are secured, by virtue of the provisions of Act No. 39 of 2005, by the full faith, credit and taxing power of the Commonwealth.

THE VARIABLE RATE BONDS

General

The Variable Rate Bonds were originally issued bearing interest in ARS Rate Periods. Pursuant to an election by the Secretary to convert the Variable Rate Bonds to new Interest Rate Periods, the Variable Rate Bonds are subject to mandatory tender and will be converted on the applicable Conversion Date to a Daily Interest Rate Period, in the case of the Series 2007A-6 Bonds, a Weekly Interest Rate Period, in the case of the Series 2007A-7 Bonds, a Weekly Interest Rate Period, in the case of the Series 2007A-8 Bonds, and a Weekly Interest Rate Period, in the case of the Series 2007A-9 Bonds. On their respective Conversion Dates, the Variable Rate Bonds will be remarketed as described herein. The Variable Rate Bonds are dated as of their date of original issuance, will bear interest from their respective Conversion Date in the Interest Rates Periods, and mature on the dates and in the principal amounts set forth on the inside cover page of this Remarketing Circular. Interest on the Variable Rate Bonds will be payable monthly as described below. The Variable Rate Bonds are subject to redemption at the times and at the prices set forth below under "Redemption." Banco Popular de Puerto Rico will serve as paying agent and registrar (the "Registrar") for the Variable Rate Bonds.

As more fully described below, upon conversion and remarketing, the Variable Rate Bonds shall bear interest at the Daily Interest Rate for a Daily Interest Rate Period or at the Weekly Interest Rate for a Weekly Interest Rate Period, in the respective aggregate principal amounts specified on the inside cover page of this Remarketing Circular, until converted and remarketed to another Interest Rate Period. At the direction of the Commonwealth, from time to time, a subseries of the Variable Rate Bonds may be converted in whole, from an Interest Rate Period to another Interest Rate Period, including the Daily Interest Rate Period, the Weekly Interest Rate Period, the Long-Term Interest Rate Period, the Short-Term Interest Rate Period, the ARS Rate Period and the Indexed Put Interest Rate Period. *This Remarketing Circular provides information concerning the Variable Rate Bonds while bearing interest at a Daily Interest Rate or a Weekly Interest Rate. There are significant differences in the terms of the Variable Rate Bonds if they are bearing interest at a Long-Term Interest Rate, a Bond Interest Term Rate during each Bond Interest Term in a Short-Term Interest Rate Period, an Auction Period Rate or an Indexed Put Rate. This Remarketing Circular does not provide information with respect to the Variable Rate Bonds other than Variable Rate Bonds in a Daily Interest Rate Period or a Weekly Interest Rate Period. Reference is made to the Variable Rate Bonds for their complete text and to the Bond Resolution for a more detailed description of the provisions of the Variable Rate Bonds.*

The Variable Rate Bonds are being remarketed in the form of fully registered bonds without coupons in the denomination of $100,000 or multiples of $5,000 in excess thereof. As described below under the caption "Book-Entry Only System", when remarketed, the Variable Rate Bonds will continue to be registered in the name of Cede & Co., as Bondholder and nominee of The Depository Trust Company ("DTC"), New York, New York, which acts as securities depository for the Variable Rate Bonds.

Interest Payment. Upon remarketing, all Variable Rate Bonds of a subseries shall bear interest at the same interest rate and in the same Interest Rate Period. Variable Rate Bonds bearing interest at the Daily Interest Rate or Weekly Interest Rate shall not, at any time, bear interest in excess of the maximum rate permitted by Puerto Rico law, currently being 12% per annum (the "Maximum Bond Interest Rate"). Interest on the Variable Rate Bonds shall be paid on each Interest Payment Date, any redemption date and on the Maturity Date. Variable Rate Bonds in the Daily Interest Rate Period and Weekly Interest Rate Period shall accrue interest from the Conversion Date on the basis of the actual number of days elapsed during the Interest Rate Period and a year of 365 days (366 in a leap year). The initial Interest Payment Date for interest accrued on the Variable Rate Bonds will be June 2, 2008. Thereafter, the Interest Payment Date for Variable Rate Bonds in the Daily Interest Rate Period and the Weekly Interest Rate Period will be the first Business Day of each calendar month.

Place of Payment. The principal and Tender Price of and interest on the Variable Rate Bonds in the Daily Interest Rate Period or Weekly Interest Rate Period shall be paid by the Registrar by wire transfer of immediately available funds to the respective Holders thereof on the applicable Record Date to an account specified by the Holder thereof in a writing delivered to the Registrar.

Remarketing Agents; Tender Agent. UBS Securities LLC has been appointed Remarketing Agent for the Series 2007A-6 Bonds and the Series 2007A-7 Bonds, and Wachovia Bank, National Association has been appointed Remarketing Agent for the Series 2007A-8 Bonds and the Series 2007A-9 Bonds. Banco Popular de Puerto Rico will serve as Tender Agent for the Variable Rate Bonds. All determinations of interest rates for the Variable Rate Bonds shall be conclusive and binding upon the Commonwealth, the Registrar, the Tender Agent, the applicable Remarketing Agent, the applicable Provider and the Bondholders, as applicable. At the direction of the Commonwealth, a subseries of Variable Rate Bonds may be converted, in whole, from one Interest Rate Period to another Interest Rate Period.

Daily Interest Rate and Daily Interest Rate Period. During each Daily Interest Rate Period, the Variable Rate Bonds or any subseries of Variable Rate Bonds shall bear interest at the Daily Interest Rate, which shall be determined by the applicable Remarketing Agent on each Business Day for such Business Day.

The Daily Interest Rate shall be the rate of interest per annum determined by the applicable Remarketing Agent (based on an examination of tax-exempt obligations comparable, in the judgment of the Remarketing Agent, to the Variable Rate Bonds and known by such Remarketing Agent to have been priced or traded under then-prevailing market conditions) on or before 10:30 a.m., New York City time, on a Business Day to be the minimum interest rate which, if borne by such Bonds, would enable such Remarketing Agent to sell all of such Bonds on such Business Day at a price (without regard to accrued interest) equal to the principal amount thereof. The Daily Interest Rate for any day which is not a Business Day shall be the same as the Daily Interest Rate for the immediately preceding Business Day. If for any reason a Daily Interest Rate for the Variable Rate Bonds or any subseries of the Variable Rate Bonds is not so established for any Business Day by the applicable Remarketing Agent, the Daily Interest Rate for such Business Day shall be equal to the Index.

Weekly Interest Rate and Weekly Interest Rate Period. During each Weekly Interest Rate Period, the Variable Rate Bonds or any subseries of the Variable Rate Bonds shall bear interest at the Weekly Interest Rate, which shall be determined by the applicable Remarketing Agent by 5:00 p.m., New York City time, on Wednesday of each week during the Weekly Interest Rate Period, or if such day is not a Business Day, then on the next succeeding Business Day. The first Weekly Interest Rate for each Weekly Interest Rate Period shall be determined on or prior to the first day of such Weekly Interest Rate Period and shall apply to the period commencing on the first day of such Weekly Interest Rate Period and ending on and including the next succeeding Wednesday. Thereafter, each Weekly Interest Rate shall apply to the period commencing on and including Thursday and ending on and including the next succeeding Wednesday, unless such Weekly Interest Rate Period ends on a day other than Wednesday, in which event the last Weekly Interest Rate for such Weekly Interest Rate Period shall apply to the period commencing on and including the Thursday preceding the last day of such Weekly Interest Rate Period and ending on and including the last day of such Weekly Interest Rate Period.

Each Weekly Interest Rate with respect to the Variable Rate Bonds shall be the rate of interest per annum determined by the applicable Remarketing Agent (based on an examination of tax-exempt obligations comparable, in the judgment of the Remarketing Agent, to the Variable Rate Bonds and known by them to have been priced or traded under then-prevailing market conditions) to be the minimum interest rate which, if borne by such Variable Rate Bonds, would enable such Remarketing Agent to sell all of such Variable Rate Bonds on the effective date of that rate at a price (without regard to accrued interest) equal to the principal amount thereof.

If the Remarketing Agent fails to establish a Weekly Interest Rate for any week with respect to the applicable Variable Rate Bonds bearing interest at such rate, then the Weekly Interest Rate for such week with respect to such Variable Rate Bonds shall be equal to the Index. The Registrar shall give notice by first-class mail of a Conversion to a Weekly Interest Rate Period to the Holders of the Variable Rate Bonds or any subseries of Variable Rate Bonds not less than 30 days prior to the proposed effective date of such Weekly Interest Rate Period, in accordance with requirements under the Bond Resolution.

Conversion Provisions

If the Secretary elects to convert the interest rate of a subseries of Variable Rate Bonds, the written direction furnished by the Secretary to the Registrar, the Tender Agent, the applicable Provider and applicable Remarketing Agent, as required shall be made by registered or certified mail, or by telecopy confirmed by registered or certified mail. In connection with any Conversion of the Interest Rate Period for any subseries of Variable Rate Bonds, the Secretary shall have the right to deliver to the Registrar, the Tender Agent, the applicable Remarketing Agent and the applicable Provider on or prior to 11:00 a.m., New York City time, on the second Business Day preceding the effective date of any such Conversion a notice to the effect that the Secretary elects to rescind its election to make such Conversion. If such election to convert is rescinded, then the applicable subseries shall bear interest at a Weekly Interest Rate commencing on the date which would have been the effective date of the Conversion, but if such subseries were in a Daily Interest Rate Period immediately prior to such proposed Conversion, then the Variable Rate Bonds of such subseries shall continue to bear interest at the Daily Interest Rate as in effect immediately prior to such proposed Conversion. In any event, if notice of a Conversion has been mailed to the Holders of such Bonds and the Secretary rescinds its election to make such Conversion, then the Variable Rate Bonds of such subseries shall continue to be subject to mandatory tender for purchase on the date which would have been the effective date of the Conversion.

No Conversion from one Interest Rate Period to another shall take effect unless each of the following conditions, to the extent applicable, shall have first been satisfied:

(1) With respect to the new Interest Rate Period, there shall be in effect a Liquidity Facility if and as required under the Bond Resolution.

(2) The Registrar shall have received a Favorable Opinion of Bond Counsel with respect to such Conversion dated the effective date of such Conversion.

(3) In the case of any Conversion with respect to which there shall be no Liquidity Facility in effect to provide funds for the purchase of Variable Rate Bonds or any subseries of Variable Rate Bonds on the Conversion Date, the remarketing proceeds available on the Conversion Date shall not be less than the amount required to purchase all of the Variable Rate Bonds or any subseries of Variable Rate Bonds at the Tender Price (not including any premium).

(4) In the case of a Conversion from any Weekly Interest Rate Period or Daily Interest Rate Period to an ARS Rate Period, prior to the Conversion Date the Secretary shall have appointed an Auction Agent, and one or more Broker-Dealers and there shall have been executed and delivered an Auction Agreement and one or more Broker-Dealer Agreements.

(5) In the case of a Conversion to any Indexed Put Interest Rate Period, prior to the Conversion Date, the Secretary shall have appointed a Tender Agent and a Remarketing Agent.

In the case of failure to meet these conditions: (1) the Variable Rate Bonds or any subseries of Variable Rate Bonds shall bear interest at a Weekly Interest Rate commencing on the date which would have been the effective date of the Conversion, unless they were Auction Rate Securities right before the proposed conversion in which case they will remain as Auction Rate Securities and shall bear interest and be in an Auction Period as provided in the Bond Resolution; and (2) the Variable Rate Bonds or any subseries of Variable Rate Bonds shall continue to be subject to mandatory tender for purchase on the date which would have been the effective date of the Conversion.

Purchase of Variable Rate Bonds

During Daily Interest Rate Period. Any Variable Rate Bond (other than a Bank Bond) bearing interest at a Daily Interest Rate shall be purchased in an Authorized Denomination from its Bondholder at the option of the Bondholder on any Business Day at a purchase price equal to the Tender Price, payable in immediately available funds, upon delivery to the Tender Agent at its principal office for delivery of applicable Variable Rate Bonds, to the Registrar at its corporate trust office and to the Remarketing Agent, by no later than 10:00 a.m., New York City time, on such Business Day, of an irrevocable notice by Electronic Means, which states the principal amount of such Bonds to be purchased and the date of purchase. For payment of such purchase price on the date specified in such notice, such Bonds must be delivered, at or prior to 12:00 noon, New York City time, on such Business Day, to the Tender Agent at its principal office for delivery of applicable Variable Rate Bonds, accompanied by an instrument of transfer thereof, in form satisfactory to such Tender Agent, executed in blank by the Bondholder thereof or its duly-authorized attorney, with such signature guaranteed by a commercial bank, trust company or member firm of the New York Stock Exchange.

During any Daily Interest Rate Period for which the book-entry-only system (see "Book-Entry Only System" herein) is in effect, any Bonds bearing interest at the Daily Interest Rate or portion thereof in an Authorized Denomination shall be purchased on the date specified in the notice referred to below at the Tender Price. The irrevocable notice by Electronic Means by the Participant shall be delivered on any Business Day by the Participant for such Bonds to the Tender Agent at its principal office for the delivery of such Bonds, to the Registrar at its corporate trust office and to the Remarketing Agent prior to 10:00 a.m., New York City time. That notice shall state the principal amount of such Bonds or portion thereof to be purchased and the date on which the same shall be purchased. Upon confirmation by the Securities Depository to the Registrar that such Participant has an ownership interest in the applicable Variable Rate Bonds at least equal to the amount of Variable Rate Bonds specified in such irrevocable written notice, payment of the Tender Price of such Bonds shall be made by 4:00 p.m., New York City time, or as soon as practicably possible thereafter, upon the receipt by the Registrar of the Tender Price on the Business Day specified in the notice upon the transfer on the registration books of the Securities Depository of the beneficial ownership interest in such Bonds tendered for purchase to the account of the Tender Agent, or a Participant acting on behalf of such Tender Agent, at or prior to 2:30 p.m., New York City time, on the date specified in such notice.

During Weekly Interest Rate Period. Any Variable Rate Bond (other than a Bank Bond) bearing interest at a Weekly Interest Rate shall be purchased in Authorized Denominations from its Bondholder at the option of the Bondholder on any Business Day at a purchase price equal to the Tender Price, payable in immediately available funds, upon delivery to the Tender Agent at its principal office for delivery of the Variable Rate Bonds, to the Registrar at its corporate trust office and to the applicable Remarketing Agent of an irrevocable notice by Electronic Means which states the principal amount of such Bonds, the principal amount thereof to be purchased and the date on which the same shall be purchased, which date shall be a Business Day not prior to the seventh day after the date of the delivery of such notice to the Tender Agent. Any notice delivered to the Tender Agent after 5:00 p.m., New York City time, shall be deemed to have been received on the next succeeding Business Day. Bank Bonds may not be tendered for purchase at the option of the Holder thereof. For payment of the Tender Price on the Tender Date, such Bonds must be delivered at or prior to 11:00 a.m., New York City time, on the Tender Date to the Tender Agent at its principal office for delivery of the applicable Variable Rate Bonds accompanied by an instrument of transfer, in form satisfactory to the Tender Agent executed in blank by the Bondholder or its duly-authorized attorney, with such signature guaranteed by a commercial bank, trust company, or member firm of the New York Stock Exchange.

During any Weekly Interest Rate Period for which the book-entry-only system (see "Book-Entry Only System" herein) is in effect, any Variable Rate Bonds bearing interest at the Weekly Interest Rate or portion thereof in an Authorized Denomination shall be purchased on the date specified in the notice referred to below at the Tender Price. The irrevocable notice by Electronic Means by the Participant shall be delivered on any Business Day by the Participant for such Bonds to the Tender Agent at its principal office for the delivery of such Bonds, to the

Registrar at its corporate trust office and to the applicable Remarketing Agent. That notice shall state the principal amount of such Bonds or portion thereof to be purchased and the date on which the same shall be purchased, which date shall be a Business Day at least seven days after the date of delivery of such notice to the Registrar. Upon confirmation by the Securities Depository to the Registrar that such Participant has an ownership interest in the applicable Variable Rate Bonds at least equal to the amount of Variable Rate Bonds specified in such irrevocable written notice, payment of the Tender Price of such Bonds shall be made by 4:00 p.m., New York City time, or as soon as practicably possible thereafter, upon the receipt by the Registrar of the Tender Price on the Business Day specified in the notice upon the transfer on the registration books of the Securities Depository of the beneficial ownership interest in such Bonds tendered for purchase to the account of the Tender Agent, or a Participant acting on behalf of such Tender Agent, at or prior to 11:00 a.m., New York City time, on the date specified in such notice.

Mandatory Tender for Purchase on First Day of Each Interest Rate Period. The applicable Variable Rate Bonds shall be subject to mandatory tender for purchase on the first day of each Interest Rate Period at the Tender Price, payable in immediately available funds. For payment of the Tender Price on the Tender Date, Variable Rate Bonds must be delivered at or prior to 11:00 a.m., New York City time, on the Tender Date. If delivered after that time, the Tender Price shall be paid on the next succeeding Business Day.

Mandatory Tender for Purchase upon Termination, Replacement or Expiration of Letter of Credit (or alternate liquidity/credit facility); Mandatory Standby Tender. If at any time the Registrar gives notice that the Tender Price on applicable Variable Rate Bonds tendered for purchase shall cease to be subject to purchase pursuant to any of the Letters of Credit or any alternate liquidity/credit facility then in effect with respect to said Bonds as a result of (i) the termination, replacement or expiration of the term, as extended, of such Letter of Credit or any alternate liquidity/credit facility, including but not limited to termination at the option of the Secretary in accordance with the terms of such Letter of Credit or any alternate liquidity/credit facility then in effect, or (ii) the occurrence of a Mandatory Standby Tender (as hereinafter defined), then each such Variable Rate Bond shall be purchased or deemed purchased at the Tender Price. Any purchase of such Variable Rate Bonds pursuant to the foregoing events shall occur: (1) on the fifth Business Day preceding any such termination, replacement or expiration of such Letter of Credit or any alternate liquidity/credit facility then in effect without replacement by an alternate liquidity/credit facility or upon any termination thereof as a result of a Mandatory Standby Tender, and (2) on the date of the replacement of such Letter of Credit or any alternate liquidity/credit facility then in effect, in any case where an alternate liquidity/credit facility has been delivered to the Tender Agent. In the case of any replacement, the existing Letter of Credit or existing alternate liquidity/credit facility will be drawn to pay the Tender Price, if necessary, rather than the replacement alternate liquidity/credit facility. No such mandatory tender will be effected upon the replacement of a Letter of Credit or an alternate liquidity/credit facility in the case where such Letter of Credit or alternate liquidity/credit facility is failing to honor conforming draws. "Mandatory Standby Tender" means the mandatory tender of the applicable Variable Rate Bonds upon receipt by the Registrar of written notice from the applicable Provider or the applicable alternate liquidity/credit provider that an event with respect to its Letter of Credit or its alternate liquidity/credit facility, as applicable, has occurred which gives such provider or the applicable alternate liquidity/credit provider the option to terminate its Letter of Credit or its alternate liquidity/credit facility, as applicable, upon notice.

If at any time the Registrar receives notice that a substitute letter of credit or liquidity facility will be delivered, then each applicable Variable Rate Bond shall be purchased or deemed purchased at the Tender Price. Any purchase of such Bond shall occur on the Business Day preceding the delivery of a substitute letter of credit or liquidity facility.

The Variable Rate Bonds are subject to mandatory tender for purchase by the applicable Provider on the date specified by such Provider which date shall be a Business Day not later than the next Interest Payment Date succeeding the date the Registrar receives the notice mentioned below (not later than the tenth day following receipt of such notice in the case of a failure of the Provider to reinstate the Letter of Credit or any alternate liquidity/credit facility with respect to interest) and not earlier than one Business Day following receipt of such notice by the Registrar from the Provider in writing by hand delivery, certified mail or Electronic Means, that an event of default under the applicable Reimbursement Agreement has occurred and is continuing, at a purchase price equal to 100% of the outstanding principal amount thereof, plus accrued interest, if any, to such Date.

Payment of the Tender Price of any such Bonds shall be made in immediately available funds by 4:00 p.m., New York City time, on the Tender Date upon delivery of such Bonds to the Tender Agent at its principal office for delivery of applicable Variable Rate Bonds, accompanied by an instrument of transfer, in form satisfactory to the Tender Agent, executed in blank by the Bondholder with the signature of such Bondholder guaranteed by a commercial bank, trust company or member firm of the New York Stock Exchange, at or prior to 12:00 noon, New York City time, on the Tender Date. If subsequent to any such mandatory tender, Variable Rate Bonds are no longer subject to purchase pursuant to such Letter of Credit or alternate liquidity/credit facility, the Tender Agent (upon receipt from the Holder thereof in exchange for payment of the Tender Price thereof) shall present such Bonds to the Registrar for notation of such fact thereon.

Notice. In connection with any mandatory tender for purchase of applicable Variable Rate Bonds, the Registrar shall give the notice in accordance with the Bond Resolution. Such notice shall state (i) in the case of a mandatory tender for purchase on the first day of each Interest Rate Period, the type of Interest Rate Period to commence on such mandatory purchase date; (ii) in the case of a mandatory tender for purchase upon termination, replacement or expiration of a Letter of Credit or any alternate liquidity/credit facility, on a Mandatory Standby Tender, that the applicable Letter of Credit or alternate liquidity/credit facility will expire, terminate or be replaced and that the applicable Variable Rate Bonds will no longer be payable from that Letter of Credit or alternate liquidity/credit facility and that any rating applicable to such Bonds may be reduced or withdrawn; (iii) that the Tender Price of any Variable Rate Bonds subject to mandatory tender for purchase shall be payable only upon surrender of that Variable Rate Bond or Bonds to the Tender Agent at its principal office for delivery of applicable Variable Rate Bonds, accompanied by an instrument of transfer, in form satisfactory to the Tender Agent, executed in blank by the Bondholder or its duly-authorized attorney, with such signature guaranteed by a commercial bank, trust company or member firm of the New York Stock Exchange; (iv) that, provided that moneys sufficient to effect such purchase shall have been provided through the remarketing of such Bonds by the applicable Remarketing Agent, through said Letter of Credit or alternate liquidity/credit facility or funds provided by the Commonwealth, all Variable Rate Bonds subject to mandatory tender for purchase shall be purchased on the mandatory Tender Date; and (v) that if any Holder of a Variable Rate Bond subject to mandatory tender for purchase does not surrender that Bond to the Tender Agent for purchase on the mandatory Tender Date, then that Bond shall be deemed to be an Undelivered Bond, no interest shall accrue on that Bond on and after the mandatory Tender Date and such Holder shall have no rights under the Bond Resolution other than to receive payment of the Tender Price.

Payment of Tender Price by Secretary. If all or a portion of the applicable Variable Rate Bonds tendered for purchase cannot be remarketed and are not purchased under the applicable Letter of Credit or alternate liquidity/credit facility then in effect on a Tender Date, the Secretary may at its option, but shall not be obligated to, pay to the Tender Agent as soon as practicable on a Tender Date immediately available funds (together with any remarketing proceeds and any funds provided under said Letter of Credit or alternate liquidity/credit facility then in effect) sufficient to pay the Tender Price on the Variable Rate Bonds tendered for purchase. The Tender Agent shall deposit the amount paid by the Secretary, if any, in the Commonwealth Purchase Account of the Bond Purchase Fund pending application of the money to the payment of the Tender Price.

Tender Process and Sales of Variable Rate Bonds by Remarketing Agent

The below provisions apply to each subseries of Variable Rate Bonds to which the particular Remarketing Agent is serving as such.

The Remarketing Agent is Paid by the Commonwealth. The Remarketing Agent's responsibilities include determining the interest rate from time to time and remarketing Variable Rate Bonds that are optionally or mandatorily tendered to it by the beneficial owners thereof (subject, in each case, to the terms of the Remarketing Agreement and the Bond Resolution). The Remarketing Agent is appointed by the Commonwealth and is paid by the Commonwealth for its services. As a result, the interests of the Remarketing Agent may differ from those of beneficial owners and potential purchasers of Variable Rate Bonds.

