NEW ISSUE — FULL BOOK ENTRY

See "Book-Entry Only System" under *The 1998 Bonds*

In the opinion of Bond Counsel, subject to continuing compliance with certain tax covenants, interest on the 1998 Bonds is not includable in gross income for federal income tax purposes under existing statutes, regulations, rulings and court decisions. However, see "Tax Exemption" for a description of the alternative minimum tax and certain other federal tax consequences of ownership of the 1998 Bonds. Bond Counsel is further of the opinion that the 1998 Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation.

$1,129,643,740

Puerto Rico Highway and Transportation Authority

Transportation Revenue Bonds (Series A)

Dated: February 15, 1998*

Due: July 1, as shown below

The Transportation Revenue Bonds (Series A) (the "1998 Bonds") are issuable as registered bonds without coupons in denominations of $5,000 and any multiple thereof ($5,000 maturity amount and any multiple thereof in the case of the Capital Appreciation Bonds). Interest on the 1998 Bonds (other than the Capital Appreciation Bonds and the 1998 Variable Rate Bonds (as defined below)) will be payable on each January 1 and July 1, commencing July 1, 1998. Interest on the Capital Appreciation Bonds will be compounded on January 1 and July 1 of each year, commencing July 1, 1998 and will be payable only at maturity. The 1998 Bonds due July 1, 2028 in the original principal amount of $200,000,000 will be delivered as variable rate bonds (the "1998 Variable Rate Bonds"). The terms of the 1998 Variable Rate Bonds will be set forth in a supplement to this Official Statement (the "1998 Variable Rate Bond Supplement") which will be delivered to the initial purchasers of the 1998 Variable Rate Bonds. The term 1998 Bonds (other than the 1998 Variable Rate Bonds) are subject to redemption prior to maturity as set forth herein, the earliest possible redemption date being July 1, 2008. The 1998 Variable Rate Bonds are subject to redemption as described in the 1998 Variable Rate Bond Supplement.

The 1998 Bonds will be issued pursuant to Resolution No. 98-06 adopted by the Authority on February 26, 1998 (the "1998 Resolution"). The 1998 Bonds and any additional bonds that the Authority may from time to time issue under the 1998 Resolution (collectively, the "Transportation Revenue Bonds") are payable solely from, and are secured by a pledge of, revenues of the Authority consisting of: (i) the total amount of excise taxes, up to $120 million per fiscal year, imposed by the Commonwealth of Puerto Rico (the "Commonwealth") on certain petroleum products, (ii) tolls and other charges imposed by the Authority for the use of its Toll Facilities (other than Existing Toll Facilities Revenues prior to the repeal of the 1968 Resolution) (as each is defined herein), and (iii) certain investment earnings, as described herein. This is the first issue of Transportation Revenue Bonds under the 1998 Resolution.

The Transportation Revenue Bonds are also payable from, and are secured by a pledge of, certain other revenues of the Authority, which revenues, however, are first pledged to the payment of debt service on the Authority's outstanding Highway Revenue Bonds issued under Resolution No. 68-18 adopted by the Authority on June 13, 1968, as amended (the "1968 Resolution Revenues"). The 1968 Resolution Revenues consist of: (i) all current gasoline taxes, a portion of the current gas oil and diesel oil taxes and a portion of the current motor vehicle license fees allocated to the Authority by the Commonwealth, (ii) all Existing Toll Facilities Revenues, and (iii) certain investment earnings, as described herein. For a description of the revenues of the Authority and their disposition under the 1968 Resolution and 1998 Resolution, see "Security for the Senior Transportation Revenue Bonds-Pledged Revenues" under *The 1998 Bonds* herein.

All of the aforesaid taxes and license fees, which constitute revenues of the Authority, are subject to being applied first to the payment of general obligation debt of and debt guaranteed by the Commonwealth, if and to the extent that other Commonwealth revenues are not sufficient therefor.

The 1998 Bonds are not a debt of the Commonwealth or any of its political subdivisions, other than the Authority, and neither the Commonwealth nor any such subdivision, other than the Authority, shall be liable thereon.

The 1998 Bonds are offered for delivery when, as and if issued and accepted by the Underwriters, subject to the approval of legality by 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, San Juan, Puerto Rico. It is expected that the 1998 Bonds will be available for delivery to The Depository Trust Company in New York, New York, on or about March 19, 1998.

MERRILL LYNCH & CO. MORGAN STANLEY DEAN WITTER	BEAR, STEARNS & CO. INC.	GOLDMAN, SACHS & CO. PAINEWEBBER INCORPORATED
RAYMOND JAMES & ASSOCIATES INC. SAMUEL A. RAMIREZ & CO., INC.	JP MORGAN & CO.	PRUDENTIAL SECURITIES INCORPORATED SALOMON SMITH BARNEY

February 26, 1998

*Capital Appreciation Bonds and 1998 Variable Rate Bonds dated their date of delivery.

$1,129,643,740
Puerto Rico Highway and Transportation Authority
Transportation Revenue Bonds (Series A)

$271,730,000 Serial Bonds

Maturity (July 1)	Principal Amount	Interest Rate	Price or Yield
1999	$11,980,000	4.25%	3.840%
2000	12,490,000	4.25	3.970
2001	13,020,000	3.90	100
2002	13,530,000	5.00	4.050
2003	14,205,000	4.10	4.200
2004*	14,785,000	4.10	4.150
2005*	15,395,000	4.20	4.250
2006*	16,040,000	4.25	4.300
2007*	16,720,000	4.30	4.350
2008*	17,440,000	5.00	4.400
2009*	18,310,000	5.50	4.475
2010*	19,320,000	5.50	4.575
2011*	20,380,000	5.50	4.650
2012*	21,500,000	5.50	4.700
2013*	22,685,000	5.50	4.750
2014*	23,930,000	5.50	4.800

$10,845,127.50 Capital Appreciation Bonds due July 1, 2015* -- Yield 4.950%
$10,235,845.00 Capital Appreciation Bonds due July 1, 2016* -- Yield 5.000%
$ 9,651,307.50 Capital Appreciation Bonds due July 1, 2017* -- Yield 5.050%
$ 9,136,460.00 Capital Appreciation Bonds due July 1, 2018* -- Yield 5.075%

$818,045,000 Term Bonds

$114,360,000 5.00% Term Bonds due July 1, 2028* -- Yield 5.160%
$200,000,000 Term Bonds due July 1, 2028*† -- NRO
$250,000,000 5.00% Term Bonds due July 1, 2038 -- Yield 5.300%
$253,685,000 4.75% Term Bonds due July 1, 2038 -- Yield 5.220%

*Insured by Ambac Assurance Corporation.
†1998 Variable Rate Bonds.

No dealer, broker, sales representative or other person has been authorized by the Authority 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 Authority 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 Transportation Revenue Bonds (Series A) (the "1998 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 Authority and other official sources that are believed to be reliable, but is not guaranteed as to accuracy or completeness and is not to be construed as a representation by any Underwriter. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs or condition of the Authority or the Commonwealth since the date hereof.

IN CONNECTION WITH THE OFFERING OF THE 1998 BONDS, THE UNDERWRITERS MAY EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE 1998 BONDS AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL ON THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

TABLE OF CONTENTS

[This page intentionally left blank]

$1,129,643,740
PUERTO RICO HIGHWAY AND TRANSPORTATION AUTHORITY
Transportation Revenue Bonds (Series A)

This Official Statement sets forth information in connection with the sale by Puerto Rico Highway and Transportation Authority (the "Authority") of $1,129,643,740 aggregate principal amount of its Puerto Rico Highway and Transportation Authority Transportation Revenue Bonds (Series A) (the "1998 Bonds"). The 1998 Bonds will be issued pursuant to Act No. 74 of the Legislature of Puerto Rico, approved June 23, 1965, as amended (the "Authority Act"), and Resolution No. 98-06, adopted by the Authority on February 26, 1998 (the "1998 Resolution") and Resolution No. 98-07, adopted by the Authority on February 26, 1998 ("Resolution 98-07"). The Chase Manhattan Bank has been appointed to act as fiscal agent under the 1998 Resolution (in such capacity, the "1998 Fiscal Agent").

The 1998 Bonds maturing on July 1 of the years 2015 through 2018 are being issued as capital appreciation bonds (the "Capital Appreciation Bonds"). The 1998 Bonds due July 1, 2028 in the original principal amount of $200,000,000 will be delivered as variable rate bonds (the "1998 Variable Rate Bonds"). The terms of the 1998 Variable Rate Bonds will be set forth in a supplement to this Official Statement (the "1998 Variable Rate Bond Supplement") which will be delivered to the initial purchasers of the 1998 Variable Rate Bonds. The principal of and interest on the 1998 Bonds maturing on July 1 of the years 2004 through 2028 (the "Insured Bonds") will be insured by a municipal bond insurance policy (the "Ambac Bond Insurance Policy") issued to the 1998 Fiscal Agent by Ambac Assurance Corporation ("Ambac Assurance"). The 1998 Bonds and any additional bonds issued under the 1998 Resolution, as described below, are herein collectively referred to as the "Transportation Revenue Bonds". The 1998 Bonds are the first Series of Transportation Revenue Bonds issued under the 1998 Resolution.

The Authority is issuing the 1998 Bonds to finance or refinance a portion of the costs of construction of a new urban rail mass transit system for the San Juan metropolitan region, known as Tren Urbano, and certain highway system improvements, to make a deposit to the 1998 Senior Bond Reserve Account hereinafter mentioned and to refund a portion of the Authority's outstanding Puerto Rico Highway Authority Highway Revenue Bonds (Series G), Puerto Rico Highway Authority Highway Revenue Bonds (Series Q) and Puerto Rico Highway and Transportation Authority Highway Revenue Bonds (Series Y) (collectively, the "Refunded Bonds") issued under the 1968 Resolution (hereinafter mentioned). See *Financing Plan.*

As described more fully below, the 1998 Resolution permits the Authority to issue bonds subordinated in right of payment to the 1998 Bonds and any additional Transportation Revenue Bonds issued on a parity with the 1998 Bonds (the "Subordinated Bonds") for the purpose of financing transportation projects eligible for federal assistance. The Authority is contemplating issuing Subordinated Bonds under the 1998 Resolution to finance certain highway projects eligible for federal financial assistance. See "Additional Bonds-Subordinated Bonds" under *The 1998 Bonds*. The 1998 Bonds and all Transportation Revenue Bonds senior to the Subordinated Bonds are hereinafter referred to as the "Senior Transportation Revenue Bonds". All Senior Transportation Revenue Bonds will be secured equally and ratably under the 1998 Resolution. All Subordinated Bonds will be secured equally and ratably under the 1998 Resolution (except for differences in any debt service reserve requirements related thereto as permitted by the 1998 Resolution) and will be payable from 1998 Resolution Revenues (as defined below) remaining after providing for the payment of debt service on Senior Transportation Revenue Bonds and providing the required debt service reserve therefor.

The Authority has heretofore issued pursuant to Resolution No. 68-18, adopted by the Authority on June 13, 1968, as amended (the "1968 Resolution"), Puerto Rico Highway and Transportation Authority Highway Revenue Bonds, of which $2,411,955,000 principal amount was outstanding as of December 31, 1997 (said bonds, and any additional bonds that may be issued under the 1968 Resolution (subject to the limitations as to the issuance of such additional bonds contained in the 1998 Resolution, as hereinafter described) are herein collectively called the "Highway Revenue Bonds"). The Authority has determined to finance its future capital requirements, after applying other available funds, through the issuance of Transportation Revenue Bonds under the terms and conditions of the 1998

Resolution and has covenanted in the 1998 Resolution not to issue additional bonds under the 1968 Resolution, other than bonds whose maturity does not extend beyond July 1, 2036 and which are issued (i) to refund outstanding Highway Revenue Bonds to achieve debt service savings, or (ii) in exchange for all outstanding Puerto Rico Highway and Transportation Authority Special Facility Revenue Bonds issued under a separate trust agreement to finance the Teodoro Moscoso Bridge, as described below. See "Additional Bonds-Highway Revenue Bonds" under *The 1998 Bonds* and "Teodoro Moscoso Bridge" under *Transportation System Revenues and Expenditures.*

Capitalized terms used herein but not otherwise defined herein have the meanings assigned to them under *Summary of Certain Provisions of the 1968 Resolution* and *Summary of Certain Provisions of the 1998 Resolution.*

INTRODUCTION

The Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico") established the Authority in 1965 as a public corporation and governmental instrumentality to design and oversee the construction, reconstruction and improvement of Puerto Rico's highway system. Puerto Rico's highway system consists of 4,590 miles of roads, highways, bridges and tunnels, including the Luis A. Ferré (PR-52), De Diego (PR-22) and PR-53 tollways (see the Puerto Rico Strategic Network map). The Authority operates and maintains these tollways and related connecting roads. The Department of Transportation and Public Works (the "Department"), through its Public Works Directorate, operates and maintains all other portions of Puerto Rico's highway system. There are also approximately 9,970 miles of local streets and adjacent roads in Puerto Rico operated and maintained at the municipal level which are not part of Puerto Rico's highway system.

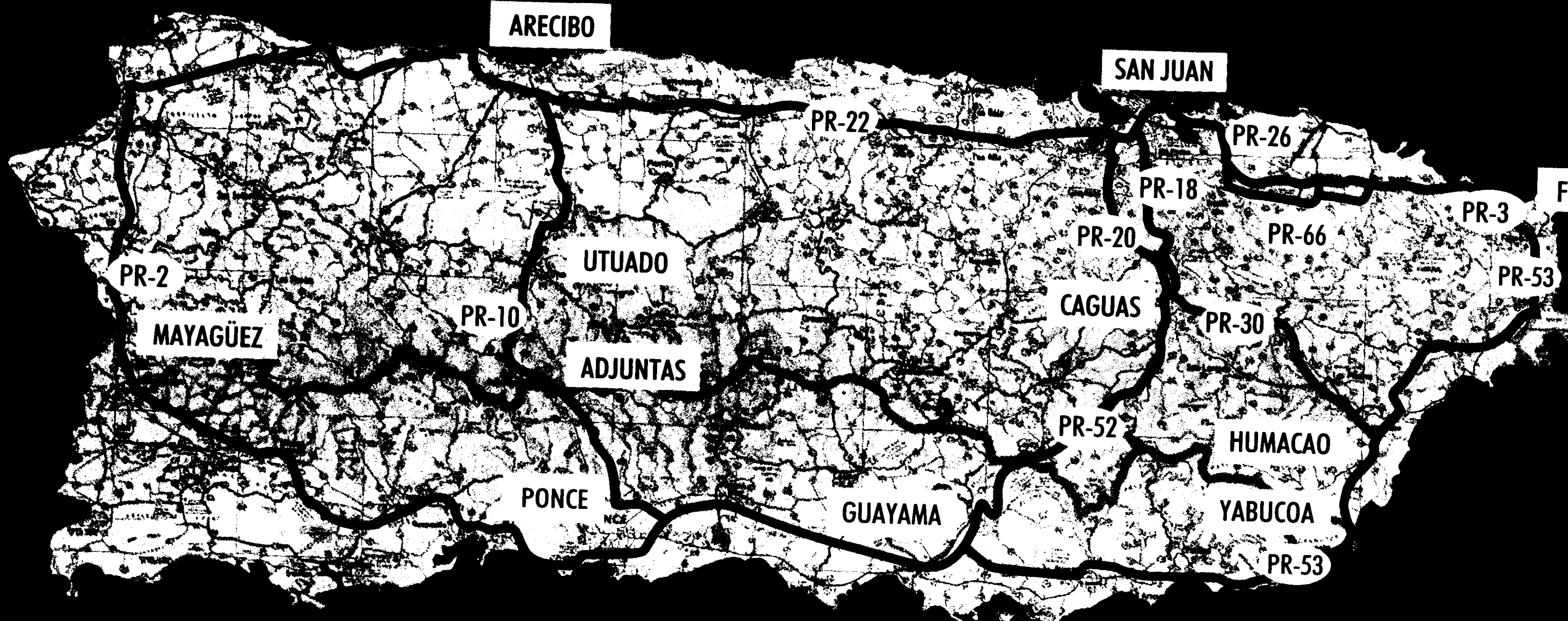
Since 1968, the Authority has carried out the planning, construction, improvement and equipping of all Puerto Rico roads, highways, bridges and tunnels pursuant to its master plan for the long-range development of the highway system, which plan is supplemented as necessary, and an ongoing five-year priorities construction program (the "Priorities Construction Program"). During this time, the Authority has constructed highway system facilities with a total cost of approximately $6,121 million. This amount includes approximately $2,267 million financed with internally generated funds, $2,580 million financed through the issuance of Highway Revenue Bonds, $1,200 million paid with federal highway assistance funds and $74 million paid with funds provided by the Legislature of Puerto Rico.

Legislation enacted in 1990 and 1991 expanded the Authority's power to enable it to contract for the private design, construction, operation and maintenance of roads, highways, bridges and tunnels and to implement public policy relating to the development of a multi-modal transportation system for Puerto Rico. In furtherance of these expanded powers, in 1991 the Authority entered into a concession agreement with a private company for the design, construction, operation and maintenance of a toll bridge facility known as the Teodoro Moscoso Bridge. The bridge opened to traffic in February 1994. See "Teodoro Moscoso Bridge" under *Transportation System Revenues and Expenditures.*

In 1994, the Authority began planning and designing and in 1996 began constructing a new mass transit rail project for the San Juan Metropolitan Region known as the Tren Urbano (see the Tren Urbano Alignment map). Through the end of fiscal 1997, the Authority had invested $158 million in this project. The Tren Urbano is the largest single project included in the Authority's current Priorities Construction Program. Its initial phase consists of approximately 17 km. of trackway running from Bayamón to Santurce. This initial phase is expected to be fully operational by the end of 2001, and its total construction cost is estimated to be $1.55 billion, approximately 30% of which is expected to be funded by the federal government. The Authority has contracted with various private parties for the construction of the project and has entered into a five-year contract for the operation and maintenance of the system. See "Operating Expenses and Capital Expenditures-Priorities Construction Program-Tren Urbano" under *Transportation System Revenues and Expenditures.*

The 1998 Bonds, together with any additional Transportation Revenue Bonds issued by the Authority, are payable solely from, and are secured by a pledge of, the Authority's 1998 Resolution Revenues (as defined below), including 1968 Resolution Revenues (as defined below) remaining after their application to pay debt service on the Authority's outstanding Highway Revenue Bonds and providing a reserve therefor. Under certain circumstances relating

Puerto Rico Strategic Network



Completed
Under construction

Programmed

[This page intentionally left blank]

Tren Urbano Alignment

Elevated Center Platform

Elevated Side Platform

Retained Cut Side Platform

Retained Cut Center Platform

Underground Center Platform with Mezzanine

Park & Ride

[This page intentionally left blank]

to the termination of the Authority's private concession agreement for the Teodoro Moscoso Bridge, such remaining 1968 Resolution Revenues would be applied to the payment of debt service on the Authority's Special Facility Revenue Bonds issued to finance the Teodoro Moscoso Bridge prior to the application of such revenues to the payment of debt service on the Transportation Revenue Bonds. See the fifth paragraph in "Teodoro Moscoso Bridge" under *Transportation System Revenues and Expenditures.* Any Subordinated Bonds issued by the Authority will be payable from 1998 Resolution Revenues remaining after their application to pay debt service on the Senior Transportation Revenue Bonds and providing a reserve therefor. See "Security for the Senior Transportation Revenue Bonds" under *The 1998 Bonds.*

The 1998 Resolution Revenues consist of: (i) the total amount of excise taxes, up to $120 million per fiscal year, imposed by Puerto Rico on certain petroleum products (as defined herein), (ii) the tolls and other charges imposed by the Authority for the use of Toll Facilities (other than Existing Toll Facilities Revenues (as defined below) prior to the repeal and cancellation of the 1968 Resolution), (iii) certain investment earnings, all as described more fully below, and (iv) until the Highway Revenue Bonds are paid or defeased and the 1968 Resolution is repealed and canceled, Excess 1968 Resolution Revenues (as defined below) and, after the repeal and cancellation of the 1968 Resolution, all 1968 Resolution Revenues. See "Security for the Senior Transportation Revenue Bonds-Pledged Revenues-1998 Resolution Revenues" under *The 1998 Bonds.*

The 1968 Resolution Revenues consist of: (i) all current gasoline taxes, a portion of the current gas oil and diesel oil taxes and a portion of the current motor vehicle license fees allocated to the Authority by the Commonwealth, (ii) all toll revenues of the Traffic Facilities (as defined in the 1968 Resolution) financed with Highway Revenue Bonds and any extensions, improvements or betterments thereto however financed (the "Existing Toll Facilities Revenues"), and (iii) certain investment earnings, all as described more fully below. See "Security for the Senior Transportation Revenue Bonds" under *The 1998 Bonds.*

All of the aforesaid taxes and license fees constituting revenues of the Authority pledged under the 1968 Resolution or the 1998 Resolution are subject to being applied first to the payment of general obligation debt of and debt guaranteed by the Commonwealth, if and to the extent that all other Commonwealth revenues are not sufficient therefor. See "Prior Payment of Full Faith and Credit Obligations of the Commonwealth" under *The 1998 Bonds* and "Debt" in *Appendix I.* The Commonwealth has never applied the taxes or license fees allocated to the Authority to the payment of such Commonwealth debt.

Neither the credit of the Commonwealth nor that of any of its political subdivisions, other than the Authority, is pledged for the payment of the 1998 Bonds.

The financial condition of the Commonwealth and economic conditions in Puerto Rico, including gasoline and oil prices and automobile usage, affect the level of revenues available to the Authority. In addition, Commonwealth appropriations for the Department affect the level of maintenance for the portion of the Puerto Rico highway system which is the responsibility of the Department. Certain information regarding the Commonwealth is set forth in *Appendix I* hereto and the financial statements of the Commonwealth are incorporated herein by reference. See *Miscellaneous.*

This Official Statement includes brief descriptions of the Authority, the Commonwealth and the Authority's transportation system, revenues and expenditures and Priorities Construction Program, together with other information, including summaries of the terms of the 1998 Bonds (except the 1998 Variable Rate Bonds), the 1998 Resolution, the 1968 Resolution, and the various statutes affecting the Authority. Such summaries and the references to all documents referred to herein do not purport to be complete, and each summary and reference is qualified in its entirety by reference to each such document, copies of which are available from the Authority. All references to the 1998 Bonds are qualified in their entirety by reference to the definitive forms thereof and the information with respect thereto contained in the 1998 Resolution and Resolution 98-07.

FINANCING PLAN

The Authority is issuing the 1998 Bonds (i) to finance or refinance a portion of the costs of the Tren Urbano and various highway projects included in the Authority's current Priorities Construction Program, including the payment of approximately $280 million principal amount of notes (the "Outstanding Notes") held by Government Development Bank for Puerto Rico ("Government Development Bank"), (ii) to make a deposit to the 1998 Senior Bond Reserve Account, and (iii) to refund the Refunded Bonds. See "Operating Expenses and Capital Expenditures-Priorities Construction Program" under *Transportation System Revenues and Expenditures* and "Security for the Senior Transportation Revenue Bonds-1998 Senior Bond Reserve Account" under *The 1998 Bonds*.

Sources and Uses of Funds

Sources:

Principal Amount of 1998 Bonds	$1,129,643,740.00
Accrued Interest	4,111,828.49
Deposit from 1968 Reserve Account	5,660,631.31
Total Sources	$1,139,416,199.80

Uses:

Deposit into 1998 Construction Fund	$ 663,000,000.00
Payment of Outstanding Notes	280,000,000.00
Net Original Issue Discount	23,538,887.45
Deposit to Escrow Fund for Refunded Bonds	90,664,374.31
Deposit to 1998 Senior Bond Service Account	4,111,828.49
Deposit into 1998 Senior Bond Reserve Account	64,834,252.50
Underwriting discount, municipal bond insurance premium, and legal, printing and financing expenses	13,266,857.05
Total Uses	$1,139,416,199.80

Refunding of Highway Revenue Bonds

From the proceeds of the 1998 Bonds, $85,003,743, together with other available moneys, will be deposited into an Escrow Deposit Trust Fund (the "Escrow Fund") pursuant to the Escrow Deposit Letter, dated March 19, 1998 (the "Escrow Deposit Letter"), from the Authority to The Chase Manhattan Bank, Fiscal Agent under the 1968 Resolution (in such capacity, the "1968 Fiscal Agent"), in order to refund the Refunded Bonds on the dates and at the redemption prices set forth below:

Refunded Bonds	Amount to be Refunded	Interest Rate	Maturity Date	Redemption Date	Redemption Price
Highway Revenue Bonds of 1973 (Series G)	$37,600,000	5.50%	July 1, 2003	April 23, 1998	100.00%
Highway Revenue Bonds of 1990 (Series Q)	30,000,000	6.00	July 1, 2020	July 1, 2000	100.00
Highway Revenue Bonds of 1996 (Series Y)	20,000,000	6.00	July 1, 2022	July 1, 2006	101.50

The refunding will permit the Authority to realize annual savings on its debt service requirements on outstanding Highway Revenue Bonds under the 1968 Resolution. The moneys deposited in the Escrow Fund will be invested in Government Obligations (as defined in the 1968 Resolution) maturing in amounts and bearing interest at rates sufficient to pay, when due, without any reinvestment, the principal of and premium, if any, and interest on the Refunded Bonds as described above. All amounts held in the Escrow Fund will be held in trust solely for the benefit of the holders of the Refunded Bonds. Upon the deposit into the Escrow Fund, the Refunded Bonds will no longer be deemed to be outstanding under the 1968 Resolution.

THE 1998 BONDS

Description of the 1998 Bonds

General

The 1998 Bonds (other than the 1998 Variable Rate Bonds) will be issued as registered bonds without coupons, will be dated, will bear interest at the rates (or have such yields in the case of the Capital Appreciation Bonds), will be payable at the times, and will mature on the dates and in the principal amounts (except with respect to the Capital Appreciation Bonds) set forth on the inside cover of this Official Statement. Principal of and premium, if any, and interest on the 1998 Bonds will be payable in the manner described below in "Book-Entry Only System" under *The 1998 Bonds*. The 1998 Bonds are subject to redemption as described below under "Redemption Provisions".

The Capital Appreciation Bonds will be payable at maturity in amounts (the "Accreted Values") equal to the original principal amounts of such Bonds plus interest from their dated dates, compounded semi-annually. The Accreted Values per $5,000 maturity amount of each Capital Appreciation Bond, on the date of delivery of the 1998 Bonds and on each January 1 and July 1, commencing July 1, 1998, is shown in Appendix VI. The Accreted Value of the Capital Appreciation Bonds on any other date is calculated on the assumption that such Accreted Value increases in equal daily amounts up to the Accreted Value on the next January 1 or July 1, as appropriate. Interest on the Capital Appreciation Bonds will be payable only at maturity.

The terms of the 1998 Variable Rate Bonds will be set forth in a supplement to this Official Statement which will be delivered to the initial purchasers of the 1998 Variable Rate Bonds.

Redemption Provisions

Optional Redemption

The 1998 Bonds maturing on July 1, 2028 and issued in the original principal amount of $114,360,000 and on July 1, 2038 and issued in the original principal amount of $250,000,000 at the time outstanding may be redeemed on or after July 1, 2008 at the option of the Authority from any available moneys (other than moneys deposited in the 1998 Senior Bond Sinking Fund in respect of an Amortization Requirement) on any date either in whole or, as the Authority may direct, in part at the following prices (expressed as percentages of the principal amount) plus accrued interest to the redemption date:

Period During Which Redeemed	Redemption Price
July 1, 2008 through June 30, 2009	101 %
July 1, 2009 through June 30, 2010	100½
July 1, 2010 and thereafter	100

The 1998 Bonds maturing on July 1, 2038 in the original principal amount of $253,685,000 at the time outstanding may be redeemed on or after July 1, 2018 at the option of the Authority from any available moneys (other than moneys deposited in the 1998 Senior Bond Sinking Fund in respect of an Amortization Requirement) on any date either in whole or in part at a redemption price equal to the principal amount thereof plus accrued interest to the redemption date, without premium.

Mandatory Redemption

The 1998 Bonds issued as term bonds are subject to redemption on each July 1 immediately after the fiscal year for which there is an Amortization Requirement to the extent of the respective Amortization Requirements for said 1998 Bonds (less the amount of moneys in the 1998 Senior Bond Sinking Fund used to retire bonds by purchase) from moneys in the 1998 Senior Bond Sinking Fund at par plus accrued interest in the years and amounts set forth below:

	Amortization Requirements(1) for 1998 Bonds due July 1,		
Year	**2028 ($114,360,000 term bond)**	**2038 ($250,000,000 term bond)**	**2038 ($253,685,000 term bond)**
2019	$ 9,160,000		
2020	9,600,000		
2021	10,065,000		
2022	10,550,000		
2023	11,065,000		
2024	11,600,000		
2025	12,165,000		
2026	12,755,000		
2027	13,375,000		
2028	14,025,000*		
2029		$19,865,000	$20,415,000
2030		20,860,000	21,385,000
2031		21,905,000	22,400,000
2032		23,005,000	23,460,000
2033		24,155,000	24,570,000
2034		25,370,000	25,730,000
2035		26,640,000	26,955,000
2036		27,975,000	28,230,000
2037		29,375,000	29,570,000
2038		30,850,000*	30,970,000*
Average life (years)	26.17	36.18	36.16

* Maturity.

(1) The Amortization Requirements for the 1998 Variable Rate Bonds are set forth in the 1998 Variable Rate Bond Supplement.

Notice of Redemption

Notice of redemption of the 1998 Bonds shall be given not less than 30 days prior to the redemption date by first-class mail, postage prepaid, to The Depository Trust Company ("DTC"), New York, New York (or if the book-entry only system has been discontinued as described below, to the registered owners of the 1998 Bonds or portions thereof to be redeemed at their addresses appearing upon the registration books, but failure to mail such notice to the registered owner of any 1998 Bond or any defect in such notice will not affect the redemption of any other 1998 Bonds as to which proper notice shall have been duly mailed). If notice of redemption shall have been duly mailed as aforesaid, and if on the redemption date moneys or Government Obligations which will provide moneys sufficient for the redemption of all 1998 Bonds or portions thereof to be redeemed, together with interest to the redemption date, shall be held by the 1998 Fiscal Agent for such payment, then interest on such 1998 Bonds or portions thereof shall cease to accrue.

Selection of 1998 Bonds to be Redeemed

If less than all of the 1998 Bonds of any one maturity shall be called for redemption, the particular 1998 Bonds or portions thereof to be redeemed shall be selected by the 1998 Fiscal Agent in such manner as it in its discretion may determine to be appropriate and fair. If during any fiscal year the total principal amount of term 1998 Bonds of a particular maturity retired by purchase or redemption exceeds the Amortization Requirement for such term 1998 Bonds for such year, the Amortization Requirements for such term 1998 Bonds shall be reduced for subsequent fiscal years in amounts aggregating such excess as shall be determined by the Authority.

Security for the Senior Transportation Revenue Bonds

Pledged Revenues

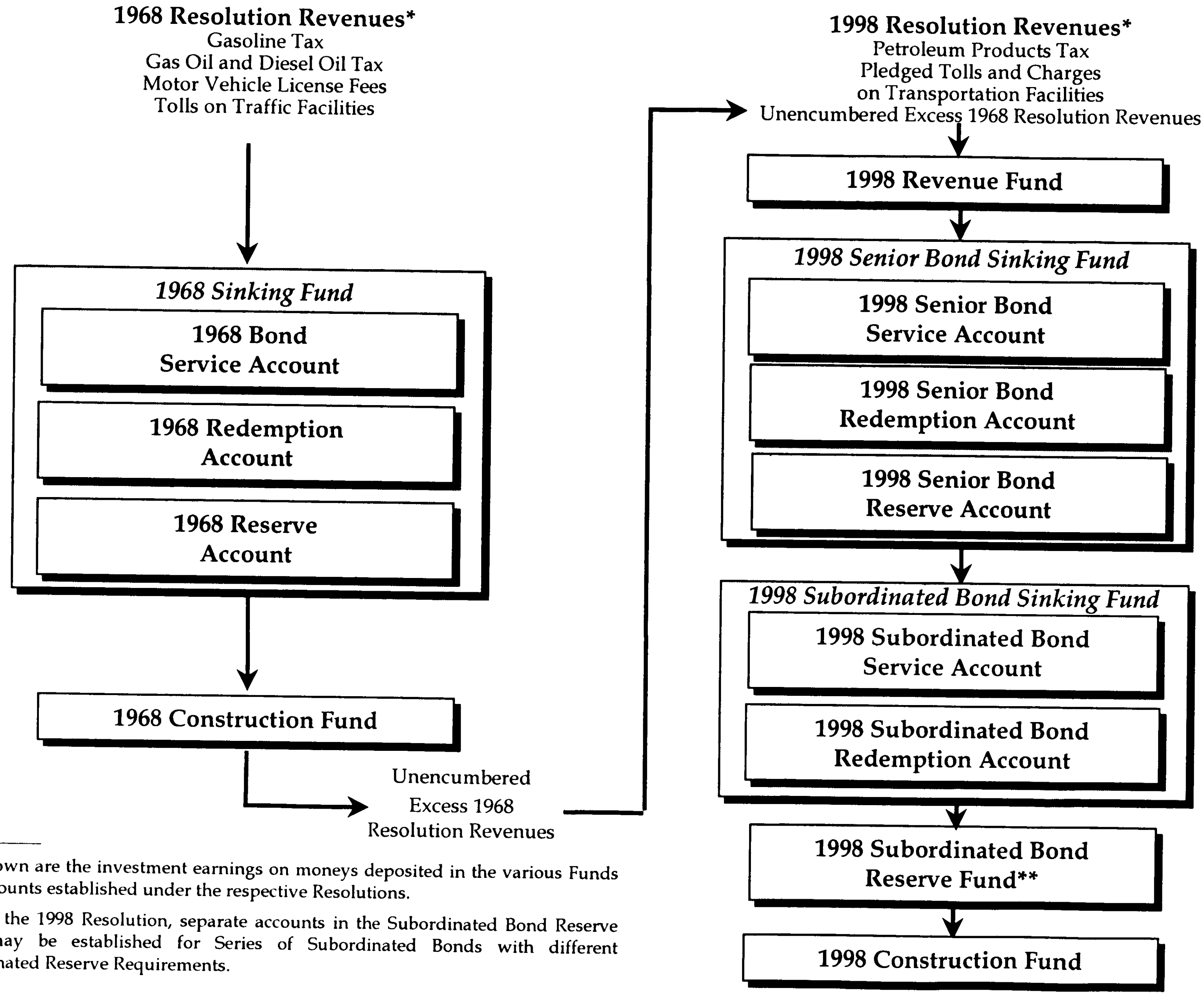
The 1998 Bonds and any additional Senior Transportation Revenue Bonds issued under the 1998 Resolution are payable solely from, and secured by a pledge of, the 1998 Resolution Revenues and all other moneys held for the credit of the 1998 Senior Bond Sinking Fund, which includes the 1998 Senior Bond Service Account, the 1998 Senior Bond Redemption Account and the 1998 Senior Bond Reserve Account. Under certain circumstances described below, moneys in the 1998 Construction Fund or the 1998 Subordinated Bond Sinking Fund may be used to pay debt service on the Senior Transportation Revenue Bonds, if moneys in the 1998 Senior Bond Service Account or the 1998 Senior Bond Redemption Account are insufficient therefor, prior to applying moneys in the 1998 Senior Bond Reserve Account.

