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

In the opinion of Hawkins, Delafield & Wood, Bond Counsel, under the provisions of the Acts of Congress now in force, and under existing statutes and court decisions, and assuming compliance with the tax covenants described herein, (i) interest on the Offered Bonds is excluded from gross income for Federal income tax purposes, and (ii) interest on the Offered Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Internal Revenue Code of 1986, as amended (the "Code"); such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax that may be imposed on such corporations. In addition, in the opinion of Bond Counsel, under existing statutes, the Offered Bonds, and the interest thereon, are exempt from state, Commonwealth of Puerto Rico and local income taxation. See "TAX MATTERS" herein.

$1,292,960,000
COMMONWEALTH OF PUERTO RICO
$455,000,000 Public Improvement Bonds of 2002, Series A
$837,960,000 Public Improvement Refunding Bonds, Series 2002 A
(General Obligation Bonds)

Dated: Date of Delivery **Due: July 1, as shown below**

The Offered Bonds are issuable as registered bonds without coupons in denominations of $5,000 or any multiple thereof. Interest on the Offered Bonds will be payable January 1, 2002 and each July 1 and January 1 thereafter. Certain of the Offered Bonds are subject to redemption prior to maturity as set forth herein, the earliest possible date of redemption being July 1, 2011. See *The Offered Bonds*.

Concurrently with the issuance of the Offered Bonds, the Commonwealth of Puerto Rico (the "Commonwealth") is issuing its $20,000,000 Public Improvement Bonds of 2002, Series B. The Series B Bonds are being offered for sale solely in the Commonwealth pursuant to a separate Official Statement.

The Offered 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 Offered Bonds. The Constitution of Puerto Rico provides that public debt of the Commonwealth, including the Offered Bonds, constitutes a first claim on available Commonwealth revenues.

The Offered Bonds are offered for delivery when, as and if issued and accepted by the Underwriters subject to the approval of legality by Hawkins, Delafield & Wood, New York, New York, Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the Underwriters by Pietrantoni Méndez & Alvarez LLP, San Juan, Puerto Rico. It is expected that settlement for the Offered Bonds will occur in New York, New York, on or about October 25, 2001.

UBS PAINEWEBBER INC.	GOLDMAN, SACHS & CO.	SALOMON SMITH BARNEY
ABN AMRO FINANCIAL SERVICES, INC.		BANC OF AMERICA SECURITIES LLC
BEAR, STEARNS & CO. INC.	WACHOVIA SECURITIES	LEHMAN BROTHERS
MERRILL LYNCH & CO.		MORGAN STANLEY

October 11, 2001

$1,292,960,000
Commonwealth of Puerto Rico
$455,000,000 Public Improvement Bonds of 2002, Series A
$837,960,000 Public Improvement Refunding Bonds, Series 2002 A

$455,000,000 Public Improvement Bonds of 2002, Series A

$51,000,000 5⅜% Term Bond due July 1, 2028; Yield 5.05%*
$100,400,000 5½ % Term Bond due July 1, 2029; Yield 5.02%
$303,600,000 5⅛% Term Bond due July 1, 2031; Yield 5.17%

$837,960,000 Public Improvement Refunding Bonds, Series 2002 A

Maturity July 1,	Amount	Interest Rate	Yield
2009	$5,465,000	3.75%	3.80%
2010	5,645,000	3.80	3.90
2011	5,845,000	4.00	4.02
2012	5,895,000	4.15	4.18
2012	14,850,000	5.50	4.18
2013	2,275,000	4.25	4.30
2013	37,210,000	5.50	4.30
2014	755,000	4.40	4.43
2014	61,540,000	5.50	4.43
2015	930,000	4.50	4.54
2015	64,595,000	5.50	4.54
2016	1,095,000	4.60	4.64
2016	49,635,000	5.50	4.64
2016†	1,000,000	4.50	4.38
2016†	49,000,000	5.50	4.38
2017	1,280,000	4.70	4.73
2017	4,795,000	5.50	4.73
2017+	100,000,000	5.50	4.57
2018	330,000	4.80	4.82
2018	93,575,000	5.50	4.82
2019	655,000	4.90	4.90
2019	94,955,000	5.50	4.90
2019‡	6,770,000	4.60	4.61
2019‡	18,190,000	5.50	4.61
2020†	156,120,000	5.50	4.67
2021†	55,555,000	5.50	4.72

*Yield to July 1, 2011 call date.
†Insured by MBIA Insurance Corporation.
+Insured by XL Capital Assurance Inc.
‡Insured by Ambac Assurance Corporation.

Commonwealth of Puerto Rico

Governor

SILA M. CALDERÓN

Members of the Cabinet

CÉSAR MIRANDA
Chief of Staff

FERDINAND MERCADO
Secretary of State

ANABELLE RODRÍGUEZ
Secretary of Justice

JUAN A. FLORES GALARZA
Secretary of the Treasury

CÉSAR REY
Secretary of Education

VÍCTOR RIVERA HERNÁNDEZ
Secretary of Labor and Human Resources

JOHNNY RULLÁN
Secretary of Health

FERNANDO TOLEDO
Secretary of Agriculture

JOSÉ IZQUIERDO
Secretary of Transportation and Public Works

RAMÓN CANTERO-FRAU
Secretary of Economic Development and Commerce

YOLANDA ZAYAS
Secretary of Family Affairs

ILEANA ECHEGOYEN
Secretary of Housing

SALVADOR SALAS QUINTANA
Secretary of Natural and Environmental Resources

FERNANDO TORRES RAMÍREZ
Secretary of Consumer Affairs

JORGE ROSARIO
Secretary of Sports and Recreation

VÍCTOR RIVERA GONZÁLEZ
Secretary of Corrections and Rehabilitation

Legislative Officers

ANTONIO FAS ALZAMORA
President, Senate

CARLOS VIZCARRONDO
Speaker, House of Representatives

Fiscal Officers

MELBA ACOSTA
Director, Office of Management and Budget

JUAN AGOSTO ALICEA
President, Government Development Bank for Puerto Rico

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

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

TABLE OF CONTENTS

$1,292,960,000

Commonwealth of Puerto Rico

$455,000,000 Public Improvement Bonds of 2002, Series A
$837,960,000 Public Improvement Refunding Bonds, Series 2002 A
(General Obligation Bonds)

INTRODUCTORY STATEMENT

This Official Statement of the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico"), which includes the cover page, the inside cover page, the appendices hereto and the report incorporated by reference below, provides certain information in connection with the sale of $455,000,000 Commonwealth of Puerto Rico Public Improvement Bonds of 2002, Series A (the "Series A Bonds") and $837,960,000 Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 2002 A (the "Refunding Bonds" and collectively with the Series A Bonds, the "Offered Bonds"). Concurrently with the issuance of the Offered Bonds, the Commonwealth is issuing its $20,000,000 Public Improvement Bonds of 2002, Series B (the "Series B Bonds" and together with the Offered Bonds, the "2002 Bonds"). The Series B Bonds are being offered for sale solely in the Commonwealth pursuant to a separate Official Statement.

The Series A Bonds and Series B Bonds (the "Public Improvement Bonds") are being issued under the provisions of Act No. 54 of the Legislature of Puerto Rico, approved July 6, 2001 ("Act No. 54"), and pursuant to a resolution authorizing the issuance of the Public Improvement Bonds (the "Public Improvement Bond Resolution") adopted by the Secretary of the Treasury and approved by the Governor of Puerto Rico on October 11, 2001. The Refunding Bonds are being issued under the provisions of Act No. 33 of the Legislature of Puerto Rico, approved December 7, 1942 ("Act No. 33" and together with Act No. 54, the "Acts") and pursuant to a resolution authorizing the issuance of the Refunding Bonds (the "Refunding Bond Resolution" and together with the Public Improvement Bond Resolution, the "Bond Resolutions") adopted by the Secretary of the Treasury and approved by the Governor of Puerto Rico on October 11, 2001.

Payment of the principal of and interest on certain of the Refunding Bonds maturing on July 1, 2016 as indicated on the inside cover page of this Official Statement and on the Refunding Bonds maturing July 1 of the years 2020 and 2021 (the "MBIA Insured Bonds") when due will be insured by a municipal bond insurance policy (the "MBIA Bond Insurance Policy") to be issued by MBIA Insurance Corporation ("MBIA") simultaneously with the delivery of the Offered Bonds. Payment of the principal of and interest on certain of the Refunding Bonds maturing on July 1, 2017 as indicated on the inside cover page of this Official Statement (the "XLCA Insured Bonds") when due will be insured by a municipal bond insurance policy (the "XLCA Bond Insurance Policy") to be issued by XL Capital Assurance Inc. ("XLCA") simultaneously with the delivery of the Offered Bonds. Payment of the principal of and interest on certain of the Refunding Bonds maturing on July 1, 2019 as indicated on the inside cover page of this Official Statement (the "Ambac Insured Bonds", and collectively with the MBIA Insured Bonds and the XLCA Insured Bonds, the "Insured Bonds") when due will be insured by a financial guaranty insurance policy (the "Ambac Financial Guaranty Insurance Policy") to be issued by Ambac Assurance Corporation ("Ambac") simultaneously with the delivery of the Offered Bonds.

Under the Acts, 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 Offered Bonds. The Constitution of Puerto Rico provides that public debt of the Commonwealth, including the Offered Bonds, constitutes a first claim on available Commonwealth revenues.

This Official Statement includes the cover page, the inside cover page, the appendices and the Comprehensive Annual Financial Report of the Commonwealth for the fiscal year ended June 30, 2000 prepared by the Department of the Treasury (the "Commonwealth's Annual Financial Report"), which includes the general purpose financial statements of the Commonwealth for the fiscal year ended June 30, 2000, together with the independent auditor's report thereon, dated December 29, 2000, of Deloitte & Touche LLP, certified public accountants, and is incorporated by reference herein. 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 the Commonwealth's Annual Financial Report filed with each NRMSIR and the Municipal Securities Rulemaking Board (the "MSRB") or any other document containing the Commonwealth's Annual Financial Report filed with each NRMSIR after the date hereof and prior to the termination of the offering of the Offered Bonds shall be deemed to be incorporated by reference into this Official Statement and to be part of this Official Statement from the date of filing of such document. Any statement contained herein or in any of the above described documents incorporated herein by reference shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any subsequently filed document modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Commonwealth will provide without charge to any person to whom this Official Statement is delivered, on the written or oral request of such person, a copy of the Commonwealth's Annual Financial Report incorporated herein by reference. Requests should be directed to Director-New York Office, Government Development Bank for Puerto Rico, 140 Broadway, 38th Floor, New York, NY 10005, telephone number (212) 422-6420 or to Director-General Obligations Division, Government Development Bank for Puerto Rico, P.O. Box 42001, San Juan, PR 00940, telephone number (787) 722-7060.

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

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

OVERVIEW

The following is a summary of certain information regarding the Commonwealth contained in the Commonwealth of Puerto Rico Financial Information and Operating Data Report dated September 25, 2001 (the "Commonwealth Report"), attached hereto as *Appendix I*. This summary does not purport to be complete and is qualified in its entirety by reference to more detailed information appearing in the Commonwealth Report, which should be read in its entirety.

Puerto Rico is located approximately 1,600 miles southeast of New York City. According to the United States Census Bureau, its population was 3,808,610 in 2000. 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.

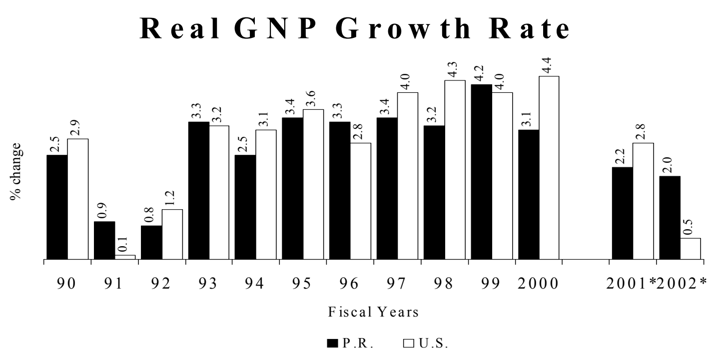
Economic Trends

Puerto Rico has enjoyed eighteen years of uninterrupted economic expansion. Almost every sector of the economy has participated in this expansion and record levels of employment have been achieved. Factors contributing to this expansion include government-sponsored economic development programs, periodic declines in the exchange value of the United States dollar, increases in the level of federal transfers, the relatively low cost of borrowing and low oil prices.

Gross product increased from $30.4 billion in fiscal 1996 to $41.4 billion ($34.8 billion in 1996 prices) in fiscal 2000. This represents an increase of 36.3% (14.7% in 1996 prices). Since fiscal 1985, personal income, both aggregate and per capita, has increased consistently each fiscal year. In fiscal 2000, aggregate personal income was $38.2 billion ($34.6 billion in 1996 prices)[*] and personal income per capita was $9,870 ($8,925 in 1996 prices).

According to the Labor Department's Household Employment Survey, average employment increased from 1,092,000 in fiscal 1996, to 1,159,470 in fiscal 2000. Average unemployment decreased from 13.8% in fiscal 1996 to 11.0% in fiscal 2000. According to the same survey, total employment decreased 0.1% from fiscal 2000 to fiscal 2001. Total monthly employment averaged 1,157,850 during fiscal 2001, compared to 1,159,466 during fiscal 2000. The seasonally adjusted unemployment rate for fiscal 2001 was 10.5%. During the first two months of fiscal 2002, total monthly employment averaged 1,142,000 compared to 1,178,000 in the same period of fiscal 2001, representing a decline of 3.1%. As a result, the unemployment rate increased from 10.5% to 11.7% during the first two months of fiscal 2002.

The Planning Board's gross product forecast for fiscal 2001 and fiscal 2002, issued in March 2001, projected an increase of 2.2% for fiscal 2001 and 2.0% for fiscal 2002. The performance of the economy during fiscal 2002 will depend primarily on the performance of the United States economy, the level of oil prices and the level of interest rates. In the past Puerto Rico has been heavily dependent on oil imports for its energy needs. As a result of the construction of two cogeneration plants, however, one of which burns liquefied natural gas and is now operational, and the other of which will burn coal and is expected to become operational during 2002, Puerto Rico's dependence on oil imports for its energy needs is expected to be reduced by approximately 30%. See "Other Public Corporations - Electric Power Authority" under *Public Corporations* in *Appendix I*.



*DRI Forecast Shock 9/01. The DRI projection of the U.S. growth rate was revised after the events of September 11. The projection of the P.R. growth rate has not been revised after such events.

[*]Different price deflators are used for gross product and personal income statistics.

Puerto Rico has a diversified economy with manufacturing and services comprising its principal sectors. Manufacturing is the largest sector in terms of gross domestic product. According to the Planning Board's figures, manufacturing generated $27.4 billion, or 43.5%, of gross domestic product and accounted for 13.7% of total employment in fiscal 2000, as compared with fiscal 1999, when it generated $26.6 billion, or 44.4%, of gross domestic product and accounted for 13.9% of total employment. See "Economic Performance by Sector" under *The Economy* in *Appendix I*. 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. Over the last three decades, industrial development has become more capital intensive and more dependent on skilled labor. This gradual shift in emphasis is best exemplified by the heavy investment in the pharmaceutical, scientific instruments, computers and electrical products industries in Puerto Rico over the last decade. One of the factors assisting the development of the manufacturing sector has been the tax incentives offered by the federal and Puerto Rico governments. Federal legislation enacted in 1996, however, which amended Section 936 of the Internal Revenue Code of 1986, phases out the federal tax incentives during a ten-year period. See "Tax Incentives - Incentives Under the Code" under *The Economy* in *Appendix I*.

The services sector, which includes hotel and related services and currently accounts for approximately 50.7% of total employment, generated $24.0 billion, or 38.1%, of Puerto Rico's gross domestic product in fiscal 2000, as compared with $22.3 billion, or 37.2%, of gross domestic product in fiscal 1999.

Growth in construction contributed to increased economic activity in fiscal 2000. The growth in the construction industry was evidenced by a nominal increase of 7.3% in construction investment for fiscal 2000 over fiscal 1999.

Tourism continues to make a significant contribution to economic activity. More than 4.6 million visitors spent $2.4 billion in Puerto Rico in fiscal 2000. San Juan has become the largest home port for cruise ships in the Caribbean and the fourth largest home port for cruise ships in the world. Twenty-six U.S. and international airlines offer scheduled service to and from San Juan, and a major airline uses San Juan as a hub for its intra-Caribbean operations. This reflects the importance of Puerto Rico as a tourist destination and as a transportation hub in the Caribbean.

Recent Events

As a result of the terrorist attacks in the United States on September 11, at present there is uncertainty as to the expected level of economic activity in Puerto Rico during the remainder of fiscal 2002. It is possible that these recent events will cause a temporary loss in consumer and business confidence, thus triggering a reduction in the level of economic activity in Puerto Rico and a decrease in General Fund revenues from those estimated in the fiscal 2002 budget. It is not possible at this time to predict with certainty how the Puerto Rico economy will be affected. One of the sectors expected to be affected immediately is tourism, as the level of leisure and business travel is reduced. Although tourism has been one of the sectors which has demonstrated consistent growth during the last decade, total visitors' expenditures represented only 3.8% of gross domestic product for fiscal 2000. It is too early to estimate what long term impact, if any, the terrorist attacks will have on the economy of Puerto Rico. The information appearing in this Official Statement with respect to periods subsequent to August 2001 does not consider the effects, if any, of these recent events.

The Commonwealth government is in the process of formulating measures to reduce the economic impact of these recent events. The Governor has met with business leaders to discuss how the government and the private sector can work together to restore consumer and business confidence. One of the steps the government proposes to take is to accelerate its capital investment program in order to stimulate economic activity.

Fiscal Management

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

Section 7 of Article VI of the Constitution of Puerto Rico provides that: "The appropriations made for any fiscal year shall not exceed the total revenues, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided by law."

The financial statements of the Commonwealth for fiscal 2000 were audited by Deloitte & Touche LLP, whose report thereon is dated December 29, 2000. For a summary of the Commonwealth's significant accounting policies, see Note 1 to the Commonwealth's general purpose financial statements included in the Commonwealth's Annual Financial Report. Preparation of the audited financial statements of the Commonwealth involves the collection and combination of audited financial statements from 50 separate reporting entities.

Debt Management

The Constitution of Puerto Rico limits the amount of general obligation debt that can be issued. The Commonwealth's policy has been and continues to be to maintain the level of such debt within a prudent range below the constitutional limitation. See "Debt Limitation" under *The Offered Bonds*.

Historically, the Commonwealth has maintained a fiscal policy which provides for a prudent relationship between the growth of public sector debt and the growth of the economic base required to service that debt. During fiscal 1996, 1997 and 1998, however, public sector debt increased at a rate greater than the growth of gross product due to an increase in the amount of debt incurred to finance certain key infrastructure projects, which are important to the development of the economy and are expected to produce long term economic benefits, and to refinance outstanding debt, enabling the Commonwealth to benefit from historically low levels of interest rates and realize debt service savings. During fiscal 1999 and 2000, growth of public sector debt was below the growth of gross product. Public sector debt increased by 12.1% during fiscal 2001. Corresponding information about the growth of the gross product during fiscal 2001 is not yet available. The increase in the rate of growth of public sector debt during fiscal 2001 is in part due to the issuance during such fiscal year of $1,092,550,000 of bonds of the Infrastructure Financing Authority and $397,005,000 of bonds of the Children's Trust Fund, both of which are payable from sources other than Commonwealth appropriations or taxes or revenues of public corporations derived from services or products. Excluding these bond issues, the rate of growth of public sector debt for fiscal 2001 was 5.9%. See "Trends of Public Sector Debt" under *Debt* and "Economic Performance by Sector - Construction" under *The Economy* in *Appendix I*.

PLAN OF FINANCING

The Series A Bonds

The net proceeds of the Series A Bonds will be deposited in (i) the 2002 Public Improvements Fund established under Act No. 54 to carry out the capital improvement programs authorized by the Legislature, including but not limited to highways and transportation facilities, aqueduct and sewer facilities, schools, health and social welfare facilities, agricultural and tourism facilities, parks and other recreation facilities, flood control and solid waste facilities, housing, municipal projects, and other governmental projects, and (ii) the Extraordinary Maintenance Fund established under Act No. 66 of the Legislature of Puerto Rico, approved August 14, 1991, to be used for infrastructure projects related to water resources, in the amounts specified below under "Sources and Uses of Funds."

The Refunding Bonds

The Refunding Bonds will be issued for the purpose of refunding certain general obligation bonds of the Commonwealth, as follows (the "Refunded Bonds"):

Refunded Bonds	Principal Amount to be Refunded	Interest Rate	Maturity Date July 1,	Redemption Date	Redemption Price (% of Par)
Public Improvement Refunding Bonds, Series 1987	$ 8,757,492.50*†	—	2003	—	—
Public Improvement Refunding Bonds, Series 1987	8,048,262.75*†	—	2004	—	—
Public Improvement Bonds of 1988, Series A	6,379,551.40*	—	2003+	—	—
Public Improvement Bonds of 1989, Series A	998,764.65*	—	2002	—	—
Public Improvement Bonds of 1989, Series A	1,001,211.30*	—	2003	—	—
Public Improvement Bonds of 1989, Series A	1,000,213.10*	—	2004	—	—
Public Improvement Bonds of 1989, Series A	2,098,040.00*	—	2005	—	—
Public Improvement Bonds of 1989, Series A	1,006,020.00*†	—	2006	—	—
Public Improvement Bonds of 1990	4,295,750.40*	—	2005	—	—
Public Improvement Bonds of 1990	3,973,624.95*	—	2006	—	—
Public Improvement Bonds of 1990	1,148,360.00*†	—	2007	—	—
Public Improvement Bonds of 1991	2,263,133.15*	—	2004	—	—
Public Improvement Bonds of 1991	2,107,755.00*	—	2005	—	—
Public Improvement Bonds of 1991	1,950,097.50*	—	2006	—	—
Public Improvement Bonds of 1991	1,816,951.50*	—	2007	—	—
Public Improvement Bonds of 1992	6,850,000.00	6.10	2002	—	—
Public Improvement Bonds of 1993	7,170,000.00	5.40	2003	07/01/2002	101.50
Public Improvement Bonds of 1993	7,585,000.00	5.40	2004	07/01/2002	101.50
Public Improvement Bonds of 1993	8,025,000.00	5.50	2005	07/01/2002	101.50
Public Improvement Refunding Bonds, Series 1993	5,505,000.00†	5.10	2002	—	—
Public Improvement Refunding Bonds, Series 1993	4,000,000.00†	8.00	2002	—	—
Public Improvement Refunding Bonds, Series 1993	3,270,000.00†	5.20	2003	—	—
Public Improvement Refunding Bonds, Series 1993	3,695,000.00†	5.30	2004	—	—
Public Improvement Refunding Bonds, Series 1993	1,995,000.00†	5.375	2005	—	—
Public Improvement Bonds of 1994	6,035,000.00	5.70	2002	—	—
Public Improvement Bonds of 1994	6,375,000.00	5.80	2003	—	—
Public Improvement Bonds of 1994	6,745,000.00	7.50	2004	—	—
Public Improvement Bonds of 1994	7,255,000.00	6.00	2005	07/01/2004	101.50
Public Improvement Bonds of 1994	7,690,000.00	6.10	2006	07/01/2004	101.50
Public Improvement Bonds of 1995	6,395,000.00	4.90	2002	—	—
Public Improvement Bonds of 1995	6,705,000.00	6.50	2003	—	—
Public Improvement Bonds of 1995	7,145,000.00	6.50	2004	—	—
Public Improvement Bonds of 1995	7,610,000.00	6.50	2005	—	—
Public Improvement Bonds of 1995	8,100,000.00	5.20	2006	07/01/2005	101.50
Public Improvement Bonds of 1995	8,525,000.00	5.30	2007	07/01/2005	101.50
Public Improvement Bonds of 1995	42,780,000.00	5.75	2024	07/01/2005	101.50
Public Improvement Bonds of 1996	6,515,000.00	4.40	2002	—	—
Public Improvement Bonds of 1996	6,800,000.00	4.50	2003	—	—
Public Improvement Bonds of 1996	7,110,000.00	4.60	2004	—	—
Public Improvement Bonds of 1996	7,435,000.00	5.50	2005	—	—
Public Improvement Bonds of 1996	7,845,000.00	5.50	2006	—	—
Public Improvement Bonds of 1996	8,275,000.00	6.50	2007	—	—
Public Improvement Bonds of 1997	7,995,000.00	4.625	2004	—	—
Public Improvement Bonds of 1997	8,365,000.00	5.50	2005	—	—
Public Improvement Bonds of 1997	8,825,000.00	5.50	2006	—	—
Public Improvement Bonds of 1997	9,310,000.00	6.00	2007	—	—
Public Improvement Bonds of 1997	33,280,000.00	5.75	2017	07/01/2007	101.50
Public Improvement Bonds of 1997, Series B	12,860,000.00	5.50	2002	—	—
Public Improvement Bonds of 1997, Series B	39,945,000.00	5.50	2003	—	—
Public Improvement Bonds of 1998	8,755,000.00	4.50	2002	—	—
Public Improvement Bonds of 1998	9,150,000.00	5.00	2003	—	—
Public Improvement Bonds of 1998	9,605,000.00	5.00	2004	—	—
Public Improvement Bonds of 1998	10,090,000.00	5.00	2005	—	—
Public Improvement Bonds of 1998	10,590,000.00	5.75	2006	—	—
Public Improvement Bonds of 1998	11,200,000.00	5.75	2007	—	—
Public Improvement Bonds of 1999	6,755,000.00†	5.00	2002	—	—
Public Improvement Bonds of 1999	7,090,000.00†	3.55	2003	—	—
Public Improvement Bonds of 1999	7,345,000.00†	3.65	2004	—	—
Public Improvement Bonds of 1999	7,610,000.00†	4.15	2005	—	—
Public Improvement Bonds of 1999	7,930,000.00†	5.00	2006	—	—
Public Improvement Bonds of 1999	8,325,000.00†	5.00	2007	—	—
Public Improvement Refunding Bonds, Series 1999**	4,685,000.00†	5.00	2005	—	—
Public Improvement Refunding Bonds, Series 1999‡	5,880,000.00†	5.00	2005	—	—
Public Improvement Bonds of 2000	7,700,000.00	4.50	2002	—	—

Refunded Bonds	Principal Amount to be Refunded	Interest Rate	Maturity Date July 1,	Redemption Date	Redemption Price (% of Par)
Public Improvement Bonds of 2000	8,045,000.00	5.00	2003	—	—
Public Improvement Bonds of 2000	8,450,000.00	5.00	2004	—	—
Public Improvement Bonds of 2000	8,870,000.00	4.70	2005	—	—
Public Improvement Bonds of 2000	9,290,000.00	4.80	2006	—	—
Public Improvement Bonds of 2000	9,735,000.00	5.25	2007	—	—
Public Improvement Bonds of 2000	6,390,000.00†	5.00	2008	—	—
Public Improvement Bonds of 2000	15,355,000.00	5.75	2016	07/01/2010	100.00
Public Improvement Bonds of 2000	16,235,000.00	5.75	2017	07/01/2010	100.00
Public Improvement Bonds of 2000	17,170,000.00	5.75	2018	07/01/2010	100.00
Public Improvement Bonds of 2000	18,160,000.00	5.75	2019	07/01/2010	100.00
Public Improvement Bonds of 2000	19,200,000.00	5.75	2020	07/01/2010	100.00
Public Improvement Bonds of 2000	20,305,000.00	5.75	2021	07/01/2010	100.00
Public Improvement Bonds of 2000	110,935,000.00	5.75	2026	07/01/2010	100.00
Total	$771,710,228.20				

* Capital Appreciation Bonds. Stated amount reflects initial principal amount.
† Partial refunding.
+ $3,310,292.25 initial principal amount is being redeemed on July 1, 2002 pursuant to an amortization requirement.
**Originally issued in the principal amount of $50,000,000.
‡ Originally issued in the principal amount of $62,730,000.