Determination of Interest Rates by the Remarketing Agent. The Remarketing Agent is required to determine the interest rate that will be effective with respect to Variable Rate Bonds on the dates specified in the Bond Resolution. That rate is required by the Bond Resolution to be the minimum interest rate which, if borne by such Variable Rate Bonds, would enable the Remarketing Agent to sell all of such Variable Rate Bonds on the effective date of that rate at a price (without regard to accrued interest) equal to the principal amount thereof.

Tenders to the Tender Agent. Beneficial owners of Variable Rate Bonds may elect to tender their bonds for purchase by the Tender Agent upon not less than the required advance notice as described while the Variable Rate Bonds are in book entry form through its Participant by causing the Participant to transfer its interest in the Variable Rate Bonds for such owner, on DTC’s records, to the Tender Agent. Tendering Bondholders will receive par, plus accrued interest, if any on the purchase date specified either by said beneficial owner or, in the case of mandatory tender, by the terms of the Bond Resolution. Tendering Bondholders will be paid from the proceeds of the remarketing of the Variable Rate Bonds and, to the extent those proceeds are insufficient, from the proceeds of draws on the Letter of Credit or any alternate liquidity/credit facility then in effect by the Tender Agent.

The Remarketing Agent Routinely Purchases Variable Rate Bonds for its Own Account. The Remarketing Agent acts as remarketing agent for a variety of variable rate demand obligations issued by many issuers and, in its sole discretion, routinely purchases such obligations for its own account. The Remarketing Agent is permitted, but not obligated, to purchase tendered Variable Rate Bonds for its own account and, in its sole discretion, may acquire such tendered Variable Rate Bonds in order to achieve a successful remarketing of the Variable Rate Bonds (*i.e*., because there otherwise are not enough buyers to purchase the Variable Rate Bonds) or for other reasons. The Remarketing Agent is not obligated, however, to purchase Variable Rate Bonds, and may cease doing so at any time without notice, in which case it may be necessary for the Tender Agent to draw on the Letter of Credit or any liquidity/credit facility then in effect to pay tendering Bondholders.

The Remarketing Agent may also make a secondary market in the Variable Rate Bonds by purchasing and selling Variable Rate Bonds other than in connection with an optional or mandatory tender and remarketing. Such purchases and sales must be at fair market value, which may be at, above, or below par. No notice period is required for such purchases. The Remarketing Agent is not required, however, to make a secondary market in the Variable Rate Bonds. Thus, investors who purchase the Variable Rate Bonds, whether in a remarketing or otherwise, should not assume that they will be able to sell their Variable Rate Bonds other than by tendering the Variable Rate Bonds in accordance with the tender process.

The Remarketing Agent may also sell any Variable Rate Bonds it has purchased to one or more affiliated investment vehicles for collective ownership or enter into derivative arrangements with affiliates or others in order to reduce its exposure to the Variable Rate Bonds. The purchase of Variable Rate Bonds by the Remarketing Agent may create the appearance that there is greater third party demand for the Variable Rate Bonds in the market than is actually the case. The practices described above also may result in fewer Bonds being tendered in a remarketing.

Variable Rate Bonds May be Offered at Prices Other Than Par. Pursuant to the Remarketing Agreement, the Remarketing Agent is required to determine the interest rate that will be effective with respect to the Variable Rate Bonds. That rate is required by the Bond Resolution to be the minimum interest rate which, if borne by such Variable Rate Bonds, would enable the Remarketing Agent to sell all of such Variable Rate Bonds on the effective date of that rate at a price (without regard to accrued interest) equal to the principal amount thereof. The interest rate will reflect, among other factors, the level of market demand for the Variable Rate Bonds (including whether the Remarketing Agent is willing to purchase Variable Rate Bonds for its own account). The Remarketing Agent is not obligated to advise purchasers in a remarketing if it does not have third-party buyers for all of the Variable Rate Bonds at the remarketing price. If the Remarketing Agent owns Variable Rate Bonds for its own account, in its sole discretion, it may sell those Variable Rate Bonds at fair market value, which may be at prices above or below par only on days other than the date of determination of an interest rate or the effective date of such interest rate after the interest rate for the succeeding interest rate effective date has been set or, in the case of Variable Rate Bonds bearing interest at a Daily Interest Rate, after 11 a.m. on the effective date of the Daily Interest Rate. The Remarketing Agent may not agree in advance of the Effective Date to sell Variable Rate Bonds to a customer at a price below par.

Under Certain Circumstances, the Remarketing Agent May Be Removed, Resign or Cease Remarketing the Variable Rate Bonds, Without a Successor Being Named. Under certain circumstances the Remarketing Agent may be removed or have the ability to resign or cease its remarketing efforts, without a successor having been named, subject to the terms of the Remarketing Agreement. In the event there is no Remarketing Agent, Bondholders will be required to tender their Variable Rate Bonds to the Tender Agent. In that event, the Variable Rate Bonds will bear interest at the rate set in accordance with the Index, remarketings of the Variable Rate Bonds will cease until a successor remarketing agent has been appointed, and tendering Bondholders will be paid from draws on the Letter of Credit or any alternate liquidity/credit facility then in effect.

Letters of Credit and Reimbursement Agreements

General. The Commonwealth has initially arranged for the Providers to provide separate Letters of Credit under separate Reimbursement Agreements (one for each subseries of Variable Rate Bonds) by and between the Provider and the Commonwealth. Each of the Reimbursement Agreements and Letters of Credit is substantially similar. Accordingly, the majority of the discussion below is generic and applies equally to each subseries of Variable Rate Bonds. Investors are urged to obtain and review the Reimbursement Agreement and the Letter of Credit applicable to the related subseries of Variable Rate Bonds for a more detailed description of the provisions thereof.

Letters of Credit. Each Letter of Credit will be issued in an amount equal to the aggregate outstanding principal amount of the applicable subseries of Variable Rate Bonds, plus 52 days' of interest (calculated at a rate of 12% per annum). The Tender Agent, upon compliance with the terms of the applicable Letter of Credit and the Bond Resolution, is authorized and directed to draw upon the Letter of Credit to make payment with respect to the principal of and interest on, or Tender Price of, the Variable Rate Bonds.

The amount available under the applicable Letter of Credit will be reduced automatically by the amount of any drawing thereunder, subject to reinstatement as described below. With respect to a drawing by the Tender Agent solely to pay interest on the Variable Rate Bonds on an interest payment date, the amount available under each applicable Letter or Credit will be automatically reinstated on the fifth calendar day following such drawing if the Tender Agent has not received notice to the contrary from the Provider under the Reimbursement Agreement and, as a result thereof, the amount of such drawing shall not be reinstated and the Provider shall direct the Tender Agent to cause a mandatory tender of the Variable Rate Bonds pursuant to the Bond Resolution. After payment by the Provider of a Liquidity Drawing (as defined in the Reimbursement Agreement), the amount available to be drawn under the applicable Letter of Credit will be automatically reduced by the amount specified in such Liquidity Drawing. In addition, prior to a subsequent Conversion Date (as defined in the Reimbursement Agreement), in the event of the remarketing of the Variable Rate Bonds (or portions thereof) previously purchased with the proceeds of a Liquidity Drawing, the amount available to be drawn under the

Letter of Credit will be automatically reinstated concurrently and when and to the extent, but only when and to the extent, that the Provider is reimbursed for any amount drawn pursuant to such Liquidity Drawing.

Each Letter of Credit will terminate on the earliest of the Provider's close of business on (a) the stated expiration date (May 12, 2010, with respect to the Series 2007A-6 Bonds, May 8, 2010, with respect to the Series 2007A-7 Bonds, May 7, 2011, with respect to the Series 2007A-8 Bonds, and May 6, 2011, with respect to the Series 2007A-9 Bonds, unless renewed or extended); (b) the earlier of (i) the date which is five (5) days following the Conversion Date of all of the corresponding Variable Rate Bonds as specified in a notice from the Tender Agent to the Provider or (ii) the date on which the Provider honors a drawing under such Letter of Credit on or after such Conversion Date; (c) the date which is fifteen (15) days following the Provider's receipt of written notice from the Tender Agent that all Variable Rate Bonds covered by the Letter of Credit have been paid or that another facility has been issued in substitution for the Letter of Credit in accordance with the terms of the Bond Resolution and the Reimbursement Agreement; (d) the date which is fifteen (15) days following the date the Tender Agent receives a written notice from the Provider specifying the occurrence of an event of default under the Reimbursement Agreement and directing the Tender Agent to cause a mandatory tender of the Variable Rate Bonds.

Reimbursement Agreements. "Events of Default" under the initial Reimbursement Agreements include the following:

(a) default in the payment when due of (i) any payments required to be made by the Commonwealth for reimbursement to the Provider of any drawings, (ii) any principal or interest with respect to any Bank Bonds (as defined in the Reimbursement Agreement) or any Liquidity Advance (as defined in the Reimbursement Agreement) or (iii) any other amount owing by the Commonwealth under the Reimbursement Agreement and such default continues for a period of ten (10) Business Days; or

(b) (i) the Commonwealth defaults in the performance or observance of any term, covenant, condition or agreement on its part to be performed or observed under certain sections of the Reimbursement Agreement or (ii) the Commonwealth defaults in the performance or observance of any other term, covenant, other condition or agreement on its part to be performed or observed and such other default continues unremedied for thirty (30) days after written notice thereof shall have been given to the Commonwealth by the Provider; or

(c) any of the Commonwealth's representations or warranties made in the Reimbursement Agreement or in any statement or certificate at any time made or deemed made by or on behalf of the Commonwealth pursuant to the Reimbursement Agreement or in connection with the Reimbursement Agreement, and/or in any of the Related Documents (as defined in the Reimbursement Agreement) is false or misleading in any material respect when made or deemed made; or

(d) (i) the Commonwealth commences any case, proceeding or other action under any existing or future law of any jurisdiction, domestic or foreign, (A) relating to bankruptcy, insolvency, reorganization or relief of debtors, seeking to have an order for relief entered with respect to it, or seeking to adjudicate it a bankrupt or insolvent, or seeking reorganization, arrangement, adjustment, winding-up, liquidation, dissolution, composition or other relief with respect to it or its debts, (B) seeking appointment of a receiver, trustee, custodian or other similar official for it or for all or any substantial part of its assets, or the Commonwealth shall make a general assignment for the benefit of its creditors; or

(ii) there is commenced against the Commonwealth any case, proceeding or other action of a nature referred to in clause (i) above which (A) results in an order for such relief or in the appointment of a receiver or similar official or (B) remains undismissed, undischarged or unbonded for a period of sixty (60) days; or

(iii) there is commenced against the Commonwealth any case, proceeding or other action seeking issuance of a warrant of attachment, execution, distraint or similar process against all or any substantial part of its assets, which results in the entry of an order for any such relief which shall not have been vacated, discharged, or stayed or bonded pending appeal within sixty (60) days from the entry thereof; or

(iv) the Commonwealth takes any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the acts set forth in clause (i), (ii) or (iii) above; or

(v) the Commonwealth shall generally not, or shall be unable to, or shall admit in writing its inability to, pay its debts; or

(vi) the Commonwealth or any other Governmental Authority (as defined in the Reimbursement Agreement) having jurisdiction over the Commonwealth imposes a debt moratorium, debt restructuring, or comparable restriction on the repayment when due and payable of the principal of or interest on any General Obligation Debt (as defined in the Reimbursement Agreement) of the Commonwealth; or

(e) the occurrence of any "event of default" on the part of the Commonwealth under any of the Related Documents to which it is a party shall have occurred and be continuing; or

(f) one or more judgments or orders for the payment of money in an aggregate amount in excess of $10,000,000 payable from the general fund of the Commonwealth shall be rendered against the Commonwealth and such judgments or orders shall remain undischarged or unstayed for a period of thirty (30) days, or any action shall be taken by a judgment creditor to levy upon assets or properties of the Commonwealth to enforce any such judgment or order; or

(g) any material provision of the Reimbursement Agreement or any other Related Document to which the Commonwealth is a party shall at any time for any reason cease to be valid and binding on the Commonwealth, or shall be declared to be null and void, or the validity or enforceability thereof shall be contested by the Commonwealth, or a proceeding shall be commenced by any governmental agency or authority having jurisdiction over the Commonwealth seeking to establish the invalidity or unenforceability thereof, or the Commonwealth shall deny that it has any or further liability or obligation under the Reimbursement Agreement or any other Related Document to which it is a party; or

(h) the Commonwealth shall fail to pay when due and payable any General Obligation Debt in excess of $10,000,000 and such failure shall continue beyond any applicable period of grace specified in any underlying resolution, indenture, contract or instrument providing for the creation of or concerning such General Obligation Debt, or pursuant to the provisions of any such resolution, indenture, contract or instrument, the maturity of any such General Obligation Debt, as a result of the occurrence of a default in the payment of principal or interest by the Commonwealth on any General Obligation Debt, may be accelerated, or may be required to be prepaid prior to the stated maturity thereof; or

(i) the long-term rating assigned by S&P or Moody's to any of the Commonwealth's General Obligation Debt (without taking into account third party credit enhancement) is withdrawn, suspended or reduced below BBB- (or its equivalent rating) by S&P or Baa3 (or its equivalent rating) by Moody's.

Upon the occurrence and during the continuance of any Event of Default, the Provider at its option, may, upon notice to the Tender Agent and the Commonwealth, do any one or more of the following:

(a) require, in accordance with the Bond Resolution, the Tender Agent to give notice of a Mandatory Standby Tender of the applicable Variable Rate Bonds and to purchase all such Variable Rate Bonds on the applicable tender date at a price equal to the principal amount thereof and interest accrued with respect thereto (each, a "Mandatory Tender Date") and to register such Variable Rate Bonds in the name or at the direction of the Provider, thereby causing the Letter of Credit to expire 15 days thereafter; or

(b) declare all other amounts payable to the Provider by the Commonwealth under the applicable Reimbursement Agreement immediately due and payable on the applicable Mandatory Tender Date, whereupon the same shall be immediately due and payable on such Mandatory Tender Date; or

(c) exercise any or all rights provided or permitted by law or granted pursuant to any of the Related Documents in such order and in such manner as the Provider may, in its sole judgment, determine.

Providers

UBS AG, Stamford Branch

UBS AG ("UBS") is a financial services firm incorporated and domiciled in Switzerland and operating under Swiss Company law and Swiss Federal Banking Law. Its two registered offices are located in Zurich and Basel, Switzerland. UBS will provide its credit and/or liquidity facilities through its Stamford branch, which is licensed as a branch by the Connecticut Banking Department and is subject to examination and regulation by Federal and Connecticut state banking authorities.

Moody's currently rates UBS's long-term senior unsecured debt as "Aa1" and short-term commercial paper as "P-1". S&P rates UBS's long-term local issuer credit as "AA-" and its short-term local issuer credits as "A-1+". Fitch rates UBS's long-term senior unsecured debt as

"AA-" and short-term debt as "F-1+". Further information with respect to such ratings may be obtained from Moody's, S&P and Fitch, respectively. No assurances can be given that the current ratings of the bank's instruments will be maintained.

UBS had total assets of 2,272,579 million Swiss francs and shareholders' equity of 35,585 million Swiss francs as of December 31, 2007.

UBS files periodic reports with the Securities Exchange Commission (SEC). Additional information, including the most recent Annual Report on Form 20-F for the year ended December 31, 2007 and reports filed on Form 6-K, can be easily obtained from the SEC website (www.sec.gov)

Wachovia Bank, National Association

Wachovia Bank, National Association (referred to in this section as the "Bank") is a subsidiary of Wachovia Corporation (the "Corporation"), whose principal office is located in Charlotte, North Carolina. The Corporation is the fourth largest bank holding company in the United States based on approximately $783 billion in total assets as of December 31, 2007.

The Bank is a national banking association with its principal office in Charlotte, North Carolina and is subject to examination and primary regulation by the Office of the Comptroller of the Currency of the United States. The Bank is a commercial bank offering a wide range of banking, trust and other services to its customers. As of December 31, 2007, the Bank had total assets of approximately $653 billion, total net loans of approximately $397 billion, and total deposits of approximately $458 billion and equity capital of approximately $72 billion.

The Bank submits quarterly to the Federal Deposit Insurance Corporation (the "FDIC") a "Consolidated Report of Condition and Income for a Bank with Domestic and Foreign Offices" (each, a "Call Report", and collectively, the "Call Reports"). The publicly available portions of the Call Reports with respect to the Bank (and its predecessor banks) are on file with the FDIC, and copies of such portions of the Call Reports may be obtained from the FDIC, Division of Insurance and Records, 550 17th Street, NW, Washington, DC 20429-9990, (800) 688-3342, at prescribed rates. In addition, such portions of the Call Reports are available to the public free of charge at the FDIC's web site at http://www.fdic.gov.

The Corporation is subject to the information requirements of the Securities Exchange Act of 1934, as amended, and in accordance therewith files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (the "Commission"). Such documents can be read and copied at the Commission's public reference room in Washington, D.C. Please call the Commission at 1-800-SEC-0330 for further information on the public reference rooms. In addition, such documents are available to the public free of charge at the SEC's web site at http://www.sec.gov. Reports, documents and other information about the Corporation also can be inspected at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York.

Upon request, the Bank will provide at no cost to any person to whom this Official Statement is delivered copies of the most recent Wachovia Corporation Annual Report to Shareholders, the publicly available portion of the most recent Call Report that the Bank has filed with the FDIC and the Corporation's most recent periodic reports under the Securities Exchange Act of 1934 on Form 10-K and Form 10-Q and any Current Report on Form 8-K subsequent to its most recent report on Form 10-K. Copies of these documents may be requested by writing to or telephoning the Bank at the following address and telephone number: Wachovia Corporation, Investor Relations, 301 South College Street, Charlotte, NC 28288-0206, (704) 374-6782.

The information contained under this heading relates to and has been obtained from the Bank. 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 regarding the Bank is qualified in its entirety by the detailed information appearing in the documents referenced above.

The delivery hereof 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 in this section is correct as of any time subsequent to its date.

THE LETTER OF CREDIT IS AN OBLIGATION OF THE BANK AND IS NOT AN OBLIGATION OF THE CORPORATION. NO BANKING OR OTHER AFFILIATE CONTROLLED BY THE CORPORATION, EXCEPT THE BANK, IS OBLIGATED TO MAKE PAYMENTS UNDER THE LETTER OF CREDIT.

Book-Entry Only System

The following information concerning DTC and DTC's book-entry system has been obtained from DTC. The Commonwealth does not take any responsibility for the accuracy thereof.

DTC will act as securities depository for the Variable Rate Bonds. The Variable Rate Bonds were initially issued and will be remarketed as fully registered bonds registered in the name of Cede & Co. (DTC's partnership nominee) or such other nominee as may be requested by an authorized representative of DTC. One fully registered bond will be issued for each maturity (and within a maturity, each subseries) of the Variable Rate Bonds, each in the aggregate principal amount of such maturity, 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 2.2 million issues of U.S. and non-U.S. equity, corporate and municipal debt, and money market instruments from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, FICC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has the highest rating issued by S&P: "AAA". The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of the Variable Rate Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Variable Rate Bonds on DTC's records. The ownership interest of each actual purchaser of a Variable Rate Bond ("Beneficial Owner") will in turn be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchases. Beneficial Owners are, however, expected to receive written confirmations providing details of their transactions, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Variable Rate Bonds 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 the Variable Rate Bonds, except in the event that use of the book-entry system for the Variable Rate Bonds is discontinued.

To facilitate subsequent transfers, all Variable Rate Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co, or such other nominee as may be requested by an authorized representative of DTC. The deposit of Variable Rate Bonds 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 Variable Rate Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Variable Rate Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

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

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

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

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

A Beneficial Owner shall give notice to elect to have its Variable Rate Bonds purchased or tendered, through its Participant, to the Registrar, and shall effect delivery of such Variable Rate Bonds by causing the Direct Participant to transfer the Participant's interest in the Variable Rate Bonds, on DTC's records, to the Registrar. The requirement for physical delivery of Variable Rate Bonds in connection with an optional tender or a mandatory purchase will be deemed satisfied when the ownership rights in the Variable Rate Bonds are transferred by Direct Participants on DTC's records and followed by a book-entry credit of tendered Variable Rate Bonds to the Registrar's DTC account.

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

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

Payments and Transfers

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

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

Discontinuance of the Book-Entry Only System

In the event that the book-entry only system is discontinued, the following provisions will apply: principal of and redemption premium, if any, on the Variable Rate Bonds shall be payable in lawful money of the United States of America at the principal office of the Registrar in San Juan, Puerto Rico. Interest on the Variable Rate Bonds will be payable by check mailed to the respective addresses (shown on the registration books of the Commonwealth maintained by the Registrar) of the registered owners determined, with respect to the Variable Rate Bonds, as of the 15th day of the month preceding the interest payment date and, with respect to the Variable Rate Bonds, as of the record date established pursuant to the Bond Resolution, as shown on the registration books of the Commonwealth maintained by the Registrar. The Variable Rate Bonds offered by virtue of this Remarketing Circular will be remarketed only as registered bonds without coupons in denominations of $100,000 or any multiple $5,000 in excess thereof. The transfer of the Variable Rate Bonds will be registrable and they may be exchanged at the corporate trust office of the Registrar in San Juan, Puerto Rico, upon the payment of any taxes or other governmental charges required to be paid with respect to such transfer or exchange.

Authorization

Section 2 of Article VI of the Constitution of the Commonwealth provides that the power of the Commonwealth to contract and to authorize the contracting of debts shall be exercised as determined by the Legislative Assembly. Pursuant to this power, the Legislative Assembly enacted the Act, which authorizes the Secretary of the Treasury to issue the Variable Rate Bonds pursuant to one or more resolutions adopted by the Secretary of the Treasury and approved by the Governor. In accordance with the Act, the Secretary of the Treasury adopted and the Governor approved the Bond Resolution.

Redemption

Optional Redemption. The Variable Rate Bonds shall be subject to redemption at the option of the Secretary, in whole or in part (and if in part, such order of maturity and subseries as the Secretary shall determine), at a redemption price of 100% of the principal amount thereof at any time.

Mandatory Redemption. The Variable Rate Bonds consisting of the Series 2007A-6 Bonds and the Series 2007A-8 Bonds are subject to redemption to the extent of the respective amortization requirements therefor set forth below (less the amount applied to the purchase of any such Variable Rate Bonds and otherwise subject to adjustment as described below), upon at least 30 days' notice, on July 1, 2032 and July 1, 2033, respectively, and on July 1 in each year thereafter at a redemption price of par plus accrued interest to the dates fixed for redemption:

Amortization Requirements
(due July 1,)

Year	2033 (Series 2007A-6)	2034 (Series 2007A-8)
2032	$23,525,000	
2033	26,475,000*	$32,350,000
2034		17,650,000*

*Maturity

If the amount of such Variable Rate Bonds purchased or redeemed in a fiscal year exceeds the amount of the amortization requirement for such Variable Rate Bonds for such fiscal year, the amortization requirement for such Variable Rate Bonds may be decreased for such subsequent fiscal years and in such amounts aggregating the amount of such excess as the Secretary of the Treasury shall determine.

Notice of Redemption; Effect of Redemption

Any redemption of the Variable Rate Bonds, either in whole or in part, shall be made upon at least a 30-day (15 days, in the case of Indexed Put Bonds) prior notice by mail to DTC or, if the book-entry only system described above has been discontinued, by registered or certified mail, postage prepaid, to all registered owners of the Variable Rate Bonds to be redeemed in the manner and under the terms and conditions provided in the Bond Resolution. On the date designated for redemption, notice having been given as provided in the Bond Resolution and moneys for payment of the principal of and accrued interest on the Variable Rate Bonds or portions thereof so called for redemption being held by the Registrar, interest on the Variable Rate Bonds or portions thereof so called for redemption shall cease to accrue.

