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

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

$1,018,605,000
COMMONWEALTH OF PUERTO RICO
$360,000 Public Improvement Refunding Bonds, Series 2003 B
$1,018,245,000 Public Improvement Refunding Bonds, Series 2003 C
(General Obligation Bonds)

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

The Bonds will be issued as registered bonds without coupons in denominations of $5,000 or any multiple thereof. Interest on the Bonds will be payable January 1, 2004 and each July 1 and January 1 thereafter.

The Series 2003 C Bonds will bear interest at the rates shown on the inside cover until July 1, 2008 (the "Mandatory Tender Date"). The Series 2003 C Bonds are subject to mandatory tender by the holders for purchase by the Commonwealth on the Mandatory Tender Date at a price equal to the principal amount thereof. Holders of the Series 2003 C Bonds will have no right to retain the Series 2003 C Bonds after the Mandatory Tender Date. After the Mandatory Tender Date, the Commonwealth may from time to time change the method of determining the interest on the Series 2003 C Bonds, as provided in the Bond Resolution. See "Mandatory Tender for Purchase of Series 2003 C Bonds" under *The Bonds*.

The scheduled payment of principal of and interest on some of the Bonds will be insured by Financial Security Assurance Inc. and MBIA Insurance Corporation, as indicated on the inside cover of this Official Statement.

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

The Bonds are offered for delivery when, as and if issued and accepted by the Underwriters subject to the approval of legality by Sidley Austin Brown & Wood LLP, New York, New York, Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the Underwriters by Pietrantoni Méndez & Alvarez LLP, San Juan, Puerto Rico. It is expected that settlement for the Bonds will occur in New York, New York, on or about May 6, 2003.

LEHMAN BROTHERS GOLDMAN, SACHS & CO. MORGAN STANLEY

BANC OF AMERICA SECURITIES LLC CITIGROUP JP MORGAN

MERRILL LYNCH & CO. RAYMOND JAMES & ASSOCIATES, INC.

SAMUEL RAMÍREZ & CO., INC. UBS PAINEWEBBER INC.

WACHOVIA BANK, NATIONAL ASSOCIATION

April 16, 2003

$1,018,605,000
COMMONWEALTH OF PUERTO RICO
$360,000 Public Improvement Refunding Bonds, Series 2003 B
$1,018,245,000 Public Improvement Refunding Bonds, Series 2003 C
(General Obligation Bonds)

$360,000 Public Improvement Refunding Bonds, Series 2003 B

Maturity	Amount	Interest Rate	Yield
2008	$360,000	3.00%	3.10%

$1,018,245,000 Public Improvement Refunding Bonds Series 2003 C

$ 36,450,000	6.00%+	Term Bonds due July 1, 2013 - Yield-	3.48 %*
$ 5,585,000	3.50%+	Term Bonds due July 1, 2014 - Yield-	3.48 %*
$229,215,000	5.00%+	Term Bonds due July 1, 2018 - Yield-	3.48 %*
$ 46,385,000	5.50%+	Term Bonds due July 1, 2018 - Yield-	2.98 %*†
$233,615,000	5.00%+	Term Bonds due July 1, 2021 - Yield-	2.98 %*†
$ 15,730,000	3.00%+	Term Bonds due July 1, 2021 - Yield-	2.98 %*‡
$ 50,000,000	4.25%+	Term Bonds due July 1, 2022 - Yield-	2.98 %*‡
$401,265,000	5.00%+	Term Bonds due July 1, 2028 - Yield-	2.98 %*‡

+ Initial Rate
* Initial Yield to July 1, 2008 Mandatory Tender Date.
† Insured by Financial Security Assurance Inc.
‡ Insured by MBIA Insurance 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 A. REY
Secretary of Education

VÍCTOR RIVERA HERNÁNDEZ
Secretary of Labor and Human Resources

JOHNNY V. RULLÁN
Secretary of Health

LUIS RIVERO CUBANO
Secretary of Agriculture

FERNANDO E. FAGUNDO
Secretary of Transportation and Public Works

MILTON SEGARRA
Secretary of Economic Development and Commerce

YOLANDA ZAYAS
Secretary of Family Affairs

ILEANA ECHEGOYEN
Secretary of Housing

LUIS E. RODRÍGUEZ
Secretary of Natural and Environmental Resources

JAVIER A. ECHEVARRÍA
Secretary of Consumer Affairs

JORGE L. ROSARIO
Secretary of Sports and Recreation

MIGUEL A. PEREIRA
Secretary of Corrections and Rehabilitation

Legislative Officers

ANTONIO FAS ALZAMORA
President, Senate

CARLOS VIZCARRONDO
Speaker, House of Representatives

Fiscal Officers

MELBA ACOSTA
Director, Office of Management and Budget

HÉCTOR MÉNDEZ VÁZQUEZ
President, Government Development Bank for Puerto Rico

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

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

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

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$1,018,605,000
Commonwealth of Puerto Rico
$360,000 Public Improvement Refunding Bonds, Series 2003 B
$1,018,245,000 Public Improvement Refunding Bonds, Series 2003 C
(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 reports incorporated by reference below, provides certain information in connection with the sale of $360,000 Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 2003 B (the "Series 2003 B Bonds") and $1,018,245,000 Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 2003 C (the "Series 2003 C Bonds" and together with the Series 2003 B Bonds, the "Bonds").

The Bonds are being issued under the provisions of Act No. 2 of the Legislature of Puerto Rico, approved October 10, 1985, and Joint Resolution No. 57 of the Legislature of Puerto Rico, approved July 12, 1993 (collectively, the "Act"), and pursuant to a resolution authorizing the issuance of the Bonds (the "Bond Resolution") adopted by the Secretary of the Treasury and approved by the Acting Governor of Puerto Rico on April 16, 2003.

The Series 2003 C Bonds maturing on July 1 of the years 2018 and 2021, bearing interest at a rate of 5.50% and 5.00%, respectively (the "FSA Insured Bonds"), will be insured by a municipal bond insurance policy (the "FSA Bond Insurance Policy") issued by Financial Security Assurance Inc. ("FSA"). The Series 2003 C Bonds maturing on July 1 of the years 2021, 2022, and 2028, bearing interest at a rate of 3.00%, 4.25% and 5.00%, respectively (the "MBIA Insured Bonds", and collectively with the FSA Insured Bonds, the "Insured Bonds"), will be insured by a financial guarantee insurance policy (the "MBIA Bond Insurance Policy") issued by MBIA Insurance Corporation ("MBIA").

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

This Official Statement includes the cover page, the inside cover page, the appendices, and the Comprehensive Annual Financial Report of the Commonwealth for the fiscal year ended June 30, 2001 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, 2001, together with the independent auditor's report thereon, dated January 21, 2002, of KPMG LLP, certified public accountants, and is incorporated by reference herein. KPMG LLP did not audit the financial statements of the pension trust funds, the public university funds, and certain activities and component units separately identified in their report. Those financial statements were audited by other auditors whose reports have been furnished to KPMG LLP, and their opinion on the general purpose financial statements, insofar as it relates to the amounts included in the general purpose financial statements pertaining to such activities and component units, is based solely on the reports of the other auditors. It is expected that the audited financial statements of the Commonwealth for fiscal year 2002 will be available during the second calendar quarter of 2003.

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 Bonds shall be deemed to be incorporated by reference into this Official Statement and to be part of this Official Statement from the date of filing of such document. Any statement contained in the Commonwealth's Annual Financial Report 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 statement contained herein shall also be deemed to be modified or superseded to the extent that a statement contained 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.

The Comprehensive Annual Financial Report of the Commonwealth for fiscal year 2002 to be prepared by the Department of the Treasury, which will include the audited financial statements of the Commonwealth for fiscal year 2002, will be filed by the Commonwealth with each NRMSIR promptly upon release of such audited financial statements.

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 April 1, 2003 (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

General. Puerto Rico enjoyed almost two decades of economic expansion through fiscal year 2001. 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 value of the United States dollar, increases in the level of federal transfers, a significant expansion in construction investment driven by infrastructure projects and private investment, primarily in housing, the relatively low cost of borrowing, and low oil prices.

The economy of Puerto Rico is closely linked to the United States economy. The following exogenous variables are affected by the United States economy: exports, direct investment, transfer payments, interest rates, inflation, and tourist expenditures. During fiscal year 2002 (July 2001 through June 2002), approximately 89% of Puerto Rico's exports went to the United States mainland, which was also the source of approximately 50% of Puerto Rico's imports.

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. The Planning Board estimates that in fiscal year 2002 manufacturing generated $30.0 billion, or 42.2%, of gross domestic product, as compared with fiscal year 2001 when it generated $28.8 billion, or 41.6%, of gross domestic product. During the first eight months of fiscal year 2003, payroll employment for the manufacturing sector was 118,300, a decrease of 4.0% compared with the same period for fiscal year 2002, with most job losses occurring in labor-intensive industries. 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. In the last three decades, industrial development has tended to be more capital intensive and more dependent on skilled labor. This gradual shift in emphasis is best exemplified by the large investment over the last decade in the pharmaceutical, scientific instruments, computers and electrical products industries in Puerto Rico. One of the factors assisting the development of the manufacturing sector has been the tax incentives offered by the federal and Puerto Rico governments. Federal legislation enacted in 1996, however, which amended Section 936 of the Internal Revenue Code of 1986, as amended, phases out the federal tax incentives during a ten-year period. See "Tax Incentives - Incentives Under the Code" under *The Economy* in *Appendix I*.

The services sector, which includes finance, insurance, real estate, wholesale and retail trade, tourism, and other services currently accounts for approximately 48.4% of total employment, and generated $27.2 billion, or 38.2%, of Puerto Rico's gross domestic product in fiscal year 2002, as compared with $26.7 billion, or 38.6%, of gross domestic product in fiscal year 2001. The development of the services sector has shown a strong interaction with manufacturing, tourism, construction, and agriculture.

Tourism makes a significant contribution to economic activity. Total visitors' expenditures accounted for 3.5% of the island's gross domestic product in fiscal year 2002. An estimated 4.4 million visitors spent $2.5 billion in Puerto Rico in fiscal year 2002. 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.

Growth in the construction sector contributed to increased economic activity from fiscal year 1998 through fiscal year 2002. During that period, construction investment increased 27.5%.

Puerto Rico is heavily dependent on oil imports for the production of electricity. As a result of the construction of two cogeneration plants, however, one of which is fueled by liquefied natural gas and the other by coal, Puerto Rico's dependence on oil imports for the production of electricity has been reduced from 99% to 72%. See "Other Public Corporations - Electric Power Authority" under *Public Corporations* in *Appendix I*.

Fiscal Year 2002. The Planning Board's preliminary reports of the performance of the Puerto Rico economy during fiscal year 2002 indicate that the economy registered a decline of 0.2% in real gross product. In fiscal year 2002, gross product was $45.2 billion in nominal terms ($35.2 billion in 1996 prices) compared to $44.2 billion ($35.3 billion in 1996 prices) for fiscal year 2001. This represents a nominal increase in gross product from fiscal year 2001 to 2002 of 2.3% (-0.2% in 1996 prices). In terms of personal income, in fiscal year 2002, aggregate personal income was $42.6 billion ($38.0 billion in 1996 prices)[*] and personal income per capita was $11,069 ($9,861in 1996 prices).

According to the Department of Labor and Human Resources Household Employment Survey, during fiscal year 2002, total monthly employment averaged 1,169,600 compared to 1,158,000 in fiscal year 2001, an increase of 1.0%. Notwithstanding the increase in average monthly employment, due to a higher labor participation rate and a significant increase in the civilian population aged 16 years and over, the unemployment rate increased from 10.5% during fiscal year 2001 to 12.0% during fiscal year 2002.

Fiscal Year 2003. During the first eight months of fiscal year 2003, seasonally adjusted total monthly employment averaged 1,201,800 compared to 1,161,800 in the same period of fiscal year 2002, an increase of 3.4%. The unemployment rate increased to 12.0% during the first eight months of fiscal year 2003 from 11.8% during the first eight months of fiscal year 2002. Total employment for February 2003 was 1,203,000, an increase of 23,000, or 2.0%, compared to the same month in 2002. The seasonally adjusted unemployment rate for February 2003 was 12.0%.

The Planning Board is forecasting an increase in real gross product of 1.7% for fiscal year 2003. The performance of the Puerto Rico economy during the balance of fiscal year 2003 and fiscal year 2004 may be adversely affected by a drawn out conflict with Iraq, the occurrence of terrorist acts and sustained high oil prices. To mitigate the impact of high oil prices, the Electric Power Authority has instituted a hedging program with respect to a portion (around 8%) of its oil supply. The hedging contracts expire in June 2004.

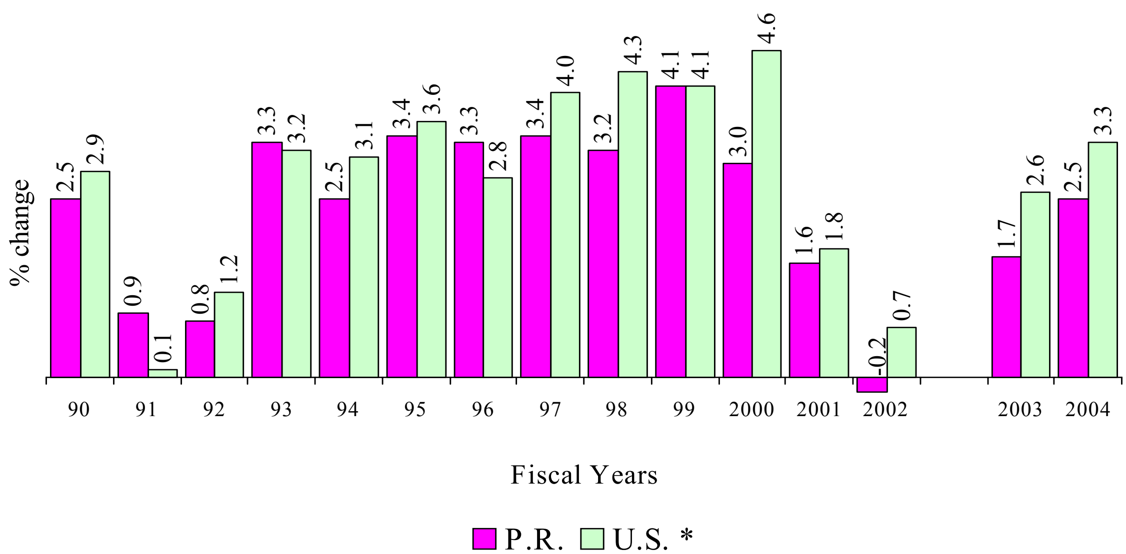
Fiscal Year 2004. The Planning Board's current real gross product forecast for fiscal year 2004, made in February 2003, projects an increase of 2.5%.

As in the past, the economy of Puerto Rico is expected to follow the performance of the United States economy. Construction activity is expected to be a driving force for economic growth in the short and medium-term. For fiscal year 2004 a significant amount of public construction investment is expected, which, together with a sustained level of private construction investment, primarily in housing, should stimulate the economy on a short term basis.

The graph on the next page compares the growth rate of real gross national product for the Puerto Rico and United States economies since fiscal 1990, and the projection of the growth rate for fiscal years 2003 and 2004.

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

Real GNP Growth Rate



*Global Insight Inc. forecast as of March 2003.

Recent Events

On April 14, 2003, Standard & Poor's Rating Services, a division of The McGraw-Hill Companies, Inc. ("Standard & Poor's") removed the Commonwealth's outstanding general obligation debt from credit watch with negative implications and assigned to it a rating of "A-" with negative outlook. See *Ratings*, below. Information on Standard & Poor's rating rationale is available at its website at www.standardandpoors.com.

Standard & Poor's had previously announced on December 11, 2002, that it was placing its ratings and underlying ratings on the Commonwealth's outstanding debt on credit watch with negative implications, reflecting concerns over the Commonwealth's general ability to enforce appropriate accounting, fiscal, and management controls with respect to equipment leases entered into by certain Commonwealth agencies and municipalities. Standard & Poor's indicated that the Commonwealth's laxity in such controls was noted in three transactions entered into by two Commonwealth agencies and one municipality, where the Commonwealth may have been incorrectly represented to the investors as the ultimate obligor of the leases in question. Standard & Poor's indicated it would be reviewing information to be provided by the Commonwealth and should its concerns not be speedily resolved, rating action could follow.

The Commonwealth provided to Standard & Poor's information addressing its concerns after conducting an audit of all leasing contracts involving Commonwealth agencies and municipalities. It also took measures to reinforce its controls over the execution of lease contracts by government agencies, including proposing legislation making it a crime for any Commonwealth employee to enter into any such leasing contract without the written approval of Government Development Bank.

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. 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 year 2001 were audited by KPMG LLP, independent auditors whose report thereon is dated January 21, 2002. 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 approximately 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 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 certain fiscal years, however, public sector debt has increased at a rate greater than the growth of gross product. For instance, public sector debt increased by 12.1% during fiscal year 2001, compared to a 6.7% increase in gross product for the same fiscal year. The increase in the rate of growth of public sector debt during fiscal year 2001 was in part due to the issuance during such fiscal year of $1,092,550,000 of bonds of Infrastructure Financing Authority and $397,005,000 of bonds of Children's Trust, 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 year 2001 was 5.9%. During fiscal year 2002, public sector debt grew by 10.5%, compared to a 2.3% increase in gross product for the same fiscal year. See "Trends of Public Sector Debt" under *Debt* in *Appendix I*.