1998 Resolution Revenues. The 1998 Resolution Revenues consist of: (i) all excise taxes on crude oil, unfinished oil and derivative products ("petroleum products"), up to $120 million per fiscal year, imposed by Puerto Rico and allocated to the Authority by Act No. 34 of the Legislature of Puerto Rico approved July 16, 1997, as amended ("Act No. 34"), which amended Subtitle B of Act No. 120 of the Legislature of Puerto Rico, approved October 31, 1994, as amended (the "1994 Code"); (ii) the tolls and other charges imposed by the Authority for the use of Toll Facilities (other than Existing Toll Facilities Revenues prior to the repeal and cancellation of the 1968 Resolution); (iii) the proceeds of any other taxes, fees or charges which the Legislature of Puerto Rico allocates to the Authority in the future and which the Authority pledges to the payment of Transportation Revenue Bonds; (iv) investment earnings on deposits to the credit of funds and accounts established under the 1998 Resolution, except for the 1998 Construction Fund; and (v) prior to the repeal and cancellation of the 1968 Resolution, any unencumbered 1968 Resolution Revenues (as described below) remaining on deposit in the 1968 Construction Fund after payment or provision for payment of debt service and required reserves on the outstanding Highway Revenue Bonds (the "Excess 1968 Resolution Revenues") and, after said repeal and cancellation, all 1968 Resolution Revenues. 1998 Resolution Revenues do not include excise taxes on petroleum products which may be levied or collected from time to time other than the amount of such taxes described in this paragraph unless allocated to the Authority and pledged by the Authority to the payment of Transportation Revenue Bonds. The excise tax on petroleum products imposed by the 1994 Code and allocated to the Authority by Act No. 34 is a different tax from the excise tax on gasoline and gas oil and diesel oil imposed by the 1994 Code and allocated to the Authority, as discussed below.

Under certain circumstances relating to the termination of the Authority's private concession agreement for the Teodoro Moscoso Bridge, the Excess 1968 Resolution Revenues would be encumbered for the benefit of the holders of the Authority's Special Facility Revenue Bonds issued to finance the Teodoro Moscoso Bridge and would be required to be applied to the payment of debt service on such bonds prior to the application of such revenues to the payment of debt service on the Transportation Revenue Bonds. See the fifth paragraph in "Teodoro Moscoso Bridge" under *Transportation System Revenues and Expenditures.* Under the 1998 Resolution, the Authority has covenanted not to encumber, withdraw or pledge any Excess 1968 Resolution Revenues deposited in the 1968 Construction Fund except in the limited circumstance of the Authority's taking over operation of the Teodoro Moscoso Bridge.

1968 Resolution Revenues. The 1968 Resolution Revenues consist of: (i) the gross receipts of the current $0.16 per gallon excise tax on gasoline and $0.04 of the current $0.08 per gallon excise tax on gas oil and diesel oil imposed by Puerto Rico and allocated to the Authority (after any deductions for taxes on fuels used in sea and air transportation that are required to be reimbursed under certain circumstances) by the 1994 Code (the remaining $0.04 per gallon excise tax has been allocated to the Metropolitan Bus Authority by Act No. 39 of July 19, 1997); (ii) the gross receipts derived from the $15 per vehicle increase of annual motor vehicle license fees imposed by Puerto Rico and allocated to the Authority by Act No. 9 of the Legislature of Puerto Rico, approved August 12, 1982 ("Act No. 9"); (iii) Existing Toll Facilities Revenues; and (iv) investment earnings on deposits to the credit of funds and accounts established under the 1968 Resolution, except for the 1968 Construction Fund. 1968 Resolution Revenues do not include gasoline taxes, gas oil and diesel oil taxes, and motor vehicle license fees which may be levied or collected from time to time other than the amounts of the taxes and fees described in this paragraph unless allocated to the Authority and pledged by the Authority to the payment of Highway Revenue Bonds or Transportation Revenue Bonds, as the case may be.

Flow of Funds Under 1968 Resolution and 1998 Resolution



*Not shown are the investment earnings on moneys deposited in the various Funds and Accounts established under the respective Resolutions.

**Under the 1998 Resolution, separate accounts in the Subordinated Bond Reserve Fund may be established for Series of Subordinated Bonds with different Subordinated Reserve Requirements.

Commitment Not to Reduce Taxes and Fees. The Commonwealth has agreed and committed in the 1994 Code that it will not reduce the gasoline tax below $0.16 per gallon, the tax on gas oil and diesel oil below $0.04 per gallon or the tax on petroleum products below the tax rates in effect on July 16, 1997 (as described below), and that it will not reduce the amount of any such taxes allocated to the Authority until all obligations of the Authority, including the Highway Revenue Bonds and the Transportation Revenue Bonds, secured by the pledge thereof are fully paid. The Commonwealth has also agreed and pledged in Act No. 9 that it will not reduce the motor vehicle license fees allocated and pledged to the payment of obligations of the Authority, including the Highway Revenue Bonds and the Transportation Revenue Bonds, so long as the proceeds of such increase in fees remain pledged to the payment of such obligations.

Special Fund. Under the 1994 Code and Act No. 9, the proceeds of the taxes and license fee increase allocated to the Authority are deposited by the Department of the Treasury in a special fund (the "Special Fund") in favor of the Authority. In accordance with the Constitution of Puerto Rico, the proceeds of such taxes and license fee increase are subject to being applied first to the payment of general obligation debt of and debt guaranteed by the Commonwealth, if and to the extent that other Commonwealth revenues are insufficient therefor. The Commonwealth has never applied the proceeds of such taxes or license fee increase allocated to the Authority to the payment of such debt nor has the Commonwealth ever defaulted on the payment of principal of or interest on any of such debt. For information with respect to Commonwealth debt and the economic and financial condition of the Commonwealth, see "Prior Payment of Full Faith and Credit Obligations of the Commonwealth" below and "Debt" in *Appendix I.*

Flow of Funds. Moneys in the Special Fund are transferred by the Department of the Treasury to the Authority at least monthly. Upon receipt of such moneys, the Authority makes the deposits described below. The chart on page 9 illustrates the flow of such moneys into the various funds and accounts established under the 1968 Resolution and the 1998 Resolution. The chart is provided only as a summary of the flow of funds under the 1968 Resolution and the 1998 Resolution, and does not purport to be complete. Reference is made to *Summary of Certain Provisions of the 1968 Resolution* and *Summary of Certain Provisions of the 1998 Resolution*, which should be read in conjunction herewith.

Upon receipt from the Department of the Treasury of any moneys in the Special Fund constituting 1998 Resolution Revenues, the Authority is required under the 1998 Resolution to deposit such moneys, together with any other moneys constituting 1998 Resolution Revenues (other than investment earnings), into the 1998 Revenue Fund. In addition, the Authority is required to deposit monthly into the 1998 Revenue Fund all unencumbered Excess 1968 Resolution Revenues. The Authority is required to withdraw monthly from the 1998 Revenue Fund and deposit into the 1998 Senior Bond Service Account and the 1998 Senior Bond Redemption Account the respective equal monthly amounts necessary to provide for the payment of principal of and interest and premium, if any, on the Senior Transportation Revenue Bonds and the amount necessary for required deposits to the 1998 Senior Bond Reserve Account. Any remaining 1998 Resolution Revenues (other than investment earnings) are then required to be deposited monthly (in the respective equal monthly amounts) into the 1998 Subordinated Bond Service Account and the 1998 Subordinated Bond Redemption Account to provide for the payment of principal of and interest and premium, if any, on the Subordinated Bonds and thereafter, into the 1998 Subordinated Bond Reserve Fund, as required. Any remaining 1998 Resolution Revenues are then deposited into the 1998 Construction Fund and are available to the Authority for any of the authorized purposes of the Authority, but subject to the payment of certain operation and maintenance expenses and repair, renewal and replacement costs, as required by the 1998 Resolution. See *Summary of Certain Provisions of the 1998 Resolution.* Once all outstanding Highway Revenue Bonds are paid or defeased and the 1968 Resolution is repealed and canceled, all revenues of the Authority formerly constituting 1968 Resolution Revenues will be deposited upon receipt by the Authority into the 1998 Revenue Fund for application as described above.

Upon receipt from the Department of the Treasury of any moneys in the Special Fund constituting 1968 Resolution Revenues, the Authority is required under the 1968 Resolution to deposit such moneys, together with all Existing Toll Facilities Revenues, in equal monthly amounts into the 1968 Bond Service Account and the 1968 Redemption Account to provide for the payment of principal of and interest and premium, if any, on the Highway Revenue Bonds and in the amounts necessary for the required deposits to the 1968 Reserve Account. Any remaining 1968 Resolution Revenues (other than investment earnings) are deposited into the 1968 Construction Fund to be applied to authorized purposes of the Authority. See *Summary of Certain Provisions of the 1968 Resolution.* Pursuant to the

1998 Resolution, all such Excess 1968 Resolution Revenues deposited in the 1968 Construction Fund, to the extent not encumbered by the Authority, must be withdrawn monthly and transferred to the 1998 Revenue Fund for application as described above. See *Summary of Certain Provisions of the 1998 Resolution*. Under certain circumstances relating to the termination of the concession agreement for the Teodoro Moscoso Bridge, such Excess 1968 Resolution Revenues would be encumbered for the benefit of the holders of the Authority's Special Facility Revenue Bonds issued to finance the Teodoro Moscoso Bridge and would have to be applied by the Authority for the payment of debt service on such bonds. See the fifth paragraph in "Teodoro Moscoso Bridge" under *Transportation System Revenues and Expenditures*. Under the 1998 Resolution, the Authority has agreed not to encumber or withdraw or pledge any Excess 1968 Resolution Revenues deposited in the 1968 Construction Fund except in the limited circumstance of the Authority's taking over operation of the Teodoro Moscoso Bridge.

Replenishment of Reserve Accounts. Under the 1994 Code, if moneys in the 1968 Reserve Account, 1998 Senior Bond Reserve Account or any accounts established in the 1998 Subordinated Bond Reserve Fund (collectively, the "Reserve Accounts") are applied to cover a deficiency in the amounts necessary for payment of the principal of and interest on the Highway Revenue Bonds, Senior Transportation Revenue Bonds or Subordinated Bonds, respectively, the amounts used from any of the applicable Reserve Accounts to cover said deficiency shall be reimbursed to the Authority from the first amounts received in the next fiscal year or subsequent years by the Commonwealth derived from (i) any other taxes which may then be in effect on any other fuel or propellant which is used, among other purposes, to propel highway vehicles, and (ii) any remaining portion of the gasoline tax and petroleum products tax then in effect. The proceeds of said other taxes and the remainder of the gasoline tax and petroleum products tax to be used to reimburse the applicable Reserve Accounts are not deposited in the General Fund of the Commonwealth when collected, but are deposited instead in the Special Fund for the benefit of the Authority, and, subject to the provisions of Section 8 of Article VI of the Constitution of Puerto Rico, used to reimburse said Reserve Accounts. In the 1998 Resolution, the Authority covenants to apply any such reimbursement received first to replenish the 1968 Reserve Account, then to replenish the 1998 Senior Bond Reserve Account, and finally to replenish any accounts in the 1998 Subordinated Bond Reserve Fund.

The 1998 Bonds are not a debt of the Commonwealth or any of its political subdivisions (other than the Authority), and neither the Commonwealth nor any such subdivision (other than the Authority) shall be liable thereon.

Neither the 1968 Resolution nor the 1998 Resolution contains events of default or provides for the acceleration of the maturities of the Highway Revenue Bonds or the Transportation Revenue Bonds.

1998 Senior Bond Reserve Account

The 1998 Resolution establishes a 1998 Senior Bond Reserve Account, the moneys in which are to be applied to the payment of interest on the Senior Transportation Revenue Bonds, and maturing principal of serial Senior Transportation Revenue Bonds whenever moneys in the 1998 Senior Bond Service Account are insufficient for such purpose and thereafter for the purpose of making deposits to the credit of the 1998 Senior Bond Redemption Account to satisfy any Amortization Requirements for the term Senior Transportation Revenue Bonds whenever 1998 Resolution Revenues are insufficient for such purpose. The 1998 Resolution provides, however, that before the moneys in the 1998 Senior Bond Reserve Account are used to cover any insufficiency in the 1998 Senior Bond Service Account or the 1998 Senior Bond Redemption Account, the 1998 Fiscal Agent shall cover such insufficiency by first withdrawing from the 1998 Construction Fund any unencumbered 1998 Resolution Revenues deposited therein and, to the extent such moneys are insufficient to cover said deficiency, by withdrawing moneys on deposit in the 1998 Subordinated Bond Service Account and 1998 Subordinated Bond Redemption Account.

The Authority covenants to accumulate and maintain in the 1998 Senior Bond Reserve Account an amount equal to the lesser of the maximum annual Principal and Interest Requirements for any fiscal year on all outstanding Senior Transportation Revenue Bonds and 10% of the original principal amount of each Series of Senior Transportation Revenue Bonds outstanding (the "Reserve Requirement"). The Reserve Requirement will be $64,834,252.50 upon the issuance of the 1998 Bonds, and such amount will be on deposit in the 1998 Senior Bond Reserve Account following the issuance of the 1998 Bonds. The 1998 Resolution permits any increase in the Reserve Requirement to be funded over not more than five years and allows the Authority to use a letter of credit or insurance policy to fund the Reserve Requirement. See *Summary of Certain Provisions of the 1998 Resolution* below.

Excess moneys in the 1998 Senior Bond Reserve Account may be retained in such Reserve Account, may be applied to the payment of outstanding notes issued by the Authority to finance temporarily any Transportation Facilities or outstanding Senior Transportation Revenue Bonds to be refunded or may be transferred to the 1998 Senior Bond Service Account, the 1998 Senior Bond Redemption Account, or the 1998 Construction Fund, as directed by the Authority.

If the moneys in the 1998 Senior Bond Reserve Account are used to cover any deficiency in the 1998 Senior Bond Service Account or the 1998 Senior Bond Redemption Account, the 1994 Code provides that the 1998 Senior Bond Reserve Account shall be reimbursed, subject to the provisions of the Constitution of Puerto Rico relating to payment of Commonwealth debt and to the prior reimbursement of the 1968 Reserve Account, as discussed above under "Pledged Revenues-Replenishment of Reserve Accounts", from the first proceeds received by the Commonwealth in the next fiscal year or years derived from (i) any remaining portion of the gasoline tax and petroleum products tax then in effect and (ii) any other taxes which may then be in effect on any other fuels or propellants which are used, among other purposes, to propel highway vehicles.

Prior Payment of Full Faith and Credit Obligations of the Commonwealth

Provision for Prior Payment. The Constitution of Puerto Rico provides that public debt of the Commonwealth constitutes a first lien on available Commonwealth taxes and revenues. Public debt includes bonds and notes of the Commonwealth to which the full faith, credit and taxing power of the Commonwealth are pledged, and, according to opinions heretofore rendered by the Secretary of Justice of the Commonwealth, any payments which are required to be made by the Commonwealth under its guarantees of bonds and notes issued by its public corporations. The 1998 Bonds do not constitute public debt.

The proceeds of the gasoline tax, the gas oil and diesel oil tax, the petroleum products tax and the motor vehicle license fees allocated to the Authority by the 1994 Code and Act No. 9 are available Commonwealth taxes and revenues under the Constitution. Accordingly, if needed, they are subject to being applied first to the payment of debt service on the public debt of the Commonwealth but, under the 1994 Code and Act No. 9, such taxes and license fees are to be used for such payments only if and to the extent that all other available revenues of the Commonwealth under the Constitution are insufficient for such purpose. Tolls and other fees and charges collected by the Authority and investment earnings are not available Commonwealth taxes and revenues.

The Commonwealth has never applied taxes or license fees allocated to the Authority to the payment of its public debt nor has the Commonwealth ever defaulted on the payment of principal of or interest on any of its public debt. See *Debt* in *Appendix I.*

Under the provisions of Act No. 39 of the Legislature of Puerto Rico, approved May 13, 1976, as amended ("Act No. 39"), the Secretary of the Treasury of Puerto Rico is obligated to fund annual debt service on general obligation bonds and notes of the Commonwealth by monthly deposits into the Special Fund for the Amortization of General Obligations Evidenced by Bonds and Promissory Notes (the "Commonwealth Redemption Fund"). On January 31, 1998, the amount on deposit in the Commonwealth Redemption Fund was $126,386,365, as required. Moneys in the Commonwealth Redemption Fund may also be applied to payment of other Commonwealth guaranteed obligations outstanding prior to adoption of Act No. 39. Such moneys are not available to pay the 1998 Bonds.

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 internal revenues of the Commonwealth for the two preceding fiscal years. The Constitution of Puerto Rico does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded. Internal revenues (that is, revenues raised under the provisions of Commonwealth legislation) consist principally of income taxes, excise taxes, property taxes, licenses and miscellaneous non-tax revenues. 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 Department of the Treasury, and motor vehicle fuel taxes, petroleum products taxes and license fees, which are allocated to the Authority as described above, are not included as internal revenues for the purpose of calculating the debt limit, although they are available for the payment of debt service.

On December 21, 1995, Puerto Rico Aqueduct and Sewer Authority 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 is being taken into account as an additional amount of debt service on the Commonwealth's general obligation debt for purposes of computing the above described 15% constitutional debt limitation.

Future maximum annual debt service for the Commonwealth's currently outstanding general obligation debt will be $434,567,000 in the fiscal year ending June 30, 2000. See "Debt Service Requirements for Commonwealth General Obligation Bonds" under *Debt* in *Appendix I*. Debt service for the PRASA Guaranteed Bonds paid during fiscal 1997 (including for this purpose debt service payments due July 1, 1997) was $20,794,919. The sum of those amounts ($455,362,000) is equal to 8.83% of $5,155,398,500, which is the average of the adjusted internal revenues for the prior two fiscal years ended June 30, 1997.

Additional Bonds

Highway Revenue Bonds. The Authority has covenanted in the 1998 Resolution that it will not issue additional Highway Revenue Bonds except bonds maturing no later than July 1, 2036, which are issued (i) to refund outstanding Highway Revenue Bonds in order to achieve debt service savings or (ii) in exchange for the outstanding $116,752,769 Special Facility Revenue Bonds issued by the Authority under a separate trust agreement to finance the construction of the Teodoro Moscoso Bridge, as required under the concession agreement relating to such Bridge. See the last paragraph in "Teodoro Moscoso Bridge" under *Transportation System Revenues and Expenditures*. The issuance of such Highway Revenue Bonds must meet the tests for the issuance of such bonds under the 1968 Resolution, which tests are more fully described in "Issuance of Additional Bonds" under *Summary of Certain Provisions of the 1968 Resolution.*

Senior Transportation Revenue Bonds. The Authority may issue additional Senior Transportation Revenue Bonds under the 1998 Resolution to provide funds for any lawful purpose of the Authority, including the payment of all or any part of the cost of Transportation Facilities (including the payment of any outstanding notes of the Authority issued for the purpose of paying all or a part of such cost); provided that the 1998 Resolution Revenues for any 12 consecutive months of the 15 months immediately preceding the issuance of such Senior Transportation Revenue Bonds (adjusted to take into account for such entire 12 months moneys allocated to and pledged by the Authority to the payment of the Transportation Revenue Bonds under legislation enacted or toll rate revisions made effective on or prior to the date of delivery of such bonds and tolls from Toll Facilities to be financed from the proceeds of such bonds) are not less than 150% of the maximum Principal and Interest Requirements for any fiscal year thereafter on account of all outstanding Senior Transportation Revenue Bonds and the additional Senior Transportation Revenue Bonds then to be issued and not less than 100% of the maximum Principal and Interest Requirements for any fiscal year thereafter on account of all outstanding Transportation Revenue Bonds (including Subordinated Bonds) and the additional Senior Transportation Revenue Bonds then to be issued.

The Authority may also issue additional Senior Transportation Revenue Bonds to refund all or any part of the outstanding Senior Transportation Revenue Bonds of any Series without satisfying such requirement, provided that the Authority certifies that the maximum annual Principal and Interest Requirements on the Senior Transportation Revenue Bonds to be outstanding after the issuance of such additional Senior Transportation Revenue Bonds will be equal to or less than the maximum annual Principal and Interest Requirements on the Senior Transportation Revenue Bonds outstanding prior to the issuance of the additional Senior Transportation Revenue Bonds. See "Issuance of Additional Bonds" under *Summary of Certain Provisions of the 1998 Resolution.*

Any additional Senior Transportation Revenue Bonds issued under the 1998 Resolution will be on a parity with the outstanding Senior Transportation Revenue Bonds and will be entitled to the equal benefit, protection and security of the provisions, covenants and agreements of the 1998 Resolution.

Subordinated Bonds. The Authority may issue Subordinated Bonds under the 1998 Resolution to pay all or any part of the cost of any highway project or transit project eligible for financial assistance under federal legislation, provided that the 1998 Resolution Revenues for any 12 consecutive months of the 15 months immediately preceding the issuance of such Subordinated Bonds (adjusted to take into account for such entire 12 months moneys allocated to and pledged by the Authority to the payment of the Transportation Revenue Bonds under legislation enacted or toll rate changes made effective on or prior to delivery of such bonds and tolls from Toll Facilities to be financed from the proceeds of such bonds) are not less than 125% of the maximum Principal and Interest Requirements for any fiscal year thereafter on account of all outstanding Transportation Revenue Bonds and the Subordinated Bonds then to be issued.

The Authority may also issue Subordinated Bonds to refund all or any part of the outstanding Subordinated Bonds of any Series without satisfying such requirement, provided that the Authority certifies that the maximum Principal and Interest Requirements on the Subordinated Bonds to be outstanding after the issuance of such additional Subordinated Bonds will be equal to or less than the maximum annual Principal and Interest Requirements on the Subordinated Bonds outstanding prior to the issuance of the additional Subordinated Bonds. See "Issuance of Additional Bonds" under *Summary of Certain Provisions of the 1998 Resolution.*

In December 1997, the Authority entered into a Cooperative Agreement with the Federal Highway Administration ("FHWA"), the Federal Transit Administration ("FTA") and the Department that provides for the establishment of a State Infrastructure Bank ("SIB") under the provisions of Section 350 of the National Highway System Designation Act of 1995, which bank is expected to be capitalized 80% by federal capitalization grants and 20% by matching Authority funds. The SIB can be used to provide various forms of financial assistance, other than grants, to the Authority to finance eligible highway and transit projects.

The Authority expects to issue in the spring of 1998 Subordinated Bonds (the "1998 SIB Bonds") under the 1998 Resolution in a principal amount expected not to exceed $45 million. The reserve account in the Subordinated Bond Reserve Fund to be established as part of the security for the 1998 SIB Bonds will be entitled to the benefits of an agreement with the SIB under which agreement the 1998 Fiscal Agent will be authorized and directed to request funds from the depository institution holding the SIB moneys (currently expected to be Government Development Bank), up to the full amount on deposit in the SIB, in the event it is necessary to apply moneys in such account in the Subordinated Bond Reserve Fund to pay debt service on the 1998 SIB Bonds. The Authority's obligation to repay any amounts drawn under the agreement with the SIB also will be secured by a lien on 1998 Resolution Revenues subordinate to the lien securing the Senior Transportation Revenue Bonds. See "Sinking Fund" under *Summary of Certain Provisions of the 1998 Resolution.* The proceeds of the 1998 SIB Bonds will be used to finance eligible highway projects.

Book-Entry Only System

The following information concerning DTC and DTC's book-entry system has been obtained from DTC and neither the Authority nor the Underwriters take any responsibility for the accuracy thereof.

DTC will act as securities depository for the 1998 Bonds. The 1998 Bonds will be issued as fully registered bonds in the name of Cede & Co. (DTC's partnership nominee). One fully registered 1998 Bond will be issued for each maturity of each series of the 1998 Bonds in the aggregate principal amount of such maturity and will be deposited with DTC.

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

Purchases of the 1998 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the 1998 Bonds on DTC's records. The ownership interest of each actual purchaser of a 1998 Bond (under this caption, a "Beneficial Owner") will in turn be recorded in the Direct or Indirect Participants' records. Beneficial Owners will not receive written confirmations from DTC of their purchases, but Beneficial Owners are expected to receive written confirmation providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the 1998 Bonds will be accomplished by entries made on the books of Participants acting on behalf of the Beneficial Owners. Beneficial Owners will not receive definitive 1998 Bonds except in the event that use of the book-entry system for the 1998 Bonds is discontinued.

To facilitate subsequent transfers, all 1998 Bonds deposited by Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. The deposit of 1998 Bonds with DTC and their registration in the name of Cede & Co. effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the 1998 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such 1998 Bonds are credited, which may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

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

Redemption notices will be sent to Cede & Co. If less than all of the 1998 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 1998 Bonds to be redeemed.

Neither DTC nor Cede & Co. will consent or vote with respect to the 1998 Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to the Authority 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 1998 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 1998 Bonds will be made to DTC. DTC's practice is to credit Direct Participants' accounts on the payable date in accordance with their respective holdings shown on DTC's records unless DTC has reason to believe that it will not receive payment on the payable date. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC, the Authority, or the 1998 Fiscal Agent, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, redemption premium, if any, and interest to DTC is the responsibility of the Authority or the 1998 Fiscal Agent, disbursement of such payments to Direct

Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the 1998 Bonds at any time by giving reasonable notice to the Authority or the 1998 Fiscal Agent. Under such circumstances, in the event that a successor securities depository is not obtained, definitive 1998 Bonds are required to be printed and delivered.

The Authority may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, definitive 1998 Bonds will also be printed and delivered.

Payments and Transfers

No assurance can be given by the Authority that DTC will make prompt transfer of payments to the Participants or that Participants will make prompt transfer of payments to Indirect Participants or to Beneficial Owners. The Authority 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.

The Authority and the 1998 Fiscal Agent will have no responsibility or obligation to such DTC Participants, Indirect Participants, or the persons for whom they act as nominees with respect to the payments to or the providing of notice for the DTC Participants, the Indirect Participants, or the Beneficial Owners. Payments made to DTC or its nominee shall satisfy the obligations of the Authority to the extent of such payments.

For every transfer of the 1998 Bonds, the Beneficial Owner may be charged a sum sufficient to cover any tax or other governmental charge that may be imposed in relation thereto.

Discontinuance of Book-Entry Only System

In the event that such book-entry only system is discontinued for the 1998 Bonds, the following provisions will apply to the 1998 Bonds: principal of the 1998 Bonds and redemption premium, if any, thereon will be payable in lawful money of the United States of America at the principal corporate trust office of the 1998 Fiscal Agent in New York, New York. Interest on the 1998 Bonds (except for the interest on the Capital Appreciation Bonds, which interest is payable at maturity of such Bonds and interest on the 1998 Variable Rate Bonds which is payable as described in the 1998 Variable Bond Supplement) will be payable on each January 1 and July 1, by check mailed to the respective addresses of the registered owners thereof as shown on the registration books of the Authority maintained by the Fiscal Agent as of the close of business on the record date therefor as set forth in the 1998 Resolution. The 1998 Bonds will be issued only as registered bonds without coupons in authorized denominations. The transfer of the 1998 Bonds will be registrable and the 1998 Bonds may be exchanged at the principal corporate trust office of the 1998 Fiscal Agent in New York, New York upon the payment of any taxes or other governmental charges required to be paid with respect to such transfer or exchange.

Bond Insurance

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

Payment Pursuant to the Ambac Bond Insurance Policy. Ambac Assurance has made a commitment to issue the Ambac Bond Insurance Policy relating to the Insured Bonds effective as of the date of issuance of the 1998 Bonds. Under the terms of the Ambac Bond Insurance Policy, Ambac Assurance will pay to the United States Trust Company of New York, in New York, New York, or any successor thereto (the "Insurance Trustee"), that portion of the principal of and interest on the corresponding Insured Bonds which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer (as such terms are defined in the Ambac Bond Insurance Policy). Ambac Assurance will make such payments to the Insurance Trustee on the later of the date on which such principal and interest becomes Due for Payment or within one business day following the date on which Ambac Assurance shall have received notice of

Nonpayment from the 1998 Fiscal Agent. The insurance will extend for the respective terms of the Insured Bonds and, once issued, cannot be canceled by Ambac Assurance.

The Ambac Bond Insurance Policy will insure payment only on stated maturity dates and on mandatory sinking fund installment dates, in the case of principal, and on stated dates for payment, in the case of interest. If the Insured Bonds become subject to redemption (other than a mandatory sinking fund redemption) and insufficient funds are available for redemption of all outstanding Insured Bonds, Ambac Assurance will remain obligated to pay principal of and interest on outstanding Insured Bonds on the originally scheduled interest and principal payment dates, including mandatory sinking fund redemption dates.

In the event the 1998 Fiscal Agent has notice that any payment of principal of or interest on an Insured Bond which has become Due for Payment and which is made to a bondholder by or on behalf of the Authority has been deemed a preferential transfer and theretofore recovered from its registered owner pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court of competent jurisdiction, such registered owner will be entitled to payment from Ambac Assurance to the extent of such recovery if sufficient funds are not otherwise available.

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

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

2. payment of any redemption or prepayment premium; and

3. nonpayment of principal or interest caused by the insolvency or negligence of the 1998 Fiscal Agent.

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

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

The Ambac Bond Insurance Policy does not insure against loss relating to payments of the purchase price of Insured Bonds upon tender by a registered owner thereof or any preferential transfer relating to payments of the purchase price of Insured Bonds upon tender by a registered owner thereof.

Ambac Assurance Corporation. Ambac Assurance is a Wisconsin-domiciled stock insurance corporation regulated by the Office of the Commissioner of Insurance of the State of Wisconsin and licensed to do business in 50 states, the District of Columbia, the Territory of Guam and the Commonwealth of Puerto Rico, with admitted assets of approximately $2,813,000,000 (unaudited) and statutory capital of approximately $1,605,000,000 (unaudited) as of September 30, 1997. Statutory capital consists of Ambac Assurance's policyholders' surplus and statutory contingency reserve. Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., Moody's Investors Service and Fitch IBCA, Inc. have each assigned a triple-A claims-paying ability rating to Ambac Assurance.

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

Ambac Assurance makes no representation regarding the 1998 Bonds (including the Insured Bonds) or the advisability of investing in the 1998 Bonds (including the Insured Bonds) and makes no representation regarding, nor has it participated in the preparation of, this Official Statement other than the information supplied by Ambac Assurance and presented under the heading *Bond Insurance*.

Available Information. The parent company of Ambac Assurance, Ambac Financial Group, Inc. (the "Company"), is subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and in accordance therewith files reports, proxy statements and other information with the Securities and Exchange Commission (the "Commission"). Such reports, proxy statements and other information may be inspected and copied at the public reference facilities maintained by the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549 and at the Commission's regional offices at 7 World Trade Center, New York, New York 10048 and Northwestern Atrium Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. Copies of such material can be obtained from the public reference section of the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549 at prescribed rates. In addition, the aforementioned material may also be inspected at the offices of the New York Stock Exchange, Inc. (the "NYSE") at 20 Broad Street, New York, New York 10005. The Company's Common Stock is listed on the NYSE.

Copies of Ambac Assurance's financial statements prepared in accordance with statutory accounting standards are available from Ambac Assurance. The address of Ambac Assurance's administrative offices and its telephone number are One State Street Plaza, 17th Floor, New York, New York 10004, and (212) 668-0340.

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

1. The Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1996 and filed on March 31, 1997;

2. The Company's Current Report on Form 8-K dated March 12, 1997 and filed on March 12, 1997;

3. The Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended March 31, 1997 and filed on May 15, 1997;

4. The Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended June 30, 1997 and filed on August 14, 1997; and

5. The Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended September 30, 1997 and filed on November 14, 1997.

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

Concerning the Ambac Bond Insurance Policy. As provided in the Resolution 98-07, the consent of Ambac Assurance shall be required instead of the consent of the owners of the Insured Bonds, when required, to the adoption of any agreement supplemental to Resolution 98-07, for the removal of the 1998 Fiscal Agent and the appointment of a successor or for approving any other action which requires such consent of the owners of the Insured Bonds.

THE AUTHORITY

General Description

The Authority was created in 1965 to assume responsibility for the construction of roads and highways and related transportation facilities in Puerto Rico. The Authority is a separate entity from the Department for purposes of financing and constructing Puerto Rico's transportation system, but since 1971, the Secretary of Transportation and Public Works (the "Secretary"), appointed by the Governor, has overseen the management of the Authority and exercises the powers of the Governing Board of the Authority.

The Authority has adopted a long-range master plan for development of the transportation infrastructure necessary to foster and sustain Puerto Rico's economic growth and a five-year Priorities Construction Program to implement that plan. As required by the 1968 Resolution and the 1998 Resolution, the Authority supplements the master plan as necessary and annually updates the five-year Priorities Construction Program. See "Operating Expenses and Capital Expenditures-Priorities Construction Program" under *Transportation System Revenues and Expenditures.*

The Authority Act gives the Authority broad powers to carry out its responsibilities in accordance with the Department's overall transportation policies. These powers include, among other things, the complete control and supervision of any highway and other transportation facilities owned, operated or constructed by it; the ability to set tolls and other charges for the use of the highway and other transportation facilities; and the power to issue bonds, notes or other obligations. The Authority plans and manages the construction of all major projects relating to Puerto Rico's transportation system, undertakes major repairs and maintains the tollways. The Department maintains Puerto Rico's highway system, other than the tollways, and undertakes construction of smaller projects. The Authority will also be responsible for the maintenance and operation of the Tren Urbano and, in connection therewith, has entered into a five-year agreement with a private company for such operation and maintenance. See "Operating Expenses and Capital Expenditures-Operation and Maintenance-Tren Urbano" under *Transportation System Revenues and Expenditures.*

As of December 31, 1996, Puerto Rico had 4,590 miles of highway system and 9,967 miles of local streets and adjacent roads. The highway system comprises 691 miles of primary system highways, which are the more important inter-regional traffic routes and include the Luis A. Ferré (PR-52), the De Diego (PR-22) and PR-53 tollways, 1,319 miles of secondary system highways serving the needs of intra-regional traffic and 2,580 miles of tertiary highways and public housing development roads serving local, intra-regional traffic.

In August 1990, the Authority Act was amended to empower the Authority to enter into concession agreements, subject to approval by a government board of adjudications, with private parties for the design, construction, operation and maintenance of highway projects. Such projects, to be owned by the Authority and the Commonwealth, could be financed by such private parties by the imposition of tolls or otherwise. To date, the only highway facility subject to a private concession agreement is the Teodoro Moscoso Bridge, which spans the San José Lagoon from San Juan to Carolina. See "Teodoro Moscoso Bridge" under *Transportation System Revenues and Expenditures.*

In March 1991, the Authority Act was further amended to authorize the Authority to work with and implement policies established by the Secretary for the purpose of developing a multi-modal transportation system for the Commonwealth to alleviate traffic congestion. In line with this expanded power, the Authority has undertaken the planning, design, construction and operation of the Tren Urbano. See "Operating Expenses and Capital Expenditures-Priorities Construction Program-Tren Urbano" under *Transportation System Revenues and Expenditures.*

Organization

To carry out its responsibilities to develop Puerto Rico's transportation system, the Authority is organized into the Executive Director's Office, which provides overall management of the Authority, to whom report four Assistant Executive Directors. The Assistant Executive Director for Infrastructure oversees the Planning Area, which is responsible for the development of the Priorities Construction Program as well as long-range planning; the Design Area, which is responsible for designing and supervising the design by consultants of Authority projects; the Property Acquisition Area, which acquires necessary easements and rights-of-way for Authority projects; and the Construction Area, which supervises and inspects the construction work performed by the Authority's contractors. The Assistant Executive Director for Traffic Engineering is responsible for certain projects specifically designed to alleviate urban congestion. The Assistant Executive Director for Administration and Finance oversees the Finance Area, which is responsible for the financial affairs of the Authority, including budgetary services; the Human Resources Area, which provides personnel services; the Administration Area, which provides administrative support to the Authority; and the Information Technologies Area, which oversees computer operations. The Assistant Executive Director for Operations oversees all aspects of the operation, maintenance, and repair of the Luis A. Ferré, De Diego and PR-53 tollways. Most construction, renovation and improvement of highway facilities is performed by private contractors selected through a public bidding process mandated by the Authority Act. The Authority plans, inspects and supervises such work.

The Authority's Tren Urbano office manages the Tren Urbano project and reports to the Secretary and the Executive Director. See "Operating Expenses and Capital Expenditures-Tren Urbano" under *Transportation System Revenues and Expenditures.*

Management

The Secretary of Transportation and Public Works, who has ultimate managerial power over the Authority, is Dr. Carlos I. Pesquera. Dr. Pesquera was appointed Secretary by the Governor of Puerto Rico in January 1993. Prior to his appointment as Secretary, Dr. Pesquera, who received a B.S. degree in civil engineering from the University of Puerto Rico and a masters degree and a Ph.D. degree in structural engineering from Cornell University, was the Director of the Center for Research in Infrastructure at the University of Puerto Rico.