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

If less than all of a subseries of Variable Rate Bonds are called for redemption, Bank Bonds of such subseries shall be selected for redemption by the Registrar by such method as it deems proper, before any other Variable Rate Bonds of such subseries shall be selected. All other Bonds of such subseries so called for redemption shall be selected (in Authorized Denominations) by the Registrar by such method as it deems fair and appropriate.

Security

Provision for Payment of Public Debt

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

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

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

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

In 2006, the Commonwealth allocated a portion of the sales tax to service the bonds issued by Sales Tax Financing Corporation to refinance a portion of the Commonwealth's outstanding extra constitutional debt (including the Sales Tax Bonds). The legislation making such allocation provides that the portion so set aside is not "available Commonwealth revenues" for purposes of the above Constitutional provision. No ruling from the Puerto Rico Supreme Court has been solicited as to the validity of such "set aside" vis-a-vis the Constitutional provision referred to above, and the Commonwealth cannot give any assurance that the Puerto

Rico Supreme Court when faced with this issue in a properly briefed and litigated proceeding would agree that such segregated sales tax revenues are "unavailable".

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

Special Fund for the Bonds (General Obligation) Debt Service

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

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

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

Payment Record

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

Debt Limitation

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

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% debt limitation.

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

Act No. 39 of 2005 authorizes the Commonwealth to enter into interest rate exchange agreements with respect to its general obligation bonds, subject to certain conditions, including that the agreements are entered into to reduce certain financial risks associated with issuing variable rate obligations. In August 2006, the Commonwealth issued its $500,000,000 Public Improvement Bonds of 2006, Series A, a portion of which bonds bear interest at a rate that will change periodically based on changes in the United States consumer price index, and in connection with such consumer price index floating rate bonds (said portion, the "2006 CPI Bonds") entered into an interest rate exchange agreement, the effect of which will economically enable the Commonwealth to pay a fixed rate of interest in respect thereof. In October 2007, the Commonwealth issued its $926,570,000 Public Improvement Refunding Bonds, Series 2007A, a portion of which bonds bear interest at a variable rate and, in connection with said bonds (said portion, the "2007 Swap Bonds") entered into an interest rate exchange agreement, the effect of which will economically enable the Commonwealth to pay a fixed rate of interest in respect thereof. Act No. 39 of 2005 allows the Commonwealth to calculate the constitutional debt limit in a manner identical to that utilized in Joint Resolution No. 2104. In addition, the Commonwealth has also executed under the authority granted in Act No. 39 of 2005, interest rate exchange agreements in which the Commonwealth is making payments (1) on $1,698,370,000 notional amount of public improvement bonds based on a short-term interest rate index published by Securities Industry and Financial Markets Association ("SIFMA") and is receiving from its counterparties payments on the same notional amount based on the published three-month London Interbank Offered Rate index (the "basis swap") and (2) on $850,000,000 notional amount of public improvement bonds based on the published short-term SIFMA municipal swap rate and is receiving from its counterparties payments on the same notional amount based on a published index of municipal bonds having a maturity of 10 years (the "constant maturity swap").

After giving effect to the issuance of the Series 2008 A Bonds, the Series 2008 B Bonds and the Series 2008 C Bonds, and the refunding of certain public improvement and public improvement refunding bonds refunded thereby, future maximum annual debt service for the Commonwealth's outstanding general obligation debt is $929,044,644 in the fiscal year ending June 30, 2016 (based on the assumption that (i) the bonds refunded with non-eligible investments are treated as being outstanding, (ii) the Series 2004 A Bonds bear interest at their actual rate per annum through July 1, 2012 and thereafter at 12% per annum, (iii) the Series 2004 B Bonds, the 2006 CPI Bonds and the 2007 Swap Bonds, bear interest at 12% per annum and (iv) the public improvement bonds to which the basis swap and the constant maturity swap relate bear interest at their stated interest rates rather than the rates set forth in said swaps). This amount ($929,044,644) is equal to 11.13% of $8,346,104,000, which is the average of the adjusted internal revenues for the fiscal year ended June 30, 2006 and the currently estimated adjusted internal revenues for the fiscal year ended June 30, 2007. If the bonds refunded with non-eligible investments were treated as not being outstanding, and the interest on the Series 2004 B Bonds, the 2006 CPI Bonds and the 2007 Swap Bonds, is calculated using the fixed rate paid by the Commonwealth under the interest rate exchange agreements executed in connection with such bonds, the percentage referred to in the preceding sentence would be 9.19%.

Debt service for the Puerto Rico Aqueduct and Sewer Authority ("PRASA") guaranteed bonds of approximately $30 million is paid by PRASA and, thus, is not included in the calculation of the 15% debt limitation. See "Other Public Corporations – Aqueduct and Sewer Authority" under *Public Corporations* in *Appendix I*. In the event PRASA is unable to make any portion of the future debt service payments on its guaranteed bonds, the Commonwealth would be required to make such payments under its guarantee from the General Fund and such debt service would, to the extent paid by the Commonwealth, be included in the calculation of the 15% debt limitation.

Maturity Limitation

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

PUBLIC SECTOR DEBT OF THE COMMONWEALTH

Public Sector Debt

The following table presents a summary of the public sector debt of the Commonwealth as of December 31, 2007. The table also shows the public sector debt as further adjusted by the following bond issuances and events that have occurred after December 31, 2007: (i) the issuance of the Series A Pension Bonds, the PRASA Bonds, the $1,316,204,456 principal amount of Puerto Rico Aqueduct and Sewer Authority Revenue Bonds, Series A (Senior Lien) and the $22,445,000 principal amount of Puerto Rico Aqueduct and Sewer Authority Revenue Bonds, Series B (Senior Lien), and (ii) the issuance of the Series 2008 A Bonds, the Series 2008 B Bonds and the Series 2008 C Bonds and the refunding of certain general obligation bonds being refunded thereby. The table should be read in conjunction with the information set forth under *Debt* in *Appendix I*.

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

	December 31, 2007	As Adjusted
Puerto Rico direct debt[(1)]	$ 10,701,206	$ 10,924,775
Municipal debt	2,420,487	2,420,487
Public corporations debt		
Puerto Rico guaranteed debt	864,547	1,149,302
Debt supported by Puerto Rico appropriations or taxes	19,694,714	19,694,714
Other non-guaranteed debt	12,252,019	15,179,479
Total public corporations debt	$ 32,811,280	$ 36,023,495
Total public sector debt	$ 45,932,973	$ 49,368,757

* For a complete recital of all notes to this table, see "Public Sector Debt" under *Debt* in *Appendix I*.

(1) Includes general obligation bonds, tax and revenues anticipation notes, and lines of credit provided by Government Development Bank. The amount excludes certain Commonwealth general obligations bonds that have been refunded with proceeds that were invested in non-eligible investments, even though such bonds will be considered outstanding under their respective authorizing resolutions and for purposes of calculating the Commonwealth's constitutional debt limitation.

Source: Government Development Bank

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

The following table presents the debt service requirements for (i) Commonwealth general obligation bonds outstanding on December 31, 2007, and (ii) total Commonwealth general obligation bonds, adjusted for the issuance of the Series 2008 A Bonds, the Series 2008 B Bonds and the Series 2008 C Bonds, and the refunding of the bonds refunded thereby, but without giving effect to the conversion of the Variable Rate Bonds. The table excludes debt service on Commonwealth general obligation bonds that have been refunded with the proceeds of refunding bonds invested in non-eligible investments, notwithstanding that such bonds will be considered to be outstanding under their authorizing resolution and for purposes of calculating the Commonwealth's debt limitation. Debt service requirements for each fiscal year, as shown in the following table, include principal and interest due on July 1 immediately following the close of such fiscal year.

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

Fiscal Year Ending June 30,	Debt Service as of December 31, 2007[1]	Total Debt Service[2]
2008	$ 492,513	$ 239,721
2009	678,784	395,179
2010	685,299	739,368
2011	682,919	736,989
2012	682,647	743,923
2013	685,930	747,208
2014	673,668	734,948
2015	688,149	749,430
2016	688,515	749,798
2017	688,204	676,262
2018	680,009	661,062
2019	684,345	731,168
2020	719,927	766,748
2021	548,797	595,619
2022	478,647	525,471
2023	431,844	478,665
2024	428,368	475,191
2025	409,122	455,946
2026	400,320	447,146
2027	399,957	446,779
2028	398,507	448,251
2029	400,793	405,540
2030	398,897	401,244
2031	398,325	404,122
2032	219,015	223,993
2033	186,032	186,032
2034	132,007	132,007
2035	61,497	61,497
2036	33,676	33,676
2037	3,680	3,680
Total	$14,060,393	$14,396,664

* Totals may not add due to rounding.

(1) Includes debt service requirements on the Variable Rate Bonds prior to their remarketing. In the event PRASA is unable to make any portion of the future debt service payments on its guaranteed bonds, the Commonwealth would be required to make such payments under its guarantee from the General Fund.

Sources: Government Development Bank and Department of the Treasury

TAX MATTERS

In connection with the original issuance of the Variable Rate Bonds, Squire, Sanders and Dempsey L.L.P. delivered its approving opinion which concluded that under existing law (i) assuming continuing compliance with certain covenants and the accuracy of certain representations, interest on the Variable Rate Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations, and (ii) the Variable Rate Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation. The approving opinion further concluded that interest on the Variable Rate Bonds may be subject to certain federal taxes imposed only on certain corporations, including the corporate alternative minimum tax on a portion of that interest.

A copy of said approving opinion is contained in Appendix II to this Remarketing Circular.

On the effective date of the conversion of the Variable Rate Bonds as herein contemplated, Sidley Austin LLP, New York, New York, will deliver its opinion to the effect that such conversion is permitted under the Bond Resolution and will not in and of itself impair or affect the exclusion of interest on said Variable Rate Bonds from gross income for purposes of federal income taxation.

A copy of said conversion opinion of Sidley Austin LLP is included as part of Appendix II to this Remarketing Circular. Sidley Austin LLP expresses no opinion as to the current tax exempt status of the interest on the Variable Rate Bonds.

APPROVAL OF LEGAL PROCEEDINGS

Legal matters incident to the conversion of the Variable Rate Bonds are subject to the Favorable Opinion of Bond Counsel to be delivered by Sidley Austin LLP, New York, New York, the proposed form of which opinion is included in as *Appendix II*. Certain legal matters will be passed upon for the Remarketing Agents by Squire, Sanders & Dempsey L.L.P., Miami, Florida.

LEGAL INVESTMENT

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

REMARKETING

The Remarketing Agents have agreed, subject to certain conditions, to remarket the Variable Rate Bonds in accordance with the Bond Resolution and the Remarketing Agreements for an initial remarketing fee of $500,000.00 and certain ongoing fees.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

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

RATINGS

The Series 2007A-6 Bonds and the Series 2007A-7 Bonds are expected to be assigned ratings of "Aaa/VMIG1" from Moody's and "AA+/A-1+" from S&P on the strength of the Letters of Credit to be issued by UBS AG concurrently with the conversion of the Series 2007A-6 Bonds and the Series 2007A-7 Bonds. The "Aaa/VMIG1" ratings on the Series 2007A-6 Bonds and the Series 2007A-7 Bonds reflect Moody's approach to rating jointly supported transactions and is based upon a rating of "Baa3" for the Commonwealth and ratings of "Aa1/Prime-1" for UBS AG. The "AA+/A-1+" ratings on the Series 2007A-6 Bonds and the Series 2007A-7 Bonds are based on the application of S&P's low correlation joint criteria where the Commonwealth is rated "BBB-" and UBS AG is rated "AA-/A-1+".

The Series 2007A-8 Bonds and the Series 2007A-9 Bonds are expected to be assigned ratings of "Aaa/VMIG1" from Moody's and "AA+/A-1+" from S&P on the strength of the Letters of Credit to be issued by Wachovia concurrently with the conversion of the Series 2007A-8 Bonds and the Series 2007A-9 Bonds. The "Aaa/VMIG1" ratings on the Series 2007A-8 Bonds and the Series 2007A-9 Bonds reflect Moody's approach to rating jointly supported transactions and is based upon a rating of "Baa3" for the Commonwealth and ratings of "Aa1/Prime-1" for Wachovia. The "AA+/A-1+" ratings on the Series 2007A-8 Bonds and the Series 2007A-9 Bonds are based on the application of S&P's low correlation joint criteria where the Commonwealth is rated "BBB-" and Wachovia is rated "AA/A-1+".

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, the Variable Rate Bonds the Providers and other relevant information, and no application has been made to any other rating agency for the purpose of obtaining a rating on the Variable Rate Bonds. There is no assurance that the ratings described above will remain in effect for any given period of time or that they will not be revised downward or withdrawn entirely by either or both of such rating agencies, if in the judgment of either or both, circumstances so warrant. Any such downward revision or withdrawal of such ratings, or either of them, may have an adverse effect on the market prices of the Variable Rate Bonds.

CONTINUING DISCLOSURE

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

1. to file, within 305 days after the end of each fiscal year commencing with the fiscal year ending June 30, 2008, with each NRMSIR and with any Commonwealth state information depository ("SID"), core financial information and operating data for the prior fiscal year, including (i) the Commonwealth's audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time, and (ii) material historical quantitative data (including financial information and operating data) on the Commonwealth and its revenues, expenditures, financial operations and indebtedness, in each case generally found in this Remarketing Circular; and

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

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

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

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

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

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

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

The Commonwealth has made similar continuing disclosure covenants in connection with prior bond issuances, and has complied with all such covenants, except as hereinafter noted. The Commonwealth's audited financial statements for the fiscal year ended June 30, 2002 were filed after the Commonwealth's filing deadline of May 1, 2003 because of delays in finalizing such financial statements resulting from the implementation of GASB Statement No. 34 ("GASB 34"). The Commonwealth's audited financial statements for the fiscal year ended June 30, 2003 were also filed after the Commonwealth's filing deadline of April 30, 2004, because of delays in finalizing the financial statements of certain of the Commonwealth's reporting units due to the implementation of GASB 34. The Commonwealth's audited financial statements for the fiscal year ended June 30, 2004 and 2006 were also filed after the Commonwealth's respective filing deadlines of May 1, 2005 and 2007, because various governmental agencies did not submit their audited financial statements to the central government's external auditors on time, thereby delaying submission of the Commonwealth's audited financial statements. The Commonwealth's audited financial statements for fiscal year ended June 30, 2007 are not expected to be filed by the deadline of May 1, 2008 because various government agencies did not submit their audited financial statements to the central government's external auditors on time, thereby delaying submission of the Commonwealth's audited financial statements.

As of the date of this Remarketing Circular, there is no Commonwealth SID, and the NRMSIRs are: Bloomberg Municipal Repository, 100 Business Park Drive, Skillman, New Jersey 08558; Standard & Poor's Securities Evaluations, Inc., 55 Water Street, 45th Floor, New York, New York 10041; Interactive Data Pricing and Reference Data, Inc., Attn: NRMSIR, 100 William Street, 15th Floor, 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 Variable Rate Bonds, but the Commonwealth does not undertake to provide any such notice of the occurrence of any material event except those events listed above.

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

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

The Covenants may only be amended if:

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

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

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

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

MISCELLANEOUS

The foregoing summaries of or references to the Act, the Variable Rate Bonds, the Bond Resolution, the Letters of Credit, the Reimbursement Agreements, the Escrow Deposit Agreement and the other documents and agreements referred to herein and the summaries of or references to the various acts contained in the Commonwealth Report, are made subject to all the detailed provisions thereof to which reference is hereby made for further information and do not purport to be complete statements of any or all of such provisions.

Appended to and constituting a part of this Remarketing Circular are the Commonwealth Report (*Appendix I*) and Copy of Original Approving Opinion and Form of Opinion of Bond Counsel (*Appendix II*).

The information set forth in this Remarketing Circular and incorporated herein by reference, except for information pertaining to DTC and the Providers 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 Remarketing Circular on the authority of such officials or the authority of such publications as public official documents. The information pertaining to DTC was supplied by DTC. The information pertaining to each Provider was supplied by such Provider.

This Remarketing Circular will be filed with each NRMSIR and with the Municipal Securities Rulemaking Board.

COMMONWEALTH OF PUERTO RICO

By: /s/ José Guillermo Dávila
Secretary of the Treasury

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APPENDIX I

COMMONWEALTH OF PUERTO RICO FINANCIAL INFORMATION AND OPERATING DATA REPORT DATED JANUARY 2, 2008

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January 2, 2008

INTRODUCTION

General

The operating and financial information about the Commonwealth included in this Report has been updated as of December 31, 2007, except as to certain information which has been updated as of later dates, as set forth herein.

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 (3,927,776 as of July 1, 2006 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" or "Puerto Rico") 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.

Principal Officials Responsible for Fiscal Matters

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 L.L.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.

CPA José Guillermo Dávila Matos was appointed Secretary of the Treasury in January, 2008 (confirmation by the Senate is pending). Before that he served as Executive Director of the Commonwealth of Puerto Rico Office and Management and Budget and before that he served for two years as Executive Vice President for Administration, Controllership and Operations at GDB. Prior to entering public service, Dávila-Matos worked in the private sector for close to 20 years in various upper management positions. He is a Certified Public Accountant and earned a Bachelor's degree in Business Administration with a major in accounting from the University of Puerto Rico, Río Piedras. He is also a member of the American Institute of Certified Public Accountants.

Armando A. Valdez was appointed Executive Director of the Commonwealth of Puerto Rico Office of Management and Budget in January, 2008. Before that he served as Advisor to the Governor from January 2005 to December 2007, as Executive Director of the Incoming Transition Committee from November 2004 to December 2004, and as Director of

Intergovernmental Affairs to the Puerto Rico Federal Affairs Administration form June 2001 to December 2003. He earned a Bachelor of Arts degree in Architecture from Yale University and a Masters degree in Government (thesis pending) from John Hopkins University.

Jorge Irizarry Herrans was appointed President of Government Development Bank ("GDB") on December 4, 2007. Mr. Irizarry served as Executive Vice President and Director of Financing of GDB from 2005 until his appointment as Acting President, and has over 30 years of experience in banking, investments and consulting, which he acquired while working at Chase Manhattan, Booz Allen Hamilton, Inc., Banco Mercantil, Banco de Ponce, PaineWebber, Inc., and Sandoval Associates. Mr. Irizarry has a Bachelor's degree in finance from New York University and holds a Masters Degree in Business Administration from 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
Total	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's economy has expanded, on average, for more than two decades. 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 some years, these factors were aided by a significant rise in construction investment driven by infrastructure projects, private investment, primarily in housing, and relatively low oil prices. In the three fiscal years after the previous recession, during fiscal year 2002, the economy expanded at a moderate annual rate of 2.2%. During fiscal year 2007, real gross national product decreased by 1.8%. This contraction has continued into the current fiscal year 2008. The Planning Board expects a reduction of 2.1% of real gross national product for fiscal year 2008 and a recovery of 2.1% for fiscal year 2009.

Personal income, both aggregate and per capita, has increased consistently each fiscal year from 1985 to 2007. In fiscal year 2007, aggregate personal income was $53.1 billion ($44.4 billion in 2000 prices) and personal income per capita was $13,491 ($11,279 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 amount to around $12 billion annually and 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. Eighty two percent (82%) of the transfer payments to individuals in fiscal year 2007 ($8.9 billion), represented entitlements for previously performed services or resulting from contributions to programs such as Social Security, Veterans' Benefits, Medicare, and U.S. Civil Service retirement pensions. Grants represent the remainder of the federal transfers to individuals, mostly concentrated in the Nutritional Assistance Program (Food Stamps) and Pell Grant (higher education) Scholarships.

Total average annual employment (as measured by the Department of Labor and Human Resources Household Employment Survey (the "Household Survey")) has also increased. From fiscal year 2003 to fiscal year 2007, annual employment increased 6.3% to 1,262,900.

The dominant sectors of the Puerto Rico economy in terms of production and income are manufacturing and services. The manufacturing sector has undergone fundamental changes over

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[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 years as a result of increased emphasis on higher wage, high technology industries, such as pharmaceuticals, biotechnology, 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.

The following table shows the gross national product for the five fiscal years ended June 30, 2007.

Commonwealth of Puerto Rico
Gross National Product
Fiscal Years Ended June 30,

	2003	2004	2005	2006	2007[1]
Gross national product – $ millions[2]	$47,479	$50,709	$53,752	$56,733	$58,712
Real gross national product – $ millions (2000 prices)	42,795	43,967	44,819	45,061	44,252
Annual percentage increase in real gross national product (2000 prices)	2.1%	2.7%	1.9%	0.5%	(1.8)%
U.S. annual percentage increase in real gross national product (2000 prices)	1.9%	4.0%	3.0%	3.1%	2.0%

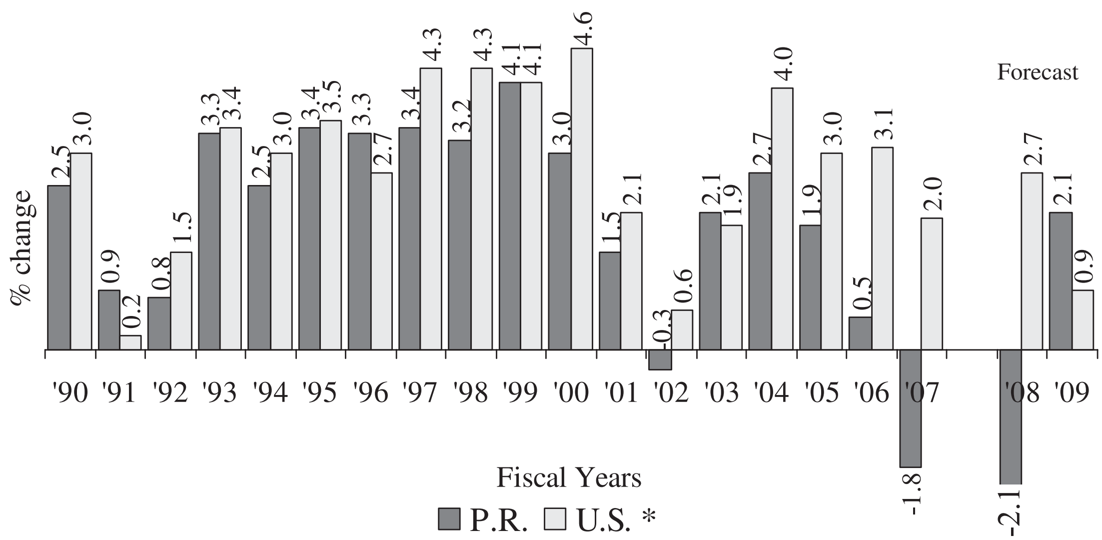
(1) Preliminary.
(2) In current dollars.

Sources: Puerto Rico Planning Board and Global Insight Inc.

The economy of Puerto Rico is closely linked to the United States economy, as most of the external factors that affect the Puerto Rico economy (other than the price of oil) are determined by the policies and performance of the economy of the United States. These external factors include exports, direct investment, the amount of federal transfer payments, the level of interest rates, the rate of inflation, and tourist expenditures. During fiscal year 2007 (from July 1, 2006 to June 30, 2007) approximately 77% of Puerto Rico's exports went to the United States mainland, which was also the source of approximately 50% of Puerto Rico's imports. Consequently, the current slowdown of the United States' economy could be reflected in Puerto Rico's economy.

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 2008 and 2009.