PLAN OF FINANCING

The Bonds are being issued for the purpose of repaying a GDB line of credit in the amount of $11.3 million and refunding the following general obligation bonds of the Commonwealth (the "Refunded Bonds"):

Refunded Bonds	Principal Amount to be Refunded	Interest Rate	Maturity Date July 1	Redemption Date July 1	Redemption Price (% of Par)
Public Improvement Refunding Bonds, Series 1987	$26,475,822.50*	7.50%	2003	—	—
Public Improvement Refunding Bonds, Series 1987	4,000,000.00	3.00	2006	2003	100.00
Public Improvement Bonds of 1989, Series A	1,086,118.40*	7.60	2007	—	—
Public Improvement Bonds of 1989, Series A	970,507.20*	7.65	2008	—	—
Public Improvement Refunding Bonds, Series 1992 A	780,000.00	5.75	2003	—	—
Public Improvement Refunding Bonds, Series 1992	3,265,000.00	5.80	2004	2003	100.75

Refunded Bonds	Principal Amount to be Refunded	Interest Rate	Maturity Date July 1	Redemption Date July 1	Redemption Price (% of Par)
A					
Public Improvement Refunding Bonds, Series 1993	159,700,000.00	5.25	2018	2003	101.50
Public Improvement Refunding Bonds, Series 1993	87,295,000.00	5.00	2021	2003	100.00
Public Improvement Bonds of 1995	118,695,000.00	5.375	2022	2005	101.50
Public Improvement Bonds of 1996	155,150,000.00	5.40	2025	2006	101.50
Public Improvement Bonds of 1997	78,400,000.00	5.375	2021	2007	101.50
Public Improvement Bonds of 1997	96,665,000.00	5.375	2025	2007	100.00
Public Improvement Bonds of 1998	27,660,000.00	5.00	2024	2008	101.00
Public Improvement Bonds of 1998	91,570,000.00	5.00	2027	2008	101.00
Public Improvement Bonds of 1999	88,195,000.00	5.00	2028	2008	101.00
Total	$939,907,448.10				

* Capital Appreciation Bonds. Stated amount reflects initial principal amount.

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

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 Causey Demgen & Moore (the "Verification Agent").

Sources and Uses of Funds

Sources:	
Principal amount of the Bonds	$1,018,605,000
Net original issue premium	89,978,068
Moneys from Redemption Fund	77,385,580
Total sources	$1,185,968,648
Uses:	
Deposit into the Escrow Fund for Refunded Bonds	$1,154,685,121
Underwriting discount, bond insurance premium and legal, printing, and other financing expenses	31,283,527
Total uses	$1,185,968,648

THE BONDS

Description of the Series 2003 B Bonds

The Series 2003 B Bonds will be issued in book-entry only form, dated the date of their delivery, will bear interest from that date at such rate, and mature on the date set forth on the inside cover of this Official Statement. The Series 2003 B Bonds will be issuable as registered bonds without coupons in denominations of $5,000 or any multiple thereof. Interest on the Series 2003 B Bonds will be payable January 1, 2004 and each July 1 and January 1 thereafter and will be computed on the basis of a 360-day year of twelve 30-day months. The Series 2003 B Bonds will not be subject to redemption.

Description of the Series 2003 C Bonds

This description of the Series 2003 C Bonds relates only to the terms and provisions which are applicable during the period from their date of delivery through July 1, 2008 (the “Mandatory Tender Date”).

The Series 2003 C Bonds will be dated the date of their delivery and will bear interest from that date. The Series 2003 C Bonds will be issued in book-entry only form and will mature, subject to prior redemption, on the dates set forth on the inside cover of this Official Statement. The Series 2003 C Bonds will be issuable as fully registered bonds without coupons in denominations of $5,000 or any multiple thereof during the period prior to the Mandatory Tender Date.

The Series 2003 C Bonds initially will bear interest at the rates set forth on the inside cover hereof during the period ending on the Mandatory Tender Date. During that period, interest will be payable semiannually on each January 1 and July 1, commencing January 1, 2004, and will be computed on the basis of a 360-day year of twelve 30-day months.

The Series 2003 C Bonds are subject to mandatory tender by the holders thereof for purchase by the Commonwealth on the Mandatory Tender Date. Holders of the Series 2003 C Bonds will have no right to retain the Series 2003 C Bonds on and after the Mandatory Tender Date. Prior to the Mandatory Tender Date, the Series 2003 C Bonds may not be tendered and may not be converted to bear interest at any rate other than the rate set forth on the inside cover hereof, as provided in the Bond Resolution. See “Mandatory Tender for Purchase of Series 2003 C Bonds,” below.

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

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

Purchases of the Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of a Bond (a "Beneficial Owner") is in turn to 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 Bonds are to 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 definitive Bonds except in the event that use of the book-entry system for the Bonds is discontinued.

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

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

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

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

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

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the Commonwealth or the Registrar. Under such circumstances, in the event that a successor securities depository is not obtained, definitive Bonds 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 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 Bonds, the Beneficial Owners may be charged a sum sufficient to cover any tax, fee or other charge that may be imposed in relation thereto.

Discontinuance of the Book-Entry Only System

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

Authorization

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

Mandatory Tender for Purchase of Series 2003 C Bonds

The Series 2003 C Bonds are subject to mandatory tender for purchase on the Mandatory Tender Date, subject to a successful remarketing, at a purchase price equal to the principal amount of such bonds (the "Tender Purchase Price"), with no right of the owners of such bonds to retain them. On the Mandatory Tender Date, the Series 2003 C Bonds must be tendered for purchase by the holders thereof to the Registrar. Lehman Brothers, Inc. (the "Remarketing Agent") will act as remarketing agent of the Series 2003 C Bonds pursuant to a remarketing agreement with the Commonwealth acting through the Secretary.

Prior to the Mandatory Tender Date, the Secretary will determine the initial interest rate mode or modes that will be applicable to such bonds from and after the Mandatory Tender Date. The interest rate or rates to be borne by such bonds immediately after the Mandatory Tender Date will be determined by the Remarketing Agent and will be equal to the lowest rate or rates that, in the opinion of the Remarketing Agent, will permit the remarketing of such bonds at par. The interest rate or rates to be determined by the Remarketing Agent may be a fixed or variable rate, and the Series 2003 C Bonds may be subject to subsequent remarketings. If the Secretary determines that the interest rate mode applicable immediately after the Mandatory Tender Date will be a fixed rate mode (in which the interest rate on the Series 2003 C Bonds will be fixed to their maturity) or a term rate mode (in which the interest rate on the Series 2003 C Bonds will be fixed for one year or longer), the bonds may be remarketed at an aggregate price exceeding par, but the tendering holders will only receive the Tender Purchase Price. The Secretary in conjunction with any such remarketing may establish amortization requirements for such bonds that will result in the mandatory redemption of such bonds prior to maturity.

As of the date of this Official Statement, the Commonwealth has not provided and does not intend to provide any liquidity facility for the payment of the purchase price payable upon the mandatory tender of the Series 2003 C Bonds on the Mandatory Tender Date, nor is there any requirement that such liquidity facility be obtained. The Tender Purchase Price for such bonds is expected to be obtained from the remarketing thereof.

The Remarketing Agent will use its best efforts to remarket the Series 2003 C Bonds on the Mandatory Tender Date. On the Mandatory Tender Date (or such later date to which such tender has been postponed as described below), the Series 2003 C Bonds shall be deemed to have been tendered on such date for purchase and, if on such date moneys sufficient to pay the Tender Purchase Price thereof shall be on deposit with the Registrar, acting as Tender Agent, interest on such bonds shall cease to accrue.

Any Series 2003 C Bonds not purchased on the Mandatory Tender Date (i) will be returned to their holder and remain outstanding and will bear interest at the rate of 8% per annum, and (ii) will be purchased upon the availability of funds to purchase such bonds. The Commonwealth has covenanted that it will cause the Series 2003 C Bonds to be remarketed (in such rate mode or modes) on the Mandatory Tender Date or on the first date thereafter at which they can be sold at par (or above par in the two exceptions described above) at a rate not exceeding the maximum legal rate (currently 12% per annum).

Notice of the mandatory tender for purchase of the Series 2003 C Bonds will be given not less than 15 days prior to the Mandatory Tender Date by first-class mail, postage prepaid, to DTC (or if the book-entry only system has been discontinued as described above, to the registered owners of the Series 2003 C Bonds, at their addresses appearing upon the registration books maintained by the Registrar). The notice of tender for purchase shall state that such tender is conditioned upon the ability of the Remarketing Agent to remarket all (and not less than all) of the Series 2003 C Bonds on the Mandatory Tender Date and should it not be possible for the Series 2003 C Bonds to be sold on such date, the tender will be postponed (with such owners retaining their Series 2003 C Bonds) until such date as such bonds are able to be so remarketed. Failure to mail such notice to the registered owner of any Series 2003 C Bond will not affect the tender, purchase or remarketing of such bond.

Security

Provision for Payment of Public Debt

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

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

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

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

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

Special Fund for General Obligation Debt Service

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

Act No. 39 of the Legislature of Puerto Rico, approved May 13, 1976, as amended ("Act No. 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 March 26, 2003, the amount on deposit in the Redemption Fund was $99,541,791, 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.

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

After giving effect to the issuance of the Bonds, future maximum annual debt service for the Commonwealth's outstanding general obligation debt is $621,713,848.75 in the fiscal year ending June 30, 2005. Debt service for the PRASA Guaranteed Bonds paid by the Commonwealth during fiscal year 2002 (including for this purpose debt service payments due July 1, 2002) was $33,541,577.50. See "Debt Service Requirements for Commonwealth General Obligation Bonds and Certain Guaranteed Debt" under *Public Sector Debt of the Commonwealth*, below. The sum of those amounts ($655,255,426.25) is equal to 9.51% of $6,888,545,000, which is the average of the adjusted internal revenues for the two fiscal years ended June 30, 2001 and June 30, 2002. If the bonds refunded with non-eligible investments were treated as not being outstanding, the percentage referred to in the preceding sentence would be 8.01%.

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 FSA Bond Insurance Policy

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

Bond Insurance Policy. The FSA Bond Insurance Policy guarantees the scheduled payment of principal of and interest on the FSA Insured Bonds when due as set forth in the form of the FSA Bond Insurance Policy included as *Appendix III* of this Official Statement.

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

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

At December 31, 2002, FSA's total policyholders' surplus and contingency reserves were approximately $1,876,117,000 and its total unearned premium reserve was approximately $1,055,340,000 in accordance with statutory accounting principles. At December 31, 2002, FSA's total shareholders' equity was approximately $1,971,325,000 and its total net unearned premium reserve was approximately $892,552,000 in accordance with generally accepted accounting principles.

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

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

The MBIA Bond Insurance Policy

The following information has been furnished by MBIA for use in this Official Statement. Reference is made to *Appendix IV* for a specimen of the MBIA Bond Insurance Policy.

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 Bonds. 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); (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 its successor for the MBIA Insured Bonds.

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

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

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

The MBIA Bond Insurance Policy is 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, 2001; and

(2) The Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.

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

The Company files annual, quarterly and special reports, information statements and other information with the SEC under File No. 1-9583. Copies of the SEC filings (including (1) the Company's Annual Report on Form 10-K for the year ended December 31, 2001, and (2) the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002), 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, 2001, MBIA had admitted assets of $8.5 billion (audited), total liabilities of $5.6 billion (audited), and total capital and surplus of $2.9 billion (audited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of September 30, 2002, MBIA had admitted assets of $9.0 billion (unaudited), total liabilities of $5.9 billion (unaudited), and total capital and surplus of $3.1 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. rates the financial strength of MBIA "Aaa."

Standard & Poor's, a division of The McGraw-Hill Companies, Inc. rates the financial strength of MBIA "AAA."

Fitch Ratings 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.

PUBLIC SECTOR DEBT OF THE COMMONWEALTH

Pro Forma Public Sector Debt

The following table presents a summary of public sector debt as of December 31, 2002, as adjusted by the inclusion of the Bonds and the exclusion of the Refunded Bonds. The figures for December 31, 2002 have been adjusted to include the issuance on April 3, 2003 of $272,717,418 Puerto Rico Public Buildings Authority Government Facilities Revenue Refunding Bonds, Series H, and on April 2, 2003 of $95,295,000 Commonwealth Public Improvement Refunding Bonds, Series 2003 (collectively, the "Forward Delivery Refunding Bonds"), and the refunding of the bonds refunded with the proceeds thereof. Excluded from the table is debt not primarily payable from either Commonwealth or municipal taxes, Commonwealth appropriations or rates charged by public corporations for services or products. Also excluded from the table is debt the inclusion in which would reflect double counting, including, but not limited to $1,404,270,000 of outstanding bonds issued by the Municipal Finance Agency to finance its purchase of bonds of Puerto

Rico municipalities, and $634,512,000 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. 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)

	December 31, 2002 (1)	As Adjusted by the Issuance of the Bonds (2)
Puerto Rico direct debt (3)	$ 7,170,768	$ 7,249,466
Municipal debt	1,849,919	1,849,919
Public corporations debt		
Puerto Rico guaranteed debt	609,392	609,392
Debt supported by Puerto Rico appropriations or taxes	13,793,155	13,793,155
Other non-guaranteed debt	7,021,901	7,021,901
Total public corporations debt	$ 21,424,448	$ 21,424,448
Total public sector debt	$ 30,445,135	$ 30,523,833

* For a complete recital of all notes to this table, see "Public Sector Debt" under "Debt" in *Appendix I.*
(1) As adjusted by the inclusion of the Forward Delivery Refunding Bonds and the exclusion of the bonds refunded with the proceeds thereof.
(2) Adjusted to include the issuance of the Bonds and to exclude the Refunded Bonds.
(3) This amount excludes certain Commonwealth general obligation bonds that have been refunded with proceeds that were invested in non-eligible investments, even though such bonds will be considered outstanding under their respective authorizing resolutions and for purposes of calculating the Commonwealth's constitutional debt limitation.

Source: Government Development Bank

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

The following table presents the debt service requirements for (i) Commonwealth general obligation bonds and PRASA bonds for which debt service payments are being made under the Commonwealth guaranty, in each case outstanding on April 4, 2003 (adjusted to exclude debt service on the Refunded Bonds); (ii) debt service on the Bonds; and (iii) total debt service adjusted for the issuance of the Bonds, and the refunding of the Refunded Bonds. The table excludes debt service on Commonwealth general obligation bonds that have been refunded with the proceeds of refunding bonds invested in non-eligible investments, notwithstanding that such bonds will be considered to be outstanding for purposes of calculating the Commonwealth's constitutional debt limitation. With respect to other debt of PRASA, see *Public Corporations* in *Appendix I.* Debt service requirements for each fiscal year, as shown in the following table, include principal and interest due on July 1 immediately following the close of such fiscal year.

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	Bonds Principal	Bonds Interest	Grand Total[2]
2003	$ 205,272	$ 32,745	$ 0	$ 0	$ 238,017
2004	384,423	30,125	0	58,499	473,047
2005	428,834	30,127	0	50,746	509,708
2006	429,316	30,121	0	50,746	510,183
2007	429,191	30,126	0	50,746	510,063
2008	438,560	30,131	360	50,746	519,797
2009	442,670	30,123	6,690	35,944	515,427
2010	442,807	29,984	6,980	35,708	515,479
2011	440,360	29,928	7,275	35,461	513,025
2012	440,154	30,127	7,590	35,205	513,076
2013	440,152	30,128	7,915	34,937	513,131
2014	416,963	30,125	33,470	34,657	515,216
2015	416,957	30,126	34,905	33,476	515,464
2016	402,558	30,121	50,805	32,244	515,727
2017	402,552	30,122	52,980	30,450	516,104
2018	349,747	30,126	109,025	28,580	517,478
2019	370,701	30,125	92,560	24,732	518,117
2020	400,819	0	96,150	21,464	518,433
2021	263,622	0	85,275	18,070	366,967
2022	205,050	0	66,500	15,060	286,610
2023	181,770	0	48,290	12,712	242,773
2024	130,601	0	77,825	11,008	219,433
2025	110,133	0	101,305	8,261	219,698
2026	153,263	0	53,345	4,684	211,292
2027	153,261	0	55,415	2,801	211,477
2028	186,886	0	23,945	845	211,677
2029	211,765	0	0	0	211,765
2030	211,764	0	0	0	211,764
2031	211,762	0	0	0	211,762
2032	33,070	0	0	0	33,070
Total	$9,334,983	$514,410	$1,018,605	$717,783	$11,585,782

* Totals may not add due to rounding.

(1) Debt service requirements on all general obligation bonds outstanding on April 16, 2003, adjusted to exclude debt service on all general obligation bonds refunded with proceeds invested in non-eligible investments and, therefore, considered to be outstanding for purposes of calculating the Commonwealth's constitutional debt limitation.

(2) Debt service requirements on all general obligation bonds outstanding, adjusted as discussed in footnote 1 above and further adjusted to include the issuance of the Bonds and the refunding of the Refunded Bonds.

Sources: Government Development Bank and Department of the Treasury

TAX EXEMPTION

The Internal Revenue Code of 1986, as amended (the "Code"), includes requirements regarding the use, expenditure and investment of bond proceeds and the timely payment of certain investment earnings to the Treasury of the United States, if required, which the Commonwealth must continue to meet after the issuance of the Bonds in order that interest on the Bonds not be included in gross income for federal income tax purposes. The Commonwealth's failure to meet these requirements may cause interest on the Bonds to be included in gross income for federal income tax purposes retroactive to their date of issuance. The Commonwealth has covenanted to comply, to the extent permitted by the Constitution and the laws of the Commonwealth, with the requirements of the Code in order to maintain the exclusion from gross income for federal income tax purposes of interest on the Bonds. 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.