The Executive Director of the Authority, who oversees the Authority's operations, is Dr. Sergio L. González, who received a B.S. degree in civil engineering from the University of Puerto Rico, a masters degree in Transportation from the Massachusetts Institute of Technology ("M.I.T.") and a Ph.D. degree in Civil Engineering Systems, also from M.I.T. Dr. González was appointed Executive Director by the Secretary in 1993. Prior to joining the Authority, Dr. González was Associate Professor and Director of the Traffic Engineering Laboratory of the Civil Engineering Department at the University of Puerto Rico.

The Authority retains the firm of Roy Jorgensen Associates, Inc. as independent Traffic Engineers to carry out certain responsibilities under the 1968 Resolution. These include an annual evaluation of the Authority's master plan and Priorities Construction Program for capital improvements and the maintenance activities of the Department and the Authority with respect to Puerto Rico's highway system. The Authority employs Ernst & Young LLP as independent accountants responsible for auditing the Authority's books and accounts.

The administrative offices of the Authority are in the Minillas Government Center, De Diego Avenue, Stop 22, San Juan, Puerto Rico. The mailing address is P.O. Box 42007, San Juan, Puerto Rico 00940-2007. The telephone number is (787) 721-8787.

Employee Relations

As of December 31, 1997, the Authority employed 3,114 persons, of whom 460 were professionals, 653 were office workers and 2,001 were field supervisors and laborers. Of the total employees, 2,049 were regular employees and 1,065 were temporary employees. The Authority believes that relations with its employees are good.

In 1987, the Puerto Rico Supreme Court classified the Authority as a "private employer" for purposes of the Puerto Rico labor law provisions, permitting the Authority's employees to engage in collective bargaining. An independent union, representing approximately 1,185 of the Authority's 2,049 regular employees, has been certified for collective bargaining purposes. The current collective bargaining agreement expires on June 30, 1999.

TRANSPORTATION SYSTEM REVENUES AND EXPENDITURES

Revenues

Various factors affect the level of 1968 Resolution Revenues and 1998 Resolution Revenues available to the Authority, including, in particular, economic conditions, the supply and cost of crude oil and gasoline and other oil-derived fuels. These factors have an impact on motor vehicle usage and fuel consumption and are discussed further below. In addition, decisions by the Authority as to the types and level of charges it may impose for the use of its Transportation Facilities will affect the amount of moneys available to the Authority for its authorized purposes.

Sources of 1998 Resolution Revenues

Petroleum Products Tax. On July 16, 1997, the 1994 Code was amended by Act No. 34 to allocate to the Authority, beginning on July 16, 1997, the total amount of excise taxes, up to $120 million per fiscal year, imposed by the Commonwealth on petroleum products (which includes crude oil, unfinished oil and derivative products). The tax is imposed on any petroleum product introduced, consumed, sold or transferred in Puerto Rico. The petroleum products tax rate varies on a monthly basis according to an index price of crude oil determined by the Department of the Treasury (based on the market price of crude oil quoted in certain markets specified in the 1994 Code), as follows:

Index Price of Crude Oil (per barrel)	Rate of Tax ($ per barrel)
$0.01 to $16.00	$6.00
$16.01 to $24.00	5.00
$24.01 to $28.00	4.00
$28.01 and higher	3.00

The following table presents the number of barrels of crude oil on which the petroleum products tax was imposed, the average annual tax rate (per barrel) and the total taxes collected by the Department of the Treasury in each fiscal year since fiscal 1987 (the first full fiscal year in which the tax was collected).

COLLECTIONS OF PETROLEUM PRODUCTS TAX

Fiscal Year Ended June 30,	Number of Barrels Taxed (million)	Average Annual Tax Rate* ($ per barrel)	Total Tax Collected ($ million)
1987	23.67	$4.91	$119.90
1988	22.13	4.41	98.54
1989	25.11	5.00	128.23
1990	22.74	4.91	112.79
1991	26.80	4.16	112.17
1992	24.07	5.00	120.37
1993	26.09	5.00	130.47
1994	28.27	5.41	152.91
1995	28.02	5.00	139.59
1996	31.55	5.00	157.74
1997	32.29	4.91	158.74

* The average annual tax rate is the arithmetic average of the monthly tax rate determined by the Department of the Treasury during such fiscal year. The total tax collected is the actual amount of tax collected during the fiscal year. Due to the monthly fluctuations in the tax rate, the total tax collected is different from the result produced from multiplying the number of barrels taxed by the average annual tax rate.

Source: Department of the Treasury.

The 1994 Code authorizes the Authority to pledge the entire amount of petroleum products tax allocated to the Authority (not to exceed $120 million in any fiscal year) to the payment of the principal of and interest on bonds and other obligations of the Authority or for any other lawful purpose of the Authority. The Authority has pledged the petroleum products tax receipts to the holders of the Transportation Revenue Bonds (including the 1998 Bonds), but such pledge is subject to the Constitution of Puerto Rico, which permits the Commonwealth to apply such tax receipts to the payment of certain Commonwealth debts to the extent other Commonwealth moneys are insufficient therefor. See "Security for the Senior Transportation Revenue Bonds-Prior Payment of Full Faith and Credit Obligations of the Commonwealth" under *The 1998 Bonds*. The Commonwealth has agreed and committed in the 1994 Code not to eliminate or reduce the rates of excise tax on petroleum products in effect on July 16, 1997 (set forth above) and the amount of such taxes allocated to the Authority until all obligations of the Authority secured by the pledge thereof (including the 1998 Bonds), together with the interest thereon, are fully paid. Any petroleum product tax collected in excess of $120 million per fiscal year is not required to be allocated to the Authority and is not pledged by the Authority to the holders of Transportation Revenue Bonds.

Petroleum products taxes are collected by the Department of the Treasury. All taxes collected, up to $11 million per month, are deposited in the Special Fund and transferred on a monthly basis to the Authority during the first eleven months of the fiscal year, subject to the $120 million ceiling. If the total amount of the taxes collected by the Department of the Treasury and transferred to the Authority in any month is less than $11 million, such deficiency must be made up by the Department of the Treasury with the amount of such taxes in excess of $11 million which were collected in any prior month or which may be collected in any subsequent month of the same fiscal year.

Tolls and Other Charges. The Authority is authorized to impose tolls and other charges on its Transportation Facilities. All tolls collected on PR-66, the new tollway being financed with a portion of the proceeds of the 1998 Bonds, will be pledged to the payment of Transportation Revenue Bonds. See, "Operating Expenses and Capital Expenditures-Priorities Construction Program-Highway Construction," below. Until the 1968 Resolution is repealed and canceled, all Existing Toll Facilities Revenues will constitute 1968 Resolution Revenues and are pledged to the payment of the Transportation Revenue Bonds only to the extent they are Excess 1968 Resolution Revenues. Upon the repeal and cancellation of the 1968 Resolution, the Existing Toll Facilities Revenues will constitute 1998 Resolution Revenues and be pledged to the payment of the Transportation Revenue Bonds.

The Authority is not pledging the fare box revenues of Tren Urbano to the payment of the Transportation Revenue Bonds or the Highway Revenue Bonds.

The Authority Act grants to the Authority plenary power to fix, impose, alter and collect tolls and other reasonable charges for the use of the Transportation Facilities operated by the Authority or for services rendered thereby. The Authority is obligated to take into account in setting or changing such tolls and other charges such factors as will promote the use of the Transportation Facilities in the broadest and most varied manner economically possible. Prior to fixing or altering such tolls or other charges, the Authority must hold a public hearing to receive comments with respect thereto.

Excess 1968 Resolution Revenues. Before the repeal and cancellation of the 1968 Resolution, the Excess 1968 Resolution Revenues (which consist of all unencumbered 1968 Resolution Revenues remaining after payment of debt service and required reserves on the outstanding Highway Revenue Bonds) are included as 1998 Resolution Revenues. After the payment or defeasance of all Highway Revenue Bonds and the repeal and cancellation of the 1968 Resolution, all 1968 Resolution Revenues will become 1998 Resolution Revenues. The sources of the 1968 Resolution Revenues are discussed below.

Investment Earnings. Moneys held for the credit of the 1998 Senior Bond Service Account and the 1998 Senior Bond Redemption Account shall, as nearly as may be practicable, be continuously invested and reinvested at the written direction of the Authority in Government Obligations. Moneys held for the credit of the 1998 Senior Bond Reserve Account shall, as nearly as may be practicable, be continuously invested and reinvested at the written direction of the Authority in Investment Obligations. Such Government Obligations and Investment Obligations shall mature, or be subject to redemption, at the option of the holder, not later than the respective dates when moneys held for the credit of such Accounts will be required for the purposes intended; provided, however, that the amounts on deposit in the 1998 Senior Bond Reserve Account shall be invested in Investment Obligations which mature not later than the final maturity date of any Senior Transportation Revenue Bonds outstanding. Income from investments of moneys held for the credit of the 1998 Construction Fund is not considered 1998 Resolution Revenues under the 1998 Resolution.

Sources of 1968 Resolution Revenues

General. The major sources of the Authority's 1968 Resolution Revenues are the gasoline tax and the gas oil and diesel oil tax allocated to the Authority pursuant to the 1994 Code, motor vehicle license fee allocated to the Authority pursuant to Act No. 9 and toll charges on the Authority's existing tollways, including tolls collected on any extension thereof however financed. In fiscal 1997, 1968 Resolution Revenues were derived 50% from gasoline taxes, 32% from toll charges, 8% from motor vehicle license fees, 5% from investment earnings and 5% from gas oil and diesel oil taxes. See "Historical Revenues-1968 Resolution Revenues" below.

Gasoline and Gas Oil Taxes. The 1994 Code currently imposes a $0.16 per gallon tax on gasoline and an $0.08 per gallon tax on gas oil and diesel oil and authorizes the Authority to pledge the entire $0.16 tax on gasoline and $0.04 of the tax on gas oil and diesel oil to the payment of the principal of and interest on its bonds and other obligations or for any other lawful purpose of the Authority. The Authority has pledged such tax receipts to the holders of the Highway Revenue Bonds, but such pledge is subject to the Constitution of Puerto Rico, which permits the Commonwealth to apply such taxes to payment of certain Commonwealth debts to the extent other Commonwealth moneys are insufficient therefor. See "Security for the Senior Transportation Revenue Bonds-Prior Payment of Full Faith and Credit Obligations of the Commonwealth" under *The 1998 Bonds*. The Authority has also pledged such tax receipts to the holders of the Transportation Revenue Bonds, subject to the prior application of such tax receipts to the payment of debt service on Highway Revenue Bonds and the maintenance of a reserve therefor. The Commonwealth has agreed and committed in the 1994 Code that the tax on gasoline will not be reduced below $0.16 per gallon and the tax on gas oil and diesel oil will not be reduced below $0.04 per gallon and that the amount of such taxes allocated to the Authority will not be reduced until all obligations of the Authority secured by the pledge thereof (including the 1998 Bonds), together with the interest thereon, are fully paid. Gasoline taxes and gas oil and diesel oil taxes which may be levied or collected from time to time other than the amounts of the taxes and fees described in this paragraph are not required to be allocated to the Authority or pledged by the Authority to the holders of the Highway Revenue Bonds or the Transportation Revenue Bonds.

Gasoline taxes, gas oil and diesel oil taxes and motor vehicle license fees are collected by the Department of the Treasury. The portions of such taxes and fees allocated to the Authority are transferred to the Authority at least monthly as such revenues are collected.

The Department of the Treasury periodically conducts an audit of gasoline, gas oil, diesel oil and petroleum products importers, producers and wholesalers to verify amounts reported and paid. In addition to such audit procedures, the Authority reviews monthly the records of the Department of the Treasury for consistency with monthly reports provided to the Authority by distributors of oil, gasoline and petroleum products.

Motor Vehicle License Fees. Under the Vehicle and Traffic Law (Act No. 141 of the Legislature of Puerto Rico, approved July 20, 1960, as amended), the Commonwealth imposes annual license fees on various classes of motor vehicles. The current license fees range from $25 to $40 for passenger cars and vary for other vehicles. Act No. 9 increased the per vehicle annual motor vehicle license fees by $15 and provided for the deposit of the proceeds of the $15 increase in the Special Fund for the Authority, which may pledge such proceeds to the payment of debt service on obligations of the Authority or any other legal purpose of the Authority. As with the gasoline and gas and diesel oil taxes described above, the Authority has pledged such license fees to the holders of the Highway Revenue Bonds and, subject to the prior application of such fees to the payment of debt service on Highway Revenue Bonds and the maintenance of a reserve therefor, the Authority has also pledged such fees to the holders of the Transportation Revenue Bonds. Under Act No. 9, the Commonwealth has agreed and pledged that the license fees allocated to the Authority, as described herein, will not be reduced so long as such proceeds remain pledged to the payment of such obligations.

Tolls on Existing Tollways. Until the 1968 Resolution is repealed and canceled, all tolls collected on the Authority's existing tollways, including tolls collected on any extension thereof financed with Transportation Revenue Bonds (the Existing Toll Facilities Revenues), will constitute 1968 Resolution Revenues. As such, they will be pledged to the payment of the Highway Revenue Bonds and, subject to the prior application of such toll revenues to the payment of debt service on the Highway Revenue Bonds and the maintenance of a reserve therefor, will be additionally pledged to the payment of Transportation Revenue Bonds.

Under the 1968 Resolution, the Authority has covenanted not to reduce or eliminate any tolls and other charges for the use of Traffic Facilities if such tolls and other charges have been taken into account in the calculation of 1968 Resolution Revenues for purposes of satisfying the tests for the issuance of additional bonds under the 1968 Resolution and if the 1968 Resolution Revenues for any 12 consecutive months out of the immediately preceding 15 months prior to the proposed adjustment, after adjusting such revenues for the proposed decrease in tolls, would have been less than 150% of the maximum Principal and Interest Requirements for any fiscal year thereafter for all Highway Revenue Bonds then outstanding. See "Issuance of Additional Bonds" under *Summary of Certain Provisions of the 1968 Resolution*. Such tolls and other charges are being taken into account for satisfying such additional bonds' test under the 1968 Resolution.

Notwithstanding the provisions in the 1968 Resolution relating to the reduction or elimination of tolls, under the 1998 Resolution the Authority has covenanted that it will not reduce any tolls or other charges imposed for the use of its Toll Facilities unless the 1998 Resolution Revenues received by the Authority for any 12 consecutive months out of the 15 months immediately prior to such reduction (adjusted to give effect for such entire 12 months to moneys allocated to and pledged by the Authority to the payment of the Transportation Revenue Bonds under legislation enacted or toll rate changes made effective on or prior to the effective date of any such toll reduction, and tolls from Toll Facilities which have begun operations or been removed from operation during such 12 months) is at least equal to 150% and 100% of the maximum Principal and Interest Requirements for any fiscal year thereafter for all Senior Transportation Revenue Bonds then outstanding and for all Transportation Revenue Bonds then outstanding, respectively. See "Miscellaneous Covenants" under *Summary of Certain Provisions of the 1998 Resolution*.

Tolls are currently imposed on the Luis A. Ferré tollway (PR-52), which extends 60 miles from San Juan to Ponce, the De Diego tollway (PR-22), which extends 62 miles from San Juan to Arecibo, and PR-53, which will connect Fajardo and Salinas upon its completion in 2001, a distance of 57 miles. Approximately 24 miles of PR-53 are completed. The Luis A. Ferré tollway has four toll stations in the northerly direction and three toll stations in the southerly direction, and the total minimum toll for a vehicle making a round-trip between San Juan and Ponce is currently \$3.65. An extension of the Luis A. Ferré tollway bypassing Ponce includes a toll station with a minimum toll of \$0.50. The De Diego tollway has six toll stations, and the total minimum toll for a vehicle passing through all six stations is \$2.40. PR-53 currently has five toll stations with a total minimum toll of \$1.55.

Currently, the toll collection and data processing equipment in place at existing toll stations of the Authority is furnished and maintained by a private entity pursuant to a lease contract that expires on June 30, 2002. This lease contract provides for the furnishing, installation and maintenance of an electronic toll collection and data processing system for both its existing toll stations and all new toll stations. The new system has certain security features which include, among others, a device for the collection of tolls without manual operation, a device installed in each toll lane to verify the classification of a vehicle passing through the lane, computer systems which receive, store and process toll data from the toll plazas and the toll lanes for verification, and electronic gates located as a barrier across each toll station. The new tollway security system has virtually eliminated uncollected tollway revenues.

The Authority's tollway revenues have always exceeded its tollway operation and maintenance expenses. Tollway revenues and expenses for fiscal 1997 were \$103.7 million and \$26.9 million, respectively, compared to \$93.0 million and \$23.0 million, respectively, for fiscal 1996.

Investment Earnings. Moneys held for the credit of the 1968 Bond Service Account and the 1968 Redemption Account shall, as nearly as may be practicable, be continuously invested and reinvested at the written direction of the Authority in Government Obligations. Moneys held for the credit of the 1968 Reserve Account shall, as nearly as may be practicable, be continuously invested and reinvested at the written direction of the Authority in Investment Obligations. Such Government Obligations and Investment Obligations shall mature, or be subject to redemption, at the option of the holder, not later than the respective dates when moneys held for the credit of such Accounts will be required for the purposes intended; provided, however, that the amounts on deposit in the 1968 Reserve Account shall be invested in Investment Obligations which mature not later than the final maturity date of any Highway Revenue Bonds outstanding. Income from investments of moneys held for the credit of the 1968 Construction Fund is not considered 1968 Resolution Revenues under the 1968 Resolution.

Historical Revenues - 1968 Resolution Revenues

The following table presents the Authority's 1968 Resolution Revenues in each of the five fiscal years ended June 30, 1993 to June 30, 1997, inclusive, and in the first five months of fiscal years 1997 and 1998, and the Excess 1968 Resolution Revenues for each of said fiscal years. Under the 1998 Resolution, the Excess 1968 Resolution Revenues representing unencumbered funds in the 1968 Construction Fund must be deposited monthly in the 1998 Revenue Fund and are available for the payment of debt service on Transportation Revenue Bonds, for required deposits to the reserve accounts established thereunder and for other authorized purposes under the 1998 Resolution. See "Security for the Senior Transportation Revenue Bonds-Pledged Revenues" under *The 1998 Bonds*.

HISTORICAL REVENUES

	Fiscal Year Ended June 30					First Five Months of Fiscal Year	
	1993	1994	1995	1996	1997	1997	1998
	(dollars in thousands)						
Gasoline taxes	$ 141,846	$ 147,868	$ 152,052	$ 163,005	$ 163,580*	$ 67,778*	$ 69,844
Gas oil and diesel oil taxes	3,683	4,365	11,129	14,083	16,552*	6,597*	5,577
Subtotal	**$ 145,529**	**$ 152,233**	**$ 163,181**	**$ 177,088**	**$ 180,132**	**$ 74,375**	**$ 75,421**
Motor vehicle license fees	23,169	24,391	25,016	25,139	26,533	10,490	10,732
Subtotal	**$ 168,698**	**$ 176,624**	**$ 188,197**	**$ 202,227**	**$ 206,665**	**$ 84,865**	**$ 86,153**
Toll receipts	59,028	67,780	80,703	92,994	103,708	41,396	45,366
Investment income	10,130	8,206	11,000	13,298	16,127	6,598	5,432
Total 1968 Resolution Revenues	$ 237,856	$ 252,610	$ 279,900	$ 308,519	$ 326,500	$ 132,859	$ 136,951
Debt service on Highway Revenue Bonds	$ 115,507	$ 129,118	$ 132,936	$ 147,729	$ 188,454		
Excess 1968 Resolution Revenues**	$ 122,349	$ 123,492	$ 146,964	$ 160,790	$ 138,046		

*Excludes $2,483,000 in gasoline tax and $212,000 in diesel oil tax corresponding to March, 1997, which were pending payment by one taxpayer as of June 30, 1997. Since that date, payments of $1,400,000 have been received.
**Under the 1998 Resolution, the Authority has covenanted not to encumber or withdraw or pledge any Excess 1968 Resolution Revenues deposited in the 1968 Construction Fund except in the limited circumstance of the Authority's taking over operation of the Teodoro Moscoso Bridge. See "Teodoro Moscoso Bridge" below.

The Authority's 1968 Resolution Revenues have risen at a compound annual rate of 8.2% during the period from fiscal 1993 through fiscal 1997. The increase in the amount of 1968 Resolution Revenues during this period is attributable primarily to the growth in tax collections and toll receipts.

Gasoline taxes, which accounted for approximately 50.1% of 1968 Resolution Revenues as of June 30, 1997, experienced a compound annual increase of 3.6% during this five-year period. The growth in gasoline taxes is attributable principally to increases in consumption. The number of vehicles in Puerto Rico increased from 1.59 million to 1.81 million from fiscal 1993 to fiscal 1997. The growth in gas oil and diesel oil tax receipts beginning in fiscal 1995 reflects, among other factors, a rise in the consumption of gas oil and diesel oil subject to tax and the commencement in that fiscal year of payment by Puerto Rico Electric Power Authority of the tax on No. 2 diesel oil used in the generation of electricity.

Motor vehicle license fees accounted for approximately 8.1% of annual 1968 Resolution Revenues as of June 30, 1997. Beginning in fiscal 1993, fee collections have risen at a compound annual rate of 3.4% through fiscal 1997. The number of licensed taxable vehicles grew from nearly 1.54 million in fiscal 1993 to approximately 1.76 million in fiscal 1997.

Toll revenues rose at a compound annual rate of 15.1% during the period from fiscal 1993 through fiscal 1997. Toll revenues have grown as a percentage of total 1968 Resolution Revenues over the last five fiscal years and comprised approximately 31.8% of total 1968 Resolution Revenues as of June 30, 1997. The increase in toll receipts from fiscal 1993 through fiscal 1997 corresponded principally to the growing number of vehicles using these roads, and the expansion of the tollway network. The number of paying vehicles which used the tollways rose from 150.6 million in fiscal 1993 to 241.0 million in fiscal 1997.

The foregoing discussion of past revenue growth is not intended to be predictive of future revenue growth. In particular, the Authority is not anticipating that any new Toll Facilities will be coming into service prior to fiscal 2001. The revenues allocated to the Authority from the petroleum products tax are capped at $120 million in each fiscal year. Economic conditions in Puerto Rico, as well as the price of oil and petroleum products and the levels of automobile registration and usage, will affect the Authority's revenues in the future.

Projected 1968 Resolution Revenues and 1998 Resolution Revenues

The following table presents the Authority's estimates of 1968 Resolution Revenues for each of the five fiscal years ending June 30, 1998 to June 30, 2002 and its estimates of 1998 Resolution Revenues expected to be available for the payment of debt service on the Transportation Revenue Bonds, including the 1998 Bonds, together with debt service coverage for each of the five fiscal years ending June 30, 1998 to 2002, inclusive, after taking into account the issuance of the 1998 Bonds and the refunding of the Refunded Bonds. The projected 1968 Resolution Revenues and 1998 Resolution Revenues shown below are based on tax rates and allocations to the Authority now in effect and debt service on Highway Revenue Bonds currently outstanding. Such projections are subject to periodic review and may be adjusted to reflect such factors as changes in economic conditions, in the demand for gasoline and other petroleum products and in the levels of automobile registration and usage. The estimates of 1998 Resolution Revenues expected to be available for the payment of debt service on Transportation Revenue Bonds assumes that the Excess 1968 Resolution Revenues will not be applied to the payment of debt service on the Authority's Special Facility Revenue Bonds issued to finance the Teodoro Moscoso Bridge. See the fifth paragraph in "Teodoro Moscoso Bridge" under *Transportation System Revenues and Expenditures.* The projections are based on assumptions which the Authority believes to be reasonable; however, there is no assurance that the projections will prove to be accurate.

PROJECTED REVENUES AND DEBT SERVICE COVERAGE

	Fiscal Year Ending June 30				
	1998	1999	2000	2001	2002
1968 Resolution Revenues:	(dollars in thousands)				
Gasoline taxes	$171,900	$177,600	$183,100	$188,700	$194,300
Gas oil and diesel oil taxes	17,200	17,300	18,400	20,300	22,400
Subtotal	**$189,100**	**$194,900**	**$201,500**	**$209,000**	**$216,700**
Motor vehicle license fees	27,600	28,100	29,000	29,800	30,600
Subtotal	**$216,700**	**$223,000**	**$230,500**	**$238,800**	**$247,300**
Toll receipts	105,500	112,700	118,900	125,400	132,300
Investment income	14,940	15,400	15,600	15,800	15,900
Total 1968 Resolution Revenues	$337,140	$351,100	$365,000	$380,000	$395,500
Debt Service on Highway Revenue Bonds	$183,433	$180,787	$181,988	$181,727	$181,359
Excess 1968 Resolution Revenues	$153,707	$170,313	$183,012	$198,273	$214,141
1998 Resolution Revenues:					
Petroleum Products Tax	$108,860	$120,000	$120,000	$120,000	$120,000
PR-66 Toll Receipts(1)	-	-	-	14,000	17,000
Excess 1968 Resolution Revenues	153,707	170,313	183,012	198,273	214,141
Investment Income	900	3,660	4,800	6,100	6,100
Total 1998 Resolution Revenues	$263,467	$293,973	$307,812	$338,373	$357,241
Debt service on the Transportation Revenue Bonds(2)	$19,087	$64,832	$76,500	$105,125	$105,127
Coverage ratio(3)	13.80	4.53	4.02	3.22	3.40
Additional bonds test, 1998 Resolution (4)	4.06	4.53	2.93	3.22	3.40
Aggregate Revenues(5)	$446,900	$474,760	$489,800	$520,100	$538,600
Aggregate Debt Service(6)	$202,520	$245,619	$258,488	$286,852	$286,486
Aggregate Coverage Ratio(7)	2.21	1.93	1.89	1.81	1.88

(1) Projected PR-66 toll receipts for each of the fiscal years in question were estimated by Steer Davies Gleave, Traffic Consultants, in their report dated December 1995, updated in December 1997.

(2) Reflects the issuance of 1998 Bonds and assumes the issuance of additional Transportation Revenue Bonds in 2000 in the principal amount of $490 million at an average interest rate of 7% per annum with a 30-year final maturity.

(3) Equals ratio of Total 1998 Resolution Revenues to Debt service on the Transportation Revenue Bonds in the fiscal year in question.

(4) This test uses as its denominator maximum annual debt service on all Transportation Revenue Bonds outstanding under the 1998 Resolution (including the Transportation Revenue Bonds then proposed to be issued) and as its numerator the 1998 Resolution Revenues of the Authority for the fiscal year in question.

(5) Represents the sum of Total 1968 Resolution Revenues and Total 1998 Resolution Revenues (less Excess 1968 Resolution Revenues) for the fiscal year in question.

(6) Represents the sum of Highway Revenue Bonds debt service and Transportation Revenue Bonds debt service for the fiscal year in question.

(7) Aggregate Revenues divided by Aggregate Debt Service.

Total 1968 Resolution Revenues and 1998 Resolution Revenues for the period from fiscal 1998 through fiscal 2002 are projected by the Authority to grow at a compound annual rate of 4.1% and 7.8%, respectively. The projected growth in gasoline tax revenues is based on econometric models prepared for the Authority which project increases in disposable income in Puerto Rico. The Authority has found such projections to be the most reliable indicator of future growth in gasoline tax receipts. The Authority's projections of growth in its other revenues is based on historic trends and, in the case of toll revenues, on the additional receipts expected from the growth in traffic and the opening of new toll plazas.

In 1993 the Authority projected that total 1968 Resolution Revenues would grow during the period from fiscal 1993 through fiscal 1997 at a compound annual rate of 4.3%. The actual compound growth rate for those years was 8.2%.

Operating Expenses and Capital Expenditures

Operation and Maintenance- Highway Facilities

The Department has the responsibility for maintaining Puerto Rico's highway system, except for the Luis A. Ferré (PR-52), the De Diego (PR-22) and PR-53 tollways and related connecting roads, which are maintained by and at the expense of the Authority. The maintenance expenses of the Department are paid with moneys appropriated annually by the Legislature of Puerto Rico. On occasion the Authority advances funds to pay the costs of emergency repairs which are the responsibility of the Department. It is subsequently reimbursed for these advances. To the extent funds are not provided by the Legislature, the Authority has agreed under the 1998 Resolution that it will pay from available moneys in the 1998 Construction Fund the costs of maintenance of the Traffic Facilities financed with proceeds of Highway Revenue Bonds and Transportation Revenue Bonds. Upon the adoption of the 1998 Resolution, moneys in the 1968 Construction Fund will no longer be used for these maintenance purposes as had been the case in the past. In addition, the 1998 Resolution requires the Authority to pay from available moneys in the 1998 Construction Fund (and not from moneys in the 1968 Construction Fund) the costs of any necessary repairs to, or renewals or replacements of, Traffic Facilities financed with proceeds of Highway Revenue Bonds and Transportation Revenue Bonds, as recommended by the Transportation Engineers.

The Authority's operation and maintenance expenses payable from available moneys in the 1998 Construction Fund consist of the expenses of operating and maintaining the tollways and related roads and, upon completion, the Tren Urbano. Under the 1998 Resolution, these expenses are payable from available moneys in the 1998 Construction Fund after payment of debt service on the Highway Revenue Bonds and Transportation Revenue Bonds and any required deposits to the 1998 Senior Bond Reserve Account and the accounts in the 1998 Subordinated Bond Reserve Fund. Other expenses of the Authority, including its administration costs, are included in the Priorities Construction Program and are capitalized.

The following table sets forth the annual highway maintenance expenses paid by the Department and the annual tollway operation and maintenance expenses paid by the Authority from unencumbered moneys in the 1968 Construction Fund for each of the five fiscal years ended June 30, 1997 and the Authority's projections of annual highway maintenance expenses to be paid by the Department and projected annual tollway operation and maintenance expenses to be paid by the Authority from unencumbered moneys in the 1968 Construction Fund (before the 1998 Resolution was adopted) and the 1998 Construction Fund for the five fiscal years ending June 30, 2002.

HIGHWAY FACILITIES
OPERATION AND MAINTENANCE EXPENSES

	Department	Authority		
Fiscal Year Ended June 30	Highway System Maintenance[1]	Tollway Maintenance	Tollway Operation	Total
		(in thousands)		
1992	$26,254	$ 8,388	$ 6,267	$14,655
1993	26,010	9,289	7,008	16,297
1994	27,540	12,238	7,362	19,600
1995	27,932	12,321	7,552	19,873
1996	26,831	13,345	9,676	23,021
1997	31,727	13,943	12,994	26,937
1998[p]	28,400	20,600	13,200	33,800
1999[p]	29,200	18,060	12,040	30,100
2000[p]	30,000	18,700	11,500	30,200
2001[p]	31,000	19,520	13,390	32,910
2002[p]	32,000	19,520	13,290	32,810

(p) Projected.

(1) The Authority contributed to the Department $5 million for fiscal years 1993, 1995 and 1996, $6.5 million for fiscal year 1994 and $10 million for fiscal year 1997 for the maintenance of the Puerto Rico highway system. For fiscal years 1998 through 2002, the amount of the contribution projected is $5 million annually.

In certain years, emergency repairs to the highway system have been necessary, particularly as a result of storm or flood damage. The cost of these repairs is borne by the Department, except for the cost of repairs to the tollways, which is borne by the Authority. The Department and the Authority have been reimbursed from the Federal Emergency Management Agency for the portion of the costs of such repairs attributable to federally designated disaster areas. The Legislature of Puerto Rico also appropriates funds from time to time for emergency repairs by the Department in addition to amounts appropriated for maintenance.

The Traffic Engineers under the 1968 Resolution conduct an annual evaluation of the level of maintenance of the highway system. In their most recent evaluation completed in December 1997, the Traffic Engineers found that the current level of maintenance was generally adequate. The projected maintenance budgets for the next five fiscal years show a steady increase for non-toll roads. For fiscal 1998, the tollway maintenance expense increase was partly caused by the purchase of equipment which will enable the Authority to upgrade its maintenance of toll plazas and other areas. For fiscal 1998 and subsequent years, the Authority has increased the amounts budgeted for tollway maintenance to reflect an expanded tollway network and increased levels of maintenance. The Traffic Engineers believe that the Authority's maintenance program represents an adequate level of maintenance to preserve the investment and provide an acceptable level of service. The results of the Traffic Engineers' most recent maintenance evaluation are summarized in the letter of the Traffic Engineers included as *Appendix III.*

Operation and Maintenance - Tren Urbano

The Authority has entered into a Systems and Test Track Turnkey Contract (the "STTT Contract") with the Siemens Transit Team ("STT"), comprised of Siemens Transportation Partnership Puerto Rico, S.E., Alternate Concepts, Inc. and Juan R. Requena and Associates, covering, among other things, the operations and maintenance of the Tren Urbano. For a more detailed discussion of the scope of the STTT Contract, see "Priorities Construction Program-Tren Urbano" below. The operations portion of the contract is for an initial term of five years with an option by the Authority to extend the term for an additional five years. Under the STTT Contract, STT is responsible for operating and maintaining the Tren Urbano and is entitled to receive for such services an annual base compensation, which is subject to an inflation adjustment for changes in the cost of labor (based on the changes to consumer price index) and materials (based on the changes to producer price index). The base compensation does not include the cost of insurance and electricity which is paid separately by the Authority. In addition, STT is entitled to receive incentive compensation based on meeting certain operating and maintenance performance measures.

The table below shows the Authority's estimate of the annual operating and maintenance expenses of the Tren Urbano for the first ten years of service. These estimates are based upon the terms of the STTT Contract and include an inflation adjustment and the Authority's estimate of the cost of insurance and electricity.

Year of Service*	Estimated Annual Operation and Maintenance Cost (in millions)
1	$47.7
2	49.7
3	51.7
4	53.7
5	55.9
Option Period	
6	58.1
7	60.5
8	62.9
9	65.4
10	68.0

*Based on twelve full months of operation starting from the date when the system opens for service.

The Authority projects annual net operating costs of approximately $33 million per year for each of the Tren Urbano's first ten years of operation after deducting expected operating revenues from operating and maintenance costs. This estimate is based, among other factors, on an annual average daily ridership of 113,000 passengers by the year 2010, and an initial ridership in the first full year of operation of 64% of the ridership expected for 2010, with such ridership growing for each year of operation. These costs will be covered by available moneys in the 1998 Construction Fund.

Priorities Construction Program

As required by the 1968 Resolution and as will be required by the 1998 Resolution, the Authority has developed a master plan to serve as the basis for the long-range planning of Puerto Rico's transportation facilities, which it supplements as necessary. To implement the plan, the Authority prepares a five-year Priorities Construction Program which is updated annually. The Authority has focused its current Priorities Construction Program on constructing the Tren Urbano and improving the primary highway facilities, while also addressing the most essential needs of secondary and tertiary roads. The Authority has also included in its Priorities Construction Program the cost of repairs, renewals and replacements to the highway system, plans for dealing with urban congestion and for local improvements, and certain capitalized expenditures.

The following table presents the Authority's current Priorities Construction Program for the five fiscal years ending June 30, 2002 and the sources of funds required to finance such program. The Priorities Construction Program is subject to various changing factors, including cost increases, variations in availability of internal and external funds, availability of qualified construction resources, the need for emergency repairs and changing traffic patterns. The Authority's projections assume no changes in the statutory taxes and license fees currently allocated to the Authority, see the table entitled "Projected Revenues and Debt Service Coverage" above, and that the Authority will not be required to assume the payment of the Special Facility Revenue Bonds relating to the Teodoro Moscoso Bridge. See "Teodoro Moscoso Bridge" below.