The Secretary of the Treasury will deposit the net proceeds of the Refunding Bonds into escrow funds (the "Escrow Funds") with Banco Popular de Puerto Rico (the "Escrow Agent"). The net proceeds of the Refunding Bonds will be invested in two guaranteed investment contracts with Trinity Plus Funding Company, LLC, one of which will be collateralized and insured by Financial Guaranty Insurance Company and the other of which is not collateralized or insured, the principal of and interest (or other payments) on which, with any uninvested moneys, will be sufficient to pay the principal of and premium, if any, on the Refunded Bonds on the maturity or redemption dates set forth above, which redemption dates will be irrevocably designated by the Secretary of the Treasury, and to pay the interest thereon to such dates.

The sufficiency of the amount so deposited, with investment earnings thereon, to accomplish the refunding of the Refunded Bonds referred to above, will be verified by Samuel Klein and Company (the "Verification Agent"). Since the Refunded Bonds are being refunded with guaranteed investment contracts instead of United States Treasury obligations, the Refunded Bonds will continue to be outstanding under the terms of their respective authorizing resolutions and for the purpose of applying the debt limitation under Section 2 of Article VI of the Constitution of Puerto Rico.

Sources and Uses of Funds

Sources:

Principal amount of the Offered Bonds	$1,292,960,000
Net original issue premium	83,067,261
Total sources	$1,376,027,261

Uses:

Deposit into the 2002 Public Improvements Fund	$ 433,134,404
Deposit into the Extraordinary Maintenance Fund	24,500,000
Deposit into Escrow Funds for Refunded Bonds	903,743,100
Underwriting discount, insurance premiums and legal, printing, and other financing expenses	14,649,757
Total uses	$1,376,027,261

THE OFFERED BONDS

General

The Offered Bonds will be dated, bear interest at such rates, be payable at such times, and mature on the dates and in the principal amounts set forth on the cover and inside cover page of this Official Statement. The Offered Bonds are subject to redemption at the times and at the prices set forth below in "Redemption."

Book-Entry Only System

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

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

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds securities that its participants (the "Direct Participants") deposit with DTC. DTC also facilitates the settlement among Direct Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in Direct Participants' accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc. and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (the "Indirect Participants" and, together with the Direct Participants, the "Participants"). The Rules applicable to DTC and its Participants are on file with the Securities and Exchange Commission.

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

To facilitate subsequent transfers all Offered 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 Offered Bonds with DTC and their registration in the name of Cede & Co. effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Offered Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Offered Bonds are credited, which 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.

Redemption notices will be sent to Cede & Co. If less than all of the Offered 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 the Offered Bonds to be redeemed.

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

Principal, redemption premium, if any, and interest payments on the Offered Bonds will be made to DTC or to such other nominee as may be requested by DTC. DTC's practice is to credit Direct Participants' accounts on the payable date in accordance with their respective holdings shown on DTC's records unless DTC has reason to believe that it will not receive payment on the payable date. 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, the Commonwealth, or Banco Popular de Puerto Rico as registrar (the "Registrar"), 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 DTC is the responsibility of the Commonwealth or the Registrar, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Offered 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 Offered Bonds are required to be printed and delivered.

The Commonwealth may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, definitive Offered Bonds will also 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 Offered 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 Offered 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 Offered Bonds will be payable by check mailed to the respective addresses of the registered owners determined as of the applicable record date thereof provided in the applicable Bond Resolution as shown on the registration books of the Commonwealth maintained by the Registrar. The Offered Bonds will be issued only as registered Offered Bonds without coupons in denominations of $5,000 or any multiple thereof. The transfer of the Offered 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 Legislature. Pursuant to this power, the Legislature enacted the Acts, which authorize the issuance of the Offered Bonds.

Redemption

The Refunding Bonds are not subject to redemption prior to maturity. The Series A Bonds are subject to redemption prior to maturity as described below.

Optional Redemption. At the option of the Secretary of the Treasury and upon at least 30 days' notice, the Series A Bonds maturing on July 1 of the years 2028 and 2031 are subject to redemption, from any moneys that may be available for that purpose (other than from moneys set aside in respect of an amortization requirement), prior to maturity, on or after July 1, 2011, either in whole or in part, on any date, as directed by the Secretary of the Treasury, at the principal amount of such Series A Bonds to be redeemed, together with accrued interest to the date fixed for redemption, without premium.

Mandatory Redemption. The Series A Bonds maturing July 1 of the years 2029 and 2031 (the "Term 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 Term Bonds and otherwise subject to adjustment as described below), upon at least 30 days' notice, on July 1, 2026 and on July 1, 2029, 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 for Series A Bonds due	
July 1	**July 1, 2029**	**July 1, 2031**
2026	$ 6,105,000	
2027	17,255,000	
2028	835,000	
2029	76,205,000†	$ 9,445,000
2030		124,175,000
2031		169,980,000†
Average life (years) . . .	27.1	29.2

† Maturity.

If the amount of the Term Bonds purchased or redeemed exceeds the amount of the amortization requirement for such bonds for such fiscal year, the amortization requirement for such 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 or Deposit in Trust

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

Subject to certain provisions of the Public Improvement Bond Resolution, Series A Bonds and portions of Series A Bonds which have been duly called for redemption under the provisions of the Public Improvement Bond Resolution, or with respect to which irrevocable instructions to call for redemption or to pay at maturity have been given, and for the payment of the principal of and redemption premium, if any, and the accrued interest on which sufficient moneys or investments permitted by law shall be held in separate trust for the owners of the Series A Bonds or portions thereof to be paid or redeemed, shall not be deemed to be outstanding under the Public Improvement Bond Resolution, and the registered owners thereof shall have no rights in respect thereof except to receive payment of the principal thereof and the redemption premium, if any, and the accrued interest thereon from said separate trust.

Each notice of redemption shall contain, among other things, the particular Series A Bonds (or portions thereof) being called for redemption, the redemption date and price and the address at which such Series A 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 Bond will not affect the validity of the proceedings for the redemption of any other Bond.

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

Security

Provision for Payment of Public Debt

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

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

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

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

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

Special Fund for General Obligation Debt Service

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

Act No. 39 of the Legislature of Puerto Rico, approved May 13, 1976, as amended ("Act No. 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 funds otherwise deposited therein will be equal to the sum of one-sixth of the interest to be paid in the next six months and one-twelfth of the principal to be paid or required to be amortized within the next twelve months on all bonds and notes of the Commonwealth for which its full faith and credit are pledged as the same become due and all bonds and notes of the Commonwealth for which the guaranty of the Commonwealth has been exercised. Moneys in the Redemption Fund are held in trust by Government Development Bank. Act No. 39 provides that the obligation of the Secretary of the Treasury to make the above transfers is cumulative, and the amount of any deficiency in any month shall be added to the amount of transfers required in future months until such deficiency has been fully paid. On August 29, 2001, the amount on deposit in the Redemption Fund was $85,307,990, which was the required amount.

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

Payment Record

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

Debt Limitation

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

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

On June 7, 2001, the Commonwealth authorized the issuance, on a delayed basis, of $501,565,000 aggregate principal amount of its Public Improvement Refunding Bonds, Series 2002 (the "Forward Delivery Bonds"). The Forward Delivery Bonds have been sold and will be delivered in April of 2002. A portion of the proceeds of the Forward Delivery Bonds will be invested in guaranteed investment contracts instead of United States Treasury obligations. The bonds to be refunded with the proceeds of such guaranteed investment contracts will be treated as outstanding for purposes of the 15% debt limitation.

After giving effect to the issuance of the 2002 Bonds, future maximum annual debt service for the Commonwealth's outstanding general obligation debt is $626,113,289 in the fiscal year ending June 30, 2003.* Debt service for the PRASA Guaranteed Bonds paid by the Commonwealth during fiscal 2001 (including for this purpose debt service payments due July 1, 2001) was $33,473,102. See "Debt Service Requirements for Commonwealth General Obligation Bonds and Certain Guaranteed Debt" under *Public Sector Debt of the Commonwealth*, below. The sum of those amounts ($659,586,392) is equal to 9.94% of $6,634,417,500, which is the average of the adjusted internal revenues for the two fiscal years ended June 30, 2000 and June 30, 2001. If the Refunded Bonds were treated as not being outstanding (they will be treated as outstanding because they will be refunded with the proceeds of guaranteed investment contracts instead of United States Treasury obligations) the percentage referred to in the preceding sentence would be 8.29%.

Upon the issuance of the Forward Delivery Bonds in April 2002, the percentage referred to in the last sentence of the preceding paragraph will be 10.51%. If all of the bonds being refunded with proceeds of the Forward Delivery Bonds invested in guaranteed investment contracts were deemed not to be outstanding, such percentage would be 7.85%.

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.

BOND INSURANCE

The MBIA Bond Insurance Policy

The following information has been furnished by MBIA for use in this Official Statement. No representation is made by the Commonwealth as to the accuracy or completeness of the information. Reference is made to *Appendix III* for a specimen of the MBIA Bond Insurance Policy.

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

The MBIA Bond Insurance Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any MBIA Insured Bond. The MBIA Bond Insurance Policy does not, under any circumstance, insure against loss relating to: (i) optional or mandatory redemptions (other than mandatory sinking fund redemptions);

---

*Future maximum annual debt service will be $663,603,802 in the fiscal year ending June 30, 2003 after giving effect to the issuance of the Forward Delivery Bonds and the refunding of the bonds refunded thereby, as discussed below under "Pro Forma Public Sector Debt" in *Public Sector Debt of the Commonwealth*.

(ii) any payments to be made on an accelerated basis; (iii) payments of the purchase price of MBIA Insured Bonds upon tender by an owner thereof; or (iv) any Preference relating to (i) through (iii) above. The MBIA Bond Insurance Policy also does not insure against nonpayment of principal of or interest on the MBIA Insured Bonds resulting from the insolvency, negligence or any other act or omission of the Registrar or any other paying agent for the MBIA Insured Bonds.

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

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

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

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

MBIA Information. The following documents filed by the Company with the Securities and Exchange Commission (the “SEC”) are incorporated herein by reference:

(1) The Company’s Annual Report on Form 10-K for the year ended December 31, 2000;

(2) The Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2001; and

(3) The report on Form 8-K filed by the Company on January 30, 2001.

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

The Company files annual, quarterly and special reports, information statements and other information with the SEC under File No. 1-9583. Copies of the SEC filings (including (1) the Company's Annual Report on Form 10-K for the year ended December 31, 2000, (2) the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001, and (3) the report on Form 8-K filed by the Company on January 30, 2001) are available (i) over the Internet at the SEC's web site at http://www.sec.gov; (ii) at the SEC's public reference room in Washington D.C.; (iii) over the Internet at the Company's web site at http://www.mbia.com; and (iv) at no cost, upon request to MBIA Insurance Corporation, 113 King Street, Armonk, New York 10504. The telephone number of MBIA is (914) 273-4545.

As of December 31, 2000, MBIA had admitted assets of $7.6 billion (audited), total liabilities of $5.2 billion (audited), and total capital and surplus of $2.4 billion (audited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of June 30, 2001, MBIA had admitted assets of $8.1 billion (unaudited), total liabilities of $5.8 billion (unaudited), and total capital and surplus of $2.3 billion (unaudited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

Financial Strength Ratings of MBIA. Moody's Investors Service, Inc. ("Moody's") rates the financial strength of MBIA "Aaa."

Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("S&P"), rates the financial strength of MBIA "AAA."

Fitch, Inc. ("Fitch") rates the financial strength of MBIA "AAA."

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

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

The XLCA Bond Insurance Policy

The following information has been supplied by XLCA for inclusion in this Official Statement. No representation is made by the Commonwealth as to the accuracy or completeness of the information. Reference is made to *Appendix IV* for a specimen of the XLCA Bond Insurance Policy.

General. XLCA is a monoline financial guaranty insurance company incorporated on July 25, 1991 under the laws of the State of New York. XLCA is currently licensed to do insurance business in, and is subject to the insurance regulation and supervision by, the State of New York, forty-two other states, the District of Columbia and Singapore. XLCA has license applications pending in the majority of the states in which it is not currently licensed.

XLCA is an indirect wholly-owned subsidiary of XL Capital Ltd, a Cayman Islands corporation ("XL Capital Ltd"). Through its subsidiaries, XL Capital Ltd is a leading provider of insurance and reinsurance, including coverages relating to certain financial risks, to industrial, commercial and professional service firms, insurance companies and other enterprises on a worldwide basis. The common stock of XL Capital Ltd is publicly traded in the United States and listed on the New York Stock Exchange. **Neither XL Capital Ltd nor, except as set forth below, any subsidiaries or shareholders of XL Capital Ltd is obligated to pay the debts of or claims against XLCA.**

XLCA was formerly known as The London Assurance of America Inc. (“London”). On February 22, 2001, XLCA’s direct parent, XL Reinsurance America Inc. (“XL Re”), acquired 100% of the stock of London. XL Re merged its former financial guaranty subsidiary, known as XL Capital Assurance Inc. (formed September 13, 1999) with and into London, with London as the surviving entity. London immediately changed its name to XL Capital Assurance Inc. The name change is effective in the majority of states where XLCA is licensed, including the State of New York. XLCA has applications pending to change its name with the insurance departments of several other states in the United States. All previous business of London was 100% reinsured to Royal Indemnity Company, the previous owner at the time of acquisition.

Reinsurance. XLCA has entered into a facultative quota share reinsurance agreement with XL Financial Assurance Ltd, a monoline financial guaranty insurance company organized under the laws of Bermuda, and an affiliate of XLCA (“XLFA”). Pursuant to this reinsurance agreement, XLCA expects to cede up to 90% of its business to XLFA. In addition, the obligations of XLFA to XLCA under the reinsurance agreement are unconditionally guaranteed by XL Insurance Ltd (“XLI”), a Bermuda company and one of the world’s leading excess commercial insurers. XLI is a wholly-owned indirect subsidiary of XL Capital Ltd. XLFA also has the benefit of a nine-year stop-loss reinsurance facility from an “AAA” rated reinsurer with coverage of $100 million for losses in excess of $250 million. As of December 31, 2000, the capital and surplus of XLI is approximately $3.025 billion and the capital and surplus of XLFA is approximately $281 million. XLCA may also cede reinsurance to third parties on a transaction-specific basis, which cessions may be any or a combination of quota share, first loss or excess of loss. Such reinsurance is used by XLCA as a risk management device and to comply with statutory and rating agency requirements and does not alter or limit XLCA’s obligations under any financial guaranty insurance policy. Notwithstanding the capital support provided to XLCA described in this paragraph, the holders of XLCA Insured Bonds will have direct recourse against XLCA only, and neither XLFA nor XLI will be directly liable to the holders of XLCA Insured Bonds.

Effect of September 11, 2001 Events. XLCA and XLFA, XLCA’s primary reinsurer, believe that they will not sustain any material claims as a result of the attacks on the World Trade Center on September 11, 2001, and related events. In addition, XLCA does not believe that these events will have a material adverse effect on its ability to pay claims on the XLCA Insured Bonds.

Financial Strength and Financial Enhancement Ratings. XLCA’s financial strength is rated “Aaa” by Moody’s and “AAA” by S&P and Fitch. In addition, XLCA has obtained a financial enhancement rating of “AAA” from S&P. These ratings reflect Moody’s, S&P’s and Fitch’s current assessment of XLCA’s creditworthiness and claims-paying ability. The reinsurance arrangement with XLFA described under “Reinsurance” above is integral to these ratings given XLCA’s relatively small capital base.

The above ratings are not recommendations to buy, sell or hold securities, including the XLCA Insured Bonds and are subject to revision or withdrawal at any time by Moody’s, S&P or Fitch. Any downward revision or withdrawal of these ratings may have an adverse effect on the market price of the XLCA Insured Bonds. XLCA does not guaranty the market price of the XLCA Insured Bonds nor does it guaranty that the ratings on the XLCA Insured Bonds will not be revised or withdrawn.

Capitalization of XLCA. As of December 31, 1999, XLCA had total admitted assets of $83,964,000 (audited), total liabilities of $751,000 (audited) and total capital and surplus of $83,213,000 (audited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities (“SAP”). As of December 31, 2000, XLCA had total admitted assets of $86,959,000 (audited), total liabilities of $5,275,000 (audited) and total capital and surplus of $81,684,000 (audited) determined in accordance with SAP.

XLCA has filed the following information with entities designated as NRMSIRs pursuant to Rule 15c2-12 of the Exchange Act:

(1) XLCA’s consolidated financial statements for the years ended December 31, 2000 and 1999 prepared in accordance with generally accepted accounting principles, an independent auditor’s report and notes relating to those statements;

(2) XLCA's quarterly unaudited consolidated balance sheet as of March 31, 2001, unaudited condensed statement of operations and comprehensive income for the three month period then ended and unaudited condensed statement of cash flows for the three month period then ended, prepared in accordance with generally accepted accounting principles, and notes related to those condensed statements; and

(3) XLCA's quarterly unaudited consolidated balance sheet as of June 30, 2001, unaudited condensed statement of operations and comprehensive income for the six month period then ended, unaudited condensed statement of changes in shareholder's equity for the six month period then ended, and unaudited condensed statement of cash flows for the six month period then ended, prepared in accordance with generally accepted accounting principles, and notes related to those condensed statements.

Regulation of XLCA. XLCA is regulated by the Superintendent of Insurance of the State of New York. In addition, XLCA is subject to regulation by the insurance laws and regulations of the other jurisdictions in which it is licensed. As a financial guaranty insurance company licensed in the State of New York, XLCA is subject to Article 69 of the New York Insurance Law, which, among other things, limits the business of each insurer to financial guaranty insurance and related lines, prescribes minimum standards of solvency, including minimum capital requirements, establishes contingency, loss and unearned premium reserve requirements, requires the maintenance of minimum surplus to policyholders and limits the aggregate amount of insurance which may be written and the maximum size of any single risk exposure which may be assumed. XLCA is also required to file detailed annual financial statements with the New York Insurance Department and similar supervisory agencies in each of the other jurisdictions in which it is licensed.

The extent of state insurance regulation and supervision varies by jurisdiction, but New York and most other jurisdictions have laws and regulations prescribing permitted investments, payment of dividends, transactions with affiliates, mergers, consolidations, acquisitions or sales of assets and incurrence of liabilities for borrowings.

THE FINANCIAL GUARANTY INSURANCE POLICIES ISSUED BY XLCA, INCLUDING THE XLCA BOND INSURANCE POLICY, ARE NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

The principal executive offices of XLCA are located at 250 Park Avenue, 19th Floor, New York, New York 10177 and its telephone number at this address is (646) 658-5900.

XLCA accepts no responsibility for the accuracy or completeness of this Official Statement or any other information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding XLCA and its affiliates set forth under the heading "The XLCA Bond Insurance Policy" under *Bond Insurance*. In addition, XLCA makes no representation regarding the XLCA Insured Bonds or the advisability of investing in the XLCA Insured Bonds.

The Ambac Financial Guaranty Insurance Policy

The following information has been furnished by Ambac for use in this Official Statement. No representation is made by the Commonwealth as to the accuracy or completeness of the information. Reference is made to *Appendix V* for a specimen of the Ambac Financial Guaranty Insurance Policy.

Payment Pursuant to the Ambac Financial Guaranty Insurance Policy. Ambac has made a commitment to issue the Ambac Financial Guaranty Insurance Policy relating to the Ambac Insured Bonds effective as of the date of issuance of the Ambac Insured Bonds. Under the terms of the Ambac Financial Guaranty Insurance Policy, Ambac will pay to The Bank of New York, in New York, New York or any successor thereto (the "Insurance Trustee") that portion of the principal of and interest on the Ambac Insured Bonds which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Obligor (as such terms are defined in the Ambac Financial Guaranty Insurance Policy). Ambac will make such payments to the Insurance Trustee on the later of the date on which such principal and interest becomes Due for Payment or within one business day following the date on which Ambac shall have received notice of Nonpayment from the Registrar. The insurance will extend for the term of the Ambac Insured Bonds and, once issued, cannot be canceled by Ambac.

The Ambac Financial Guaranty Insurance Policy will insure payment only on stated maturity dates and on mandatory dates, in the case of principal, and on stated dates for payment, in the case of interest. If the Ambac Insured Bonds become subject to mandatory redemption and insufficient funds are available for redemption of all outstanding Ambac Insured Bonds, Ambac will remain obligated to pay principal of and interest on outstanding Ambac Insured Bonds on the originally scheduled interest and principal payment dates including mandatory sinking fund redemption dates. In the event of any acceleration of the principal of the Ambac Insured Bonds, the insured payments will be made at such times and in such amounts as would have been made had there not been an acceleration.

In the event the Registrar has notice that any payment of principal of or interest on an Ambac Insured Bond which has become Due for Payment and which is made to a Holder by or on behalf of the Obligor has been deemed a preferential transfer and theretofore recovered from its registered owner pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court of competent jurisdiction, such registered owner will be entitled to payment from Ambac to the extent of such recovery if sufficient funds are not otherwise available.

The Ambac Financial Guaranty Insurance Policy does not insure any risk other than Nonpayment, as defined in the Policy. Specifically, the Ambac Financial Guaranty Insurance Policy does not cover:

(1) payment on acceleration, as a result of a call for redemption (other than mandatory sinking fund redemption) or as a result of any other advancement of maturity.

(2) payment of any redemption, prepayment or acceleration premium.

(3) nonpayment of principal or interest caused by the insolvency or negligence of the Registrar.

If it becomes necessary to call upon the Ambac Financial Guaranty Insurance Policy, payment of principal requires surrender of Ambac Insured Bonds to the Insurance Trustee together with an appropriate instrument of assignment so as to permit ownership of such Ambac Insured Bonds to be registered in the name of Ambac to the extent of the payment under the Ambac Financial Guaranty Insurance Policy. Payment of interest pursuant to the Ambac Financial Guaranty Insurance Policy requires proof of Holder entitlement to interest payments and an appropriate assignment of the Holder's right to payment to Ambac.

Upon payment of the insurance benefits, Ambac will become the owner of the Ambac Insured Bond, appurtenant coupon, if any, or right to payment of principal or interest on such Ambac Insured Bond and will be fully subrogated to the surrendering Holder's rights to payment.

Ambac Assurance Corporation. Ambac is a Wisconsin-domiciled stock insurance corporation regulated by the Office of the Commissioner of Insurance of the State of Wisconsin and licensed to do business in 50 states, the District of Columbia, the Territory of Guam and the Commonwealth, with admitted assets of approximately $4,830,000,000 (unaudited) and statutory capital of approximately $2,870,000,000 (unaudited) as of June 30, 2001. Statutory capital consists of Ambac's policyholders' surplus and statutory contingency reserve. S&P, Moody's and Fitch have each assigned a triple-A financial strength rating to Ambac.

Ambac has obtained a ruling from the Internal Revenue Service to the effect that the insuring of an obligation by Ambac will not affect the treatment for federal income tax purposes of interest on such obligation and that insurance proceeds representing maturing interest paid by Ambac under policy provisions substantially identical to those contained in its financial guaranty insurance policy shall be treated for federal income tax purposes in the same manner as if such payments were made by the Commonwealth.

Ambac makes no representation regarding the Ambac Insured Bonds or the advisability of investing in the Ambac Insured Bonds and makes no representation regarding, nor has it participated in the preparation of, the Official Statement other than the information supplied by Ambac Assurance and presented in "The Ambac Financial Guaranty Insurance Policy" under *Bond Insurance*.

Available Information. The parent company of Ambac, Ambac Financial Group, Inc. ("Ambac Financial"), is subject to the informational requirements of the Exchange Act, and in accordance therewith files reports, proxy statements and other information with the SEC. Such reports, proxy statements and other information may be inspected and copied at the public reference facilities maintained by the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549 and Northwestern Atrium Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. Copies of such material can be obtained from the public reference section of the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549 at prescribed rates. In addition, the aforementioned material may also be inspected at the offices of the New York Stock Exchange, Inc. (the "NYSE") at 20 Broad Street, New York, New York 10005. Ambac Financial's Common Stock is listed on the NYSE.