In the opinion of Bond Counsel, subject to continuing compliance by the Commonwealth with the tax covenant referred to above, under the provisions of the Acts of Congress now in force and under existing regulations, rulings and court decisions, interest on the Bonds will not be includable in gross income for federal income tax purposes. Interest on the Bonds will not be an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. Interest on the Bonds will, however, be includable in the computation of the alternative minimum tax on corporations imposed by the Code. Bond Counsel is rendering no opinion on the effect of any action taken or not taken after the date of its opinion without its approval (except for such action or omission to act as is provided for in the documents pertaining to the Bonds) or in reliance upon the advice of counsel other than such firm on the exclusion from gross income of the interest on the Bonds for federal income tax purposes. Bond Counsel is further of the opinion that under the provisions of the Acts of Congress now in force, the Bonds and the interest thereon will be exempt from state, Commonwealth and local income taxation.

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

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

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

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

Discount Bonds

The excess, if any, of the amount payable at maturity of any maturity of the Bonds over the issue price thereof constitutes original issue discount. The amount of original issue discount that has accrued and is properly allocable to an owner of any of the Bonds with original issue discount (a "Discount Bond") will not be includable in gross income for federal income tax purposes to the same extent as interest on the Bonds. In general, the issue price of a Bond is the first price at which a substantial amount of Bonds of the same maturity as that Bond was sold (excluding sales to bond houses, brokers or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers) and the amount of original issue discount accrues in accordance with a constant yield method based on the compounding of interest. A purchaser's adjusted basis in a Discount Bond is to be increased by the amount of such accruing discount for purposes of determining taxable gain or loss on the sale, redemption or other disposition of such Discount Bond for federal income tax purposes.

A portion of the original issue discount that accrues in each year to an owner of a Discount Bond that is a corporation will be included in the calculation of the corporation's federal alternative minimum tax liability. In addition, original issue discount that accrues in each year to an owner of a Discount Bond that is a regulated investment company may be included in the calculation of the distribution requirements of that regulated investment company and may result in some of the collateral federal income tax consequences discussed herein. Consequently, an owner of a Discount Bond should be aware that the accrual of original issue discount in each year may result in an alternative minimum tax liability, additional distribution requirements or other collateral federal income tax consequences although the owner of such Discount Bond has not received cash attributable to such original issue discount in such year.

The accrual of original issue discount and its effect on the redemption, sale or other disposition of any Discount Bond that is not purchased in the initial offering at the first price at which a substantial amount of Discount Bonds of the same maturity is sold to the public may be determined according to rules that differ from those described above. An owner of a Discount Bond should consult his tax advisor with respect to the determination for federal income tax purposes of the amount of original issue discount with respect to such Discount Bond and with respect to state, Commonwealth and local tax consequences of owning and disposing of such Discount Bond.

Premium Bonds

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

LEGAL MATTERS

The proposed form of opinion of Sidley Austin Brown & Wood LLP, New York, New York, Bond Counsel, is set forth in *Appendix 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 Bonds will be eligible for deposit by banks in Puerto Rico to secure public funds and will be approved investments for insurance companies to qualify them to do business in Puerto Rico, as required by law.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

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

UNDERWRITING

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Bonds from the Commonwealth at an aggregate discount of $6,009,137.88 from the initial offering prices of the Bonds. The obligations of the Underwriters are subject to certain conditions precedent, and they will be obligated to purchase all the Bonds, if any bonds are purchased. The Underwriters may offer to sell the 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.

Lehman Brothers Inc., a managing underwriter, has entered into a written agreement with Santander Securities Corporation, pursuant to which Santander Securities Corporation has agreed to provide investment banking services to Lehman Brothers in connection with Lehman Brothers' provision of underwriting and investment banking services to the Commonwealth with respect to the Bonds. Pursuant to this agreement, the existence of which has been disclosed to the Commonwealth and Government Development Bank, Santander Securities Corporation will be entitled to receive a portion of Lehman Brothers' actual net profits, if any, in connection with the underwriting of the 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: Goldman, Sachs & Co. and Firstbank Puerto Rico; Raymond James & Associates, Inc. and Prudential Securities Corporation; Banc of America Securities LLC and Oriental Financial Services Corporation; Morgan Stanley & Co. Incorporated and Popular Securities, Inc; Wachovia Bank, National Association and Doral Securities, Inc.; JP Morgan Securities, Inc. and R-G Investments Corporation; and Merrill Lynch, Pierce, Fenner & Smith Incorporated and BBVA Capital Markets of Puerto Rico, Inc.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

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

RATINGS

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

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

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

CONTINUING DISCLOSURE

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

1. to file within 305 days after the end of each fiscal year commencing with the fiscal year ending June 30, 2003, 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 Bonds, if material:

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

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 Bonds do not provide for "debt service reserves," or "credit or liquidity providers". For a description of the Bonds, see *The 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 Bonds, unless the Commonwealth applies for or participates in obtaining the enhancement.

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

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: (i) the terms, dates and amounts of redemption are set forth in detail in this Official Statement under "*The Bonds* — Redemption"; (ii) the only open issue is which Bonds will be redeemed in the case of a partial redemption; (iii) notice of redemption is given to the Bondholders as required under the terms of the Bonds; and (iv) 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 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 Bonds, and shall be enforceable by any such Beneficial Owners; provided that the right to enforce the provisions of its undertaking shall be limited to a right to obtain specific enforcement of the Commonwealth's obligations thereunder.

No Beneficial Owner may institute any suit, action or proceeding at law or in equity ("Proceeding") for the enforcement of the foregoing covenants (the "Covenants") or for any remedy for breach thereof, unless such Beneficial Owner shall have filed with the Commonwealth written notice of any request to cure such breach, and the Commonwealth shall have refused to comply within a reasonable time. All Proceedings shall be instituted only in a Commonwealth court located in the Municipality of San Juan, Puerto Rico for the equal benefit of all Beneficial Owners of the outstanding Bonds 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 Bonds, after taking into account any amendments or change in circumstances; and the amendment does not materially impair the interest of Beneficial Owners, as determined by persons unaffiliated with the Commonwealth; or

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

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

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

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

MISCELLANEOUS

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

Appended to and constituting a part of this Official Statement are the Commonwealth Report (*Appendix I*), the proposed form of opinion of Bond Counsel *(Appendix II*), a specimen of the FSA Bond Insurance Policy *(Appendix III)*, and a specimen of the MBIA Bond Insurance Policy *(Appendix IV)*.

The information set forth in this Official Statement and incorporated herein by reference, except for information pertaining to DTC, FSA and MBIA, 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 FSA Bond Insurance Policy" under *Bond Insurance* and *Appendix III* was supplied by FSA. The information in "The MBIA Bond Insurance Policy" under *Bond Insurance* and *Appendix IV* was supplied by MBIA.

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

COMMONWEALTH OF PUERTO RICO

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

APPENDIX I

COMMONWEALTH OF PUERTO RICO
Financial Information and Operating Data Report
April 1, 2003

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COMMONWEALTH OF PUERTO RICO

Financial Information and Operating Data Report
April 1, 2003

INTRODUCTION

Geographic Location and Demography

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

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

Relationship with the United States

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

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

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

The official languages of Puerto Rico are Spanish and English.

Governmental Structure

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

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

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

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

Melba Acosta, Director of the Office of Management and Budget, took office on January 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.

Héctor Méndez-Vázquez, President of Government Development Bank for Puerto Rico (“Government Development Bank” or “GDB”), took office on July 1, 2002. At the time of his appointment, he was Executive Vice President and Treasurer of GDB, a position he had held since February 2001. He obtained a Bachelor’s degree in Business Administration with a major in Accounting and Management from the University of Puerto Rico, and a Master’s degree in Finance and International Trade from Inter American University of Puerto Rico. He is licensed as a Certified Trading Advisor by the Commodity Futures Trading Commission and as a Financial Advisor by the Puerto Rico Commissioner of Financial Institutions. He has vast experience in securities arbitrage, rate risk management, and future swaps and options. He began his professional career with The Chase Manhattan Bank in Puerto Rico in 1974 as an internal auditor. In 1977, he joined Banco Central Hispano Puerto Rico, where he occupied several management positions, including Executive Vice President and member of the Board of Directors.

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	7	21
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 services sectors of the economy and expanding and modernizing the island's infrastructure. Domestic and foreign investment have been stimulated by selective tax exemptions, development loans, and other financial and tax incentives. Infrastructure expansion and modernization have been to a large extent financed by bonds and notes issued by the Commonwealth, its public corporations, and municipalities. Economic progress has been aided by significant increases in the levels of education and occupational skills of the island's population.

The economy of Puerto Rico is closely linked to the United States economy. The following exogenous variables are affected by the United States economy: exports, direct investment, transfer payments, interest rates, inflation, and tourist expenditures. During fiscal year 2002 (July 2001 through June 2002), approximately 89% of Puerto Rico's exports went to the United States mainland, which was also the source of approximately 50% of Puerto Rico's imports. In fiscal year 2002, Puerto Rico experienced an $18.2 billion positive merchandise trade balance.

Puerto Rico enjoyed almost two decades of economic expansion through fiscal year 2001. 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 value of the United States dollar, increases in the level of federal transfers, a significant expansion in construction investment driven by infrastructure projects and private investment, primarily in housing, the relatively low cost of borrowing, and low oil prices. In fiscal year 2002, however, preliminary Planning Board figures indicate that the economy of Puerto Rico registered a decline of 0.2% in real gross product.

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

Puerto Rico is heavily dependent on oil imports for the production of electricity. As a result of the construction of two cogeneration plants, however, one of which is fueled by liquefied natural gas and the other by coal, Puerto Rico's dependence on oil imports for the production of electricity has been reduced from 99% to 72%.

Fiscal Years 1998 to 2002

Gross product in fiscal year 1998 was $35.1 billion ($32.4 billion in 1996 prices) and gross product in fiscal year 2002 was $45.2 billion ($35.2 billion in 1996 prices). This represents an increase in gross product of 28.7% from fiscal year 1998 to fiscal year 2002 (8.6% in 1996 prices).

Since fiscal year 1985, personal income, both aggregate and per capita, has increased consistently each fiscal year. In fiscal year 2002, aggregate personal income was $42.6 billion ($38.0 billion in 1996 prices)* and personal income per capita was $11,069 ($9,861 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 year 2002 were $8.9 billion, of which $6.8 billion, or 75.8%, 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 Department of Labor and Human Resources Household Employment Survey, average employment increased from 1,137,000 in fiscal year 1998 to 1,169,600 in fiscal year 2002. Average unemployment rate decreased from 13.6% in fiscal year 1998 to 12.0% in fiscal year 2002.

The following table shows the gross product for the five fiscal years ended June 30, 2002.

Commonwealth of Puerto Rico
Gross Product

	Fiscal Year Ended June 30				
	1998	**1999**	**2000**	**2001**	**2002**(1)
Gross product - $ millions(2)	$ 35,111	$ 38,281	$ 41,419	$ 44,173	$ 45,189
Real gross product - $ millions (1996 prices)	32,410	33,723	34,724	35,270	35,185
Annual percentage increase in real gross product (1996 prices)	3.2%	4.1%	3.0%	1.6%	(0.2%)
U.S. annual percentage increase in real gross product (1996 prices)	4.3%	4.1%	4.6%	1.8%	0.7%

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

Sources: Planning Board and Global Insight 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 year 2002 are preliminary until the revised figures are released.

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

Fiscal Year 2003

According to the Department of Labor and Human Resources Household Employment Survey, during the first eight months of fiscal year 2003, total monthly seasonally adjusted employment averaged 1,201,800 compared to 1,161,800 in the same period of fiscal year 2002, an increase of 3.4%. Notwithstanding this increase in average monthly employment, due to a higher labor participation rate and a significant increase in the civilian population aged 16 years and over, the unemployment rate increased to 12.0% during the first eight months of fiscal year 2003 from 11.8% during the same period of fiscal year 2002. Total employment for February 2003 was 1,203,000, an increase of 23,000 compared to the same month in 2002.

The Planning Board's real gross product forecast for fiscal year 2003, made in February 2003, projects an increase of 1.7%. The performance of the Puerto Rico economy during the balance of fiscal year 2003 and fiscal year 2004 may be adversely affected by a drawn out conflict with Iraq, the occurrence of terrorist acts and sustained high oil prices. To mitigate the adverse impact of sustained high oil prices, the Electric Power Authority has begun a hedging program with respect to a portion (around 8%) of its oil supply. The hedging contracts expire in June 2004.

Fiscal Year 2004

The Planning Board's current real gross product forecast for fiscal year 2004, released in February 2003, projects an increase of 2.5%.

As in the past, the economy of Puerto Rico is expected to follow the performance of the United States economy. Construction activity is expected to be a driving force for economic growth in the short and medium-term. For fiscal year 2004 public construction investment is expected to reach approximately $4.0 billion. See "Economic Performance by Sector – Construction" below.

Economic Development Program for the Private Sector

The Commonwealth's current economic development program for the private sector is based on the following four initiatives: (i) the enactment of laws in Puerto Rico providing tax benefits that will promote foreign and local investment and increased economic activity; (ii) the acceleration and simplification of the local permitting process; (iii) the reduction of the costs of doing business in Puerto Rico; and (iv) the amendment of Section 956 of the United States Internal Revenue Code of 1986, as amended (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 has enacted legislation extending certain benefits of its most recent tax incentive law, Act No. 135 of December 2, 1997, as amended (the "1998 Tax Incentives Act"), to all eligible businesses operating under previous tax incentives laws. These benefits include a 200% deduction for research and development expenses and worker training expenses, the ability to deduct as a current expense investments in machinery and equipment, and the ability to claim a tax credit equal to

25% of the purchase price of a product manufactured in the Commonwealth (in excess of a base amount) or 35% of the purchase price of a locally manufactured recycled product.

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

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

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

Acceleration and Simplification of Local Permitting Process

Another government initiative to promote economic activity involves the simplification of the permitting process. By simplifying the permitting process, the government has accelerated the granting of permits and reduced related costs. As part of this initiative, the Commonwealth has established a multi-agency center that handles, in a coordinated manner, the permitting process and allows the filing of a single application for all government permits required for a project. Furthermore, the government has developed a procedure that will allow agencies to conduct simultaneous public hearings in those instances when two or more agencies require them.

Reduction of the Costs of Doing Business

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

One of the costs of doing business which is high, particularly for the manufacturing industry, relative to competing jurisdictions, is the cost of electricity. The Commonwealth has sought to lower this cost by reducing Puerto Rico's dependence on oil for the production of electricity through the development of two cogeneration plants. See "Other Public Corporations – Electric Power Authority" under *Public Corporations*. The Electric Power Authority has commenced a hedging program with respect to a portion (about 8%) of its oil supplies to lessen the impact that the volatility of oil prices may have on the cost of electricity. Oil price hedging contracts currently in effect expire in June 2004.

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 amend Section 956 of the Code to provide for a new and permanent tax regime applicable to U.S. based businesses that have operations in the Commonwealth or other U.S. possessions. 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 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 year 2002 averaged 1,169,600. Unemployment, although at relatively low historical levels, remains above the United States average. Average unemployment rate decreased from 13.6% in fiscal year 1998 to 12.0% in fiscal year 2002.

The following table presents annual statistics of employment and unemployment for fiscal year 1998 through fiscal year 2002, and monthly statistics for July 2002 to February 2003.

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)		
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
2002	1,330	1,170	160	12.0
Fiscal Year 2003		(Seasonally Adjusted)		
July	1,363	1,181	183	13.4%
August	1,374	1,205	169	12.3
September	1,373	1,207	166	12.1
October	1,362	1,206	156	11.5
November	1,357	1,204	153	11.3
December	1,354	1,183	171	12.6
January	1,378	1,225	153	11.1
February	1,367	1,203	164	12.0

(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 year 1998 and 2002, 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, 2002.

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

	Fiscal Year Ended June 30				
	1998	**1999**	**2000**	**2001**	**2002**(1)
Manufacturing	$22,994	$23,312	$24,079	$28,806	$29,991
Services(2)	20,682	22,435	24,920	26,748	27,168
Government(3)	5,251	5,530	5,478	5,992	6,295
Transportation, communication and public utilities	3,978	4,032	4,237	4,688	5,078
Agriculture, forestry and fisheries	437	336	529	453	424
Construction(4)	1,482	1,668	1,875	1,800	1,842
Statistical discrepancy	(739)	529	585	824	317
Total gross domestic product(5)	54,086	57,841	61,702	69,312	71,115
Less: net payment abroad	(18,976)	(19,560)	(20,283)	(25,139)	(25,926)
Total gross product(5)	$35,111	$38,281	$41,419	$44,173	$45,189

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

Source: Planning Board

The following table presents annual statistics of average employment by sector for the five fiscal years ended June 30, 2002.