PRIORITIES CONSTRUCTION PROGRAM

	Fiscal Year Ending June 30 (in $ millions)					
	1998	**1999**	**2000**	**2001**	**2002**	**Total**
Sources of Funds:						
Internally generated funds[1] .	$176.26	$195.71	$155.38	$190.37	$177.88	$ 895.60
Federal aid for highways . . .	92.00	94.00	96.00	98.00	100.00	480.00
Federal aid for Tren Urbano[2]	35.70	105.50	136.40	188.10	38.20	503.90
External financing[3]	537.84	476.09	360.42	129.53	128.12	1,632.00
Total	**$841.80**	**$871.30**	**$748.20**	**$606.00**	**$444.20**	**$3,511.50**
Uses of Funds:						
Design	$ 24.40	$ 9.70	$ 4.80	$ 0.80	$ 1.50	$ 41.20
Rights of way	74.30	27.10	10.60	5.50	3.00	120.50
Highway Construction	328.00	398.30	336.00	222.00	198.00	1,482.30
Tren Urbano	301.70	329.20	299.80	289.70	171.70	1,392.10
Capitalized expenditures	113.40	107.00	97.00	88.00	70.00	475.40
Total	**$841.80**	**$871.30**	**$748.20**	**$606.00**	**$444.20**	**$3,511.50**

(1) Includes funds on hand, current 1968 Resolution Revenues and 1998 Resolution Revenues and investment income available after provision for debt service and reserve requirements for Highway Revenue Bonds and Transportation Revenue Bonds, estimated tollway maintenance and operating expenses, estimated Tren Urbano maintenance and operating expenses (for seven months of fiscal 2002). To the extent such funds on hand are held in the 1968 Construction Fund, the holders of the Special Facility Revenue Bonds issued by the Authority to finance the Teodoro Moscoso Bridge have a claim on such funds in certain circumstances. See "Teodoro Moscoso Bridge" below.

(2) See the discussion of the Authority's Full Funding Grant Agreement with the United States Department of Transportation in "Tren Urbano" below.

(3) Includes interim financing, net proceeds of borrowings, including Transportation Revenue Bonds, and other.

In the five-year period from fiscal 1993 through fiscal 1997 the Authority expended approximately $2.1 billion on the Priorities Construction Program. The current Priorities Construction Program projects an expenditure of about $3.5 billion from fiscal 1998 through fiscal 2002. This increase is almost entirely due to the inclusion of the Tren Urbano and PR-66 in the Priorities Construction Program.

The Authority's internally generated funds available to finance its current Priorities Construction Program consist primarily of 1968 Resolution Revenues and 1998 Resolution Revenues remaining after payment of debt service for the Highway Revenue Bonds and Transportation Revenue Bonds, provision of reserve requirements for the Highway Revenue Bonds and the Transportation Revenue Bonds and payment of expenses for operating and maintaining the tollways as well as the Tren Urbano (as to the latter, only for the last seven months in fiscal 2002 during which it is expected to be operational). Such internally generated funds are estimated to aggregate approximately $895.1 million during the five-year period from fiscal 1998 through fiscal 2002, including investment income, which is estimated at approximately $99.2 million for the five-year period.

The current Priorities Construction Program contemplates new construction borrowings, in addition to the 1998 Bonds, aggregating approximately $612 million net proceeds from fiscal 1998 to fiscal 2002.

Tren Urbano. The largest single project included in the Authority's current Priorities Construction Program is Tren Urbano, a new-start mass transit project for the San Juan metropolitan region. The initial phase of Tren Urbano consists of approximately 17 km. of trackway, running from Bayamón to Santurce, via Río Piedras and Hato Rey, and sixteen stations. The project also includes the construction of a maintenance and storage facility. The project is scheduled to be fully operational by the end of 2001.

Tren Urbano is being constructed under seven separate design/build contracts. Siemens Transit Team, comprised of Siemens Transportation Partnership Puerto Rico, S.E., Alternate Concepts, Inc., and Juan R. Requena and Associates, is the contractor under the STTT Contract, the largest of these contracts, with a value of approximately $544 million. The STTT Contract includes: (i) the design and construction of two stations and a 2.6 km. test track; (ii) the design, procurement and installation of all systems for the project, such as the trackway, the train control system, and the communications system; (iii) the design and manufacturing of the vehicles; (iv) the design and construction of the maintenance and storage facility; (v) the responsibility for design and construction coordination among the several civil contracts; and (vi) operating Tren Urbano for a period of five years, with an additional five-year option exercisable by the Authority. Six other design/build contracts have been executed, with an aggregate value of $592 million, for the design and construction of all remaining stations and guideway. Total estimated costs for the first phase of Tren Urbano, including contingency amounts and right-of-way and administrative costs, is $1.55 billion. Of this amount, $158 million has been paid through fiscal year 1997, and $1.392 billion is included in the five-year Priorities Construction Program for fiscal years 1998 through 2002.

To manage the Tren Urbano project, the Authority has established the Tren Urbano Office. The Tren Urbano Office includes Authority staff, local and mainland design firms experienced in transit projects and local infrastructure projects, and financial and legal advisors. The Tren Urbano Office provides overall direction and management for the project. The office oversees all engineering and construction activities for the project, and is responsible for scheduling, budgeting, contract administration, risk management and quality assurance. Design review is provided by a consortium of design firms that includes Daniel, Mann, Johnson and Mendenhall and Frederick R. Harris Inc. Construction oversight is provided by experienced Authority personnel and mainland consultants experienced in large transit projects.

The Tren Urbano has been designated as one of four national turnkey demonstration projects by the Federal Transit Administration of the United States Department of Transportation (the "FTA"). In March 1996, the Authority entered into a Full Funding Grant Agreement with the FTA for the project in the amount of $307 million. The Authority also has requested and expects to receive an additional $110 million for the project following the reauthorization of the federal Intermodal Surface Transportation Efficiency Act ("ISTEA"), which is expected to occur during 1998. The balance of federal aid for the Tren Urbano will come from moneys provided under certain formula programs established by federal law, which moneys are expected to be earmarked to the Tren Urbano. While the Authority cannot assure the amount or timing of federal funds for the project, if federal funds are received slower or in a lesser amount than currently projected, the Authority will adjust the timing or scope of the remainder of its Priorities Construction Program, or adjust its borrowing schedule, as necessary, to accommodate any such changes.

Tren Urbano is being designed in order to provide flexibility for future extensions. The Authority is currently undertaking the preliminary planning of an extension to the Minillas area of Santurce, a major residential, commercial and governmental section of San Juan (the "Minillas Extension"). The Minillas Extension, and any other extension of Tren Urbano, will be subject to the Authority's identifying adequate funding for such project prior to its inclusion in the Priorities Construction Program.

The size and complexity of the Tren Urbano project present certain challenges related to the coordination among the several design/build contractors, community impacts, and issues related to permits and governmental approvals, as well as traditional construction risk factors such as unknown site conditions. The Authority believes that it has made adequate provision for these and other factors in planning the project and developing the project contracts. The Authority further believes that the construction risks associated with such a large scale project have been minimized since the Authority has already executed fixed price contracts for all components of the first phase of Tren Urbano. As with all of the projects contained in the Authority's Priorities Construction Program, however, the timetable and expenditure forecasts for the Tren Urbano are subject to change. Unforeseen circumstances could result in delays or cost escalations not currently provided for in the Authority's projections.

Highway Construction. Highway construction projects included by the Authority in its current Priorities Construction Program are designed to enhance the economic development of Puerto Rico. The major portion of the program consists of new highway construction, principally of primary roads and tollways. It also includes reconstruction of existing highways, a bridge program and installation of safety features and other projects.

The largest single highway construction project included in the program is the construction of PR-66, a 9-mile four lane tollway from Carolina to Canóvanas. PR-66 is estimated to cost $125 million and is expected to be completed by mid-2000. It will serve to reduce congestion on a portion of PR-3 which runs parallel to the PR-66 corridor and to provide a convenient access to new and existing development in Puerto Rico's northeastern region. The Authority's estimate of the toll revenues to be generated by PR-66 is based on a traffic study report prepared by Steer Davies Gleave, Traffic Consultants, in December 1995 and updated in December 1997. Such report is based on certain assumptions which, although the Authority believes to be reasonable, may not be realized and methodologies that cannot take into account all possible factors that may affect toll revenues. Therefore, there may be differences between the estimated and actual toll revenues from PR-66.

PR-66 was one of two projects which the Authority originally intended to have designed, built, operated and maintained by Autopistas de Puerto Rico y Compañía, S.E. ("APR"), through a concession agreement. The other project was the Teodoro Moscoso Bridge, with respect to which the Authority has in effect a private concession agreement with APR, as discussed below. In February 1997, the Authority decided to design, construct, operate and maintain PR-66 as a government project instead of as a private concession. In connection therewith, APR filed a lawsuit against the Authority seeking to enjoin the public bidding process for the construction of PR-66 and seeking monetary damages in the amount of $200 million. The lawsuit was dismissed on jurisdictional grounds. APR has filed an appeal seeking to reverse the dismissal, which appeal is still pending resolution.

Also, a group of citizens filed an action to have the Circuit Court of Appeals review the compliance by the Authority with certain requirements in issuing a final environmental impact statement for PR-66. The Authority requested dismissal on jurisdictional grounds. On January 30, 1998, the appeals court denied the motion to dismiss and ordered the Authority to file its response to the lawsuit. The Authority's motion for reconsideration was also denied.

Based on the opinion of its legal counsel, while the Authority cannot predict the outcome of this or any other litigation, the Authority does not expect the outcome of either lawsuit relating to PR-66 to materially affect its 1998 Resolution Revenues, its 1968 Resolution Revenues or its operations or financial condition.

Other major highway projects include the construction of various sections of PR-53 from Ceiba to Guayama, the construction of additional lanes on PR-2 between Arecibo and Ponce, the relocation of PR-167 from Bayamón to Comerío and Naranjito, and of PR-10 from Arecibo to Ponce, the conversion to an expressway of Baldorioty de Castro Avenue (PR-26) in San Juan and a section of PR-17 in Hato Rey, the extension of the Martinez Nadal Expressway in Guaynabo, the relocation of PR-137 in Morovis and PR-156 in Aguas Buenas, the construction of PR-142 from Dorado to Corozal, Las Cumbres Avenue (PR-199) from Guaynabo to Bayamón, PR-203 from Gurabo to San Lorenzo, and the conversion of a portion of PR-2 in San Juan into an expressway and its linkage with the Martinez Nadal expressway to make available a new north-south expressway in the San Juan metropolitan area.

The Authority receives aid for highway construction from the Federal Highway Administration of the U.S. Department of Transportation. Such aid is recorded as related costs which are billed to the Federal Highway Administration, regardless of the year of appropriation. In fiscal years ended 1995, 1996 and 1997, such aid amounted to $90.2 million, $101.2 million and $73.4 million, respectively.

Federal aid for highway construction is received under a number of federal programs, including those directed to construction of new roads and repair and reconstruction of existing roads. The programs provide for matching federal assistance, ranging generally from 80% to 90% of the cost of a project. The level of federal highway aid is dependent upon Congressional authorizations that are apportioned to the states, including Puerto Rico. The U.S. Department of Transportation has broad discretion to release funds for spending within the limits set by Congress. Upon its approval of a state's program, funds are reserved but not committed. Federal-aid funds are committed when the U.S. Department of Transportation approves the detailed plans for specific projects. Congress has authorized funding for the federal highway programs through fiscal 1998 depending on the program. Federal highway legislation has liberalized certain types of federal highway aid and granted more flexibility to the states, including Puerto Rico, in the use of such aid in highway or other transportation projects. No assurance can be given that the level of federal highway aid will be maintained at the levels projected in the above table. In the event of material reductions in such aid, the Priorities Construction Program will be appropriately adjusted in the absence of internally generated funds, external financing or other sources of funds shown in the above table available to offset any such reductions.

The federal government conducts periodic audits of the federal aid it provides to the Authority to ascertain that funds are being expended consistently with the federal programs pursuant to which they are provided. Audit findings of a failure by the Authority to expend funds in compliance with federal programs could result in the withholding of federal aid for the project involved or could result in offset claims by the federal government for funds previously received by the Authority.

The Traffic Engineers under the 1968 Resolution and the Transportation Engineers under the 1998 Resolution, if different, annually review the Priorities Construction Program and the Authority's estimates of revenue sources available for its implementation. In their most recent evaluation, the Traffic Engineers concluded that the Authority's current Priorities Construction Program is a reasonable response to the immediate and short-term transportation needs and is generally consistent with the Authority's long-range transportation master plan. The Traffic Engineers also concluded that revenue projections have been reasonably accurate and provide a sound basis for determining the size of future programs. The results of that review are summarized in the Traffic Engineers' letter included as *Appendix III.*

Teodoro Moscoso Bridge

In furtherance of its expanded powers to enter into concession agreements with private companies, the Authority entered into a concession agreement with APR for the design, construction, operation and maintenance of the Teodoro Moscoso Bridge, a bridge spanning the San José Lagoon from San Juan to Carolina. Pursuant to the concession agreement, APR is obligated to operate and maintain the bridge for a term of 35 years, subject to extension or to earlier termination. The bridge opened in February 1994 at a cost of approximately $109.5 million. The bridge does not constitute a Traffic Facility under the 1968 Resolution or a Transportation Facility under the 1998 Resolution.

Construction of the bridge was financed through the issuance by the Authority of its Special Facility Revenue Bonds in the principal amount of $116,752,769 (the "Special Facility Bonds"). The proceeds of such bonds were loaned to APR, and APR has agreed to repay the loan in amounts sufficient to pay the principal of and interest on the bonds. APR's obligation in respect of the Special Facility Bonds is payable solely from the net toll revenues of the bridge, after payment of current operating expenses.

Under the concession agreement, the Authority is required to replace APR with a new concessionaire or assume APR's obligation to pay the Special Facility Bonds upon the occurrence, among other things, of APR payment defaults or traffic using the bridge not meeting specified traffic levels in the concession agreement (based on traffic projections prepared in connection with the construction of the bridge).

Since operations commenced, traffic using the bridge has been less than the levels specified in the concession agreement. As a result, APR currently has the right, but not the obligation, to terminate the concession agreement and require the Authority to assume APR's obligations to pay the Special Facility Bonds. While the aggregate volume of traffic during the bridge's first four years of operation has been significantly less than the minimum level specified in the concession agreement, the traffic has been, however, increasing steadily during the last three years. During 1997, the actual volume of traffic was 85% of the agreement's specified minimum level, compared to 62% during 1994, 69% during 1995 and 76% during 1996. Due to the improvement in the level of traffic, the Authority does not expect APR to terminate the concession agreement.

If the concession is terminated by APR, the Authority would be required to assume the obligation to pay principal of and interest on the Special Facility Bonds, in the first instance from such net toll revenues. If such net toll revenues are insufficient to make such payment, the Authority has agreed to cover any such insufficiency with unencumbered moneys in the 1968 Construction Fund (available pursuant to clause (4) of the third paragraph under "Sinking Fund" in *Summary of Certain Provisions of the 1968 Resolution*). The Authority has further agreed that, upon the occurrence of any such insufficiency and for so long as it shall exist, the Authority shall not make any withdrawal and expenditure, pledge or encumbrance of such unencumbered 1968 Construction Fund moneys and has further agreed that until such insufficiency is cured, such unencumbered 1968 Construction Fund moneys will be subject to the lien and pledge in favor of the holders of the Special Facility Bonds.

The Authority has further agreed that, after its assumption of the obligation to repay the Special Facility Bonds, it will use its best efforts to issue additional Highway Revenue Bonds under Section 208 of the 1968 Resolution to the extent permitted by said Section and exchange the Special Facility Bonds for such additional Highway Revenue Bonds so issued or redeem any such outstanding Special Facility Bonds. Under the 1998 Resolution the Authority has agreed that any bonds issued to redeem the Special Facility Bonds would be Senior Transportation Revenue Bonds.

DEBT

Authority Debt

The outstanding debt of the Authority as of December 31, 1997 and as adjusted for the issuance of the 1998 Bonds and the refunding of the Refunded Bonds is as follows:

	As of December 31, 1997	As Adjusted
	(in thousands)	
Bonds[1]	$2,411,955	$3,453,999
Notes[2]	160,185	0
Total	**$2,572,140**	**$3,453,999**

(1) Includes $4,510,000 Highway Revenue Bonds sold to the Farmers Home Administration, of which $3,600,000 is currently outstanding. Does not include the Special Facility Bonds issued by the Authority in April 1992 to finance the Teodoro Moscoso Bridge. See "Teodoro Moscoso Bridge" under *Highway System Revenues and Expenditures*.

(2) Notes payable to Government Development Bank for interim financing for certain capital improvements, which notes are being repaid from a portion of the proceeds of the 1998 Bonds.

Principal and Interest Requirements

The Principal and Interest Requirements for the outstanding Highway Revenue Bonds and the 1998 Bonds (after taking into account the refunding of the Refunded Bonds) as of the date hereof are set forth in the following table:

Principal and Interest Requirements*

Year Ending June 30	Outstanding Highway Revenue Bonds[1] Debt Service	1998 Bonds Principal	1998 Bonds Interest [2]	1998 Bonds Total	Total Debt Service
1998	$183,433,400	$ 0	$19,086,564	$19,086,564	$202,519,964
1999	180,786,775	11,980,000	52,852,008	64,832,008	245,618,783
2000	181,988,425	12,490,000	52,342,858	64,832,858	246,821,283
2001	181,726,950	13,020,000	51,812,033	64,832,033	246,558,983
2002	181,358,650	13,530,000	51,304,253	64,834,253	246,192,903
2003	158,474,800	14,205,000	50,627,753	64,832,753	223,307,553
2004	168,830,400	14,785,000	50,045,348	64,830,348	233,660,748
2005	168,866,600	15,395,000	49,439,163	64,834,163	233,700,763
2006	156,935,200	16,040,000	48,792,573	64,832,573	221,767,773
2007	156,909,300	16,720,000	48,110,873	64,830,873	221,740,173
2008	156,911,500	17,440,000	47,391,913	64,831,913	221,743,413
2009	156,900,800	18,310,000	46,519,913	64,829,913	221,730,713
2010	156,949,000	19,320,000	45,512,863	64,832,863	221,781,863
2011	156,797,100	20,380,000	44,450,263	64,830,263	227,627,363
2012	156,809,400	21,500,000	43,329,363	64,829,363	221,638,763
2013	156,806,200	22,685,000	42,146,863	64,831,863	221,638,063
2014	156,811,500	23,930,000	40,899,188	64,829,188	221,640,688
2015	156,806,500	10,845,128	53,987,910	64,833,038	221,639,538
2016	156,813,300	10,235,845	54,597,193	64,833,038	221,646,338
2017	156,806,100	9,651,308	55,181,730	64,833,038	221,639,138
2018	153,191,700	9,136,460	55,696,578	64,833,038	218,024,738
2019	144,972,800	25,250,000	39,583,038	64,833,038	209,805,838
2020	144,956,700	26,455,000	38,375,646	64,830,646	209,787,346
2021	122,625,800	27,720,000	37,110,624	64,830,624	187,456,424
2022	102,603,300	29,045,000	35,785,093	64,830,093	167,433,393
2023	55,366,000	30,435,000	34,396,188	64,831,188	120,197,188
2024	55,365,080	31,890,000	32,940,780	64,830,780	120,195,860
2025	55,363,030	33,415,000	31,415,773	64,830,773	120,193,803
2026	55,365,450	35,015,000	29,817,805	64,832,805	120,198,255
2027	55,362,400	36,690,000	28,143,295	64,833,295	120,195,695
2028	55,363,650	38,445,000	26,388,649	64,833,649	120,197,299
2029	55,363,680	40,280,000	24,550,038	64,830,038	120,193,718
2030	55,362,730	42,245,000	22,587,075	64,832,075	120,194,805
2031	55,365,850	44,305,000	20,528,288	64,833,288	120,199,138
2032	55,362,500	46,465,000	18,369,038	64,834,038	120,196,538
2033	55,367,430	48,725,000	16,104,438	64,829,438	120,196,868
2034	55,364,300	51,100,000	13,729,613	64,829,613	120,193,913
2035	55,367,380	53,595,000	11,238,938	64,833,938	120,201,318
2036	55,364,800	56,205,000	8,626,575	64,831,575	120,196,375
2037	-	58,945,000	5,886,900	64,831,900	64,831,900
2038	-	61,820,000	3,013,575	64,833,575	64,833,575

*Totals may not add up due to rounding.

(1) Includes $4,510,000 Highway Revenue Bonds sold to the Farmers Home Administration, of which $3,600,000 is currently outstanding, which mature in the year 2020. Does not include the Special Facility Bonds issued by the Authority in April 1992 to finance the Teodoro Moscoso Bridge. See "Teodoro Moscoso Bridge" under *Transportation System Revenues and Expenditures*. The interest on certain variable rate Highway Revenue Bonds (Series W), issued in August 1993 has been calculated on the basis of the fixed interest rate payable by the Authority under a related interest rate swap agreement as permitted by the 1968 Resolution.

(2) The interest on the 1998 Variable Rate Bonds has been calculated on the basis of the fixed interest rate payable by the Authority under a related interest rate swap agreement to be entered into upon the delivery of the 1998 Variable Rate Bonds.

Upon the issuance of the 1998 Bonds (and the refunding of the Refunded Bonds), the remaining average life of the Highway Revenue Bonds and the 1998 Bonds will be approximately 21.2 years.

SUMMARY OF CERTAIN PROVISIONS OF THE 1968 RESOLUTION

The following are brief summaries of certain provisions of the 1968 Resolution. Such statements do not purport to be complete and reference is made to the 1968 Resolution, copies of which are available from the Authority or the 1968 Fiscal Agent. The 1968 Resolution, the Highway Revenue Bonds issued thereunder and the 1968 Resolution Revenues are referred to in this summary as the "Resolution", the "Bonds" and "Revenues", respectively. The Authority proposes to amend the 1968 Resolution as described in *Summary of Certain Provisions of the Proposed Supplemental Resolution.*

Definition of Certain Terms

"Accreted Value" means, with respect to any Capital Appreciation Bond or Capital Appreciation and Income Bond, an amount equal to the principal amount of such Bond on the date of original issuance plus the interest accrued on such Capital Appreciation Bond or Capital Appreciation and Income Bond from the date of original issuance to the date of calculation or the Interest Commencement Date, as the case may be, compounded on the dates and in the manner provided for in the resolution authorizing the issuance of such Capital Appreciation Bond or Capital Appreciation and Income Bond.

"Balloon Bonds" means any Bonds, the interest on which is payable periodically and twenty-five percent (25%) or more of the original principal amount of which matures during any one fiscal year and for which maturing principal amount Amortization Requirements have not been fixed.

"Capital Appreciation Bonds" means any Bonds as to which interest is compounded periodically on each of the applicable dates designated for compounding in the resolution authorizing said Bonds and payable in an amount equal to the then current Accreted Value only at the maturity (or extended maturity date for Extendible Maturity Bonds), earlier redemption or other payment date therefor, all as so provided by such resolution, and which may be either serial bonds or term bonds.

"Capital Appreciation and Income Bonds" means any Bonds as to which accruing interest is not paid prior to the interest payment date immediately succeeding the Interest Commencement Date specified in the resolution authorizing such Bonds and the interest on which is compounded periodically on the dates designated in such resolution prior to the Interest Commencement Date for such Capital Appreciation and Income Bonds, and which may be either serial bonds or term bonds.

"Code" means the Internal Revenue Code of 1986, as amended from time to time, and the regulations promulgated thereunder and applicable regulations promulgated under the Internal Revenue Code of 1954, as amended.

"Extendible Maturity Bonds" means Bonds the maturities of which, by their terms, may be extended by and at the option of the holders of the Bonds or the Authority.

"1968 Fiscal Agent" means the bank or trust company appointed by the Authority and acting as fiscal agent whether original or successor pursuant to the provisions of the Resolution.

"fiscal year" means the period commencing on the first day of July of any year and ending on the last day of June of the following year or any other twelve month period designated by the Authority.

"Government Obligations" means (i) direct obligations of, or obligations the payment of the principal of and interest on which are unconditionally guaranteed by, the United States of America; (ii) municipal obligations, the payment of the principal of and interest and redemption premium, if any, on which are irrevocably secured by obligations described in clause (i) above and which obligations are not subject to redemption prior to the date on which the proceeds attributable to the principal of the obligations are to be used and have been deposited in an escrow account which is irrevocably pledged to the payment of the principal of and interest and redemption premium, if any, on such municipal obligations; (iii) evidences of ownership of proportionate interests in future interest or principal payments on obligations specified in clauses (i) and (ii) above held by a bank (including the Fiscal Agent) or trust company as custodian, under which the owner of said interests is the real party in interest and has the right to proceed directly and individually against the issuer of the underlying obligations described in said clauses (i) and (ii) and which underlying obligations are not available to satisfy any claim of the custodian or any person claiming through the custodian or to whom the custodian may be obligated; and (iv) secured time deposits.

"Interest Commencement Date" means, with respect to any particular Capital Appreciation and Income Bonds, the date specified in the resolution authorizing the issuance of such Bonds after which interest accruing on such Bonds shall be payable on a periodic basis prior to maturity, with the first such payment date being the applicable interest payment date immediately succeeding such Interest Commencement Date.

"Interim Bonds" means any Bonds issued under the Resolution on an interim basis which are expected to be repaid from the proceeds of Bonds or other indebtedness.

"Investment Obligations" means any of the following, to the extent that the same is legal for the investment of public funds under the laws of the Commonwealth:

(i) Government Obligations;

(ii) obligations issued or guaranteed by any instrumentality or agency of the United States of America, whether now existing or hereafter organized, including but not limited to those of the Federal Financing Bank, Federal Home Loan Banks, the Export-Import Bank, Government National Mortgage Association and the Tennessee Valley Authority;

(iii) bankers' acceptances, certificates of deposit or time deposits of any bank, national banking association (including the 1968 Fiscal Agent), trust company or savings and loan association (including any investment in pools of such bankers acceptances, certificates of deposit or time deposits), which to the extent that such obligations are not insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, are either (A) issued by a bank, trust company, or savings and loan association having a combined capital and surplus aggregating at least $50,000,000 or (B) collateralized at all times by such securities as are described in clause (i) or (ii) above or (iv) or (v) below, having a market value at least equal to the principal amount of such bankers' acceptances, certificates of deposit or time deposits (or portion thereof not so insured); provided that the 1968 Fiscal Agent has a perfected first security interest in the collateral and that such collateral is held free and clear of claims by third parties;

(iv) obligations issued by any state or territory of the United States, which are rated, on the date of investment therein, in one of the three highest rating categories (without regard to any gradation within such category) by both Moody's Investors Service ("Moody's") or any successors thereto and Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies Inc. ("S&P") or any successors thereto;

(v) municipal obligations, the payment of the principal of and the interest on which is insured, which are rated, on the date of investment therein, in one of the three highest rating categories (without regard to any gradation within such category) by both Moody's or any successors thereto and S&P or any successors thereto;

(vi) any repurchase, reverse repurchase or investment agreement with any bank or trust company organized under the laws of any state of the United States or the Commonwealth or any national banking association (including the 1968 Fiscal Agent), insurance company, or government bond dealer reporting to, trading with, and recognized as a primary dealer by the Federal Reserve Bank of New York and a member of the Security Investors Protection Corporation, which agreement is secured by any one or more of the securities described in clause (i) or (ii) above, provided that the 1968 Fiscal Agent has a perfected first security interest in the collateral and that such collateral is held free and clear of claims by third parties;

(vii) commercial paper rated, or backed by a letter of credit or line of credit the issuer of which is rated, on the date of investment therein, in one of the three highest rating categories (without regard to any gradation within such category) by both Moody's or any successors thereto and S&P or any successors thereto; and

(viii) any other investment obligations, which are rated, on the date of investment therein, in one of the three highest rating categories (without regard to any gradation within such category) by both Moody's or any successors thereto and S&P or any successors thereto.

"Principal and Interest Requirements" for any period, as applied to the Bonds of any Series, means the sum of:

(i) the amount required to pay interest on all Bonds of such Series then outstanding which is payable on each interest payment date in such period;

(ii) the amount required to pay principal of all serial Bonds of such Series then outstanding which is payable upon the stated maturity of such serial Bonds in such period; and

(iii) the Amortization Requirements for the term Bonds of such Series for such period.

To the extent that the period for calculating Principal and Interest Requirements shall be a fiscal year and the first day of the next fiscal year shall be an interest or principal payment date, such first day of the next fiscal year shall be included in the preceding fiscal year and not in the current fiscal year for purposes of calculating Principal and Interest Requirements.

The following rules apply in determining the amount of the Principal and Interest Requirements for any period:

(a) in the case of Variable Rate Bonds the interest rate thereon shall be assumed to be the greater of (A) one hundred ten percent (110%) of the average interest rate on such Variable Rate Bonds during the twelve months ending with the month preceding the date of calculation or such shorter period that such Variable Rate Bonds shall have been outstanding, (B) the actual rate of interest on such Variable Rate Bonds on the date of calculation and (C) the lesser of the maximum rate then permitted by law and the maximum rate permitted on such Variable Rate Bonds by the resolution authorizing the issuance thereof; provided, however, that if the Authority has notified the 1968 Fiscal Agent that a Swap agreement is in effect in respect of such Variable Rate Bonds, then for all purposes of this paragraph the interest rate on such Variable Rate Bonds shall be the Swap rate under such Swap agreement.

(b) in the case of Put Bonds, the tender date or dates shall be ignored if the source for payment of said tender is a liquidity facility and the stated periods for Amortization Requirements and the stated dates for principal payments shall be used, and in the case of Bonds secured by a credit facility or a liquidity facility, the terms of the reimbursement obligation to the issuers thereof shall be ignored and the stated periods for Amortization Requirements and the stated dates for principal payments shall be used; provided, however, that during any period after the issuer of a credit facility or a liquidity facility, as the case may be, has advanced funds thereunder, the reimbursement obligation of which is payable from and secured on a parity with the Bonds and before such amount is repaid, Principal and Interest Requirements shall include the principal amount so advanced and interest thereon, in accordance with the principal repayment schedule and interest rate or rates specified in the credit facility or liquidity facility, as the case may be, in lieu of the stated principal of and Amortization Requirements and interest on such Bonds;

(c) in the case of Extendible Maturity Bonds, the Bonds shall be deemed to mature on the later of the stated maturity date and the date to which such stated maturity date shall have been extended;

(d) in the case of Capital Appreciation Bonds, the Accreted Value of Capital Appreciation Bonds becoming due at maturity or by virtue of an Amortization Requirement shall be included during such period in which said principal and interest portions are due;

(e) in the case of Capital Appreciation and Income Bonds, the principal and interest portions of the Appreciated Value of Capital Appreciation and Income Bonds shall be included during the period in which said principal and interest portions are due;

(f) in the case of Balloon Bonds or Interim Bonds, the debt service requirements of the Balloon Bonds or Interim Bonds may be excluded and in lieu thereof the Balloon Bonds or Interim Bonds shall be viewed as debt securities having a comparable federal tax status as such Balloon Bonds or Interim Bonds, maturing in substantially equal annual payments of principal and interest over a period of not more than 30 years from the date of issuance thereof, bearing interest at a fixed rate per annum equal to the average interest rate per annum for such debt securities on the date of issuance of the Balloon Bonds or Interim Bonds and issued by issuers having a credit rating, issued by Moody's or any successors thereto or S&P or any successors thereto comparable to that of the Authority, as shown by a certificate of an underwriting or investment banking firm experienced in marketing such securities; and

(g) if all or a portion of the principal of or interest on a Series of Bonds is payable from moneys irrevocably set aside or deposited for such purpose, together with projected earnings thereon to the extent such earnings are projected to be from Investment Obligations irrevocably set aside or deposited for such purpose on the date of computation, such principal or interest shall not be included in determining Principal and Interest Requirements; provided that the above computation shall be supported by a verification report from a nationally recognized independent certified public accountant as to the sufficiency of such moneys set aside and projected earnings.

"Put Bonds" means Bonds which by their terms may be tendered by and at the option of the holder thereof for payment prior to the stated maturity thereof.

"Reserve Account Insurance Policy" means the insurance policy, surety bond or other acceptable evidence of insurance, which policy, bond or other evidence of insurance constitutes an unconditional senior obligation of the issuer thereof. The issuer shall be a municipal bond insurer whose senior debt obligations, ranking *pari passu* with its obligations under such policy, bond or other evidence of insurance, are rated at the time of deposit to the credit of the 1968 Reserve Account in any of the three highest rating categories (without regard to any gradation within any such category) of either Moody's or any successors thereto or S&P or any successors thereto.

"Reserve Account Letter of Credit" means the irrevocable, transferable letter of credit, if any, which letter of credit constitutes an unconditional senior obligation of the issuer thereof. The issuer shall be a banking association, bank or trust company or branch thereof whose senior debt obligations, ranking pari passu with its obligations under such letter of credit, are rated at the time of deposit to be credit of the 1968 Reserve Account in any of the three highest rating categories (without regard to any gradation within any such category) of either Moody's or any successors thereto or S&P or any successors thereto.

"1968 Reserve Requirement" means the lesser of (a) the maximum Principal and Interest Requirements for any fiscal year on account of the outstanding Bonds and (b) ten percent (10%) of the original principal amount of each Series of Bonds outstanding (determined on the basis of their initial offering prices to the public).

"1968 Revenues" means (a) all moneys received by the Authority on account of the gasoline tax allocated to the Authority by Act No. 75, approved June 23, 1965; (b) Toll Revenues; (c) the proceeds of any other taxes, fees or charges which the Legislature of Puerto Rico has allocated or may hereafter allocate to the Authority and expressly authorize the Authority to pledge to the payment of the principal of and interest on bonds or other obligations of the Authority and which are pledged by the Authority to the payment of the principal of and interest on Bonds issued under the provisions of the Resolution; provided that written notice of such pledge has been delivered to S&P, Moody's and any other rating agency then rating the Bonds and (d) investment earnings on deposits to the credit of funds and accounts established under the Resolution, except for the Construction Fund.

"Swap agreement" means an agreement between the Authority and a Swap party whereby the Swap party agrees to pay to the Authority amounts calculated on the basis of all or a portion of the interest on Variable Rate Bonds at or prior to the times such interest is due and payable in consideration of the Authority's payment to the Swap party of amounts set forth in the Swap agreement.

"Swap party" means a person who is party to a Swap agreement and whose senior obligations are rated at the time of the execution and delivery of such Swap agreement in one of the three highest rating categories (without regard to gradations within a category) by (i) S&P or its successor and (ii) Moody's or its successor.

"Swap rate" means the fixed rate per annum on the principal amount of Variable Rate Bonds covered by a Swap agreement equal to the percentage derived by dividing (i) the sum of the amounts in the last twelve months paid by the Authority in respect of interest on such bonds and to the Swap party less the amount paid to the Authority by the Swap party by (ii) such principal amount of Variable Rate Bonds; provided, however, that if such Swap agreement has been in effect for less than twelve months, such percentage shall be multiplied by 360 divided by the number of days between the effective date of such Swap agreement and the date of calculation determined on the basis of 30-day month; provided, further, that if no amount has been paid under the Swap agreement, the Swap rate shall be deemed to be the fixed rate per annum contracted to be paid by the Authority to the Swap party.

"Toll Revenues" means the tolls or other charges, if any, imposed by the Authority for the use of any of its Traffic Facilities.

"Traffic Facilities" means any of the following facilities for which Bonds shall be issued under the Resolution the cost of which facilities paid from the proceeds of such Bonds shall not have been reimbursed to the Authority from funds not encumbered by the Resolution: (1) roads, avenues, streets, thoroughfares, speedways, bridges, tunnels, channels, stations, terminals, and any other land or water facilities necessary or desirable in connection with the movement of persons, freight, vehicles or vessels; (2) parking lots and structures and other facilities necessary or desirable in connection with the parking, loading or unloading of all kinds of vehicles and vessels; and (3) all property, rights, easements, and interests therein necessary or desirable for the construction, maintenance, control, operation or development of such traffic facilities.

"Variable Rate Bonds" means Bonds issued with a variable, adjustable, convertible or similar interest rate which is not fixed in percentage at the date of issue for the term thereof, but which may or may not be convertible to a fixed interest rate for the remainder of their term. (Section 101).