REAL GNP GROWTH RATE

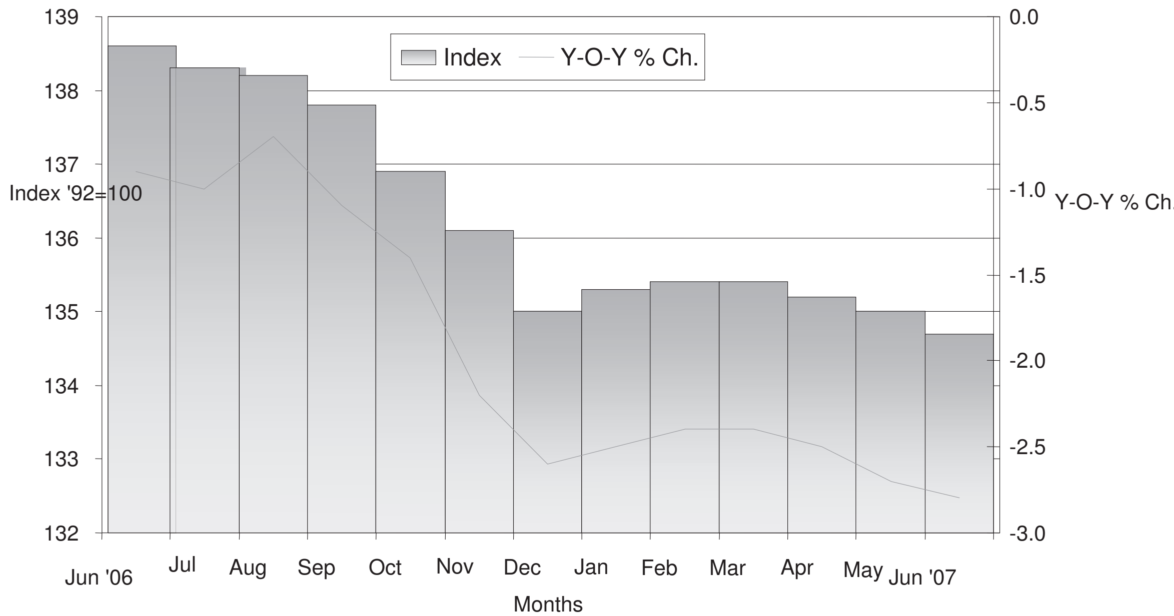


* Global Insight 3/08.

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, as part of the National Income and Product Accounts ("NIPA"). In contrast with BEA, which computes the economic accounts on a quarterly basis, the Planning Board computes Puerto Rico's NIPA on an annual basis. Like BEA, the Planning Board revises its statistics on a regular basis. The Planning Board classifies its statistics as preliminary until they are revised and made final in conjunction with the release of new data each year. Thus, all macroeconomic accounts for fiscal year 2007 shown in this report are preliminary until the revised figures are released and the forecasts for fiscal years 2008 and 2009 revised. Certain information regarding current economic activity is, however, available in the form of the economic activity index of Puerto Rico, a coincident indicator of ongoing economic activity. This index, which is shown in the table below, is composed of several variables (total employment, retail sales, electric power generation, motor vehicle registrations, and indices for manufacturing, construction, tourism, and external trade), which gauge virtually all sectors of the economy. The Planning Board is revising the methodology used to compile the Index.

As the following graph shows, the economic activity index has been declining on a year-over-year basis for fiscal year 2007.

COINCIDENT ECONOMIC ACTIVITY INDEX



Forecast for Fiscal Year 2008

The Planning Board's gross national product forecast for fiscal year 2008, which was released in March 2008, projected a decline of 2.1% in constant dollars, or an increase of 3.4% in current dollars. Personal income is expected to increase by 0.8% in real terms, or 4.3% in nominal terms (see footnote 1 on page I-4). The Planning Board expects real growth to return in fiscal year 2009, at 2.1%, or 7.1% in current dollars. The major factors affecting the economy at this point are, among others, the continued increase of oil prices, the slowdown of the U.S. economic activity, and the continuing economic uncertainty generated by the Commonwealth's fiscal crisis. These factors and the effects on economic activity of the implementation of the new sales tax are persuading consumers to adjust their behavior to the new economic conditions.

According to the Household Survey, total employment for the first eight months of fiscal year 2008 averaged 1,214,800, a decrease of 3.8% compared to 1,262,900 for the same period of fiscal year 2007. At the same time, the unemployment rate for the first eight months of fiscal year 2008 was 11.2%, an increase from 10.3% for the same period of fiscal year 2007.

Fiscal Year 2007

The Planning Board's preliminary reports on the performance of the Puerto Rico economy for fiscal year 2007 indicate that real gross national product decreased 1.8% (3.5% in current dollars) over fiscal year 2006. Nominal gross national product was $58.7 billion in fiscal year 2007 ($44.3 billion in 2000 prices), compared to $56.7 billion in fiscal year 2006 ($45.1

billion in 2000 prices). Aggregate personal income increased from $51.1 billion in fiscal year 2006 ($44.0 billion in 2000 prices) to $53.9 billion in fiscal year 2007 ($44.4 billion in 2000 prices), and personal income per capita increased from $13,033 in fiscal year 2006 ($11,229 in 2000 prices), to $13,491 in fiscal year 2007 ($11,279 in 2000 prices).

According to the Household Survey, total employment for fiscal year 2007 averaged 1,262,900, an increase of 0.8% compared to 1,253,400 for fiscal year 2006. The driving force behind total employment is self-employment. The unemployment rate for fiscal year 2007 was 10.4%, a decrease from 11.7% for fiscal year 2006. As in the past, the economy of Puerto Rico followed the general performance and trends of the United States economy, although at a lower rate of growth.

Among the variables contributing to the Planning Board's downward revision in the forecast were the current effect of persistent high levels of oil prices, and the current slowdown of the United States economy. Moreover, the continuing weakness of local construction investment has aggravated the current situation. The persistent high level of the price of oil and its derivatives (such as gasoline) has served to reduce the income available for other purchases and, thereby, negatively affected domestic demand. Due to the Commonwealth's dependence on oil for power generation and gasoline in spite of its recent improvements in power production diversification, the high level of oil prices is expected to account for an increased outflow of local income in fiscal year 2008. The current financial difficulties associated with the subprime mortgage crisis have resulted in lowering of short-term interest rates. This could help alleviate the situation of the construction sector, which historically has been a major contributor to economic growth. The implementation of the tax reform legislation discussed below may reduce net disposable income even after giving effect to certain income tax reductions provided in the tax reform legislation. For a discussion of the Commonwealth's fiscal difficulties and the recently enacted tax reform, see "Tax Reform" under Puerto Rico Taxes, Other Revenues, and Expenditures.

Fiscal Year 2006

The Planning Board's reports of the performance of the Puerto Rico economy during fiscal year 2006 indicate that the economy (as registered by real gross national product) grew by 0.5%. Nominal gross national product was $56.7 billion ($45.1 billion in 2000 prices), compared to $53.8 billion in fiscal year 2005 ($44.8 billion in 2000 prices). This represents an increase in nominal gross national product of 5.5%. Aggregate personal income increased from $48.8 billion ($44.0 billion in 2000 prices) to $51.1 billion in fiscal year 2006 ($44.0 billion in 2000 prices), and personal income per capita increased from $12,507 in fiscal year 2005 ($11,267 in 2000 prices), to $13,033 in fiscal year 2006 ($11,229 in 2000 prices).

According to the Household Survey, total employment for fiscal year 2006 averaged 1,253,400, an increase of 1.3% compared to 1,237,600 for fiscal year 2005. The unemployment rate for fiscal year 2006 was 11.7%, an increase from 10.6% for fiscal year 2005, due to the partial government shutdown in May 2006 that resulted in the two week furlough of many government employees. As in the past, the economy of Puerto Rico followed the performance and general trends of the United States economy but did not reach the level of U.S. real economic growth.

Economic Development Program

The Commonwealth's economic development program is now focused on initiatives aimed at producing more diversified and sustainable economic development. The six principal elements of these initiatives, as expressed in the Governor's Economic Development and Government Transformation Plan for Puerto Rico, are the following: (i) developing world-class infrastructure, while encouraging private investment with innovative financial models and agile, effective evaluation processes; (ii) accelerating Puerto Rico's entry into the knowledge economy by creating a center of excellence in biotechnology, engineering and computing; (iii) promoting local enterprise and supporting local businesses (in Spanish, Apoyo al de Aquí) by providing innovative financing alternatives and access to domestic and foreign markets; (iv) transforming the tourist industry into a vehicle for Puerto Rico's economic development; (v) diversifying energy-generating sources to reduce dependence on petroleum by half; and (vi) transforming Puerto Rico's government, without the need for layoffs or privatization, through effective agency consolidation and decentralization functions to offer first-class services to all citizens in a sensible, effective and agile manner and to contribute to Puerto Rico's socio-economic development.

The Commonwealth has formulated a strategic plan to increase 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 (currently capitalized at $4.9 million and expected to grow to $25 million in three years), that will provide grants and financing to companies, entrepreneurs, and universities that engage in these activities. As part of this plan, construction has begun on a biotechnology plant in Mayagüez and a molecular sciences building on the main campus of the University of Puerto Rico in Río Piedras. Additionally, the Department of Transportation has transferred land to the University of Puerto Rico for the construction of a cancer center.

As part of this strategic plan, the Commonwealth is actively pursuing local participation in the aerospace industry, including engineering design services and the outsourcing of business activities. Also, recently Industrial Development Company ("PRIDCO") began a program to improve local entrepreneurial capacity by evaluating local businesses with worldwide best practices, and the Economic Development Bank started a new venture capital program offering financing to entrepreneurs that present projects with great potential for commercialization.

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 a preferential tax rate of 4% for call centers located in Puerto Rico if they offer services to Latin America and 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. Over two dozen call centers have recently been established with employment of over 2,500 persons.

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) requiring at least 15% of products and services purchased by government agencies to 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 on income derived in Puerto Rico. This enables the Commonwealth to utilize local tax legislation as a tool for stimulating economic development, and it has done so for many years. See "Tax Incentives" below.

In this regard, the Commonwealth enacted legislation extending certain benefits of its most recent tax incentives 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 their Puerto Rico income tax liability for 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 income 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.

In addition, legislation was enacted (i) amending the 1998 Tax Incentives Act to permit income tax rates lower than 2% for companies that establish operations in Puerto Rico in "core pioneer industries" which utilize innovative technology in their operations 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) granting income tax exemption to financial institutions for the fees and interest income received in connection with loans or guarantees of loans made to finance tourism development projects; (iv) granting an exemption to qualified associations administering timesharing rights or vacation clubs and to owners' associations in areas designated as tourism enhancement districts; (v) granting tax exemption for investments in infrastructure made by housing developers; (vi) granting tax credits to Puerto Rico businesses that acquire products manufactured in Puerto Rico for exportation; and (vii) granting tax credits for 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.

In December 2006, two laws were approved that provide additional tax incentives to foster economic development in Puerto Rico. Act No. 289 of December 26, 2006 amended the 1994 Puerto Rico tax code in order to facilitate the creation of local Real Estate Investment Trusts (REITs). A REIT is a corporation, usually publicly traded, that manages a portfolio of real estate to earn profits for shareholders. Under Act No. 289, a special tax rate of 10% applies to the income from this type of investment. The creation of REITs is expected to encourage investment in residential, commercial and industrial properties and hotels, and will contribute to the development of a local capital market.

Act No. 287 of December 26, 2006 created a new financing conduit for PRIDCO-sponsored economic development activity, to be known as the Puerto Rico Investment Development Initiative. The interest paid on debt securities issued by companies operating under the Puerto Rico Industrial Incentives Act of 1998 is exempt from Puerto Rico income taxes for *bona fide* residents of Puerto Rico and local corporations. The proceeds of such debt can be used for general business purposes, such as raw materials and machinery acquisition, construction, general business expenses, intellectual property and research and development, among others, but 80% of the proceeds must be used within Puerto Rico by the benefited company.

The tax incentives under the 1998 Tax Incentives Act will be available until December 31, 2007 (although tax incentive concessions granted thereunder will continue to be in effect until their respective dates of expiration). Currently, the Puerto Rico Legislature is considering whether to amend, replace, or extend the effectiveness of the 1998 Tax Incentives Act.

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. The Commonwealth has also implemented additional initiatives to restructure certain government agencies in order to improve the services offered by these agencies and provide such services in a more efficient manner. Both PRIDCO and Tourism Company have completed restructurings resulting in their being able to respond more quickly to the needs of their constituents while shedding over 500 employment positions.

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.

The Department of Economic Development and Commerce initiated a reengineering of the Commonwealth's investment project evaluation process in which all branches of the Commonwealth government participated. The first phase, completed in December 2006, evaluated and developed the model. Currently, the project is in second phase, which should be completed by the end of fiscal year 2007, and which consists of evaluating all laws, bylaws and management styles. The third phase – the implementation and measurement of the reengineering – is scheduled to start during the first semester of fiscal year 2008 and is expected to be completed the following fiscal year.

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 United States Government Accountability Office ("GAO") to study the economic impact of this 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 converted from United States corporations to Controlled Foreign Corporations ("CFCs"), thus lessening the impact of the phase-out of those sections on their operations.

In May 2006, the GAO published its study titled "Fiscal Relations with the Federal Government and Economic Trends during the phase-out of the Possessions Tax Credit." The GAO study found that Puerto Rico's per capita gross domestic product and gross national product were significantly lower compared to United States averages, and the absolute gap between the per capita gross national product of Puerto Rico residents and that of United States residents has increased. The GAO study further found that, although the value-added by United States companies claiming the possessions tax credit decreased by about two-thirds during the period 1993-2003, much of the decline was offset by growth in other corporations, such as pharmaceuticals. Finally, the GAO study determined that although residents of Puerto Rico pay considerably less total tax per capita than residents of the United States, they pay approximately the same percentage of their personal income in taxes. The GAO study, which is informative in nature, is intended to help the United States Congress decide which economic development initiatives will best suit Puerto Rico's current situation.

In June 2006, the JCT published its pamphlet titled "An Overview of the Special Tax Rules related to Puerto Rico and an Analysis of the Tax and Economic Policy Implications of Recent Legislative Options" (the "JCT Report"). The JCT Report provides an overview of the tax and non-tax rules applicable to United States possessions, the special tax rules applicable to Puerto Rico and an economic analysis of such special tax rules. The JCT Report also presents certain legislative options and specific proposals that have been advocated by various parties in order to stimulate economic growth in Puerto Rico. Although these legislative options and specific proposals are not recommendations, the JCT Report does state that federal and Commonwealth tax policy must be coordinated in order to design and implement new tax proposals aimed at enhancing development in Puerto Rico by targeting problems unique to Puerto Rico, instead of problems common to the United States and Puerto Rico, which proposals are likely to induce business to relocate from the United State to Puerto Rico.

Recently, the United States Congress approved legislation to extend to production activities that take place in Puerto Rico the benefit of section 199 of the U.S. Code, which provides a nine percent reduction in the federal income tax rate, phased-in over five years (from 35% to 31.85% after 2009). This extension applies to activities occurring on the island of branches of U.S. corporations that are not controlled foreign corporations ("CFCs"). 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 2007 averaged 1,262,900, a 0.8% increase from 1,253,400 in fiscal year 2006. Unemployment, although at relatively low historical levels, is about twice the United States average. The average unemployment rate decreased from 11.7% in fiscal year 2006 to 10.4% in fiscal year 2007.

The following table presents annual statistics of employment and unemployment for fiscal year 2003 through fiscal year 2007 and monthly statistics, seasonally adjusted, for the first eight months of fiscal year 2008. 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)		
2003	1,352	1,188	164	12.1%
2004	1,360	1,206	155	11.4
2005	1,385	1,238	147	10.6
2006	1,420	1,253	167	11.7
2007	1,409	1,263	147	10.4
Fiscal Year 2008		(Seasonally Adjusted)		
July	1,389	1,226	163	11.8%
August	1,412	1,279	133	9.4
September	1,364	1,213	151	11.1
October	1,372	1,210	163	11.9
November	1,369	1,217	151	11.0
December	1,361	1,209	152	11.2
January	1,374	1,226	148	10.8
February	1,374	1,216	158	11.5

(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 2003 to fiscal year 2007, 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, 2003 through 2007.

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

	Fiscal Years Ended June 30,				
	2003	**2004**	**2005**	**2006**	**2007**[1]
Manufacturing	$31,532	$33,267	$34,534	$36,547	$36,717
Services[2]	28,919	30,476	32,449	33,948	35,925
Government[3]	6,948	7,389	8,150	8,424	8,586
Transportation, communication and public utilities	5,178	5,343	5,309	5,701	5,971
Agriculture, forestry and fisheries	333	414	375	385	441
Construction[4]	1,772	1,905	1,848	1,807	1,875
Statistical discrepancy	146	415	144	131	186
Total gross domestic product[5]	$74,827	$79,209	$82,809	$86,943	$89,701
Less: net payment abroad	(27,348)	(28,501)	(29,056)	(30,210)	(30,989)
Total gross national product[5]	$47,479	$50,709	$53,753	$56,733	$58,712

(1) Preliminary.
(2) Includes wholesale and retail trade, finance, insurance and real estate, tourism, and other services.
(3) Includes the Commonwealth, its municipalities and certain public corporations, and the federal government. Excludes certain other public corporations, like the Electric Power Authority and the Aqueduct and Sewer Authority whose activities are included under Services in the table.
(4) Includes mining.
(5) Totals may not add due to rounding.

Source: Planning Board

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

The following table presents annual statistics of average employment based on the North American Industry Classification System (NAICS) for fiscal years 2003 to 2007.

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

	Fiscal Years Ended June 30,				
	2003	**2004**	**2005**	**2006**	**2007(2)**
Natural Resources and Construction	68,525	69,300	68,233	67,442	67,392
Manufacturing					
Durable Goods	48,567	48,808	48,067	46,492	44,850
Non-Durable Goods	70,192	69,633	69,250	66,367	60,958
Sub Total	118,759	118,441	117,317	112,859	105,808
Trade, Transportation, Warehouse & Utilities					
Wholesale Trade	32,183	33,300	33,717	33,992	33,158
Retail Trade	130,183	132,008	136,192	137,800	135,058
Transportation, Warehouse & Utilities	17,358	17,042	17,617	17,433	16,700
Sub Total	179,724	182,350	187,526	189,225	184,916
Information	21,617	21,917	22,608	22,600	21,733
Finance	44,667	46,850	48,633	49,767	49,975
Professional & Business	98,500	101,900	103,767	106,400	104,767
Educational & Health	92,408	98,108	99,967	103,583	105,842
Leisure & Hospitality	67,917	70,317	72,592	74,767	73,433
Other Services	18,858	20,671	21,257	21,267	22,283
Government	297,717	303,408	307,825	302,025	297,450
Total Non-Farm	1,008,692	1,033,262	1,049,725	1,049,935	1,033,599

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

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

Manufacturing

Manufacturing is the largest sector of the Puerto Rico economy in terms of gross domestic product. The Planning Board figures show that in fiscal year 2007 manufacturing generated $36.7 billion, or 40.9%, of gross domestic product. During fiscal year 2007, payroll employment for the manufacturing sector was 105,808, a decrease of 6.2% compared with fiscal year 2006. Most of the island's manufacturing output is shipped to the United States mainland, which is also the principal source of semi-finished manufactured articles on which further manufacturing operations are performed in Puerto Rico. The United States minimum wage laws are applicable in Puerto Rico. As of February 2008, the average hourly manufacturing wage rate in Puerto Rico was 68.0% 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, phased out these federal tax incentives during a ten-year period that recently ended. This change has had a long-term impact on local manufacturing activity. 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, 2002 through June 30, 2006.

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

	Fiscal Years Ended June 30,				
	2002	**2003**	**2004**	**2005**	**2006**
Pharmaceuticals	$18,681	$18,998	$19,814	$20,705	$21,837
Machinery and metal products:					
Machinery, except electrical	3,845	3,507	3,372	3,307	3,215
Electrical machinery	1,757	1,771	1,818	1,904	1,852
Professional and scientific instruments	2,191	2,981	3,540	3,698	4,157
Other machinery and metal products	312	288	274	283	285
Food products	2,092	1,903	2,202	2,312	2,958
Other chemical and allied products	578	502	591	613	624
Apparel	530	353	344	325	228
Other(1)	1,258	1,231	1,312	1,387	1,391
Total gross domestic product of manufacturing sector(2)	$31,243	$31,532	$33,267	$34,534	$36,547

(1) Includes petroleum products; petrochemicals; tobacco products; stone, clay and glass products; textiles and others.
(2) 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 2003 to 2007.

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	**2003**	**2004**	**2005**	**2006**	**2007**[(1)]
Durable Goods					
Nonmetallic Mineral Products Manufacturing	4,444	4,706	4,471	4,108	3,792
Cement and Concrete Products Manufacturing	3,543	3,867	3,750	3,542	3,208
Fabricated Metal Products	6,198	6,490	6,427	5,808	5,817
Computer and Electronic	11,623	10,581	10,673	10,808	10,133
Electrical Equipment	7,415	7,744	7,645	6,858	6,567
Electrical Equipment Manufacturing	4,399	4,935	4,971	4,708	4,525
Miscellaneous Manufacturing	12,308	12,070	11,157	11,225	11,200
Medical Equipment and Supplies Manufacturing	11,336	11,059	10,473	10,492	10,467
Other Durable Goods Manufacturing	7,646	8,185	7,693	7,685	7,341
Total – Durable Goods	49,634	49,776	48,066	46,492	44,850
Non-Durable Goods					
Food Manufacturing	13,628	13,244	13,050	12,667	12,433
Beverage and Tobacco Products Manufacturing	3,159	3,038	3,175	3,425	3,267
Apparel Manufacturing	8,988	8,522	8,873	8,400	7,250
Cut and Sew Apparel Manufacturing	8,969	8,518	8,846	8,183	6,933
Chemical Manufacturing	31,183	31,385	32,885	32,335	30,067
Pharmaceutical and Medicine Manufacturing	26,645	27,187	28,572	28,017	25,742
Plastics and Rubber Products	3,340	3,210	2,744	2,350	2,217
Plastics Product Manufacturing	3,030	2,917	2,266	2,158	2,083
Other Non-Durable Goods Manufacturing	8,823	9,261	8,529	7,200	5,724
Total – Non-Durable Goods	69,121	68,660	69,256	66,367	60,958
Total Manufacturing Employment	118,755	118,436	117,322	112,869	105,808

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

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

Total employment in the manufacturing sector decreased by 12,947 from fiscal year 2003 to fiscal year 2007. Manufacturing employment had been declining during the past decade, but the decline accelerated during fiscal years 2002 and 2003, falling -10.6% and -4.8%, respectively. After that, manufacturing employment seemed to stabilize around 118,000 jobs, but the deceleration reappeared in fiscal year 2006 with the sector experiencing another significant drop of -3.8%. For fiscal year 2007 the employment decline accelerated further to -6.2%. During the last year the economy has lost around 7,050 jobs in the manufacturing sector. There are several reasons which explain this sector's job shrinkage: the end of the phase-out of Section 936, the net loss of patents on certain pharmaceutical products, the escalation of manufacturing production costs (particularly labor and electricity), and the increased use of job outsourcing. Puerto Rico's manufacturing sector is facing increased international competition, and new ideas and initiatives are necessary to improve this sector.

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
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
Hubbell 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
Wellco Enterprises, Inc.	Footwear

Employment 200 to 499	Product
Alcan Finance (BDA) LTC	Plastics
Bacardí Limited	Food
Biovail Corporation International	Pharmaceuticals
Carolina Underwear Co.	Apparel
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
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 2003 and 2007, the gross domestic product in this sector, in nominal terms, increased at an average annual rate of 5.4%, while payroll employment in this sector increased at an average annual rate of 1.8%. 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. 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 2007, services generated $35.9 billion of gross domestic product, or 40% of the total. Services employment grew from 523,691 in fiscal year 2003 to 562,949 in fiscal year 2007 (representing 54.5% of total, non-farm, payroll employment). This represents a cumulative increase of 7.5% during such period. Wholesale and retail trade, finance, insurance and real estate experienced significant growth in fiscal years 2003 to 2007, as measured by gross domestic product. From fiscal year 2003 to 2007, gross domestic product increased in wholesale and retail trade from $9.2 billion to $11.1 billion, and in finance, insurance, and real estate from $12.5 billion to $16.3 billion. There are sixteen commercial banks and trust companies currently operating in Puerto Rico. Total assets of these institutions as of December 31, 2007 were $113.9 billion. As of December 31, 2007, there were approximately thirty-five international banking entities operating in Puerto Rico licensed to conduct offshore banking transactions with total assets of $75.8 billion.

The following tables set forth gross domestic product for fiscal years 2003 to 2007 and employment for the services sector for fiscal years 2003 to 2007.