Commonwealth of Puerto Rico
Non-Farm Payroll Employment by Economic Sector[(1)]
(thousands of persons)

	Fiscal Year Ended June 30				
	1998	**1999**	**2000**	**2001[(2)]**	**2002[(2)(3)]**
Manufacturing	150	146	142	140	131
Services[(4)]	444	459	480	491	484
Government[(5)]	310	302	286	280	278
Transportation, communication and public utilities	27	29	35	34	33
Construction[(6)]	59	66	71	74	73
Total[(7)]	990	1,002	1,014	1,019	999

(1) The figures presented in this table are based on the Current Employment Statistics Survey (Establishment Survey) prepared by the Bureau of Labor and Statistics of the Department of Labor and Human Resources. There are numerous conceptual and methodological differences between the Current Population Survey (Household Survey) and the Establishment Survey. 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. The Establishment Survey excludes the self-employed and agriculture employment. In Puerto Rico, self-employment represents around 14% of total employment, while representing around 6% of total employment in the United States.

(2) Each year, the Establishment Survey revises its sample-based estimates to reflect more current counts of employment. This process is known as benchmarking. Preliminary revised data for fiscal year 2002 indicates that total payroll employment was 984,800 or 2.8% lower than the total for the previous year. The figure represents a downward adjustment of 14,600 jobs from the previous estimate of 999,400 that appears in the table above. According to the revised data, employment in the government sector was 288,700, which represents an upward adjustment of 10,300 jobs and employment in the private sector was 696,100, which represents a downward adjustment of 25,000 jobs. Revised data for fiscal year 2001 indicates that total payroll employment was 1,013,200 or 0.1% lower than the total for the previous year. This figure represents a downward adjustment of 6,200 jobs from the previous estimates that appear in the table above. For fiscal year 2001, the revision in the figures reflects an upward adjustment in government employment of 2,400 jobs and a downward adjustment in private sector employment of 8,600 jobs. The revisions described above are in line with what would be expected in times of slow economic growth. This year's benchmark revision introduces a new classification system, the North American Industry Classification System (NAICS), which substitutes the Standard Industrial Classification (SIC). NAICS represents one of the most profound changes for statistical programs focusing on emerging economic activities. At present, the payroll employment analysis on a sector by sector basis is restricted to 2001 and 2002, since the Department of Labor and Human Resources has not yet released the revised numbers on a sector by sector basis reflecting the new NAICS codes for prior years.

(3) Preliminary.

(4) Includes wholesale and retail trade, finance, insurance and real estate, tourism, and other services.

(5) Includes the Commonwealth, its municipalities and the federal government; excludes public corporations.

(6) Includes mining.

(7) Adjusted for rounding.

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

Manufacturing

Manufacturing is the largest sector of the Puerto Rico economy in terms of gross domestic product. The Planning Board estimates that in fiscal year 2002 manufacturing generated $30.0 billion, or 42.2%, of gross domestic product. During the first eight months of fiscal year 2003, payroll employment for the manufacturing sector was 118,300, a decrease of 4.0% compared with the same period for fiscal year 2002, with most of the job losses occurring in labor-intensive industries. Most of the island's manufacturing output is shipped to the United States mainland, which is also the principal source of 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 December 2002, the average hourly manufacturing wage rate in Puerto Rico was 67.0% 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 large 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, 2002.

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

	Fiscal Year Ended June 30				
	1998	**1999**	**2000**	**2001**	**2002**(1)
Pharmaceuticals	$13,192	$12,913	$13,580	$16,630	$17,741
Machinery and metal products:					
Machinery, except electrical	1,131	1,847	2,031	3,320	3,582
Electrical machinery	1,506	1,410	1,525	1,739	1,792
Professional and scientific instruments	1,596	1,697	1,758	1,874	1,888
Other machinery and metal products	351	377	341	315	286
Food products	2,073	1,910	1,912	2,121	2,133
Other chemical and allied products	941	898	835	805	836
Apparel	610	609	610	569	463
Other(2)	1,595	1,651	1,486	1,433	1,271
Total gross domestic product of manufacturing sector(3)	$22,994	$23,312	$24,079	$28,806	$29,991

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

Source: Planning Board

The following table sets forth manufacturing employment by industry group as of March for the last five years.

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

	As of March				
Industry Group	**1998**	**1999**	**2000**	**2001**	**2002[(1)]**
Apparel and related products	19,039	18,349	16,770	15,304	12,757
Food and related products	17,816	16,852	15,182	14,877	14,696
Electrical machinery, equipment and supplies	22,728	20,254	19,394	18,883	16,480
Chemicals and related products (includes pharmaceuticals)	27,524	26,899	28,714	29,169	31,177
Professional and scientific instruments	15,105	14,542	14,818	15,068	14,733
Machinery, except electrical and transportation equipment	3,068	3,790	3,593	3,457	2,817
Petroleum refining and related industries; rubber and miscellaneous plastic products	5,994	5,970	6,197	5,690	5,266
Leather and leather products	5,834	4,749	3,982	2,884	1,847
Paper and related products; printing, publishing and related industries	8,698	9,418	9,536	9,078	8,714
Metal products	6,159	6,390	6,719	7,672	6,677
Stone, clay and glass products	5,217	5,509	5,929	5,888	5,001
Lumber and wood products; furniture and fixtures	3,538	3,446	3,343	3,597	3,593
Textile mill products	3,282	2,827	2,010	2,081	1,279
Tobacco products	1,285	1,297	1,254	1,438	1,437
Miscellaneous manufacturing industries	3,558	3,125	3,114	2,684	2,549
Total	148,845	143,417	140,555	137,770	129,023

(1) These figures are based on the Current Employment Statistics Survey (Establishment Survey) prepared by the Bureau of Statistics of the Department of Labor and Human Resources. There are numerous conceptual and methodological differences between the Census of Manufacturing, the "benchmark" on Employment, Hours and Earnings, and the Establishment Survey. The Establishment Survey reflects information collected from payroll records of a sample of business establishments.

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 19,822 from March 1998 to March 2002, other indicators of the manufacturing sector suggest that manufacturing production increased. Average weekly hours worked increased 2.5% from fiscal year 1998 to fiscal year 2002. The reduction in manufacturing employment occurred during a period of significant expansion in real manufacturing output, as reflected in the growth of exports. This trend suggests a significant increase in manufacturing investment and productivity. Most of the decreases in employment have been concentrated in labor intensive industries, particularly apparel, textiles, tuna canning, and leather products.

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

Employment 2,500 and over	Product
Baxter International, Inc.	Surgical Instruments
Bristol Myers Squibb Company	Pharmaceuticals
Eaton Corporation	Electronic Instruments
GE Power Systems	Electronic Instruments
Johnson and Johnson	Surgical Supplies
Pfizer Inc.	Pharmaceuticals
Sara Lee Corp.	Apparel

Employment 1,000 to 2,499	Product
Abbott Laboratories Inc.	Pharmaceuticals
Astra Zeneca PLC	Pharmaceuticals
Edwards Lifesciences LLC	Surgical Instruments
Hewlett-Packard Co.	Computer Devices
Hubell Incorporated	Electrical Instruments
McAndrews & Forbes Holdings, Inc.	Tobacco Products
Medtronics, Inc.	Surgical Instruments
Merck & Co., Inc.	Pharmaceuticals
Nypro Inc.	Computer Devices
Ocular Science	Ophthalmic Goods
Pharmacia	Pharmaceuticals
Pharmacia Up-John Co.	Pharmaceuticals
Propper International Co.	Apparel
Schering Plough Corporation	Pharmaceuticals
TYCO, Int.	Communications Equipment
Wyeth	Pharmaceuticals

Employment 500 to 999	Product
Advanced Medical Optics, Inc.	Ophthalmic Goods
B. Braun Medical Inc.	Surgical and Medical Instruments
Becton-Dickinson & Co.	Scientific Instruments
Bumble Bee Seafoods	Food
Cardinal Health, Inc.	Pharmaceuticals
Conagra, Inc.	Food
Dean Foods Company	Plastic Bottles
Eli Lilly and Company	Pharmaceuticals
Guidant Corp.	Medical Instrumets
Hamilton Sundstrand	Electrical Instruments
Ingersoll-Rand Co.	Electrical Instruments
Novartis-Holding AG	Ophthalmic Goods
Pall Corporation	Filters
Procter & Gamble Co. (The)	Pharmaceuticals
SmithKline Beecham	Pharmaceuticals
Solectron Corp.	Semiconductor Devices
Unilever PLC	Consumer Products
United States Surgical Corp.	Surgical Instruments

Employment 200 to 499	Product
Amgen Inc.	Pharmaceuticals
Aramark	Apparel
Bacardí Limited	Distilled & Blended Liquors
Bard, Inc.	Surgical Instruments
Cardinal Healthcare	Packaging Products
Carolina Underwear Co.	Apparel
Checkpoint Systems Inc.	Electronic Instruments
Coca Cola Company (The)	Food
Colgate-Palmolive Company	Consumer Products
Corning Cable Systems LLC	Electronic Components
Curtis Instruments Inc.	Electrical Instruments
Dooney & Bourke Inc.	Leather
E.I. DuPont de Nemours & Co.	Agricultural Chemicals
Emerson Electric Co.	Electronic Instruments
Espace Europee de Lenterprise	Pharmaceuticals
Essilor International	Ophthalmic Goods
I C N Pharmaceuticals Inc.	Pharmaceuticals
ICI Omicron B.V.	Chemicals
Intercandy B.V. World Trade Center	Plastics
Ivax Pharmaceuticals Caribe, Inc.	Pharmaceuticals
Jostra Med Izintechnick AG	Surgical Instruments
JTI, SA	Food
Kendall Co.	Surgical Supplies
Lawson Mardon Wheaton	Glass and Plastics
Loctite Corporation	Chemicals
Lutron Electronics Co. Inc.	Electronic Instruments
Millipore Corporation	Surgical Instruments
Molex Inc.	Electrical Instruments
Owens Illinois Inc.	Glass and Plastics
Packaging Coordinators Inc.	Packaging Products
PepsiCo	Food
Praxair Inc.	Chemicals
Rocky Shoes & Boots	Footwear
Signal Transformer Co. Inc.	Electrical Instruments
St. Jude Medical Inc.	Surgical Instruments
Standard Motor Products Inc.	Motor Vehicle Parts
Storage Technology, Corp.	Electronics
Symmetricom Inc.	Electronic Equipment
Thomas & Betts Corporation	Electronic Equipment
Timberland Company (The)	Footwear

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

Source: PRIDCO, Office of Economic Research (as of March 2003)

Services

Puerto Rico has experienced significant growth in the services sector (including finance, insurance, real estate, wholesale and retail trade, tourism and other services) in terms of both income and employment over the past decade, showing a favorable trend as compared with certain other industrialized economies. During the period between fiscal years 1998 and 2002, the gross domestic product in this sector increased at an annual average rate of 7.1%, while employment increased at an annual average rate of 2.2%. The development of the services sector has shown a strong interaction with 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 year 2002, services generated $27.2 billion of gross domestic product, or 38.2%, of the total. Service employment grew from 444,000 in fiscal year 1998 to 484,000 in fiscal year 2002, a cumulative increase of 8.9%, which increase was greater than the 0.9% cumulative growth in total employment over the same period. Wholesale and retail trade, finance, insurance and real estate experienced significant growth in fiscal years 1998 to 2002, as measured by gross domestic product. Gross domestic product in wholesale and retail trade increased from $7.3 billion in fiscal year 1998 to $8.7 billion in fiscal year 2002. In finance, insurance and real estate, gross domestic product increased from $7.7 billion in fiscal year 1998 to $11.3 billion in fiscal year 2002. There are sixteen commercial banks and trust companies currently operating in Puerto Rico. Total assets of these institutions as of December 31, 2002 were $90.5 billion. As of December 31, 2002, there were thirty-five international banking entities operating in Puerto Rico licensed to conduct offshore banking transactions with total assets of $50.5 billion.

The following tables set forth gross domestic product and employment for the services sector for the five fiscal years ended June 30, 2002.

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

	Fiscal Year Ended June 30				
	1998	**1999**	**2000**	**2001**	**2002**(1)
Wholesale and retail trade	$ 7,287	$ 8,112	$ 8,340	$ 8,656	$ 8,718
Finance, insurance and real estate	7,672	8,183	9,977	11,116	11,288
Other services(2)	5,723	6,140	6,603	6,976	7,163
Total(3)	$20,682	$22,435	$24,920	$26,748	$27,168

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

Source: Planning Board

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

	Fiscal Year Ended June 30				
	1998	1999	2000	2001	2002[1]
Wholesale and retail trade	200	205	217	222	218
Finance, insurance and real estate	47	48	49	48	47
Other services[2]	197	205	215	221	219
Total[3]	444	459	480	491	484

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

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

Hotels and Related Services - Tourism

Total visitors' expenditures accounted for 3.5% of the island's gross domestic product in fiscal year 2002, compared to 3.9% in fiscal year 2001. Visitors' expenditures and the number of visitors to the island had grown consistently from 1985 to 1998. In fiscal year 1999, however, the number of visitors to the island and visitors' expenditures decreased, due in part to the effect of Hurricane Georges, which struck the island in September 1998. During fiscal years 2000 and 2001, the number of visitors to the island increased to 4.6 million and 4.9 million, respectively, and visitors' expenditures increased to $2.4 billion and $2.7 billion, respectively.

In fiscal year 2002, in the aftermath of the terrorist acts of September 11, 2001, the number of visitors to the island decreased to 4.4 million, visitors' expenditures decreased to $2.5 billion and the number of persons registered in tourist hotels decreased 3.4%. The average occupancy rate in tourist hotels during fiscal year 2002 was 64.3% compared to 70.0% in fiscal year 2001. The average number of rooms rented in tourist hotels decreased 4.9% during fiscal year 2002 compared with fiscal year 2001. The average number of rooms available in tourist hotels increased 3.3% during fiscal year 2002 compared with fiscal year 2001.

During the first seven months of fiscal year 2003, the number of persons registered in tourist hotels was 974,400, an increase of 14.8% over the number of persons registered during the same period of fiscal year 2002. The average occupancy rate in tourist hotels during the first seven months of fiscal year 2003 was 64.8% compared to 59.7% in the same period of fiscal year 2002. The average number of rooms rented in tourist hotels increased 13.2% during the first seven months of fiscal year 2003 compared with the same period of fiscal year 2002. The average number of rooms available in tourist hotels increased 4.2% during the first seven months of fiscal year 2003 compared with the same period of fiscal year 2002, representing openings of new hotels and hotel expansions. During the first eight months of fiscal year 2003, hotels comprising 686 new hotel rooms have opened and, as of March 2003, several hotels, representing 1,613 additional rooms, are under various stages of development or construction.

San Juan is 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, 2002.

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)**
1998	1,013,800	1,274,700	2,382,400	4,670,900	$ 2,232.9
1999	1,042,000	1,197,200	1,982,100	4,221,300	2,138.5
2000	1,050,100	1,224,600	2,291,300	4,566,000	2,387.9
2001	1,186,800	1,356,600	2,364,400	4,907,800	2,728.1
2002(3)	1,147,800	1,277,000	1,939,300	4,364,100	2,486.4

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

Sources: Puerto Rico Tourism Company and the Planning Board

Government

The government sector of Puerto Rico plays an important role in the economy. In fiscal year 2002, government accounted for $6.3 billion of Puerto Rico's gross domestic product, or 8.9%, of the total. The government is also a significant employer, providing jobs for 278,000 workers, or 27.8%, of total non-farm payroll employment in fiscal year 2002. See footnote 2 in the table appearing on page I-11, however, for a discussion of the adjustment to these numbers based on the most recent benchmark revision. Government sector employment includes federal government employees but excludes the employees of public corporations, which are 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 non-farm payroll employment, measured according to the payroll survey, has diminished from 36.4% in fiscal year 1980, to 33.6% in fiscal year 1990, and to 28.2% in fiscal year 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; salary increases are contingent on the availability of budgeted revenues; employees cannot be required to become union members and pay union dues; and collective bargaining negotiations cannot occur in an election year.

Transportation

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

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

The island's major cities are connected by a modern highway system, which, as of December 31, 2001, totaled approximately 4,607 miles. The highway system comprises 228 miles of primary urban system highways, 379 miles of primary rural system highways and 4,000 miles of secondary and tertiary highways and roads.

The Commonwealth is conducting a request for proposal process to select a private company to develop, construct and operate a world class transshipment facility in the south coast of Puerto Rico, to be called the Port of the Americas. This state-of-the-art facility will handle Post-Panamax vessels with a capacity of more than 6,000 TEU's (Twenty-Foot Equivalent Unit cargo trailers). The Port of the Americas Authority, created by legislation, will select and negotiate with the developer and operator of the project. GDB has provided a $10 million line of credit earmarked for the initial environmental and feasibility studies, and it is anticipated that an additional $31.5 million will be made available to the Authority in fiscal year 2004 to make initial infrastructure improvements for the project.

In December 2001 and January 2002, the preliminary environmental impact statements for this project were filed. Currently, Port of Ponce piers 4 through 7 are undergoing improvements as part of the initial stages of Port of the Americas development. The Authority expects the permits for this project to be granted by the end of 2003. Construction is expected to begin in 2004, and partial operation of the Port of the Americas could begin as early as 2005. In connection with this project, PRIDCO selected an international real estate brokerage firm to attract businesses to the value-added areas to be developed near the Port of the Americas.

Construction

The construction industry has experienced substantial real growth since fiscal year 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 year 1998 through fiscal year 2002, construction investment increased 27.5%. The total value of construction permits increased 63.9% for the same five year period. The strength of public investment has been an important component in the significant expansion of construction investment. During fiscal year 2002, approximately 36.7% of the total investment in construction was related to public projects. In fiscal year 2002, the average employment in the construction sector was 71,200, a decrease of 2.0% from fiscal year 2001.