Sinking Fund

The Resolution creates the "Puerto Rico Highway Authority Highway Revenue Bonds Interest and Sinking Fund" (the "1968 Sinking Fund"). The "1968 Bond Service Account", "1968 Redemption Account" and "1968 Reserve Account" are created within the 1968 Sinking Fund. (Section 401).

The moneys in each Account are held by the 1968 Fiscal Agent in trust and, pending application, are subject to a lien in favor of the holders of the outstanding Bonds and for the further security of such holders until paid out or transferred as provided in the Resolution. (Section 401).

All Revenues (other than investment earnings), and any other funds of the Commonwealth allocated to the Authority for the payment of principal of and interest on any Bonds, are deposited monthly with the 1968 Fiscal Agent as follows:

(1) To the 1968 Bond Service Account, an amount equal to 1/6th of the amount of interest payable on all Bonds of each Series on the next succeeding interest payment date and an amount equal to 1/12th of the next maturing installment of principal of any serial bonds; provided, however, that the amount so deposited on account of the interest in each month after the delivery of the Bonds of any Series up to and including the month immediately preceding the first interest payment date thereafter of the Bonds of such Series shall be that amount which when multiplied by the number of such deposits will be equal to the amount of interest payable on such

Bonds on such first interest payment date less the amount of any accrued interest paid on such Bonds and deposited to the credit of the 1968 Bond Service Account;

(2) To the 1968 Redemption Account, an amount equal to 1/12th of the Amortization Requirement for such fiscal year for the term bonds of each Series then outstanding plus an amount equal to 1/12th of the premium, if any, which would be payable on the first redemption date in the following fiscal year on a like principal amount of Bonds if such principal amount of Bonds should be redeemed prior to their maturity from moneys in the 1968 Sinking Fund;

(3) To the 1968 Reserve Account, such amount as is required to make the amount deposited to the credit of said Account in the then current fiscal year at least equal to 20% of the 1968 Reserve Requirement; provided, however, that such deposits shall only be made to the extent necessary to make the amount then in the 1968 Reserve Account equal to the 1968 Reserve Requirement; provided, further, that in the event of an increase in the 1968 Reserve Requirement due to the issuance of additional Series of Bonds, such increase may be funded by deposits in each of the five (5) years, commencing in the fiscal year in which such additional Series of Bonds is issued, of 20% of such increase in the Reserve Requirement; and

(4) Any 1968 Revenues remaining after making the deposits referred to above shall be deposited to the credit of the 1968 Construction Fund for use by the Authority for any of its authorized purposes. (Section 401).

The requirements specified in paragraphs (1), (2) and (3) above are cumulative. (Section 401).

In lieu of any required deposit of Revenues into the 1968 Reserve Account, or in substitution for all or a portion of the moneys then on deposit in the 1968 Reserve Account, the Authority may deposit into the 1968 Reserve Account a Reserve Account Insurance Policy or a Reserve Account Letter of Credit for the benefit of the holders in an amount equal to the required deposit, which Reserve Account Insurance Policy or Reserve Account Letter of Credit shall be payable or available to be drawn upon, as the case may be (upon the giving of notice as required thereunder), on any interest payment date on which a deficiency exists which cannot be cured by moneys in any other fund or account held by the 1968 Fiscal Agent pursuant to the Resolution and available for such purpose. If a disbursement is made under the Reserve Account Insurance Policy or the Reserve Account Letter of Credit, the Authority shall be obligated either to reinstate the limits of such Reserve Account Insurance Policy or Reserve Account Letter of Credit following such disbursement, or to deposit into the 1968 Reserve Account from Revenues, funds in the amount of the disbursement made under such Reserve Account Insurance Policy or Reserve Account Letter of Credit. (Section 401).

Moneys in the 1968 Redemption Account shall be applied to the retirement of Bonds as follows:

(a) Subject to the provisions of paragraph (c) below, the 1968 Fiscal Agent shall endeavor to purchase outstanding Bonds, whether or not such Bonds shall then be subject to redemption, at the most advantageous price obtainable with reasonable diligence, having regard to interest rate and price, such price not to exceed the principal of such Bonds plus the amount of the premium, if any, which would be payable on the next redemption date to the holders of such Bonds if such Bonds should be called for redemption on such date from moneys in the 1968 Sinking Fund. The 1968 Fiscal Agent shall pay the interest accrued on such Bonds to the date of delivery thereof from the 1968 Bond Service Account and the purchase price from the 1968 Redemption Account, but no such purchase shall be made within 45 days next preceding any interest payment date on which such Bonds are subject to redemption except from moneys in excess of the amounts set aside or deposited for the redemption of Bonds.

(b) Subject to the provisions of paragraph (c) below, the 1968 Fiscal Agent shall call for redemption on each interest payment date on which Bonds are subject to redemption from moneys in the 1968 Sinking Fund such amount of Bonds then subject to redemption as, with the redemption premium, if any, will exhaust the 1968 Redemption Account as nearly as may be; provided, however, that not less than $50,000 principal amount of Bonds shall be called for redemption at any one time.

(c) Moneys in the 1968 Redemption Account shall be applied to the purchase or redemption of Bonds in the following order:

First, the term Bonds of each Series, if any, in the order of their issuance, to the extent of the Amortization Requirement, if any, of the then current fiscal year for such term Bonds and any deficiency in preceding fiscal years in the purchase or redemption of such term Bonds under the provisions of this subdivision; provided, however, that if none of the term Bonds of a Series shall be subject to redemption from moneys in the 1968 Sinking Fund and if the 1968 Fiscal Agent shall at any time be unable to exhaust the moneys applicable to the Bonds of any such Series in the purchase of such Bonds under the provisions of paragraph (a) above, such moneys or the balance of such moneys, as the case may be, shall be retained in the 1968 Redemption Account and, as soon as it is feasible, applied to the retirement of the Bonds of such Series;

Second, to the purchase of any outstanding Bonds, whether or not such Bonds shall then be subject to redemption, in accordance with the provisions of paragraph (a) above;

Third, term Bonds of each Series in proportion (as nearly as practicable) to the aggregate principal amount of the Bonds of each such Series originally issued; and

Fourth, after the retirement of all term Bonds, serial Bonds in the inverse order of their maturities, and to the extent that serial Bonds of different Series mature on the same date, in proportion (as nearly as practicable) to the principal amount of each Series maturing on such date. (Section 403).

All expenses in connection with such purchase or redemption shall be paid from the 1968 Construction Fund. (Section 403).

Moneys in the 1968 Reserve Account shall be used for the purpose of paying interest on the Bonds and maturing principal of serial Bonds whenever and to the extent that the moneys held for the credit of the 1968 Bond Service Account shall be insufficient for such purpose and thereafter for the purpose of making deposits to the credit of the 1968 Redemption Account pursuant to the requirements mentioned in paragraph (2) above whenever and to the extent that the Revenues are insufficient for such purpose. Excess moneys in the 1968 Reserve Account shall be transferred to the 1968 Construction Fund, the 1968 Bond Service Account or the 1968 Redemption Account, as directed by the Authority. (Section 404).

1968 Construction Fund

Moneys in the 1968 Construction Fund may be used for any authorized purpose of the Authority, including, prior to the adoption of the 1998 Resolution, the payment of the cost of maintaining, repairing and operating the Traffic Facilities and the cost of necessary renewals and replacements of Traffic Facilities. (Sections 401, 604 and 605). Before any payment or withdrawal shall be made from moneys in the 1968 Construction Fund there shall be filed with the 1968 Fiscal Agent a certificate signed by a designated officer of the Authority setting forth the amount of money to be so disbursed and stating that such money will be used to pay the costs of constructing Traffic Facilities or for other purposes permitted by the Resolution. Upon receipt of such certificate the 1968 Fiscal Agent shall withdraw from the 1968 Construction Fund and deposit to the credit of a special checking account in its commercial department in the name of the Authority the amount so specified in such certificate. The 1968 Fiscal Agent shall also at any time at the written direction of the Authority transfer any part of the moneys in the 1968 Construction Fund to the credit of the 1968 Redemption Account. (Section 405).

Defeasance

If all the outstanding Bonds shall have been paid or deemed to have been paid as provided below, then and in that case the right, title and interest of the bondholders under the Resolution shall cease, terminate and become void, and such Bonds shall cease to be entitled to any lien, benefit or security under the Resolution. In such event, the Authority shall repeal and cancel the Resolution and may apply any surplus in the 1968 Sinking Fund and all balances remaining in any other funds and accounts other than moneys held for the redemption or payment of Bonds to any lawful purposes of the Authority as the Secretary shall determine. Under the terms of the 1998 Resolution, all such surplus and balances are required upon the repeal and cancellation of the Resolution to be transferred to the 1998 Revenue Fund.

Any outstanding Bond shall be deemed to have been paid within the meaning and with the effect expressed in the Resolution when the whole amount of the principal of, redemption premium, if any, and interest on such Bond shall have been paid or duly provided for and the conditions set forth in clause (c) below have been satisfied or when (a) in case such Bond has been called for redemption or the Authority has given irrevocable instructions to call such Bond for redemption, (b) there shall have been deposited either moneys in an amount which shall be sufficient, or Government Obligations the principal of and interest on which are sufficient, to pay when due the principal of and premium, if any, and interest due and to become due on such Bond on or prior to the redemption date or maturity date thereof, as the case may be, and (c) in the event such Bond does not mature and is not to be redeemed within the next succeeding sixty (60) days, the Authority shall have given irrevocable instructions to give, as soon as practicable, a notice to the holder of such Bond by first-class mail, postage prepaid, stating that the deposit in trust of moneys or such time deposits or Government Obligations required by clause (b) of this paragraph has been made and that such Bond is deemed to have been paid in accordance with the Resolution and stating such maturity or redemption date upon which moneys are to be available for the payment of the principal of and premium, if any, and interest on such Bond.

Neither the moneys nor Government Obligations deposited with the 1968 Fiscal Agent or other appropriate fiduciary institution acting as escrow agent nor principal or interest payments on any such obligations shall be withdrawn or used for any purpose other than, and shall be held in trust for, the payment of the principal of and redemption premium, if any, and interest on the Bonds which have been defeased.

As to Variable Rate Bonds, the amount required for the interest thereon shall be calculated at the maximum rate permitted by the terms of the provisions of the resolution which authorized the issuance of such Variable Rate Bonds.

Notwithstanding any of the provisions of the Resolution to the contrary, Put Bonds and Extendible Maturity Bonds may only be fully discharged and satisfied either by paying the principal of and interest on said Bonds as they become due and payable or by depositing moneys which shall be sufficient at the time of such deposit to pay when due the maximum amount of principal of and redemption premium, if any, and interest on such Put Bonds and Extendible Maturity Bonds which could become payable to the holders of such Bonds upon the exercise of any options provided to the holders of such Bonds and the Authority; provided, however, that if, at the time a deposit is made pursuant to this paragraph, the options originally exercisable on the Put Bonds and Extendible Maturity Bonds are no longer exercisable, such Bonds shall not be considered Put Bonds or Extendible Maturity Bonds for these purposes.

If any portion of the moneys deposited for the payment of the principal of and redemption premium, if any, and interest on any portion of Bonds is not required for such purpose, the Authority may use the amount of such excess, subject to certain tax covenants contained in the Resolution, free and clear of any trust, lien, security interest, pledge or assignment securing said Bonds or otherwise existing under the Resolution. (Section 901).

Issuance of Additional Bonds

Note: Upon the adoption of the 1998 Resolution, the purposes for which additional Bonds may be issued is limited to refunding other Bonds for debt service savings and to exchange Bonds for Special Facility Bonds. See "Additional Bonds-Highway Revenue Bonds" under *The 1998 Bonds* above in this Official Statement.

Bonds may be issued under and secured by the Resolution, subject to the conditions hereinafter described, at any time or times for the purpose of providing funds to pay the cost of Traffic Facilities, to refund all or any part of the outstanding Bonds of any one or more Series by payment at maturity or redemption at a selected redemption date or dates, including the payment of any redemption premium thereon, to fund a deposit to the 1968 Reserve Account and to pay any costs of issuance of such Bonds. (Sections 208 and 209).

Before such Bonds shall be authenticated and delivered, there shall be filed with the 1968 Fiscal Agent, among other things, a certificate dated the date of original issuance of the Bonds, signed by the Executive Director, setting forth:

(i) the amount of the Revenues for any twelve (12) consecutive calendar months out of the fifteen (15) calendar months immediately preceding the month in which such certificate is signed;

(ii) the amount of the Toll Revenues for the twelve (12) calendar months for which the Revenues are shown in item (i) above;

(iii) the difference between the amounts set forth in items (i) and (ii) above;

(iv) the amount of the maximum Principal and Interest Requirement for any fiscal year thereafter on account of the Bonds then outstanding and the Bonds then requested to be delivered;

(v) the percentage derived by dividing the amount in item (i) above by the amount in item (iv) above; and

(vi) the percentage derived by dividing the amount in item (iii) above by the amount in item (iv) above. (Section 208).

The 1968 Fiscal Agent may only deliver such additional Bonds if the percentage shown in either item (v) or item (vi) is not less than 150%. (Section 208). The Authority need not deliver said certificate in connection with the issuance of refunding bonds if the Executive Director delivers a certificate to the effect that the amount of the maximum Principal and Interest Requirements for any fiscal year thereafter on account of the Bonds to be outstanding after the issuance of the refunding Bonds shall be equal to or less than the maximum Principal and Interest Requirements for any fiscal year thereafter on account of the Bonds outstanding prior to the issuance of such refunding Bonds. (Section 209).

If the percentage shown in item (vi) of the certificate mentioned above and filed with the 1968 Fiscal Agent in connection with the issuance of any additional Bonds is less than 150%, the Authority may not reduce the tolls or other charges imposed by it for the use of its Traffic Facilities such that, as of the effective date of such reduction, the amount of Revenues for any twelve (12) consecutive calendar months out of the fifteen (15) calendar months immediately preceding such effective date, adjusted to reflect the Toll Revenues it would have received, based on the volume of traffic for such twelve (12) months, if such reduction had been in effect for such twelve (12) months, is less than 150% of the maximum Principal and Interest Requirements for any fiscal year thereafter on account of all Bonds then outstanding. (Section 609).

Any increase in the 1968 Reserve Requirement resulting from the issuance of such additional Bonds may be satisfied by equal deposits of 20% of such increase into the 1968 Reserve Account in each of the next five years beginning with the fiscal year in which such additional Bonds were issued. (Section 401).

Other Indebtedness

The Authority will not incur any indebtedness nor create or cause or suffer to be created any debt, lien, pledge, assignment, encumbrance or any other charge having a priority to or being on a parity with the lien on Revenues of the Bonds issued under the Resolution, except upon the conditions and in the manner provided in the Resolution. Any other indebtedness incurred by the Authority shall contain an express statement that such indebtedness is junior, inferior and subordinate in all respects to the Bonds. For purposes of the above limitation in incurrence of indebtedness, indebtedness shall not be deemed to include contracts entered into in the ordinary course of business or agreements to repay advances received from the federal government. Nothing in the Resolution shall be deemed to prohibit the Authority from entering into currency swaps, interest rate swaps or other arrangements for hedging of interest rates on any indebtedness. (Section 602).

Nothing in the Resolution is to be construed as preventing the Authority from financing any facilities authorized by the act creating the Authority by the issuance of bonds or other obligations which are not secured under the provisions of the Resolution. (Section 1001).

Investment of Funds

Moneys held for the credit of the 1968 Bond Service Account and the 1968 Redemption Account shall, as nearly as may be practicable, be continuously invested and reinvested at the written direction of the Authority in Government Obligations, and moneys held for the credit of the 1968 Construction Fund and the 1968 Reserve Account shall, as nearly as may be practicable, be continuously invested and reinvested at the written direction of the Authority in Investment Obligations, which Government Obligations and Investment Obligations shall mature, or which shall be subject to redemption by the holder thereof at the option of such holder, not later than the respective dates when moneys held for the credit of such Fund or Accounts will be required for the purposes intended. Amounts on deposit in the 1968 Reserve Account shall be invested in Investment Obligations which mature not later than the final maturity date of any Bonds outstanding. (Section 502).

Investment earnings on moneys on deposit to the credit of the following Fund and Accounts shall be applied as follows:

(a) investment earnings on moneys on deposit to the credit of the 1968 Construction Fund shall be retained to the credit of said Fund;

(b) investment earnings on moneys on deposit to the credit of the 1968 Reserve Account shall be retained in said Account at any time that the amounts on deposit to the credit of said Account are less than the 1968 Reserve Requirement and, if moneys on deposit therein are sufficient for such purposes, then such earnings shall be withdrawn and deposited to the credit of the 1968 Construction Fund, the 1968 Bond Service Account or the 1968 Redemption Account, as the Authority shall direct; and

(c) investment earnings on moneys on deposit to the credit of the 1968 Bond Service Account and the 1968 Redemption Account shall be transferred to the 1968 Construction Fund or at the option of the Authority retained in such Account. (Section 502).

In computing the amount in any Fund or Account created pursuant to the provisions of the Resolution, obligations purchased as an investment of moneys therein shall be valued at par if purchased at par or at amortized value if purchased at other than par, plus, in each case, accrued interest. Amortized value, when used with respect to an obligation purchased at a premium above or a discount below par, means the value as of any given time obtained by dividing the total premium or discount at which such obligation was purchased by the number of days remaining to maturity on such obligation at the date of such purchase and by multiplying the amount thus calculated by the number of days having passed since such purchase; and (1) in the case of an obligation purchased at a premium by deducting the product thus obtained from the purchase price, and (2) in the case of an obligation purchased at a discount by adding the product thus obtained to the purchase price. Valuation on any particular date shall include the amount of interest then earned or accrued to such date on any moneys or investments in such Fund or Account. The computation of the amount on deposit in or credited to the Fund and Accounts created under the Resolution and the valuation of the investments of such amount shall be performed by the 1968 Fiscal Agent as of the close of business on the last day of each fiscal year and at such other times as the Authority shall request, and such computation and valuation shall not be required to be performed at other times. (Section 503).

Modifications

Upon the adoption of the 1998 Resolution, the ability of the Authority to amend the Resolution will be limited. See "Miscellaneous Covenants-Relating to the 1968 Resolution" in *Summary of Certain Provisions of the 1998 Resolution.*

The Authority may adopt resolutions supplemental to the Resolution without the consent of the bondholders to cure any ambiguity, formal defect or omission, or to correct any inconsistent provisions or errors in the Resolution or any supplemental resolution, or to grant or confer upon the bondholders any additional rights, remedies, powers, authority or security, or to add to the conditions, limitations and restrictions on the issuance of Bonds under the provisions of the Resolution, or to add to the covenants and agreements of the Authority in the Resolution or to surrender any right or power reserved to or conferred upon the Authority, or to make necessary changes to facilitate the issuance of Variable Rate Bonds, Capital Appreciation Bonds, Capital Appreciation and Income Bonds, Put Bonds, Extendible Maturity Bonds, Balloon Bonds, Interim Bonds and such other bonds as may be marketable from time to time, or to make changes as may evidence the right and interest of an issuer of a Credit Facility or a Liquidity Facility that secures any Series of Bonds. (Section 801).

The holders of not less than two-thirds in aggregate principal amount of the Bonds then outstanding shall have the right to consent to and approve the adoption of such resolution or resolutions supplemental to the Resolution as shall be deemed necessary or desirable by the Authority for the purpose of modifying, altering, amending, adding to or rescinding any of the terms and provisions contained in the Resolution or in any supplemental resolution; provided, however, that nothing contained in the Resolution shall permit, or be construed as permitting, (a) an extension of the maturity of the principal of or the interest on any Bond, or (b) a reduction in the principal amount of any Bond or the redemption premium or the rate of interest thereon, or (c) the creation of a lien upon or a pledge of Revenues other than the lien and pledge created by the Resolution, or (d) a preference or priority of any Bond or Bonds over any other Bond or Bonds, or (e) a reduction in the aggregate principal amount of the Bonds required for consent to such supplemental resolution. (Section 802).

Upon the adoption of any supplemental resolution pursuant to the provisions of the Resolution, the Resolution shall be and be deemed to be modified and amended in accordance therewith, and the respective rights, duties and obligations under the Resolution of the Authority, the 1968 Fiscal Agent and all holders of Bonds then outstanding shall thereafter be determined, exercised and enforced in all respects under the provisions of the Resolution as so modified and amended. (Section 802).

Miscellaneous Covenants

Master Plan. The Authority covenants that the master plan for the construction of required Traffic Facilities in Puerto Rico will be supplemented periodically as necessary and that the five-year Priorities Construction Program will be updated each year to cover the Traffic Facilities to be constructed by the Authority in the ensuing five-year period. (Section 603).

Costs of Maintenance, Repair and Operation of Traffic Facilities. The Authority covenants that, if and to the extent funds for the purpose of maintaining, repairing and operating all Traffic Facilities financed by the Authority in whole or in part by the issuance of Bonds of the Authority under the provisions of the Resolution are not provided by the Commonwealth, the Authority will pay such costs from unencumbered funds then on deposit in the 1968 Construction Fund or from the Revenues thereafter deposited to the credit of the 1968 Construction Fund pursuant to the Resolution. (Section 604). **Upon the adoption of the 1998 Resolution, the Authority's obligations under this paragraph will be payable from moneys in the 1998 Construction Fund instead of the 1968 Construction Fund.**

The Authority covenants that it will cause an annual general evaluation to be made by the Traffic Engineers of the level of maintenance of Traffic Facilities financed in whole or in part by the issuance of Bonds, which Traffic Facilities shall be, in the judgment of the Authority with the approval of the Traffic Engineers, material to the overall system of traffic facilities operated by the Authority. This evaluation is to be directed towards surface and shoulder conditions and condition of structures and signs on the Traffic Facilities. The annual report delivered by the Traffic Engineers under Section 605 of the Resolution and the Authority's obligations to cause repairs, renewal or replacements to be made to Traffic Facilities, shall pertain to the Traffic Facilities financed in whole or in part with Bond proceeds and adjudged to be material to the overall system of traffic facilities operated by the Authority. (Section 604).

Annual Report of Traffic Engineers. The Authority covenants that it will cause the Traffic Engineers to prepare a report each year promptly after the completion of their general evaluation of the level of maintenance of the Traffic Facilities referred to in the preceding paragraph setting forth (i) their comments with respect to any supplements or revisions made by the Authority in the master plan or in the five-year Priorities Construction Program referred to above under "Master Plan" and their recommendations as to any supplements or revisions which should be made in such plan or in the Priorities Construction Program, and (ii) their findings as to whether the Traffic Facilities have been maintained in good repair, working order and sound condition and their recommendations as to necessary repairs, renewals or replacements. (Section 605).

If it appears from such report that repairs, renewals or replacements of any such Traffic Facilities are necessary, the Authority shall promptly cause the same to made and if and to the extent that funds for such purpose have not been made available by the Commonwealth, moneys on deposit to the credit of the 1968 Construction Fund which have not theretofore been encumbered for other purposes, and moneys which are thereafter deposited to the credit of the 1968 Construction Fund pursuant to the Resolution shall first be applied for such purpose. (Section 605). **Upon the adoption of the 1998 Resolution, the Authority's obligations under this paragraph will be payable from moneys in the 1998 Construction Fund instead of the 1968 Construction Fund.**

SUMMARY OF CERTAIN PROVISIONS OF THE PROPOSED SUPPLEMENTAL RESOLUTION

The following is a brief summary of certain provisions of a resolution proposing to amend the 1968 Resolution, which resolution will be adopted when the consent of the owners of 100% of the Highway Revenue Bonds has been obtained. Such statements do not purport to be complete and reference is made to the proposed supplemental resolution, copies of which are available from the Authority or the 1968 Fiscal Agent. See "Modifications" in *Summary of Certain Provisions of the 1968 Resolution* for limitations as to the ability of the Authority to modify the 1968 Resolution further. The 1968 Resolution, the Highway Revenue Bonds issued thereunder and the 1968 Resolution Revenues are referred to in this summary as the "Resolution", the "Bonds" and "Revenues", respectively.

The proposed supplemental resolution will provide as follows:

Modification with Consent of Holders of Majority of Bonds

Subject to the terms and provisions contained below, and not otherwise, the holders of not less than a majority in aggregate principal amount of the Bonds at the time outstanding (or in case less than all of several Series of Bonds then outstanding are affected by the supplement thereto, the holders of a majority or more in principal amount of the Bonds of the Series so affected and outstanding at the time the consent and approval are given) shall have the right, from time to time, anything contained in the Resolution to the contrary notwithstanding, to consent to and approve the adoption by the Authority of such resolution or resolutions supplemental thereto as shall be deemed necessary or desirable by the Authority for the purpose of modifying, altering, amending, adding to or rescinding, in any particular, any of the terms or provisions contained in the Resolution or in any supplemental resolution; provided, however, that nothing contained in the Resolution shall permit, or be construed as permitting, without the consent of the holders of one hundred percent (100%) of the Bonds outstanding (a) an extension of the maturity of the principal of or interest on any Bond issued thereunder (other than as provided for by the terms of an Extendible Maturity Bond), or (b) a reduction in the principal amount of any Bond or the redemption premium or the rate of interest thereon, or (c) the creation of a lien upon or a pledge of Revenues ranking prior to or on a parity with the lien or pledge created by the Resolution, except for a parity lien on or pledge of Revenues given to any provider of a credit facility or liquidity facility under any reimbursement or similar agreement, or (d) a preference or priority of any Bond or Bonds over any other Bond or Bonds, or (e) a reduction in the aggregate principal amount of the Bonds required for consent to and approval of such supplemental resolution. Nothing contained in the Resolution, however, shall be construed as making necessary the approval by bondholders of the adoption of a supplemental resolutions that would otherwise not require their consent. Except as to supplemental resolutions containing changes described in clauses (a) through (e) of the proviso to the first sentence of this paragraph, the provider of any credit facility or liquidity facility shall have the right, in lieu of the holders of Bonds secured thereby, to give consent and approval to any supplemental resolution for which the consent of the holders of such Bonds is required under the Resolution, and all references to bondholders for purposes of such consent and approval shall mean instead the provider of said credit facility or liquidity facility; provided, however, that said provider of a credit facility or liquidity facility shall not be in default on its obligations in connection with said credit facility or liquidity facility.

The consent of the holders of any Series of additional Bonds shall be deemed given if the underwriters or initial purchasers for resale consent in writing to such supplemental resolution and the nature of the amendment effected by such supplemental resolution is disclosed in the official statement or other offering document pursuant to which such series of additional Bonds is offered and sold to the public.

Parity Liens to Providers of Credit Facilities and Liquidity Facilities

In connection with the execution and delivery of a reimbursement or similar agreement in which the Authority agrees to reimburse a provider of a credit facility or a liquidity facility for amounts drawn on any such facility or to pay fees for any such facility, the Authority can grant a security interest and lien upon all or any portion of the Revenues to secure said reimbursement obligation on a parity with the Bonds.

SUMMARY OF CERTAIN PROVISIONS OF THE 1998 RESOLUTION

The following are brief summaries of certain provisions of the 1998 Resolution. Such statements do not purport to be complete and reference is made to the 1998 Resolution, copies of which are available from the Authority or the 1998 Fiscal Agent. For the purposes of this summary, the term "senior bonds" shall refer to Senior Transportation Revenue Bonds; the term "subordinated bonds" shall refer to "Subordinated Bonds"; and the term "bonds" shall refer to "Transportation Revenue Bonds"; as those terms are used in this Official Statement.

Definition of Certain Terms

"Accreted Value" means, with respect to any Capital Appreciation Bond or Capital Appreciation and Income Bond, an amount equal to the principal amount of such Bond on the date of original issuance plus the interest accrued on such Capital Appreciation Bond or Capital Appreciation and Income Bond from the date of original issuance to the date of computation or the Interest Commencement Date, as the case may be, such interest to accrue at the rate set forth in the resolution providing for the issuance of said Bond, but not exceeding the maximum rate permitted by law, compounded periodically at the times provided for in such resolution.

"Capital Appreciation Bonds" means any bonds as to which interest is compounded periodically on each of the applicable dates designated for compounding in the resolution authorizing said Bonds and payable in an amount equal to the then current Accreted Value only at the maturity, earlier redemption or other payment date therefor, all as so provided by said resolution, and which may be either serial bonds or term bonds.

"Capital Appreciation and Income Bonds" means any bonds as to which accruing interest is not paid prior to the interest payment date immediately following the Interest Commencement Date specified in the resolution authorizing such Bonds and the interest on which is compounded periodically on the dates designated in such resolution prior to the Interest Commencement Date for such Capital Appreciation and Income Bonds, and which may be either serial bonds or term bonds.

"Cost of Transportation Facilities" or "cost of Transportation Facilities" means the cost of acquisition and construction of Transportation Facilities and the cost of all labor, materials, machinery and equipment, the cost of all lands, property, rights, easements and franchises acquired, interest prior to and during construction and for any additional period authorized by law if so provided by, and subject to any limitations in, the resolution authorizing the issuance of a Series of bonds, the cost of engineering and legal services, cost of preliminary surveys, plans and specifications, expenses of administration properly chargeable to such construction or acquisition, legal, architectural and engineering expenses and fees, the cost of audits and of preparing and issuing the bonds, fees and expenses of the 1998 Fiscal Agent and consultants, financing charges, taxes or other governmental charges lawfully assessed during construction, claims arising in connection with construction, premiums on insurance in connection with construction, premiums for bond insurance, interest rate insurance or insurance assuring availability of the amounts required to be on deposit in the Senior Bond Reserve Account or any account in the Subordinated Bond Reserve Fund, any amounts required to be deposited in the Senior Bond Reserve Account or any account in the Subordinated Bond Reserve Fund, initial set-up fees and annual fees for any Credit Facility or Liquidity Facility and tender agent fees and fees payable for remarketing bonds supported by any Credit Facility or Liquidity Facility during such period, as may be specified in the resolution authorizing the issuance of such Series of bonds and all other items of expense not elsewhere in this definition specified, incident to the financing or construction of any Transportation Facilities and the placing of the same in operation.

"Existing Tax and Fee Revenues" shall mean (1) the proceeds of the sixteen cents a gallon tax imposed on gasoline and one-half of the eight cents per gallon tax imposed on gas oil and diesel oil imposed by Subtitle B of Act No. 120, approved October 31, 1994, as amended, and allocated to the Authority by Act No. 223 of November 30, 1995, as amended, and by said Act's predecessor statutes and (2) the proceeds of the $15 increase per vehicle of annual motor vehicle license fees imposed by the Commonwealth and allocated to the Authority by Act. No. 9, approved August 12, 1982.

"Existing Toll Facilities Revenues" means the tolls or other charges imposed by the Authority for the use of any Traffic Facilities financed in whole or in part by the issuance of 1968 Resolution Bonds, including any extensions, betterments or improvements to such Facilities however financed or otherwise paid for.

"Fiscal Year" means the period commencing on the first day of July of any year and ending on the last day of June of the following year or any other twelve month period designated by the Authority.

"Government Obligations" means (i) direct obligations of, or obligations the principal of and the interest on which are unconditionally guaranteed by, the United States Government, (ii) bonds, debentures or notes issued by any of the following Federal Agencies: Banks for Cooperatives, Federal Intermediate Credit Banks, Federal Home Loan Banks, Export-Import Bank of the United States, Government National Mortgage Association or Federal Land Banks, (iii) obligations issued or guaranteed by an agency of the United States of America or person controlled or supervised by and acting as an instrumentality of the United States of America pursuant to authority granted by the Congress, (iv) municipal obligations, the payment of the principal of and interest and redemption premium, if any, on which are irrevocably secured by obligations described in clause (i) of this definition and which obligations are not subject to redemption prior to the date on which the proceeds attributable to the principal of the obligations are to be used and have been deposited in an escrow account which is irrevocably pledged to the payment of the principal of and interest and redemption premium, if any, on such municipal obligations, and (v) evidences of ownership of proportionate interests in future interest or principal payments on obligations specified in clauses (i), (ii), (iii) and (iv) of this definition held by a bank (including the 1998 Fiscal Agent) or trust company as custodian and which underlying obligations are not available to satisfy any claim of the custodian or any person claiming through the custodian or to whom the custodian may be obligated.

"Interest Commencement Date" means, with respect to any particular Capital Appreciation and Income Bonds, the date specified in the resolution providing for the issuance of such bonds after which interest accruing on such bonds shall be payable on a periodic basis prior to maturity, with the first such payment date being the applicable interest payment date immediately succeeding such Interest Commencement Date.

"Investment Obligations" means:

(i) Government Obligations,

(ii) direct and general obligations of any state or territory of the United States of America to the payment of the principal of and interest on which the full faith and credit of such state or territory is pledged, provided that such obligations are rated, on the date of investment therein, in any of the three highest rating categories (without regard to any gradations within any such category) by both Moody's or any successors thereto and S&P or any successors thereto,

(iii) bankers' acceptances, certificates of deposit or time deposits of any bank or national banking association (including the 1998 Fiscal Agent), trust company or savings and loan association (including any investment in pools of such bankers' acceptances, certificates of deposit or time deposits), which to the extent that such obligations are not insured by the Federal Deposit Insurance Corporation, are either (A) issued by a bank, trust company or savings and loan association having a combined capital and surplus aggregating at least $50,000,000 or (B) collateralized at all times by such securities as are described in clauses (i) or (ii) above, having a market value at least equal to the principal amount of such bankers' acceptances, certificates of deposit or time deposits (or portion thereof not so insured); provided that the 1998 Fiscal Agent has a perfected first security interest in the collateral and that such collateral is held free and clear of claims by third parties,

(iv) any repurchase, reverse repurchase or investment agreement with any bank or trust company organized under the laws of any state of the United States or the Commonwealth or any national banking association (including the 1998 Fiscal Agent), insurance company, or government bond dealer reporting to, trading with, and recognized as a primary dealer by the Federal Reserve Bank of New York and a member of the Security Investors Protection Corporation, which agreement is secured by any one or more of the securities described in clauses (i) or (ii) above, provided that the 1998 Fiscal Agent has a perfected first security interest in the collateral and that such collateral is held free and clear of claims by third parties,

(v) obligations, whether or not insured, issued by any state or territory of the United States, or any political subdivision, agency or instrumentality thereof which are rated, on the date of investment therein, in one of the three highest rating categories (without regard to any gradations within any such category) by both Moody's or any successors thereto and S&P or any successors thereto,

(vi) participating shares in a mutual fund or investment pool for local government investment; provided that the investments of such mutual fund or investment pool are rated in one of the three highest rating categories (without regard to any gradations within any such category) by both Moody's or any successors thereto, and S&P or any successors thereto,

(vii) (1) shares of stock in a corporation rated in the highest rating category by Moody's or any successors thereto and S&P or any successors thereto (without regard to gradations within such category) that (A) is a regulated investment company within the meaning of Section 851(a) of the Internal Revenue Code of 1986, as amended, and, meets the requirements of Section 852(a) of said Code for the calendar year; (B) invests all of its assets in obligations described in clauses (i) and (ii) above; and (C) has at least 98% of (I) its gross income derived from interest on, or gain from the sale of or other disposition of, such obligations or (II) the weighted average of its assets is represented by investments in such obligations or (2) money market accounts of the 1998 Fiscal Agent or any state or federally chartered bank, banking association, trust company or subsidiary trust company that is rated or whose parent state bank is rated in the highest short-term rating category or in one of the two highest long-term rating categories by Moody's or any successors thereto and S&P or any successors thereto (without regard to any gradations within such category), and

(viii) any other obligations permitted under the laws of the Commonwealth which are rated, or which are issued by issuers which are rated, on the date of investment therein, in any of the three highest rating categories (without regard to any gradations within any such category) by both Moody's or any successors thereto and S&P or any successors thereto, or which are collateralized by such Investment Obligations.

"Mass Transit Facilities" means the equipment, omnibus facilities, rail facilities, and real property, constituting or to constitute part of, or used or reasonably anticipated to be used in connection with the operation of, any mass transportation facility or system, and related services operated by the Authority directly or by contract, lease or other arrangements entered into by the Authority, as the foregoing may from time to time be augmented or diminished.