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

	Fiscal Years Ended June 30,				
	2003	2004	2005	2006	2007[1]
Wholesale and retail trade	$ 9,150	$ 9,802	$10,217	$10,709	$11,061
Finance, insurance and real estate	12,508	13,029	14,267	14,998	16,336
Other services[2]	7,261	7,646	7,965	8,241	8,529
Total	$28,919	$30,476	$32,449	$33,948	$35,925

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

Source: Planning Board.

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

	Fiscal Years Ended June 30,				
	2003	2004	2005	2006	2007[1]
Wholesale Trade	32,181	33,299	33,710	33,992	33,158
Retail Trade	130,180	132,008	136,189	137,800	135,058
Transportation, Warehouse & Utilities	17,352	17,054	17,615	17,433	16,700
Trade, Transportation, Warehouse & Utilities	179,713	182,361	187,514	189,225	184,916
Information	21,619	21,907	22,598	22,600	21,733
Finance	44,648	46,852	48,621	49,767	49,975
Professional and Business	98,498	101,899	103,767	106,400	104,767
Educational & Health	92,409	98,101	99,963	103,583	105,842
Leisure & Hospitality	67,912	70,310	72,586	74,767	73,433
Other Services	18,808	20,671	21,257	21,267	22,283
Total	523,607	542,101	556,306	567,609	562,949

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

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

Hotels and Related Services – Tourism

During fiscal year 2006, 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 1,913,400, an increase of 3.4% over the number of persons registered during the same period in fiscal year 2005. The number of non-resident tourists registered in tourist hotels during fiscal year 2006 increased 4.6% compared to fiscal year 2005. Hotel rooms available during fiscal year 2006 increased 3.9% compared to fiscal year 2005. The average number of rooms rented in tourist hotels increased 3.9% during fiscal year 2006 compared to fiscal year 2005. The average occupancy rate in tourist hotels during fiscal years 2005 and 2006 was 70.8%.

During fiscal year 2007, 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 1,798,300, a decrease of 6.5% over the number of persons registered during fiscal year 2006. The average occupancy rate in tourist hotels during fiscal year 2007 was 71.3%, compared to 70.1% in fiscal year 2006. The average number of rooms rented in tourist hotels decreased 5.0% during fiscal year 2007 compared with fiscal year 2006. The average number of rooms available in tourist hotels decreased 6.3% from fiscal year 2006 to fiscal year 2007 as the completion of regular maintenance and rehabilitation of rooms (that normally results in a certain number of rooms being unavailable at any time) took longer to complete than in the past.

The number of persons registered in tourist hotels during the first four months of fiscal year 2008, was 688,100, a decrease of 2.2% over the number of persons registered during the same period of fiscal year 2007. The average occupancy rate in tourist hotels during the first four months of fiscal year 2008 was 68.2%, compared to 68.4% in the period for fiscal year 2007. During the first four months of fiscal year 2008, the average number of rooms rented in tourist hotels decreased 2.3% and the average number of rooms available in tourist hotels decreased 2.7% compared with the same period in fiscal year 2007.

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, 2006.

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)
2003	$1,239,200	$1,163,900	$1,999,200	$4,402,300	$2,676.6
2004	1,307,000	1,348,200	2,234,000	4,889,200	3,024.0
2005	1,361,640	1,386,925	2,324,275	5,072,840	3,238.6
2006	1,424,170	1,300,120	2,297,840	5,022,130	3,369.3
2007(4)	1,353,380	1,375,430	2,333,600	5,062,410	3,143.9

(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.
(4) Preliminary.

Sources: Puerto Rico Tourism Company and the Planning Board

The Commonwealth, through the Convention Center District Authority, has completed the development of the largest convention center in the Caribbean, and the centerpiece of a 100-

acre, private development, to include hotels, restaurants, cinemas, office space and housing. The convention center district is being developed at a total cost of $1.3 billion to improve Puerto Rico's competitive position in the convention and group travel segments. The convention center opened on November 17, 2005.

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 2007, the government accounted for $8.6 billion of Puerto Rico's gross domestic product, or 9.6% of the total. The government is also a significant employer, providing jobs for 297,400 workers, or 28.8% of total, non-farm, payroll employment in fiscal year 2006. This total includes municipal employees. As of January 31, 2008, central government employment has been reduced by approximately 11,500 positions since September 2004.

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 began to negotiate the economic and non-economic terms of at least forty collective bargaining agreements. The results of these negotiations could have a material impact on the General Fund.

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 in Puerto Rico 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, 2006, totaled approximately 4,621 miles. The highway system comprises 391 miles of primary system highways, which are the more important interregional traffic routes and include PR-52, 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. It currently has ridership of about 33,000 per day.

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 the second phase of the Port, which phase is expected to be completed by the end of calendar year 2008. 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) reconstructing the container terminals; (iii) commencing certain required environmental risk mitigation procedures; and (iv) preparing final construction schematics. With respect to these tasks, dredging is completed, the final design contract has been awarded, acquisition of environmental risk mitigation land is underway, and the contract for reconstruction of the container terminal was awarded in April 2006. The Port is expected to be capable of providing capacity for up to 700,000 TEUs when the third phase is completed.

As of September 30, 2007, PAA had an outstanding balance of $94.6 million under various lines of credit from GDB. PAA is authorized to borrow up to $250 million under these lines of credit. This debt is payable from annual legislative appropriations until the PAA starts generating revenues sufficient to cover debt service and is also guaranteed by the Commonwealth. Partial operation of the Port of the Americas, at a capacity of up to 250,000 TEUs per year, could begin in 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, due to its multiplier effect on the whole economy. During the period from fiscal year 2003 through fiscal year 2007, however, real construction investment has decreased at an average annual growth rate of 5.9%. The total value of construction permits decreased by 5.4% during the same five fiscal year period.

Public investment has been an important component of construction investment. During fiscal year 2007, approximately 43.4% of the total investment in construction was related to public projects. For fiscal year 2007 compared to fiscal year 2006, the total value of construction permits decreased 22.2% and total sales of cement, including imports, decreased 8.2%. Average payroll employment in the construction sector during fiscal year 2007 was 67,400, a reduction of 0.1% from fiscal year 2006. Cement sales (including imports) continued their decline, during the first three quarters of fiscal year 2008, falling 11.4% compared to the same period in fiscal year 2007.

Total construction investment for fiscal year 2007 decreased (in real terms) by 6.3% (following a 10.4% real decline in fiscal year 2006) due principally to the drop in construction related public projects. For fiscal year 2008, the Planning Board forecasts further construction investment decreases (in real terms) of 5.3% and stagnation (0% real growth) for fiscal year 2009. Public investment will be primarily in housing, new schools (and school reconstruction programs), water projects, and other public infrastructure projects. Public investment in construction has been negatively affected by the Commonwealth's fiscal difficulties.

During the first six months of fiscal year 2008, the number of construction permits decreased 18.5% and the total value of construction permits increased 23% compared to the same period in fiscal year 2007.

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 2007, gross income from agriculture was $814.2 million, an increase of 1.6% compared with fiscal year 2006. 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, ornamental plants and other products. During fiscal year 2007, starchy vegetables, coffee, livestock products and ornamental plants 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, and the college-age population has declined since 2000.

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)	15,313,000	56.4%
2001	426,194(3)	185,015	43.4%	27,971,000(3)	15,928,000	56.9%
2002	423,852(3)	190,776	45.0%	28,463,000(3)	16,612,000	58.4%
2003	420,295(3)	199,842	47.5%	28,947,000(3)	16,900,000	58.4%
2004	416,020(3)	207,074	49.8%	29,245,000(3)	17,272,000	59.1%
2005	411,580(3)	208,032	50.5%	29,307,000(3)	17,428,000	59.5%

(1) Number of persons of all ages enrolled in institutions of higher education as percent of population 18-24 years of age.
(2) Based on census population as of April 1 of 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 2006-2007 was approximately 62,340 students. The Commonwealth is legally bound to appropriate annually for the University of Puerto Rico an amount equal to 9.60% of the average annual revenue from internal sources for each of the two fiscal years immediately preceding the current fiscal year.

In addition to the University of Puerto Rico, there are 40 public and private institutions of higher education located in Puerto Rico. Such institutions had an enrollment during academic year 2005-2006 of approximately 145,574 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.

Enrollment at other postsecondary education programs, including technical and vocational programs, amounted to an additional 33,629 students at approximately 76 institutions. This figure represents enrollment at federal Title IV eligible, non-degree granting institutions reporting data to the National Center for Education Statistics (Integrated Postsecondary Education Data System).

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

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, which are designed to promote investment in Puerto Rico, 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.

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, expand current operations or commence operating a new eligible business. The activities eligible for tax exemption include manufacturing, certain designated services performed for markets outside Puerto Rico (including the United States), the production of energy from local renewable sources for consumption in Puerto Rico and laboratories for research and development. Companies qualifying thereunder can benefit from income tax rates ranging from 2% to 7% for periods ranging from 10 to 25 years. In addition, the 1998 Tax Incentives Act grants 90% exemption from property taxes, 100% exemption from municipal license taxes during the first three semesters of operations and between 60% and 80% thereafter, and 100% exemption from excise taxes with respect to the acquisition of 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 up 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.

Under the 1998 Tax Incentives Act, core pioneer industries that employ innovative technologies in their operations, including high technology industries with activities that produce a significant economic impact, can be eligible for income tax rates below 2%. Eligible manufacturing industries may also qualify for certain payroll and training deductions, building and construction expense deductions, a 25% credit for purchases of products manufactured in Puerto Rico, and a 35% credit for purchases of locally recycled products and products manufactured with locally recycled materials.

The 1998 Tax Incentives Act also provides investors who acquire an exempted business that is in the process of closing its operations in Puerto Rico a 50% credit in connection with the cash purchase of such corporation's stocks or assets. Also, exempted businesses that produce high technology products may be eligible for a credit equal to the amount in excess of $100 million of the annual taxes retained on the payment of rights, rents, royalties and licenses related to the production of such goods. Finally, call centers servicing markets outside Puerto Rico are exempt from paying excise taxes on the purchase of equipment needed for the operation of such call centers.

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 3,900 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"), its income tax credit based on operating and certain investment income was phased out over a ten-year period for companies that were operating in Puerto Rico in 1995, and is no longer available.

Controlled Foreign Corporations

Because of the modification and phase out of the federal tax incentives under Section 936 of the U.S. Code, many corporations previously operating thereunder 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 numerous corporations that have converted part or all of their operations to CFCs. These include most of the major pharmaceutical, instrument and electronics manufacturing companies in Puerto Rico.

CFCs operate under transfer pricing rules for intangible income that are different from those applicable to United States corporations operating under Section 936 of the U.S. Code ("Section 936 Corporations"). 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 fifteen percent Puerto Rico withholding tax on royalty payments.

Recently, the United States Congress approved legislation that would extend the benefit of Section 199 of the U.S. Code to production activities that take place in Puerto Rico. Section 199 provides a three-point reduction in the federal income tax rate, phased in over five years (from 35% to 31.85% after 2009). This extension applies to the U.S. branch activities located on the island and are not controlled foreign corporations.

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 the Commonwealth 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 fiscal year preceding the fiscal year of such proposed issuance 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 fiscal year of such proposed issuance. 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 through payments by the Commonwealth on such guaranteed debt. 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. In addition, the portion of the Sales Tax (as defined under "Tax Reform" under *Puerto Rico Taxes, Other Revenues, and Expenditures* below) allocated to the Puerto Rico Sales Tax Financing Corporation is also not included as internal revenues consistent with the legislation creating the Sales Tax Financing Corporation, which legislation provides that such portion is not "available resources" under the Constitutional provisions relating to the Bonds.

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 category by Moody's and S&P, none of which is eligible to be used for a legal defeasance under Puerto Rico law ("non-eligible investments")). Since bonds refunded with proceeds of non-eligible investments are not legally defeased, such bonds are treated as outstanding for purposes of the 15% debt limitation.

Future maximum annual debt service for the Commonwealth's outstanding general obligation debt is $859,632,840 in the fiscal year ending June 30, 2020 (based on the assumption that the Public Improvement Refunding Bonds, Series 2004 A, which are variable rate bonds, 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, a portion of the Public Improvement Bonds of 2006, Series A, and a portion of the Public Improvement Refunding Bonds, Series 2007A, each of which are also variable rate bonds, bear interest at 12% per annum). This amount ($859,632,840) is equal to 10.30% of $8,344,210,500, which is the average of the adjusted internal revenues for the fiscal years ended June 30, 2006 and June 30,

2007. If bonds refunded with non-eligible investments described in the preceding paragraph were treated as not being outstanding, and the interest on the Public Improvement Refunding Bonds, Series 2004 B, the portion of the Public Improvement Bonds of 2006, Series A, and the portion of the Public Improvement Refunding Bonds, Series 2007A, 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 8.63% and future maximum annual debt service for the Commonwealth's outstanding general obligation debt would be $719,927,041 in the fiscal year ending June 30, 2020. Annual debt service payments on the PRASA guaranteed bonds are not included in the calculation of the 15% debt limitation. In the event PRASA is unable to make any portion of the future debt service payments on its guaranteed bonds, the Commonwealth would be required to make such payments under its guarantee from the General Fund, and such debt service would be included in the calculation of the 15% debt limitation.

The 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 ordinances adopted by the respective municipal assemblies. Debt of public corporations is issued in accordance with their enabling statutes. GDB, as fiscal agent of the Commonwealth and its municipalities and public corporations, must approve the specific terms of each issuance.

The following table presents a summary of public sector debt as of December 31, 2007. 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, $1.4 billion of outstanding bonds (as of December 31, 2007) issued by the Municipal Finance Agency to finance its purchase of bonds of Puerto Rico municipalities, and $2.4 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)

	December 31, 2007
Puerto Rico direct debt[(1)]	$10,701,206
Municipal debt	2,420,487
Public corporations debt	
Puerto Rico guaranteed debt[(2)]	864,547
Debt supported by Puerto Rico appropriations or taxes[(3)]	19,694,714
Other non-guaranteed debt[(4)]	12,252,019
Total public corporations debt	32,811,280
Total public sector debt	$45,932,973

(1) Includes general obligation bonds, tax and revenue anticipation notes, and lines of credit provided by GDB. Excludes certain Commonwealth general obligation bonds in the principal amount of $1.1 billion 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 $509.1 million of bonds issued by Aqueduct and Sewer Authority, $255.5 million of State Revolving Fund Loans incurred under various federal water laws, and $99.9 million of bonds issued by Port of the Americas Authority. Excludes Public Buildings Authority bonds in the principal amount of $3.099 billion and $267 million of GDB bonds payable from available moneys of GDB.

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

(4) Excludes the following: $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; $596.3 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 the pledge of certain payments made by a private corporation under a special facilities agreement; $81.2 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 $111 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. The bonds listed in this footnote are subsequently collectively referred to as the "Excluded Bonds." If the principal amounts of the Excluded Bonds were included in the above table, total public corporations' debt would be $36,107,778,000 and total public sector debt would be $49,229,473,000.

Source: Government Development Bank for Puerto Rico

No deductions have been made in the table above 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 December 31, 2007.

The table excludes debt service on $1.08 billion of 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, in respect of certain variable rate, general obligation bonds as to which the Commonwealth has entered into interest rate exchange agreements, the interest in the table is calculated by using the respective fixed rates of interest that the Commonwealth is paying under said agreements. 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)]**
2008	$ 64,137	$ 428,376	$ 492,513
2009	266,840	411,944	678,784
2010	288,540	396,759	685,299
2011	301,872	381,047	682,919
2012	323,305	359,342	682,647
2013	346,325	339,605	685,930
2014	332,043	341,625	673,668
2015	362,250	325,899	688,149
2016	380,185	308,330	688,515
2017	397,802	290,402	688,204
2018	408,715	271,294	680,009
2019	447,781	236,564	684,345
2020	513,180	206,747	719,927
2021	367,095	181,702	548,797
2022	314,635	164,012	478,647
2023	282,545	149,299	431,844
2024	291,535	136,833	428,368
2025	284,035	125,087	409,122
2026	287,480	112,840	400,320
2027	300,190	99,767	399,957
2028	313,290	85,217	398,507
2029	326,875	73,918	400,793
2030	341,510	57,387	398,897
2031	356,450	41,875	398,325
2032	193,095	25,920	219,015
2033	167,910	18,122	186,032
2034	120,785	11,222	132,007
2035	55,380	6,117	61,497
2036	30,400	3,276	33,676
2037	32,000	1,680	3,680
	$8,498,183	$5,592,209	$14,090,392

* 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) In the event PRASA is unable to make any portion of the future debt service payments on its guaranteed bonds, the Commonwealth would be required to make such payments under its guarantee from the from the General Fund. See "Other Public Corporations - Aqueduct and Sewer Authority" under *Public Corporations* below.

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

Ratings of Commonwealth General Obligation Bonds

On May 22, 2007, Moody's Investors Service ("Moody's") confirmed its "Baa3" and "Ba1" rating on the Commonwealth's general obligation debt and its appropriation debt, respectively, and its negative ratings outlook thereon.

On May 22, 2007, Standard & Poor's Rating Services, a division of The McGraw-Hill Companies, Inc. ("S&P"), lowered its rating on the Commonwealth's general obligation debt to "BBB-", changed its negative ratings outlook thereon to stable, and confirmed its "BBB-" rating on the Commonwealth's appropriation debt.

Commonwealth Guaranteed Debt

As of December 31, 2007, $3.09 billion of Commonwealth guaranteed bonds of the Public Buildings Authority were outstanding. Maximum annual debt service on these bonds is $236.2 million in fiscal year ending June 30, 2011, with their final maturity being July 1, 2037. No payments under the Commonwealth guaranty have been required to date for these bonds.

As of December 31, 2007, $267 million of Commonwealth guaranteed bonds of GDB were outstanding. No payments under the Commonwealth guaranty have been required for these bonds.

As of December 31, 2007, GDB held approximately $99.9 million of the Port of the Americas Authority's outstanding bonds, which are guaranteed by the Commonwealth. The Authority is authorized to issue and GDB is authorized to purchase its bonds guaranteed by the Commonwealth in a maximum aggregate principal amount of $250 million. The proceeds from these bonds will be used to continue the development of the Port of the Americas. No payments under the Commonwealth guaranty have been required for these bonds.

As of December 31, 2007, the aggregate outstanding principal amount of obligations of PRASA guaranteed by the Commonwealth was $764.6 million. This amount consisted of $262.8 million in revenue bonds sold to the public, $246.3 million in bonds issued to the United States Department of Agriculture, Rural Development, and $255.5 million of loans by the State Revolving (Clean Water and Safe Drinking Water Act) Funds for the benefit of PRASA. From January 1997 through fiscal year 2005, the Commonwealth made debt service payments under its guaranty. Beginning with the debt service payment due January 1, 2006, the Commonwealth stopped making guarantee payments on these obligations. PRASA has resumed making payment on this debt. In the event PRASA is unable to make any portion of the future debt service payments on its guaranteed obligations, the Commonwealth would be required once more to make such payments from the General Fund under its guarantee. See "Other Public Corporations – Aqueduct and Sewer Authority" under *Public Corporations* below.

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, 2007 and the first six months of fiscal year 2008. As of December 31, 2007, outstanding short-term debt, relative to total debt, was 11.1%.

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

June 30,	Public Sector Long Term(2)	Short Term(3)	Short Term as % of Total	Total	Rate of Increase	Gross National Product(1) Amount	Rate of Increase
2003	$28,102	$1,605(4)	5.4%	$29,707	6.1%	$47,479	5.3%
2004	31,767	2,175(4)	6.4	33,942	14.3	50,709	6.8
2005	34,789	1,914(4)	5.2	36,703	8.1	53,601	5.7
2006	37,313	2,620(4)(5)	6.6	39,933	8.8	56,689	5.8
2007	39,492	3,326	7.8	42,818	7.2	N/A	N/A
December 31, 2007	40,821	5,112	11.1	45,933	7.3	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) 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.
(5) Includes a $368 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.

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, 2007 and the first six months of fiscal year 2008.

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

June 30,	Commonwealth Long Term	Commonwealth Short Term(2)	Commonwealth Total	Municipalities Long Term	Municipalities Short Term(2)	Municipalities Total	Public Corporation(1) Long Term	Public Corporation(1) Short Term(2)	Public Corporation(1) Total	Total Long Term	Total Short Term(2)	Total
2003	$6,709	$177(3)	$6,886	$1,754	$201	$1,955	$19,639	$1,227	$20,866	$28,102	$1,605	$29,707
2004	7,758	761(3)	8,519	1,820	226	2,046	22,190	1,187	23,377	31,767	2,175	33,942
2005	8,761	257(3)	9,018	1,927	254	2,181	24,101	1,403	25,504	34,789	1,914	36,703
2006	9,841	552(3)(4)	10,393	2,037	293	2,330	25,435	1,775	27,210	37,313	2,620	39,933
2007	10,335	224	10,559	2,164	299	2,463	26,993	2,803	29,796	39,492	3,326	42,818
December 31, 2007	9,131	1,570	10,701	2,122	299	2,421	29,568	3,243	32,811	40,821	5,112	45,933

* Totals may not add due to rounding.
(1) Includes Commonwealth guaranteed debt; does not include the Excluded Bonds.
(2) Obligations (other than bonds) issued with an original maturity of three years or less and lines of credit with a remaining maturity of three years or less are considered short-term debt.
(3) Does not include the tax and revenue anticipation notes which were outstanding at the close of the indicated fiscal years because prior to the end of said fiscal years sufficient funds had been set aside for the payment of such notes in full.
(4) Includes a $368 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.

Source: Government Development Bank for Puerto Rico

PUBLIC CORPORATIONS

In Puerto Rico, many governmental and quasi-governmental functions are performed by public corporations created by the Legislative Assembly with varying degrees of independence from the central government to perform generally 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 whose members are appointed by the Governor with the advice and consent of the Senate, but some public corporations are attached to departments of the central government. Capital improvements of most of the larger public corporations are financed by revenue bonds issued under trust agreements or bond resolutions, or notes issued under loan agreements. The following table presents the outstanding bonds and notes of certain of the public corporations as of December 31, 2007 ("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, is payable from sources other than Commonwealth appropriations or taxes or revenues of public corporations, or is payable from revenues derived from private sector services or products, such as industrial development bonds. Also excluded from this table is debt of certain public corporations the inclusion of which would reflect double counting. No deductions have been made in the table for debt service funds and debt service reserve funds. More detailed information about the major public corporations is presented in the following sections.

Commonwealth of Puerto Rico
Outstanding Debt of Public Corporations
December 31, 2007
(in thousands)

	With Guaranty	Bonds Without Guaranty	Total	With Guaranty	Notes Without Guaranty	Total	With Guaranty	Total Bonds and Notes Without Guaranty	Total
Aqueduct and Sewer Authority	$ 509,139	$ -	$ 509,139	$255,481	$1,231,797	$1,487,278	$ 764,620	$ 1,231,797	$ 1,996,417
Convention Center District Authority	-	465,800	465,800	-	150,692	150,692	-	616,492	616,492
Electric Power Authority	-	5,498,238	5,498,238	-	1,074,218	1,074,218	-	6,572,456	6,572,456
Highway and Transportation Authority	-	6,428,074[1]	6,428,074	-	300,474	300,474	-	6,728,548	6,728,548
Housing Finance Authority[2]	-	493,804	493,804	-	49,003	49,003	-	542,807	542,807
Industrial Development Company	-	263,744	263,744	-	86,710	86,710	-	350,454	350,454
Infrastructure Financing Authority	-	1,876,578[3]	1,876,578	-	21,283	21,283	-	1,897,861	1,897,861
Public Buildings Authority	3,098,773	-	3,098,773	-	75,000	75,000	3,098,773	75,000	3,173,773
Public Finance Corporation	-	2,427,604[4]	2,427,604	-	103,936	103,936		2,531,540	2,531,540
Port of the Americas Authority	99,927	-	99,927	-	-	-	99,927	-	99,927
Ports Authority	-	61,315[5]	61,315	-	594,578	594,578	-	655,893	655,893
P.R. Sales Taxes Financing Corp. (COFINA)	-	4,500,702	4,500,702	-	-	-	-	4,500,702	4,500,702
University of Puerto Rico	-	604,758[6]	604,758	-	24,703	24,703	-	629,461	629,461
Others	-	-	-	-	2,514,949	2,514,949	-	2,514,949	2,514,949
Total[7]	$3,707,839	$22,620,617	$26,328,456	$255,481	$6,226,803	$6,482,284	$3,963,320	$28,847,960	$32,811,280

(1) 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.
(2) Excludes the $596.3 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.
(3) Excludes $1 billion of outstanding bonds of Infrastructure Financing Authority, which bonds 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.
(4) Payable primarily from Commonwealth appropriations.
(5) Excludes $155 million of Special Facilities Bonds issued by the Ports Authority, which bonds are payable solely from by the pledge of certain payments made by a private corporation under a special facilities agreement.
(6) Excludes $81.2 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 bonds are payable from rent payments made by the University of Puerto Rico.
(7) 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, which bonds 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 December 31, 2007, just under $2 billion of bonds and notes of GDB (excluding its subsidiaries) were outstanding, consisting of $267 million in Commonwealth guaranteed bonds and $1.5 billion of medium term senior notes. Act No. 12 of May 9, 1975, as amended, provides that the payment of principal of and interest on specified notes and other obligations of GDB, not exceeding $550 million, may be guaranteed by the Commonwealth, of which $267 million were outstanding as of December 31, 2007. As of said date, GDB also had $4.4 billion in loans outstanding to the central government of the Commonwealth and its public corporations and municipalities.