During the first eight months of fiscal year 2003, the total value of construction permits increased 32.7%, compared with the same period in fiscal year 2002. Total sales of cement, including imports, increased 5.3% during the first eight months of fiscal year 2003 in comparison with the same period of fiscal year 2002. The average payroll employment in the construction sector during the first eight months of fiscal year 2003 was 65,800.

For fiscal year 2004 approximately $4.0 billion is expected to be invested in public improvements. Public investment will be primarily in housing, new schools (and school reconstruction programs), water projects and other infrastructure projects to be undertaken by the Aqueduct and Sewer Authority, Convention Center District Authority, Electric Power Authority, Highway and Transportation Authority, Infrastructure Financing Authority, Ports Authority, Public Buildings Authority, Special Communities Perpetual Trust, and the University of Puerto Rico.

Agriculture

The Department of Agriculture and related agencies have directed their efforts at increasing and improving local agricultural production, increasing efficiency and quality of produce, and stimulating the consumption of locally produced agricultural products. During fiscal year 2002, gross income from agriculture was $724.1 million, an increase of 1.2% in comparison with fiscal year 2001. 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 issued by financial institutions to provide financing to agricultural businesses. Subsequent legislation imposed an aggregate annual limit of $15 million on the investment tax credits available under Act No. 225.

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

Higher Education

During the 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. During the 1990's, college attendance and college attendance as a percentage of the college age population continued to increase.

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

Commonwealth of Puerto Rico
Trend in College Enrollment

	Commonwealth of Puerto Rico			Mainland United States		
Academic Year	**Population 18-24 Years of Age**	**Higher Education Enrollment**	**Percent(1)**	**Population 18-24 Years of Age**	**Higher Education Enrollment**	**Percent(1)**
1970	341,448(2)	57,340	16.8%	23,714,000(2)	8,580,887	36.2%
1980	397,839(2)	130,105	32.7	30,022,000(2)	12,096,895	40.3
1990	417,636(2)	156,147	37.4	26,961,000(2)	13,819,000	51.3
2000	428,892(2)	176,015	41.0	27,143,455(2)	15,312,000	56.4
2001	424,760(3)	184,126	43.3	27,282,000(3)	15,442,000	56.6
2002	421,440(4)	190,776	45.3	27,643,000(4)	15,608,000	56.5

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

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

The University of Puerto Rico, the only public university in Puerto Rico, includes eleven campuses located throughout the island. The University's total enrollment for academic year 2001-2002 was 68,830 students. The Commonwealth is legally bound to appropriate annually for the University of Puerto Rico an amount equal to 9.60% of the average annual revenue from internal sources for each of the two fiscal years immediately preceding the current fiscal year.

In addition to the University of Puerto Rico, there are 37 private institutions of higher education located in Puerto Rico. Such institutions have a 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 promoting investment in Puerto Rico.

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

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

Tourism Incentives Program

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

As part of the incentives to promote the tourism industry, the Commonwealth established the Tourism Development Fund as a subsidiary of GDB with the authority to (i) make investments in or provide financing to entities that contribute to the development of the tourism industry and (ii) provide financial guarantees for financing hotel development projects. As of February 2003, the Fund's aggregate capital was $106.8 million. To date, the Fund has provided financial guarantees for loans made or bonds issued to finance the development of fifteen hotel projects representing approximately 3,400 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 is subject to a cap based on the Section 936 Corporation's possession income for an average adjusted base period ending on October 14, 1995. The Section 936 credit is eliminated for taxable years commencing after 2005.

Controlled Foreign Corporations

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

CFCs operate under transfer pricing rules for intangible income that are different from those applicable to corporations operating under 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. A proposal to amend the Code in this regard put forth by the Governor of Puerto Rico has broad bi-partisan support in both the U.S. Senate and the House of Representatives.

The proposal would 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; and (iv) 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 the Commonwealth or a possession of the United States. "Qualified Income" would be limited to that portion of the CFC's 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.

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

DEBT

Public Sector Debt

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

The following table presents a summary of public sector debt as of December 31, 2002 and as adjusted by the issuance of $272,717,418 Puerto Rico Public Buildings Authority Government Facilities Revenue Refunding Bonds, Series H (the "Forward PBA Refunding Bonds"), which were sold in October 2002 for delivery in April 3, 2003, and $95,295,000 Commonwealth Public Improvement Refunding Bonds, Series 2003, which were sold in August 2002 for delivery in April 2, 2003 (the "Forward Commonwealth Refunding Bonds" and together with the Forward PBA Refunding Bonds, the "Forward Delivery Refunding Bonds"), and the refunding of the bonds refunded with the proceeds thereof. Excluded from the table is debt not primarily payable from either Commonwealth or municipal taxes, Commonwealth appropriations or rates charged by public corporations for services or products. Also excluded from the table is debt the inclusion of which would reflect double counting, including, but not limited to $1,404,270,000 of outstanding bonds issued by the Municipal Finance Agency to finance its purchase of bonds of Puerto Rico municipalities, and $634,512,000 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)

	December 31, 2002	As Adjusted by the inclusion of the Forward Delivery Refunding Bonds and the exclusion of the bonds refunded with the proceeds thereof
Puerto Rico direct debt(1)	$ 7,176,218	$ 7,170,768
Municipal debt	1,849,919	1,849,919
Public corporations debt		
Puerto Rico guaranteed debt(2)	609,392	609,392
Debt supported by Puerto Rico appropriations or taxes(3)	13,804,558	13,793,155
Other non-guaranteed debt(4)	7,021,901	7,021,901
Total public corporations debt	21,435,851	21,424,448
Total public sector debt	$30,461,988	$30,445,135

(1) Includes $34,775,000 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") (such indebtedness is referred to as "Transferred CRUV Debt"). Also includes $37,627,000 of indebtedness originally incurred by Housing Bank and subsequently assumed by the Commonwealth in connection with the reorganization of Housing Finance Corporation. This amount excludes any Commonwealth general obligation bonds that have been refunded with proceeds that were invested in guaranteed investment contracts or other securities not eligible to effect a legal defeasance, even though such bonds will be considered outstanding under their respective authorizing resolutions and for purposes of calculating the Commonwealth's constitutional debt limitation.
(2) Consists of $475,013,000 of bonds issued by the Aqueduct and Sewer Authority and $134,379,000 of State Revolving Fund Loans, incurred under various federal water laws. Excludes Public Buildings Authority bonds and notes in the principal amount of $2,097,930,459 as of December 31, 2002 and $2,086,527,877 as of April 3, 2003, 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 Housing Finance Authority, the Infrastructure Financing Authority, the Public Buildings Authority and the Public Finance Corporation.
(4) Includes $1,074,180,000 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. Excludes $1,171,200,000 of Children's Trust bonds which are payable solely from the payments to be received pursuant to the tobacco litigation settlement.

Source: Government Development Bank

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

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

The following table presents the debt service requirements for Commonwealth general obligation bonds outstanding as of December 31, 2002 and bonds of the Aqueduct and Sewer Authority for which debt service payments are being made under the Commonwealth guaranty.

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

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

Fiscal Year Ending June 30	Outstanding Bonds Principal	Interest	Total Debt Service	PRASA Bonds Debt Service	Grand Total
2003	$ 98,006	$ 373,196	$ 471,202	$ 32,745	$ 503,947
2004	102,608	378,114	480,722	30,125	510,847
2005	168,955	311,765	480,720	30,127	510,848
2006	152,824	327,901	480,724	30,121	510,845
2007	136,443	344,275	480,719	30,126	510,845
2008	173,463	316,505	489,967	30,131	520,098
2009	203,990	285,968	489,958	30,123	520,081
2010	216,585	273,510	490,095	29,984	520,079
2011	226,497	261,151	487,648	29,928	517,576
2012	244,515	242,927	487,442	30,127	517,569
2013	258,180	229,260	487,440	30,128	517,567
2014	253,933	235,534	489,466	30,125	519,591
2015	266,075	223,392	489,467	30,126	519,593
2016	279,125	210,348	489,473	30,121	519,594
2017	292,707	196,760	489,466	30,122	519,588
2018	307,940	182,497	490,437	30,126	520,563
2019	339,786	150,660	490,446	30,125	520,570
2020	396,015	124,550	520,565	0	520,565
2021	265,200	103,561	368,761	0	368,761
2022	198,110	89,996	288,106	0	288,106
2023	163,970	80,064	244,034	0	244,034
2024	148,645	71,881	220,526	0	220,526
2025	156,250	64,268	220,518	0	220,518
2026	155,570	56,191	211,761	0	211,761
2027	163,480	48,280	211,760	0	211,760
2028	171,895	39,866	211,761	0	211,761
2029	180,770	30,995	211,765	0	211,765
2030	190,285	21,479	211,764	0	211,764
2031	200,000	11,762	211,762	0	211,762
2032	31,520	1,550	33,070	0	33,070
	$6,143,340	$5,288,206	$11,431,545	$ 514,410	$11,945,956

* Totals may not add due to rounding.

Sources: Government Development Bank and Department of the Treasury

Commonwealth Guaranteed Debt

As of December 31, 2002, $2,097,930,459 of Commonwealth guaranteed bonds of the Public Buildings Authority were outstanding. Maximum annual debt service on these bonds is $176,780,312 in fiscal year ending June 30, 2011, with their final maturity being July 1, 2036. No payments under the Commonwealth guaranty have been required to date for bonds of the Public Buildings Authority.

As of December 31, 2002, $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 December 31, 2002, the Commonwealth had guaranteed the outstanding Series 1995 revenue bonds of the Aqueduct and Sewer Authority in the aggregate principal amount of $332,710,000. 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 December 31, 2002, aggregate principal amounts outstanding on these obligations were $142,303,000 and $134,379,000, respectively.

Trends of Public Sector Debt

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 certain fiscal years, however, public sector debt has increased at a rate greater than the growth of gross product. For instance, public sector debt increased by 12.1% during fiscal year 2001, compared to a 6.7% increase in gross product for the same fiscal year. The increase in the rate of growth of public sector debt during fiscal year 2001 was in part due to the issuance during such fiscal year of $1,092,550,000 of bonds of Infrastructure Financing Authority and $397,005,000 of bonds of Children’s Trust, 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 year 2001 was 5.9%. During fiscal year 2002, public sector debt increased by 10.5%, compared to a 2.3% increase in gross product for the same fiscal year.

As of December 31, 2002, outstanding short-term debt, relative to total debt, was 7.1%.

The following table shows the trends in gross product (in current dollars) and public sector debt for the five fiscal years ended June 30, 2002 and the first six months of fiscal year 2003.

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
1998………………..	20,759	1,563[(3)]	7.0	22,322	14.4	35,111	8.6
1999………………..	20,905	1,773[(3)]	7.8	22,678	1.6	38,281	9.0
2000………………..	21,620	2,202[(3)]	9.2	23,822	5.0	41,419	8.2
2001[(4)]……………..	23,436	2,871[(5)]	10.9	26,307	10.4	44,173	6.7
2002[(6)]……………..	27,818	1,250	4.3	29,068	10.5	45,189	2.3
December 31, 2002[(7)]	28,378	2,084	6.8	30,462	4.8	N/A	N/A

* Totals may not add due to rounding.
(1) In current dollars.
(2) Obligations (other than bonds) issued with an original maturity of three years or less and lines of credit with a remaining maturity of three years or less are considered short-term debt.
(3) Does not include the tax and revenue anticipation notes that were outstanding at the close of the indicated fiscal years because prior to the end of said fiscal years sufficient funds had been set aside for the payment of such notes in full.
(4) Excludes $397.0 million of bonds of Children's Trust outstanding on this date. If these bonds had been included, the rate of growth of public sector debt for fiscal year 2001 would have been 12.1%. Includes $1,092.5 million of bonds of Infrastructure Financing Authority outstanding on this date, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.
(5) Includes a $164 million line of credit from GDB to the Secretary of the Treasury whose proceeds were applied to pay debt service on general obligation bonds in lieu of funds available therefor in the General Fund.
(6) Excludes $390.1 million of bonds of Children's Trust outstanding on this date. Includes $1,081.5 million of bonds of Infrastructure Financing Authority outstanding on this date, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.
(7) Excludes $1,171.2 million of bonds of Children's Trust outstanding on this date. Includes $1,074.2 million of bonds of Infrastructure Financing Authority outstanding on this date, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.

Source: Government Development Bank

The following table shows the trend of public sector debt by major category for the five fiscal years ended June 30, 2002 and for the first six months of fiscal year 2003.

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)	
1998	4,819	0(3)	4,819(4)	974	57	1,030	14,967	1,506	16,474	20,760	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	1,773(3)	22,678(4)
2000	5,349	0(3)	5,349(4)	1,396	68	1,464	14,875	2,134	17,008	21,620	2,202(3)	23,822(4)
2001	5,674	164(5)	5,838(4)	1,468	164	1,632	16,294(6)	2,543	18,837	23,436	2,871	26,307(4)
2002	6,024	91	6,115	1,618	178	1,796	20,176(7)	982	21,158	27,818	1,250	29,068
December 31, 2002	6,360	816	7,176	1,666	184	1,850	20,352(8)	1,084	21,436	28,378	2,084	30,462

* Totals may not add due to rounding.
(1) Includes Commonwealth guaranteed debt.
(2) Obligations (other than bonds) issued with an original maturity of three years or less and lines of credit with a remaining maturity of three years or less are considered short-term debt.
(3) Does not include the tax and revenue anticipation notes which were outstanding at the close of the indicated fiscal years because prior to the end of said fiscal years sufficient funds had been set aside for the payment of such notes in full.
(4) Includes the Transferred CRUV Debt.
(5) Includes a $164 million line of credit from GDB to the Secretary of the Treasury the proceeds of which were applied to pay debt service on general obligation bonds in lieu of funds available therefor in the General Fund.
(6) Excludes $397.0 million original principal amount of bonds issued by Children's Trust. Includes $1,092.5 million original principal amount of bonds issued by Infrastructure Financing Authority, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.
(7) Excludes $390.1 million of bonds of Children's Trust outstanding on this date. Includes $1,081.5 million of bonds of Infrastructure Financing Authority outstanding on this date, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.
(8) Excludes $1,171.2 million original principal amount of bonds of Children's Trust. Includes $1,074.2 million of bonds of Infrastructure Financing Authority outstanding on this date, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.

Source: Government Development Bank

PUBLIC CORPORATIONS

In Puerto Rico, many governmental or quasi-governmental functions are performed by public corporations. These are governmental entities created by the Legislature with varying degrees of independence from the central government. Public corporations are generally created to perform a single function or a limited number of related functions. Most public corporations obtain revenues from rates charged for services or products, but many are subsidized to some extent by the central government. Most public corporations are governed by boards appointed by the Governor with the advice and consent of the Senate, but some public corporations are subsidiaries of departments of the central government. Capital improvements of most of the larger public corporations are financed by revenue bonds under trust agreements or bond resolutions or notes under loan agreements. The following table presents the outstanding bonds and notes of certain of the public corporations as of December 31, 2002 ("notes" as used in this section refers primarily to certain types of non-bonded debt regardless of maturity). Debt of certain other public corporations is excluded from this table because such debt is payable primarily from funds or grants provided by the Federal government or is payable from sources other than Commonwealth appropriations or taxes or revenues of public corporations, or is payable from revenues derived from private sector services or products, such as industrial development bonds. Also excluded from this table is debt of certain public corporations the inclusion of which would reflect double counting. No deductions have been made in the table for debt service funds and debt service reserve funds. More detailed information about the major public corporations is presented in the following sections.

Commonwealth of Puerto Rico
Outstanding Debt
December 31, 2002
(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	$ 475,013	$ 0	$ 475,013	$ 134,379	$ 29,449[(1)]	$ 163,828	$ 609,392	$ 29,449[(1)]	$ 638,841
Electric Power Authority	0	4,630,889	4,630,889	0	125,000	125,000	0	4,755,889	4,755,889
Highway and Transportation Authority	0	4,430,349	4,430,349	0	370,121	370,121	0	4,800,470	4,800,470
Housing Finance Authority	0	786,858	786,858	0	181,162	181,162	0	968,020	968,020
Industrial Development Company	0	163,316	163,316	0	84,917	84,917	0	248,233	248,233
Infrastructure Financing Authority	0	2,018,935[(2)]	2,018,935	0	9,816	9,816	0	2,028,751	2,028,751
Public Buildings Authority	2,097,930	0	2,097,930	0	0	0	2,097,930	0	2,097,930
Public Finance Corporation	0	4,273,849[(3)]	4,273,849	0	0	0	0	4,273,849[(3)]	4,273,849
Ports Authority	0	87,335	87,335	0	267,843	267,843	0	355,178	355,178
University of Puerto Rico	0	450,463	450,463	0	446	446	0	450,909	450,909
Others	0	0	0	0	817,781	817,781	0	817,781	817,781
Total[(4)]	$2,572,943	$16,841,994	$19,414,937	$ 134,379	$1,886,535	$2,020,914	$2,707,322	$18,728,529	$21,435,851

(1) Principal of and interest on this debt is reimbursed from Commonwealth appropriations.
(2) Includes $1,074.2 million of outstanding bonds of Infrastructure Financing Authority, which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.
(3) Payable primarily from Commonwealth appropriations.
(4) Excludes accretion of interest from the respective issuance dates on capital appreciation bonds. Also excludes $1,171.2 million original principal amount of Children's Trust Tobacco Settlement Asset-Backed Bonds, Series 2002, issued on October 10, 2002, which will be repaid from payments made by certain tobacco companies under a master settlement agreement. See "Other Public Corporations" below.