"1968 Resolution Bonds" means all bonds issued under the 1968 Resolution.

"Principal and Interest Requirements" means for any fiscal year, as applied to the bonds of any Series issued under the provisions of the 1998 Resolution, the sum of:

(i) the amount required to pay the interest on all outstanding bonds of such Series which is payable after July 31 in such fiscal year and on or before July 31 in the following fiscal year,

(ii) the amount required to pay the principal of the serial bonds of such Series then outstanding which is payable after July 31 in such fiscal year and on or before July 31 in the following fiscal year, and

(iii) the Amortization Requirement for the term bonds of such Series for such fiscal year.

The following rules shall apply in determining the amount of the Principal and Interest Requirements for any period:

(a) in the case of Capital Appreciation Bonds, the Accreted Value of Capital Appreciation Bonds becoming due at maturity or by virtue of an Amortization Requirement shall be included when due and payable as part of the principal or Amortization Requirements in accordance with the above provisions;

(b) in the case of Capital Appreciation and Income Bonds, the Appreciated Value of Capital Appreciation and Income Bonds becoming due at maturity or by virtue of an Amortization Requirement shall be included when due and payable as part of the principal or Amortization Requirements in accordance with the above provisions;

(c) the interest rate on bonds issued with a variable, adjustable, convertible or similar rate of interest shall be the greater of (A)(1) the average rate of interest on such bonds for the preceding twelve months or such shorter period that such bonds shall have been outstanding, or (2) if such bonds had not been outstanding prior to the date of calculation, the rate of interest on such bonds on the date of calculation and (B) the lesser of the maximum rate then permitted by law and the maximum rate permitted on such bonds by the resolution authorizing the issuance thereof; provided, however, that if the Authority has notified the 1998 Fiscal Agent that a Swap agreement is in effect in respect of such bonds, then for all purposes of this paragraph, except for the purpose of determining the required deposits to the Senior Bond Sinking Fund or the Subordinated Bond Sinking Fund described in "Sinking Funds" below, the interest rate on such bonds shall be the Swap rate under such Swap agreement; and if such Swap rate is a variable rate, the interest rate on such bonds (except for the purpose specified above in this paragraph) shall be the average Swap rate for the preceding twelve months or such shorter period that the Swap agreement has been in effect, or if such Swap agreement has not been in effect prior to the date of calculation, the Swap rate on the date of calculation;

(d) in the case of the bonds which by their terms may be tendered at the option of the holder thereof for payment prior to maturity, the tender date or dates shall be ignored if the tender price for such bonds is payable from a letter of credit or insurance policy or similar credit or liquidity facility and the stated dates for Amortization Requirements and principal payments shall be used; provided, however, that if the issuer of the letter of credit or insurance policy or similar credit or liquidity facility has advanced funds thereunder and such amount has not been repaid, Principal and Interest Requirements shall include the repayment obligations thereof in accordance with the principal repayment schedule and interest rate or rates specified in the letter of credit or insurance policy or similar credit or liquidity facility or in the agreement with the Authority providing for the issuance of such instrument;

(e) in the case of bonds the maturity of which may be extended by and at the option of the holder of the bonds or the Authority, the bonds shall be deemed to mature on the later of the stated maturity date and the date to which such stated maturity date has been extended; and

(f) in the case of bonds (A) which are expected to be repaid from the proceeds of bonds or other indebtedness or (B) on which interest is payable periodically and for which twenty-five percent (25%) or more of the principal amount matures during any one year and for which no Amortization Requirements have been established, the debt service requirements of the bonds may be excluded and in lieu thereof the bonds shall be treated, for purposes of the computation of Principal and Interest Requirements, as debt securities having a comparable federal tax status as such bonds, maturing in substantially equal annual payments of principal and interest over a period of not more than thirty (30) years from the date of issuance thereof, bearing interest at a fixed rate per annum equal to the average interest rate per annum for such debt securities issued on the date of issuance of the bonds and issued by issuers having a credit rating, issued by Moody's or any successors thereto or S&P or any successors thereto, comparable to that of the Authority, as shown by a certificate of an underwriting or investment banking firm experienced in marketing such securities; and

(g) if all or a portion of the principal of or interest on a Series of bonds is payable from moneys irrevocably set aside or deposited for such purpose, together with projected earnings thereon to the extent such earnings are projected to be from Investment Obligations irrevocably set aside or deposited for such purpose on the date of computation, such principal or interest shall not be included in determining Principal and Interest Requirements; provided that the above computation shall be supported by a verification report from a nationally recognized independent certified public accountant as to the sufficiency of such moneys set aside and projected earnings.

"Reserve Account Insurance Policy" means an insurance policy, surety bond or other acceptable evidence of insurance, which policy, bond or other evidence of insurance constitutes an unconditional senior obligation of a municipal bond insurer whose policy or bond results in the rating of municipal obligations secured by such policy or bond, at the time of deposit to the credit of the Reserve Account, in either of the two highest rating categories (without regard to any gradations within either such category) of either Moody's or any successors thereto or S&P or any successors thereto.

"Reserve Account Letter of Credit" means an irrevocable, transferable letter of credit, which letter of credit constitutes an unconditional senior obligation of a banking association, bank or trust company or branch thereof whose letter of credit results in the rating of municipal obligations secured by such letter of credit, at the time of deposit to the credit of the Reserve Account, in either of the two highest categories (without regard to any gradations within either such category) of either Moody's or any successors thereto or S&P or any successors thereto.

"Revenues" means all moneys received by the Authority on account of the crude oil tax allocated to the Authority by Act No. 34, approved July 16, 1997, as amended, all Existing Tax and Fee Revenues upon the repeal and cancellation of the 1968 Resolution, any tolls or other charges imposed by the Authority for the use of any of the Toll Facilities other than Existing Toll Facilities Revenues received by the Authority prior to the repeal and cancellation of the 1968 Resolution, the proceeds of any other taxes, fees or charges which the Legislature of Puerto Rico may hereafter allocate to the Authority and expressly authorize the Authority to pledge to the payment of the principal of and interest on bonds or other obligations of the Authority and which are pledged by the Authority to the payment of the principal of and interest on bonds or other obligations issued under the provisions of the 1998 Resolution, and investment earnings on deposits to the credit of funds and accounts established under the 1998 Resolution, except for the 1998 Construction Fund.

"Senior Reserve Requirement" with respect to the senior bonds means the lesser of (i) the maximum Principal and Interest Requirements for any fiscal year on account of the outstanding senior bonds and (ii) ten (10%) percent of the original principal amount of each Series of senior bonds outstanding determined on the basis of their initial offering prices to the public.

"Subordinated Reserve Requirement" with respect to any Series of subordinated bonds means that amount fixed from time to time by resolution of the Authority as the amount required to be held to the credit of a separate account in the Subordinated Bond Reserve Fund corresponding to such Series. For purposes of determining the amount on deposit to the credit of any such separate account, any agreement between the 1998 Fiscal Agent and a financial institution serving as the depository institution of the Commonwealth state infrastructure bank (or other similar fund) created by virtue of Section 350 of the National Highway System Designation Act of 1995, as amended (23 U.S.C. Section 101), or any similar federal legislation, pursuant to which agreement such depository institution irrevocably agrees to provide funds to the 1998 Fiscal Agent for deposit to the credit of any separate account in the Subordinated

Bond Reserve Fund shall be treated as satisfying the applicable Subordinated Reserve Requirement to the extent of the maximum amount of funds so available to be provided to the 1998 Fiscal Agent for deposit to the credit of such separate account.

"Swap agreement" means an agreement between the Authority and a Swap party whereby the Swap party agrees to pay to the Authority amounts calculated on the basis of all or a portion of the interest on Bonds issued under the 1998 Resolution with a variable, adjustable convertible or similar rate of interest at or prior to the times such interest is due and payable in consideration of the Authority's payment to the Swap party of amounts set forth in the Swap agreement.

"Swap party" means a person who is party to a Swap agreement and whose senior obligations are rated at the time of the execution and delivery of such Swap agreement in one of the three highest rating categories (without regard to any gradations within any such category) by (i) S&P or its successors and (ii) Moody's or its successors.

"Swap rate" means the fixed rate per annum on the principal amount of bonds issued under the 1998 Resolution with a variable, adjustable convertible or similar rate of interest covered by a Swap agreement equal to the percentage derived by dividing (i) the sum of the amounts in the last twelve months paid by the Authority in respect of interest on such bonds and to the Swap party less the amount paid to the Authority by the Swap party by (ii) such principal amount of bonds; provided, however, that if such Swap agreement has been in effect for less than twelve months, such percentage shall be multiplied by 360 divided by the number of days between the effective date of such Swap agreement and the date of calculation determined on the basis of 30-day months;

"Toll Facilities" means any Traffic Facilities for the use of which the Authority imposes tolls.

"Traffic Facilities" means any of the following facilities for which 1968 Resolution Bonds or bonds or other obligations shall be issued by the Authority under the provisions of the 1998 Resolution the cost of which facilities paid from the proceeds of such bonds or other obligations shall not have been reimbursed to the Authority from funds not encumbered by the 1998 Resolution or the 1968 Resolution:

> roads, avenues, streets, thoroughfares, speedways, bridges, tunnels, channels, stations, terminals and any other land or water facilities necessary or desirable in connection with the movement of persons, freight, vehicles or vessels;
>
> parking lots and structures and other facilities necessary or desirable in connection with parking, loading or unloading of all kinds of vehicles or vessels; and
>
> all property rights, easements, and interests therein necessary or desirable for the construction, maintenance control, operation or development of such traffic facilities.

"Transportation Engineers" means the engineer or engineers or engineering firm or firms or corporation or corporations at the time employed by the Authority under the provisions of the 1998 Resolution.

"Transportation Facilities" means all Traffic Facilities, all Mass Transit Facilities, and any other highway, road, transportation or other facilities or undertakings permitted from time to time by the enabling act for which bonds or other obligations shall be issued by the Authority under the provisions of the 1998 Resolution the cost of which facilities paid from the proceeds of such bonds or other obligations shall not have been reimbursed to the Authority from funds not encumbered by the 1998 Resolution.

Sinking Funds

The 1998 Resolution creates the "Puerto Rico Highways and Transportation Authority Transportation Revenue Bonds Interest and Sinking Fund" (the "Senior Bond Sinking Fund"). The "Senior Bond Service Account", "Senior Bond Redemption Account" and "Senior Bond Reserve Account" are created within the Senior Bond Sinking Fund. (Section 401).

The 1998 Resolution also creates the "Puerto Rico Highways and Transportation Authority Subordinated Transportation Revenue Bonds Interest and Sinking Fund" (the "Subordinated Bond Sinking Fund"). The "Subordinated Bond Service Account," and "Subordinated Bond Redemption Account" are created within the Subordinated Bond Sinking Fund. (Section 401).

The 1998 Resolution also creates the "Puerto Rico Highways and Transportation Authority Subordinated Transportation Revenue Bonds Reserve Fund" (the "Subordinated Bond Reserve Fund"). The Authority may establish one or more accounts in the Subordinated Bond Reserve Fund to correspond to Series of subordinated bonds with different Subordinated Reserve Requirements. (Section 401).

The 1998 Resolution also creates the "Puerto Rico Highways and Transportation Authority Transportation Revenue Fund" (the "Revenue Fund"). The Authority has covenanted that all Revenues (except investment earnings or deposits to the credit of the funds and accounts established under the 1998 Resolution) will be deposited when received to the credit of the Revenue Fund. Until the outstanding 1968 Resolution Bonds have been paid or provision has been made for their payment and the repeal and cancellation of the 1968 Resolution, the Authority shall on or before the last day of the month during which the 1998 Bonds shall be issued and on or before the 25th day of each month thereafter withdraw from the 1968 Construction Fund and transfer to the credit of the Revenue Fund all unencumbered moneys held for the credit of the 1968 Construction Fund (herein "unencumbered 1968 Construction Fund moneys"), such transfer to be made on the books of the Authority as of the close of the preceding month. (Section 401).

The moneys in each Fund or Account are held by the 1998 Fiscal Agent in trust and, pending application, are subject to a lien in favor of the holders of the outstanding bonds and for the further security of such holders until paid out or transferred as provided in the 1998 Resolution. (Section 401).

All Revenues (other than investment earnings), and any other funds of the Commonwealth allocated to the Authority for the payment of principal of and interest on any bonds, are withdrawn monthly from the Revenue Fund and deposited with the 1998 Fiscal Agent as follows:

(1) to the Senior Bond Service Account, an amount equal to 1/6th of the amount of interest payable on all senior bonds of each Series on the next succeeding interest payment date and an amount equal to 1/12th of the next maturing installment of principal of any serial bonds of such Series until the amount in the Senior Bond Service Account equals the amount of interest payable on such interest payment date and the amount of such principal installment; provided, however, that the amount so deposited on account of the interest in each month after the delivery of the senior bonds of any Series up to and including the month immediately preceding the first interest payment date thereafter of the bonds of such Series shall be that amount which when multiplied by the number of such deposits will be equal to the amount of interest payable on such bonds on such first interest payment date less the amount of any accrued interest paid on such bonds and deposited to the credit of the Senior Bond Service Account;

(2) to the Senior Bond Redemption Account, an amount equal to 1/12th of the Amortization Requirement for such fiscal year for the term bonds of each Series of senior bonds then outstanding plus an amount equal to 1/12th of the premium, if any, which would be payable on the first redemption date in the following fiscal year on a like principal amount of bonds if such principal amount of bonds should be redeemed prior to their maturity from moneys in the Senior Bond Sinking Fund;

(3) to the Senior Bond Reserve Account, such amount as is required to make the amount deposited to the credit of said Account in the then current fiscal year at least equal to 20% of the Senior Reserve Requirement; provided, however, that such deposits shall only be made to the extent necessary to make the amount then in the Senior Bond Reserve Account equal to the Senior Reserve Requirement; provided, further, that in the event of an increase in the Senior Reserve Requirement due to the issuance of additional Series of senior bonds, such increase will be funded by deposits in each of the five (5) years, commencing in the fiscal year in which such additional Series of senior bonds is issued, of 20% of such increase in the Senior Reserve Requirement;

(4) to the Subordinated Bond Service Account, an amount equal to one-sixth (1/6) of the amount of interest payable on all subordinated bonds of each Series on the interest payment date next succeeding and an amount equal to one-twelfth (1/12) of the next maturing installment of principal of such serial bonds of such Series until the amount in the Subordinated Bond Service Account equals the amount of interest payable on such interest payment date and the amount of such principal installment; provided, however, that the amount so deposited on account of interest in each month after the delivery of the subordinated bonds of any Series up to and including the month immediately preceding the first interest payment date thereafter of the bonds of such Series shall be that amount which when multiplied by the number of such deposits will be equal to the amount of interest payable on such bonds on such first interest payment date less the amount of any accrued interest paid on such bonds and deposited with the 1998 Fiscal Agent to the credit of the Subordinated Bond Service Account;

(5) to the Subordinated Bond Redemption Account, an amount equal to one-twelfth (1/12) of the Amortization Requirement for such fiscal year for the term bonds of each Series of subordinated bonds then outstanding plus one-twelfth (1/12) of the premium, if any, which would be payable on the first redemption date in the following fiscal year on a like principal amount of bonds if such principal amount of bonds should be redeemed prior to their maturity from moneys in the Subordinated Bond Sinking Fund;

(6) to each separate account within the Subordinated Bond Reserve Fund, such amount, if any, of any balance remaining after making the deposits described under paragraph (1) through (5) above (allocated pro rata to each account on the basis of the corresponding Subordinated Reserve Requirements) at least equal to the respective deposit requirements corresponding to each such account established by the Authority; provided, however, that no such deposits to any such account described under this paragraph shall be made in any month if the amount then to the credit of such account shall be equal to the applicable Subordinated Reserve Requirement; and provided, further, that notwithstanding the above, in the event that any Subordinated Reserve Requirement shall have increased on account of the issuance of additional Series of subordinated bonds, the Authority may provide for equal annual deposits as will ensure that the applicable Subordinated Reserve Requirement be met not earlier than the end of a five year period following the issuance of such series of Subordinated Bonds; and

(7) the balance remaining after making the deposits referred to above shall be deposited to the credit of the 1998 Construction Fund for use by the Authority for any of its authorized purposes, subject to the provisions of Sections 604 and 605 of the 1998 Resolution. (Section 401).

The requirements specified in paragraphs (1) through (6) above are cumulative. (Section 401).

The Authority further covenants that any other funds which it receives from the Commonwealth or any other source to make up any deficiencies in the amounts needed to pay the principal of and interest on any bonds issued under the provisions of the 1968 Resolution and the 1998 Resolution will be applied for such purpose first to make up any deficiencies in the amounts needed to pay the principal and interest on any 1968 Resolution Bonds and then to make up any such deficiencies needed to pay such principal of and interest on the senior bonds and then the subordinated bonds. (Section 401).

When the 1968 Resolution is repealed and cancelled, all moneys (other than those held for the redemption or payment of 1968 Resolution Bonds), including obligations purchased as an investment of such moneys will be withdrawn from the 1968 Construction Fund and 1968 Sinking Fund and deposited into the Revenue Fund. (Section 402).

Moneys in the Senior Bond Redemption Account shall be applied to the retirement of senior bonds as follows:

(a) Subject to the provisions of paragraph (c) below, the 1998 Fiscal Agent shall endeavor to purchase outstanding senior bonds, whether or not such bonds shall then be subject to redemption, at the most advantageous price obtainable with reasonable diligence, having regard to interest rate and price, such price not to exceed the principal of such bonds plus the amount of the premium, if any, which would be payable on the next redemption date to the holders of such bonds if such bonds should be called for redemption on such date from moneys in the Senior Bond Sinking

Fund. The 1998 Fiscal Agent shall pay the interest accrued on such bonds to the date of delivery thereof from the Senior Bond Service Account and the purchase price from the Senior Bond Redemption Account, but no such purchase shall be made within 45 days next preceding any interest payment date on which such bonds are subject to redemption except from moneys in excess of the amounts set aside or deposited for the redemption of senior bonds.

(b) Subject to the provisions of paragraph (c) below, the 1998 Fiscal Agent shall call for redemption on each date on which senior bonds are subject to redemption from moneys in the Senior Bond Sinking Fund on the forty-fifth day prior to such redemption date such amount of senior bonds then subject to redemption as, with the redemption premium, if any, will exhaust the Senior Bond Redemption Account as nearly as may be; provided, however, that not less than $50,000 principal amount of senior bonds shall be called for redemption at any one time.

(c) Moneys in the Senior Bond Redemption Account shall be applied to the purchase or redemption of senior bonds in the following order:

First, the term bonds of each Series of senior bonds, if any, in the order of their issuance, to the extent of the Amortization Requirement, if any, of the then current fiscal year for such term bonds and any deficiency in preceding fiscal years in the purchase or redemption of such term bonds under the provisions of this subdivision; provided, however, that if none of the term bonds of a Series of senior bonds shall be subject to redemption from moneys in the Senior Bond Sinking Fund and if the 1998 Fiscal Agent shall at any time be unable to exhaust the moneys applicable to the bonds of any such Series in the purchase of such bonds under the provisions of paragraph (a) above, such moneys or the balance of such moneys, as the case may be, shall be retained in the Senior Bond Redemption Account and, as soon as it is feasible, applied to the retirement of the bonds of such Series;

Second, to the purchase of any outstanding senior bonds, whether or not such bonds shall then be subject to redemption, in accordance with the provisions of paragraph (a) above;

Third, term bonds of each Series of senior bonds in proportion (as nearly as practicable) to the aggregate principal amount of the bonds of each such Series originally issued; and

Fourth, after the retirement of all term senior bonds, any balance shall be applied to the retirement of serial senior bonds of each Series in proportion to the aggregate principal amount of each such Series originally issued.

All expenses in connection with such purchase or redemption shall be paid from the 1998 Construction Fund. (Section 404).

Moneys in the Senior Bond Reserve Account shall be used for the purpose of paying interest on the senior bonds and maturing principal of serial senior bonds whenever and to the extent that the moneys held for the credit of the Senior Bond Service Account shall be insufficient for such purpose and thereafter for the purpose of making deposits to the credit of the Senior Bond Redemption Account whenever and to the extent that the Revenues or other moneys deposited to the credit of the Revenue Fund are insufficient for such purpose; provided, however, prior to making any withdrawal from the Senior Bond Reserve Account, the 1998 Fiscal Agent shall withdraw first available unencumbered moneys in the 1998 Construction Fund and then any moneys held to the credit of the Subordinated Bond Redemption Account and then any moneys held to the credit of the Subordinated Bond Service Account in respect of the principal of any subordinated bonds and finally any other moneys held to the credit of the Subordinated Bond Service Account and transfer all such money so withdrawn to the Senior Bond Service Account or the Senior Bond Redemption Account in the respective amounts necessary to cure any insufficiencies in said Accounts. (Sections 405, 409 and 411).

Moneys held in the Subordinated Bond Service Account and Subordinated Bond Redemption Account will be applied to the payment of subordinated bonds' debt service in an analogous manner as moneys in the Senior Bond Service Account and the Senior Bond Redemption Account are applied to the payment of senior bonds' debt service, subject to the provisions employing moneys in the Subordinated Bond Sinking Fund to address insufficiencies in the Senior Bond Sinking Fund described in the previous paragraph. (Sections 406, 407, 411).

Money held for the credit of each account in the Subordinated Bond Reserve Fund shall be used for the purpose of paying interest on each Series of subordinated bonds and maturing principal of serial subordinated bonds of each such Series to which such account relates whenever and to the extent that the moneys held for the credit of the Subordinated Bond Service Account shall be insufficient for such purpose and thereafter for the purpose of making deposits to the credit of the Subordinated Bond Redemption Account whenever and to the extent that the Revenues or other moneys deposited to the credit of the Revenue Fund are insufficient for such purpose. (Section 408).

The Authority may deposit into the Senior Bond Reserve Account or any account in the Subordinated Bond Reserve Fund, a Reserve Account Insurance Policy or a Reserve Account Letter of Credit in an amount equal to all or a portion of the applicable reserve requirement, which Reserve Account Insurance Policy or Reserve Account Letter of Credit shall be payable or available to be drawn upon, as the case may be (upon the giving of notice as required thereunder), on any interest payment date on which a deficiency exists in the applicable reserve account which cannot be otherwise cured. If a disbursement is made under the Reserve Account Insurance Policy or the Reserve Account Letter of Credit, the Authority shall be obligated either to reinstate the limits of such Reserve Account Insurance Policy or Reserve Account Letter of Credit following such disbursement, or to deposit into the Senior Bond Reserve Account or any account in the Subordinated Bond Reserve Fund from Revenues, funds in the amount of the disbursement made under such Reserve Account Insurance Policy or Reserve Account Letter of Credit, and any moneys held in any such reserve account may be applied for such purpose. (Section 401, 405, 408).

1998 Construction Fund

Before any payment or withdrawal shall be made from moneys in the 1998 Construction Fund there shall be filed with the 1998 Fiscal Agent a certificate signed by a designated officer of the Authority setting forth the amount of money to be so disbursed and stating that such money will be used to pay the costs of constructing Transportation Facilities or for other authorized purposes. Upon receipt of such certificate the 1998 Fiscal Agent shall withdraw from the 1998 Construction Fund and deposit to the credit of a special checking account in its commercial department in the name of the Authority the amount so specified in such certificate. The 1998 Fiscal Agent shall also at any time at the written direction of the Authority transfer any part of the moneys in the 1998 Construction Fund to the credit of any account in the Senior Bond Sinking Fund and shall make the transfers to the Senior Bond Service Account and Senior Bond Redemption Account to cure deposit deficiencies therein as described above. (Section 409).

Defeasance

If all the outstanding bonds shall have been paid or deemed to have been paid as provided below, then and in that case the rights, title and interest of the 1998 Fiscal Agent under the 1998 Resolution shall cease, terminate and become void, and such bonds shall cease to be entitled to any lien, benefit or security under the 1998 Resolution. In such event, the Authority shall repeal and cancel the 1998 Resolution and may apply any surplus in the Senior Bond Sinking Fund, Subordinated Bond Sinking Fund and all balances remaining in any other fund and accounts other than moneys held for the redemption or payment of bonds to any lawful purposes of the Authority.

Any outstanding bond shall be deemed to have been paid within the meaning and with the effect expressed in the 1998 Resolution when the whole amount of the principal of, redemption premium, if any, and interest on such bond shall have been paid or duly provided for and the conditions set forth in clause (c) below have been satisfied or when (a) in case such bond has been called for redemption or the Authority has given to the 1998 Fiscal Agent irrevocable instructions to call such bond for redemption, (b) there shall have been deposited with the 1998 Fiscal Agent or other appropriate fiduciary institution acting as escrow agent for the holder of such bond and the holders of other bonds being defeased and specifically designated for the purpose of defeasance either moneys in an amount which shall be sufficient, or Government Obligations the principal of and interest on which are sufficient, without any reinvestment thereof, to pay when due the principal of and premium, if any, and interest due and to become due on such bond on or prior to the redemption date or maturity date thereof, as the case may be, and (c) in the event such bond does not mature and is not to be redeemed within the next succeeding sixty (60) days, the Authority shall have given the 1998 Fiscal Agent irrevocable instructions to give, as soon as practicable, a notice to the holder of such bond by first-class mail, postage prepaid, stating that the deposit of moneys or Government Obligations required by clause (b) of this paragraph has been made with the 1998 Fiscal Agent or other appropriate fiduciary institution acting as escrow agent for the holder of such bond, and that such bond is deemed to have been paid in accordance with the 1998 Resolution and stating such maturity or redemption date upon which moneys are to be available for the payment of the principal of and premium, if any, and interest on such bond.

Neither the moneys nor Government Obligations deposited with the 1998 Fiscal Agent or other appropriate fiduciary institution acting as escrow agent nor principal or interest payments on any such obligations shall be withdrawn or used for any purpose other than, and shall be held in trust for, the payment of the principal of and redemption premium, if any, and interest on the bonds which have been defeased.

As to Variable Rate Bonds, the amount required for the interest thereon shall be calculated at the maximum rate permitted by the terms of the provisions of the resolution which authorized the issuance of such Variable Rate Bonds. (Section 1001).

Issuance of Additional Bonds

Senior bonds may be issued under and secured by the 1998 Resolution, subject to the conditions hereinafter described, at any time or times for any lawful purpose of the Authority. (Sections 208 and 209).

Before such bonds shall be delivered, there shall be filed with the 1998 Fiscal Agent, among other things, a certificate signed by the Executive Director not earlier than thirty (30) days prior to the delivery date of such bonds setting forth:

(i) the amount of Revenues received by the Authority and until the outstanding 1968 Resolution Bonds have been paid or provision has been made for their payment and the repeal and cancellation of the 1968 Resolution, the amount of Excess 1968 Resolution Revenues deposited to the credit of the Revenue Fund in each of the fifteen (15) months immediately preceding the month in which such certificate is signed, adjusted (I) to give effect to legislation enacted on or prior to the date of delivery of such bonds that would have increased the Revenues or the amounts of Excess 1968 Resolution Revenues deposited to the credit of the Revenue Fund as aforesaid if such legislation (x) had been in effect throughout such fifteen (15) months, (y) allocates additional moneys to the Authority and (z) expressly permits the Authority to pledge to the payment of the bonds issued under the provisions of the 1998 Resolution or the 1968 Resolution until the 1968 Resolution Bonds have been paid or provision has been made for their payment and the repeal and cancellation of the 1968 Resolution and the Authority has expressly pledged such additional moneys to such payment on or prior to such date of delivery and (II) to reflect the moneys which would have been received if (A) the schedule of tolls in effect on the date of delivery of such bonds had been in effect and (B) the Toll Facilities to be financed in whole or part with the proceeds of such bonds had been in operation throughout such fifteen (15) months,

(ii) the amount of the maximum Principal and Interest Requirements for any fiscal year thereafter on account of all senior bonds theretofore issued under the provisions of the 1998 Resolution and then outstanding and the senior bonds then requested to be delivered, and

(iii) the amount of the maximum Principal and Interest Requirements for any fiscal year thereafter on account of all senior bonds and subordinated bonds theretofore issued under the provisions of the 1998 Resolution and then outstanding and the senior bonds then requested to be delivered; and

(iv) the percentage derived by dividing the amount in item (i) above for any twelve consecutive months by the amount in item (ii) above; and

(v) the percentage derived by dividing the amount in item (i) above for any twelve consecutive months by the amount in item (iii) above. (Section 208).

The 1998 Fiscal Agent may only deliver such additional senior bonds if the percentages shown in item (iv) and item (v) are not less than 150% and 100%, respectively. (Section 208).

The Authority need not deliver said certificate in connection with the issuance of senior bonds issued for the purpose of refunding senior bonds of any Series if the amount of the maximum Principal and Interest Requirements for any fiscal year thereafter on account of the senior bonds to be outstanding after the issuance of such refunding senior bonds shall be equal to or less than the maximum Principal and Interest Requirements for any fiscal year thereafter on account of the senior bonds outstanding prior to the issuance of such refunding senior bonds. (Section 209).

Subordinated bonds may be issued under and secured by the 1998 Resolution, subject to the conditions hereinafter described, at any time or times for the purpose of paying the cost of any Transportation Facilities falling within the definition of "Federal-aid highway" or "capital projects" under Section 101 of Title 23 and Section 5302 of Title 49, respectively, of the United States Code, as such definitions may be amended from time to time, or qualifying for any other federal transportation assistance for the defraying (directly or indirectly) of such cost.

Before subordinated bonds shall be delivered, there shall be filed with the 1998 Fiscal Agent, among other things, a certificate signed by the Executive Director not earlier than thirty (30) days prior to the delivery date of such subordinated bonds indicating that the percentage derived by dividing (a) the amount of Revenues and Excess 1968 Resolution Revenues determined in the same manner as specified in clause (i) above by (b) the amount of the maximum Principal and Interest Requirements for any fiscal year thereafter on account of all senior bonds and subordinated bonds theretofore issued under the provisions of the 1998 Resolution and then outstanding and the subordinated bonds then requested to be delivered is not less than 125%. (Section 210).

Refunding subordinated bonds may be issued only to refund other subordinated bonds of any Series. The Authority need not deliver said certificate in connection with the issuance of refunding subordinated bonds if the amount of the maximum Principal and Interest Requirements for any fiscal year thereafter on account of the subordinated bonds to be outstanding after the issuance of such refunding subordinated bonds shall be equal to or less than the maximum Principal and Interest Requirements for any fiscal year thereafter on account of the subordinated bonds outstanding prior to the issuance of such refunding subordinated bonds. (Section 211).

Other Indebtedness

The Authority will not incur any indebtedness nor create or suffer to be created any lien, pledge, assignment, encumbrance or charge upon the Revenues ranking equally with or prior to the senior bonds issued under the 1998 Resolution, except the lien and charge of the senior bonds secured by the 1998 Resolution, or ranking equally with the subordinated bonds except the lien and charge of the subordinated bonds secured by the 1998 Resolution. Any other indebtedness incurred by the Authority after the effective date of the 1998 Resolution under documents not in effect on the effective date of the 1998 Resolution shall contain a statement that such indebtedness is junior, inferior and subordinate in all respects to the bonds. For purposes of the above limitation on incurrence of indebtedness, indebtedness shall not be deemed to include contracts entered into in the ordinary course of business, agreements to repay advances received from the Federal government or agreements to repay (to the extent drawn) all or a portion of the stated amount drawn under any Credit Facility, Liquidity Facility, Reserve Account Letter of Credit or Reserve Account Insurance Policy. Nothing in the 1998 Resolution shall be deemed to prohibit the Authority from entering into currency swaps, interest rate swaps or other arrangements for hedging of interest rates on any indebtedness. (Section 602).

Nothing in the 1998 Resolution is to be construed as preventing the Authority from financing any facilities authorized by the act creating the Authority, as amended, by the issuance of bonds or other obligations which are not secured under the provisions of the 1998 Resolution. (Section 1101).

Investment of Funds

Moneys held for the credit of the Revenue Fund, Senior Bond Service Account, Senior Bond Redemption Account, Subordinated Bond Service Account, and Subordinated Bond Redemption Account shall, as nearly as may be practicable, be continuously invested and reinvested at the written direction of the Authority in Government Obligations, and moneys held for the credit of the 1998 Construction Fund, Senior Bond Reserve Account and each account in the Subordinated Bond Reserve Fund shall, as nearly as may be practicable, be continuously invested and reinvested at the written direction of the Authority in Investment Obligations, which Government Obligations and Investment Obligations shall mature, or which shall be subject to redemption by the holder thereof at the option of such holder, not later than the respective dates when moneys held for the credit of said Fund or Accounts will be required for the purposes intended. Amounts on deposit in the Senior Bond Reserve Account and each account in the Subordinated Bond Reserve Fund shall be invested in Investment Obligations which mature not later than the final maturity date of any senior bonds or subordinated bonds Outstanding, as the case may be. (Section 502).

Investment earnings on moneys on deposit to the credit of the following Funds and Accounts shall be applied as follows:

(a) Investment earnings on moneys on deposit to the credit of the Senior Bond Service Account, the Senior Bond Redemption Account, the Subordinated Bond Service Account, the Subordinated Bond Redemption Account and the 1998 Construction Fund shall be transferred to the credit of or retained in the 1998 Construction Fund; provided that the Authority may elect to have such investment earnings remain to the credit of the Senior Bond Service Account, the Senior Bond Redemption Account, the Subordinated Bond Service Account or the Subordinated Bond Redemption Account to fund the next payment of principal of, Amortization Requirements for and interest on the senior bonds or the subordinated bonds, in which event the Authority shall receive a credit against the amounts required to be deposited in said Accounts as applicable;

(b) Investment earnings on moneys on deposit to the credit of the Senior Bond Reserve Account and each account in the Subordinated Bond Reserve Fund shall be retained in said accounts at any time that the respective amounts on deposit to the credit of said accounts is less than the Senior Reserve Requirement or the corresponding Subordinated Reserve Requirement, as applicable; and

(c) Investment earnings on moneys on deposit to the credit of the Revenue Fund shall be retained therein. (Section 502).

In computing the amount in any Fund or Account created pursuant to the provisions of the 1998 Resolution, obligations purchased as an investment of moneys therein shall be valued at par if purchased at par or at amortized value if purchased at other than par, plus, in each case, accrued interest. Amortized value, when used with respect to an obligation purchased at a premium above or a discount below par, means the value as of any given time obtained by dividing the total premium or discount at which such obligation was purchased by the number of days remaining to maturity on such obligation at the date of such purchase and by multiplying the amount thus calculated by the number of days having passed since such purchase; and (1) in the case of an obligation purchased at a premium by deducting the product thus obtained from the purchase price, and (2) in the case of an obligation purchased at a discount by adding the product thus obtained to the purchase price. Valuation on any particular date shall include the amount of interest then earned or accrued to such date on any moneys or investments in such Fund or Account. The computation of the amount on deposit in or credited to the Fund and Accounts created under the 1998 Resolution and the valuation of the investments of such amount shall be performed by the 1998 Fiscal Agent as of the close of business on the last day of each fiscal year and at such other times as the Authority shall request, and such computation and valuation shall not be required to be performed at other times. (Section 503).

Modifications

The Authority may adopt resolutions supplemental to the 1998 Resolution without the consent of the bondholders to cure any ambiguity, formal defect or omission, or to correct any inconsistent provisions or errors in the 1998 Resolution or any supplemental resolution, or to grant or confer upon the bondholders any additional rights, remedies, powers, authority or security, or to add to the conditions, limitations and restrictions on the issuance of bonds under the provisions of the 1998 Resolution, to add to the covenants and agreements of the Authority in the 1998 Resolution or to surrender any right or power reserved to or conferred upon the Authority, or to amend the conditions, limitations and restrictions on the issuance of subordinated bonds or the covenants and agreements relating to the subordinated bonds (as shall not adversely affect the interests of the holders of any senior bonds) as may be required to enable the Authority to comply with the provisions of any federal legislation, rules or regulations or court decisions or orders relating to the receipt by the Authority of grants or other assistance from the United States Government. (Section 801).