Act No. 82 of June 16, 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 $18.4 million for fiscal year 2004. GDB did not make a payment to the General Fund under Act No. 82 for fiscal years 2005, 2006 and 2007 and does not expect to make a payment for fiscal year 2008.

Under Act No. 271 of November 21, 2002, GDB made a required special capital contribution to the Special Communities Perpetual Trust (the "Trust") of $500 million and provided the Trust with a $500 million, non-revolving, 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 December 31, 2007, the Trust had repaid $123.9 million of its line of credit and had an outstanding balance of $376 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 the 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 December 31, 2007, Housing Finance Authority's total outstanding loans to the private sector for development of housing projects targeted to low and moderate income families were $104.1 million. The Authority's mortgage loans to low and moderate income homeowners represented an additional $78.2 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 generally limited obligations of Housing Finance Authority payable solely from revenues collected from such housing units, with certain exceptions. As of December 31, 2007, $1.097 billion of Housing Finance Authority bonds were outstanding.

As of December 31, 2007, the Authority also had outstanding $486.6 million of bonds and notes issued to fund certain payments of the Commonwealth under its mortgage subsidy and other programs for low and moderate income families, and to guarantee certain insurance obligations of the former Housing Bank and Finance Agency.

As of December 31, 2007, the Authority had total notes and bonds outstanding of $1.209 billion (including $101.4 million of debt outstanding under GDB lines of credit and repos $10.2 million with other banks) and total unrestricted net assets of $324.8 million.

Tourism Development Fund. The Tourism Development Fund promotes Puerto Rico's hotel and tourism industry by making available direct loans and guarantees to secure the private financing for new hotel development projects. The Tourism Development Fund is also authorized to make capital investments in tourism related projects. As of December 31, 2007, the Tourism Development Fund had outstanding direct loans in an aggregate principal amount of $257.4 million and guarantees issued in the outstanding amount of $127.9 million to finance several hotels and tourism-related projects.

The 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 the Tourism Development Fund due to the failure of the applicable borrowers to comply with their obligations under the related reimbursement agreements. Of the total amount disbursed, the Tourism Development Fund has been able to recover approximately $199.7 million from the borrowers. After taking these payments and all related recoveries into account, the unrestricted net assets of the Tourism Development Fund as of December 31, 2007, were approximately $146.2 million, and its allowances for losses on guarantees, loans, other assets and letters of credit were approximately $24.7 million.

Capital Fund. The Government Development Bank for Puerto Rico Capital Fund (the "Capital Fund") invests and trades in debt obligations and publicly traded shares of domestic and foreign corporations separate from GDB's general investment operations. As of December 31, 2007, the Capital Fund had assets of $89.1 million, of which $58.9 million were invested in an equity index fund that invests mainly in growth, value, small cap and international stocks.

Development Fund. The Puerto Rico Development Fund (the "Development Fund") provides an alternate source of financing to private enterprises in Puerto Rico that have difficulties in obtaining financing from traditional sources. The Development Fund also guarantees obligations of these enterprises and invests in their equity securities. As of December 31, 2007, the Development Fund had no investments due to the sale of most of its assets to the Economic Development Bank for Puerto Rico in June 2006.

Public Finance Corporation. Puerto Rico Public Finance Corporation ("Public Finance Corporation") provides agencies and instrumentalities of the Commonwealth with alternate means of meeting their financing requirements. 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 December 31, 2007, it had $2.4 billion aggregate principal amount of bonds outstanding. All such bonds are limited, non-recourse obligations of Public Finance Corporation payable from the Puerto Rico Sales Tax Financing Corporation and/or Commonwealth appropriations made to pay the notes held by Public Finance Corporation. In addition, Public Finance Corporation had $104 million of notes outstanding under a line of credit with GDB whose proceeds were used to pay fiscal year 2007 debt service on its bonds due to the failure of the Commonwealth to make the required debt service appropriations on account of its fiscal problems.

Sales Tax Financing Corporation ("COFINA") was created by Act No. 91 of the Legislative Assembly of Puerto Rico, approved May 13, 2006, as amended ("Act 91"), for the purpose of financing the payment, retirement or defeasance of certain appropriation-backed debt outstanding as of June 30, 2006. Act 91 vested COFINA with all the powers conferred on Government Development Bank under its charter (other than the power to act as fiscal agent), including the power to issue bonds for its corporate purposes, to the extent required in order for the Corporation to carry out the purposes for which it was created. Act 91 provides that present and future collections of the pledged sales tax be transferred to COFINA in exchange for, and in consideration of, COFINA's commitment to pay, or establish mechanisms to pay, all or part of virtually all appropriation-backed debt outstanding as of June 30, 2006 with the net proceeds of the bonds issued by COFINA and with other funds and resources available to COFINA. As of December 31, 2007, $4.5 billion of COFINA's bonds were outstanding, the net proceeds of all of which bonds were used to refinance and retire outstanding debt of 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. Puerto Rico Aqueduct and Sewer Authority ("PRASA") owns and operates the island's public water supply and sanitary sewer facilities systems (the "Systems").

PRASA needs to make substantial investments in infrastructure and a major overhaul of its operations to maintain the viability of the Systems and to finance its expansion for new users. Funds for this investment will be provided through a combination of revenues from PRASA, financing transactions, federal grants and other sources. Debt service on revenue bonds is payable from net revenues of the Systems after payment of current expenses. Due to PRASA's financial difficulties and its inability to access the bond market, the Commonwealth guarantees the principal and interest payments to the bondholders of all outstanding revenue bonds issued by PRASA, including those issued to the United States Department of Agriculture, Rural Development, and loans granted by the Clean Water and Drinking Water State Revolving Funds for the benefit of PRASA. In February 2004, this guaranty was extended through new legislation to include debt obligations issued until 2010.

PRASA reported net operational losses of $361 million and net operational income of $31.2 million during fiscal years 2006 and 2007, respectively. The total debt of PRASA was $2 billion as of December 31, 2007.

Beginning in fiscal year 2006, the Commonwealth's General Fund ceased to provide financial assistance to PRASA, including making payments on PRASA's guaranteed revenue bonds (as of January 1, 2006). As part of its efforts to regain fiscal independence, PRASA implemented substantial increases in water and wastewater service rates in two phases. The first phase took effect on October 10, 2005. The second phase took effect on July 1, 2006. In the event PRASA is unable to make any portion of the future debt service payments on its guaranteed bonds, the Commonwealth would be required to make such payments under its guarantee from the General Fund. PRASA has also begun to pay from its revenues the debt service on a note it issued to Public Finance Corporation (in the principal amount of $368.3 million), which note financed the cost of the north coast super-aqueduct, as well as notes issued to Public Finance Corporation (in the principal amount of approximately $747 million), which notes financed its operations.

In June 2006, PRASA entered into an agreement to plead guilty to an indictment charging 15 felony counts of violating the federal Clean Water Act through the illegal discharge of pollutants from nine sanitary wastewater treatment plants and five drinking water treatment plants. Under the plea agreement, PRASA will pay a criminal fine of $9 million and was placed on five years' probation. PRASA and the United States also reached a comprehensive civil settlement to resolve repeated environmental violations at 62 wastewater treatment plants throughout the Commonwealth. According to the civil settlement, PRASA will spend an estimated $1.7 billion implementing approximately 145 capital improvement projects and other remedial measures at all of its wastewater treatment plants and related collection systems over the next 15 years. In December 2006, PRASA and the Commonwealth Department of Health executed a settlement agreement superseding 180 administrative orders against, and three prior settlement agreements with, PRASA. Under the terms of this agreement, PRASA paid a civil penalty of $1.0 million and agreed to implement short, medium and long-term work plans, as well as interim mitigation and preventative measures, all to bring PRASA's water system into compliance with federal and Commonwealth potable water regulations. The total cost of complying with this settlement agreement is expected to be between $700 and $800 million.

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 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 $108.2 million subordinate Tobacco Settlement Asset-Backed Bonds to pay working capital expenses of the Commonwealth. As of December 31, 2007, 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 the participating cigarette manufacturers under the Master Settlement Agreement. To date, all principal and interest payments required to be made by the Trust on its outstanding bonds have been made on a timely basis from contribution payments made by the participating cigarette manufacturers under the Master Settlement Agreement.

Convention Center District Authority. The Convention Center District Authority was created to own, develop, finance, plan, design, build, operate, maintain, administrate and promote a new convention center and designated private parcels located within the Convention Center District in San Juan. The convention center opened on November 17, 2005.

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 José Miguel Agrelot Coliseum, with a line of credit provided by GDB. The Coliseum was transferred to the Convention Center District Authority along with the associated line of credit. As of December 31, 2007, this line of credit with GDB had an outstanding balance of $150.7 million, which is expected to be paid from the proceeds of Commonwealth general obligation bonds. The Authority's debt as of May 31, 2007 was $624 million including $468.8 million of bonds issued in March 2006 to finance the Convention Center and payable from a portion of a hotel room tax.

Electric Power Authority. The Authority owns and operates the island's electric system. The capital improvement program for the five-year period ending June 30, 2012 is estimated to cost approximately $2.3 billion and will be financed primarily by borrowed funds, supplemented by internally generated funds. The Authority's bonded debt consists of Power Revenue Bonds, secured by a lien on net revenues of the electric system. As of December 31, 2007, the Authority's total debt was $6.6 billion, including $5.5 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 agreements with the operators of two co-generation plants that use fuels other than oil. Currently, these two co-generation plants provide approximately 27% of the Authority's energy needs.

Health Insurance Administration was created in 1993 to negotiate and contract 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 health insurance system covers the entire island, and approximately 1.5 million persons were covered by the system during fiscal year 2007.

In January 2006, the Commonwealth entered into various contracts with several Medicare Advantage Organizations for the provision of health coverage to approximately 200,000 eligible beneficiaries. Pursuant to these agreements, the Commonwealth pays each Medicare Advantage Organization a premium difference to cover services not included in their contracts with the Center for Medicaid and Medicare Services.

The total cost of the health insurance program for fiscal year 2007 was $1.59 billion, compared to $1.56 billion for fiscal year 2006 and $1.46 billion for fiscal year 2005. For fiscal year 2007, the General Fund covered $934.5 million of the total cost of the health insurance program, $203 million of costs were covered with a loan from the GBD, and the remaining $457 million was paid from federal, municipal and other sources. The fiscal year 2008 budget pegs the cost of the health insurance program at $1.67 billion, of which the General Fund is expected to cover $1.061 billion, while the remaining $611 million will be paid from federal, municipal and other sources. The health insurance program projects a $394 million deficit for fiscal year 2009. Negotiations with insurance companies will be focused on cost containment strategies that will seek to reduce this cost to the amount appropriated. See *Budget of the Commonwealth of Puerto Rico*.

Highways and Transportation Authority. The 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 tax on gasoline, one-half of the proceeds of the tax on gas oil and 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 to payments required to be made by the Commonwealth under its guarantees of bonds and notes, to the extent that no other revenues are available for such purpose. The Commonwealth has never applied such revenues for such payment. As of December 31, 2007, the Authority's total debt was $6.7 billion, including $6.4 billion in outstanding bonds.

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. It was constructed under several design/build contracts and is being privately operated under a five-year contract 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 revenue bonds. Tren Urbano commenced operations in June 2005.

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, 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 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.

Industrial Development Company participates in the Commonwealth-sponsored economic development program by providing physical facilities, general assistance, and special incentive grants to manufacturers. The Company was merged with the Economic Development Administration in January 1998. Rentals derived from the leasing of specified facilities of the Company are pledged to the payment of the Company's revenue bonds. As of December 31, 2007, the Company's total debt was $350.4 million. The Company restructured its operations in order to allow it to react quickly to changing business situations. Part of this restructuring included a significant reduction in the number of its employees.

Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority was created to finance (through the issuance of its revenue bonds) 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 AFICA by such private companies, non-profit entities, or government agencies, and do not constitute a debt of the Commonwealth or any of its other public corporations or municipalities. As of December 31, 2007, approximately $1.6 billion of AFICA's bonds were outstanding.

Infrastructure Financing Authority was created 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 those 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 oversees the Puerto Rico Infrastructure Fund, which is 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 $90 million through fiscal year 2009 and will then increase to $117 million annually through fiscal year 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 December 31, 2007, the Authority's total debt was $1.9 billion.

The Authority will invest approximately $405 million in new infrastructure projects in connection with the holding of the Central American and Caribbean Games in Mayagüez, Puerto Rico, in 2010. In September 2006, the Authority issued $469.8 million of bonds to finance these and other infrastructure projects.

Municipal Finance Agency is the 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 and notes 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 December 31, 2007, the Agency had $1.4 billion of bonds outstanding.

Port of the Americas Authority. Port of the Americas Authority is responsible for the development and operation of the Port of the Americas (the "Port"), a deep draft port on the south coast of Puerto Rico. In December of 2004, the first phase of the Port was completed at a cost of $40 million. The Authority is authorized to issue bonds guaranteed by the Commonwealth in a maximum aggregate principal amount of $250 million. The proceeds from these bonds will be used to continue the development of the Port. Currently, GDB is authorized to purchase bonds of the Authority in an aggregate principal amount not to exceed $250 million. As of December 31, 2007, GDB held approximately $99.9 million of the Authority's outstanding bonds, which are guaranteed by the Commonwealth.

Ports Authority. The 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 property and seaport equipment. As of December 31, 2007, the Authority had $655.9 million in debt.

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 secured by the Commonwealth's guaranty. The Authority is authorized by law to have outstanding at any one time up to $3.325 billion of bonds guaranteed by the Commonwealth. As of December 31, 2007, $3.098 billion of such bonds of the Authority were outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds). As of December 31, 2007, Public Building Authority's line of credit with GDB had an outstanding balance of $75 million.

Special Communities Perpetual Trust. The Special Communities Perpetual Trust, a public corporation, is an irrevocable and permanent trust. The Trust's principal purpose is to fund development projects which address the infrastructure and housing needs of underprivileged communities. GDB has made a special capital contribution to the Special Communities Perpetual Trust of $500 million and provided the Trust with a $500 million, non-revolving, line of credit. The amounts transferred by GDB were deposited in two investment accounts held by GDB for the benefit of the Special Communities Irrevocable Trust, of which $698.2 million had been disbursed to the Trust as of December 31, 2007. As of December 31, 2007, the Special Communities Perpetual Trust's line of credit with GDB had an outstanding balance of $376.1 million. The line of credit is payable from legislative appropriations.

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 1999, the Telephone Authority sold a controlling interest in PRTC to a consortium led by a predecessor of Verizon Communications, Inc ("Verizon"). The net proceeds of $1.2 billion, after PRTC's outstanding debt was retired and certain employee benefits were paid, was deposited into the Infrastructure Development Fund held by the Infrastructure Financing Authority. In 2002, Verizon exercised an option to purchase additional shares from the Telephone Authority for $172 million, leaving the Authority with a 28% ownership interest in PRTC. In 2007, the Authority sold its remaining interest in PRTC to a subsidiary of América

Móvil, S.A. de C.V. for $529 million, the proceeds from which were transferred to the Employees Retirement System of the Commonwealth.

University of Puerto Rico (the "University"), with approximately 62,340 students in academic year 2006-2007, is by far the largest institution of higher education on the island. Government appropriations are the principal source of University revenues, but additional revenues are derived from tuition, student fees, auxiliary enterprises, interest income, federal grants, and other sources. University capital improvements have been financed mainly by revenue bonds. As of December 31, 2007, the University's total debt was $629.5 million, including $604.8 million of outstanding revenue bonds.

In 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 was built, is being 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. These bonds are not included in the University's total debt or outstanding revenue bonds set forth in the prior paragraph.

Other public corporations (not described above) have outstanding debt in the aggregate amount of $1.8 billion as of December 31, 2007. Debt service on $685 million of such outstanding debt is being paid from legislative appropriations and sales tax receipts. The Commonwealth is not, however, 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, whose properties are 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

General. 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.

Covered Employees. The Teachers Retirement System covers public school teachers and certain private school teachers, as well as teachers working in administrative positions. Substantially all active teachers of the Commonwealth's Department of Education are covered by Act No. 91 of March 29, 2004 which superseded Act No. 218 of 1951. The new law establishes that: (i) the Teachers Retirement System's active employees as of March 29, 2004 (not public school teachers or other Education Department employees) have the option to participate in the Teachers Retirement System or in the Employees Retirement System; (ii) persons hired by Teachers Retirement System after the approval of the new law may only become members of the Teachers Retirement System, (iii) active teacher employees of the Department of Education are members of the Teachers Retirement System, and (iv) licensed teachers working in private schools or other educational organizations may elect to become members of the Teachers Retirement System as long as the required employer and employee contributions are satisfied. The Judiciary Retirement System covers judges, and the Employees Retirement System covers all other employees of the Commonwealth, its municipalities and instrumentalities. As of June 30, 2007, the total number of participants, including active participants and retirees, in the three systems was as follows: Employees Retirement System, 276,688; Teachers Retirement System, 77,500; and Judiciary Retirement System, 685. The three systems are financed by contributions made by employers (the Commonwealth, public corporations, and municipalities) and employees, and investment income.

Funding Requirements. The central government is responsible for approximately 64% of total employer contributions to the Employees Retirement System, and the other 36% 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 are 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 are 20% of applicable payroll for the employer and 8% for the employees. For the Teachers Retirement System, required contributions are 8.5% of applicable payroll for the employer and 9.0% for the employees.

Actuarial Valuation of Employees and Judiciary Retirement System. 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, 2005, the total pension benefit obligations for the Employees Retirement System and Judiciary Retirement System were $12.284 billion and $179 million, respectively. The unfunded pension benefit obligations of the Employees Retirement System and Judiciary Retirement System for the same period were $9.956 billion and $104 million, respectively, representing funding ratios of 19% and 40%, 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 pension benefit obligation of the Employees Retirement

System to the extent receivables are recognized as such by the Employees Retirement System. The June 30, 2005 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 benefit obligation, the unfunded pension benefit obligation of the System will continue to increase in the short term, and additional funding from the Commonwealth may ultimately be necessary to cover such unfunded obligation.

Actuarial Valuation of Teachers Retirement System. According to the most recent actuarial valuation of the Teachers Retirement System submitted by a firm of independent consulting actuaries, as of June 30, 2007 the accrued actuarial liability of the system was $7.756 billion and the value of its assets amounted to $3.163 billion, representing a funding ratio of 41%, and the resulting unfunded accrued liability was $4.593 billion. The actuarial valuation assumed an investment return of 8%, yearly salary increases of 3.5%, employee and employer contributions of 9% and 8.5%, respectively, an inflation rate of 2.5%, and a remaining amortization period of 30 years for the unfunded accrued liability. Under the same above assumptions, but without taking into account benefits paid under special benefits laws (described below) and does not include the obligation with respect to the prospective payments under special benefits laws because these are not obligations of the Teachers Retirement System, and the funding for such benefits will originate from the Commonwealth's General Fund, as of June 30, 2007, the accrued actuarial liability was $7.227 billion and the value of its assets amounted to $3.163 billion, representing a funding ratio of 44%, and the resulting unfunded accrued liability was $4.064 billion. 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, and additional funding from the Commonwealth may ultimately be necessary to cover such unfunded liability.

Special Benefits. Various special benefits laws enacted in previous years provided for additional benefits for the Employees Retirement System, Teachers Retirement System, and Judiciary Retirement System. 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 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 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. In June 2007, the Legislative Assembly approved a sixth increase of 3% in post retirement benefits effective January 1, 2007. 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 Board of Trustees of the Employees Retirement System 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.

The Teachers Retirement System is seeking reimbursement from the Commonwealth's Office of Management and Budget in the amount of $119 million for special benefits paid by the System to its beneficiaries through June 30, 2004 pursuant to special benefit laws enacted by the Legislative Assembly. The Teachers Retirement System's interpretation of these special benefit laws, to the effect that the Commonwealth is required to reimburse the Teachers Retirement System for such special benefits paid, is being disputed by OMB. This dispute 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 $73.8 million, representing cumulative benefits paid to beneficiaries through June 30, 2005. OMB believes that the basis of the claims from the Employees Retirement System is valid but that the amounts claimed remain to be verified and reconciled.

Amendments to Employees Retirement System. In February 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 Employees Retirement 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 benefit obligation 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.) (see *Public Corporations* – Other Public Corporations – Telephone Authority) 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 Commonwealth has decided to exercise its "tag along" rights in connection with the sale by Verizon of its PRTC stock to Sercotel. As a result of the exercise of such rights, the Employees Retirement System received in June 2007 approximately $529 million from the sale of its remaining stock participation in PRTC.

Historically, the Employees Retirement System achieved a return on investment of less than 2% on the PRTC stock, while the average return of the other assets in its portfolio was approximately 10.8%. In order to improve its funding ratio and address its continuing cash shortfalls, the Employees Retirement System intends to use the proceeds received from the sale of the PRTC stock to acquire other, higher-yield assets, such as personal and mortgage loans to participants of the System.

Cash Flow Shortfalls. The Employees Retirement System's disbursements of benefits during fiscal years 2003 through 2007 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 Department of the Treasury. The cash shortfall for fiscal year 2004 was covered with a loan received from the Department of the Treasury. Balances owed to the Department of 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 assets of the Employees Retirement System. The cash shortfall for fiscal year 2006 was approximately $70 million. This shortfall was covered with a line of credit provided by a private financial institution and collateralized with the assets of the Employees Retirement System. There was no cash shortfall for fiscal year 2007 on account of the receipt of the proceeds from the sale of the PRTC stock. Also with these proceeds the Employees Retirement System paid off the balances of the 2005 repurchase agreement and the 2006 line of credit used to cover the respective year's cash shortfalls.

Efforts to Address Cash Flow Shortfall and Improve Funding Ratio. The Employees Retirement System anticipates that its future cash flow needs for disbursement of benefits to participants are likely to exceed the sum of the employer and employee contributions received and its investment and other recurring income. 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, and the transfer to the Employees Retirement System of any amounts remaining in the Children's Trust after payment of all the outstanding bonds. See "Tax Reform" under *Puerto Rico Taxes, Other Revenues, and Expenditures*.

In addition, the Employees Retirement System is currently undertaking a financing that would significantly increase the System's funding ratio and reduce its unfunded pension benefit obligation. The financing involves the issuance by the Employees Retirement System of debt secured by a pledge of future employer contributions over the next 50 years. All net cash generated by this financing would be deposited into the Employees Retirement System trust to be invested along with its other assets as described above. The Employees Retirement System estimates that the financing will be undertaken during fiscal year 2008 and subsequent years.