Source: Government Development Bank

Government Development Bank for Puerto Rico

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

As of December 31, 2002, $972,261,000 of bonds and notes of GDB were outstanding. As of said date, GDB also had $1,894,448,000 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 December 31, 2002.

Act No. 271 of November 21, 2002, requires GDB to make a capital contribution of $500 million to the Special Communities Perpetual Trust. This contribution shall be withdrawn from GDB's equity capital and disbursed gradually to the Trust, as required. See "Other Public Corporations – Special

Communities Perpetual Trust" below. GDB expects to replenish its equity capital with future operating net income.

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

GDB has the following principal subsidiaries:

Housing Finance Authority (formerly known as Housing Finance Corporation) was originally created in November 1977 to provide needed rental-housing units and stimulate the construction industry under federally subsidized programs. Effective February 8, 2002, the Housing Finance Corporation became the Housing Finance Authority and the Housing Bank and Finance Agency was dissolved and its powers transferred to the Authority. The Authority is engaged in insuring and servicing mortgages originated by the Urban Renewal and Housing Corporation. It also provides financing for qualified rental housing units, stimulates the construction industry under federally subsidized programs and provides interim financing for low-income housing projects and single-family homeownership programs. Housing Finance Corporation had issued tax-exempt revenue bonds and notes to finance the construction of housing units approved for federal rental subsidies and to finance home ownership of single family housing units, which bonds and notes are now limited obligations of the Housing Finance Authority payable solely from revenues collected in respect to such housing units. The Federal Housing Administration has insured mortgages on certain of the housing units. As of December 31, 2002, $1,609,757,420 of Housing Finance Authority bonds were outstanding.

As of December 31, 2002, the Authority also had outstanding $786,858,000 of bonds issued to (i) pay obligations of the Commonwealth under law, (ii) fund certain payments of the Commonwealth under its mortgage subsidy program for low and moderate income families, (iii) guarantee certain insurance obligations of the Housing Bank and Finance Agency under certain programs, and (iv) refund bonds originally issued by the 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.

Tourism Development Fund was created in November 1993 to promote Puerto Rico's hotel and tourism industry, primarily by making available guarantees to secure the payment of private financing used for new hotel development projects. The Tourism Development Fund is also authorized to make capital investments and provide direct financing to tourism related projects. As of March 1, 2003, the Tourism Development Fund had outstanding guarantees with respect to the financing of thirteen hotel projects totaling $548,121,000.

Tourism Development Fund has made disbursements under its guarantees in the aggregate amount of approximately $111.6 million, including a disbursement of $83.8 million made in September 2002 to repay the bonds of a project, which bonds had been declared due and payable at the direction of Tourism Development Fund due to the failure of the borrower of such project to comply with its obligations under the related reimbursement agreement. Another project is not currently making scheduled debt service payments, and Tourism Development Fund is making the corresponding payments under the related guaranty agreement. The total aggregate initial principal amount of the financing of this project was approximately $27.1 million. The pro-forma capital of Tourism Development Fund as of February 2003, after giving effect to the payment of the bonds described above, was approximately $106.8 million and its pro-forma allowance for losses on guarantees and letters of credit was approximately $17.0 million.

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

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

Public Finance Corporation was created in December 1984 to provide agencies and instrumentalities of Puerto Rico with alternate means of meeting their financing requirements. As of December 31, 2002, the Corporation had $4,273,849,000 aggregate principal amount of bonds outstanding, substantially all of which have been issued to purchase debt of agencies and instrumentalities of the Commonwealth, and are payable from Commonwealth appropriations. Said debt includes debt from the following sources: Maritime Shipping Authority, the Secretary of the Treasury relating to advances made by the Secretary to the municipalities to settle certain property tax claims, Office for the Improvement of Public Schools incurred in connection with its public schools repair and improvement program, the Health Facilities and Services Administration ("AFASS"), Aqueduct and Sewer Authority relating to the construction of the North Coast Superaqueduct (discussed below) and debt of these and other agencies relating to lines of credit extended by GDB.

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

Other Public Corporations

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

PRASA has embarked on an extensive capital improvement program for the four-year period ending June 30, 2006 that is estimated to cost approximately $1.1 billion. PRASA needs to make a substantial investment in infrastructure and a major overhaul of its operations to maintain the viability of the existing system and to finance its expansion for new users. Funds for this investment are expected to be provided through a combination of revenues from PRASA, bond issues, legislative appropriations and federal grants. Debt service on revenue bonds is payable from net revenues of the system after payment of current expenses. Due to PRASA's financial difficulties (discussed below) and its inability to access the bond market, Act No. 45 was enacted in July 1994 to provide a Commonwealth guaranty of the principal and interest payments to the bondholders of all outstanding debt issued by PRASA. In addition, Act No. 45 was amended in 2000 to extend the payment guaranty of the Commonwealth to all of the outstanding bonds issued by PRASA 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 PRASA. The extended guaranty will cover any additional issuance of these obligations until June 30, 2005.

PRASA has reported net losses of $94.9 million, $130 million, $100.7 million, $510,000 and $191.8 million during fiscal years 1998, 1999, 2000, 2001, and 2002, respectively. The net losses reported for fiscal years 2001 and 2002 are not comparable to the losses reported in prior fiscal years due to the implementation of a change in government accounting rules which allows government grants to be treated as revenues instead of as capital contributions. Without such favorable treatment of government grants, PRASA's net loss would have been $169.6 million in fiscal year 2001 and $349 million in fiscal year 2002. These losses reflect the continuing financial and operating difficulties that PRASA has experienced. The total debt of PRASA, including bonds and loans, was $638.8 million as of December 31, 2002.

On May 26, 1995, PRASA and Professional Services Group, Inc. entered into a five-year agreement, which expired in June 2002, for the operations, management, repair and maintenance of PRASA's systems. This agreement was replaced by a new 10-year agreement entered into on May 3, 2002 with Ondeo Puerto Rico, Inc. ("Ondeo"), an affiliate of Ondeo Suez, under which Ondeo will manage, operate, maintain, repair and, as and when necessary or appropriate, replace the PRASA systems. This agreement has as its major objectives the elimination of PRASA's operating deficit, the elimination of unaccounted-for-water, the achievement of environmental compliance, the improvement of the planning and implementation of capital projects and the general improvement of the water and sewer service available to the residents of Puerto Rico.

Ondeo will be compensated through a service fee component (the "SFC") which consists of a fixed part and a variable part. The SFC may be adjusted for additions and/or deletions of components to PRASA's systems (new plants, pumping stations, etc.), for uncontrollable circumstances and for inflation. With respect to inflation, the agreement may be adjusted only during the last five years by the difference between an inflation index and 4.5%. The SFC includes all operating expenses (regardless of the actual amount of such expenses) with the exception of electricity and insurance, which are treated as pass-through costs. The SFC also includes the replacement of any system component as required during the life of the agreement. The replacement requirement applies to all system components in operation with the exception of pipelines, where the requirement is for the annual replacement of at least 0.5% of the pipes.

The agreement also provides for a variable compensation component (the "VCC") which may not exceed 20% of total compensation. The VCC includes incentives for increasing PRASA revenues, reducing electricity consumption, achieving general performance improvements and reducing PRASA operating costs.

The agreement contains a number of operating commitments to ensure that its objectives are met. The commitments include reduction of unaccounted-for-water, existing pipeline rehabilitation, pipe repair to control leaks, improvement in customer service and achievement of environmental compliance.

The agreement contains a number of events of default relating to operator nonperformance with the agreement's standards. The agreement may be cancelled without cause by PRASA after five years upon payment of a termination fee. PRASA's monetary obligations under the agreement are unconditionally guaranteed by GDB.

Children's Trust (the "Trust") is a not-for-profit corporate entity created in 1999 as a public instrumentality of the Commonwealth. 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 payments to be made by the participating cigarette manufacturers under the MSA.

The Trust issued $1,171,200,000 aggregate principal amount of Tobacco Settlement Asset-Backed Bonds, Series 2002, on October 10, 2002. The Series 2002 Bonds and any other additional series of senior bonds will be secured by a statutory pledge of (i) the Initial Payments made by the Original Participating Manufacturers under the MSA which were required to be made annually on each January 10, through January 10, 2003, (ii) Annual Payments made by the Participating Manufacturers ("PM") under the MSA, which are required to be made on each April 15 in perpetuity and (iii) Strategic

Contribution Payments made by the PM's under the MSA, which are required to be made annually on each April 15, commencing April 15, 2008 through April 15, 2017. To date, all Initial Payments and Annual Payments required to be paid under the MSA have been made on a timely basis and Puerto Rico's share thereof has been received by the Trust.

Convention Center District Authority, created by Act No. 142 of October 4, 2001, is a public corporation and an instrumentality of the Commonwealth. The Authority was established to own, develop, finance, plan, design, build, operate, maintain, administrate and promote the Convention Center and designated private parcels located within the Convention Center District in San Juan. The Authority currently has two lines of credit with GDB totaling $220,750,000, of which $71,000,000 is outstanding.

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 December 31, 2002, Economic Development Bank had outstanding debt of $13,357,000. A bill to make the bank a subsidiary of GDB is presently pending in the Legislature.

Electric Power Authority owns and operates the island's electric system. The capital improvement program for the five-year period ending June 30, 2007, is estimated to cost approximately $2.1 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 December 31, 2002, the Authority had $4,630,889,000 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, LP's 507 megawatts liquefied natural gas plant at Guayanilla and a 454 megawatts clean coal facility at Guayama operated by an affiliate of Applied Energy Systems ("AES"). EcoElectrica's and AES plant started commercial operations in March 2000 and November 2002, respectively. It is expected that these two cogeneration plants will initially provide approximately one-third of the Authority's energy needs.

Health Insurance Administration was created in 1993 to implement the health reform by negotiating and contracting for the provision of comprehensive health insurance coverage for qualifying (generally low income) Puerto Rico residents. Under this system, the government selects, through a bidding system, one private health insurance company in each of several designated regions of the island and pays such insurance company the insurance premium for each eligible beneficiary within such region. The health insurance system covers all of the municipalities, and approximately 1.6 million persons were covered by the system as of June 30, 2002.

The cost to the General Fund of the health insurance program for fiscal year 2003 is expected to be $1,301.6 million, compared to $1,302 million for fiscal year 2002. The fiscal year 2004 recommended budget estimates the cost of the health insurance program to be $1,347.9 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 Commonwealth grants. Debt service on the Authority's revenue bonds constitutes a first lien on its gross revenues, which consist currently of all the proceeds of the gasoline tax; one-half of the proceeds of the tax on gas oil or diesel oil; all the proceeds of the excise taxes on crude oil, unfinished oil and derivative products, up to $120 million per fiscal year; highway toll revenues; and the gross receipts of $15.00 per vehicle per year from certain motor vehicle license fees. Such revenues (except for toll revenues) may be applied first to the payment of debt service on general obligation bonds and notes of the Commonwealth and payments required to be made by the Commonwealth under its guarantees of bonds and notes to the extent that no other revenues are available for such purpose. The Commonwealth has never applied such revenues for such payment. As of December 31, 2002, the Authority had $4,430,349,000 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 $2.3 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.

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.

Industrial Development Company participates in the Commonwealth-sponsored economic development program by providing physical facilities, general assistance, and special incentive grants to manufacturers. The Company was merged with the Economic Development Administration in January 1998. Rentals derived from the leasing of specified facilities of the Company are pledged to the payment of the Company's revenue bonds. As of December 31, 2002, the Company had $163,316,000 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, environmental control, medical, and educational facilities in Puerto Rico for the use of private companies, non-profit entities, or government agencies. The bonds are payable solely from payments to be made to the Authority by such private companies, non-profit entities, or government agencies, and do not constitute a debt of the Commonwealth or any of its other public corporations or municipalities. As of December 31, 2002, $2,855,643,833 of the Authority's bonds were outstanding. The Authority financed the construction of a multi-purpose coliseum in San Juan with a line of credit provided by GDB. Upon completion of construction, the coliseum will be transferred to the Tourism Company.

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 with annual fixed amounts from the first proceeds of federal excise taxes imposed on rum and other articles produced in Puerto Rico and sold in the United States which are transferred to Puerto Rico pursuant to the United States Internal Revenue Code of 1986, as amended. Currently, this amount is $70 million, and it will increase to $90 million for fiscal years 2007 to 2052. The Authority is using these amounts to provide financial support to aqueduct and sewer projects. The Authority had $2,018,935,000 in bonds outstanding as of December 31, 2002.

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

In June 1998, 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 outstanding as of December 31, 2002, was $258,784,000 (not including accreted values of capital appreciation bonds outstanding). The bonds are payable from funds to be appropriated annually by the Legislature of Puerto Rico.

Municipal Finance Agency was created in 1972 as a municipal "bond bank" for Puerto Rico. The Agency is authorized to issue bonds to purchase general obligation bonds and notes of Puerto Rico municipalities and to fund a debt service reserve. Debt service on the Agency's bonds is payable from debt service payments on municipal bonds held by the Agency and from the debt service reserve, including investment income thereon. The Commonwealth has agreed to pay such amounts to the debt service reserve as may be necessary to maintain it at its required level, subject to appropriation by the Legislature, which appropriation is authorized but not legally required to be made. To date no such payments have been required. As of December 31, 2002, the Agency had $1,404,270,000 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. 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 income of $29.0 million and $16.2 million for fiscal year 2001 and 2002, respectively. The decrease in net income from fiscal year 2001 to fiscal year 2002 resulted principally from a decrease in airline passenger traffic and special incentives granted by the Authority to the airlines in response to the September 11, 2001 terrorist attacks. As of December 31, 2002, the Authority had $87,335,000 in bonds outstanding.

Public Buildings Authority is authorized to construct, purchase or lease office, school, health, correctional and other facilities for lease to departments, public corporations, and instrumentalities of the Commonwealth. Bonds that have been issued by the Authority to finance such facilities (through retirement of interim notes or otherwise) are payable from lease payments, which are largely derived from legislative appropriations and are further secured by the Commonwealth's guaranty. The Authority is authorized by Act No. 17 of 1968, as amended, to have outstanding at any one time up to $2,500,000,000 of bonds guaranteed by the Commonwealth. As of December 31, 2002, $2,097,930,459 of such bonds of the Authority was outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds).

On April 3, 2003, the Authority expects to close a forward refunding bond issue in the amount of $272,717,418. As of that date the outstanding balance of its bonds will be $2,086,527,877.

Special Communities Perpetual Trust is a new, irrevocable and permanent trust created as a public corporation. The Trust's principal purpose is to fund development projects which address the infrastructure and housing needs of underprivileged communities. The Trust's initial capital will be funded with a grant from GDB of $500 million and borrowings of $500 million.

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 transferred the operations of the Corporation to certain entities formed by sugar cane growers. The Corporation retained substantially all its liabilities. During fiscal year 2002, the debt of the Corporation was restructured and refinanced by bonds issued by Public Finance Corporation, which bonds will be paid from funds to be appropriated annually by the Legislature of Puerto Rico.

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 was acquired by Verizon Communications, Inc. The net proceeds of the sale received at closing were applied to defease outstanding bonds of the Authority in the principal amount of $756 million, to make a $1.2 billion deposit to the Infrastructure Development Fund held by the Infrastructure Financing Authority and to pay certain benefits to PRTC employees. On January 2002, Verizon exercised its option to purchase an additional 15% of PRTC stock for $172 million. The Government retains a 28% stock participation in PRTC. The proceeds from the Verizon option exercise were transferred to the Employees Retirement System of the Commonwealth and its instrumentalities.

University of Puerto Rico (the "University"), with 68,830 students in academic year 2001-2002, 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 $450,463,000 was outstanding as of December 31, 2002.

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.

Public corporations, in addition to those mentioned above, have outstanding debt in the aggregate amount of $684,065,000 as of December 31, 2002. Debt service on $139,595,000 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, 2001, the total number of active members of the three systems was as follows: Employees Retirement System, 156,009; Teachers Retirement System, 46,640, and Judiciary Retirement System, 357. 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 67% of total employer contributions to the Employees Retirement System, and the other 33% is the responsibility of public corporations and municipalities. The central government is also responsible for 100% and 99% of total employer contributions to the Judiciary and Teachers Retirement Systems, respectively. Retirement and related benefits provided by the systems and required contributions to the systems by employees are determined by law. Required employers' contributions to the systems are determined by law and are not actuarially determined. For the Employee Retirement System, required employer contributions consist of 9.275% of applicable payroll in the case of municipalities, central government and public corporations. Required employee contributions for the Employee Retirement System vary according to salary and how the individual employee's retirement benefits are coordinated with social security benefits. For the Judiciary Retirement System, required contributions consist of 20% of applicable payroll for the employer and 8% for the employees.

According to the most recent actuarial valuation of the Employees Retirement System and Judiciary Retirement System submitted by a firm of independent consulting actuaries, as of June 30, 2001, the total pension benefit obligation for the Employees Retirement System and Judiciary Retirement System was $9,881,481,000 and $162,186,168, respectively. The unfunded pension benefit obligation of the Employees Retirement System and Judiciary Retirement System for the same period was $7,452,817,000 and $92,103,168, respectively, representing a funding ratio of 25% and 43%, respectively. This funding ratio does not take into account the reduction in the value of their respective equity portfolios resulting from the decline in the equities market since fiscal year 2001. It is estimated that as of June 30, 2002, the total pension benefit obligation for the Employees Retirement System is $10,540,000,000 and the unfunded pension benefit obligation is $8,560,000,000, representing a funding ratio of 19%.