The holders of not less than a majority in aggregate principal amount of the senior bonds and of the subordinated bonds then Outstanding and affected thereby shall have the right to consent to and approve the adoption of such resolution or resolutions supplemental to the 1998 Resolution as shall be deemed necessary or desirable by the Authority for the purpose of modifying, altering, amending, adding to or rescinding any of the terms and provisions contained in the 1998 Resolution or in any supplemental resolution; provided, however, that nothing contained in the 1998 Resolution shall permit, or be construed as permitting, without consent of the holders of all bonds affected thereby, (a) an extension of the maturity of the principal of or the interest on any bond, or (b) a reduction in the principal amount of any bond or the redemption premium or the rate of interest thereon, or (c) the creation of a lien upon or a pledge of Revenues other than the lien and pledge created by the 1998 Resolution, or (d) a preference or priority of any bond or bonds over any other bond or bonds, or (e) a reduction in the aggregate principal amount of the bonds required for consent to such supplemental or (f) a change in the subordination provisions. (Section 802).

If at any time the Authority shall determine that it is necessary or desirable to adopt any supplemental resolution for any of the purposes of the above paragraph, the 1998 Fiscal Agent at the expense and request of the Authority shall cause notice of the proposed adoption of such supplemental resolution to be mailed, first class, postage prepaid, to all bondholders and to Government Development Bank for Puerto Rico. Such notice shall briefly set forth the nature of the proposed supplemental resolution and shall state that copies thereof are on file at the office of the 1998 Fiscal Agent for inspection by all bondholders. The 1998 Fiscal Agent shall not, however, be subject to any liability to any bondholder by reason of its failure to cause such notice to be mailed, and any such failure shall not affect the validity of such supplemental resolution when consented to and approved. (Section 802).

Whenever, at any time within one year after the date of the mailing of such notice, the Authority shall obtain an instrument or instruments in writing purporting to be executed by the holders of not less than a majority in aggregate principal amount of the senior bonds and of the subordinated bonds then Outstanding, which instrument or instruments shall refer to the proposed supplemental resolution described in such notice and shall specifically consent to and approve the adoption thereof in substantially the form of the copy thereof referred to in such notice, and the Authority shall deliver to the 1998 Fiscal Agent a certificate signed by the Executive Director that the holders of such required percentages of bonds have filed such consents; thereupon, but not otherwise, the Authority may adopt such supplemental resolution in substantially such form, without liability or responsibility to any holder of any bond, whether or not such holder shall have consented thereto. (Section 802).

If the holders of not less than a majority in aggregate principal amount of the affected senior bonds and of the affected subordinated bonds Outstanding at the time of the adoption of such supplemental resolution shall have consented to and approved the adoption thereof, no holder of any bond shall have any right to object to the adoption of such supplemental resolution, or to object to any of the terms and provisions contained therein or the operation thereof, or in any manner to question the propriety of the adoption thereof, or to enjoin or restrain the Authority from adopting the same or from taking any action pursuant to the provisions thereof and such consent shall be binding on the holder giving such consent and upon any subsequent holder whether or not he has notice thereof. (Section 802).

Upon the adoption of any supplemental resolution pursuant to the provisions of the 1998 Resolution, the 1998 Resolution shall be and be deemed to be modified and amended in accordance therewith, and the respective rights, duties and obligations under the 1998 Resolution of the Authority, the 1998 Fiscal Agent and all holders of bonds then outstanding shall thereafter be determined, exercised and enforced in all respects under the provisions of the 1998 Resolution as so modified and amended. (Section 803).

Miscellaneous Covenants

Master Plan. The Authority covenants that the master plan for the construction of required Transportation Facilities in Puerto Rico will be supplemented periodically as necessary and that the five-year priorities construction program will be updated each year to cover the Transportation Facilities to be constructed by the Authority in the ensuing five-year period. (Section 603).

Costs of Maintenance, Repair and Operation of Traffic Facilities. The Authority covenants that, if and to the extent funds for the purpose of maintaining, repairing and operating all Traffic Facilities financed by the Authority in whole or in part by 1968 Resolution Bonds and all Transportation Facilities financed by the Authority in whole or in part by bonds under the provisions of the 1998 Resolution are not provided by the Commonwealth, the Authority will pay such costs from unencumbered funds then on deposit in the 1998 Construction Fund or from the Revenues or unencumbered 1968 Construction Fund moneys thereafter deposited to the credit of the 1998 Construction Fund pursuant to the 1998 Resolution and not from funds then on deposit or thereafter deposited to the credit of the 1968 Construction Fund. (Section 604).

The Authority further covenants that it will cause an annual general evaluation to be made by the Transportation Engineers of the level of maintenance of all Traffic Facilities and Transportation Facilities financed in whole or in part by the issuance of bonds under the provisions of, respectively, the 1968 Resolution and the 1998 Resolution, which Facilities shall be, in the judgment of the Authority and of the Traffic Engineers, material to the overall system of Transportation Facilities of the Authority. (Section 604).

The Authority further covenants that it will operate or cause to be operated the Toll Facilities, any Mass Transit Facilities and all other Transportation Facilities that it may from time to time operate or cause to be operated in an efficient and economical manner, that it will at all times maintain or cause to be maintained such Transportation Facilities in good repair and in sound operating condition and that it will make or cause to be made all necessary repairs, renewals and replacements thereto. (Section 604).

Annual Report of Traffic Engineers. The Authority covenants that it will cause the Transportation Engineers to prepare a report each year promptly after the completion of their general evaluation of the level of maintenance, repair and operating condition of the Transportation Facilities setting forth (i) their comments with respect to any supplements or revisions made by the Authority in the master plan or in the five-year priorities construction program referred to above under "Master Plan" and their recommendations as to any supplements or revisions which should be made in such plan or in the priorities construction program, and (ii) their findings as to whether those Traffic Facilities have been maintained in good repair, working order and sound operating condition and their recommendations as to necessary repairs, renewals or replacements. (Section 605).

If it appears from such report that repairs, renewals or replacements of any such Facilities are necessary, the Authority shall promptly cause the same to be restored to a condition of good repair and to sound operating condition, and if and to the extent that funds for such purpose have not been made available by the Commonwealth, moneys on deposit to the credit of the 1998 Construction Fund which have not theretofore been encumbered for other purposes, and moneys which are thereafter deposited to the credit of the 1998 Construction Fund pursuant to the 1998 Resolution shall first be applied for such purpose. No funds then on deposit or thereafter deposited to the credit of the 1968 Construction Fund shall be applied for such purpose. (Section 605).

Relating to the 1968 Resolution. The Authority covenants that immediately upon the repeal and cancellation of the 1968 Resolution, all Existing Tax and Fee Revenues and Existing Toll Revenues shall be pledged to the payment of the principal of and premium, if any, and interest on the bonds issued under the provisions of the 1998 Resolution to the same extent and with the same effect as the pledge of Revenues and other moneys deposited to the credit of the Revenue Fund. (Section 601).

The Authority further covenants that it will cause the 1968 Resolution to be repealed and cancelled at the earliest practicable date. The Authority further covenants that, except for the proposed supplemental resolution described in *Summary of Certain Provisions of the Proposed Supplemental Resolution,* it will not adopt any resolution supplemental to the 1968 Resolution for the purpose of granting to or conferring upon the 1968 Fiscal Agent for the benefit of the holders of the bonds issued under the 1968 Resolution any additional rights, remedies, powers, authority or security that may lawfully be granted to or conferred upon such holders or the 1968 Fiscal Agent, or for the purpose of modifying, altering, amending, adding to or rescinding, in any particular, any of the terms or provisions contained in the 1968 Resolution, or for the purpose of extending the maturity of any 1968 Resolution Bond or creating a lien upon or a pledge of revenues ranking prior to or on a parity with the lien or pledge created by the 1968 Resolution. Nothing shall prevent the Authority from adopting a resolution supplemental to the 1968 Resolution to cure any ambiguity or formal defect or omission in the 1968 Resolution. (Section 609).

The Authority covenants that so long as any 1968 Resolution Bonds are outstanding under the provisions of the 1968 Resolution it will cause to be made the deposits to the credit of the 1968 Construction Fund required by the 1968 Resolution. The Authority further covenants that except for any withdrawals required to be made as set forth in the third sentence of the fourth paragraph of a "Sinking Funds" above, it will not withdraw, expend, pledge or otherwise encumber moneys held to the credit of the 1968 Construction Fund whether for the purpose of satisfying the Authority's priorities construction program or otherwise, except for the satisfying the Authority's obligations under Section 513 of that certain trust agreement, dated as of April 1, 1992, by and between the Authority and Banco Santander Puerto Rico, successor trustee. (Section 610).

Use of Revenues. The Authority covenants and agrees that, so long as any of the bonds secured by the 1968 Resolution shall be outstanding, none of the Revenues will be used for any purpose other than as provided in the 1968 Resolution and the 1998 Resolution, and that no contract or contracts will be entered into or any action taken by which the rights of the 1998 Fiscal Agent or of the bondholders might be impaired or diminished. (Section 611).

Additional 1968 Resolution Bonds. The Authority covenants that so long as any bonds shall be outstanding under the provisions of the 1998 Resolution it will not issue additional 1968 Resolution Bonds which mature after July 1, 2036 and except for (a) refunding bonds and (b) bonds issued for the purpose of meeting the obligations of the Authority under Section 11.4(b) of that certain Concession Agreement for the Final Design, Construction, Operation and Maintenance of a Privatized Transportation Facility, dated December 20, 1991, as amended, by and between the Authority and Autopistas de Puerto Rico y Compañía, S.E. relating to its obligations in respect of the Teodoro Moscoso Bridge. See, "Teodoro Moscoso Bridge" under *Transportation System Revenues and Expenditures* above in this Official Statement (Section 612).

Swap Agreements. The Authority covenants that it will not enter into a Swap agreement unless it first delivers copies of the proposed Swap agreement to S&P and Moody's and any other rating agency then rating the bonds. (Section 613).

Level of Tolls and Other Charges. Notwithstanding any provisions in the 1968 Resolution enabling the Authority to reduce tolls or other charges, the Authority covenants that it will not reduce the tolls or other charges imposed by it for the use of its Transportation Facilities unless, as of the effective date of such reduction, the Authority delivers to the 1998 Fiscal Agent a certificate, signed by the Executive Director of the Authority not earlier than thirty (30) days prior to the effective date of such reduction, setting forth:

(i) the amount of Revenues received by the Authority and until the outstanding 1968 Resolution Bonds have been paid or provision has been made for their payment and the repeal and cancellation of the 1968 Resolution, the amount of Excess 1968 Resolution Revenues deposited to the credit of the Revenue Fund in each of the fifteen (15) months immediately preceding the month in which such certificate is signed, adjusted

(I) to give effect to legislation enacted on or prior to the effective date of such reduction that would have increased the Revenues or the amounts deposited to the credit of the Revenue Fund from the 1968 Construction Fund as aforesaid if such legislation (x) had been in effect throughout such fifteen (15) months, (y) allocates additional moneys to the Authority and (z) expressly permits the Authority to pledge to the payment of the bonds issued under the provisions of the 1998 Resolution or the 1968 Resolution until the 1968 Resolution Bonds have been paid or provision has been made for their payment and the repeal and cancellation of the 1968 Resolution and the Authority has expressly pledged such additional moneys to such payment on or prior to such date of delivery and (II) to reflect the moneys which would have been received if (A) the schedule of tolls in effect on such effective date had been in effect and (B) any Toll Facilities which have commenced operation or been removed from operation during such fifteen (15) months either had been in operation or not operating throughout such fifteen (15) months,

(ii) the amount of the maximum Principal and Interest Requirements for any fiscal year thereafter on account of all senior bonds theretofore issued under the provisions of the 1998 Resolution and then outstanding, and

(iii) the amount of the maximum Principal and Interest Requirements for any fiscal year thereafter on account of all senior bonds and all subordinated bonds theretofore issued under the provisions of the 1998 Resolution and then outstanding and

it shall appear from such certificate that the percentages derived by dividing the sum of the amounts shown in item (i) of such certificate for any twelve (12) consecutive months by the amount shown in item (ii) of said certificate and by the amount shown in item (iii) of said certificate, shall not be less than one hundred fifty per centum (150%) and one hundred per centum (100%), respectively. (Section 614).

TAX EXEMPTION

The Internal Revenue Code of 1986, as amended (the "Code"), includes requirements which the Authority must continue to meet after the issuance of the 1998 Bonds in order that interest on the 1998 Bonds not be included in gross income for federal income tax purposes. The Authority's failure to meet these requirements may cause interest on the 1998 Bonds to be included in gross income for federal income tax purposes retroactive to their date of issuance. The Authority has covenanted to comply to the extent permitted by the Constitution and the laws of Puerto Rico with the requirements of the Code in order to maintain the exclusion from gross income for federal income tax purposes of interest on the 1998 Bonds. Bond Counsel is aware of no provision of the Constitution or laws of Puerto Rico which would prevent the Authority from complying with the requirements of the Code.

In the opinion of Bond Counsel, subject to continuing compliance by the Authority with the tax covenant referred to above, under existing statutes, regulations, rulings and court decisions, interest on the 1998 Bonds is not includable in gross income for federal income tax purposes. Interest on the 1998 Bonds is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; however, interest on the 1998 Bonds will be includable in the computation of the alternative minimum tax on corporations imposed by the Code. Bond Counsel is further of the opinion that the 1998 Bonds and the interest thereon are 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 1998 Bonds should consult their tax advisors as to 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 1998 Bonds will not have an adverse effect on the tax-exempt status of the 1998 Bonds. Legislative or regulatory actions and proposals may also affect the economic value of tax exemption or the market prices of the 1998 Bonds.

Capital Appreciation Bonds and Discount Bonds

The difference, if any, between the respective Accreted Values at maturity of the Capital Appreciation Bonds or the amount payable at maturity of 1998 Bonds maturing July 1 of the years 2003 through 2007 and on July 1 of the years 2028 (in respect of the $114,360,000 5% term bond) and 2038 and the corresponding initial public offering price to the public (excluding bond houses, brokers or similar persons acting in the capacity of underwriters or wholesalers) at which price a substantial amount of each such maturity is sold constitutes original issue discount. The amount of original issue discount accrues in accordance with a constant yield method based on the compounding of interest. Original issue discount accruing pursuant to the constant yield method described above will be excluded from gross income to the same extent as interest on the 1998 Bonds for federal income tax purposes. A portion of the original issue discount that accrues in each year to an owner of the 1998 Bonds with original issue discount (the "Discount Bonds") 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 is included in the calculation of the distribution requirements of certain regulated investment companies and may result in some of the collateral federal income tax consequences discussed above. Consequently, owners of any 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.

A purchaser in the initial offering who acquires a Discount Bond at an issue price equal to the initial offering price thereof as set forth or derived from information set forth on the inside cover page hereof will be treated as receiving an amount of interest not includable in gross income for federal income tax purposes equal to the original issue discount accruing during the period he holds such Discount Bond and will increase his adjusted basis in such Discount Bond by the amount of such accruing discount for purposes of determining taxable gain or loss on the redemption, sale or other disposition of such Discount Bond for federal income tax purposes. The accrual of original issue discount and its effect on redemption, sale or other disposition of a Discount Bond that is not purchased in the initial offering at its initial offering price may be determined according to rules that differ from those described above.

Owners of Discount Bonds should consult their tax advisors with respect to the determination for federal income tax purposes of the amount of original issue discount or interest properly accruable with respect to such Discount Bonds and with respect to Commonwealth, state and local income tax consequences of owning and disposing of Discount Bonds.

Premium Bonds

The difference between the amount payable at maturity of any 1998 Bonds maturing July 1 of the years 1999, 2000, 2002, and July 1 of the years 2008 through 2014, and the tax basis of such 1998 Bonds to a purchaser (other than a purchaser who holds such 1998 Bonds as inventory, stock in trade or for sale to customers in the ordinary course of business) who purchases any such 1998 Bonds at its initial offering price is "bond premium." Bond premium is amortized over the term of such 1998 Bonds for federal income tax purposes. Beneficial Owners of such 1998 Bonds are required to decrease their adjusted bases in such 1998 Bonds by the amount of amortizable bond premium attributable to each taxable year such 1998 Bonds are held. The amortizable bond premium on such 1998 Bonds attributable to a taxable year is not deductible for federal income tax purposes. Beneficial Owners of such 1998 Bonds should consult their tax advisors with respect to the precise determination for federal income tax purposes of the treatment of bond premium upon redemption, sale or other disposition of such 1998 Bonds and with respect to the Commonwealth, state and local income tax consequences of owning and disposing of such 1998 Bonds.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

Deloitte & Touche LLP will verify from the information provided to it the mathematical accuracy as of the date of the delivery of the 1998 Bonds of (1) the computations contained in schedules provided to it to determine that the anticipated receipts from the Government Obligations and cash deposits listed in such schedules, to be held in escrow, will be sufficient to pay, when due, the principal, interest and call premium payment requirements of the Refunded Bonds (see "*Financing Plan*") and (2) the computations of yield on both such Obligations and the 1998 Bonds contained in such schedules and used by Bond Counsel in its determination that the interest on the 1998 Bonds is exempt from tax. Deloitte & Touche LLP will express no opinion on the assumptions provided to it, nor as to the exemption from taxation of the interest on the 1998 Bonds.

UNDERWRITING

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the 1998 Bonds from the Authority at an aggregate discount of $7,053,116.85 from the initial offering prices of the 1998 Bonds set forth or derived from information set forth on the inside cover page hereof. The obligations of the Underwriters are subject to certain conditions precedent, and they will be obligated to purchase all the 1998 Bonds if any 1998 Bonds are purchased. The 1998 Bonds may be offered and sold to certain dealers (including dealers depositing 1998 Bonds into investment trusts) and institutional purchasers at prices lower than such public offering prices and such offering prices may be changed, from time to time, by the Underwriters.

Morgan Stanley & Co. Incorporated ("Morgan Stanley"), a managing underwriter, has entered into a written agreement with Popular Securities, Inc. ("Popular Securities"), a subsidiary of Popular Inc., pursuant to which Popular Securities has agreed to cooperate in connection with Morgan Stanley's provision of underwriting and investment banking services to the Authority with respect to the 1998 Bonds. Pursuant to these arrangements, the existence of which has been disclosed to the Authority and Government Development Bank, Popular Securities will be entitled to receive a portion of Morgan Stanley's actual net profits, if any, in connection with the underwriting of the 1998 Bonds.

Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), a managing underwriter, has entered into a written agreement with Santander Securities Corporation of Puerto Rico ("Santander Securities"), a subsidiary of Banco Santander, S.A., pursuant to which Santander Securities has agreed to cooperate in connection with Merrill Lynch's provision of underwriting and investment banking services to the Authority with respect to the 1998 Bonds. Pursuant to these arrangements, the existence of which has been disclosed to the Authority and Government Development Bank, Santander Securities will be entitled to receive a portion of Merrill Lynch's actual net profits, if any, in connection with the underwriting of the 1998 Bonds.

LITIGATION

There is no pending litigation of any nature restraining or enjoining or seeking to restrain or enjoin the issuance, sale or delivery of the 1998 Bonds or in any way contesting or affecting the validity of the 1998 Bonds, the resolutions or the proceedings of the Authority taken with respect to the authorization, issuance or sale thereof, or the pledge or application of any moneys under the 1998 Resolution or the existence or powers of the Authority.

The Authority is currently involved in two legal proceedings relating to the construction of PR-66. See "Operating Expenses and Capital Expenditures-Priorities Construction Program-Highway Construction" under *Transportation System Revenues and Expenditures.* Based on the opinion of its legal counsel, while the Authority cannot predict the outcome of this or any other litigation, the Authority does not expect the outcome of either legal proceeding to materially affect its 1998 Resolution Revenues, its 1968 Resolution Revenues or its operations or financial condition.

The Authority is also involved in various other legal proceedings arising in the normal course of its business. The Authority and its General Counsel do not believe that liability from any such legal proceedings, in excess of available insurance coverage and the provision for losses not covered by insurance, as shown on the financial statements, will have a material adverse effect on the financial condition of the Authority.

LEGAL MATTERS

The form of opinion of Brown & Wood LLP, New York, New York, Bond Counsel, is set forth in *Appendix IV* to this Official Statement. Certain legal matters will be passed upon for the Underwriters by Pietrantoni Méndez & Alvarez, San Juan, Puerto Rico.

LEGAL INVESTMENT

The 1998 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.

GOVERNMENT DEVELOPMENT BANK

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 Authority in connection with the 1998 Bonds offered hereby. As financial advisor, Government Development Bank participated in the selection of the Underwriters of the 1998 Bonds. Certain of the Underwriters have been selected by Government Development Bank to serve from time to time as underwriters of its obligations and the obligations of the Commonwealth, its instrumentalities and public corporations. Certain of the Underwriters or their affiliates participate in other financial transactions with Government Development Bank.

RATINGS

Moody's and S&P have given the 1998 Bonds ratings of Baa1 and A, respectively. These ratings do not reflect the Ambac Bond Insurance Policy. Moody's and S&P have given the Insured Bonds ratings of Aaa and AAA, respectively. The ratings reflect only the respective views of the rating agencies and an explanation of the significance of each rating may be obtained only from the respective rating agency.

Such rating agencies were provided with materials relating to the Authority, the Commonwealth and the 1998 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 1998 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 1998 Bonds.

CONTINUING DISCLOSURE

In accordance with the requirements of Rule 15c2-12, as amended (the "Rule"), promulgated by the Securities and Exchange Commission ("SEC"), the Commonwealth and the Authority, as specifically stated hereinbelow, will agree to the following:

1. Each of the Authority and the Commonwealth will agree to file within 305 days after the end of each fiscal year beginning with its fiscal year ending on June 30, 1998, with each nationally recognized municipal securities information repository ("NRMSIR") and with any Commonwealth state information depository ("SID"), core financial information and operating data for the prior fiscal year, including (i) its 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 Authority and the Commonwealth, as the case may be, and information as to revenues, expenditures, financial operations and indebtedness of the Authority and the Commonwealth, as the case may be, generally found in this Official Statement; and

2. The Authority will agree to file, in a timely manner, with each NRMSIR or with the Municipal Securities Rulemaking Board (the "MSRB") and with any SID, notice of any failure to comply with paragraph 1 above and of the occurrence of any of the following events with respect to the 1998 Bonds if, in the judgment of the Authority or its agent, such event is 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 1998 Bonds;
g. modifications to rights of the holders (including Beneficial Owners) of the 1998 Bonds;
h. bond calls;
i. defeasances;
j. release, substitution, or sale of property securing repayment of the Series 1998 Bonds; and
k. rating changes.

With respect to the following events:

Events (d) and (e). The Authority does not undertake to provide any notice with respect to credit enhancement added after the primary offering of the 1998 Bonds, unless the Authority applies for or participates in obtaining the enhancement.

Event (f). For information on the tax status of the 1998 Bonds, see *Tax Exemption.*

Event (h). The Authority 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 "Description of the 1998 Bonds -- Redemption Provisions -- Mandatory Redemption" under *The 1998 Bonds*, (ii) the only open issue is which 1998 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 1998 Bonds and the 1998 Resolution, 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 purchases of 1998 Bonds.

The Commonwealth expects to provide the information described in clause (1) above by delivering its first bond official statement that includes its financial statements for the preceding fiscal year or, if no such official statement is issued by the 305-day deadline, by delivering its Comprehensive Annual Financial Report by such deadline and a supplemental report containing other information to the extent necessary to provide the information described in paragraph 1 by such deadline.

As of February 26, 1998, there is no Commonwealth SID, and the nationally recognized municipal securities information repositories are: Bloomberg Municipal Repository, P.O. Box 840, Princeton, New Jersey 08542-0840; Kenny Information Systems, Inc., Attn: Kenny Repository Service, 65 Broadway, New York, New York 10006; Thomson NRMSIR, 395 Hudson Street, New York, New York 10004, Attn: Municipal Disclosure; and DPC Data Inc., One Executive Drive, Fort Lee, New Jersey 07024.

The Authority may from time to time choose to provide notice of the occurrence of certain other events in addition to those listed above if, in the judgment of the Authority, such other events are material with respect to the 1998

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

The Commonwealth and the Authority acknowledge that their respective undertakings pursuant to the Rule described above are intended to be for the benefit of the Beneficial Owners of the 1998 Bonds, and shall be enforceable by any such Beneficial Owners; provided that the right to enforce the provisions of their respective undertakings shall be limited to a right to obtain specific enforcement of the Authority's or the Commonwealth's obligations hereunder.

No Beneficial Owner may institute any suit, action or proceeding at law or in equity ("Proceeding") for the enforcement of the foregoing covenants (the "Covenants") or for any remedy for breach thereof, unless such beneficial owner shall have filed with the Authority and the Commonwealth written notice of any request to cure such breach, and the Authority or the Commonwealth, as applicable, shall have refused to comply within a reasonable time. All Proceedings shall be instituted only in a Commonwealth court located in the Municipality of San Juan for the equal benefit of all beneficial owners of the outstanding 1998 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 Sections 2 and 2A 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 Authority or 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 1998 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 parties unaffiliated with the Authority or 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 Authority or the Commonwealth, as applicable, elects that the Covenants shall be deemed amended accordingly.

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

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

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

MISCELLANEOUS

The foregoing references to and summaries of certain provisions of the 1968 Resolution, 1998 Resolution, the various acts and the 1998 Bonds 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.

There are appended to this Official Statement certain information concerning the Commonwealth *(Appendix I)*, the audited financial statements of the Authority for the fiscal year ended June 30, 1997 with comparative totals for the fiscal year ended June 30, 1996, together with the report of Ernst & Young LLP *(Appendix II)*, the letter of the Traffic

Engineers *(Appendix III)*, the proposed form of opinion of Bond Counsel *(Appendix IV)*, a specimen of the Ambac Bond Insurance Policy *(Appendix V)*, and the Table of Accreted Values *(Appendix VI)*.

This Official Statement incorporates by reference the general purpose financial statements of the Commonwealth for the fiscal year ended June 30, 1997, together with the independent auditor's report thereon, dated December 15, 1997, of Deloitte & Touche LLP, certified public accountants (the "Commonwealth Financial Statements"),which have been filed by the Commonwealth with each NRMSIR as part of the Comprehensive Annual Financial Report of the Commonwealth for the fiscal year ended June 30, 1997 contained in *Appendix II* to the Official Statement of the Commonwealth, dated January 15, 1998, relating to the sale of $503,963,264.10 Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 1998 (General Obligation Bonds).

Any appendix of an Official Statement of the Commonwealth or of any instrumentality of the Commonwealth filed with each NRMSIR and the MSRB or any other document containing the Commonwealth Financial Statements filed with each NRMSIR after the date hereof and prior to the termination of the offering of the 1998 Bonds shall be deemed to be incorporated by reference into this Official Statement and to be part of this Official Statement from the date of filing of such document. Any statement contained herein or in any of the above described documents incorporated herein by reference shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other 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 Financial Statements so incorporated herein by reference. Requests for such document should be directed to Director-New York Office, Government Development Bank for Puerto Rico, 140 Broadway, 38th Floor, New York, N.Y. 10005, telephone number (212) 422-6420, or to Director-General Obligations Division, Government Development Bank for Puerto Rico, P.O. Box 42001, Santurce, PR 00940, telephone number (787) 722-7060.

A copy of the Commonwealth Financial Statements may be obtained by contacting a NRMSIR. The address of each NRMSIR is set forth in *Continuing Disclosure* above.

The financial statements of the Authority included in *Appendix II* and the Commonwealth Financial Statements have been audited by Ernst & Young LLP and Deloitte & Touche LLP, San Juan, Puerto Rico, respectively, as set forth in their respective reports therein. The information set forth in *Appendix I* 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 in this Official Statement on the authority of such officials or the authority of such publications as public official documents, respectively. The information pertaining to DTC was supplied by DTC. The information in "Bond Insurance" under *The 1998 Bonds* and *Appendix VI* was supplied by Ambac Assurance. The remaining information set forth in this Official Statement, except the information appearing in *Underwriting*, in *Appendices I* and *IV*, and the Commonwealth Financial Statements, was supplied by the Executive Director of the Authority in his official capacity as such Executive Director and is included in this Official Statement on his authority.

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

PUERTO RICO HIGHWAY AND
TRANSPORTATION AUTHORITY

By: /s/ Sergio González
Executive Director

[This page intentionally left blank]

COMMONWEALTH OF PUERTO RICO

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 approximately 3,522,000 in 1990, compared to 3,196,520 in 1980. According to estimates of the Planning Board, the population of Puerto Rico increased to 3,770,000 in fiscal 1997. As of 1990, the population of San Juan, the island's capital and largest city, was approximately 437,000.

Relationship with the United States

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

Puerto Rico came under United States sovereignty pursuant to the Treaty of Paris, signed on December 10, 1898, which ended the Spanish-American War. Puerto Ricans became citizens of the United States in 1917, with the approval of the Jones Act by the United States Congress. In 1950, after a long evolution toward greater self-government, Congress enacted Public Law 600 which provided that the existing political, economic, and fiscal relationship between Puerto Rico and the United States would remain the same, but Puerto Rico would be authorized to draft and approve its own Constitution, guaranteeing a republican form of government. The Constitution was drafted by a popularly elected constitutional convention, approved in a special referendum by the people of Puerto Rico, amended and ratified by the United States Congress, and subsequently approved by the President of the United States. Puerto Rico's constitutional status is that of a territory of the United States, and pursuant to the territorial clause of the Federal Constitution, the ultimate source of power over Puerto Rico is the United States Congress. The relationship between the United States and Puerto Rico is referred to herein as commonwealth status.

Puerto Rico exercises virtually the same control over its internal affairs as do the fifty states; however, it differs from the states 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 and limited voting power. Most federal taxes, except those such as Social Security taxes, 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. Income earned by Puerto Rico residents from sources outside of Puerto Rico, however, is subject to federal income tax. Federal excise taxes on shipments of alcoholic beverages from Puerto Rico and other rum producing countries (which are at $11.30 per gallon through October 1, 1998, and thereafter at $10.50 per gallon) and other taxes on shipments of tobacco products from Puerto Rico to the mainland are returned to the Treasury of Puerto Rico.

The official languages of Puerto Rico are Spanish and English. Although the culture of Puerto Rico is mostly Hispanic, a considerable intermingling of Hispanic and United States cultures has occurred.

On February 26, 1997 legislation was introduced in the U.S. House of Representatives (the "Political Status Act") proposing a mechanism to settle permanently the political relationship between Puerto Rico and the United States, either through full self-government (e.g., statehood or independence, including, as an alternative, free association via a bilateral treaty) or continued commonwealth status. Under the proposed legislation, failure to settle on full self-government after completion of the referenda process provided therein would result in retention of the current commonwealth status. On March 19, 1997, similar legislation was introduced in the U.S. Senate. The House Resources Committee held hearings and voted in favor of the Political Status Act. It is expected that the Political Status Act will be voted on by the full

House of Representatives sometime in early 1998. It is not possible at this time to predict, however, whether the Act will be approved, what course the legislation will follow in the Senate, and whether it will be subsequently enacted into law.

Governmental Structure

The Constitution of the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico") 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. Decisions of the Supreme Court of Puerto Rico may be appealed to the Supreme Court of the United States under the same terms and conditions as decisions from state courts. 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 Puerto Rico 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.

Pedro Rosselló was sworn in as Governor of Puerto Rico on January 2, 1993. He was re-elected for a second four year term in the November 1996 elections and sworn in again as Governor of Puerto Rico on January 2, 1997. He obtained a medical degree from Yale University in 1970, after completing his undergraduate studies at Notre Dame University in 1966. He specialized in General and Pediatric Surgery at Harvard University. In 1985, he was appointed Director of San Juan's Health Department, a position which he held for three years. As a member of the New Progressive Party, he was the party's candidate for Resident Commissioner to the United States Congress in 1988. In 1991, he was elected President of the New Progressive Party.

Xenia Vélez Silva, Secretary of the Treasury, took office on November 20, 1997. 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. Prior to her appointment, she was a partner in a San Juan law firm specializing in tax law.

Jorge E. Aponte Hernández, Director of the Office of Management and Budget, took office in January 1993. In November 1996, he was re-appointed by the Governor to continue in his position. He is a certified public accountant and a graduate of the University of Puerto Rico, where he obtained a bachelor's degree in Business Administration and Accounting. Prior to his appointment, he worked for twenty years as an accountant and auditor for various accounting firms.

Marcos Rodríguez-Ema, President of Government Development Bank for Puerto Rico ("Government Development Bank" or "GDB"), took office in January 1993. In November 1996, he was re-appointed by the Governor to continue in his position. He is a lawyer and a graduate of Georgetown University, where he obtained a Juris Doctor degree after completing his bachelor of science degree in foreign service. Prior to his appointment, he worked for five years as a lawyer in a San Juan law firm and for six years as an investment banker for two major securities firms.

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 statehood, represented by the New Progressive Party, and the other favoring the existing commonwealth status, represented by the Popular Democratic 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 statehood, commonwealth status, 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.

	1980	1984	1988	1992	1996
New Progressive Party	47.3%	45.5%	45.8%	49.9%	51.1%
Popular Democratic Party	47.0	48.5	48.7	45.9	44.5
Puerto Rico Independence Party	5.4	3.9	5.4	4.2	3.8
Others	0.3	2.1	0.1	--	0.6

With the results of the 1996 election, control of the executive and legislative branches continued under the New Progressive Party. The composition of the Senate and House by the several political parties is as follows:

	Senate	House
New Progressive Party	19	37
Popular Democratic Party	8	16
Puerto Rico Independence Party	1	1
	28	54

The next general election (gubernatorial, municipal, and legislative) in Puerto Rico will be held in November 2000. Voter participation in Puerto Rico is substantially higher than in the United States, averaging 85% since 1972.

THE ECONOMY

General

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

The economy of Puerto Rico is fully integrated with that of the United States mainland. During fiscal 1997, approximately 88% of Puerto Rico's exports went to the United States mainland, which was also the source of approximately 62% of Puerto Rico's imports. In fiscal 1997, Puerto Rico experienced a $2.7 billion positive adjusted merchandise trade balance.

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

Fiscal 1993 to 1997

Puerto Rico's more than decade-long economic expansion continued throughout the five-year period from fiscal 1993 through fiscal 1997. Almost every sector of the economy participated and record levels of employment were achieved. Factors behind this expansion included government-sponsored economic development programs, periodic declines in the exchange value of the United States dollar, increases in the level of federal transfers, and the relatively low cost of borrowing.

Gross product in fiscal 1993 was $25.1 billion ($24.5 billion in 1992 prices) and gross product in fiscal 1997 was $32.1 billion ($27.7 billion in 1992 prices). This represents an increase in gross product of 27.7% from fiscal 1993 to 1997 (13.0% in 1992 prices).

Since fiscal 1985, personal income, both aggregate and per capita, has increased consistently each fiscal year. In fiscal 1997, aggregate personal income was $32.1 billion ($30.0 billion in 1992 prices) and personal income per capita was $8,509 ($7,957 in 1992 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 1997 were $7.3 billion, of which $5.2 billion, or 71.2%, 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.

Average employment increased from 999,000 in fiscal 1993, to 1,128,300 in fiscal 1997. Average unemployment decreased from 16.8% in fiscal 1993, to 13.1% in fiscal 1997.

The following table shows the gross product for the five fiscal years ended June 30, 1997.

Puerto Rico

Gross Product

	Fiscal Year Ended June 30,				
	1993	1994	1995	1996	1997(p)
Gross product — $ millions	$25,133	$26,641	$28,452	$30,331	$32,102
Real gross product — $ millions (1992 prices)	24,483	25,103	25,968	26,827	27,673
Annual percentage increase in real gross product (1992 prices)	3.3%	2.5%	3.4%	3.3%	3.1%
U.S. annual percentage increase in real gross product (1992 prices)(1)	2.8%	2.6%	2.7%	2.1%	3.2%

(p) Preliminary.
(1) Restated to correspond to Puerto Rico's fiscal year ending June 30.