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 Teacher's Retirement System for the fiscal years 2006 and 2007 and as of the period ended December 31, 2007.

The Commonwealth of Puerto Rico
Employees Retirement System
Statement of Plan Net Assets*
As of June 30, 2006 and 2007 and as of December 31, 2007

	2008(1) Unaudited	2007(1)	2006(1)
ASSETS			
Cash and Investments:			
Cash and Cash Equivalents:	$ 16,904,000	$ 41,365,000	$ 27,849,000
Deposited with GDB:			
Unrestricted	38,391,000	266,633,000	25,777,000
Restricted	2,458,000	2,310,000	2,156,000
Total Cash	57,753,000	310,308,000	55,783,000
Marketable Securities:			
Notes and Bonds	183,931,000	149,639,000	6,667,000
Stocks	1,689,931,000	1,693,144,000	1,376,901,000
Master Repo	-	-	148,158,000
Alternative investments	51,250,000	47,784,000	41,609,000
Total Cash and Investments	1,925,112,000	1,890,566,000	1,573,336,000
LOANS TO PLAN MEMBERS:			
Mortgage	107,687,000	107,680,000	96,542,000
Personal	702,447,000	440,167,000	406,883,000
Cultural Trips	29,179,000	28,933,000	24,894,000
PEC	529,000	533,000	233,000
Total Loans to Plan Members	839,841,000	577,314,000	528,552,000
Investment in PRTA Holdings	-	-	495,318,000
Total cash, investments and loans to plan members	2,822,707,000	2,778,188,000	2,652,988,000
RECEIVABLES:			
Employer	98,777,000	117,420,000	43,343,000
General Fund of the Commonwealth	2,236,000	4,615,000	10,405,000
The Commonwealth of PR Judiciary	11,974,000	5,113,000	3,161,000
Investment Sales	652,000	2,470,000	1,279,000
Accrued Interest	3,438,000	3,119,000	2,385,000
Dividend Receivable	-	-	23,720,000
Other	25,183,000	4,527,000	23,575,000
Total Receivables	142,261,000	137,264,000	107,868,000
PROPERTY:	6,851,000	7,101,000	7,694,000
OTHER ASSETS:	7,091,000	7,371,000	7,592,000
Construction in Progress	2,938,000	1,375,000	
Total Assets	2,981,848,000	2,931,299,000	2,776,142,000
LIABILITIES			
Book overdraft	43,403,000	1,566,0000	-
Short Term Obligations	-	-	139,074,000
Repurchase Obligations	-	-	1,245,000
Escrow Funds to Plan Members and Guarantee	9,353,000	8,914,000	8,433,000
Investment Purchases	1,499,000	2,172,000	1,179,000
Accounts Payable and Accrued Liabilities	99,366,000	10,125,000	-
Line of Credit	-	-	60,000,000
Other Liabilities	9,893,000	17,022,000	24,880,000
Total Liabilities	163,515,000	39,780,000	209,931,000
Net Assets Held in Trust for Pension Benefits	$2,818,332,000	$2,891,499,000	$2,566,210,000

* Totals may not add due to rounding.
(1) Rounded to the nearest thousand.

The Commonwealth of Puerto Rico
Employees Retirement System
Statement of Changes in Plan Net Assets*
As of June 30, 2006 and 2007 and as of December 31, 2007

The Commonwealth of Puerto Rico
Employees Retirement System
Statement of Changes in Plan Net Assets*
As of June 30, 2006 and 2007 and as of December 31, 2007

	2008[(1)] Unaudited	2007[(1)]	2006[(1)]
ADDITIONS:			
Contributions:			
Employer	$ 187,493,000	$ 374,394,000	$ 398,521,000
Participating Employees	169,935,000	338,791,000	342,830,000
Special	16,789,000	17,000,000	16,684,000
Retirement Benefits	13,457,000	69,097,000	-
Total Contributions	387,674,000	799,282,000	758,035,000
Investment Income:			
Realized Gain or Loss	23,356,000	74,304,000	33,023,000
Unrealized Gain or Loss	(15,277,000)	289,881,000	156,492,000
Dividend Income	2,531,000	14,494,000	49,939,000
Interest Income	48,890,000	68,231,000	63,486,000
Total	59,501,000	446,910,000	302,939,000
Less Investment Expense	(569,000)	(12,940,000)	(10,123,000)
Insurance Premiums	4,260,000	2,441,000	14,492,000
Other Income	5,178,000	17,431,000	8,496,000
Net Investment Income	68,370,000	453,841,000	315,804,000
Total Additions	456,044,000	1,253,123,000	1,073,839,000
DEDUCTIONS:			
Annuities	465,164,000	800,787,000	772,647,000
Special	16,789,000	17,000,000	16,684,000
Death Benefits	9,260,000	13,872,000	14,984,000
Refunds:			
Employers	2,060,000	5,296,000	1,666,000
Participating Employees	18,025,000	28,009,000	20,707,000
Personal Loans Adjustments	-	-	1,658,000
Loan Premium Death Benefits	495,000	2,118,000	1,216,000
Other Expense	15,054,000	6,666,000	
Administrative Expenses	2,364,000	29,208,000	30,817,000
Net Adjustment in the conversion to a new loan application			
Total Deductions	529,210,000	902,955,000	860,379,000
Net Increase	(73,167,000)	350,168,000	213,459,000
Net Assets Restated per Auditors	-	-	-
Net Assets Held in Trust for Pension Benefits:			
Beginning of the Year	2,891,499,000	2,541,331,000	2,327,871,000
End of Year	$ 2,818,332,000	$ 2,891,499,000	$ 2,541,331,000

* Totals may not add due to rounding.

(1) Rounded to the nearest thousand.

The Commonwealth of Puerto Rico
Judiciary Retirement System
Statement of Plan Net Assets*
As of June 30, 2006 and 2007 and as of December 31, 2007

	2008(1) Unaudited	2007(1)	2006(1)
ASSETS			
Cash and Investments:			
Cash and Cash Equivalents	$ 3,110,000	$ 2,735,000	$ 1,599,000
Cash Deposited with GDB			
Unrestricted	1,542,000	197,000	179,000
Restricted	76	192	781
Total Cash	4,652,000	2,932,000	1,779,000
Receivables:			
Accrued Interest	231,000	237,000	250,000
Investment Sales	106,000	179,000	561,000
Other	18,000	86,000	45,000
Total Receivables	355,000	502,000	856,000
Marketable Securities:			
Notes and Bonds	21,468,000	20,728,000	19,822,000
Stock	68,345,000	68,345,000	56,108,000
Total Marketable Securities	89,812,000	89,812,000	75,930,000
LOANS TO PLAN MEMBERS (including accrued interest receivables)			
Mortgage	13,000	17,000	34,000
Personal	363,000	195,000	191,000
Cultural Trips	39,000	44,000	49,000
Total Loans to Plan Members	415,000	256,000	274,000
Total Cash, Investments and Loans to Plan Members	95,235,000	93,072,000	78,838,000
LIABILITIES			
Book Overdraft	1,436,000	5,415,000	1,902,000
Due to the Employees Retirement System of the Government of Puerto Rico	11,974,000	5,113,000	3,161,000
Escrow Funds to Plan Members and Guarantee Insurance	55,000	53,000	52,000
Investment Purchases	193,000	180,000	67,000
Other Liabilities	2,183,000	838,000	807,000
Total Liabilities	15,841,000	11,599,000	5,989,000
Net Assets Held in Trust for Pension Benefits	$79,394,000	$81,473,000	$72,849,000

* Totals may not add due to rounding.
(1) Rounded to the nearest thousand.

The Commonwealth of Puerto Rico
Judiciary Retirement System
Statement of Changes in Plan Net Assets*
As of June 30, 2005, 2006, and 2007 and as of December 31, 2007

	2008[(1)] Unaudited	2007[(1)]	2006[(1)]
ADDITIONS:			
Contributions:			
Employer	$ 3,309,000	$ 6,632,000	$ 6,727,000
Participating employees	1,490,000	2,828,000	2,960,000
Special			
Total Contributions	4,800,000	9,460,000	9,687,000
Investment Income:			
Realized Gain or Loss	906,000	1,484,000	1,189,000
Unrealized Gain or Loss	(1,108,000)	10,954,000	4,630,000
Dividend Income	123,000	224,000	205,000
Interest Income	823,000	1,447,000	1,219,000
Total	744,000	14,110,000	7,243,000
Less Investment Expense		(192,000)	(279,000)
Other Income			1,000
Net Investment Income	744,000	13,918,000	6,965,000
Total Additions	5,543,000	23,378,000	16,652,000
DEDUCTIONS:			
Annuities	6,895,000	13,461,000	12,273,000
Refunds:			
Employers	46,000		
Participating Employees	19,000	38,000	130,000
Administrative Expenses	666,000	1,254,000	1,197,000
Net Adjustment in the conversion to new loans application			
Total Deductions	7,623,000	14,753,000	13,600,000
Net Increase	(2,079,000)	8,624,000	3,052,000
Net Assets Held in Trust for Pension Benefits:			
Beginning of the Year	81,473,000	72,849,000	69,797,000
End of the Year	$79,394,000	$81,473,000	$72,849,000

* Totals may not add due to rounding.
(1) Rounded to nearest thousand.

The Commonwealth of Puerto Rico
Annuities and Pensions for Teachers
Statement of Plan Net Assets*
As of June 30 of the Indicated Years
(in thousands)

	2007	2006	2005
ASSETS			
Cash:			
Cash and cash equivalents	$ 33,542	$ 53,515	$ 79,017
Cash with fiscal agent	-	-	2,853
Cash restricted	-	1,717	1,595
Cash deposited with Government Development Bank for Puerto Rico	3,123	2,993	3,536
Total Cash	36,665	58,225	87,001
Investments, at fair value:			
Bonds and notes	468,452	463,474	257,030
Stocks	2,218,033	1,886,625	1,833,168
Total investment at fair value	2,686,485	2,350,099	2,090,198
Other investments:			
Mortgage notes acquired from third parties		-	-
Private equity investments	46,686	46,215	44,747
Total investments	2,733,171	2,396,314	2,134,945
Loan to plan members:			
Mortgage	102,684	104,830	109,605
Personal	260,066	246,074	234,335
Cultural trips	1,371	1,429	1,338
Total loans to plan members	364,121	352,333	345,278
Total investments and loans	3,133,957	2,806,872	2,567,224
Accounts receivable:			
Receivable for investments sold	12,242	12,163	10,516
Accrued interest and dividends receivable	6,312	6,371	4,449
Other	14,640	14,932	2,593
Total accounts receivable	33,194	33,466	17,558
Property and equipment, net	25,890	25,665	26,206
Other assets	700	691	600
Total Assets	3,193,741	$2,866,694	$2,611,588
LIABILITIES			
Investments purchased	11,258	$11,422	$14,262
Cash overdraft in cash with fiscal agent	5,619	13,949	-
Accounts payable	4,152	3,043	3,768
Obligation under capital lease	35	57	78
Accrued expenses	4,270	4,289	4,314
Line of credit	4	4	4
Escrow fund of mortgage loans and guarantee insurance reserve for loans to plan members	4,916	5,988	6,069
Bonds payable	-	20,430	21,285
Other liabilities	567	625	669
Total liabilities	31,021	59,807	50,449
Net Assets Held in Trust for Pension Benefits	$3,162,720	$2,806,887	$2,561,139

* 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 of the Indicated Years
(in thousands)

	2007	2006	2005
ADDITIONS:			
Contributions:			
Participating Employees	$127,809	$ 129,473	$ 131,481
Employer	116,320	119,199	120,887
Contributions transferred from other systems**	12,396	921	-
Special	57,960	61,066	60,853
Total contributions	314,485	310,659	313,221
Investment Income:			
Interest income	65,367	57,899	47,577
Dividend Income	13,654	14,684	20,339
Net appreciation (depreciation) in fair value of investments	406,131	258,182	161,685
	485,152	330,765	229,601
Less investment expense	6,217	5,792	4,986
Net investment income	478,935	324,973	224,615
Other income	1,299	13,085	1,167
Total additions	$ 794,719	$ 648,717	$ 539,003
DEDUCTIONS:			
Benefit paid to participants:			
Annuities and death benefits	364,998	332,425	313,551
Special benefits	45,564	42,837	38,592
Refunds of contributions	5,447	4,135	2,912
Administrative expenses	22,877	22,651	25,804
Total deductions	438,886	402,969	380,859
Net increase in net assets held in trust for pension benefits	355,833	245,748	158,144
Net assets held in trust for pension benefits			
Beginning of year	2,806,887	2,561,139	2,402,995
End of year	$3,162,720	$2,806,887	$2,561,139

* Totals may not add due to rounding.
** This line item was segregated from Refunds of Contributions for 2006 and 2007, but not in 2005.

COMMONWEALTH FINANCIAL STATEMENTS

For fiscal year 2006, the basic 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 or The Children's Trust special revenue funds (major funds), and certain activities, funds and component units identified separately in its 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, is based solely on the reports of the other auditors. The report of KPMG LLP contains an emphasis paragraph for the adoption of Governmental Accounting Standards Board (GASB)

Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, as of June 30, 2006.

The Comprehensive Annual Financial Report of the Commonwealth ("CAFR") for fiscal year 2006, which includes the basic financial statements of the Commonwealth for fiscal year 2006, was filed by the Commonwealth with each nationally recognized municipal securities information repository (each, a "NRMSIR") in August 2007, and an amendment thereto was filed with each NRMSIR in September 2007.

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 and sales 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 2004 through fiscal year 2006, and the preliminary and projected revenues and expenditures for fiscal years 2007 and 2008, respectively.

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. In fiscal years 2004 and 2005, there were approximately $85 million and $98.6 million, respectively, of such expenditures that are not reflected in the table. A discussion of the budget for fiscal years 2007 and 2008 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)

	2004	2005	2006	2007(*)	2008(+)
Beginning cash balance	$ 179,058	$ 108,512	$ 42,933	$ (0)	$ (478,665)
Revenues from internal sources:					
Income Taxes:					
Individuals	2,720,920	2,885,903	3,087,748	3,112,892	2,898,000
Corporations	1,831,027	1,870,937	1,872,458	2,007,902	1,730,000
Partnerships	3,005	3,245	2,787	2,960	3,000
Withheld from non-residents	631,100	612,005	921,260	933,728	1,206,000
Tollgate taxes	31,579	22,973	27,396	25,082	14,000
Interest	10,108	10,489	11,536	12,112	13,000
Dividends	70,192	80,398	66,721	138,860	64,000
Total income taxes	5,297,931	5,485,950	5,989,906	6,233,536	5,928,000
Sales and use tax	-	-	-	582,560	911,000
Commonwealth excise taxes:					
Alcoholic beverages	296,302	298,235	292,180	279,028	279,000
Cigarettes	144,733	146,527	135,267	132,398	116,000
Motor vehicles	551,181	606,662	533,957	396,667	394,000
Other excise taxes	701,129	740,921	682,477	315,847	94,000
Total Commonwealth excise taxes	1,693,345	1,792,345	1,643,881	1,123,940	883,000
Property taxes	-	3,949	1,106	800	-
Inheritance and gift taxes	15,691	7,129	9,466	4,663	7,000
Licenses	84,231	85,216	91,310	98,594	93,000
Other:					
Lottery	65,387	64,638	62,729	65,508	58,000
Electronic lottery	86,115	68,011	55,212	72,253	96,000
Miscellaneous non-tax revenues	379,501	430,534	431,803(6)	321,154	329,000
Total Other	531,003	563,183	549,744	458,915	483,000
Total revenues from internal sources	7,622,201	7,937,772	8,285,413	8,503,008	8,305,000
Revenues from non-Commonwealth sources:					
Federal excise taxes(1)	328,921	341,166	346,272	372,536	361,000
Customs	34,266	26,731	9,553	14,503	5,000
Total revenues from non-Commonwealth sources	363,187	367,897	355,825	387,039	366,000
Total net revenues	7,985,388	8,305,669	8,641,238	8,890,047	8,671,000
Other Income (refunds)(2)	62,789	(55,409)	76,085	(8,335)	183,917(8)
Transfers to Redemption Fund(3)	(341,538)	(369,985)	(484,812)	(512,197)	(450,702)
Proceeds of notes and other borrowings(4)	3,940,397	4,925,595	4,115,897(7)	1,872,096	2,520,000
Repayment of notes and other borrowings(5)	(3,713,634)	(3,909,434)	(3,005,838)	(1,926,273)	(2,585,620)
Adjusted revenues	7,933,402	8,896,436	9,342,570	8,315,338	8,338,595
Expenditures:					
Grants and subsidies	3,468,531	3,617,386	3,944,349	3,387,199	2,031,701
Personal services	3,951,387	4,783,567	4,796,382	4,590,962	5,990,308
Other services	400,594	389,346	525,377	594,345	426,185
Materials and supplies	73,757	72,411	50,227	79,186	161,924
Equipment purchases	20,572	20,707	19,378	27,965	62,757
Capital outlays and other debt service	675	78,598	49,789	21,576	103,423
Transfers to agencies	-	-	-	92,770	-
Other disbursements	88,432	-	-	-	-
Total expenditures	8,003,948	8,962,015	9,385,503	8,794,003	8,776,298
Adjusted revenues less expenditures	(70,546)	(65,579)	(42,933)	(478,665)	(437,703)
Ending cash balance	$ 108,512	$ 42,933	$ (0)	$ (478,665)	$ (916,368)

(*) Preliminary.
(+) Estimated.
(1) 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.
(2) Consists of net revenues from the General Fund's non budgetary funds plus a reserve for future tax refunds reduced by estimated tax refunds.
(3) Consists of amounts to pay principal of and interest on general obligation bonds and notes of the Commonwealth. Does not include amounts deposited directly into the Redemption Fund from non-General Fund revenues.
(4) Consists of proceeds of borrowing from GDB and proceeds from Commonwealth's Tax and Revenue Anticipation Notes, including a $741 million loan from GDB authorized by the Legislature in 2006.
(5) Consists of repayments of borrowing from GDB and repayments of Commonwealth's Tax and Revenue Anticipation Notes.
(6) Includes proceeds of $100 million generated by the issuance of the Commonwealth's Public Improvement Refunding Bonds, Series 2006 A, which were privately placed.
(7) Includes $50 million from the Emergency Fund used for operating expenses.
(8) Includes $150 million related to the sale of properties.
Source: Department of the Treasury

Fiscal Year 2008

Original General Fund estimated revenues were revised from $9.227 billion to $8.821 billion due to the economic recession and the fact that the Puerto Rico Planning Board revised its estimates on the economic growth to -2.1% for fiscal year 2008. The $406 million revision is reflected in revenue categories associated with economic activity, such as individual, corporate and excise taxes. For fiscal year 2008, as revised, the major revenue categories include: (i) $2.898 billion in individual income taxes, (ii) $1.730 billion in corporate income taxes, (iii) $1.206 billion in non-resident withholdings and (iv) $911 million in sales and use tax.

General Fund expenses for fiscal year 2008 are currently projected to be $9.227 billion, which is the same amount as originally estimated. The difference between revenues, as revised, and expenses for fiscal year 2008 will be covered by federal funds recovery (already received) of approximately $300 million and delinquent income tax receivables of approximately $60 million. The remaining shortfall will be covered by cash management procedures.

Fiscal Year 2007

Preliminary collections for the fiscal year ended on June 30, 2007 totaled $8.890 billion, $7 million more than the Treasury Department's revised estimate for that period. This amount includes (i) $933 million in non-resident withholding, (ii) $1.123 billion in excise taxes, (iii) $583 million of sales tax revenues, and (iv) $269 million from special temporary tax measures.

General Fund expenses for fiscal year 2007 are currently projected to be $9.221 billion, which is $267 million below the amount initially budgeted and takes into consideration $160 million in a portion of savings from the 10% budget reserve and $107 in million in health-related expenditure reductions. The $9.221 billion amount does not include $522 million of debt service payments on a portion of the Commonwealth's outstanding appropriation debt, which debt service was excluded from the budget based on the provisions of Act No. 91 of May 13, 2006, which created the Dedicated Sales Tax Fund to service in part the repayment of such appropriation debt.

The difference between projected revenues and expenses for fiscal year 2007 will be covered, if legislation is approved, by a $240 million transfer of funds from Government Development Bank that was originally set aside from General Fund appropriations to cover a portion of debt service payments on the Commonwealth's appropriation debt which set aside is no longer needed on account of the passage of Act No. 91 referred to above. The remaining shortfall (about $100 million) will be covered by cash management procedures such as delaying payments to certain vendors for a short period of time (carrying over into fiscal year 2008).

Fiscal Year 2006

General Fund total revenues for fiscal year 2006 were $8.541 billion (approximately $235 million, or 2.8%, more than received in fiscal year 2005). This increase was attributable to increases in income taxes ($504 million, including $309 million in taxes withheld from non-residents), together with decreases in external revenues ($12 million), excise taxes ($147 million), and miscellaneous non-tax revenues ($113 million). The increase in revenues from individual income taxes is mainly attributable to administrative measures and economic activity.

The increase in the withholding tax on non-residents includes two extraordinary payments amounting to $200 million.

Total cash expenditures for fiscal year 2006 were $9.596 billion (excluding about $500 million in expenditures that occurred "off budget" for items such as refinanced debt service on general obligation debt and payment of vendor debts from prior years for Public Buildings Authority and subsidy and operational expenses of Agricultural Services and Development Administration) which exceeded original budgeted expenditures by $651 million, attributed mainly to increases in the area of education ($321 million), public safety and protection ($99 million), health ($207 million), and special contributions to pensions ($42 million), and reductions in the area of general government ($4 million), welfare ($3 million), contributions to municipalities ($1 million), and other debt service ($10 million).

The approximately $1.6 billion shortfall was covered by the release of $64 million in reserve funds held at GDB, borrowings from GDB and other sources of about $1.4 billion and about $150 million of "cash management" practices which had the effect of delaying payment of certain expenses until the start of fiscal year 2007. Also, during a two-week period in early May 2006, the Commonwealth was forced to furlough non-essential government workers because it was projected to run out of cash until the above borrowings were implemented in the aftermath of the passage of fiscal and tax reform legislation described below in order to allow the workers to return to work.

Fiscal Year 2005

General Fund total net revenues for fiscal year 2005 were $8.306 billion, representing an increase of $320 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 $188 million, mainly resulting from increases in income taxes collected from individuals of $165 million and in income taxes collected from corporations of $40 million; (ii) increases in total excise taxes of $99 million; and (iii) net increases in other revenues of $32 million, mainly as a result of an increase in miscellaneous non-tax revenues of $51 million.

Total cash expenditures for fiscal year 2005 were $9.220 billion (excluding $98.6 million covered with funds from the Budgetary Fund), which exceeded budgeted expenditures by $366 million, attributed mainly to increases in the area of education ($300.5 million), public safety and protection ($18.6 million), health ($28.7 million), welfare ($10.2 million), and economic development ($8 million). This amount also excludes approximately $98.6 million of additional expenditures that were not originally budgeted. Various financing transactions were entered into to cover this imbalance.

Fiscal Year 2004

General Fund total net revenues for fiscal year 2004 were $7.985 billion, representing an increase of $394 million, or 5.2%, 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 $377 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.

Tax Reform

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

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

Act 117 also repealed the 5% general excise tax imposed on imported goods and the 3.6% general excise tax imposed on goods manufactured in Puerto Rico. Other items, such as fuel, crude oil and petroleum products, and vehicles, however, will remain subject to the excise tax previously applicable to such items, and are not subject to the Sales Tax.