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

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 Commonwealth after December 31, 1999 and for those current employees who elect to transfer from the existing defined benefit system. The individual account of each current employee is credited initially with an amount equal to his aggregate contributions to the Employees Retirement System, plus interest. Current employees who did not elect to transfer to the new defined contribution system will continue accruing benefits under the current defined benefit system. The individual account of each participant of the new defined contribution system is credited monthly with the participant's contribution and is credited semiannually with a rate of return based on either of two notional investment returns. Such accounts are not credited with any contribution by the employer. Instead, employer contributions will now be used completely to reduce the 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. In January 2002, Verizon exercised its option to purchase and purchased an additional 15% of the stock of PRTC for $172 million. The proceeds of the sale were transferred to the Employees Retirement System.

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

The Employee Retirement System anticipates that its future cash flow needs for disbursement of benefits to participants may exceed the sum of the employer and employee contributions received and its investment and other recurring income. The Employee Retirement System expects to cover this cash flow imbalance in fiscal year 2003 with the remaining proceeds from the sale of its 15% stock ownership in PRTC and in fiscal years 2004 through 2006 with the proceeds from the sale of its remaining shares of PRTC stock. It is currently evaluating other measures to increase its revenues to cover any cash flow imbalance after fiscal year 2006.

According to the most recent actuarial valuation of the Teachers Retirement System submitted by a firm of independent consulting actuaries, as of June 30, 2001, the accrued actuarial liability of the system was $3,834 million and the value of assets amounted to $2,284 million, representing a funding ratio of 60%, and the resulting unfunded accrued liability was $1,550 million. This funding ratio does not take into account the recent significant decline in the equities market and the resulting reduction in the value of the equity portfolio. As of June 30, 2000, the remaining amortization period for the unfunded liability is 19 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, 2000, June 30, 2001, and June 30, 2002. The investment income figures presented in the table include unrealized gains and losses.

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

	Employees Retirement System	Judiciary Retirement System	Teachers Retirement System
Fiscal Year Ended June 30, 2002			
Income:			
Employers' contributions	$308,228	$ 5,412	$124,152
Employee contributions	259,203	2,448	99,454
Investment income	(306,008)	(7,791)	(41,068)
Total	261,423	69	182,538
Expenses:			
Benefit payments	683,106	8,462	278,168
Administrative and other expenses	27,304	1,072	18,481
Total	710,410	9,714	296,649
Net Income (Loss)	(448,987)	(9,645)	(114,111)
Fiscal Year Ending June 30, 2001			
Income:			
Employers' contributions	302,234	5,394	116,134
Employee contributions	245,221	2,240	94,295
Special Contribution-PRTC Stock	701,000(1)	N/A	N/A
Investment income	(232,479)	(11,048)	37,332
Total	1,015,976	(3,414)	247,761
Expenses:			
Benefit payments	600,674	8,262	240,761
Administrative and other expenses	28,404	1,049	22,507
Total	629,078	9,311	263,268
Net Income (Loss)	386,898	(12,725)	(15,507)
Fiscal Year Ended June 30, 2000			
Income:			
Employers' contributions	309,097	5,222	86,246
Employee contributions	218,342	2,094	68,864
Investment income	290,912	10,662	286,507
Total	818,351	17,978	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	$ 184,235	$8,901	$ 189,976

(1) Value of 43% stock ownership interest in PRTC based on an appraisal made by an independent firm. As of June 30, 2002, the remaining shares, after the sale of the optioned shares to Verizon, were valued at $383.1 million.

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

COMMONWEALTH FINANCIAL STATEMENTS

Since fiscal year 1990, the complete financial statements of the Commonwealth have been audited. For fiscal year 2002, such financial statements are being audited by KPMG LLP. The release of the Commonwealth's audited financial statements for fiscal year 2002 has been delayed due to the conversion of the Commonwealth's financial statements to comply with Governmental Accounting Standards Board Statement No. 34. It is expected that the audited financial statements for fiscal year 2002 will be available during the second calendar quarter of 2003. Preparation of the audited financial statements of the Commonwealth involves the collection and combination of audited financial statements from approximately fifty separate reporting entities. KPMG LLP will not audit the financial statements of the pension trust funds, the public university funds, and certain activities and component units to be identified separately in their report. Those financial statements will be audited by other auditors whose reports will be furnished to KPMG LLP, and its opinion on the basic financial statements, insofar as it relates to the amounts included in the basic financial statements pertaining to such activities and component units, will be based solely on the reports of the other auditors.

The Comprehensive Annual Financial Report of the Commonwealth for fiscal year 2002 to be prepared by the Department of the Treasury, which will include the basic financial statements of the Commonwealth for fiscal year 2002, will be filed by the Commonwealth with each nationally recognized municipal securities information repository upon release of the audited financial statements for that year.

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 for financial reporting purposes (but not for budgetary purposes), commencing in fiscal year 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 year 2000 through fiscal year 2002, the Commonwealth's estimated revenues and budgeted expenditures for fiscal year 2003 and the Commonwealth's proposed budget revenues and expenditures for fiscal year 2004. The information through fiscal year 2002 is based on actual fiscal year-end results. The information relating to fiscal year 2003 is based on (i) revenue estimates made by the Secretary of the Treasury in February 2003 and (ii) expenditures included in the approved budget for fiscal year 2003. The information relating to fiscal year 2004 is based on the proposed budget of revenues and expenditures submitted by the Governor to the Legislative Assembly in February 2003.

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)

	2000	2001	2002(p)	2003(e)	2004(1)
Beginning cash balance	$ 474,759	$ 287,055	$ 125,154	$ 235,772	$ 37,676
Revenues from internal sources:					
Income Taxes:					
Individuals	2,352,066	2,259,090	2,449,982	2,775,000	2,816,000
Corporations	1,781,862	1,696,766	1,706,137	1,846,000	1,838,000
Partnerships	2,339	3,026	2,670	3,000	2,000
Withheld from non-residents	557,276	696,835	583,256	561,000	560,000
Tollgate taxes	111,130	49,511	59,515	36,000	22,000
Interest	11,674	14,782	14,310	16,000	13,000
Dividends	39,664	58,580	62,548	43,000	47,000
Total income taxes	4,856,011	4,778,590	4,878,418	5,280,000	5,298,000
Commonwealth excise taxes:					
Alcoholic beverages	236,374	237,512	249,705	326,000	313,000
Cigarettes	115,157	119,135	116,055	170,000	159,000
Motor vehicles	389,995	406,252	418,024	504,000	543,000
Other excise taxes	668,820	579,050	681,344	746,000	738,000
Total Commonwealth excise taxes	1,410,346	1,341,949	1,465,128	1,746,000	1,753,000
Property taxes	1,131	287	-	-	-
Inheritance and gift taxes	3,109	7,475	1,962	2,000	3,000
Licenses	73,801	76,338	82,575	84,000	87,000
Other:					
Lottery	63,779	57,482	61,358	70,000	66,000
Electronic Lottery	70,209	70,211	57,897	87,000	88,000
Miscellaneous non-tax revenues	169,246	299,758	610,213(2)	232,000	280,000
Total Other	303,234	427,451	729,468	389,000	434,000
Total revenues from internal sources	6,647,632	6,632,090	7,157,551	7,501,000	7,575,000
Revenues from non-Commonwealth sources:					
Federal excise taxes	245,750	286,890	314,253	305,000	330,000
Customs	50,231	43,154	30,595	30,000	20,000
Total revenues from non-Commonwealth sources	295,981	330,044	344,848	335,000	350,000
Sub-total revenues	6,943,613	6,962,134	7,502,399	7,836,000	7,925,000
Proceeds from Special Funds	-	-	-	-	-
Total revenues	6,943,613	6,962,134	7,502,399	7,836,000	7,925,000
Other Income (refunds)(3)	64,325	84,878	53,796	(115,213)	268,500
(Transfers) to Redemption Fund(4)	(410,046)	(245,814)	(274,773)	(375,889)	(407,948)
Proceeds of notes and other borrowings(5)	778,863	825,703	1,161,856	1,219,444	-
Repayment of notes and other borrowings(6)	(787,155)	(686,024)	(1,201,084)	(1,231,501)	-
Adjusted revenues	6,589,600	6,940,577	7,242,194	7,332,841	7,785,552
Expenditures:					
Grants and subsidies	2,864,215	3,078,505	2,864,533	3,442,932	3,131,452
Personal services	2,737,159	2,779,989	3,017,984	3,291,562	3,942,146
Other services	745,194	778,236	757,090	644,494	548,303
Materials and supplies	109,081	106,072	105,532	114,468	142,917
Equipment purchases	56,404	48,326	20,354	37,471	20,734
Capital outlays and other debt service	101,178	33,235	51,172	11	-
Transfers to agencies	164,073	280,415	314,911	-	-
Total expenditures	6,777,304	7,102,778	7,131,576	7,530,938	7,785,552
Adjusted revenues less expenditures	(187,704)	(161,901)	110,618	(198,096)	-
Ending cash balance	$ 287,055	$ 125,154	$ 235,772	$ 37,676	$ 37,676

(p) Preliminary.
(e) Estimated.
(1) Budget, as proposed.
(2) Includes certain non-recurring revenues totaling $292.1 million.
(3) Consists of reimbursement of certain advances to agencies to cover expenses, revenues from the General Fund's non budgetary funds and a reserve for future tax refunds reduced by estimated tax refunds.
(4) Consists of amounts to pay principal of and interest on general obligation bonds and notes of the Commonwealth. Does not include amounts deposited directly to the Redemption Fund from non-General Fund revenues.
(5) Consists of proceeds of Commonwealth tax and revenue anticipation notes and borrowings from Government Development Bank.
(6) Consists of repayment of Commonwealth tax and revenue anticipation notes and borrowings from Government Development Bank.

Source: Department of the Treasury

Projected Fiscal Year 2004 Compared to Estimated Fiscal Year 2003

It is projected that General Fund total revenues for fiscal year 2004 will be $7,925 million, representing an increase of $89 million, or 1.1%, from estimated fiscal year 2003 revenues. The major changes from fiscal year 2003 are expected to be: (i) projected increases in income taxes from individuals of $41 million and in miscellaneous non-tax revenues of $48 million; (ii) projected increases in motor vehicle excise taxes of $39 million and in federal excise taxes of $25 million; and (iii) projected decreases in corporate income taxes of $8 million, tollgate taxes of $14 million, excise taxes on alcoholic beverages and cigarettes of $13 million and $11 million, respectively, and customs of $10 million.

The projection of General Fund revenues for fiscal year 2004 is based on a nominal growth and real growth in gross national product of 6.0% and 2.5%, respectively, and assumes additional revenues of $225 million from new legislative measures. This revenue projection includes an adjustment for potential revenue shortfalls (when compared to revenues estimates for fiscal year 2003) as a result of: (i) a possible conflict with Iraq; (ii) the impact on excise tax collections of an adverse court decision (handed down in February 2003) regarding the Treasury Department's implementation of a local regulation that precludes air carriers from delivering goods brought into the island prior to the consignee evidencing the payment of the excise tax on such goods; and (iii) the effect of certain proposed tax legislation.

Proposed expenditures for fiscal year 2004 total $8,193.5 million, which is $350.8 million or 4.5% higher than the $7,842.7 million budgeted for fiscal year 2003. The principal reasons for the differences are (i) education related expenditures, which are proposed to be approximately $101 million higher; (ii) health related expenditures, which are proposed to be approximately $88 million higher; (iii) special pension contributions to cover increases in retiree benefits, which are proposed to be approximately $72 million higher; and (iv) debt service which is $34 million higher.

Estimated Fiscal Year 2003 Compared to Actual Fiscal Year 2002

It is projected that General Fund total revenues for fiscal year 2003 will be $7,836 million, representing an increase of $334 million, or 4.5%, from actual fiscal year 2002 revenues. The major changes from fiscal year 2002 are expected to be: (i) increases in income taxes from individuals of $325 million and in corporate income taxes of $140 million; (ii) increases in excise taxes on alcoholic beverages and cigarettes of $76 million and $54 million, respectively, motor vehicle excise taxes of $86 million, other excise taxes of $65 million; (iii) an increase in electronic lottery of $29 million; (iv) a decrease in miscellaneous non-tax revenues of $378 million and in income taxes withheld from non-residents of $22 million; and (v) decreases in tollgate taxes of $24 million, taxes on dividends of $20 million and federal excise taxes of $9 million. The decrease in miscellaneous non-tax revenues of $378 million relates to certain special administrative measures that had been implemented by the Secretary of the Treasury in fiscal year 2002 and that do not apply to fiscal year 2003.

As of March 2003, General Fund total revenues for fiscal year 2003 were $57 million below the amount originally budgeted. The Secretary of the Treasury has identified certain sources of additional revenues, which are expected to bring total General Fund revenues for fiscal year 2003 to at least the original budgeted amount.

Expenditures for fiscal year 2003 are projected to be $7,968.9 million, which is $126.2 million or 1.6% higher than the $7,842.7 million budgeted. The principal reasons for these differences are (i) expenditures by the Department of Education of $191.5 million or 12% higher than budgeted; (ii) Police Department expenditures of $16.7 million or 2.3% higher than budgeted; (iii) health reform expenditures of $47 million or 4.6% higher than budgeted; and (iv) under spending by other agencies of approximately $129 million. The $126.2 million excess is expected to be covered by a $50 million expense reduction initiative at the Department of Education and the use of $76.2 million of the Commonwealth's reserve funds.

Fiscal Year 2002 Compared to Fiscal Year 2001

General Fund total revenues for fiscal year 2002 were $7,502 million, representing an increase of $540 million, or 7.8%, from fiscal year 2001 revenues. The major changes from fiscal year 2001 were: (i) increases in income taxes from individuals of $191 million and in corporate income taxes of $9 million; (ii) an increase in Commonwealth excise taxes of $123 million; (iii) an increase in miscellaneous non-tax revenues of $310 million; and (iv) a decrease in income taxes withheld from non-residents, tollgate taxes and dividend taxes totaling $100 million.

The increase in miscellaneous non-tax revenues of $310 million relates to certain special revenue raising measures adopted by the Secretary of the Treasury in fiscal year 2002. Such measures included the transfer to the General Fund of funds on deposit in a contingency fund related to the sale of PRTC stock and of certain compulsory insurance premiums, the sale of certain tax receivables to GDB, and savings generated by the refinancing of certain Commonwealth bonds.

Expenditures for fiscal year 2002 were $7,597.1 million, which was $131.4 million or 1.8% higher than the $7,465.7 million budgeted. The principal reasons for the difference were: (i) health reform costs of approximately $125 million; (ii) payroll and other costs of education of approximately $64.9 million; and (iii) public safety costs of approximately $66.5 million. These amounts were offset by lower expenditures in other areas of approximately $125 million. The Government covered these additional expenditures with reserve funds from the Commonwealth's Budgetary Fund and from unused funds of certain agencies that had operating surpluses.

Fiscal Year 2001 Compared to Fiscal Year 2000

General Fund total revenues for fiscal year 2001 were $6,962 million, an increase of approximately $18.5 million from fiscal year 2000. The major changes from fiscal year 2000 were a decrease of $85 million in corporate income taxes; a decrease of $93 million on individual income taxes; a decrease of $62 million in tollgate taxes; a decrease of $90 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.

Total expenditures for fiscal year 2001 were $7,103 million, an increase of $325 million, or 4.8%, over fiscal year 2000. Expenditures grew primarily in the areas of education, health and public safety. This growth was attributable in part to the rising cost of services and expanding programs.

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. Dividend income from Puerto Rico corporations and certain qualifying foreign corporations is taxed at a rate of 10%.

Gain realized from the sale or exchange of a capital asset by resident individuals, if held for more than six months, is taxed at a rate of 20%. It is taxed at a rate of 10% if the capital asset consists of certain property located or deemed located in Puerto Rico. Gains realized by Puerto Rico resident individuals, trusts and estates from the sale of stock of certain Puerto Rico corporations in an initial public offering made prior to December 31, 2001 are subject to a special capital gains rate of 7%.

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

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

The PR Code provides for six income tax brackets for corporations and partnerships, with the highest rate (39%) applicable to net taxable income in excess of $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 or deemed 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. However, royalty payments made by such corporations to non-resident recipients are subject to a 10% withholding tax. The basic tax on dividends paid to foreign corporate shareholders of Section 936 Corporations operating under grants of tax exemption issued under prior incentives laws is 10% but is subject to reduction with respect to dividends paid from profits invested in certain eligible instruments for specified periods of time.

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

Excise Taxes

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

Other Taxes and Revenues

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

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

Revenues from non-Commonwealth sources include customs duties collected in Puerto Rico and excise taxes on shipments of rum from the island to the United States mainland. The customs duties and excise taxes on shipments are imposed and collected by the United States and returned to the Commonwealth. The excise tax on shipments of rum from Puerto Rico and other rum producing countries is $13.50 per gallon. Of this amount, $13.25 per gallon is returned to the Treasury of Puerto Rico during the period from October 1, 1999 to December 31, 2003. Effective on January 1, 2004, the amount returned will be $10.50 per gallon. The budget submitted by the President for fiscal year 2004 extends the period during which the tax returned to Puerto Rico remains at $13.25 per gallon to December 2005.

Property Taxes

Personal property, which accounts for approximately 53% 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.