Copies of Ambac's financial statements prepared in accordance with statutory accounting standards are available from Ambac. The address of Ambac's administrative offices and its telephone number are One State Street Plaza, 19th Floor, New York, New York 10004 and (212) 668-0340.

Incorporation of Certain Documents by Reference. The following documents filed by Ambac Financial with the SEC (File No. 1-10777) are incorporated by reference in this Official Statement:

(1) Ambac Financial's Current Report on Form 8-K dated January 24, 2001 and filed on January 24, 2001;

(2) Ambac Financial's Current Report on Form 8-K dated March 19, 2001 and filed on March 19, 2001;

(3) Ambac Financial's Annual Report on Form 10-K for the fiscal year ended December 31, 2000 and filed on March 28, 2001;

(4) Ambac Financial's Quarterly Report on Form 10-Q for the fiscal quarterly period ended March 31, 2001 and filed on May 15, 2001;

(5) Ambac Financial's Current Report on Form 8-K dated July 18, 2001 and filed on July 23, 2001; and

(6) Ambac Financial's Quarterly Report on Form 10-Q for the fiscal quarterly period ended June 30, 2001 and filed on August 10, 2001.

All documents subsequently filed by Ambac Financial pursuant to the requirements of the Exchange Act after the date of this Official Statement will be available for inspection in the same manner as described above in "Available Information".

PUBLIC SECTOR DEBT OF THE COMMONWEALTH

Pro Forma Public Sector Debt

The following table presents a summary of the public sector debt of the Commonwealth as of June 30, 2001, as adjusted for the issuance of the Forward Delivery Bonds and the refunding of the bonds refunded thereby, and as adjusted for the issuance of the 2002 Bonds and the refunding of the Refunded Bonds. The table should be read in conjunction with the information set forth in "Debt" in *Appendix I*.

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

	June 30, 2001	As Adjusted by the Issuance of the 2002 Bonds(1)	As Adjusted by the Issuance of the 2002 Bonds and the Forward Delivery Bonds(1)
Puerto Rico direct debt	$ 5,837,909	$ 5,936,380(2)	$ 5,933,185(2)
Municipal debt	1,632,170	1,632,170	1,632,170
Public corporations debt			
Puerto Rico guaranteed debt	603,334	603,334	603,334
Debt supported by Puerto Rico appropriations or taxes	12,091,422	12,091,422	12,091,422
Other non-guaranteed debt	6,539,423	6,539,423	6,539,423
Total public corporations debt	$19,234,179	$19,234,179	$19,234,179
Total public sector debt	$26,704,258	$26,802,729	$26,799,534

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

(1) Adjusted to exclude the bonds refunded thereby, including bonds refunded with proceeds that are or will be invested in guaranteed investment contracts and that will be considered to be outstanding under their authorizing resolutions and for purposes of calculating the Commonwealth's debt limitation.

(2) Adjusted to exclude payments of principal made on July 1, 2001.

Source: Government Development Bank

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

The following table presents (i) the debt service requirements for Commonwealth general obligation bonds and PRASA bonds for which debt service payments are being made under the Commonwealth guaranty, in each case outstanding on June 30, 2001 (adjusted to exclude debt service on the Refunded Bonds and the bonds being refunded by the Forward Delivery Bonds); (ii) debt service on the 2002 Bonds; (iii) debt service on the Forward Delivery Bonds, and (iv) total debt service adjusted for the issuance of the 2002 Bonds, the issuance of the Forward Delivery Bonds and the refunding of the Refunded Bonds and the bonds refunded by the Forward Delivery Bonds. The table excludes debt service on the bonds being refunded with the proceeds of the Forward Delivery Bonds and the Refunding Bonds invested in guaranteed investment contracts, notwithstanding that such bonds will be considered to be outstanding under their respective authorizing resolutions and for purposes of calculating the Commonwealth's debt limitation. See "Commonwealth Guaranteed Debt" in *Appendix I*. With respect to other debt of PRASA, see "Public Corporations" in *Appendix I*. Debt service requirements for each fiscal year, as shown in the following table, include principal and interest due on July 1 immediately following the close of such fiscal year.

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

Fiscal Year Ending June 30	Outstanding Bonds Total Debt Service[(1)]	Outstanding PRASA Bonds Debt Service	2002 Bonds		Forward Delivery Bonds		Grand Total[(2)]
			Principal	Interest	Principal	Interest	
2002	$ 383,306	$ 33,542	$ 0	$ 48,217	$ 0	$ 6,385	$ 471,449
2003	346,776	32,745	0	70,499	11,070	26,421	487,510
2004	347,975	30,125	0	70,499	13,045	25,867	487,511
2005	338,030	30,127	0	70,499	23,640	25,215	487,511
2006	330,041	30,121	0	70,499	32,815	24,033	487,509
2007	310,041	30,126	0	70,499	54,450	22,392	487,509
2008	314,103	30,131	0	70,499	53,105	19,670	487,507
2009	314,219	30,123	11,545	70,499	44,090	17,014	487,491
2010	314,811	29,984	12,145	69,966	45,885	14,700	487,490
2011	300,639	29,928	13,265	69,397	61,975	12,291	487,494
2012	293,613	30,127	20,745	68,755	65,370	8,882	487,493
2013	275,929	30,128	39,485	67,694	68,970	5,287	487,492
2014	300,880	30,125	62,295	65,551	27,150	1,493	487,493
2015	329,709	30,126	65,525	62,133	0	0	487,492
2016	298,107	30,121	100,730	58,538	0	0	487,495
2017	298,280	30,122	106,075	53,018	0	0	487,494
2018	316,269	30,126	93,905	47,194	0	0	487,494
2019	294,775	30,125	120,570	42,031	0	0	487,501
2020	295,908	0	156,120	35,465	0	0	487,493
2021	253,257	0	55,555	26,878	0	0	335,691
2022	231,212	0	0	23,823	0	0	255,034
2023	187,139	0	0	23,823	0	0	210,962
2024	163,632	0	0	23,823	0	0	187,455
2025	163,626	0	0	23,823	0	0	187,449
2026	148,764	0	6,105	23,823	0	0	178,692
2027	137,949	0	17,255	23,487	0	0	178,691
2028	104,319	0	51,835	22,538	0	0	178,692
2029	73,292	0	85,650	19,751	0	0	178,693
2030	39,443	0	124,175	15,075	0	0	178,693
2031	0	0	169,980	8,711	0	0	178,691
Total	$7,506,044	$ 547,952	$1,312,960	$1,417,005	$ 501,565	$ 209,648	$11,495,174

* Totals may not add due to rounding.
(1) Debt service requirements on all general obligation bonds outstanding on June 30, 2001, excluding debt service on bonds to be refunded by the Refunding Bonds and the Forward Delivery Bonds.
(2) Debt service requirements on all general obligation bonds outstanding, adjusted to include the issuance of the 2002 Bonds, the issuance of the Forward Delivery Bonds, and the refunding of the bonds refunded by the Refunding Bonds and the Forward Delivery Bonds.

Sources: Government Development Bank and Department of the Treasury

TAX MATTERS

Opinion of Bond Counsel

In the opinion of Hawkins, Delafield & Wood, Bond Counsel, under the provisions of the Acts of Congress now in force and under existing statutes and court decisions (i) interest on the Offered Bonds is excluded from gross income for Federal income tax purposes, and (ii) interest on the Offered Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Internal Revenue Code of 1986, as amended (the "Code"); such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In rendering its opinion, Bond Counsel has relied on certain representations, certifications of fact, and statements of reasonable expectation made by the Commonwealth and others in connection with the Offered Bonds, and Bond Counsel has assumed compliance by the Commonwealth with the covenant referred to below.

In addition, in the opinion of Bond Counsel, under existing statutes and court decisions, the Offered Bonds, and the interest thereon, are exempt from state, Commonwealth of Puerto Rico and local income taxation.

Bond Counsel expresses no opinion regarding any other Federal, state, Commonwealth or local tax consequences with respect to the Offered Bonds. Bond Counsel renders its opinion under existing statutes and court decisions as of the issue date, and assumes no obligation to update its opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. Bond Counsel expresses no opinion on the effect of any action hereafter taken or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for Federal income tax purposes of interest on the Offered Bonds, or under state, Commonwealth or local tax law.

Certain Ongoing Federal Tax Requirements and Covenants

The Code establishes certain ongoing requirements that must be met subsequent to the issuance and delivery of the Offered Bonds in order that interest on the Offered Bonds be and remain excluded from gross income for Federal income tax purposes. These requirements include, but are not limited to, requirements relating to use and expenditure of gross proceeds of the Offered Bonds, yield and other restrictions on investments of gross proceeds, and the arbitrage rebate requirement that certain excess earnings on gross proceeds be rebated to the Federal government. Noncompliance with such requirements may cause interest on the Offered Bonds to become included in gross income for Federal income tax purposes retroactive to their issue date, irrespective of the date on which such noncompliance occurs or is discovered. The Commonwealth has covenanted to comply, to the extent permitted by the Constitution and existing laws of the Commonwealth, with certain applicable requirements of the Code to assure the exclusion of interest on the Offered Bonds from gross income for Federal income tax purposes. Bond Counsel is not aware of any provision of the Constitution or laws of the Commonwealth which would prevent the Commonwealth from complying with the requirements of the Code.

Certain Collateral Federal Tax Consequences

The following is a brief discussion of certain collateral Federal income tax matters with respect to the Offered Bonds. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the Federal tax consequences of owning and disposing of the Offered Bonds.

Prospective owners of the Offered Bonds should be aware that the ownership of such obligations may result in collateral Federal income tax consequences to various categories of persons, such as corporations (including S corporations and foreign corporations), financial institutions, property and casualty and life insurance companies, individual recipients of Social Security and railroad retirement benefits, individuals otherwise eligible for the earned income tax credit, and taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is not included in gross income for Federal income tax purposes. Interest on the Offered Bonds may be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Code.

Original Issue Discount

"Original issue discount" ("OID") is the excess of the sum of all amounts payable at the stated maturity of an Offered Bond (excluding certain "qualified stated interest" that is unconditionally payable at least annually at prescribed rates) over the issue price of that maturity. In general, the "issue price" of a maturity means the first price at which a substantial amount of the Offered Bonds of that maturity was sold (excluding sales to bond houses, brokers, or similar persons acting in the capacity of underwriters, placement agents, or wholesalers). In general, the issue price for each maturity of Offered Bonds is expected to be the initial public offering price set forth on the cover page of this Official Statement. Bond Counsel further is of the opinion that, for any Offered Bonds having OID (a "Discount Bond"), OID that has accrued and is properly allocable to the owner of the Discount Bond under the Code is excludable from gross income for Federal income tax purposes to the same extent as other interest on the Offered Bonds.

In general, under Section 1288 of the Code, OID on a Discount Bond accrues under a constant yield method, based on periodic compounding of interest over prescribed accrual periods using a compounding rate determined by reference to the yield on that Discount Bond. An owner's adjusted basis in a Discount Bond is increased by accrued OID for purposes of determining gain or loss on sale, exchange, or other disposition of such Bond. Accrued OID may be taken into account as an increase in the amount of tax-exempt income received or deemed to have been received for purposes of determining various other tax consequences of owning a Discount Bond even though there will not be a corresponding cash payment.

Owners of Discount Bonds should consult their own tax advisors with respect to the treatment of original issue discount for Federal income tax purposes, including various special rules relating thereto, and the state, Commonwealth and local tax consequences of acquiring, holding, and disposing of Discount Bonds.

Bond Premium

In general, if an owner acquires an Offered Bond for a purchase price (excluding accrued interest) or otherwise at a tax basis that reflects a premium over the sum of all amounts payable on the Offered Bond after the acquisition date (excluding certain "qualified stated interest" that is unconditionally payable at least annually at prescribed rates), that premium constitutes "bond premium" on that Offered Bond (a "Premium Bond"). In general, under Section 171 of the Code, an owner of a Premium Bond must amortize the bond premium over the remaining term of the Premium Bond, based on the owner's yield over the remaining term of the Premium Bond, determined based on constant yield principles. An owner of a Premium Bond must amortize the bond premium by offsetting the qualified stated interest allocable to each interest accrual period under the owner's regular method of accounting against the bond premium allocable to that period. In the case of a tax-exempt Premium Bond, if the bond premium allocable to an accrual period exceeds the qualified stated interest allocable to that accrual period, the excess is a nondeductible loss. Under certain circumstances, the owner of a Premium Bond may realize a taxable gain upon disposition of the Premium Bond even though it is sold or redeemed for an amount less than or equal to the owner's original acquisition cost. Owners of any Premium Bonds should consult their own tax advisors regarding the treatment of bond premium for Federal income tax purposes, including various special rules relating thereto, and state, Commonwealth and local tax consequences, in connection with the acquisition, ownership, amortization of bond premium on, sale, exchange, or other disposition of Premium Bonds.

Possible Government Action

Legislation affecting municipal bonds is regularly under consideration by the United States Congress. In addition, the Internal Revenue Service has established an expanded audit program for tax-exempt bonds. There can be no assurance that legislation enacted or proposed or an audit initiated by the Internal Revenue Service after the issue date of the Offered Bonds will not have an adverse effect on the tax-exempt status or market price of the Offered Bonds.

LEGAL MATTERS

The proposed forms of opinions of Hawkins, Delafield & Wood, New York, New York, Bond Counsel, are set forth in *Appendix II* to this Official Statement. Certain legal matters will be passed upon for the Underwriters by Pietrantoni Méndez & Alvarez LLP, San Juan, Puerto Rico.

LEGAL INVESTMENT

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

VERIFICATION

Samuel Klein and Company will verify, from the information provided to them, the mathematical accuracy as of the date of the closing of the Offered Bonds of (i) the computations contained in the provided schedules to determine that the anticipated receipts from the securities and cash deposits listed in such schedules, to be held in escrow, will be sufficient to pay, when due, the principal, interest and call premium payment requirements, if any, of the Refunded Bonds (see *Plan of Financing*), and (ii) the computations of yield on both the securities and the Offered Bonds contained in such schedules used by Bond Counsel in its determination that interest on the Offered Bonds is excludable from gross income for federal income tax purposes. Samuel Klein and Company will express no opinion on the assumptions provided to them, nor as to the exclusion from gross income for Federal income tax purposes of the interest on the Offered Bonds.

UNDERWRITING

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Offered Bonds from the Commonwealth at an aggregate discount of $7,525,815.06 from the initial offering prices of the Offered Bonds. The obligations of the Underwriters are subject to certain conditions precedent, and they will be obligated to purchase all the Series A Bonds and all of the Refunding Bonds, if any bonds of such respective issue are purchased. The Underwriters may offer to sell the Offered Bonds to certain dealers and others at prices lower than the initial public offering prices. The offering prices may be changed, from time to time, by the Underwriters.

Goldman, Sachs & Co. ("GS"), a managing underwriter, has entered into a written agreement with FirstBank Puerto Rico ("FirstBank"), a bank organized under the laws of the Commonwealth, pursuant to which FirstBank has agreed to act as a consultant to GS in connection with GS's provision of underwriting and investment banking services to the Commonwealth with respect to the Offered Bonds. Pursuant to this agreement, the existence of which has been disclosed to the Commonwealth and Government Development Bank, FirstBank will be entitled to receive a portion of GS's actual net profits, if any, in connection with the underwriting of the Offered Bonds. Other similar agreements with respect to the sharing of underwriting net profits have been entered into and disclosed to the Commonwealth and Government Development Bank by the following Underwriters: Banc of America Securities LLC and Oriental Financial Services Corporation; Lehman Brothers Inc. and BBVA Capital Markets of Puerto Rico, Inc.; Wachovia Securities and Doral Securities Inc.; Morgan Stanley & Co. Incorporated and Popular Securities, Inc.; Merrill Lynch & Co. and Santander Securities Corporation; and ABN Amro Financial Services, Inc. and Prudential Securities Corporation.

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 Offered Bonds offered hereby. As financial advisor, Government Development Bank participated in the selection of the Underwriters of the Offered Bonds. Certain of the Underwriters have been selected by Government Development Bank to serve from time to time as underwriters of its obligations and the obligations of the Commonwealth, its instrumentalities and public corporations. Certain of the Underwriters or their affiliates participate in other financial transactions with Government Development Bank.

RATINGS

Moody's and S&P have given the Offered Bonds ratings of "Baa1" and "A", respectively, and are expected to give the Insured Bonds ratings of Aaa and AAA, respectively, based on the expected issuance by MBIA, XLCA and Ambac of their respective insurance policies covering the Insured Bonds. These ratings reflect only the respective views of the rating agencies and an explanation of the significance of each rating may be obtained only from the respective rating agency.

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

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

CONTINUING DISCLOSURE

In accordance with the requirements of Rule 15c2-12, as amended (the "Rule"), promulgated by the SEC, the Commonwealth has covenanted in the Bond Resolutions for the benefit of the Beneficial Owners (as defined in such Bond Resolutions and generally the tax owners of the Offered Bonds):

1. to file within 305 days after the end of each fiscal year commencing with the fiscal year ending June 30, 2001, with each NRMSIR and with any Commonwealth state information depository ("SID"), core financial information and operating data for the prior fiscal year, including (i) the Commonwealth's audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time, and (ii) material historical quantitative data (including financial information and operating data) on the Commonwealth and its revenues, expenditures, financial operations and indebtedness, in each case generally found in this Official Statement; and

2. to file, in a timely manner, with each NRMSIR or with the MSRB and with any 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 Offered Bonds, if material:

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

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

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

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

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

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

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

The Commonwealth may from time to time choose to provide notice of the occurrence of certain other events in addition to those listed above regardless of whether, in the judgment of the Commonwealth, such other events are material with respect to the Offered Bonds, but the Commonwealth does not undertake to provide any such notice of the occurrence of any event except those material 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 Offered 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 Offered Bonds benefitted by the Covenants, and no remedy shall be sought or granted other than specific performance of any of the Covenants at issue. Moreover, Proceedings filed by Beneficial Owners against the Commonwealth may be subject to the sovereign immunity provisions of Section 2 of Act No. 104, approved June 29, 1955, as amended (32 L.P.R.A. §3077 and §3077a), which governs the scope of legal actions against the Commonwealth, substantially limits the amount of monetary damages that may be awarded against the Commonwealth and provides certain notice provisions, the failure to comply with which may further limit any recovery.

The Covenants may only be amended if:

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

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

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

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

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

MISCELLANEOUS

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

Appended to and constituting a part of this Official Statement are the Commonwealth Report *(Appendix I)*, the proposed forms of opinions of Bond Counsel *(Appendix II)*, a specimen of the MBIA Bond Insurance Policy *(Appendix III)*, a specimen of the XLCA Bond Insurance Policy *(Appendix IV)*, and a specimen of the Ambac Financial Guaranty Insurance Policy *(Appendix V)*.

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

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

COMMONWEALTH OF PUERTO RICO

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

APPENDIX I

COMMONWEALTH OF PUERTO RICO

Financial Information and Operating Data Report

September 25, 2001

COMMONWEALTH OF PUERTO RICO
Financial Information and Operating Data Report
September 25, 2001

TABLE OF CONTENTS

Page

COMMONWEALTH OF PUERTO RICO

Financial Information and Operating Data Report
September 25, 2001

INTRODUCTION

Geographic Location and Demography

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

According to the United States Census Bureau, the population of Puerto Rico was 3,808,610 in 2000, compared to 3,522,000 in 1990. As of 1999, the population of San Juan, the island's capital and largest city, was approximately 439,000.

Relationship with the United States

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

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

The United States and the Commonwealth of Puerto Rico (the "Commonwealth") share a common defense, market and currency. The Commonwealth exercises virtually the same control over its internal affairs as do the fifty states. It differs from the states, however, in its relationship with the federal government. The people of Puerto Rico are citizens of the United States but do not vote in national elections. They are represented in Congress by a Resident Commissioner who has a voice in the House of Representatives but no vote. Most federal taxes, except those such as Social Security taxes which are imposed by mutual consent, are not levied in Puerto Rico. No federal income tax is collected from Puerto Rico residents on income earned in Puerto Rico, except for certain federal employees who are subject to taxes on their salaries. A portion of the federal excise taxes imposed on shipments of alcoholic beverages from Puerto Rico and other rum producing countries and other taxes on shipments of tobacco products from Puerto Rico to the mainland are returned to the Treasury Department of Puerto Rico. See "Major Sources of General Fund Revenues - Other Taxes and Revenues" under *Puerto Rico Taxes, Other Revenues and Expenditures* for a discussion of a current federal legislative proposal relating to the elimination of the rebate of federal excise taxes on shipments of alcoholic beverages.

The official languages of Puerto Rico are Spanish and English.

Governmental Structure

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

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

Sila M. Calderón was sworn in as Governor of Puerto Rico on January 2, 2001. She obtained a Bachelor's degree in Political Science from Manhattanville College in New York and undertook graduate studies at the School of Public Administration of the University of Puerto Rico. Since 1973, she has worked in the public sector as Executive Assistant to the Labor Secretary, Special Assistant to the Governor of Puerto Rico, Chief of Staff of the Governor of Puerto Rico and Secretary of State. In the private sector, she was an executive in charge of Business Development for Citibank, N.A., President of Commonwealth Investment Company Inc., and a member of the Board of Directors of BanPonce, Banco Popular de Puerto Rico and Pueblo International, Inc. From 1996 until taking office as Governor, she served as elected Mayor of the municipality of San Juan.

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

Melba Acosta, Director of the Office of Management and Budget, took office on January 3, 2001. She is a graduate of the University of Puerto Rico, where she obtained a Bachelor's degree in Business Administration and a Juris Doctor degree. She obtained a Master's degree in Business Administration from the Harvard Graduate School of Business. She is a certified public accountant and has six years of experience as a tax consultant and corporate attorney in the private sector. Prior to her appointment as head of the Office of Management and Budget, she served for four years in the public sector.

Juan Agosto Alicea, President of Government Development Bank for Puerto Rico ("Government Development Bank" or "GDB"), took office on January 2, 2001. He obtained a Bachelor's degree in Business Administration from the University of Puerto Rico and has been a licensed certified public accountant since 1966. He has worked as an auditor for Arthur Andersen & Co., Puerto Rico Industrial Development Company, Peat Marwick & Mitchell, and the Federal Department of Housing and Urban Development. From 1985 to 1988 he served as Secretary of the Treasury, and was chairman of the Board of Directors of Government Development Bank. From 1995 to 1996, he was Administrator of the Municipality of San Juan. He is a former president of the Puerto Rico College of CPAs and the Board of Directors of United Way of Puerto Rico.

Political Trends

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

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

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

	Senate	House
Popular Democratic Party	19	29
New Progressive Party	8	20
Puerto Rico Independence Party	1	1
Independent	-	1
	28	51

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

THE ECONOMY

General

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

The economy of Puerto Rico is fully integrated with that of the United States mainland. During fiscal 2000 (July 1999 through June 2000), approximately 88% of Puerto Rico's exports went to the United States mainland, which was also the source of approximately 56% of Puerto Rico's imports. In fiscal 2000, Puerto Rico experienced an $11.4 billion positive merchandise trade balance.

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

Fiscal 1996 to 2000

Puerto Rico's almost two decades-long economic expansion continued throughout the five-year period from fiscal 1996 through fiscal 2000. Almost every sector of the economy participated, and record levels of employment were achieved. Factors behind this expansion included government-sponsored economic development programs, periodic declines in the exchange value of the United States dollar, increases in the level of federal transfers, the relatively low cost of borrowing and low oil prices.

Gross product in fiscal 1996 was $30.4 billion and gross product in fiscal 2000 was $41.4 billion ($34.8 billion in 1996 prices). This represents an increase in gross product of 36.3% from fiscal 1996 to 2000 (14.7% in 1996 prices). Since fiscal 1985, personal income, both aggregate and per capita, has increased consistently each fiscal year. In fiscal 2000, aggregate personal income was $38.2 billion ($34.6 billion in 1996 prices)* and personal income per capita was $9,870 ($8,925 in 1996 prices).

Personal income includes transfer payments to individuals in Puerto Rico under various social programs. Total federal payments to Puerto Rico, which include transfers to local government entities and expenditures of federal agencies in Puerto Rico, in addition to federal transfer payments to individuals, are lower on a per capita basis in Puerto Rico than in any state. Transfer payments to individuals in fiscal 2000 were $7.6 billion, of which $5.7 billion, or 75.1%, represented entitlements to individuals who had previously performed services or made contributions under programs such as Social Security, Veterans' Benefits, Medicare and U.S. Civil Service retirement pensions.

According to the Labor Department's Household Employment Survey, average employment increased from 1,092,200 in fiscal 1996 to 1,159,470 in fiscal 2000. Average unemployment decreased from 13.8% in fiscal 1996 to 11.0% in fiscal 2000.

The following table shows the gross product for the five fiscal years ended June 30, 2000.

Commonwealth of Puerto Rico

Gross Product

	Fiscal Year Ended June 30				
	1996	**1997**	**1998**	**1999**	**2000(p)**
Gross product - $ millions	$ 30,357	$ 32,343	$ 35,161	$ 38,297	$ 41,366
Real gross product - $ millions (1996 prices)	30,357	31,390	32,401	33,750	34,812
Annual percentage increase in real gross product (1996 prices)	3.3%	3.4%	3.2%	4.2%	3.1%
U.S. annual percentage increase in real gross product (1996 prices)	2.8%	4.0%	4.4%	3.9%	5.2%

(p) Preliminary.

Sources: Planning Board and Data Resources Inc.

Since the 1950s, the Planning Board has prepared a complete set of macroeconomic measures like those prepared for the United States by the Bureau of Economic Analysis ("BEA") of the Department of Commerce. In contrast with the BEA, which computes the economic accounts on a quarterly basis, the Planning Board computes the economic accounts on an annual basis. Like the BEA, the Planning Board revises the macroeconomic numbers on a regular basis. The Planning Board has always classified the latest annual numbers as preliminary until they are revised and made final in conjunction with the release of new data each year. At present, all macroeconomic accounts for fiscal 2000 are preliminary until the revised figures are released.