The Sales Tax became effective on November 15, 2006 and the effective date of the repeal of the 5% general excise tax was October 16, 2006. Municipalities were authorized to implement the Municipal Sales Tax starting on July 1, 2006, and most have done so. The revenues derived from the Sales Tax are distributed as follows: (i) municipal governments retain 13/15 of the Municipal Sales Tax (equivalent to a tax of 1.5% out of the total 7% Sales Tax), (ii) the Dedicated Sales Tax Fund, created by Act No. 91 of May 13, 2006, as amended, receives one-seventh of the Sales Tax (equivalent to a tax of 1% out of the total 7% Sales Tax), and (iii) the General Fund receives the balance of the Sales Tax (equivalent to a tax of 4.5% out of the total 7% Sales Tax). The Secretary of the Treasury projects for fiscal year 2008 that each percentage point of the Sales Tax will generate annually approximately $202 million of gross revenues and that the Sales Tax will generate total annual gross revenues for the General Fund of approximately $911 million. For fiscal year 2007, the corresponding projections are $191 million and $576 million. The increase in revenues to be generated by the Sales Tax has been partly offset by the elimination of the 5% general excise tax and the effect of the income tax reduction measures included in Act 117.

Act 117 also provided for special income tax rates with respect to certain transactions occurring on and between July 1, 2006 and December 31, 2006 (the "Transition Period"). Eligible dividends declared by domestic corporations or partnerships during the Transition Period will qualify for a 5% special income tax. The dividend does not need to be distributed to qualify for the 5% special income tax rate. During the Transition Period, Act 117 also provides a special tax rate of 5% (10% in the case of resident corporations and partnerships) in connection with "built-in" gains associated to capital assets held for periods in excess of six months (the "Special Capital Gains Tax"). In order to take advantage of the Special Capital Gains Tax, a taxpayer must file an election with the Secretary of the Treasury. The sale of the capital asset is not required to qualify for the Special Capital Gains Tax. In addition to the other conditions mentioned herein, the Special Capital Gains Tax is only available in connection with capital assets consisting of stock or participations of domestic and foreign corporations and partnerships, and real property located in Puerto Rico. However, in the case of resident corporations and partnerships, the Special Capital Gains Tax applies only to real property located in Puerto Rico.

For a discussion of the budget imbalance in fiscal year 2007 and the revenues generated through March 31, 2007 from the provisions of Act 117, see "Fiscal Year 2007" under "Summary and Management's Discussion of General Fund Results" above.

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 four tax brackets for individuals with tax rates of 7%, 14%, 25%, 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 10%.

Interest income in excess of $2,000 on deposit with Puerto Rico financial institutions is taxed at a rate of 10%; 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, estates, corporations and partnerships 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.

In general, 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. In addition, Act No. 98 of May 16, 2006, provides for an extraordinary tax of 5% on resident corporations and partnerships engaged in business for pecuniary profit and whose gross income for the immediately preceding taxable year ended on or prior to December 31, 2005 exceed $10 million. The 5% tax must be paid on or prior to July 31, 2006 and such amount may be subsequently claimed as a tax credit against such entity's income tax liability. Act No. 89 of May 13, 2006 also imposes an additional special tax for the taxable year commencing in 2006 of 2% on the net income subject to standard taxation of all corporations operating under the provisions of the Puerto Rico Banking Law.

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 15%. 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 15%. 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 15% 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.

Sales and Use Taxes

The Sales Tax is imposed on the sale, use, consumption and storage of taxable items, which include tangible personal property, taxable services, admission rights and combined transactions, subject to certain exceptions and limitations. The Sales Tax is not imposed on, among other things: (i) taxable items acquired by merchants for resale, (ii) taxable items acquired by manufacturing plants, (iii) taxable items acquired for use and consumption outside of Puerto Rico, (iv) certain food products that do not need to be heated before their sale, (v) prescription drugs, (vi) the rental payments received by a lessor of real property which is used for residential or commercial purposes, (vii) services provided by designated professionals, (viii) cash, cash equivalents, stocks, bonds, notes, mortgage loans, insurance, securities and interest derived for the use or forbearance of money, (ix) sales of real property, and (x) leases in which the Industrial Development Company is the owner of the property. The Sales Tax was effective starting on November 15, 2006 and is projected to generate for the General Fund approximately $911 million for fiscal year 2008.

Excise Taxes

The P.R. Code imposed an excise tax on certain articles and commodities, such as cigarettes, alcohol, sugar, cement, motor vehicles and certain petroleum products, which are taxed at different rates. The excise tax imposed on articles and commodities imported into Puerto Rico for consumption in Puerto Rico ended on October 16, 2006 and has been replaced by the previously described sales and use tax on November 15, 2006.

Other Taxes and Revenues

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

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

Revenues from non-Commonwealth sources include customs duties collected in Puerto Rico and excise taxes on shipments of rum from the island to the United States mainland. The customs duties and excise taxes on shipments are imposed and collected by the United States and returned to the Commonwealth. The excise tax on shipments of rum from Puerto Rico and other rum producing countries is \$13.50 per gallon. Of this amount, the lesser of \$13.25 per proof gallon and the actual excise tax imposed is currently returned to the Treasury.

Property Taxes

Personal property, which accounts for approximately 48% 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, 2003 through June 30, 2007.

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)
2003	$23,316,400	$834,974	$671,163	$79,421	$750,584
2004	23,841,557	874,294	706,677	79,772	786,449
2005	25,277,795	899,893	738,074	50,751	788,825
2006	25,606,121	925,618	801,497	70,908	872,405
2007	26,898,519	982,400	813,700	79,720	893,420

(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, Sales 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. With the elimination of the general excise tax last October, Treasury excise tax personnel have been reassigned to monitor compliance with the new sales tax.

Transfers to General Obligation Redemption Fund

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

Components of General Fund Expenditures

Grants and Subsidies

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

Personal Services

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

Other Services

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

Materials and Supplies

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

Equipment Purchases

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

Capital Outlays and Other Debt Service

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

Transfers to Agencies

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

Other Expenditures

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

Federal Grants

Puerto Rico receives grants under numerous federal programs. Federal grants to the agencies and instrumentalities of the Commonwealth government, including public corporations, are estimated to be $4.150 billion for fiscal year 2009, a decrease of $65.2 million, or 1.5%, from fiscal year 2008. 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 2005 through 2007 are actual figures. The figures for fiscal year 2008 are estimates based on the information submitted by each agency to OMB and the figures for fiscal year 2009 are the amounts included in the recommended budget.

The Commonwealth of Puerto Rico
Federal Grants
(in thousands)

	2005	2006	2007	2008(1)	2009(2)
Education	$ 963,032	$1,004,138	$ 986,574	$ 972,708	$ 971,873
Social Services	1,952,405	1,888,150	1,923,845	1,989,398	1,989,692
Health	383,635	432,868	436,892	466,921	479,925
Labor and Human Resources(3)	150,612	197,296	183,228	225,191	231,500
Crime	29,313	41,461	29,631	28,770	26,172
Housing(4)	524,856	371,104	375,581	440,028	343,975
Drug and Justice	6,781	36,979	35,321	16,219	31,609
Agriculture and Natural Resources	9,439	11,402	12,484	9,859	8,083
Contributions to Municipalities	56,371	53,744	48,531	48,531	48,531
Other	14,256	18,251	17,095	17,766	18,852
TOTAL	$4,090,700	$4,055,393	$4,049,182	$4,215,391	$4,150,212

(1) Estimated.
(2) Recommended.
(3) Amounts include grants to the Right to Work Administration and the Occupational Development and Human Resources Council.
(4) 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 in the agencies of the Executive Branch. In helping to formulate the Governor's budget, OMB evaluates the effectiveness of agency programs, policies, and procedures, assesses competing funding demands among agencies, and sets funding priorities.

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

Budgetary Process

The fiscal year of the Commonwealth begins each July 1. The Governor is constitutionally required to submit to the 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, as was the case for fiscal year 2006, 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.

Fiscal Reform

On May 25, 2006, the Governor signed Act No. 103 providing for a fiscal reform of the Commonwealth government (the "Fiscal Reform Legislation"). The Fiscal Reform Legislation applies to every instrumentality and entity of the Executive Branch funded, in whole or in part, from the General Fund and sets forth, as the public policy of the Commonwealth, the reduction of government spending, the elimination or consolidation of redundant agencies, the reduction of government payroll without causing the layoff of regular employees or increasing the actuarial liability of the retirement systems, the limitation of unnecessary, extravagant or excessive spending, and the limitation of public relations and other similar expenses. Despite his approval of the Fiscal Reform Legislation, the Governor has stated that certain of its provisions may be unconstitutional because they infringe on Executive Branch prerogatives. As such, the Governor has informed the Legislative Assembly that certain provisions of the Fiscal Reform Legislation will be implemented at the Executive Branch's discretion and through the use of the Executive Branch's prerogatives. There is no assurance that the Fiscal Reform Legislation will result in the intended reduction of expenditures or that it will be implemented as enacted or that it will not be judicially challenged.

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 expenditures 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 March 31, 2008, the Budgetary Fund balance was $0.

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 in 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 March 31, 2008, the balance in the Emergency Fund was less than $1 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 of the Legislative Assembly are made by a single annual law known as the Joint Resolution of the General Budget.

(ii) General Fund appropriations for special operating expenses, for contributions to municipalities, the University of Puerto Rico and the Judiciary Branch and for capital expenditures 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.

For fiscal year 2007, approximately 47% of the General Fund was committed for payment of the central government payroll. In addition, approximately 26% 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, among others, and debt service on the direct debt of the Commonwealth. For fiscal year 2008, it is proposed that approximately 47% and 6% of the General Fund be committed for payment of the central government payroll (not including the University of Puerto Rico and judicial branch) and debt service on the direct debt of the Commonwealth, respectively. Commencing with fiscal year 2004, the Commonwealth appropriates 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.

Budget for Fiscal Year 2008

The consolidated budget for fiscal year 2008 totals $26.9 billion. Of this amount, $14.3 billion is assigned to the central government. This includes General Fund total appropriations of $9.227 billion, which represents an increase of $3 million over expenditures for fiscal year 2007. The following table presents a summary of the Commonwealth's proposed central government budget appropriations for the fiscal year ending June 30, 2008.

Commonwealth of Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ending June 30, 2008
(in thousands)*

	General Fund	Bond Fund	Special Funds	Total
Revenues from internal sources:				
Property taxes	$ 0	$ -	$ 120,726	$ 120,726
Personal income taxes	2,898,000	-	-	2,898,000
Retained non-resident income tax	1,206,000	-	-	1,206,000
Corporate income taxes	1,730,000	-	-	1,730,000
Partnership income taxes	3,000	-	-	3,000
Tollgate taxes	14,000	-	-	14,000
17% withholding tax on interest	13,000	-	-	13,000
10% withholding tax on dividends	64,000	-	-	64,000
Inheritance and gift taxes	7,000	-	-	7,000
Sales and use taxes	911,000		-	911,000
Excise taxes:				
Alcoholic beverages	279,000	-	-	279,000
Motor vehicles and accessories	394,000	-	-	394,000
Cigarettes	116,000	-	-	116,000
Other (excise taxes)	94,000	-	24,400	118,400
Licenses	93,000	-	-	93,000
Miscellaneous non-tax revenues:				
Contributions from lottery fund	58,000	-	-	58,000
Electronic lottery	96,000	-	-	96,000
Registration and document certification fees	184,000	-	-	184,000
Other	145,000	-	346,469	491,469
Total revenues from internal sources	8,305,000	-	491,595	8,796,595
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	361,000	-	-	361,000
Federal grants	-	-	4,215,391	4,215,391
Customs	5,000	-	-	5,000
Total revenues from non-Commonwealth sources	366,000	-	4,215,391	4,581,391
Total revenues	8,671,000	-	4,706,986	13,377,986
Other:				
Other Income	150,000	-		150,000
Balance from previous year	-	-	744,251	744,251
Bonds authorized	-	-	-	-
Total other sources	150,000	-	744,251	894,251
Total resources	8,821,000	-	5,451,237	14,272,237
Appropriations:				
Current expenses:				
General government	825,110	-	59,936	885,046
Education	3,340,777	-	1,209,947	4,550,724
Health	1,480,448	-	505,587	1,986,035
Welfare	365,106	-	2,335,248	2,700,354
Economic development	187,454	-	97,182	284,636
Public safety and protection	1,692,489	-	72,984	1,765,473
Transportation and communication	86,440	-	70,801	157,241
Housing	26,139	-	268,267	294,406
Contributions to municipalities	360,779	-	1,781	362,560
Special pension contributions	296,132	-	-	296,132
Debt service	450,702	-	120,726	571,428
Other debt service (appropriations)	103,424	-	56,348	159,772
Total appropriations – current expenses	9,215,000	-	4,798,807	14,013,807
Capital improvements	12,000	-	182,419	194,419
Total appropriations	9,227,000	-	4,981,226	14,208,226
Year-end balance	(406,000)	-	470,011	64,011
Total appropriations and year-end balance	$ 8,821,000	-	$ 5,451,237	$14,272,237

* Totals may not add due to rounding.
(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

Projected expenses and capital improvements of all budgetary funds total $14.2 billion, a decrease of $42.7 million from fiscal year 2007. The major changes in General Fund expenditures by program in fiscal year 2008 are mainly due to increases in health (up $99.1 million), public safety and protection (up $76.2 million), special pension contributions (up $30.1 million), transportation and communication (up $9.4 million), other debt service (up $8.9 million), housing (up $1.6 million) and decreases in welfare (down $100.8 million), debt service on Commonwealth's general obligation and guaranteed debt (down $49.2 million), contributions to municipalities (down $26.9 million), economic development (down $21.3 million), education (down $20.8 million) and general government (down $2 million).

Proposed Budget for Fiscal Year 2009

The proposed consolidated budget for fiscal year 2009 totals $26.3 billion. Of this amount, $14.6 billion is assigned to the central government. This includes General Fund total resources and appropriations of $9.488 billion, which represents an increase of $261 million over approved expenditures for fiscal year 2008. The fiscal year 2009 budget marks the third consecutive year in which budgeted expenditures are below the fiscal year 2006 level. The increase in expenditures is mainly due to University of Puerto Rico, judiciary and municipal formula increases and salary increases mandated by law or collective bargaining agreements. An additional $42.3 million is budgeted for the State Election Commission. The General Fund revenue projection for fiscal year 2009 is $8.488 billion, a decrease of $183 million, or 2.1%, from estimated net revenues for fiscal year 2008 of $8.671 billion. The Commonwealth's budgeted expenditures for fiscal year 2009 of $9.488 billion exceed projected revenues of $8.488 by approximately $1 billion. The Commonwealth's economic team is working together to enforce spending control measures that have been established to attempt to minimize the budget risk. In addition, the Governor has proposed two special measures which are expected to generate close to $1 billion in fiscal year 2009. These measures consist of tax receivable financings and proceeds received from a concession agreement for operation of the electronic lottery. Legislation authorizing these two measures was submitted by the Governor along with the budget. No assurance can be given that either of these measures will be enacted, or that if enacted, they will be in the forms recommended by the Governor. The following table presents a summary of the Commonwealth's proposed central government budget appropriations for the fiscal year ending June 30, 2009.

Commonwealth of Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ending June 30, 2009
(in thousands)*

	General Fund	Bond Fund	Special Funds	Total
Revenues from internal sources:				
Property taxes	$ -	$ -	$ 121,330	$ 121,330
Personal income taxes	2,770,000	-	-	2,770,000
Retained non-resident income tax	1,015,000	-	-	1,015,000
Corporate income taxes	1,751,000	-	-	1,751,000
Partnership income taxes	3,000	-	-	3,000
Tollgate taxes	10,000	-	-	10,000
17% withholding tax on interest	12,000	-	-	12,000
10% withholding tax on dividends	67,000	-	-	67,000
Inheritance and gift taxes	5,000	-	-	5,000
Sales and use taxes	977,000			977,000
Excise taxes:				
Alcoholic beverages	292,000	-	-	292,000
Motor vehicles and accessories	414,000	-	-	414,000
Cigarettes	121,000	-	-	121,000
Other (excise taxes)	95,000	-	21,701	116,701
Licenses	96,000	-	-	96,000
Miscellaneous non-tax revenues:				
Contributions from lottery fund	59,000	-	-	59,000
Electronic lottery	89,000	-	-	89,000
Registration and document certification fees	195,000	-	-	195,000
Other	140,000	-	358,747	498,747
Total revenues from internal sources	8,111,000	-	501,778	8,612,778
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	372,000	-	-	372,000
Federal grants	-	-	4,150,212	4,150,212
Customs	5,000	-	-	5,000
Total revenues from non-Commonwealth sources	377,000	-	4,150,212	4,527,212
Total revenues	8,488,000	-	4,651,990	13,139,990
Other:				
Other Income	1,000,000	-		1,000,000
Balance from previous year	-	-	470,011	470,011
Bonds authorized	-	-	-	-
Total other sources	1,000,000	-	470,011	1,470,011
Total resources	9,488,000	-	5,122,001	14,610,001
Appropriations:				
Current expenses:				
General government	898,263	-	59,554	957,817
Education	3,430,540	-	1,372,284	4,802,824
Health	1,560,237	-	501,945	2,062,182
Welfare	492,816	-	2,345,347	2,838,163
Economic development	180,378	-	94,356	274,734
Public safety and protection	1,706,674	-	69,105	1,775,779
Transportation and communication	96,515	-	75,670	172,185
Housing	29,240	-	274,863	304,103
Contributions to municipalities	378,190	-	1,781	379,971
Special pension contributions	313,641	-	0	313,641
Debt service	288,000	-	121,330	409,330
Other debt service (appropriations)	113,506	-	56,644	170,150
Total appropriations – current expenses	9,488,000	-	4,972,879	14,460,879
Capital improvements	-	-	92,635	92,635
Total appropriations	9,488,000	-	5,065,514	14,553,514
Year-end balance	-	-	56,487	56,487
Total appropriations and year-end balance	$ 9,488,000	-	$ 5,122,001	$14,610,001

* Totals may not add due to rounding.
(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

Projected expenses and capital improvements of all budgetary funds total $14.6 billion, an increase of $345.3 million from fiscal year 2008. The major changes in General Fund expenditures by program in fiscal year 2009 are mainly due to increases in welfare (up $127.7 million), education (up $89.8 million), health (up $79.8 million), general government (up $73.2 million), special pension contribution (up $17.5 million), contributions to municipalities (up $17.4 million), public safety and protection (up $14.2 million), other debt service (up $10.1 million), transportation and communication (up $10.1 million), housing (up $3.1 million) and decreases in debt service on Commonwealth's general obligation and guaranteed debt (down $162.7 million) and economic development (down $7.1 million).

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 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 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, 2006, the Commonwealth has included in its financial statements reported liabilities of approximately $306 million for awarded and anticipated unfavorable judgments. While amounts claimed exceed $9 billion, such amount represents 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 $800 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 Supreme Court of Puerto Rico, however, upheld a partial ruling allowing the Commonwealth to deduct from the payments due to the centers certain of the payments received by the centers from the federal government. Currently, audits are being carried out on the plaintiff centers. As of June 30, 2006, the Commonwealth has accrued $55 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 also a defendant in 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 court may now award damages to the class action members, and in doing so may consider the claims in groups or each case individually. This will require that the parents prove the damages suffered. The Commonwealth plans to defend vigorously each case. As of June 30, 2006, the Commonwealth had accrued $440 million for this legal contingency.

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 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, if any, would not be significant.

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APPENDIX II

COPY OF APPROVING OPINION OF SQUIRE, SANDERS & DEMPSEY L.L.P. AND CONVERSION OPINION OF SIDLEY AUSTIN LLP

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October 16, 2007

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

Dear Sir:

We have served as bond counsel in connection with the issuance by the Commonwealth of Puerto Rico of its $926,570,000 aggregate principal amount of Public Improvement Refunding Bonds, Series 2007A (the "Bonds"). The Bonds are dated, mature on July 1 of the years and in such principal amounts and bear interest at the rates, all as set forth in the Resolution referred to hereinbelow. The Bonds are issuable as fully registered Bonds without coupons, in Authorized Denominations, in the manner and in accordance with the terms and conditions of the Resolution.

In our capacity as bond counsel, we have examined the transcript of the proceedings (the "Transcript") of the Commonwealth of Puerto Rico relating to the issuance of the Bonds, including, without limitation, Act No. 2 of the Legislature of Puerto Rico (the "Legislature"), approved October 10, 1985 and Joint Resolution No. 57 of the Legislature, approved July 12, 1993 (collectively, the "Act"), and a resolution adopted on October 3, 2007 by the Secretary of the Treasury of Puerto Rico and approved by the Governor of Puerto Rico (the "Resolution"), and such other documents as we have deemed necessary to render this opinion.

We have also examined a copy of one of the Bonds as executed and authenticated. We assume that all other Bonds have been similarly executed and authenticated.

From such examination, we are of the opinion that:

1. The Act is valid.

2. Said proceedings have been validly and legally taken.

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

4. The interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and is not an item of tax preference under Section 57 of the Code for purposes of the federal alternative minimum tax imposed on individuals and corporations. The Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation. We express no opinion as to any other tax consequences regarding the Bonds.

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

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

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

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

Respectfully submitted,

Squire, Sanders + Dempsey L.L.P.

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_______ __, 2008

Secretary of the Treasury of the
Commonwealth of Puerto Rico
Department of the Treasury
San Juan, Puerto Rico

Banco Popular de Puerto Rico, registrar
under the Resolution referred to below
San Juan, Puerto Rico

UBS Securities LLC
New York, New York

Wachovia Bank, National Association
Charlotte, North Carolina

Ladies and Gentlemen:

Re: Commonwealth of Puerto Rico Public
Improvement Refunding Bonds, Series 2007A-_

In connection with the conversion of the above-captioned bonds (originally issued on October 16, 2007, the "Bonds") from the ARS Rate Period (as defined in the Resolution hereinafter mentioned) to either the Weekly Interest Rate Period of the Daily Interest Rate Period as described below, we have examined a certified copy of the bond resolution, adopted by the Secretary of the Treasury of the Commonwealth of Puerto Rico (the "Secretary") on October 3, 2007, as amended (the "Resolution") and originals or copies satisfactory to us of all records, agreements, certificates and other documents as we have deemed relevant and necessary as a basis for the opinions hereinafter expressed. In such examination we have assumed the genuineness of all signatures and the authenticity of all documents submitted to us as originals and the conformity to originals of all items submitted to us as certified or photostatic copies. Capitalized terms not otherwise defined herein shall have the respective meanings ascribed thereto in the Resolution.

On April 7, 2008, the Secretary gave notice of his election to have the Bonds convert on May __, 2008 (the "Rate Adjustment Date") from an ARS Rate Period to either a Weekly or a

Daily Interest Rate Period pursuant to Sections 4(d) and 4(e) of the Resolution. This opinion is being delivered pursuant to Sections 5(a)(b) and 11(b)(ii) of the Resolution.

Based upon the foregoing, under existing law, we are of the opinion that, subject to the satisfaction of the various conditions to the implementation of the proposed conversion on or prior to the Rate Adjustment Date contained in the Resolution and any other agreements executed in connection with the adoption of the Resolution, the proposed conversion of the Bonds from the ARS Rate Period to either the Weekly Interest Rate Period or the Daily Interest Rate Period on the Rate Adjustment Date (1) is permitted under the Resolution, (2) will not affect the validity of the Bonds and (3) will not in and of itself impair or affect the exclusion of interest on the Bonds from gross income for purposes of federal income taxation.

By rendering this opinion, we express no opinion as to the exclusion from gross income of interest on the Bonds for federal income tax purposes. Further, we have not been engaged to make, and have not made, any inquiry or investigation with respect to any circumstances that may have occurred since the date of issuance of the Bonds that would adversely affect the exclusion from gross income of interest on the Bonds for purposes of federal income taxation.

The opinions expressed herein are for the benefit of the addressees only and may not be quoted, circulated, assigned or delivered to any other person or for any other purpose without our prior written consent. The opinions expressed herein are based on an analysis of existing laws, including regulations, rulings, official interpretations of law issued by the United States Internal Revenue Service, and court decisions on or prior to the date hereof. Such opinions may be adversely affected by actions taken or events occurring, including a change in law, regulation or ruling (or in the application or official interpretation of any law, regulation or ruling) after the date hereof. We have not undertaken to determine, or to inform any person, whether such actions are taken or such events occur, and we have no obligation to update this opinion in light of such actions or events.

Respectfully submitted,

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