The following table presents the assessed valuations and real and personal property taxes collected for the fiscal years ending June 30, 1998 through 2002.

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
1998	$ 19,272,428	$ 619,343	$ 510,999	$ 90,311	$ 601,310
1999	20,042,738	642,555	523,886	47,309	571,195
2000	20,514,014	704,568	594,151	64,812	658,963
2001	21,575,063	736,667	614,411	70,496	684,907
2002	22,743,568	806,348	645,117	60,677	705,794

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

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, CRIM sold certain of these past due property tax debts to Public Finance Corporation, which financed the purchase price by issuing non-recourse bonds payable solely from the collection of such past due property taxes. The proceeds of the sale of these bonds were paid to the CRIM for the benefit of the Commonwealth and the municipalities of the Commonwealth. As a result of a series of transactions that concluded in April 2002, these bonds were retired.

Collections of Income and Excise Taxes

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

Transfers to General Obligation Redemption Fund

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

Components of General Fund Expenditures

Grants and Subsidies

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

Personal Services

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

Other Services

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

Materials and Supplies

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

Equipment Purchases

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

Capital Outlays and Other Debt Service

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

Transfers to Agencies

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

Other Expenditures

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

Federal Grants

Puerto Rico receives grants under numerous federal programs. Federal grants to the agencies and instrumentalities of the Commonwealth government are estimated to be $4,725.8 million for fiscal year 2004, an increase of $202.1 million, or 4.4%, over fiscal year 2003. The following table presents revenues from federal grants by broad program areas, which are accounted in the central accounting system of the Department of the Treasury. The figures for fiscal years 2000, 2001 and 2002 are actual figures. The estimated figures for fiscal year 2003 and the projected figures for fiscal year 2004 are based on the information submitted by each agency to the Office of Management and Budget.

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

	Fiscal Year Ending June 30				
	2000	**2001**	**2002**	**2003[2]**	**2004[3]**
Education	$ 676,018	$ 642,082	$ 721,001	$ 825,226	$ 879,301
Social Services	1,571,480	1,665,248	1,711,372	1,781,236	1,789,701
Health	353,487	356,028	320,576	342,751	352,696
Labor and Human Resources[4]	180,477	339,772	376,916	344,431	327,470
Crime	20,666	16,965	15,689	37,948	28,484
Housing[5]	268,782	336,175	385,686	353,658	431,852
Drug and Justice	14,710	17,524	11,587	12,248	29,960
Agriculture and Natural Resources	6,427	5,341	13,119	7,890	12,342
Contributions to Municipalities	58,865	56,809	59,191	59,191	59,002
Other	5,568	5,559	10,661	14,526	14,526
TOTAL	$3,156,480	$3,441,503	$3,625,798	$3,779,105	$3,925,334

(1) Federal grants to public corporations, including the Highway and Transportation Authority, are not included in this table.
(2) Estimated.
(3) Projected.
(4) Amounts include grants to the Right to Work Administration and the Occupational Development and Human Resources Council.
(5) Amounts include grants to the Public Housing Administration.

Source: Office of Management and Budget

BUDGET OF THE COMMONWEALTH OF PUERTO RICO

Office of Management and Budget

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

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

Budgetary Process

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

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

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

Financial Control and Adjustment Procedures

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

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

A Budgetary Fund was created by Act No. 147 of June 18, 1980, as amended (the "Budgetary Fund"), to cover the appropriations approved in any fiscal year in which the revenues available for such fiscal year are insufficient, to secure the payment of public debt, and to provide for unforeseen circumstances in the provision of public service. Currently, an amount equal to 1% of the total revenues of the preceding fiscal year is deposited annually into the Fund. In addition, other income (not classified as revenues) that is not assigned by law to a specific purpose is also required to be deposited in the Budgetary Fund. The maximum balance of the Budgetary Fund may not exceed 6% of the total appropriations included in the budget for the preceding fiscal year. As of June 30, 2003, the un-encumbered balance in the Budgetary Fund is expected to be $82.6 million. As of March 1, 2003, the Budgetary Fund balance was $176.8 million.

An Emergency Fund was created by Act No. 91 of June 21, 1966, as amended (the "Emergency Fund"), to cover unexpected public needs caused by calamities, such as wars, hurricanes, earthquakes, droughts, floods and plagues, and to protect people's lives and property and the public sector credit. The Emergency Fund is capitalized annually with an amount totaling no less than one percent of the previous fiscal year's net revenues. The Governor or, by designation, the Director of OMB, may order the deposit of funds from any source into the Emergency Fund in an amount greater than the amount fixed in Act No. 91 when deemed convenient. When said funds are ordered deposited into the Emergency Fund, however, the balance thereof cannot exceed five percent of the budget approved for the fiscal year in which such deposit is ordered. As part of the fiscal year 2004 budget process, OMB is recommending an amendment that would reduce the statutory upper limit of the Emergency Fund to $150 million. As of June 30, 2003, the unencumbered balance in the Emergency Fund is expected to be $141.5 million. As of March 1, 2003, the Emergency Fund balance was $143.8 million.

Appropriations

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

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

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

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

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

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

Approximately 30.0% of the General Fund is committed for payment of fixed charges such as municipal subsidies, grants to the University of Puerto Rico, contributions to the Aqueduct and Sewer Authority, funding for the judiciary branch, rental payments to the Public Buildings Authority, among others, and debt service on direct debt of the Commonwealth.

Fiscal Year 2004 Proposed Budget

On February 18, 2003, the Governor of Puerto Rico submitted a proposed budget for fiscal year 2004 to the Legislature of Puerto Rico. This budget is expected to be approved before June 30, 2003. The following table presents a summary of the Commonwealth's central government proposed budget for the fiscal year ending June 30, 2004.

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

	General Fund[1]	Bond Fund	Special Funds	Total
Revenues from internal sources:				
Property taxes	$ -		$ 103,524	$ 103,524
Personal income taxes	2,816,000	-	-	2,816,000
Retained non-resident income tax	560,000	-	-	560,000
Corporate income taxes	1,838,000	-	-	1,838,000
Partnership income taxes	2,000	-	-	2,000
Tollgate taxes	22,000	-	-	22,000
17% withholding tax on interest	13,000	-	-	13,000
10% withholding tax on dividends	47,000	-	-	47,000
Inheritance and gift taxes	3,000	-	-	3,000
Excise taxes:				
Alcoholic beverages	313,000	-	-	313,000
Motor vehicles and accessories	543,000	-	0	543,000
Cigarettes	159,000	-	-	159,000
Special excise tax on certain petroleum products	22,000	-		22,000
General 5% excise tax	543,000	-		556,000
Other	173,000	-	65,500	225,500
Licenses	87,000	-	-	87,000
Miscellaneous non-tax revenues:				
Contributions from lottery fund	66,000	-	-	66,000
Electronic lottery	88,000	-	-	88,000
Registration and document certification fees	159,000	-	-	159,000
Other	121,000	-	250,476	371,476
Total revenues from internal sources	7,575,000	-	419,500	7,994,500
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	330,000	-		330,000
Federal grants	0	-	3,925,334 [2]	3,925,334
Customs	20,000	-		20,000
Total revenues from non-Commonwealth sources	350,000	-	3,925,334	4,275,334
Total revenues	7,925,000	0	4,344,834	12,269,834
Other:				
Other Income	268,500		0	268,500
Balance from previous year	0		427,833	427,833

	General Fund(1)	Bond Fund	Special Funds	Total
Bonds authorized	0	540,000	-	540,000
Total other sources	268,500	540,000	427,833	1,236,333
Total resources	8,193,500	540,000	4,772,667	13,506,167
Appropriations:				
Current expenses:				
General government	768,847	-	46,572	815,419
Education	2,546,530	-	992,751	3,539,281
Health	1,364,306	-	381,205	1,745,511
Welfare	393,799	-	2,208,550	2,602,349
Economic development	184,049	-	72,752	256,801
Public safety and protection	1,381,360	-	77,632	1,458,992
Transportation and communications	79,546	-	44,866	124,412
Housing	24,839	-	254,096	278,935
Contributions to municipalities	351,695	-	2,091	353,786
Special pension contributions	202,895	-	0	202,895
Debt service	407,948	-	103,524	511,472
Other debt service	487,686	-	25,992	513,678
Total appropriations-current expenses	8,193,500	-	4,210,031	12,403,531
Capital improvements	0	540,000	255,048	795,048
Total appropriations	8,193,500	540,000	4,465,079	13,198,579
Year-end balance	0	-	307,588	307,588
Total appropriations and year-end balance	$8,193,500	$540,000	$4,772,667	$13,506,167

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

Sources: Department of the Treasury and Office of Management and Budget, as reported on March 3, 2003.

In the fiscal year 2004 budget proposal, revenues and other resources of all budgetary funds total $12,538,334,000 excluding balances from the previous fiscal year and general obligation bonds authorized. The estimated net increase in General Fund revenues in fiscal year 2004 is accounted mainly by increases in other miscellaneous non-tax revenues (up $48,000,000), personal income taxes (up $41,000,000), excise taxes on motor vehicles and accessories (up $39,000,000), federal excise taxes on off-shore rum shipments (up $25,000,000) and decreases in corporation income taxes (down $8,000,000), customs (down $10,000,000), excise taxes on cigarettes (down $11,000,000), excise taxes on alcoholic beverages (down $13,000,000) and tollgate taxes (down $14,000,000).

Current expenses and capital improvements of all budgetary funds total $13,198,579,000, an increase of $597,786,000 from fiscal year 2003. The major changes in General Fund expenditures by program in fiscal 2004 are: education (up $100,551,000), health (up $88,401,000), special pension contributions to cover added benefits (up $72,275,000), other debt service (up $63,193,000), debt service (up $33,809,000) and general government (up $8,980,000).

The general obligation bond authorization for the fiscal year 2004 budget is $540,000,000.

Fiscal Year 2003 Budget

The following table presents a summary of the Commonwealth's central government budget for the fiscal year ending June 30, 2003.

Commonwealth of Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ending June 30, 2003
(in thousands)

	General Fund	Bond Fund	Special Funds	Total
Revenues from internal sources:				
Property taxes	$ 0	-	$ 107,545	$ 107,545
Personal income taxes	2,775,000	-	-	2,775,000
Retained non-resident income tax	561,000	-	-	561,000
Corporate income taxes	1,846,000	-	-	1,846,000
Partnership income taxes	3,000	-	-	3,000
Tollgate taxes	36,000	-	-	36,000
17% withholding tax on interest	16,000	-	-	16,000
10% withholding tax on dividends	43,000	-	-	43,000
Inheritance and gift taxes	2,000	-	-	2,000
Excise taxes:		-		
Alcoholic beverages	326,000	-	-	326,000
Motor vehicles and accessories	504,000	-	0	504,000
Cigarettes	170,000	-	-	170,000
Special excise tax on certain petroleum products	28,000	-		28,000
General 5% excise tax	541,000	-		541,000
Other	177,000	-	63,200	240,200
Licenses	84,000	-		
Miscellaneous non-tax revenues:				
Contributions from lottery fund	70,000	-	-	70,000
Electronic lottery	87,000	-	-	87,000
Registration and document certification fees	153,000	-	-	153,000
Other	79,000	-	241,365	320,365
Total revenues from internal sources	7,501,000	-	412,110	7,913,110
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	305,000	-		305,000
Federal grants	0	-	3,779,105 (1)	3,779,105
Customs	30,000	-		30,000
Total revenues from non-Commonwealth sources	335,000	-	3,779,105	4,114,105
Total revenues	7,836,000	-	4,191,215	12,027,215
Other:				
Other Income	6,700	-	0	6,700
Balance from previous year	0	-	494,711	494,711
Bonds authorized	0	500,000	0	500,000
Total other sources	6,700	500,000	494,711	1,001,411
Total resources	7,842,700	500,000	4,685,926	13,028,626

	General Fund	Bond Fund	Special Funds	Total
Appropriations:				
Current expenses:				
General government	759,867	-	50,050	809,917
Education	2,445,979	-	867,523	3,313,502
Health	1,275,905	-	369,774	1,645,679
Welfare	400,450	-	2,220,386	2,620,836
Economic development	186,997	-	66,726	253,723
Public safety and protection	1,389,188	-	78,419	1,467,607
Transportation and communications	77,042	-	40,637	117,679
Housing	22,929	-	225,915	248,844
Contributions to municipalities	355,091	-	2,095	357,186
Special pension contributions	130,620	-	0	130,620
Debt service	374,139	-	107,545	481,684
Other debt service	424,493	-	25,992	450,485
Total appropriations-current expenses	7,842,700	-	4,055,062	11,897,762
Capital improvements	0	500,000	203,031	703,031
Total appropriations	7,842,700	500,000	4,258,093	12,600,793
Year-end balance	0	-	427,833	427,833
Total appropriations and year-end balance	$7,842,700	$500,000	$4,685,926	$13,028,626

(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 March 3, 2003.

In the fiscal year 2003 budget projected revenues and other resources of all budgetary funds total $12,033,915,000 excluding balances from the previous fiscal year and general obligation bonds authorized. The estimated net increase in general fund revenues in fiscal year 2003 are accounted mainly by increases in personal income taxes (up $325,000,000), corporation income taxes (up $139,900,000), excise taxes on motor vehicles and accessories (up $86,000,000), general excise taxes of 5% (up $55,000,000), electronic lottery (up $29,100,000), contributions from lottery fund (up $8,600,000), excise taxes on alcoholic beverages (up $76,300,000), excise taxes on cigarettes (up $54,000,000), licenses (up $1,400,000), and decreases in federal excise taxes on off-shore rum shipments (down $9,200,000), special excise tax on certain petroleum products (down $10,600,000), tollgate taxes (down $23,500,000), tax on dividends (down $19,500,000), and withheld non-resident income taxes (down $22,300,000).

Current expenses and capital improvements of all budgetary funds total $12,600,793,000, an increase of $677,139,000 from fiscal year 2002. The major changes in General Fund expenditures by program in fiscal year 2003 are: increases in education (up $116,936,000), debt service (up $99,366,000), public safety and protection (up $94,350,000), general government (up $54,274,000), special pension contributions (up $27,604,000), welfare (up $18,353,000), and contributions to municipalities (up $10,743,000), and decreases in health (down $41,408,000) and other debts (down $59,911,000).

The general obligation bond authorization for the fiscal year 2003 budget is $500,000,000.

Differences between Budget and General Purpose Financial Statements

Revenue 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 financial statements prepared by the Department of the Treasury include accruals and other adjustments as required by government accounting standards.

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

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

LITIGATION

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

With respect to pending and threatened litigation, as of June 30, 2002, the Commonwealth will include in its financial statements reported liabilities of approximately $50 million for awarded and anticipated unfavorable judgments. This amount represented the amount estimated at the time as a probable liability or a liability with a fixed or expected due date, which would require future available financial resources for its payment. The Commonwealth believes that the ultimate liability in excess of amounts provided in the financial statements, if any, would not be significant.

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

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

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

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TOKYO

May __, 2003

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

Dear Sir:

We have examined Act. No. 2 of the Legislature of Puerto Rico, approved October 10, 1985, and Joint Resolution No. 57 of the Legislature of Puerto Rico, approved July 12, 1993 (collectively, the "Act"), and certified copies of the legal proceedings, including a resolution adopted by the Secretary of the Treasury of the Commonwealth of Puerto Rico and approved by the Acting Governor of the Commonwealth of Puerto Rico on April 16, 2003 (the "Resolution"), and other proofs submitted relative to the issuance and sale of the following described bonds (the "Bonds"):

$1,018,605,000
COMMONWEALTH OF PUERTO RICO

$360,000 PUBLIC IMPROVEMENT REFUNDING BONDS, SERIES 2003 B

and

$1,018,245,000 PUBLIC IMPROVEMENT REFUNDING BONDS, SERIES 2003 C

Dated: Date of Delivery.

Maturing on July 1 of the years and in such principal amounts and bearing interest at the rates, all as set forth in the Resolution. The Bonds are issuable as registered Bonds without coupons in the manner and in accordance with the terms and conditions of the Resolution. The Series 2003 B Bonds are not subject to redemption. The Series 2003 C Bonds are subject to redemption and tender for purchase as set forth in the Resolution.

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

From such examination we are of the opinion that:

1. The Act is valid.

2. Said proceedings have been validly and legally taken.

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

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

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

The Commonwealth of Puerto Rico has covenanted to comply, to the extent permitted by the Constitution and laws of the Commonwealth of Puerto Rico, with the requirements of the Code so that interest on the Bonds will remain exempt from federal income taxes to which it is not subject on the date of issuance of the Bonds. We are not aware of any provisions of the Constitution or laws of the Commonwealth of Puerto Rico which would prevent the Commonwealth of Puerto Rico from complying with the requirements of the Code.

Respectfully submitted,

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

FINANCIAL SECURITY ASSURANCE®

MUNICIPAL BOND INSURANCE POLICY

ISSUER:

BONDS:

Policy No.: -N

Effective Date:

Premium:

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

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

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

SPECIMEN

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

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

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

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

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

[Countersignature]

By ______________________________

FINANCIAL SECURITY ASSURANCE INC.

By ______________________________
Authorized Officer

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

Form 500NY (5/90)

SPECIMEN

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 U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners, or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

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

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

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

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:

SPECIMEN

Resident Licensed Agent

City, State

MBIA Insurance Corporation

SPECIMEN

President

Attest:

Assistant Secretary

STD-RCS-6
4/95