Fiscal 2001 and 2002

According to the Labor Department's Household Employment Survey, during fiscal 2001 total employment decreased 0.1% from fiscal 2000. Total monthly employment averaged 1,157,850 during fiscal 2001, compared to 1,159,466 in fiscal 2000. During the first two months of fiscal 2002, total monthly employment averaged 1,142,000 compared to 1,178,000 in the same period of fiscal 2001, representing a decline of 3.1%. As a result, the unemployment rate increased from 10.5% to 11.7% during the first two months of fiscal 2002. The Planning Board's gross product

*Different price deflators are used for gross product and personal income statistics.

forecast for fiscal 2001 and fiscal 2002, made in March 2001, projected an increase of 2.2% for fiscal 2001 and an increase of 2.0% for fiscal 2002.

The performance of the economy during fiscal 2002 will depend primarily on the performance of the United States economy, the level of oil prices and the level of interest rates. In the past, Puerto Rico has been heavily dependent on oil imports for its energy needs. As a result of the construction of two cogeneration plants, however, one of which burns liquefied natural gas and is now operational and the other of which will burn coal and is expected to become operational during 2002, Puerto Rico's dependence on oil imports for its energy needs will be reduced by approximately 30%.

As a result of the terrorist attacks in the United States on September 11, at present there is uncertainty as to the expected level of economic activity in Puerto Rico during the remainder of fiscal 2002. It is possible that these recent events will cause a temporary loss in consumer and business confidence, thus triggering a reduction in the level of economic activity in Puerto Rico and a decrease in General Fund revenues from those estimated in the fiscal 2002 budget. It is not possible at this time to predict with certainty how the Puerto Rico economy will be affected. One of the sectors expected to be affected immediately is tourism, as the level of leisure and business travel is reduced. Although tourism has been one of the sectors which has demonstrated consistent growth during the last decade, total visitors' expenditures represented only 3.8% of gross domestic product for fiscal 2000. It is too early to estimate what long term impact, if any, the terrorist attacks will have on the economy of Puerto Rico. The information appearing in this Report with respect to periods subsequent to August 2001 does not consider the effects, if any, of these recent events.

The Commonwealth government is in the process of formulating measures to reduce the economic impact of these recent events. The Governor has met with business leaders to discuss how the government and the private sector can work together to restore consumer and business confidence. One of the steps the government proposes to take is to accelerate its capital investment program in order to stimulate economic activity.

Economic Development Program

The Commonwealth's current economic development program is based on the following four initiatives: (i) the enactment of laws in Puerto Rico providing tax benefits that will promote foreign investment and increased economic activity; (ii) the acceleration and simplification of the local permitting process; (iii) the reduction of the costs of doing business in Puerto Rico; and, (iv) the amendment of Section 956 of the United States Internal Revenue Code of 1986 (the "Code") to incorporate new Federal income tax benefits that enhance the attractiveness of establishing operations in Puerto Rico.

Puerto Rico Legislation

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

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

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

The Commonwealth has also recently enacted legislation which (i) reduces the capital gains tax from 20% to 10% in the case of individuals and estates and trusts, and from 25% to 12.5% in the case of corporations and partnerships organized under the laws of the Commonwealth or engaged in trade or business in the Commonwealth, for gains from the sale of eligible Commonwealth investments; and, (ii) allows income tax credits for extraordinary investment in housing infrastructure.

In addition, legislation has been submitted for the purpose of: (i) amending the 1998 Tax Incentives Act to provide special income tax rates ranging from 0% to 2% to companies that establish operations in Puerto Rico in "core pioneer industries" which utilize innovative technology not previously used in Puerto Rico; (ii) granting tax credits with respect to eligible investments made in the construction or substantial rehabilitation of housing units to be rented to low income families; (iii) reducing to 7% the capital gains rate applicable to gains realized on the sale of shares of stock of Puerto Rico corporations sold in an initial public offering made prior to December 31, 2007 or acquired in public offerings made prior to December 31, 2007; (iv) granting income tax exemption to the fees received by financial institutions in connection with guaranteeing the payment of debt issued to finance tourism development projects; and (v) granting exemption to qualified associations administering timesharing rights or vacation clubs and to owners' associations of areas designated as tourism enhancement districts.

Legislation has also been proposed for the purpose of granting tax credits to Puerto Rico businesses that acquire products manufactured in Puerto Rico for exportation.

Acceleration and Simplification of Local Permitting Process

Another of the government's initiatives to promote economic activity is to simplify the regulatory process for obtaining government permits in order to accelerate the granting of permits and reduce the costs of the permitting process. As part of this initiative, the government is establishing a multi-agency center that will handle in a coordinated way the permitting process and allow the filing of a single application for all government permits required for a project. When public hearings are required by various government agencies, the government is also developing a procedure to allow them to be conducted simultaneously by the various government agencies.

Reduction of the Costs of Doing Business

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

The high cost of energy in Puerto Rico has been identified as one of the costs of doing business that particularly affects the manufacturing industry. The government has sought to lower this cost by reducing Puerto Rico's dependence on oil for energy production through the development of the cogeneration plants mentioned above. In addition, Puerto Rico Electric Power Authority has commenced a hedging program with respect to oil prices to lessen the impact of the volatility of oil prices on the cost of electricity.

Federal Legislative Proposal

In order to enhance the attractiveness for United States companies of establishing operations in Puerto Rico, the Commonwealth government is seeking to have Section 956 of the Code amended to provide a new and permanent tax regime applicable to U.S. based businesses that have operations in the Commonwealth or other U.S. possessions. This proposed regime is based on the tax rules generally applied to U.S. companies with international operations, but with certain modifications intended to promote employment both in the Commonwealth and the United States. For a discussion of the bill which has been introduced in the U.S. Congress incorporating the Commonwealth's proposed amendment, see "Proposed New U.S. Tax Regime for Companies Doing Business in Puerto Rico - Section 956 of the Code" under "Tax Incentives" below.

Employment and Unemployment

The number of persons employed in Puerto Rico during fiscal 2001 averaged 1,157,850. Unemployment, although at relatively low historical levels, remains above the United States average. Average unemployment decreased from 13.1% in fiscal 1997 to 10.5% in fiscal 2001, the lowest level since 1970. The moderate increase in employment in the last few years, along with a drop in the participation rate, resulted in a decline in the unemployment rate.

The following table presents annual statistics of employment and unemployment for fiscal 1997 through fiscal 2001, and monthly statistics for July and August 2001.

Commonwealth of Puerto Rico
Employment and Unemployment (1)

Fiscal Years Ended June 30	Labor Force(1)	Employed(1)	Unemployed(1)	Unemployment Rate(2)
		(Annual Average)		
1997	1,298	1,128	170	13.1%
1998	1,317	1,137	179	13.6
1999	1,310	1,147	163	12.5
2000	1,303	1,159	143	11.0
2001	1,293	1,158	135	10.5
Fiscal 2002		(Seasonally Adjusted)		
July	1,276	1,135	140	11.0%
August	1,311	1,149	162	12.4

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

Source: Department of Labor and Human Resources - Household Survey

Economic Performance by Sector

Puerto Rico has a diversified economy. During the period between fiscal 1996 and 2000, the manufacturing and services sectors generated the largest portion of gross domestic product. Three sectors of the economy provide the most employment: manufacturing, services and government.

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

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

	Fiscal Year Ended June 30				
	1996	**1997**	**1998**	**1999**	**2000(p)**
Manufacturing	$18,467	$19,302	$22,976	$26,637	$27,442
Services[1]	17,470	18,956	20,723	22,333	24,036
Government[2]	4,841	5,220	5,251	5,526	5,478
Transportation, communication and public utilities	3,563	3,751	3,979	3,951	4,057
Agriculture, forestry and fisheries	376	466	437	336	450
Construction[3]	1,077	1,257	1,483	1,645	1,863
Statistical discrepancy	(452)	(765)	(714)	(388)	(176)
Total gross domestic product[4]	45,341	48,187	54,133	60,039	63,150
Less: net payment abroad	(14,984)	(15,844)	(18,973)	(21,742)	(21,783)
Total gross product[4]	$30,357	$32,343	$35,161	$38,297	$41,366

(p) Preliminary.
(1) Includes wholesale and retail trade, finance, insurance and real estate, hotel and related services, and other services.
(2) Includes the Commonwealth, its municipalities and the federal government; excludes public corporations.
(3) Includes mining.
(4) Totals may not add due to rounding.

Source: Planning Board

The following table presents annual statistics of average employment by sector for the six fiscal years ended June 30, 2001.

Commonwealth of Puerto Rico
Average Employment by Sector
(thousands of persons age 16 and over)

	Fiscal Year Ended June 30					
	1996	**1997**	**1998**	**1999**	**2000**	**2001(p)**
Manufacturing	167	162	161	159	159	159
Services[1]	527	551	573	578	587	584
Government[2]	246	261	244	246	249	251
Transportation, communication and public utilities	61	59	59	59	55	56
Construction[3]	59	64	69	78	85	87
Agriculture, forestry and fisheries	32	31	31	27	24	22
Total[4]	1,092	1,128	1,137	1,147	1,159	1,158

(p) Preliminary.
(1) Includes wholesale and retail trade, finance, insurance and real estate, hotels and related services, and other services.
(2) Includes the Commonwealth, its municipalities and the federal government; excludes public corporations.
(3) Includes mining.
(4) Totals may not add due to rounding.

Source: Department of Labor and Human Resources - Household Survey

Manufacturing

Manufacturing is the largest sector of the Puerto Rico economy in terms of gross domestic product. The Planning Board estimates that in fiscal 2000 manufacturing generated $27.4 billion, or 43.5% of gross domestic product. The manufacturing sector employed 136,037 workers as of March 2001 (as reported in the Department of Labor and Human Resources - Benchmark on Employment Hours and Earnings). Most of the island's manufacturing output is shipped to the United States mainland, which is also the principal source of semifinished 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 May 2001, the average hourly manufacturing wage rate in Puerto Rico was 65.5% of the average mainland United States rate.

Manufacturing in Puerto Rico is now more diversified than during the earlier phases of the industrial development program. In the last three decades, industrial development has tended to be more capital intensive and more dependent on skilled labor. This gradual shift in emphasis is best exemplified by the heavy investment in the pharmaceuticals, scientific instruments, computers, and electrical products industries in Puerto Rico over the last decade.

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

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

	Fiscal Year Ended June 30				
	1996	**1997**	**1998**	**1999**	**2000(p)**
Pharmaceuticals	$ 9,570	$10,354	$13,192	$15,569	$15,810
Machinery and metal products:					
Machinery, except electrical	904	925	1,131	2,036	2,349
Electrical machinery	1,490	1,496	1,506	1,582	1,687
Professional and scientific instruments	1,361	1,334	1,596	1,646	1,782
Other machinery and metal products	266	300	350	413	455
Food products	2,167	2,086	2,052	1,908	1,783
Other chemical and allied products	524	590	941	1,184	1,223
Apparel	645	622	610	616	671
Other[1]	1,539	1,595	1,597	1,682	1,683
Total gross domestic product of manufacturing sector[2]	$18,467	$19,302	$22,976	$26,637	$27,442

(p) Preliminary.
(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 sets forth manufacturing employment by industry group as of March 31 for the last five years.

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

Industry Group	As of March 31 1997	1998	1999	2000	2001
Apparel and related products	21,750	19,039	18,349	16,770	15,617
Food and related products	19,949	17,816	16,852	15,182	14,305
Electrical machinery, equipment and supplies	24,671	22,728	20,254	19,394	18,167
Chemicals and related products (includes pharmaceuticals)	27,235	27,524	26,899	28,714	29,509
Professional and scientific instruments	14,914	15,105	14,542	14,818	15,174
Machinery, except electrical and transportation equipment	3,755	3,068	3,790	3,593	3,297
Petroleum refining and related industries; rubber and miscellaneous plastic products	5,768	5,994	5,970	6,197	5,985
Leather and leather products	6,566	5,834	4,749	3,982	2,730
Paper and related products; printing, publishing and related industries	7,441	8,698	9,418	9,536	9,524
Metal products	5,683	6,159	6,390	6,719	6,623
Stone, clay and glass products	4,972	5,217	5,509	5,929	5,920
Lumber and wood products; furniture and fixtures	3,352	3,538	3,446	3,343	3,205
Textile mill products	3,627	3,282	2,827	2,010	1,930
Tobacco products	1,206	1,285	1,297	1,254	1,438
Miscellaneous manufacturing industries	2,384	3,558	3,125	3,114	2,613
Total	153,273	148,845	143,417	140,555	136,037

*The manufacturing employment figures presented in this table are based on the Current Employment Statistics Survey (establishment survey) and are lower than the manufacturing employment figures presented in the "Average Employment by Sector" table above, which is based on the Current Population Survey (household survey). There are numerous conceptual and methodological differences between the household and establishment surveys. The establishment 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.

Sources: Department of Labor and Human Resources, Census of Manufacturing, except for March 1999, 2000 and 2001, which information was derived from the "benchmark" on Employment, Hours and Earnings

While total employment in the manufacturing sector decreased by 17,236 from March 1997 to March 2001, other indicators of the manufacturing sector suggest that manufacturing production increased. Average weekly hours worked increased 4.1% from fiscal 1997 to fiscal 2001. The reduction in manufacturing employment occurred during a period of significant expansion in real manufacturing output, as reflected in the growth of exports. This trend suggests a significant increase in manufacturing productivity. Most of the decreases in employment have been concentrated in labor intensive industries, particularly apparel, textile and tuna manufacturing.

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

Employment 2,500 and over	Product
Baxter International	Pharmaceuticals
Sara Lee Corp.	Apparel

Employment 1,500 to 2,499	
Abbott Laboratories Inc.	Pharmaceuticals
American Home Products	Pharmaceuticals
Bristol-Myers Squibb	Pharmaceuticals
Eaton Corp.	Electronic Instruments
General Electric Co.	Electrical Instruments
Hubell Incorporated	Electrical Instruments
Integra Lifesciences Corp.	Surgical Medical Devices
International Bagle	Food
Monsanto	Pharmaceuticals
Ocular Science-American Hydron	Ophthalmic Products
Warner-Lambert Co.	Pharmaceuticals

Employment 1,000 to 1,499	
Ingersoll-Rand Co.	Electrical Instruments
MacAndrews & Forbes Holdings	Tobacco Products
Medtronics	Surgical and Medical Instruments
Pall Corp.	Filters
Schering-Plough Corp.	Pharmaceuticals
Sensormatic Electronics	Electronic Components
Solectron Corp.	Electronic Components
Start Wu	Food
Pfizer	Pharmaceuticals
Procter & Gamble Co.	Pharmaceuticals
Propper International	Apparel
U.S. Surgical Corp.	Scientific Instruments

Employment 500 to 999	
Allergan	Pharmaceuticals
Astra Zeneca Group PLC	Pharmaceuticals
Conagra	Food
Dabco Industries	Mechanical Products
Dexter Shoe	Footwear
Johnson and Johnson	Pharmaceuticals
Loclite Corp.	Chemicals
Merck & Co.	Chemicals
Ortho-Tain Enterprises Inc.	Orthodontic Products
Pharmacia UpJohn Co.	Pharmaceuticals
SmithKline Beecham	Pharmaceuticals
Storage Technology Corp.	Electronic
Stryker Corp.	Surgical and Medical Instruments
Suiza Foods	Food
Thomas & Betts	Electrical Instruments
Timberland Company (The)	Leather

Employment 300 to 499	Product
Atlantron Inc.	Communications
Avon Products Inc.	Costume Jewelry
Becton-Dickinson & Co.	Scientific Instruments
Cardinal Health Inc.	Packaging Products
Coating Co.	Litographic Platemaking
Coleman Co.	Luggage
Colgate-Palmolive Co.	Consumers Products
Dupont (E.I.) de Nemours	Chemicals
Ecolab	Electronics
Eli Lilly and Co.	Pharmaceuticals
Grupo Pacífico S.A.	Paper Products
Industrial Dielectrics Inc.	Glass and Plastics
International Molders	Apparel Related Products
Ivax Corporation	Medical Equipment
Mafcote Industries Inc.	Surgical and Medical Instruments
Nypro	Medical Devices
Oles Inc.	Envelopes
Owens Illinois	Glass and Plastics
R.J.R. Nabisco	Food and Cigarretes
Signal Transformer Co.	Signs Products
Swiss Air Services Co.	Services
Wacoal Corp.	Apparel

Source: PRIDCO, Office of Economic Research (as of July 2001)

Services

Puerto Rico has experienced significant growth in the services sector (including finance, insurance, real estate, wholesale and retail trade, hotels and related services 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 1996 and 2000, the gross domestic product in this sector increased at an annual average rate of 6.6%, while employment increased at an annual average rate of 2.2%. The development of the services sector has shown a strong interaction among the following important sectors: manufacturing, tourism, 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 2000, services generated $24 billion of gross domestic product, or 38.1% of the total. Service employment grew from 526,720 in fiscal 1996 to 587,438 in fiscal 2000, a cumulative increase of 11.5%, which increase was greater than the 6.2% cumulative growth in total employment over the same period. During fiscal 2001, however, employment in the services sector decreased to 583,900. Wholesale and retail trade, finance, insurance and real estate experienced significant growth in the fiscal 1996 to 2000 period, as measured by gross domestic product. Gross domestic product in wholesale and retail trade increased from $6.3 billion in fiscal 1996 to $8.4 billion in fiscal 2000. In finance, insurance and real estate, gross domestic product increased from $6.2 billion in fiscal 1996 to $8.9 billion in fiscal 2000. There are sixteen commercial banks and trust companies currently operating in Puerto Rico. Total assets of these institutions as of December 31, 2000 were $54.8 billion.

The following tables set forth gross domestic product for the services sector for the five fiscal years ended June 30, 2000 and employment for the services sector for the six fiscal years ended June 30, 2001.

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

	Fiscal Year Ended June 30				
	1996	**1997**	**1998**	**1999**	**2000(p)**
Wholesale and retail trade	$6,281	$ 6,724	$ 7,287	$ 7,896	$8,437
Finance, insurance and real estate	6,164	6,917	7,672	8,327	8,920
Other services(1)	5,025	5,314	5,763	6,110	6,679
Total(2)	$17,470	$18,955	$20,723	$22,333	$24,036

(p) Preliminary.
(1) Includes hotel and related services.
(2) Totals may not add due to rounding.

Source: Planning Board

Commonwealth of Puerto Rico

Average Employment by Service Sector
(thousands of persons age 16 and over)

	Fiscal Year Ended June 30					
	1996	**1997**	**1998**	**1999**	**2000**	**2001(p)**
Wholesale and retail trade	218	228	236	229	239	242
Finance, insurance and real estate	39	38	40	43	42	40
Other services[(1)]	270	285	297	306	307	302
Total	527	551	573	578	587	584

(p) Preliminary.
(1) Includes hotels and related services.

Source: Department of Labor and Human Resources Household Survey

Hotels and Related Services - Tourism

Total visitors' expenditures accounted for 3.8% of the island's gross domestic product in fiscal 2000, compared to 3.6% in fiscal 1999. Visitors' expenditures and the number of visitors to the island had grown consistently from 1985 to 1998, reaching $2.2 billion, and more than 4.6 million, respectively, in fiscal 1998. In fiscal 1999, however, the number of visitors to the island decreased to 4.2 million and visitors' expenditures decreased to $2.1 billion, a decrease of 4.2% compared to fiscal 1998, due in part to the effect of Hurricane Georges, which struck the island in September 1998. During fiscal 2000, the number of visitors to the island increased to 4.6 million and visitors' expenditures increased to $2.4 billion, an increase of 8.2% and 11.7%, respectively, compared to fiscal 1999.

The number of persons registered in tourist hotels during fiscal 2000 increased 1.3% over the number registered during fiscal 1999. The average occupancy rate in tourist hotels during fiscal 2000 was 74.3% compared to 75.4% in fiscal 1999. The average number of rooms rented in tourist hotels increased 1.7% during fiscal 2000 compared with fiscal 1999. These increases are due in part to increased marketing by the Commonwealth, trends in the U.S. economy and increased hotel usage by Puerto Rico residents.

During fiscal 2001, the number of persons registered in tourist hotels was 1,598,619, an increase of 10.3% over the number registered during fiscal 2000. The average occupancy rate in tourist hotels during fiscal 2001 was 70.3% compared to 74.4% in fiscal 2000. The average number of rooms rented in tourist hotels increased 1.2% during fiscal 2001 compared with fiscal 2000. The average number of rooms available in tourist hotels increased 8.0% during fiscal year 2001 compared with fiscal 2000. As of June 30, 2001, the total number of hotel rooms was 12,353.

San Juan has become the largest homeport for cruise ships in the Caribbean and the fourth largest homeport 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, 2000.

Commonwealth of Puerto Rico
Tourism Data

	Number of Visitors				
Fiscal Year Ended June 30	Tourist Hotels(1)	Cruise Ship	Other (2)	Total	Total Visitors' Expenditures (in millions)
1996	828,251	1,045,104	2,236,805	4,110,160	$1,898.3
1997	906,706	1,107,913	2,335,068	4,349,687	2,046.3
1998	1,030,500	1,274,700	2,365,600	4,670,800	2,232.9
1999	1,042,000	1,197,200	1,982,100	4,221,300	2,138.5
2000(p)	1,050,100	1,224,600	2,291,300	4,566,000	2,387.9

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

Sources: Puerto Rico Tourism Company and the Planning Board

Government

The government sector of Puerto Rico plays an important role in the economy. In fiscal 2000, government accounted for $5.5 billion of Puerto Rico's gross domestic product, or 8.7% of the total. The government is also a significant employer, providing jobs for 249,213 workers, or 21.5% of total employment in fiscal 2000. Government sector employment does not include employment by public corporations, which is included in the employment statistics of other sectors. These public corporations include significant employers such as the Electric Power Authority and the Aqueduct and Sewer Authority. The government's (including the central government, the public corporations and the municipalities) share of payroll employment, measured according to the payroll survey, has diminished from 34.9% in fiscal 1981, to 33.6% in fiscal 1990, and to 26.5% in fiscal 2000.

On February 25, 1998, legislation was enacted permitting the unionization of government employees (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; annual salary increases are limited; employees cannot be required to become union members and pay union dues; and, collective bargaining negotiations cannot occur in an election year. Negotiations of non-economic conditions with government employees pursuant to this law commenced in fiscal 2000, and negotiations of economic conditions commenced in fiscal 2001.

Transportation

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

Luis Muñoz Marín International Airport is currently served by twenty-six United States and international airlines. At present, there is daily direct service between San Juan and New York, Chicago, Dallas, Los Angeles, Miami, Atlanta, Boston, and numerous other destinations within the United States. There is also regularly scheduled service between Puerto Rico and other Caribbean islands and major 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, 2000, totaled approximately 4,610 miles.

Construction

The construction industry has experienced substantial real growth since fiscal 1987. Although it represents a relatively small segment of the economy compared to other sectors, it has made significant contributions to the growth of economic activity.

During the period from fiscal 1996 through fiscal 1999, construction investment increased 62%. In fiscal 2000, investment in construction rose to a record level of $7.0 billion, an increase of 7.3% from $6.6 billion in fiscal 1999, and the total value of construction permits increased 52.1%. The strength of public investment has been an important component in the significant expansion of construction investment. During fiscal 2000, approximately 41% of the total investment in construction was related to public projects. While sales of locally produced cement for fiscal 2000 decreased 3.5% in comparison with fiscal 1999, the government believes that total sales of cement for fiscal 2000 increased slightly from fiscal 1999 because of an offsetting increase in sales of imported cement. In fiscal 2000, the average employment in the construction sector was 84,886, an increase of 9.2% over fiscal 1999.

During fiscal year 2001, the total value of construction permits increased 25.3%. Total sales of locally produced cement decreased 6.7% in comparison with fiscal 2000, which decrease was offset by increases in imported cement. The average employment in the construction sector during fiscal 2001 was 84,890.

Agriculture

The Department of Agriculture and related agencies have directed their efforts at increasing and improving local agricultural production, increasing efficiency and quality of produce, and stimulating import substitution where economically feasible. During fiscal 2000, gross income from agriculture was $810.1 million, an increase of 13.5% in comparison with fiscal 1999. Agriculture gross income consists of the total value of production in the principal agricultural sectors, which include traditional crops, livestock and poultry, grains, vegetables, fruits, and other products. Recently, non-traditional crops and livestock and poultry have contributed a higher percentage of the sector's income.

The Commonwealth supports agricultural activities through incentives, subsidies, and technical and support services, in addition to income tax exemptions for qualified income derived by bona fide farmers. Act No. 225, approved on December 1, 1995, increased the tax benefits available to bona fide farmers. The Act provides a 90% income tax exemption for income derived from agricultural operations, an investment tax credit equal to 50% of the investment in qualified agricultural projects, and a 100% exemption from excise taxes, real and personal property taxes, municipal license taxes and tariff payments. It also provides full income tax exemption for interest income from bonds, notes and other debt instruments to be 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.

Since fiscal 1995, the Commonwealth has sold to private entities various agricultural operations previously conducted by governmental entities. These include certain assets of the pineapple processing operation and a mango growing facility. The Commonwealth has transferred to local private sugarcane growers the sugar processing facilities formerly operated by the Sugar Corporation.

Policy changes are expected to be implemented to promote employment and income generated by the agricultural sector. The policy initiatives being considered include a restructuring of the Department of Agriculture, an increase in government purchases of local agricultural products, and a new system of agricultural credits and subsidies for new projects.

Higher Education

During the four decades from 1950 to 1990, 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. Since the 1980s, college attendance has remained relatively stable as a percentage of the college age population, generally following the trend in the United States.

The following table presents comparative trend data for Puerto Rico and the United States with respect to college age population and 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(1)	Higher Education Enrollment(2)	Percent(3)	Population 18-24 Years of Age(1)	Higher Education Enrollment(2)	Percent(3)
1970	341,448	57,340	16.8%	23,714,000	8,580,887	36.2%
1980	397,839	130,105	32.7	30,022,000	12,096,895	40.3
1990	417,636	156,147	37.4	26,961,000	13,819,000	51.3
1997	478,028	173,608	36.3	24,979,000	14,345,000	57.4
1998	480,775	175,633	36.5	25,476,000	14,608,000	57.3
1999	483,028	175,449	36.3	26,011,000	14,881,000	57.2
2000(e)	470,660	174,550	37.1	26,748,000	15,072,000	56.3

(e) Estimated.
(1) 1970, 1980 and 1990 based on enumerated population as of April 1; other years based on estimated population as of July 1.
(2) For some small college level institutions, the data for 1998 and 1999 was estimated.
(3) Number of persons of all ages enrolled in institutions of higher education as percent of population 18-24 years of age.

Sources: United States Bureau of the Census (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, includes eleven campuses located throughout the island. Total enrollment of the University was 69,773 students during academic year 2000-2001. The Commonwealth is legally bound to appropriate annually to the University 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 37 private institutions of higher education located in Puerto Rico. Such institutions have current enrollment in excess of 100,000 students and provide programs of study in liberal arts, education, business, natural sciences, technology, secretarial and computer sciences, nursing, medicine, and law. Degrees are offered by these institutions at the associate, bachelor, master, and doctoral levels.

Tax Incentives

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

Industrial Incentives Program

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

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

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

Tourism Incentives Program

For many years Puerto Rico has also had incentives laws designed to stimulate investment in hotel operations on the island. The most recent of these laws, the Tourism Incentives Act of 1993, provides partial exemptions from income, property, and municipal license taxes for a period of up to ten years. In addition, it provides certain tax credits for qualifying investments in hotel development projects.

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 make investments in or provide financing to entities that contribute to the development of the tourism industry. The Fund was initially capitalized with $50,000,000 and was authorized to provide financial guarantees for financing hotel development projects. To date the Fund has provided financial guarantees to private entities issuing bonds or borrowing funds to finance the development of thirteen hotel projects that provided approximately 3,000 new hotel rooms.

Incentives under the Code

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

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

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

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

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

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

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

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

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

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

Controlled Foreign Corporations

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

CFCs operate under transfer pricing rules for intangible income that are different from those applicable to corporations operating under Section 936 and 30A. In many cases, they are allowed to attribute a larger share of this income to their Puerto Rico operation, but must make a royalty payment "commensurate with income" to their U.S. affiliates. Section 936 companies were exempted from Puerto Rico withholding taxes on any cost sharing payments they might have opted to make, but CFCs are subject to a ten percent Puerto Rico withholding tax on royalty payments. The recent increase in Commonwealth revenues attributable to withholding taxes on royalty payments suggests that a significant share of the net income previously reported by corporations operating under the profit split method of Section 936 has been transferred to CFCs.

Proposed New U.S. Tax Regime for Companies Doing Business in Puerto Rico - Section 956 of the Code

One of the elements of the Commonwealth's new economic development plan involves amending the Code to provide a new tax regime applicable to U.S.-based businesses that have operations in Puerto Rico or other U.S. possessions.

On July 18, 2001 a bill sponsored by various members of the House Ways and Means Committee was introduced in the United States House of Representatives to amend the Code as follows: (i) Sections 30A and 936 would be allowed to expire according to their terms; (ii) Section 956 would be amended to exclude from current U.S. tax 90% of the otherwise taxable investments in certain U.S. property made by a "Qualified CFC" out of its "Qualified Income"; (iii) as an alternative to the Section 956 exclusion, Section 245 would be amended to allow an 85% dividends received deduction with respect to dividends paid out of Qualified Income by the Qualified CFC; (iv) transition rules would be provided for companies now conducting operations in Puerto Rico (i.e., existing Section 936 and 30A credit claimants); and (v) the investment in U.S. properties by the Qualified CFC out of its Qualified Income will not be subject to the imputation of interest nor to treatment as a constructive dividend.

A "Qualified CFC" would be defined under the Code as a controlled foreign corporation which is created or organized under the laws of, or engaged in the active conduct of a trade or business within, the Commonwealth or a possession of the United States. "Qualified Income" would be limited to that portion of the CFCs post-2001 foreign source income that is derived from the active conduct by the CFC of a trade or business in Puerto Rico (or a possession of the United States) or from the sale or exchange of substantially all the assets used by the CFC in the active conduct of such a trade or business. The proposed Section 956 exclusion would be applicable only to income that is eligible for deferral under general U.S. tax principles. Thus, for example, passive income received by the CFC could not be converted from income that is currently taxable under Subpart F of the Code into income eligible for deferral by the investment of such amounts in U.S. property pursuant to the proposed amendment to Section 956.

It is proposed that the new Section 956 exclusion and the related transition rule be effective for taxable years of CFCs beginning after December 31, 2001.

The legislative process for this bill is in the early stages and, thus, it is not possible at this time to determine whether the bill will be enacted into law or what amendments, if any, may be made to the bill.

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. Direct debt of the Commonwealth is supported by Commonwealth taxes. Debt of municipalities, other than bond anticipation notes, is supported by real and personal property taxes and municipal license taxes. Debt of public corporations, other than bond anticipation notes, is generally supported by the revenues of such corporations from rates charged for services or products. See *Public Corporations*. However, certain debt of public corporations is supported, in whole or in part, directly or indirectly, by Commonwealth appropriations or taxes.

On June 7, 2001, the Commonwealth authorized the issuance, on a delayed basis, of $501,565,000 aggregate principal amount of its Public Improvement Refunding Bonds, Series 2002 (the "Forward Delivery Bonds"). The Forward Delivery Bonds have been sold and will be delivered in April 2002.

The following table presents a summary of public sector debt as of June 30, 2001, as adjusted for the issuance of the Forward Delivery Bonds and the refunding of the bonds refunded thereby, and as adjusted for the issuance of the Public Improvement Bonds of 2002, Series A and Series B in the aggregate principal amount of $475,000,000 and the Public Improvement Refunding Bonds, Series 2002 A in the aggregate principal amount of $837,960,000 (collectively, the "2002 Bonds") and the refunding of the bonds refunded thereby. The bonds that are being refunded with the proceeds of the Forward Delivery Bonds and the 2002 Bonds that are or will be invested in guaranteed investment contracts are excluded from the table below notwithstanding that such bonds will be considered to be outstanding under their respective authorizing resolutions and for purposes of calculating the Commonwealth's debt limitation. Also 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, except as otherwise noted in footnote 4 to the table below. Also excluded from the table is debt the inclusion of which would reflect double counting, including, but not limited to, $1,021,050,000 of bonds outstanding by the Municipal Finance Agency to finance its purchase of bonds of Puerto Rico municipalities, and $1,517,430,000 of obligations of GDB issued to purchase certain Commonwealth public sector debt and for other purposes, of which $267,000,000 is guaranteed by the Commonwealth.

Commonwealth of Puerto Rico
Public Sector Debt
(in thousands)

	June 30, 2001	As Adjusted by the Issuance of the 2002 Bonds	As Adjusted by the Issuance of the 2002 Bonds and the Forward Delivery Bonds
Puerto Rico direct debt(1)	$ 5,837,909	$ 5,936,380(5)	$ 5,933,185(5)
Municipal debt	1,632,170	1,632,170	1,632,170
Public corporations debt			
Puerto Rico guaranteed debt(2)	603,334	603,334	603,334
Debt supported by Puerto Rico appropriations or taxes(3)	12,091,422	12,091,422	12,091,422
Other non-guaranteed debt(4)	6,539,423	6,539,423	6,539,423
Total public corporations debt	19,234,179	$19,234,179	$19,234,179
Total public sector debt	$26,704,258	$26,802,729	$26,799,534

(1) Includes a $21,415,921 loan from GDB to the Department of the Treasury to settle certain property tax claims of the municipalities (the "GDB Tax Claims Loan") and $78,820,000 of certain indebtedness originally issued by the Urban Renewal and Housing Corporation that was transferred to the Commonwealth by virtue of Act No. 134 of the Legislature of Puerto Rico, approved on December 13, 1994 ("Act No. 134 of 1994") (such indebtedness is referred to as "Transferred CRUV Debt").

(2) Consists of bonds issued by the Housing Bank and Finance Agency and the Aqueduct and Sewer Authority. Excludes $1,562,493,219 of Public Buildings Authority bonds and notes, which are primarily payable from Commonwealth appropriations and $267,000,000 of GDB bonds payable from available moneys of GDB.

(3) Represents, among others, bonds and notes issued by the Aqueduct and Sewer Authority, the Highway and Transportation Authority, the Public Buildings Authority, the Public Finance Corporation, the Infrastructure Financing Authority and the Housing Bank and Finance Agency and notes of the Health Facilities and Services Administration which were assumed by the Department of Health.

(4) Includes $1,092,550,000 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, and $397,005,000 of The Children's Trust Fund bonds which are payable solely from a portion of the payments to be received pursuant to the tobacco litigation settlement.

(5) Adjusted to exclude payments of principal made on July 1, 2001.

Source: Government Development Bank

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

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

The following table presents (i) debt service requirements for (A) Commonwealth general obligation bonds outstanding on June 30, 2001, adjusted for the issuance of the 2002 Bonds and the refunding of the bonds refunded thereby and adjusted further to exclude debt service on the bonds being refunded by the Forward Delivery Bonds; (B) the Forward Delivery Bonds; and (C) bonds of the Aqueduct and Sewer Authority which were outstanding on June 30, 2001 for which debt service payments are being made under the Commonwealth guaranty; and (ii) total debt service on all general obligation bonds, adjusted for the issuance of the 2002 Bonds, the Forward Delivery Bonds and the refunding of the bonds refunded thereby, and the Aqueduct and Sewer Authority bonds. The table excludes debt service on the bonds being refunded with the proceeds of the Forward Delivery Bonds and the 2002 Bonds invested in guaranteed investment contracts, notwithstanding that such bonds will be considered to be outstanding under their respective authorizing resolutions and for purposes of calculating the Commonwealth's debt limitation. With respect to other debt of the Aqueduct and Sewer Authority, see *Public Corporations*. Debt service requirements for each fiscal year, as shown in the following table, include principal and interest due on July 1 immediately following the close of such fiscal year.

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

	Outstanding Bonds[1]			Forward Delivery Bonds			
Fiscal Year Ending June 30	Principal	Interest	Total Debt Service	Principal	Interest	PRASA Bonds Debt Service	Grand Total
2002	$ 159,145	$ 272,378	$ 431,523	$ 0	$ 6,385	$ 33,542	$ 471,449
2003	86,936	330,339	417,275	11,070	26,421	32,745	487,510
2004	89,563	328,911	418,474	13,045	25,867	30,125	487,511
2005	145,315	263,214	408,529	23,640	25,215	30,127	487,511
2006	120,009	280,532	400,540	32,815	24,033	30,121	487,509
2007	81,993	298,547	380,540	54,450	22,392	30,126	487,509
2008	111,103	273,499	384,602	53,105	19,670	30,131	487,507
2009	150,160	246,103	396,263	44,090	17,014	30,123	487,491
2010	160,450	236,472	396,921	45,885	14,700	29,984	487,490
2011	156,292	227,008	383,301	61,975	12,291	29,928	487,494
2012	170,450	212,663	383,113	65,370	8,882	30,127	487,493
2013	180,035	203,073	383,108	68,970	5,287	30,128	487,492
2014	215,048	213,677	428,725	27,150	1,493	30,125	487,493
2015	253,675	203,692	457,366	0	0	30,126	487,492
2016	266,030	191,344	457,375	0	0	30,121	487,495
2017	278,897	178,476	457,373	0	0	30,122	487,494
2018	292,395	164,973	457,368	0	0	30,126	487,494
2019	323,386	133,991	457,377	0	0	30,125	487,501
2020	378,710	108,783	487,493	0	0	0	487,493
2021	246,945	88,746	335,691	0	0	0	335,691
2022	178,850	76,184	255,034	0	0	0	255,034
2023	143,650	67,312	210,962	0	0	0	210,962
2024	127,310	60,145	187,455	0	0	0	187,455
2025	133,850	53,599	187,449	0	0	0	187,449
2026	132,050	46,642	178,692	0	0	0	178,692
2027	138,785	39,906	178,691	0	0	0	178,691
2028	145,965	32,727	178,692	0	0	0	178,692
2029	153,540	25,153	178,693	0	0	0	178,693
2030	161,695	16,998	178,693	0	0	0	178,693
2031	169,980	8,711	178,691	0	0	0	178,691
	$5,352,210	$4,883,800	$10,236,010	$501,565	$209,648	$ 547,952	$11,495,174

* Totals may not add due to rounding.

(1) Debt service requirements on all general obligation bonds outstanding on June 30, 2001, as adjusted for the issuance of the 2002 Bonds and the refunding of the bonds refunded thereby and as adjusted further to exclude debt service on bonds to be refunded by the Forward Delivery Bonds.

Sources: Government Development Bank and Department of the Treasury

Commonwealth Guaranteed Debt

As of June 30, 2001, $12,505,000 of Commonwealth guaranteed bonds of the Housing Bank and Finance Agency was outstanding. These bonds were originally issued by the Urban Renewal and Housing Corporation and refinanced in fiscal 1992 by the Housing Bank and Finance Agency. These bonds were paid on October 1, 2001, their final maturity date.

As of June 30, 2001, $1,562,493,219 of Commonwealth guaranteed bonds of the Public Buildings Authority was outstanding. Maximum annual debt service on these bonds is $160,698,186 in fiscal year ending June 30, 2002, with their final maturity being July 1, 2027. No payments under the Commonwealth guaranty have been required to date for bonds of the Public Buildings Authority.

As of June 30, 2001, $267,000,000 of Commonwealth guaranteed obligations of GDB were outstanding. No payments under the Commonwealth guaranty have been required for any obligations of GDB to date.

As of June 30, 2001, the Commonwealth had guaranteed the outstanding Series 1995 revenue bonds of the Aqueduct and Sewer Authority in the aggregate principal amount of $361,590,000. On January 2, 1997, the Commonwealth began to make debt service payments under the Commonwealth guaranty and expects to make all debt service payments required on these revenue bonds.

In addition, in April 2000, the Commonwealth extended its guaranty to all of the outstanding bonds issued by the Aqueduct and Sewer Authority to the United States Department of Agriculture, Rural Development, and to all of the outstanding loans by the State Revolving Funds for the benefit of the Aqueduct and Sewer Authority. The extended guaranty will also cover any additional bonds and loans that may be issued until June 30, 2005. As of June 30, 2001, aggregate principal amounts outstanding on these obligations were $126,872,000 and $102,376,000, respectively. No payments under the Commonwealth guaranty have been required to date for these obligations of the Aqueduct and Sewer Authority.

Trends of Public Sector Debt

Historically, the Commonwealth has maintained a fiscal policy that provides for a prudent relationship between the growth of public sector debt and the growth of the economic base required to service that debt. During fiscal 1996, 1997 and 1998, however, public sector debt increased at a greater rate than the growth of gross product due to an increase in the amount of debt incurred to finance certain key infrastructure projects that were important to the development of the economy and were expected to produce long-term economic benefits, and debt incurred to refinance outstanding debt, enabling Puerto Rico to benefit from historically low levels of interest rates and realize debt service savings. During fiscal 1999 and 2000, the growth of public sector debt was below the growth of gross product. Public sector debt increased by 12.1% during fiscal 2001. Corresponding information about the growth of gross product during fiscal 2001 is not yet available. The increase in the rate of growth of public sector debt during fiscal 2001 is in part due to the issuance during such fiscal year of $1,092,550,000 of bonds of the Infrastructure Financing Authority and $397,005,000 of bonds of the Children's Trust Fund, both of which are payable from sources other than Commonwealth appropriations or taxes or revenues of public corporations derived from services or products. Excluding these bond issues, the rate of growth of public sector debt for fiscal 2001 was 5.9%.

As of June 30, 2001, outstanding short-term debt, relative to total debt, was 10.8%.

The following table shows the trends in gross product (in current dollars) and public sector debt for the five fiscal years ended June 30, 2001.

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

	Public Sector Debt					Gross Product(1)	
June 30	**Long Term**	**Short Term(2)**	**Short Term as % of Total**	**Total***	**Rate of Increase**	**Amount**	**Rate of Increase**
1997	$17,865	$1,642(3)	8.4%	$19,507	10.7%	$32,343	6.5%
1998	20,759	1,563(3)	7.0	22,322	14.4	35,161	8.3
1999	20,905	1,772(3)	7.8	22,677	1.6	38,297	8.9
2000	21,620	2,202(3)	9.2	23,822	5.0	41,366(p)	8.0
2001	23,833	2,871(4)	10.8	26,704	12.1	N/A	N/A

* Totals may not add due to rounding.
(p) Preliminary.
(1) In current dollars.
(2) Obligations (other than bonds) issued with an original maturity of three years or less and lines of credit with a remaining maturity of three years or less are considered short-term debt.
(3) Does not include the tax and revenue anticipation notes that were outstanding at the close of the indicated fiscal years because prior to the end of said fiscal years sufficient funds had been set aside for the payment of such notes in full.
(4) Includes a $164 million line of credit from Government Development Bank to the Secretary of the Treasury whose proceeds were applied to pay debt service on general obligation bonds in lieu of funds available therefor in the General Fund.

Source: Government Development Bank

The following table shows the trend of public sector debt by major category for the five fiscal years ended June 30, 2001.

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

	Commonwealth			Municipalities			Public Corporations(1)			Total*		Grand Total*
June 30	**Long Term**	**Short Term(2)**	**Total***	**Long Term**	**Short Term(2)**	**Total***	**Long Term**	**Short Term(2)**	**Total***	**Long Term**	**Short Term(2)**	
1997	4,512	0(3)	4,512(4)	843	51	894	12,509	1,590	14,100	17,865	1,642(3)	19,507(4)
1998	4,819	0(3)	4,819(4)	973	57	1,030	14,967	1,506	16,473	20,759	1,563(3)	22,322(4)
1999	5,097	0(3)	5,097(4)	1,215	60	1,275	14,593	1,713	16,306	20,905	1,772(3)	22,678(4)
2000	5,349	0(3)	5,349(4)	1,396	68	1,464	14,875	2,133	17,008	21,620	2,202(3)	23,822(4)
2001	5,674	164(5)	5,838(4)	1,468	164	1,632	16,691	2,543	19,234	23,833	2,871	26,704(4)

* Totals may not add due to rounding.
(1) Includes Commonwealth guaranteed debt.
(2) Obligations (other than bonds) issued with an original maturity of three years or less and lines of credit with a remaining maturity of three years or less are considered short-term debt.
(3) Does not include the tax and revenue anticipation notes which were outstanding at the close of the indicated fiscal years because prior to the end of said fiscal years sufficient funds had been set aside for the payment of such notes in full.
(4) Includes the GDB Tax Claims Loan and the Transferred CRUV Debt.
(5) Includes a $164 million line of credit from Government Development Bank to the Secretary of the Treasury whose proceeds were applied to pay debt service on general obligation bonds in lieu of funds available therefor in the General Fund.

Source: Government Development Bank

PUBLIC CORPORATIONS

In Puerto Rico, many governmental or quasi-governmental functions are performed by public corporations. These are governmental entities created by the Legislature with varying degrees of independence from the central government. Public corporations are generally created to perform a single function or a limited number of related functions. Most public corporations obtain revenues from rates charged for services or products, but many are subsidized to some extent by the central government. Most public corporations are governed by boards appointed by the Governor with the advice and consent of the Senate, but some public corporations are subsidiaries of departments of the central government. Capital improvements of most of the larger public corporations are financed by revenue bonds under trust agreements or bond resolutions or notes under loan agreements. The following table presents the outstanding bonds and notes of certain of the public corporations as of June 30, 2001 ("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 the Federal government or is payable from sources other than Commonwealth appropriations or taxes or revenues of public corporations, or is payable from revenues derived from 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
June 30, 2001
(in thousands)

	Bonds			Notes			Total Bonds and Notes		
	With Guaranty	Without Guaranty	Total	With Guaranty	Without Guaranty	Total	With Guaranty	Without Guaranty	Total
Aqueduct and Sewer Authority	$ 487,429	$ 0	$ 487,429	$ 0	$ 969,052[1]	$ 969,052	$ 487,429	$ 969,052[1]	$1,456,481
Electric Power Authority	0	4,308,388	4,308,388	0	125,000	125,000	0	4,433,388	4,433,388
Health Facilities and Services Administration[2]	0	0	0	0	654,041	654,041	0	654,041	654,041
Highway and Transportation Authority	0	3,897,434	3,897,434	0	340,788	340,788	0	4,238,222	4,238,222
Housing Bank	12,505	526,166	538,671	0	92,195	92,195	12,505	618,361	630,866
Industrial Development Company	0	176,433	176,433	0	53,379	53,379	0	229,812	229,812
Infrastructure Financing Authority	0	2,069,295[3]	2,069,295	0	21,692	21,692	0	2,090,987	2,090,987
Public Finance Corporation	0	1,577,736[4]	1,577,736	0	0	0	0	1,577,736[4]	1,577,736
Ports Authority	0	102,670	102,670	0	257,397	257,397	0	360,067	360,067
Public Buildings Authority	1,562,493	0	1,562,493	0	230,723	230,723	1,562,493	230,723	1,793,216
Sugar Corporation	0	0	0	0	66,641	66,641	0	66,641	66,641
University of Puerto Rico	0	469,728	469,728	0	656	656	0	470,384	470,384
Others	0	397,005[5]	397,005[5]	0	835,333	835,333	0	1,232,338	1,232,338
Total[6]	$2,062,427[7]	$13,524,855	$15,587,282	$ 0	$3,646,897	$3,646,897	$2,062,427[7]	$17,171,752	$19,234,179

(1) Principal of and interest on this debt is reimbursed from Commonwealth appropriations.
(2) This is debt incurred by the Health Facilities and Services Administration prior to its dissolution on June 30, 1999, which debt was assumed by the Department of Health.
(3) $1,092.6 million of this amount is payable from interest earnings on $1.2 billion deposited in the Puerto Rico Infrastructure Development Fund which represent a portion of the proceeds received by the Commonwealth from the sale of its controlling interest in the Puerto Rico Telephone Company in 1999.
(4) Payable primarily from Commonwealth appropriations.
(5) On November 15, 2000, the Children's Trust issued its Tobacco Settlement Asset-Backed Bonds, Series 2000, in the total principal amount of $397,005,000. Said bonds will be repaid from payments made by certain tobacco companies under a master settlement agreement. See "Other Public Corporations" below.
(6) Does not include accretion of interest from the respective issuance dates on capital appreciation bonds.
(7) Authorization for Commonwealth guarantee of debt as of June 30, 2001 was $3,891,000,000.

Source: Government Development Bank

Government Development Bank for Puerto Rico

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

As of June 30, 2001, $1,249,969,000 of bonds and notes of GDB were outstanding. As of said date, GDB also had $3,710,506,000 in loans to local public corporations and municipalities. Act No. 12 of May 9, 1975, as amended, provides that the payment of principal of and interest on specified notes and other obligations of GDB, not exceeding $550,000,000, may be guaranteed by the Commonwealth, of which $267,000,000 were outstanding as of June 30, 2001.

GDB has the following principal subsidiaries:

Housing Finance Corporation was created in November 1977 to provide needed rental housing units and stimulate the construction industry under federally subsidized programs. The Corporation has issued tax-exempt revenue bonds and notes to finance the construction of housing units approved for federal rental subsidies and to finance home ownership of single family housing units, which bonds and notes are limited obligations of the Corporation payable solely from revenues collected in respect of such housing units. The Federal Housing Administration has insured mortgages on certain of the housing units. As of June 30, 2001, $891,664,827 of bonds of Housing Finance Corporation was outstanding. In August 2001, the Corporation issued $127,075,000 of its Home Mortgage Revenue Bonds and Notes.

On August 11, 2001, the Governor signed legislation creating the Puerto Rico Housing Finance Authority as the successor to the Corporation and transferring to the Authority all powers and duties of the Housing Bank and Finance Agency and dissolving the Housing Bank and Finance Agency. The legislation becomes effective 180 days after the Governor's signature thereon.

Tourism Development Fund was created in November 1993 to promote the hotel and tourism industry of Puerto Rico, primarily by making available guarantees to secure the payment of private financing used for new hotel development projects. The Tourism Development Fund is also authorized to make capital investments and provide direct financing to tourism related projects. As of June 30, 2001, the Tourism Development Fund had outstanding guarantees with respect to the financing of thirteen hotel projects totaling $603,125,000. The owner of one of these projects with a guaranty for $84,740,000 recently filed for bankruptcy. The Tourism Development Fund has commenced foreclosure proceedings in another project for which the guaranty is $27,130,000.

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

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

Public Finance Corporation was created in December 1984 to provide agencies and instrumentalities of Puerto Rico with alternate means of meeting their financing requirements. In June 1995, the Corporation issued $296,393,974 of bonds to purchase from GDB certain debt of the Maritime Shipping Authority. In April 1996, the Corporation issued $192,108,735 of bonds to purchase from GDB a portion of a debt of the Secretary of the Treasury relating to advances made by the Secretary to the municipalities to settle certain property tax claims. In June 1998, the Corporation issued $383,225,000 of bonds to purchase from GDB the debt which had been incurred by the Office for the Improvement of Public Schools in connection with its public schools repair and improvement program. In January 1999, the Corporation issued $618,085,149 of bonds to purchase from GDB a portion of the outstanding indebtedness of Health Facilities and Services Administration ("AFASS"). All of these bonds of the Corporation are payable from Commonwealth appropriations.

In February 1999, the Corporation issued $228,318,000 of bonds to refund a GDB line of credit utilized by the Corporation to purchase certain property tax debts from the Municipal Revenues Collection Center and the Department of the Treasury. Said bonds are limited obligations payable solely from collections of the property tax debts purchased by the Corporation.

As of June 30, 2001, the Corporation had $1,577,736,000 aggregate principal amount of bonds outstanding.

In August 2001, the Corporation issued $390,000,000 of bonds to purchase from GDB certain debt of Aqueduct and Sewer Authority relating to the construction of the North Coast Superaqueduct (discussed below). These bonds are also payable from Commonwealth appropriations.

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

Other Public Corporations

Aqueduct and Sewer Authority owns and operates the Commonwealth's system of public water supply and sanitary sewer facilities. Capital expenditures are financed by revenues of the system, debt issuances, and federal and Puerto Rico grants. Debt service on revenue bonds is payable from net revenues of the system after payment of current expenses.

Facilities and operations of the Authority's system are subject to regulation under numerous federal and Puerto Rico environmental laws, including the federal Clean Water Act and the Safe Drinking Water Act administered by the United States Environmental Protection Agency ("EPA"). The Authority has embarked on an extensive capital improvement program for the five-year period ending June 30, 2005, that is estimated to cost approximately $1.7 billion. A portion of the capital improvement program is designed to enable the Authority to comply with federal and Commonwealth laws and regulations.

The Authority needs to make a substantial investment in infrastructure and a major overhaul of its operations to maintain the viability of the existing system and to finance its expansion for new users. Funds for this investment are expected to be provided through a combination of bond issues, legislative appropriations and federal grants. Due to the Authority's financial difficulties (discussed below) and its inability to access the bond market, Act No. 45 was enacted in July 1994 to provide a Commonwealth guaranty of the principal and interest payments to the bondholders of all outstanding debt previously issued by the Authority which, at that time, amounted to $388 million, and to also guarantee all future bonds or any other similar obligations incurred by the Authority to refinance such debt. In December 1995, the Authority issued $400,340,000 of its Refunding Bonds, Series 1995 (the "Series 1995 Bonds"), to refund all of the Authority's outstanding revenue and revenue refunding bonds. The Series 1995 Bonds are guaranteed by the Commonwealth pursuant to Act No. 45. On January 2, 1997, the Commonwealth began making all debt service payments under said guaranty in respect of the Series 1995 Bonds. In addition, Act No. 45 was amended on April 24, 2000, to extend the payment guaranty of the Commonwealth to all of the outstanding bonds issued by the Authority to the United States Department of Agriculture, Rural Development, and to all of the outstanding loans granted by the Clean Water and Drinking Water State Revolving Funds for the benefit of the Authority. The extended guaranty will cover any additional issuance of these obligations until June 30, 2005.

The Authority has reported net losses of $55.2 million, $94.9 million, $130 million and $100.7 million during fiscal years 1997, 1998, 1999 and 2000, respectively. The estimated net loss for fiscal 2001 is $176 million. These losses, which the Authority has financed with lines of credit from Government Development Bank, reflect the continuing financial and operating difficulties that the Authority has experienced in recent years. The outstanding principal amount of these lines of credit was $865,652,000 as of June 30, 2001. These losses were aggravated in recent years by extraordinary items, including the required adoption of new government accounting requirements relating to required expense reserves, the posting of previous years' non-registered entries and adjustments, employees' salary increases and early retirement bonuses, non-budgeted or underestimated expenses relating to the PSG Agreement (described below), increased maintenance costs and additional non-budgeted reserves. Legislation was approved in July 1994 providing for annual Commonwealth appropriations to the Authority to pay a portion of the principal of and interest on the Authority's indebtedness, cover capital improvements and defray a portion of the Authority's operating and maintenance expenses, as follows: $20 million for fiscal 1995, $25 million for fiscal 1996, $30 million for fiscal 1997, and $35 million for fiscal 1998. Additional legislation was approved in August 1997 providing for annual Commonwealth appropriations of $35 million annually through fiscal 2008. Additional annual appropriations are made to cover debt service on the Public Finance Corporation bonds issued to finance the North Coast Superaqueduct.

On May 26, 1995, the Authority and Professional Services Group, Inc. ("PSG") entered into a five-year agreement (the "Agreement") for the operation, management, repair and maintenance of the Authority's public water supply and sanitary sewer systems, and for its customer service systems (the "Authority Systems"). PSG, which is headquartered in Houston, Texas, is a subsidiary of Air Water Technologies Corporation ("AWT"), which in turn is a subsidiary of Compagnie Générale des Eaux-SAHIDE ("CGE"), a member of the Vivendi Group, a French based international conglomerate of environmental, utility, energy, construction and communication companies. CGE guaranteed PSG's performance obligations under the Agreement. PSG commenced management of the Authority Systems in September 1995. Under the Agreement, all employees remained employees of the Authority, and the Authority retained management responsibilities for the capital planning, construction and environmental compliance departments. The management of certain departments, such as finance and management information systems, was shared by the Authority and PSG.

In September 1998, the Authority, PSG, AWT and CGE entered into an amendment to the Agreement (the "Amended Agreement"), that assigned all of PSG's obligations under the Agreement to CGE and AWT, with CGE being primarily responsible. The Amended Agreement extended the term of the Agreement by one year until August 31, 2001, transferred the management responsibility for the shared departments to CGE, and modified certain terms and conditions of the Agreement. The Amended Agreement includes performance incentives and penalties in the event that CGE fails to operate the Authority Systems within specified parameters, and establishes a contract administrator to oversee and monitor CGE's performance under the Amended Agreement. The annual fees payable to CGE may be adjusted to provide for certain unforeseen events and circumstances, such as additional operations expenses due to hurricanes, and for adding facilities to the Authority Systems. The Amended Agreement gave the Authority the right to terminate the Amended Agreement, without cause or penalty, at the end of the fifth contract year.

On March 1, 1999, the Authority entered into a further amendment to the Amended Agreement, which transferred to CGE responsibility of the departments that had remained under the Authority's control. In connection with such amendment, the fees and costs payable to CGE were adjusted to reflect the additional responsibilities assumed by CGE and the hoped for increased efficiencies of a private management company.

On August 31, 2001, the Authority extended the Amended Agreement for nine months and requested proposals from CGE and other multinational companies for a new agreement (or more than one agreement if the island is divided into two areas of operation) covering the operation, management, repair and maintenance of the Authority Systems. The Authority expects to select one or more operators and enter into one or more new contracts by the end of the nine-month extension period.

The Authority entered into an agreement with Thames-Dick Superaqueduct Partners, Inc. for the planning, design, construction, operation and maintenance of the North Coast Superaqueduct to supply additional potable water to certain municipalities, mainly in the San Juan Metropolitan Area. The total cost of the North Coast Superaqueduct was approximately $390 million. GDB provided interim financing for this Project. Permanent financing was provided in August 2001 through the issuance of $390,000,000 of bonds of Public Finance Corporation, payable from Commonwealth appropriations. The North Coast Superaqueduct started operations during January 2000.

Economic Development Bank was created in July 1985 to engage primarily in granting small direct loans, providing loan guarantees to private enterprises, and making equity investments in such enterprises. Its initial capital was provided by a transfer of loans in the principal amount of $15,000,000 previously administered by a now inactive subsidiary of GDB. As of June 30, 2001, Economic Development Bank had outstanding debt of $85,806,000.

Electric Power Authority owns and operates the island's electric system. The Capital Improvement Program for the five-year period ending June 30, 2005, is estimated to cost approximately $2.0 billion and is 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 June 30, 2001, the Authority had $4,308,388,000 in 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 power purchase contracts relating to the construction of certain cogeneration plants that will use fuels other than oil. These two cogeneration projects consist of EcoElectrica's 507 megawatts liquefied natural gas plant at Guayanilla and a 454 megawatts clean coal facility at Guayama to be built and operated by an affiliate of Applied Energy Systems ("AES"). EcoElectrica's plant started commercial operations in March 2000. Construction of AES' plant began in November 1999, and the plant is expected to be in service during calendar year 2002. It is expected that these two cogeneration plants will initially provide approximately one-third of the Authority's energy needs.

Health Facilities and Services Administration was created by Act No. 26 of November 13, 1975, as amended, for the principal purpose of developing and operating public hospitals and other health facilities and providing health services. In connection with the revamping of the island's public health system and as part of a health reform program that has the effect of changing the public health system from one in which the government provides health services to low income persons to one in which medical services are provided by the private sector and the government provides comprehensive health insurance cover to such persons, the Administration was dissolved on June 30, 1999, and its administrative responsibilities, agreements and claims were transferred to the Department of Health. As part of the health reform, the government sold to private companies several of the public health facilities that were operated by the Administration.

The operations of the Administration had been funded substantially by Commonwealth appropriations and lines of credit provided by GDB. Aggregate outstanding indebtedness to GDB as of June 30, 2001, relating to such lines of credit was $654,041,000. Such indebtedness is expected to be paid principally from Commonwealth appropriations.

Health Insurance Administration was created in 1993 to implement the health reform by negotiating and contracting for the provision of comprehensive health insurance coverage for qualifying (generally low income) Puerto Rico residents. Under this system, the government selects, through a bidding system, one private health insurance company in each of several designated regions of the island and pays such insurance company the insurance premium for each eligible beneficiary within such region. The health insurance system covers all of the municipalities and approximately 1.7 million persons were covered by the system as of June 30, 2001.

The government has recently completed the negotiations of the contracts with health insurance providers for fiscal 2002. The cost to the General Fund of the health insurance program for fiscal 2002 will be $1,237 million, compared to $1,302 million for fiscal 2001. This cost exceeds the amount budgeted for fiscal 2002 by $238 million.

Highway and Transportation Authority is responsible for highway construction in Puerto Rico. Such construction is financed by debt (interim notes and revenue bonds), revenues of the Authority, and federal and Puerto Rico grants. Debt service on the Authority's revenue bonds constitutes a first lien on its gross revenues, which consist currently of all the proceeds of the gasoline tax; one-half of the proceeds of the tax on gas oil or diesel oil; all the proceeds of the excise taxes on crude oil, unfinished oil and derivative products, up to $120 million per fiscal year; highway toll revenues; and, the gross receipts of $15.00 per vehicle per year from certain motor vehicle license fees. Such revenues (except for toll revenues) may be applied first to the payment of debt service on general obligation bonds and notes of the Commonwealth and payments required to be made by the Commonwealth under its guarantees of bonds and notes to the extent that no other revenues are available for such purpose. The Commonwealth has never applied such revenues for such payment. As of June 30, 2001, the Highway and Transportation Authority had $3,897,434,000 in bonds outstanding.

The Authority has under construction the first phase of a new mass transit system, known as Tren Urbano, to serve a portion of metropolitan San Juan. The first phase of Tren Urbano is being constructed under several design/build contracts, including a design/build/operate contract covering the design and construction of the system and the operation of Tren Urbano for five years with an additional five-year option at the Authority's election. The cost of the first phase is estimated to be $1.9 billion, which cost will be financed by Federal Transit Administration grants, other federal funding sources and the Authority's own resources. On August 4, 2000, the Authority entered into a loan agreement with the United States Department of Transportation Federal Transit Administration evidencing a long-term loan to the Authority in the amount of $300,000,000. This loan was used by the Authority to pay a portion of the costs related to the first phase of this project. An extension of the first phase of Tren Urbano to serve the area of Minillas Government Center is currently in the planning stage.

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 company principally from toll revenues. The concession is for a term of 35 years, subject to earlier termination or extension. The bridge opened for traffic in February 1994. In certain circumstances as described in the concession agreement, including where toll revenues are insufficient to generate certain rates of return to the private operator, the private company may require the Authority, among other things, to assume the private company'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 private company will exercise its remedy against the Authority.

Housing Bank and Finance Agency has been engaged in insuring mortgages and servicing mortgages originated by Urban Renewal and Housing Corporation and has issued bonds and notes to provide interim and permanent financing for low-income housing projects and single-family home ownership programs. The Agency obtained funds from legislative appropriations, sales of mortgages, mortgage repayments and other sources.

As of June 30, 2001, the Agency had outstanding $538,670,818 of bonds (of which $12,505,000, originally issued by the Urban Renewal and Housing Corporation, are guaranteed by the Commonwealth) issued to pay obligations of the Commonwealth under law, otherwise payable from Commonwealth appropriations, to fund certain payments of the Commonwealth under its mortgage subsidy program for low and moderate income families, to guarantee certain insurance obligations of the Agency under certain programs, and to refund bonds originally issued by Urban Renewal and Housing Corporation to carry out activities related to the provision of low-cost housing for moderate income families, federally aided public housing for low income families, and urban renewal, housing and related activities. These bonds are payable principally from appropriations in substantially the amount that the Commonwealth would otherwise have been bound to appropriate for such purposes.

The Agency will be dissolved and all of its powers and duties transferred to the newly-created Housing Finance Authority (successor to the Housing Finance Corporation), effective 180 days from August 11, 2001. The outstanding bonds of the Agency will become obligations of the Housing Finance 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 June 30, 2001, the Company had $176,433,000 in bonds outstanding.

Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority ("AFICA") was created in June 1977. The Authority has issued revenue bonds to finance industrial, tourist, pollution control, medical, and educational facilities in Puerto Rico for the use of private companies, non-profit entities, or government agencies. The bonds are payable solely from payments to be made to the Authority by such private companies, non-profit entities, or government agencies, and do not constitute a debt of the Commonwealth or any of its other public corporations or municipalities. As of June 30, 2001, $3,425,000,000 of the Authority's bonds were outstanding.

Infrastructure Financing Authority was created in June 1988 by virtue of Act No. 44 of June 21, 1988, as amended ("Act No. 44"), to provide financial, administrative, consulting, technical, advisory, and other types of assistance to other public corporations and governmental instrumentalities of Puerto Rico authorized to develop infrastructure facilities and to establish alternate means for financing infrastructure facilities. The Authority is authorized to issue bonds and provide loans, grants and other financial assistance for the construction, acquisition, repair, maintenance and reconstruction of infrastructure projects by public corporations and instrumentalities of the Commonwealth. Act No. 44 also established the Puerto Rico Infrastructure Fund, funded in the amount of $30 million during fiscal 1989 and $40 million for each of the following twenty-nine fiscal years with 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. On July 7, 1997, Act No. 44 was amended to increase to $60 million for fiscal year 1998 and $70 million for each subsequent year until fiscal year 2028 the amount of federal excise taxes transferred to the Authority. The increased level of appropriations was used by the Authority to provide financial support to aqueduct and sewer projects. The Authority had $2,069,295,000 in bonds outstanding as of June 30, 2001.

In January 1998, the Authority expanded the assistance given to Aqueduct and Sewer Authority to include assistance covering the design and construction of various strategic regional water and sewer projects intended to provide improved services to targeted regions throughout the island, the implementation of an immediate action plan to address a number of small water and sewer rehabilitation projects, and legal and technical assistance in achieving compliance with certain environmental laws and in establishing a prioritized capital program. The Authority is undertaking such projects at the request of the Aqueduct and Sewer Authority.

In June 1998, Act No. 44 was amended to establish the Infrastructure Development Fund, a permanent trust fund to be utilized by the Authority for the purpose of financing infrastructure projects. The Infrastructure Development Fund was initially funded in March 1999 with $1.2 billion of proceeds received by the Telephone Authority from the sale of a controlling interest in Puerto Rico Telephone Company ("PRTC"). This initial amount will remain permanently deposited in a segregated, perpetual account, denominated the "corpus account," and must be invested exclusively in U.S. government or U.S. government-backed obligations. The income from such investment may only be used to finance infrastructure projects related to the Commonwealth's water and sewer systems. Other moneys in the Infrastructure Development Fund not attributable to the corpus account or the investment income thereon may be used for other infrastructure projects. The Authority is the custodian and administrator of the Infrastructure Development Fund. On October 11, 2000, the Authority issued $1,092,550,000 of bonds payable from and secured by a pledge of the interest received by the Authority from the investments of the Infrastructure Development Fund. The proceeds of this bond issue are being used to finance certain aqueduct and sewer infrastructure development projects.

Maritime Shipping Authority commenced operations in 1974 upon the acquisition of three shipping lines serving Puerto Rico and the United States mainland. On March 3, 1995, the assets and operations of the Maritime Shipping Authority were acquired by an investor group headed by BTIP, a subsidiary of Bankers Trust New York Corporation, under the terms and conditions approved by the Legislature of Puerto Rico and signed by the Governor on September 27, 1994. The remaining debt of the Authority was refinanced, as allowed under Act No. 113 of September 27, 1994, through the issuance of bonds by Public Finance Corporation, a subsidiary of GDB. The aggregate principal amount of such bonds as of June 30, 2001, was $271,878,974 (not including accreted values of capital appreciation bonds outstanding). The bonds are payable from funds to be appropriated annually by the Legislature of Puerto Rico.

Municipal Finance Agency was created in 1972 as a municipal "bond bank" for Puerto Rico. The Agency is authorized to issue bonds to purchase general obligation bonds and notes of Puerto Rico municipalities and to fund a debt service reserve. Debt service on the Agency's bonds is payable from debt service payments on municipal bonds held by the Agency and from the debt service reserve, including investment income thereon. The Commonwealth has agreed to pay such amounts to the debt service reserve as may be necessary to maintain it at its required level, subject to appropriation by the Legislature, which appropriation is authorized but not legally required to be made. To date no such payments have been required. As of June 30, 2001, the Agency had $1,021,050,000 of bonds outstanding.

Ports Authority owns and operates the major airport and seaport facilities in Puerto Rico. The Authority derives revenues from a variety of sources, including charges on airplane fuel sales, air terminal space rentals, landing fees, wharfage, dockage and harbor fees, and rentals for the lease of seaport equipment and property. The Authority had total net losses of approximately $70 million during fiscal years 1993 and 1994 and, as a result, was not in compliance with its rate covenant with bondholders. After reducing its operating losses through a comprehensive rate revision process, including the implementation of annual (instead of triennial) rate revision analyses, the Authority is currently in compliance with its rate covenant. The Authority is implementing a plan to restructure its operations which, among other things, encompasses revisions to its capital improvement program, measures to increase collections from certain users of its facilities, and proposals to improve the efficiency of its operations. Act No. 1 of January 1, 2000 authorized the transfer of the Authority's unprofitable maritime ferry operations to Puerto Rico Maritime Transportation

Authority, a newly created government agency. The Authority reported net losses during the fiscal years ended June 30, 1997, 1998 and 1999 of $11.3 million, $28.8 million and $6.5 million, respectively. The Authority reported a net income of $15.3 million for fiscal year 2000 and expects its net income for fiscal 2001 to be $28.2 million. As of June 30, 2001, the Authority had $102,670,000 in bonds outstanding.

Public Buildings Authority is authorized to construct, purchase or lease office, school, health, and social welfare facilities for lease to departments, public corporations, and instrumentalities of the Commonwealth. Bonds that have been issued by the Authority to finance such facilities (through retirement of interim notes or otherwise) are payable from lease payments, which are largely derived from legislative appropriations and are further secured by the Commonwealth's guaranty. The Authority is authorized by Act No. 17 of 1968, as amended, to have outstanding at any one time up to $2,100,000,000 of bonds guaranteed by the Commonwealth. As of June 30, 2001, $1,562,493,219 of such bonds of the Authority was outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds). The Authority has four lines of credit for its capital improvement program totaling approximately $562,138,430, of which $230,724,033 was outstanding as of June 30, 2001.

The Authority is undertaking a program to construct additional correctional facilities to be completed by July 2002 at an estimated cost of $187,000,000. The Authority has previously issued $126,972,552 in bonds to finance the construction of three correctional facilities, which are being operated by private companies.

At present, several officers of the Commonwealth are defendants in a lawsuit filed in United States District Court in which they are charged with violating the constitutional rights of correctional system inmates as a result of severe overcrowding in the island's correctional system. Fines to assure compliance with minimum space standards have been assessed in the past against the defendants, such fines being paid by the Commonwealth. Most of these fines have been earmarked for improving the conditions of inmates but not for construction of additional correctional facilities to alleviate prison overcrowding. The Commonwealth can give no assurance that additional fines will not be levied in connection with this lawsuit.

Sugar Corporation was created in 1973 to consolidate ownership and management of the Commonwealth's interests in Puerto Rico's sugar industry. Until February 27, 1998, Sugar Corporation owned or leased and operated virtually all the sugar production facilities on the island. Sugar Corporation bought all cane grown by private growers, processed the cane, and sold crude and refined sugar and molasses. For many years, its operations produced substantial operating deficits.

On September 5, 1996, the Governor of Puerto Rico signed into law Act No. 189, as amended, which authorized the transfer, for a nominal sum, of certain assets and liabilities of the Corporation to entities created by the sugar cane growers. Pursuant thereto, as of December 31, 2000, the Commonwealth had transferred the operations of the Corporation to certain entities formed by sugar cane growers. The Corporation retained substantially all its liabilities. For fiscal 2001, appropriations of approximately $10,000,000 were made to cover its operating deficit. As of June 30, 2001, the total debt of the Corporation was $66,641,000. Of this amount, $62,856,000 is payable from Commonwealth appropriations.

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

On March 2, 1999, the Telephone Authority sold a controlling interest in PRTC to a consortium led by GTE International Telecommunications Incorporated, which has recently been acquired by Verizon Communications, Inc. The net proceeds of the sale received at closing were applied to defease outstanding bonds of the Authority in the principal amount of $756 million, to make a $1.2 billion deposit to the Infrastructure Development Fund held by the Infrastructure Financing Authority and to pay certain benefits to PRTC employees. The Government retained a 43% stock participation in PRTC. The proceeds from the future sale of such participation will be applied to reduce the unfunded pension benefits obligations of the Employees Retirement System of the Commonwealth and its instrumentalities.

University of Puerto Rico, with 69,773 students during academic year 2000-2001, 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 of which $469,728,000 was outstanding as of June 30, 2001.

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

Children's Trust Fund (the "Trust") is a not-for-profit corporate entity created by the Commonwealth under Act No. 173 of July 30, 1999. The Trust is a public instrumentality of the Commonwealth. Pursuant to Act No. 173, the Commonwealth has transferred to the Trust all of its rights, title and interest under the tobacco litigation Master Settlement Agreement ("MSA"), including the Commonwealth's right to receive initial, annual and strategic contribution fund payments to be made by the participating cigarette manufacturers under the MSA.

The Trust issued $397,005,000 aggregate principal amount of Tobacco Settlement Asset-Backed Bonds, Series 2000 on November 15, 2000. The Series 2000 Bonds and any other additional series of senior bonds will be secured by a statutory pledge of certain tangible and intangible assets of the Trust, including its right to receive 50% of Puerto Rico's portion of the initial payments, annual payments, and strategic contribution fund payments under the MSA.

Public corporations, in addition to those mentioned above, have outstanding debt in the aggregate amount of $726,739,000 as of June 30, 2001. Debt service on $674,394,000 of such outstanding debt is being paid from legislative appropriations. However, the Commonwealth is not obligated to make any such appropriations. Additional legislative appropriations are made to enable certain of such corporations to pay their operating expenses.

INSURANCE MATTERS

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

RETIREMENT SYSTEMS

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

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

The Teachers Retirement System covers primarily public school teachers, the Judiciary Retirement System covers judges, and the Employees Retirement System covers all other employees of the Commonwealth, its municipalities and instrumentalities. As of June 30, 2000, the total number of active members of the three systems was as follows: Employees Retirement System, 158,000; Teachers Retirement System, 48,122, and Judiciary Retirement

System, 343. The three systems are financed by contributions made by employers (the Commonwealth, public corporations, or municipalities), employees, and investment income. The central government is responsible for approximately 66% of total employer contributions to the Employees Retirement System, and the other 34% is the responsibility of public corporations and municipalities. The central government is also responsible for 100% and 99% of total employer contributions to the Judiciary and Teachers Retirement Systems, respectively. Retirement and related benefits provided by the systems and required contributions to the systems by employees are determined by statute. Required contributions to the systems by employers are determined by statute with respect to the Teachers Retirement System and, with respect to the Employees and Judiciary Retirement Systems, by the Administrators of the Systems.

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, 2000, the total pension benefit obligation for the Employees Retirement System and Judiciary Retirement System was $9,459,300,000 and $135,800,000, respectively. The unfunded pension benefit obligation of the Employees Retirement System and Judiciary Retirement System for the same period was $7,417,500,000 and $53,000,000, respectively, representing a funding ratio of 22% and 61%, respectively. This funding ratio does not take into account the recent significant decline in the equities market and the resulting reduction in the value of the equity portfolio.

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

On February 1, 1990, the Legislature of Puerto Rico enacted Act No. 1 amending the organic act of the Employees Retirement System to reduce the future pension liabilities of the Employees Retirement System. Among other provisions, the legislation increased the level of contribution to the System and limited the retirement benefits for new employees by increasing the length of time for the vesting of certain benefits and reducing the level of benefits in the case of early retirement. The legislation also reduced the level of occupational disability benefits and death benefits received by new employees.

Act No. 305 of September 24, 1999 further amended the organic act of the Employees Retirement System 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 Government 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 do 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 Government. Instead, Government contributions will now be used completely to reduce the unfunded accumulated pension liability of the Employees Retirement System.

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

The Employees Retirement System expects its disbursements of benefits during fiscal 2002 to exceed the expected contributions and investment income for such year. The Employees Retirement System proposes to finance the cash shortfall with a short-term loan from a private bank, which is expected to be repaid from the proceeds of the sale of the 15% stock ownership to Verizon upon its exercise of its stock option described above.

According to the most recent actuarial valuation of the Teachers Retirement System submitted by a firm of independent consulting actuaries, as of June 30, 1999, the accrued actuarial liability of the system was $2,904,195,938, the value of assets amounted to $2,509,490,000, representing a funding ratio of 79.67%, and the resulting unfunded accrued liability was $590,465,938, a decrease of $194,037,629 from the prior valuation made as of June 30, 1998. This funding ratio does not take into account the recent significant decline in the equities market and the resulting reduction in the value of the equity portfolio. As of June 30, 1999, the remaining amortization period for the unfunded liability is 21 years. The actuarial valuation assumed an investment return of 8% per year and salary increases of 5% per year. Act No. 43 of January 27, 2000 increased the amount of the employee contribution from 7% to 9%, effective immediately. This will result in an increase of employee contributions of $1.5 million per month.

The following table presents, in summary form, the income and expenses of the retirement systems for the fiscal years ended June 30, 1999 and June 30, 2000, and estimates for the fiscal year ending June 30, 2001. The investment income figures presented in the table for fiscal 1999 and 2000 include unrealized gains and losses. Income for fiscal 2001 is estimated as of December 31, 2000 and does not reflect the significant decline in the equities market that has occurred since December 2000. It is expected that the net income for fiscal 2001 will be significantly lower than the estimate shown as of December 31, 2000.

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

	Employees Retirement System	Judiciary Retirement System	Teachers Retirement System
Fiscal Year Ended June 30, 1999	**Actual**	**Actual**	**Actual**
Income:			
Employers' contributions	$274,658	$ 5,744	$ 91,155
Employee contributions	217,179	2,115	67,807
Investment income	244,025	7,489	242,198
Total	735,862	15,348	401,160
Expenses:			
Benefit payments	515,993	7,099	206,397
Administrative and other expenses	33,956	1,074	16,469
Total	549,949	8,173	222,866
Net Income	$185,913	$ 7,175	$178,294
Fiscal Year Ending June 30, 2000	**Actual**	**Actual**	**Actual**
Income:			
Employers' contributions	$309,097	$ 5,222	$ 86,246
Employee contributions	218,342	2,094	68,864
Investment income	296,842	11,075	286,507
Total	824,281	18,391	441,617
Expenses:			
Benefit payments	605,465	7,705	219,886
Administrative and other expenses	28,651	1,372	31,755
Total	634,116	9,077	251,641
Net Income	$190,165	$ 9,312	$189,976
Fiscal Year Ended June 30, 2001(1)	**Projected**	**Projected**	**Projected**
Income:			
Employers' contributions	$310,000	$5,500	$ 90,000
Employee contributions	220,000	2,200	95,000
Investment income	200,000	8,500	100,000
Total	730,000	16,200	285,000
Expenses:			
Benefit payments	626,000	8,800	242,000
Administrative and other expenses	34,000	1,800	32,000
Total	660,000	10,600	274,000
Net Income	$ 70,000	$ 5,600	$ 11,000

(1) Projected figures as of December 31, 2000. Does not reflect the decline in the equities market since December 2000.

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

COMMONWEALTH FINANCIAL STATEMENTS

Since fiscal 1990, the complete financial statements of the Commonwealth have been audited. For fiscal 2000, such financial statements were audited by Deloitte & Touche LLP, whose report thereon is dated December 29, 2000. Preparation of the audited financial statements of the Commonwealth involves the collection and combination of audited financial statements from fifty separate reporting entities.

The Comprehensive Annual Financial Report of the Commonwealth for fiscal 2000 prepared by the Department of the Treasury, which includes the general purpose financial statements of the Commonwealth for fiscal 2000, has been filed by the Commonwealth with each nationally recognized municipal securities information repository.

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 was incorporated into the General Fund commencing in fiscal 1993.

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

Summary and Management's Discussion of General Fund Results

The following table presents the Commonwealth revenues and expenditures of the General Fund on a cash basis for fiscal 1998 through fiscal 2001and the Commonwealth's estimated revenues and budgeted expenditures for fiscal 2002. The information through fiscal 2000 is based on actual fiscal year-end results. The information relating to fiscal 2001 is subject to audit adjustments. The information relating to fiscal 2002 is based on (i) revised revenue estimates made by the Secretary of the Treasury in September, 2001 and (ii) expenditures included in the approved budget for fiscal 2002, adjusted upward by the Office of Management and Budget in September, 2001 to incorporate the revised costs of the health insurance program as determined after completion of negotiations with the health insurance companies. The revenue estimates do not take into account any possible revenue reduction resulting from any adverse economic impact arising from the September 11 terrorist attacks in the United States.

To improve the presentation of the following table, the Department of the Treasury has eliminated the use of line items identified as "Operating Transfers In" and "Operating Transfers Out" in the financial statements of the Commonwealth and has assigned the amounts previously listed under these two categories to the following revenue and expenditure line items according to the purpose and amount of each transfer: "Other Income," "Other Expenditures," "Capital Outlays and Other Debt Service" and "Transfers to Agencies." Amounts listed under "Other Income" represent recurring General Fund revenues not appropriately attributable to other revenue line items, such as repayment of General Fund advances to municipalities and government agencies and funds. "Other Expenditures" represent recurring General Fund expenditures not appropriately attributable to other expenditures line items, such as advances to government agencies and municipalities, which advances are to be reimbursed to the General Fund by law. Amounts listed under "Capital Outlays and Other Debt Service" represent debt service on obligations and capital expenditures for which the Legislature has by resolution agreed to appropriate funds. "Transfers to Agencies" represents moneys appropriated for the operation of the Health Facilities and Services Administration. 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)

	1998	1999	2000	2001(p)	2002(1)
Beginning cash balance	$ 127,477	$ 340,771	$ 474,759	$ 287,055	$ 184,556
Revenues from internal sources:					
Income Taxes:					
Individuals	2,026,612	2,244,376	2,352,066	2,348,042	2,595,000
Corporations	1,527,415	1,653,762	1,781,862	1,696,766	1,724,000
Partnerships	4,404	2,087	2,339	3,026	3,000
Withheld from non-residents	192,463	369,384	557,276	696,835	670,000
Tollgate taxes	170,953	114,533	111,130	49,511	36,000
Interest	11,406	10,666	11,674	14,781	15,000
Dividends	39,616	38,996	39,664	58,580	40,000
Total income taxes	3,972,869	4,433,804	4,856,011	4,867,541	5,083,000
Commonwealth excise taxes					
Alcoholic beverages	238,118	243,464	236,374	237,512	242,000
Cigarettes	111,094	119,105	115,157	119,135	119,000
Motor vehicles	350,004	411,573	389,995	406,252	429,000
Other excise taxes	613,500	699,685	668,820	579,596	661,000
Total Commonwealth excise taxes	1,312,716	1,473,827	1,410,346	1,342,495	1,451,000
Property taxes	5,673	2,214	1,131	287	-
Inheritance and gift taxes	1,380	1,811	3,109	7,475	2,000
Licenses	66,167	70,848	73,801	76,335	79,000
Other:					
Lottery	57,986	59,206	63,779	57,482	62,000
Electronic Lottery	54,681	53,013	70,209	69,912	61,000
Miscellaneous	158,568	176,669	169,246	199,676	427,000
Total other	271,235	288,888	303,234	327,070	550,000
Total revenues from internal sources	5,630,040	6,271,392	6,647,632	6,621,203	7,165,000
Revenues from non-Commonwealth sources:					
Federal excise taxes	200,260	217,296	245,750	286,890	280,000
Customs	72,206	61,355	50,231	43,152	40,000
Total revenues from non-Commonwealth sources	272,466	278,651	295,981	330,042	320,000
Sub-total revenues	5,902,506	6,550,043	6,943,613	6,951,245	7,485,000
Proceeds from Special Funds	50,253	-	-	-	57,000
Total Revenues	5,952,759	6,550,043	6,943,613	6,951,245	7,542,000
Other Income (refunds)(2)	482,120	2,570	64,325	58,651	98,870
Transfers to Redemption Fund (3)	(368,544)	(320,240)	(410,046)	(297,944)	(314,636)
Proceeds of notes and other borrowings(4)	601,892	600,000	778,863	825,703	1,072,007
Repayment of notes and other borrowings(5)	(617,775)	(611,410)	(787,155)	(683,913)	(1,201,084)
Adjusted revenues	6,050,452	6,220,963	6,589,600	6,853,742	7,197,157
Expenditures:					
Grants and subsidies	2,118,266	2,392,018	2,864,215	2,997,704	2,164,701
Personal services	2,197,903	2,470,456	2,737,159	2,859,387	3,717,935
Other services	698,446	723,563	745,194	655,053	889,707
Materials and supplies	84,451	99,404	109,081	91,653	258,648
Equipment purchases	31,626	52,993	56,404	38,381	46,080
Capital outlays and other debt service	253,962	166,841	101,178	33,102	26,327
Transfers to agencies	131,174	181,700	164,073	280,961	-
Other expenditures	321,330	-	-	-	268,000
Total expenditures	5,837,158	6,086,975	6,777,304	6,956,241	7,371,398
Adjusted revenues less expenditures	213,294	133,988	(187,704)	(102,499)	(174,241)
Ending cash balance	$ 340,771	$ 474,759	$ 287,055	$ 184,556	$ 10,315

(p) Preliminary
(1) Approved budget, as revised on September 7, 2001 by the Office of Management and Budget and the Secretary of the Treasury.
(2) Consists of reimbursement of certain advances to agencies to cover expenses, revenue from the General Fund's non budgetary funds and a reserve for future tax refunds reduced by estimated tax refunds.
(3) Consists of amounts to pay principal of and interest on general obligation bonds and notes of the Commonwealth. Does not include amounts deposited directly to the Redemption Fund from non-General Fund revenues.
(4) Consists of proceeds of Commonwealth tax and revenue anticipation notes and borrowings from Government Development Bank.
(5) Consists of repayment of Commonwealth tax and revenue anticipation notes and borrowings from Government Development Bank.

Source: Department of the Treasury

Estimated Fiscal 2002 Compared to Preliminary Fiscal 2001

As of September 7, 2001, it was projected that General Fund total revenues for fiscal 2002 (excluding proceeds from special funds) would be $7,485 million, representing an increase of $534 million, or 7.6%, from fiscal 2001 revenues. The major changes from fiscal 2001 are expected to be: projected increases in income taxes from individuals of $247 million and in corporate income taxes of $27 million, a projected increase in Commonwealth excise taxes of $109 million, a projected increase in miscellaneous revenues of $227 million and a projected decrease in income taxes withheld from non-residents, tollgate taxes and dividend taxes totaling $57 million.

The revenue estimates for fiscal 2002 were based on the following assumptions: (i) the economy of Puerto Rico will continue a moderate growth pattern until at least the fourth calendar quarter of 2002 (nominal growth of the economy during fiscal 2002 was expected to be between 5% and 6%); (ii) tax collections will continue to grow in excess of the 2% growth registered in fiscal 2001, which was an election year and a year in which the last phase of a previously legislated tax rate reduction became effective; (iii) the price of crude oil will average $25 per barrel; (iv) rum excise tax collections will decrease as the amount of excise tax returned to Puerto Rico is reduced from $13.25 to $10.50 per gallon effective on January 1, 2002; and, (v) there will be some income tax revenue reductions as a result of the recently enacted local tax legislation designed to stimulate economic activity.

One of the largest components of the expected increase in tax collections ($180 million) is based on special administrative actions which the Treasury Department expects to implement during fiscal 2002. These involve stronger enforcement actions in the collection of excise taxes and an aggressive campaign to collect income taxes which are past due. The success of these actions is uncertain. The Secretary of the Treasury expects to collect an additional $20 million in income taxes by increasing the required tax withholding on professional services contracts from 7% to 10%. This increase requires legislation.

For the first two months of fiscal 2002, actual tax collections were in excess of the estimated amount by approximately 7%. It is possible, however, that as a result of the terrorist attacks, which occurred in the United States on September 11, revenues for subsequent months may be adversely affected.

It is too early to determine with any certainty the impact that such attacks will have on economic activity in Puerto Rico and on revenues of the General Fund. It is possible that there will be a short term reduction in economic activity with an adverse impact on revenues. The Commonwealth government is in the process of formulating measures to restore confidence to consumers and the business community and proposes to accelerate its capital investment program to help counteract the possible adverse effect of these recent events.

Total estimated expenditures for fiscal 2002 are $7,371 million, an increase of $415 million, or 6.0%, from fiscal 2001 expenditures. The ending cash balance for the General Fund for fiscal 2002 is estimated to be $4.2 million, a decrease of $180.3 million from fiscal 2001. This decrease resulted principally from the repayment during fiscal 2002 from General Fund moneys of short-term borrowings incurred in fiscal 2001 and not repaid in said fiscal year. It is not possible at this time to determine whether the September 11, 2001 terrorist attacks will cause General Fund expenditures to increase. For a comparison of budgeted expenditures and estimated expenditures, see "Fiscal 2002 Budget" in *Budget of the Commonwealth of Puerto Rico*.

Preliminary Fiscal 2001 Compared to Fiscal 2000

General Fund total revenues for fiscal 2001 are currently estimated at $6,951 million, an increase of approximately $8 million from fiscal 2000. The major changes from fiscal 2000 are: a decrease of $85 million in corporate income taxes; a decrease of $62 million in tollgate taxes; a decrease of $89 million in other excise taxes; an increase in income tax withheld from non-residents of $140 million; and an increase in federal excise taxes of $41 million. The decrease in corporate income taxes was due to the effects of the economic slowdown in the United States and Puerto Rico. The reduction in tollgate taxes and the increase in withholding taxes to non-residents are the result of continuing conversions of corporations to controlled foreign corporation tax status and the payment of withholding taxes on royalties paid to U.S. affiliates. The reduction in local excise taxes allocated to the General Fund was attributable principally to a reduction in the tax on crude oil (which varies inversely with the price of crude oil) and a transfer of certain excise taxes from the General Fund to other funds of the Commonwealth as required by recent Commonwealth legislation. Federal excise tax revenues rose due to growing exports of rum products. For fiscal 2000 the amount of the rum excise tax returned to the Treasury of Puerto Rico increased from $10.50 to $13.25 per gallon, but for the second half of fiscal 2002, the amount of the rum excise tax returned to the Treasury of Puerto Rico will return to $10.50 per gallon. See "Major Sources of General Fund Revenues" below.

The budget for fiscal 2001 had estimated that revenues would be $7,505 million, whereas actual revenues were only $6,951 million. This difference was attributable to: (i) the effect of slower than anticipated economic growth; (ii) the impact of the Section 936 and 30A phase out on corporate tax revenues (offset by increases in withholding taxes on royalty payments); (iii) the increase in the price of crude oil, which affects economic growth and excise tax collections; and (iv) the previously legislated tax rate reduction which became effective in fiscal 2001.

Total expenditures for fiscal 2001 were $6,956 million, an increase of $179 million, or 2.6%, over fiscal 2000. Expenditures grew primarily in the areas of education, health and public safety. This growth is attributable in part to the rising cost of services and expanding programs. For a comparison of budgeted expenditures and actual expenditures, see "Fiscal 2001 Budget" in *Budget of the Commonwealth of Puerto Rico*. The ending cash balance for the General Fund for fiscal 2001 is estimated to be $185 million, a decrease of $102 million from fiscal 2000. This decrease, together with moneys raised by the Commonwealth from short-term borrowings that were not repaid in full prior to the end of fiscal 2001, enabled the Commonwealth to cover expenses in said year in excess of the amount budgeted therefor and in the face of a decline in General Fund Revenues. General Fund deposits to the Redemption Fund in fiscal 2001 were $113 million less than in fiscal 2000 because the last four monthly deposits in fiscal 2001 were made from the proceeds of a short-term loan from GDB which loan was repaid in early fiscal 2002 from the proceeds of general obligation bonds issued in June 2001.

In lieu of issuing tax and revenue anticipation notes in fiscal 2001 to meet seasonal differences in the timing of revenues and expenses, the Commonwealth obtained a loan from the GDB in the amount of $661.4 million. This loan has been repaid.

Fiscal 2000 Compared to Fiscal 1999

General Fund total revenues for fiscal 2000 were $6,944 million, an increase of $394 million, or 6.0%, over fiscal 1999. The major changes were: an increase in revenues obtained from income taxes of $422 million and a decrease in Commonwealth excise taxes of $63 million.

Total expenditures for fiscal 2000 were $6,777 million, an increase of $690 million, or 11.3%, over fiscal 1999. The ending cash balance for the General Fund for fiscal 2000 was $287 million, a decrease of $188 million from fiscal 1999.

Fiscal 1999 Compared to Fiscal 1998

General Fund total revenues for fiscal 1999 were $6,550 million, an increase of $597 million, or 10.0%, over fiscal 1998. Major changes were: an increase in income taxes of $461 million and an increase in excise taxes of $161 million.

Total expenditures for fiscal 1999 were $6,087 million, an increase of $250 million, or 4.3%, from fiscal 1998. The ending cash balance for the General Fund for fiscal 1999 was $475 million, an increase of $134 million from fiscal 1998.

Major Sources of General Fund Revenues

Income Taxes

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

Individuals. Resident individuals are subject to tax on their taxable income from all sources. Prior to January 1, 2000, the PR Code had five tax brackets for individuals with tax rates of 8%, 12%, 18%, 31% and 33%. As a result of legislation enacted in 1999, the first four brackets have been reduced to 7.5%, 11%, 16.5% and 29.5% for the taxable year commencing on January 1, 2000, to 7%, 10%, 15% and 28% for taxable years commencing on January 1, 2001, and 6%, 9%, 14% and 27% for the taxable years commencing on and after January 1, 2002. Dividend income from Puerto Rico corporations and certain qualifying foreign corporations is taxed at a rate of 10%. A recent amendment to the PR Code provides an income tax exemption for REITs and imposes a 17% tax on taxable dividends distributed by such entities during the first ten taxable years of the REIT.

Gains realized from the sale or exchange of a capital asset, if held for more than six months, are taxed at a rate of 20% or 10% if the capital asset consists of certain property located in Puerto Rico sold or exchanged after December 31, 2000. Gains realized by Puerto Rico resident individuals, trusts and estates from the sale of stock of certain Puerto Rico corporations in an initial public offering made prior to December 31, 2000 are subject to a special capital gains rate of 7%. Legislation has been introduced to extend the eligibility date from December 31, 2000 to December 31, 2007.

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

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

The PR Code provides for six income tax brackets for corporations and partnerships, with the highest rate (39%) applicable to taxable income in excess of $275,000. Gains realized from the sale or exchange of a capital asset, if held for more than six months, are taxed at a maximum rate of 25% or 12.5% if the capital asset consists of certain property located in Puerto Rico sold or exchanged after December 31, 2000. The special tax rate applicable to dividend distributions of REIT's also applies to dividends received by corporations.

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

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

Interest from Puerto Rico sources paid to non-resident non-affiliated corporate recipients is not subject to any income or withholding tax. Interest paid to certain related non-resident recipients continues to be subject to a withholding tax of 29%. Dividends paid to non-resident corporate recipients are subject to a withholding tax of 10%. Dividends distributed by corporations (including Section 936 Corporations) operating under new grants of tax exemption issued under the 1998 Tax Incentives Act are not subject to Puerto Rico income tax. 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 with respect to dividends paid from profits invested in certain eligible instruments for specified periods of time.

Payments in excess of $1,000 during a calendar year made by the Commonwealth and persons engaged in a trade or business in Puerto Rico in consideration of the receipt of services rendered in Puerto Rico are subject to a 7% withholding tax. The Secretary of the Treasury proposes to introduce legislation increasing the withholding tax to 10%.

Excise Taxes

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

Other Taxes and Revenues

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

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

Revenues from non-Commonwealth sources include customs duties collected in Puerto Rico and excise taxes on shipments of alcoholic beverages 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 alcoholic beverages from Puerto Rico and other rum producing countries is $13.50 per gallon. Of this amount, $13.25 per gallon was returned to the Treasury of Puerto Rico during the period from October 1, 1999 to December 31, 2001. Effective on January 1, 2002, the amount returned will be $10.50 per gallon.

On April 26, 2001, legislation was introduced in the United States House of Representatives to repeal the return to the Treasury Department of Puerto Rico of the federal excise taxes on shipments of alcoholic beverages from Puerto Rico. The Commonwealth will vigorously oppose the enactment of any such repeal. No assurance can be given at this time as to the likelihood of the passage of such repeal.

Property Taxes

Personal property, which accounts for approximately 55% of total collections of taxable property, is self-assessed. Real property taxes are assessed at 1958 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.

On August 30, 1991, legislation was adopted in Puerto Rico providing a municipal reform program, which also involved the creation of the Municipal Revenues Collection Center ("CRIM") to collect property taxes. The program transferred the previous functions of the Department of the Treasury with respect to real and personal property tax assessment, notification, determination, and collection to the CRIM, as of July 1, 1993. The 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 continues to be deposited in the Commonwealth's Redemption Fund.

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

Fiscal Year Ended June 30	Assessed Valuations[1]	Taxes Levied	Collections of Current Year	Collections of Previous Years	Total
1996	$13,052,524	$416,881	$400,207	$70,571	$470,778
1997	17,499,974	533,362	437,178	82,435	519,613
1998	19,272,428	619,343	510,999	90,311	601,310
1999	20,042,738	642,555	523,886	47,309	571,198
2000	20,514,014	704,568	594,151	64,812	658,963
2001[2]	21,114,019	736,667	605,834	77,963	683,797

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

Source: Municipal Revenues Collection Center

During 1997, legislation was enacted authorizing the CRIM to sell past-due property taxes on residential, commercial and industrial properties to persons who, after payment of the purchase price to the CRIM, would then be responsible for collecting such taxes from the delinquent property taxpayers. Pursuant to this legislation, in February 1999 the Government securitized eligible property tax debts of the CRIM by issuing non-recourse bonds of Public Finance Corporation payable solely from the collection of such past due property taxes. The proceeds of the securitization were paid to the CRIM for the benefit of the Commonwealth and the municipalities of the Commonwealth.

As of July 2001, all payments of debt service on such bonds had been made. CRIM has received notice that it is not in compliance with certain requirements concerning the continuing eligibility of certain past-due accounts in the securitized pool and requesting CRIM to substitute other eligible past-due tax accounts for the pool. The Legislature recently approved a law authorizing CRIM to borrow funds for the purpose of enabling CRIM to comply with the above requirements. The funds borrowed by CRIM may be utilized to purchase the outstanding bonds of Public Finance Corporation issued to securitize the property tax debts of the CRIM.

Collections of Income and Excise Taxes

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

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

Includes 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 the Health Facilities and Services Administration 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. The following table presents revenues from federal grants by broad program areas, which are accounted in the central accounting system of the Department of the Treasury.

Commonwealth of Puerto Rico
Federal Grants
(in thousands)

	Fiscal Year Ending June 30				
	1998	**1999**	**2000(p)**	**2001(e)**	**2002(e)**
Education	$ 504,296	$ 571,758	$ 675,876	$ 734,494	$ 741,563
Social Services	1,592,402	1,548,876	1,579,453	1,685,563	1,694,593
Health	399,790	362,905	298,980	304,068	310,690
Labor and Human Resources (1)	161,272	308,699	263,263	335,158	337,073
Public Works and Transportation(2)	0	0	0	0	0
Crime	25,726	27,552	24,836	17,700	11,623
Housing(3)	224,787	232,359	232,359	232,359	236,931
Drug and Justice	10,909	9,841	14,424	14,712	11,062
Agriculture and Natural Resources	6,771	6,898	7,307	9,949	6,820
Contributions to Municipalities	64,911	58,865	58,865	56,809	59,191
Other	6,337	5,914	4,915	6,116	6,965
TOTAL	$2,997,201	$3,133,667	$3,160,278	$3,396,928	$3,416,511

(p) Preliminary.
(e) Estimated.
(1) Amounts include grants to the Right to Work Administration and to the Occupational Development and Human Resources Council.
(2) Amounts of federal grants to the Highway and Transportation Authority are not included in the Public Works and Transportation area.
(3) Amounts include grants to the Public Housing Administration.

Source: Office of Management and Budget

BUDGET OF THE COMMONWEALTH OF PUERTO RICO

Office of Management and Budget

The fundamental objective of the Office of Management and Budget ("OMB") is to improve and strengthen the relationship between policy formulation and budgetary and fiscal management. The law creating OMB also strengthened budgetary controls and created an Operational Audit Division with the primary function of evaluating government operations and programs.

Budgetary Process

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

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

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

Financial Control and Adjustment Procedures

Revenue estimates for budgetary purposes are prepared by the Department of the Treasury, except for estimates of federal grants, which are prepared by OMB and 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 severally by the Governor, through the Director of OMB, and the Secretary of the Treasury. Quarterly reviews and expenditure cut-off procedures are designed 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 Legislature a detailed report of any adjustment necessary to balance the budget, or make recommendations to the Legislature for new taxes or authorize borrowings under provisions of existing legislation or take any other necessary action to meet the estimated deficiency. Any such proposed adjustments shall give effect to the "priority norms" established by law for the disbursement of public funds in the following order of priority: first, the payment of the interest on and amortization requirements for public debt (Commonwealth general obligations and guaranteed debt for which the Commonwealth's guarantee has been exercised); second, the fulfillment of obligations arising out of legally binding contracts, court decisions on eminent domain, and other unavoidable obligations to protect the name, credit and good faith of the Commonwealth; third, current expenditures in the areas of health, protection of persons and property, education, welfare and retirement systems; and fourth, all other purposes.

A Budgetary Fund was created by Act No. 147 of June 18, 1980, as amended (the "Budgetary Fund Act"), to cover the appropriations approved in any fiscal year in which the revenues available for such fiscal year are insufficient, to honor the public debt, and to provide for unforeseen circumstances in the provision of public services. The Budgetary Fund Act was amended in 1994 to require that an annual legislative appropriation equal to 0.33% of the total budgeted appropriations for each fiscal year be deposited in the Budgetary Fund. In 1997, the Budgetary Fund Act was further amended to increase the annual legislative appropriation required to be deposited in the Budgetary Fund to 1% of the total revenues of the preceding fiscal year, beginning in fiscal year 2000. 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 June 30, 2001, the amount on deposit in the Budgetary Fund was $26.7 million.

Appropriations

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

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

(ii) General Fund appropriations for special operating expenses and for capital expenditures. Such appropriations are authorized by separate laws 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 may occur in one or more years.

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

Approximately 25.2% of the General Fund is committed for payment of fixed charges such as municipal subsidies, grants to the University of Puerto Rico, contributions to the Aqueduct and Sewer Authority, and rental payments to the Public Buildings Authority, among others, including debt service on direct debt of the Commonwealth.

Fiscal 2001 Budget

The following table presents a summary of the Commonwealth budget for the fiscal year ending June 30, 2001.

Commonwealth of Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ended June 30, 2001
(in thousands)

	General Fund	Bond Fund	Special Funds	Total
Revenues from internal sources:				
Property taxes	$ -	$ -	$ 101,371	$ 101,371
Personal income taxes	2,729,000	-	-	2,729,000
Income tax withheld from non-residents	525,000	-	-	525,000
Corporate income taxes	1,767,000	-	-	1,767,000
Partnership income taxes	3,000	-	-	3,000
Tollgate taxes	94,000	-	-	94,000
17% withholding tax on interest	13,000	-	-	13,000
10% withholding tax on dividends	40,000	-	-	40,000
Inheritance and gift taxes	2,000	-	-	2,000
Excise taxes:				
Alcoholic beverages	258,000	-	-	258,000
Motor vehicles and accessories	441,000	-	-	441,000
Cigarettes	119,000	-	-	119,000
Special excise tax on certain petroleum products	70,000	-	-	70,000
General 5% excise tax	599,000	-	-	599,000
Slot machines and machines for entertainment	-	-	-	-
Other	97,000	-	117,020	214,020
Licenses	78,000	-	-	78,000
Miscellaneous non-tax revenues:				
Contributions from lottery fund	58,000	-	-	58,000
Electronic lottery	63,000	-	-	63,000
Registration and document certification fees	147,000	-	-	147,000
Other	53,000	-	191,850	244,850
Total revenues from internal sources	7,156,000	-	410,241	7,566,241
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	291,000	-	-	291,000
Federal grants	-	-	3,396,928[1]	3,396,928
Customs	58,000	-	-	58,000
Total revenues from non-Commonwealth sources	349,000	-	3,396,928	3,745,928
Total revenues	7,505,000	-	3,807,169	11,312,169
Other:				
Balance from previous year	106,220	-	348,027	454,247
Bonds authorized	-	425,000	-	425,000
Total other sources	106,220	425,000	348,027	879,247
Total resources	7,611,220	425,000	4,155,196	12,191,416

	General Fund	Bond Fund	Special Funds	Total
Appropriations:				
Current expenses:				
General government	841,537	-	56,959	898,496
Education	2,337,485	-	796,260	3,133,745
Health	1,263,702	-	328,567	1,592,269
Welfare	382,807	-	2,049,875	2,432,682
Economic development	171,151	-	68,599	239,750
Public safety and protection	1,264,612	-	61,324	1,325,936
Transportation and communications	72,446	-	11,324	83,770
Housing	20,892	-	117,395	138,287
Contributions to municipalities	300,380	-	2,047	302,427
Special pension contributions	46,410	-	-	46,410
Debt service	446,920	-	92,455	539,375
Other debt service	436,585	-	19,000	455,585
Total appropriations-current expenses	7,584,927	-	3,603,805	11,188,732
Capital improvements	25,915	425,000	160,896	611,811
Total appropriations	7,610,842	425,000	3,764,701	11,800,543
Year-end balance	378	-	390,495	390,873
Total appropriations and year-end balance	$7,611,220	$425,000	$4,155,196	$12,191,416

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

Sources: Department of the Treasury and Office of Management and Budget as reported on March 28, 2001

In the fiscal 2001 budget, revenues and other resources of all budgetary funds total $11,312,169,000, excluding balances from the previous fiscal year and general obligation bonds authorized. The estimated net increase in General Fund revenues in the fiscal 2001 budget, as compared to the fiscal 2000 budget, was accounted for by increases in personal income taxes (up $215,934,000), corporate income taxes (up $14,138,000), Federal excise taxes on off-shore shipments (up $45,250,000), general excise tax of 5% (up $73,438,000), excise tax on motor vehicles and accessories (up $51,005,000), special excise tax on certain petroleum products (up $45,214,000), registration and documentation fees (up $21,144,000), excise tax on alcoholic beverages (up $21,626,000), and decreases in tollgate taxes (down $17,130,000) and income tax withheld from non-residents (down $32,276,000).

Current expenses and capital improvements of all budgetary funds total $11,800,543,000, an increase of $760,761,000 from fiscal 2000. The major changes in General Fund expenditures by program in fiscal 2001, as compared to the fiscal 2000 budget, were: increases in education (up $240,844,000), general government (up $129,339,000), public safety and protection (up $95,263,000), health (up $55,602,000), debt service (up $36,874,000), other debts (up $30,460,000), contributions to municipalities (up $6,567,000), special pension contributions (up $6,908,000), housing (up $1,306,000), and decreases in transportation and communications (down $5,294,000), welfare (down $6,257,000), and economic development (down $43,481,000).

Although General Fund Revenues were budgeted at $7,611 million, including a $106 million balance from the previous year, actual revenues collected were only $7,056 million (including such beginning balance), representing a reduction of $555 million from the amount budgeted. The reasons for this reduction in revenues is explained in "Summary and Management Discussion of General Fund Results - Preliminary Fiscal 2001 Compared to Fiscal 2000" in *Puerto Rico Taxes, Other Revenues and Expenditures*. General Fund Expenditures were budgeted at $7,611 million, but were actually $7,775 million, or $164 million higher. The excess expenditures from the budgeted amounts were mainly in the areas of education, health and the correctional system. The difference between revenues and expenditures of approximately $718 million was covered by: (i) measures taken by OMB to reduce expenditures and apply available surpluses which together are estimated at $176 million, (ii) the financing of certain deposits to the Redemption Fund (ordinarily made from General Fund moneys) in the amount of approximately $164 million, and (iii) loans from GDB.

The general obligation bond authorization for the fiscal 2001 budget was $425,000,000.

Fiscal 2002 Budget

The following table presents a summary of the Commonwealth budget for the fiscal year ending June 30, 2002.

Commonwealth of Puerto Rico

Summary of Central Government Annual Budget
Fiscal Year Ending June 30, 2002
(in thousands)

	General Fund	Bond Fund	Special Funds	Total
Revenues from internal sources:				
Property taxes	$ 0	$ -	$ 104,412	$ 104,412
Personal income taxes	2,687,000	-	-	2,687,000
Retained non-resident income tax	670,000	-	-	670,000
Corporate income taxes	1,612,000	-	-	1,612,000
Partnership income taxes	3,000	-	-	3,000
Tollgate taxes	36,000	-	-	36,000
17% withholding tax on interest	15,000	-	-	15,000
10% withholding tax on dividends	40,000	-	-	40,000
Inheritance and gift taxes	2,000	-	-	2,000
Excise taxes:				
Alcoholic beverages	242,000	-	-	242,000
Motor vehicles and accessories	414,000	-	-	414,000
Cigarettes	119,000	-	-	119,000
Special excise tax on certain petroleum products	20,000	-	-	20,000
General 5% excise tax	580,000	-	-	580,000
Slot machines and machines for entertainment	-	-	-	-
Other	76,000	-	126,320	202,320
Licenses	79,000	-	-	79,000
Miscellaneous non-tax revenues:				
Contributions from lottery fund	56,000	-	-	56,000
Electronic lottery	61,000	-	-	61,000
Registration and document certification fees	143,000	-	-	143,000
Other	70,000	-	212,566	282,566
Total revenues from internal sources	6,925,000	-	443,298	7,368,298
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	280,000	-	0	280,000
Federal grants	-	-	3,416,511[1]	3,416,511
Customs	40,000	-	0	40,000
Total revenues from non-Commonwealth sources	320,000	-	3,416,511	3,736,511
Total revenues	7,245,000	-	3,859,809	11,104,809
Other:				
Other Income	220,328		0	220,328
Balance from previous year	378	-	390,495	390,873
Bonds authorized	-	475,000	-	475,000
Total other sources	220,706	475,000	390,495	1,086,201
Total resources	7,465,706	475,000	4,250,304	12,191,010

	General Fund	Bond Fund	Special Funds	Total
Appropriations:				
Current expenses:				
General government	917,704	-	55,986	973,690
Education	2,289,782	-	819,428	3,109,210
Health	1,016,035	-	335,710	1,351,745
Welfare	365,907	-	2,092,769	2,458,676
Economic development	180,440	-	64,949	245,389
Public safety and protection	1,258,927	-	53,915	1,312,842
Transportation and communications	69,980	-	14,948	84,928
Housing	19,853	-	122,046	141,899
Contributions to municipalities	342,857	-	2,095	344,952
Special pension contributions	50,181	-	0	50,181
Debt service	469,636	-	104,412	574,048
Other debt service	484,404	-	19,000	503,404
Total appropriations-current expenses	7,465,706	-	3,685,258	11,150,964
Capital improvements	-	475,000	165,019	640,019
Total appropriations	7,465,706	475,000	3,850,277	11,790,983
Year-end balance	-	-	400,027	400,027
Total appropriations and year-end balance	$7,465,706	$475,000	$4,250,304	$12,191,010

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

Sources: Department of the Treasury and Office of Management and Budget as reported on June 28, 2001

In the fiscal 2002 budget, revenues and other resources of all budgetary funds total $11,325,137,000, excluding balances from the previous fiscal year and general obligation bonds authorized. Total General Fund revenues in the fiscal 2002 budget are $7,245,000,000 compared to $7,505,000,000 in the fiscal 2001 budget. However, total General Fund revenues in the fiscal 2002 budget are higher than the actual General Fund revenues for fiscal year 2001, which were $6,951,245,000. The net decrease in General Fund revenues in the fiscal 2002 budget, as compared to the fiscal 2001 budget, is accounted for principally by decreases in corporation income taxes (down $155,000,000), tollgate taxes (down $58,000,000), special excise tax on certain petroleum products (down $50,000,000), personal income taxes (down $42,000,000), excise taxes on motor vehicles and accessories (down $27,000,000), general excise tax of 5% (down $19,000,000), customs revenues (down $18,000,000), excise taxes on alcoholic beverages (down $16,000,000) and federal excise taxes on off-shore shipments (down $11,000,000). These decreases are partly offset by increases in withholding taxes to non-residents (up $145,000,000) and increases in other miscellaneous non-tax revenues (up $17,000,000).

Current expenses and capital improvements of all budgetary funds total $11,790,983,000, a decrease of $9,560,000 from the fiscal 2001 budget. The major changes in General Fund expenditures by program in fiscal 2002, as compared to the fiscal 2001 budget, are: increases in general government expenditures (up $76,167,000), other debt service (up $47,819,000), contributions to municipalities (up $42,477,000), debt service (up $22,716,000) and economic development (up $9,289,000) and decreases in health (down $247,667,000), welfare (down $16,900,000) and education (down $47,703,000). The increase in the general government category is mainly due to increases in salaries and benefits of public employees. General Fund expenditures of $7,465.4 million in the fiscal 2002 budget are $309.8 million lower than the actual amounts for fiscal 2001 (without considering the higher than budgeted health insurance costs discussed below). The principal areas where the government expects to reduce costs are education, health, welfare and public safety and protection.

In September 2001, the government announced that, based on negotiations with the several insurance companies that provide health insurance coverage to low income individuals, the projected savings for fiscal 2002 of

$300 million in the cost of health insurance, as compared to fiscal 2001, that were included in the budget will not be achieved. The government expects, however, to achieve savings of $63 million and to cover the remaining shortfall in the budget of $238 million through a series of initiatives, among which are the refinancing and restructuring of debt of the Commonwealth at lower interest rates, transfers to the General Fund of available surpluses in various special funds, including a transfer of $25 million from the Emergency Fund, and increasing the applicable withholding tax for services rendered in Puerto Rico from 7% to 10%. The transfer of moneys from the Emergency Fund and the increase in withholding taxes require the enactment of legislation. See "Summary and Management Discussion of General Fund Results - Estimated Fiscal 2002 Compared to Preliminary Fiscal 2001" in *Puerto Rico Taxes, Other Revenues and Expenditures.*

The general obligation bond authorization proposed for the fiscal 2002 budget is $475,000,000.

Differences between Budget and General Purpose Financial Statements

Revenues and expenditures, as reported by the Department of the Treasury in its General Purpose 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 the financial statements prepared by the Department of the Treasury include accruals and other adjustments as required by government accounting standards.

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

(iii) Bonds are authorized by the Commonwealth in accordance with a four-year capital improvement program. Since bond sales are determined by bond market conditions and other factors, the amount of bonds sold in any year does not necessarily equal the amount of bonds authorized in the budget for that year. Expenditures for capital improvements are financed by advances from the General Fund to the Capital Projects Fund, which are later reimbursed from proceeds of bond or note sales.

LITIGATION

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

With respect to pending and threatened litigation, as of June 30, 2000, the Commonwealth included in its financial statements reported liabilities of approximately $350 million for awarded and anticipated unfavorable judgments. This amount represented the amount estimated at the time as a probable liability or a liability with a fixed or expected due date, which would require future available financial resources for its payment. This amount includes approximately $200 million of accrued liabilities related to the fines described below. 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 approximately three hundred related lawsuits in which the plaintiffs allege a tort claim and violation of their civil rights in connection with the preparation by the government of dossiers on certain individuals. The lawsuits are still in the discovery stage. A petition to certify these claims as a class action has been denied, and such denial has become final. The aggregate amount of damages claimed by the plaintiffs exceeds $50 billion. The Commonwealth has accepted liability for the claims without renouncing the limitations, immunities and defenses available to it under Act No. 104. The Commonwealth believes that the amount of damages claimed is exaggerated and that the outcome of this litigation will not materially affect the revenues and expenditures of the Commonwealth. The Commonwealth's financial statements for the fiscal year, which ended June 30, 2000, did not include any provision for liability with respect to these lawsuits.

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

APPENDIX II

FORMS OF OPINIONS OF BOND COUNSEL

Upon delivery of the Public Improvement Bonds of 2002, Series A, Hawkins, Delafield & Wood, New York, New York, as Bond Counsel to the Commonwealth for such Bonds, proposes to render its final approving opinion in substantially the following form:

October __, 2001

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

Dear Sir:

We have examined Act. No. 54 of the Legislature of Puerto Rico, approved July 6, 2001 (the "Act"), and certified copies of the legal proceedings, including a resolution adopted by the Secretary of the Treasury of the Commonwealth of Puerto Rico and approved by the Governor of the Commonwealth of Puerto Rico (the "Resolution"), and other proofs submitted relative to the issuance and sale of the following described bonds (the "Bonds"):

$455,000,000
COMMONWEALTH OF PUERTO RICO

PUBLIC IMPROVEMENT BONDS OF 2002, SERIES A

Dated: Date of Delivery

Maturing on July 1 of the years and in such principal amounts, subject to redemption and bearing interest at the rates, all as set forth in the Resolution. The Bonds are issuable as registered Bonds without coupons in the manner and in accordance with the terms and conditions of the Resolution.

The Internal Revenue Code of 1986, as amended (the "Code"), establishes certain ongoing requirements that must be met subsequent to the issuance and delivery of the Bonds in order that interest on the Bonds be and remain excluded from gross income for Federal income tax purposes under the Code. The Commonwealth of Puerto Rico has covenanted to comply, to the extent permitted by the Constitution and existing laws of the Commonwealth of Puerto Rico, with applicable requirements of the Code. We are not aware of any provisions of the Constitution or laws of the Commonwealth of Puerto Rico which would prevent the Commonwealth of Puerto Rico from complying with the requirements of the Code.

In rendering the opinions set forth in paragraph 4 below, we have relied on certain representations, certifications of fact, and statements of reasonable expectation made by the Commonwealth of Puerto Rico and others in connection with the Bonds, and we have assumed compliance by the Commonwealth of Puerto Rico with the covenant referred to above and the applicable requirements of the Code.

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

Based upon such examination, we are of the opinion that:

1. The Act is valid.

2. Said proceedings have been validly and legally taken.

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

4. Under the provisions of the Acts of Congress now in force and under existing statutes and court decisions, (i) interest on the Bonds is excluded from gross income for Federal income tax purposes, and (ii) interest on the Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations.

5. Under existing statutes and court decisions, the Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation.

We express no opinion regarding any other Federal, state, Commonwealth of Puerto Rico or local tax consequences with respect to the Bonds. Furthermore, we express no opinion on the effect of any action hereafter taken or not taken in reliance upon an opinion of counsel other than this firm on the exclusion from gross income for Federal income tax purposes of interest on the Bonds, or under state, Commonwealth of Puerto Rico or local tax law.

We render our opinions under existing statutes and court decisions as of the issue date, and assume no obligation to update our opinions after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise.

Very truly yours,

[To be signed: Hawkins, Delafield & Wood]

Upon delivery of the Public Improvement Refunding Bonds, Series 2002 A, Hawkins, Delafield & Wood, New York, New York, as Bond Counsel to the Commonwealth for such Bonds, proposes to render its final approving opinion in substantially the following form:

October __, 2001

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

Dear Sir:

We have examined Act. No. 33 of the Legislature of Puerto Rico, approved December 7, 1942 (the "Act"), and certified copies of the legal proceedings, including a resolution adopted by the Secretary of the Treasury of the Commonwealth of Puerto Rico and approved by the Governor of the Commonwealth of Puerto Rico (the "Resolution"), and other proofs submitted relative to the issuance and sale of the following described bonds (the "Bonds"):

$837,960,000
COMMONWEALTH OF PUERTO RICO

PUBLIC IMPROVEMENT REFUNDING BONDS, SERIES 2002 A

Dated: Date of Delivery

Maturing on July 1 of the years and in such principal amounts, subject to redemption and bearing interest at the rates, all as set forth in the Resolution. The Bonds are issuable as registered Bonds without coupons in the manner and in accordance with the terms and conditions of the Resolution and are not subject to redemption prior to maturity.

The Internal Revenue Code of 1986, as amended (the "Code"), establishes certain ongoing requirements that must be met subsequent to the issuance and delivery of the Bonds in order that interest on the Bonds be and remain excluded from gross income for Federal income tax purposes under the Code. The Commonwealth of Puerto Rico has covenanted to comply, to the extent permitted by the Constitution and existing laws of the Commonwealth of Puerto Rico, with applicable requirements of the Code. We are not aware of any provisions of the Constitution or laws of the Commonwealth of Puerto Rico which would prevent the Commonwealth of Puerto Rico from complying with the requirements of the Code.

In rendering the opinions set forth in paragraph 4 below, we have relied on certain representations, certifications of fact, and statements of reasonable expectation made by the Commonwealth of Puerto Rico and others in connection with the Bonds, and we have assumed compliance by the Commonwealth of Puerto Rico with the covenant referred to above and the applicable requirements of the Code.

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

Based upon such examination, we are of the opinion that:

1. The Act is valid.

2. Said proceedings have been validly and legally taken.

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

4. Under the provisions of the Acts of Congress now in force and under existing statutes and court decisions, (i) interest on the Bonds is excluded from gross income for Federal income tax purposes, and (ii) interest on the Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations.

5. Under existing statutes and court decisions, the Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation.

We express no opinion regarding any other Federal, state, Commonwealth of Puerto Rico or local tax consequences with respect to the Bonds. Furthermore, we express no opinion on the effect of any action hereafter taken or not taken in reliance upon an opinion of counsel other than this firm on the exclusion from gross income for Federal income tax purposes of interest on the Bonds, or under state, Commonwealth of Puerto Rico or local tax law.

We render our opinions under existing statutes and court decisions as of the issue date, and assume no obligation to update our opinions after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise.

Very truly yours,

[To be signed: Hawkins, Delafield & Wood]

MBIA

FINANCIAL GUARANTY INSURANCE POLICY

MBIA Insurance Corporation
Armonk, New York 10504

Policy No. [NUMBER]

MBIA Insurance Corporation (the "Insurer"), in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to [PAYING AGENT/TRUSTEE] or its successor (the "Paying Agent") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean:

[PAR]
[LEGAL NAME OF ISSUE]

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

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

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

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

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

COUNTERSIGNED:

MBIA Insurance Corporation

SPECIMEN

Resident Licensed Agent

President

Attest:

City, State

Assistant Secretary

STD-RCS-6
4/95

XL CAPITAL ASSURANCE℠

250 Park Avenue
New York, New York 10177
Telephone: (646) 658-5900

MUNICIPAL BOND INSURANCE POLICY

ISSUER: [ ] **Policy No:** [ ]

BONDS: [ ] **Effective Date:** [ ]

XL Capital Assurance Inc. (XLCA), a New York stock insurance company, in consideration of the payment of the premium and subject to the terms of this Policy (which includes each endorsement attached hereto), hereby agrees unconditionally and irrevocably to pay to the trustee (the "Trustee") or the paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the benefit of the Owners of the Bonds or, at the election of XLCA, to each Owner, that portion of the principal and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment.

XLCA will pay such amounts to or for the benefit of the Owners on the later of the day on which such principal and interest becomes Due for Payment or one (1) Business Day following the Business Day on which XLCA shall have received Notice of Nonpayment (provided that Notice will be deemed received on a given Business Day if it is received prior to 10:00 a.m. New York time on such Business Day; otherwise it will be deemed received on the next Business Day), but only upon receipt by XLCA, in a form reasonably satisfactory to it, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in XLCA. Upon such disbursement, XLCA shall become the owner of the Bond, any appurtenant coupon to the Bond or the right to receipt of payment of principal and interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by XLCA hereunder. Payment by XLCA to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of XLCA under this Policy.

In the event the Trustee or Paying Agent has notice that any payment of principal or interest on a Bond which has become Due for Payment and which is made to an Owner by or on behalf of the Issuer of the Bonds has been recovered from the Owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such Owner within the meaning of any applicable bankruptcy law, such Owner will be entitled to payment from XLCA to the extent of such recovery if sufficient funds are not otherwise available.

The following terms shall have the meanings specified for all purposes of this Policy, except to the extent such terms are expressly modified by an endorsement to this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment", when referring to the principal of Bonds, is when the stated maturity date or a mandatory redemption date for the application of a required sinking fund installment has been reached and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by application of required sinking fund installments), acceleration or other advancement of maturity, unless XLCA shall elect, in its sole discretion, to pay such principal due upon such acceleration; and, when referring to interest on the Bonds, is when the stated date for payment of interest has been reached. "Nonpayment" means the failure of the Issuer to have provided sufficient funds to the Trustee or Paying Agent for payment in full of all principal and interest on the Bonds which are Due for Payment. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to XLCA which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

XLCAP-005

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

Except to the extent expressly modified by an endorsement hereto, (a) this Policy is non-cancelable by XLCA, and (b) the Premium on this Policy is not refundable for any reason. This Policy does not insure against loss of any prepayment or other acceleration payment which at any time may become due in respect of any Bond, other than at the sole option of XLCA, nor against any risk other than Nonpayment. This Policy sets forth the full undertaking of XLCA and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto.

THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

In witness whereof, XLCA has caused this Policy to be executed on its behalf by its duly authorized officers.

SPECIMEN
Name:
Title:

SPECIMEN
Name:
Title:

Ambac

Financial Guaranty Insurance Policy

Ambac Assurance Corporation
One State Street Plaza, 15th Floor
New York, New York 10004
Telephone: (212) 668-0340

Obligor: Policy Number:

Obligations: Premium:

Ambac Assurance Corporation (Ambac), a Wisconsin stock insurance corporation, in consideration of the payment of the premium and subject to the terms of this Policy, hereby agrees to pay to The Bank of New York, as trustee, or its successor (the "Insurance Trustee"), for the benefit of the Holders, that portion of the principal of and interest on the above-described obligations (the "Obligations") which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Obligor.

Ambac will make such payments to the Insurance Trustee within one (1) business day following written notification to Ambac of Nonpayment. Upon a Holder's presentation and surrender to the Insurance Trustee of such unpaid Obligations or related coupons, uncanceled and in bearer form and free of any adverse claim, the Insurance Trustee will disburse to the Holder the amount of principal and interest which is then Due for Payment but is unpaid. Upon such disbursement, Ambac shall become the owner of the surrendered Obligations and/or coupons and shall be fully subrogated to all of the Holder's rights to payment thereon.

In cases where the Obligations are issued in registered form, the Insurance Trustee shall disburse principal to a Holder only upon presentation and surrender to the Insurance Trustee of the unpaid Obligation, uncanceled and free of any adverse claim, together with an instrument of assignment, in form satisfactory to Ambac and the Insurance Trustee duly executed by the Holder or such Holder's duly authorized representative, so as to permit ownership of such Obligation to be registered in the name of Ambac or its nominee. The Insurance Trustee shall disburse interest to a Holder of a registered Obligation only upon presentation to the Insurance Trustee of proof that the claimant is the person entitled to the payment of interest on the Obligation and delivery to the Insurance Trustee of an instrument of assignment, in form satisfactory to Ambac and the Insurance Trustee, duly executed by the Holder or such Holder's duly authorized representative, transferring to Ambac all rights under such Obligation to receive the interest in respect of which the insurance disbursement was made. Ambac shall be subrogated to all of the Holders' rights to payment on registered Obligations to the extent of any insurance disbursements so made.

In the event that a trustee or paying agent for the Obligations has notice that any payment of principal of or interest on an Obligation which has become Due for Payment and which is made to a Holder by or on behalf of the Obligor has been deemed a preferential transfer and theretofore recovered from the Holder pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court of competent jurisdiction, such Holder will be entitled to payment from Ambac to the extent of such recovery if sufficient funds are not otherwise available.

As used herein, the term "Holder" means any person other than (i) the Obligor or (ii) any person whose obligations constitute the underlying security or source of payment for the Obligations who, at the time of Nonpayment, is the owner of an Obligation or of a coupon relating to an Obligation. As used herein, "Due for Payment", when referring to the principal of Obligations, is when the scheduled maturity date or mandatory redemption date for the application of a required sinking fund installment has been reached and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by application of required sinking fund installments), acceleration or other advancement of maturity; and, when referring to interest on the Obligations, is when the scheduled date for payment of interest has been reached. As used herein, "Nonpayment" means the failure of the Obligor to have provided sufficient funds to the trustee or paying agent for payment in full of all principal of and interest on the Obligations which are Due for Payment.

This Policy is noncancelable. The premium on this Policy is not refundable for any reason, including payment of the Obligations prior to maturity. This Policy does not insure against loss of any prepayment or other acceleration payment which at any time may become due in respect of any Obligation, other than at the sole option of Ambac, nor against any risk other than Nonpayment.

In witness whereof, Ambac has caused this Policy to be affixed with a facsimile of its corporate seal and to be signed by its duly authorized officers in facsimile to become effective as its original seal and signatures and binding upon Ambac by virtue of the countersignature of its duly authorized representative.

President

AMBAC ASSURANCE CORPORATION
CORPORATE
SEAL
WISCONSIN

Anne G. Gill
Secretary

Effective Date:

Authorized Representative

THE BANK OF NEW YORK acknowledges that it has agreed to perform the duties of Insurance Trustee under this Policy.

Authorized Officer of Insurance Trustee

Form No.: 2B-0012 (1/01)