Sources: Planning Board and Data Resources Inc.

Since the 1950's 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 in conjunction with the release of the new data each year. At present, all macroeconomic accounts for fiscal 1997 are preliminary until the revised figures are released.

Fiscal 1998

According to the Labor Department's Household Employment Survey, during the first six months of fiscal 1998, total employment increased 0.7% over the same period in fiscal 1997. Total employment averaged 1,130,500 during the first six months of fiscal 1998, compared to 1,123,000 in the same period of fiscal 1997. The seasonally adjusted unemployment rate for December 1997 was 14.6%.

The Planning Board's gross product forecast for fiscal 1998, made in February 1997, projected an increase of 3.0% over fiscal 1997.

Economic Development Program - New Economic Model

Governor Rosselló's administration has developed and is implementing a new economic development program which is based on the premise that the private sector should provide the primary impetus for economic development and growth. This new program, referred to as the New Economic Model, promotes changing the role of the government from one of a provider of most basic services, to that of a facilitator for private sector initiatives, and encourages private sector investment by reducing government-imposed regulatory constraints.

The New Economic Model contemplates the development of initiatives that will foster private investment in, and private management of, sectors that are served more efficiently and effectively by private enterprise. One of the initiatives that has already been implemented is the adoption of a new tax code intended to expand the tax base, reduce top personal and corporate tax rates and simplify the tax system. Another initiative consists of improving and expanding Puerto Rico's infrastructure to facilitate private sector development and growth, such as the construction of the water pipeline and cogeneration facilities described below and the construction of a light rail system for the San Juan metropolitan area.

The New Economic Model seeks to identify and promote those areas in which Puerto Rico can compete more effectively in the global markets. In this regard, tourism has been targeted as a priority because of its potential for job creation and increased contribution to the gross product stemming from Puerto Rico's natural competitive advantage. As part of the initiatives directed at promoting the tourism sector, in 1993 a new Tourism Incentives Act was enacted providing special tax incentives for the development of new hotel projects. See "Tax Incentives" below. Also, in November 1993, the Tourism Development Fund was created for the purpose of promoting capital investments in and providing financing to entities that contribute to the development of the tourism industry. As a result of these initiatives, several new hotels have been constructed or are in the process of being constructed, increasing the number of total rooms on the island from 8,415 at the end of fiscal 1992 to 10,877 at the end of fiscal 1997 and to a projected 11,972 by the end of fiscal 1998. Similar tax incentives have been enacted in other areas targeted by the New Economic Model as areas of opportunity for the promotion of local and foreign investment in Puerto Rico, such as agriculture, solid waste management and venture capital.

The New Economic Model also seeks to reduce the size of government's direct contribution to gross domestic product. As part of this goal, the Government has transferred certain governmental operations and sold a number of its assets to private parties. On March 3, 1995, the Government completed the sale of the assets of the Maritime Shipping Authority to a private purchaser. On May 26, 1995, the Aqueduct and Sewer Authority executed a five-year agreement pursuant to which the management, operation, repair, and maintenance of the Authority's water and waste water treatment systems is being provided by a private company. On January 31, 1996, the Aqueduct and Sewer Authority executed a construction and operating agreement with a private consortium for the design, construction, and operation of an approximately 75 million gallon per day pipeline to deliver water to the San Juan metropolitan area from Dos Bocas reservoir in Utuado. The Electric Power Authority has entered into power purchase agreements with private power producers under which two cogenerating plants (with a total capacity of approximately 874 megawatts) using fuels other than oil will be constructed, operated and owned by these producers. The Administration of Corrections has entered into operating agreements with two private companies whereby three new correctional facilities are being operated by these companies. In 1995, the Government entered into a definitive agreement to sell to private companies certain assets of the pineapple juice processing business formerly operated by the Land Authority and sold certain government owned mango growing operations. The Government is currently in the process of transferring to local sugar cane growers the sugar processing facilities operated by the Sugar Corporation. The Government has also sold two hotel properties formerly owned by a subsidiary of the Tourism Company and is currently negotiating the sale of a complex consisting of two hotels and a convention center to a Florida-based corporation. On April 7, 1997, Governor Rosselló announced the Government's intention to sell the Puerto Rico Telephone Company ("PRTC"), a subsidiary of the Telephone Authority. Legislation authorizing the Government to negotiate the sale of PRTC has been approved and the Government is currently conducting the sale process.

One of the goals of the Rosselló administration is to change Puerto Rico's public health care system from one in which the government provides free health services to low income individuals through public health facilities owned and administered by the government to one in which all medical services are provided by the private sector and the government provides comprehensive health insurance coverage for qualifying (generally low income) Puerto Rico residents. Under this new 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. This new health insurance system is now covering 61 municipalities out of a total of 78 on the island. It is expected that 11 municipalities will be added by the end of fiscal 1998 and 5 more by the end of fiscal 1999. The total cost of this program will depend on the number of municipalities included in the program, the number of participants receiving coverage, and the date coverage commences. As of June 30, 1997, over 1.1 million persons were participating in the program at an estimated annual cost to the General Fund of Puerto Rico for fiscal 1997 of approximately $521 million. In conjunction with this program, the operation of certain public health facilities has been transferred to private entities. The Government's current privatization plan for health facilities provides for the transfer of ownership of all health facilities to private entities. The Government has sold five health facilities to private companies and is currently in negotiations with other private companies for the sale of twelve health facilities to such companies.

Employment and Unemployment

The number of persons employed in Puerto Rico during fiscal 1997 averaged 1,128,300. Unemployment, although at relatively low historical levels, remains above the average for the United States.

The following table presents annual statistics of employment and unemployment from fiscal 1993 through fiscal 1997 and monthly statistics for July 1997 to December 1997.

Puerto Rico

Employment and Unemployment

Fiscal Years Ended June 30	Labor Force(1)	Employed(1)	Unemployed(1)	Unemployment Rate(2)
		(Annual Average)		
1993	1,201	999	202	16.8%
1994	1,204	1,011	193	15.9
1995	1,219	1,051	168	13.8
1996	1,268	1,092	175	13.8
1997	1,298	1,128	170	13.1
Fiscal 1998		(Seasonally Adjusted)		
July	1,309	1,125	184	14.1%
August	1,314	1,141	173	13.2
September	1,337	1,162	175	13.1
October	1,303	1,126	177	13.6
November	1,316	1,132	184	14.0
December	1,298	1,108	190	14.6

(1) Thousands of persons age 16 years 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 1993 and 1997, 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, 1997.

Puerto Rico

Gross Domestic Product by Sector and Gross Product
(in millions at current prices)

	Fiscal Year Ended June 30				
	1993	1994	1995	1996	1997(p)
Manufacturing	$15,428	$16,748	$17,867	$19,040	$19,797
Services(1)	14,109	15,214	16,443	17,450	18,365
Government(2)	3,881	3,987	4,440	4,841	5,220
Transportation, communication and public utilities	3,009	3,134	3,276	3,557	3,726
Agriculture, forestry and fisheries	411	369	318	375	368
Construction (3)	874	928	1,005	1,095	1,217
Statistical discrepancy	(789)	(689)	(703)	(846)	(591)
Total gross domestic product(4)	36,923	39,691	42,647	45,511	48,102
Less: net payment abroad	11,790	13,050	14,195	15,180	16,000
Total gross product(4)	$25,133	$26,641	$28,452	$30,331	$32,102

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

Source: Planning Board

The following table presents annual statistics of average employment by sector for the five fiscal years ended June 30, 1997.

Puerto Rico

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

	Fiscal Year ended June 30				
	1993	1994	1995	1996	1997
Manufacturing	168	166	172	167	162
Services(1)	467	478	496	527	550
Government(2)	217	224	232	246	261
Transportation, communication and public utilities	54	55	60	61	59
Construction(3)	59	54	57	59	65
Agriculture, forestry and fisheries	34	34	34	32	31
Total(4)	999	1,011	1,051	1,092	1,128

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

Source: Department of Labor and Human Resources — Household Survey.

Manufacturing

Manufacturing is the largest sector in the economy of Puerto Rico, in terms of gross domestic product. The Planning Board estimates that in fiscal 1997 manufacturing generated $19.8 billion, or 41.2% of gross domestic product. The manufacturing sector employed 153,273 workers as of March 1997 (as reported in the Department of Labor and Human Resources — Monthly Survey on Employment Hours and Earnings). Most of the island's manufacturing output is shipped to the United States mainland, which is also the principal source of semifinished manufactured articles on which further manufacturing operations are performed in Puerto Rico. The United States minimum wage laws are applicable in Puerto Rico. As of March 1997 the average hourly manufacturing wage rate in Puerto Rico was 61% 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 two decades, industrial development has tended to be more capital intensive and more dependent on skilled labor. This gradual shift in emphasis is best exemplified by the heavy investment in pharmaceuticals, scientific instruments, computers, microprocessors, medical products, and electrical products industries over the last decade.

The following table sets forth gross domestic product by manufacturing sector for the five fiscal years ended June 30, 1996.

Puerto Rico

Gross Domestic Product by Manufacturing Sector
(in millions at current prices)

	Fiscal Year Ended June 30				
	1992	1993	1994	1995	1996(p)
Pharmaceuticals	$6,460	$7,249	$8,229	$8,905	$9,214
Machinery and metal products	2,935	3,226	3,310	3,449	4,046
Food products	2,413	2,456	2,694	2,742	2,775
Apparel	536	548	504	603	607
Other(1)	1,840	1,949	2,010	2,164	2,219
Total gross domestic product of manufacturing sector(2)	$14,183	$15,428	$16,748	$17,863	$18,861

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

Source: Planning Board.

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

Puerto Rico

Manufacturing Employment by Industry Group
(persons age 16 years and over)

Industry Group	As of March 31, 1993	1994	1995	1996	1997
Apparel and related products	29,018	25,213	26,034	23,918	21,750
Food and related products	20,608	20,471	20,882	20,343	19,949
Electrical machinery, equipment and supplies	17,721	19,676	22,928	23,464	24,671
Chemicals and related products (includes pharmaceuticals)	26,141	27,174	28,104	28,047	27,235
Professional and scientific instruments	16,437	15,495	14,390	15,131	14,914
Machinery, except electrical equipment	4,241	4,262	2,612	3,824	3,755
Petroleum refining and related industries; rubber and miscellaneous plastic products	5,294	5,593	4,983	5,268	5,768
Leather and leather products	7,196	7,260	7,282	6,636	6,566
Paper and related products; printing, publishing and related industries	5,944	6,118	6,628	7,184	7,441
Metal products	4,632	4,648	4,740	5,157	5,683
Stone, clay and glass products	4,465	4,716	4,708	4,825	4,972
Lumber and wood products; furniture and fixtures	2,882	2,927	2,894	3,183	3,352
Textile mill products	3,876	3,503	3,403	3,841	3,627
Tobacco products	850	763	953	989	1,206
Miscellaneous manufacturing industries	2,223	2,443	3,069	2,134	2,384
Total	151,528	150,262	153,610	153,944	153,273

Sources: Department of Labor and Human Resources — Census of Manufacturing, except for the March 1995 to 1997 which were derived from the "Monthly Survey on Employment, Hours and Earnings."

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

Company	Product
Employment 2,500 and over	
American Home Products	Pharmaceuticals
Baxter International	Pharmaceuticals
Eaton Corp.	Electronic Instruments
General Electric Co.	Electrical Instruments
H. J. Heinz Co.	Food
Johnson and Johnson	Pharmaceuticals
Sara Lee Corp.	Apparel
Employment 1,500 to 2,499	
Abbott Laboratories, Inc.	Pharmaceuticals
Bristol-Myers Squibb	Pharmaceuticals
Hewlett-Packard	Computers
Intel	Computers
Merck & Co.	Chemicals
Unicord Co. LTD	Food
Warner-Lambert Co.	Pharmaceuticals
Employment 1,000 to 1,499	
Dexter Shoe	Footwear
Hampshire Designers Group	Textiles
Hubbell Incorporated	Electrical Instruments
Motorola, Inc.	Electronic Components
P.L. Industries, Inc.	Apparel
Pfizer	Pharmaceuticals
Schering-Plough Corp.	Pharmaceuticals
Sensormatic Electronics	Electronic Instruments
Employment 500 to 999	
Allergan	Pharmaceuticals
Angles Dairy Management	Dairy Products
Aramark	Apparel
Atlantron, Inc.	Communications
Avon Products Inc.	Costume Jewelry
B.Braun Medical Systems	Medical Equipment
Becton-Dickinson & Co.	Scientific Instruments
Checkpoint Systems, Inc.	Electronic
Coachman Inc.	Apparel
Coleman Co.	Luggage
Conagra	Food
DSC Communication Corp.	Communication Equipments
Dooney & Bourke	Leather
DuPont (E.I.) de Nemours	Chemicals
Echlin Mfg.	Motor Vehicles Parts
Eli Lilly and Co.	Pharmaceuticals
General Instruments Corp.	Communications
H.H. Brown Shoes Co., Inc.	Footwear
Ingersoll-Rand Co.	Electrical Instruments
Insilco Corporation	Office Equipment
Isla Verde Investment	Apparel
MacAndrews & Forbes Holdings	Tobacco Products
Maidenform	Apparel
Medtronics	Surgical and Medical Instruments
Monsanto	Pharmaceuticals
Nycomed ASA	Pharmaceuticals
Owens Illinois	Glass and Plastics
Penn-State Coats & Aprons	Apparel
Pharmacia Up-John Co.	Pharmaceuticals
Phillips Van-Heusen	Apparel and Footwear
Propper International	Apparel
R.J.R. Nabisco	Food and Cigarettes
Seaboard Fluor Corp.	Food
SmithKline Beecham	Pharmaceuticals
Storage Technology	Electronics
Thomas & Betts	Electrical Instruments
Timberland Company (The)	Leather
U.S. Surgical	Scientific Instruments
Wolverine World Wide	Footwear
Employment 300 to 499	
AMP Incorporated	Electronic Connectors
Amgen Manufacturing Co.	Pharmaceuticals
Block Drug Co.	Consumers Products
Carnival Creations	Apparel
Carolina Underwear Co.	Apparel
Centennial	Communications
Coca-Cola Company (The)	Food
Colgate-Palmolive Co.	Consumers Products
Collin & Aikman Group, Inc.	Stockings
Eagle Work Clothes	Apparel
Eastern Canvas Products	Leather
Emerson Electric	Electronic and Scientific Instruments
Esco Manufacturing Co.	Structural Steel
Goya Foods	Food
Granada Sales	Apparel
Lawson Mardon Wheaton	Glass and Plastics
Loctite Corp.	Chemicals
Millipore Corp.	Scientific Instruments
Nestle S.A.	Pharmaceuticals
Nypro	Medical Devices
Ocular Science-American Hydron	Ophthalmic Products
Packaging Coordinators Inc.	Packaging Products
Pall Corp.	Filters
Phillips Petroleum Co.	Petroleum Products
Procter & Gamble Co.	Pharmaceuticals
Productos del Trópico	Food
R.E. Phelon & Co.	Electronics
Randa Corporation	Textiles
Siecor Corp.	Optic Fibers
Siemens AG	Electrical Instruments
Standard Motor Products	Motor Vehicles Parts
Stryker Corp.	Surgical and Medical Instruments
Sundstrand Corp.	Electrical Instruments
Syntex Corp.	Pharmaceuticals
Unifirst Corp.	Work Garment
Unilever PLC	Consumers & Medicals
Wesley Jessen Corp.	Ophthalmic Products
Zeneca Group PLC	Pharmaceuticals

Source: Economic Development Administration, Office of Economic Research (as of January 1998).

Services

Puerto Rico has experienced significant growth in the services sector 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 1993 and 1997, the gross domestic product in the services sector increased at an annual average rate of 5.4%. Employment in this sector (including finance, insurance, real estate, wholesale and retail trade, hotels and related services and other services) increased at an annual average rate of 3.3% during the period between fiscal 1993 and 1997. The development of the services sector in the local economy has shown a strong interaction among the following important sectors: manufacturing, tourism, construction, and agriculture. The services sector in Puerto Rico has a diversified base.

The high degree of knowledge, skills, and expertise in professional and technical services available in Puerto Rico places the island in a favorable competitive position with respect to Latin America and other trading countries throughout the world. A major element in the economic program of the present administration is the further development of the local services sector which has the capacity to increase its export potential and to generate more income and jobs during the coming years.

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 1997, services generated $18.4 billion of gross domestic product, or 38.2% of the total. Service employment grew from 467,000 in fiscal 1993 to 551,000 in fiscal 1997, a cumulative increase of 17.8%, which increase was greater than the 12.9% cumulative growth in total employment over the same period. Wholesale and retail trade and finance, insurance and real estate have experienced significant growth in the fiscal 1993 to 1997 period, as measured by gross domestic product. Gross domestic product in the wholesale and retail trade increased from $5.3 billion in fiscal 1993 to $6.5 billion in fiscal 1997. In finance, insurance and real estate, gross domestic product increased from $4.9 billion in fiscal 1993 to $6.5 billion in fiscal 1997. There are 20 commercial banks and trust companies currently operating in Puerto Rico of which two are U.S. major money center banks, four are foreign banks and fifteen are local banks and trust companies. Total assets of these institutions as of June 30, 1997 were $34.7 billion. In addition, two federal thrift institutions and six major securities firms operate on the island.

The following tables set forth gross domestic product and services sector employment for the five fiscal years ended June 30, 1997.

Puerto Rico

Gross Domestic Product by Services Sector
(in millions at current prices)

	Fiscal Year Ended June 30				
	1993	**1994**	**1995**	**1996**	**1997(p)**
Wholesale and retail trade	$5,303	$5,635	$5,989	$6,290	$ 6,495
Finance, insurance and real estate	4,897	5,246	5,730	6,084	6,522
Hotels(1)	373	432	478	514	538
Other services(1)	3,536	3,901	4,246	4,562	4,810
Total(2)	$14,109	$15,214	$16,443	$17,450	$18,365

(p) Preliminary.
(1) Figures for fiscal years 1995 to 1997 are estimated.
(2) Totals may not add due to rounding.

Source: Planning Board.

Puerto Rico

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

	Fiscal Year Ended June 30				
	1993	1994	1995	1996	1997
Wholesale and retail trade	201	201	211	218	228
Finance, insurance and real estate	32	33	36	39	37
Other services(1)	234	244	249	270	285
Total(2)	467	478	496	527	550

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

Source: Department of Labor and Human Resources — Household Survey.

Hotels and Related Services - Tourism

Total visitors' expenditures accounted for 6.4% of the island's gross product in fiscal 1997. Visitors' expenditures and the number of visitors to the island have grown consistently since 1985, reaching $2.0 billion, and more than 4.3 million, respectively, in fiscal 1997. During fiscal 1997, the number of persons which registered in tourist hotels was 1,260,616, a 4.3% increase compared with fiscal 1996. The average occupancy rate in tourist hotels was 73.2% in fiscal 1997. The average number of rooms rented in tourist hotels increased 6.2% in fiscal 1997, compared with fiscal 1996. These increases are due in part to the increased marketing by the Government of Puerto Rico, the trends in the U.S. economy and increased hotel usage by Puerto Rico residents. Since fiscal 1992, a number of major hotels have undergone substantial renovation and more than 3,073 new rooms have been added with the opening of several major hotels. Various international hotel corporations have recently made substantial capital investments to develop additional tourist facilities. At June 30, 1997, the number of total rooms was 10,877 and is expected to increase to 11,972 during fiscal 1998 with the completion of several new hotels. A major reason for this increase in rooms has been the initiatives of the New Economic Model that encourage private development in tourism projects. See "Economic Development Program—New Economic Model" above and "Tax Incentives" below. During the first six months of fiscal 1998, the number of persons registered in tourist hotels totaled 648,100, a 7.9% increase compared with the same period in fiscal 1997. In the first six months of fiscal 1998, the average occupancy rate in tourist hotels was 68.0%. The average number of tourist hotel rooms available in December was 8,192.

San Juan has become the largest home port for cruise ships in the Caribbean and the second largest home port 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, 1997.

Puerto Rico

Tourism Data

	Number of Visitors				
Fiscal Year Ended June 30	Tourist Hotel(1)	Cruise Ship	Other(2)	Total	Total Visitors' Expenditures (in millions)
1993	688,509	1,014,490	2,165,959	3,868,958	$1,628.1
1994	702,310	980,220	2,340,065	4,022,595	1,728.3
1995	774,040	955,917	2,356,622	4,086,579	1,827.1
1996	828,251	1,045,104	2,336,805	4,110,160	1,898.3
1997(p)	906,706	1,107,913	2,335,068	4,349,687	2,046.3

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

Sources: Puerto Rico Tourism Company and the Planning Board.

Government

The government sector of Puerto Rico plays an important role in the economy. In fiscal 1997, government accounted for $5.2 billion of Puerto Rico's gross domestic product, or 10.9% of the total. The government is also a significant employer, providing jobs for 261,000 workers, or 23.1% of total employment in fiscal 1997. The government sector employment does not include data relating to public corporations which are included in other sectors. These public corporations include significant employers such as the Electric Power Authority, the Telephone Authority, and the Aqueduct and Sewer Authority.

On February 25, 1998, the Governor signed into law Act No. 45, which permits the unionization of government employees (excluding municipal employees). Under this law, government employees have collective bargaining rights subject to a number of limitations. Among those limitations are: employees cannot go on strike; annual salary increases are limited; employees cannot be required to become union members and pay quotas; and collective bargaining negotiations cannot occur in an election year. Negotiations of non-economic conditions with government employees pursuant to this bill will commence in the year 2000 and negotiations of economic conditions will commence in 2001.

Transportation

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

The Luis Muñoz Marín International Airport is currently served by 24 United States and international airlines. At present, there is daily direct service between San Juan and New York, Chicago, Dallas, Los Angeles, Miami, Atlanta, Boston, and numerous other destinations within the United States. There is also regularly scheduled service between Puerto Rico and other Caribbean islands and major Latin American and European cities. a major United States airline uses San Juan as a hub for its intra-Caribbean 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, 1997, totaled approximately 4,600 miles.

Construction

The construction industry has experienced substantial real growth since fiscal 1987. In fiscal 1997, investment in construction rose to an unprecedented level of $4.7 billion, a nominal increase of 14.7%, as compared to $4.1 billion for fiscal 1996. The strong growth in the construction industry resulted from increased public and private investment in the past few years. Nominal public investment in key infrastructure projects increased 19.4% in fiscal 1997 and 33.0% in fiscal 1996. Private construction investment, particularly in housing and hotels, increased 8.8% in fiscal 1997 and 17.9% in fiscal 1996. During fiscal 1997, the total value of construction permits increased 19.0% and local cement consumption increased 7.2% in comparison with fiscal 1996. The Planning Board's construction investment forecast for fiscal 1998, made in July 1997, projected a nominal increase of 21.1%. In fiscal 1997, the average employment in the construction sector was 64,401, an increase of 9.4% over fiscal 1996. During the first six months of fiscal 1998, cement sales increased 9.5% in comparison with the same period in fiscal 1997. In the first six months of fiscal 1998, the average employment in the construction sector was 68,168.

Agriculture

The Department of Agriculture and related agencies have directed their efforts at increasing and improving local agricultural production, increasing efficiency and quality of produce, and stimulating import substitution where economically feasible. During fiscal 1997, gross income from agriculture was $694.7 million, an increase of $29.9 million in comparison with fiscal 1996. Agriculture gross income consists of the total value of production in the principal agricultural sectors, which include traditional crops, cattle products, farinaceous, vegetables, fruits, and other products. Recently, cattle products, non-traditional crops, and livestock products have contributed a higher percentage of the sector's income.

The Government of Puerto Rico supports agricultural activities through incentives, subsidies, and technical and support services, in addition to income tax exemptions for qualified income derived by bona fide farmers. Act No. 225, approved on December 1, 1995, increased the tax benefits available to bona fide farmers. The Act provides a 90% income tax exemption for income derived from agricultural operations, an investment tax credit equal to 50% of the investment in qualified agricultural projects, and a 100% exemption from excise taxes, real and personal property taxes, municipal license taxes and tariff payments. It also provides full income tax exemption for interest income from bonds, notes and other debt instruments to be issued by financial institutions to provide financing to agricultural businesses. Recent legislation imposes an aggregate annual limitation of $15 million on the investment tax credits available under Act No. 225.

As part of the programs embodied in the New Economic Model, the Government of Puerto Rico has sold or has entered into a definitive agreement to sell to private entities various agricultural operations previously conducted by governmental entities. These include certain assets of the pineapple processing operation and a mango growing facility. Currently, the Government is in the process of transferring the sugar processing facilities of the Sugar Corporation to local private sugar cane growers.

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 1950's and 1960's from an agricultural economy to an industrial economy brought about an increased demand for educational services at all levels. During the 1970's and 1980's, 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, in general, and, in particular, 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. After the 1980's, college attendance has remained relatively stable as a percentage of the college age population, generally following the trend in the United States.

The University of Puerto Rico, the only public university in Puerto Rico, includes eleven campuses located throughout the island. Total enrollment of the University was 68,020 students during academic year 1997-1998. The government of Puerto Rico is legally bound to appropriate annually to the University an amount equal to 9.60% of the average annual revenue from internal sources for each of the two fiscal years immediately preceding the current fiscal year.

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.

Trend in College Enrollment

	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	57,340	16.8%	23,714,000	8,580,887	36.2%
1980	397,839	130,105	32.7	30,022,000	12,096,895	40.3
1990	417,636	156,147	37.4	26,950,000	13,820,000	51.3
1994	444,252	161,689	36.4	25,289,000	14,279,000	56.5
1995	453,476	167,172	36.9	24,932,000	14,209,000	57.0
1996	454,055	171,548	37.8	24,616,000	14,399,000	58.5

(1) Number of persons of all ages enrolled in institutions of higher education as percent of population 18-24 years of age.

Sources: Planning Board, U.S. Bureau of the Census, U.S. National Center for Education Statistics and Council on Higher Education of Puerto Rico.

In addition to the University of Puerto Rico, there are 37 private institutions of higher education located in Puerto Rico. Such institutions have current enrollment in excess of 109,180 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 assisting 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 Sections 30A and 936 of the Internal Revenue Code of 1986, as amended (the "Code"). New tax and other incentives have 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 Act No. 135 of December 2, 1997 (the "1998 Tax Incentives Law"), a new industrial incentives law aimed at attracting and retaining foreign investment in Puerto Rico.

The benefits provided by the 1998 Tax Incentives Law are available to new companies as well as companies currently conducting tax exempt operations in Puerto Rico which choose to renegotiate their existing tax exemption grant. The activities eligible for tax exemption include manufacturing, certain designated services performed for markets outside Puerto Rico, the production of energy from local renewable sources for consumption in Puerto Rico and laboratories for scientific and industrial research. For companies qualifying thereunder, the 1998 Tax Incentives Law would impose income tax rates ranging from 2% to 7%. In addition, it would grant 90% exemption from property taxes, 100% exemption from municipal license taxes during the first eighteen months of operation and between 80% and 60% thereafter, and 100% exemption from municipal excise taxes. The 1998 Tax Incentives Law 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 Law, companies can repatriate or distribute their profits free of tollgate taxes. In addition, passive income derived from the investment of eligible funds in Puerto Rico financial institutions, obligations of the Government of Puerto Rico 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 in the exempted business' 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 exemptions from income, property, and municipal license taxes for a period of up to 10 years. In addition, it provides certain tax credits for qualifying investments in hotel development projects.

As part of the incentives to promote the tourism industry, the Government of Puerto Rico established the Tourism Development Fund as a subsidiary of GDB with the authority to make investments in or provide financing to entities that contribute to the development of the tourism industry. The Fund was initially capitalized with $50,000,000 and was authorized to provide financial guarantees for financing hotel development projects. To date the Fund has provided financial guarantees to private entities issuing bonds or borrowing funds to finance the development of five hotel projects which provided approximately 1,350 new hotel rooms.

Sections 30A and 936 of the Code

For many years, United States companies operating in Puerto Rico enjoyed a special tax credit that was available under Section 936 of the Code. Originally, the credit provided an effective 100% federal tax exemption for operating and qualifying investment income from Puerto Rico sources. Amendments to Section 936 made in 1993 (the "1993 Amendments") instituted two alternative methods for calculating the tax credit and limited the amount of the credit that a qualifying company could claim. These limitations are based on a percentage of qualifying income (the "percentage of income limitation") and on qualifying expenditures on wages, other wage related benefits and other qualifying expenditures (the "economic activity limitation", also known as the "wage credit limitation"). As a result of amendments incorporated in the Small Business Job Protection Act of 1996 enacted by the United States Congress and signed into law by President Clinton on August 20, 1996 (the "1996 Amendments"), as described below, the tax credit is now being phased out over a ten-year period for existing claimants and is no longer available for corporations that establish operations in Puerto Rico after October 13, 1995 (including existing Section 936 Corporations (as defined below) to the extent substantially new operations are established in Puerto Rico). The 1996 Amendments also moved the credit based on the economic activity limitation to Section 30A of the Code and phased it out over 10 years. In addition, the 1996 Amendments eliminated the credit previously available for income derived from certain qualified investments in Puerto Rico. The Section 30A Credit and the remaining Section 936 credit are discussed below.

Section 30A. The 1996 Amendments added a new Section 30A to the Code. Section 30A permits a "qualifying domestic corporation" ("QDC") that meets certain gross income tests (which are similar to the 80% and 75% gross income tests of Section 936 of the Code discussed below) 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").

A QDC is a United States corporation which (i) was actively conducting a trade or business in Puerto Rico on October 13, 1995, (ii) had a Section 936 election in effect for its taxable year that included October 13, 1995, (iii) does not have in effect an election to use the percentage limitation of Section 936(a)(4)(B) of the Code, and (iv) does not add a "substantial new line of business."

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).

A QDC electing Section 30A of the Code may compute the amount of its active business income, eligible for the Section 30A Credit, by using either the cost sharing formula, the profit-split formula or the cost-plus formula, under the same rules and guidelines prescribed for such formulas as provided under Section 936 (see discussion below). To be eligible for the first two formulas, the QDC must have a significant presence in Puerto Rico.

In the case of taxable years beginning after December 31, 2001, the amount of possession income that would qualify for the Section 30A Credit would be 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 30A applies only to taxable years beginning after December 31, 1995 and before January 1, 2006.

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. To qualify under Section 936 in any given taxable year, a corporation must derive for the three-year period immediately preceding the end of such taxable year, (i) 80% or more of its gross income from sources within Puerto Rico, and (ii) 75% or more of its gross income from the active conduct of a trade or business in Puerto Rico.

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. To be eligible for the first two formulas, the Section 936 Corporation must have a significant business presence in Puerto Rico for purposes of the Section 936 rules.

As a result of the 1993 Amendments and the 1996 Amendments, the Section 936 credit is only available to companies that were operating in Puerto Rico on October 13, 1995 and had elected the percentage of income limitation, and is limited in amount to 40% of the credit allowable prior to the 1993 Amendments, subject to a five-year phase-in period from 1994 to 1998 during which period the percentage of the allowable credit is reduced from 60% to 40%.

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

Proposal to Extend the Phaseout of Section 30A. During 1997, Governor Rosselló proposed to Congress the enactment of a new permanent federal incentive program similar to what is now provided under Section 30A. Such program would provide U.S. companies a tax credit based on qualifying wages paid and other wage related expenses, such as fringe benefits, as well as depreciation expenses for certain tangible assets and research and development expenses. Under the Governor's proposal, the credit granted to qualifying companies would continue in effect until Puerto Rico shows, among other things, substantial economic improvements in terms of certain economic parameters. The fiscal 1998 budget submitted by President Clinton to Congress in February 1997 included a proposal to modify Section 30A to (i) extend the availability of the Section 30A Credit indefinitely, (ii) make it available to companies establishing operations in Puerto Rico after October 13, 1995, and (iii) eliminate the income cap. Although said proposal was not included in the final fiscal 1998 federal budget, President Clinton's fiscal 1999 budget submitted to Congress again included these modifications to Section 30A. While the Government of Puerto Rico plans to continue lobbying for this proposal, it is not possible at this time to predict whether the Section 30A Credit will be so modified.

Outlook. It is not possible at this time to determine the long-term effect on the Puerto Rico economy of the enactment of the 1996 Amendments. The Government of Puerto Rico does not believe there will be short-term or medium-term material adverse effects on Puerto Rico's economy as a result of the enactment of the 1996 Amendments.

The Government of Puerto Rico further believes that during the phase-out period sufficient time exists to implement additional incentive programs to safeguard Puerto Rico's competitive position.

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-bond debt regardless of maturity), subject to the exclusions described in the following paragraph. 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, 1997, adjusted for the issuance on January 29, 1998 of the Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 1998, in the principal amount of $503,963,264.10 (the "Series 1998 Refunding Bonds") and the refunding of certain general obligation bonds of the Commonwealth (the "Refunded Bonds") by the Series 1998 Refunding Bonds. Excluded from this 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 following table is debt the inclusion of which would reflect double counting, including, but not limited to, $602,985,000 of bonds issued by the Municipal Finance Agency to finance its purchase of bonds of Puerto Rico municipalities, and $1,653,762,000 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.

Puerto Rico

Public Sector Debt
(in thousands)

	December 31, 1997
Puerto Rico direct debt(1)	$ 4,919,668
Municipal debt	885,105
Public corporations debt	
Puerto Rico guaranteed debt(2)	446,420
Debt supported by Puerto Rico appropriations or taxes(3)	8,195,945
Other non-guaranteed debt	5,933,395
Total public corporations debt	14,575,760
Total public sector debt	$20,380,533

(1) Includes a $21,415,921 loan from GDB to the Department of the Treasury to settle certain property tax claims of the municipalities (the "GDB Tax Claims Loan") and $117,571,000 of certain indebtedness originally issued by Urban Renewal and Housing Corporation that was transferred to the Commonwealth by virtue of Act No. 134 of the Legislature of Puerto Rico, approved on December 13, 1994 ("Act No. 134 of 1994") (such indebtedness referred to as "Transferred CRUV Debt").

(2) Excludes $1,814,511,000 of Public Buildings Authority bonds and notes which are primarily payable from Commonwealth appropriations and $267,000,000 of GDB bonds payable from available moneys of GDB. Consists of bonds issued by Housing Bank and Finance Agency and Aqueduct and Sewer Authority.

(3) Represents, among others, bonds and notes issued by Aqueduct and Sewer Authority, Highway and Transportation Authority, Public Buildings Authority, Public Finance Corporation, Infrastructure Financing Authority, Economic Development Bank (and its affiliate, the Agriculture and Commercial Development Corporation), Health Facilities and Services Administration, and Housing Bank and Finance Agency.

Source: GDB.

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 debt service requirements for general obligation bonds and bonds of Aqueduct and Sewer Authority for which debt service payments are being made under the Commonwealth guaranty, in each case outstanding on December 31, 1997, as adjusted for the issuance of the Series 1998 Refunding Bonds and the refunding of the Refunded Bonds. See "Commonwealth Guaranteed Debt" below. With respect to other debt of 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.

Puerto Rico
Debt Service Requirements*
(in thousands)

Fiscal Year Ending June 30	Principal	Outstanding Bonds Interest	Total	Aqueduct and Sewer Authority Bonds Debt Service	Adjusted Total
1998 ...	$ 177,375	$ 223,824	$ 401,199	$ 33,473	$ 434,672
1999 ...	200,276	221,037	421,312	33,530	454,843
2000 ...	227,855	206,712	434,567	33,509	468,075
2001 ...	233,881	194,493	428,374	33,473	461,847
2002 ...	234,864	183,932	418,796	33,542	452,338
2003 ...	168,189	250,724	418,913	32,745	451,658
2004 ...	139,245	244,310	383,555	30,125	413,681
2005 ...	214,402	165,587	379,989	30,127	410,116
2006 ...	176,028	179,046	355,074	30,121	385,195
2007 ...	150,054	184,763	334,816	30,126	364,943
2008 ...	123,878	149,184	273,062	30,131	303,193
2009 ...	132,970	121,836	254,806	30,123	284,929
2010 ...	142,525	111,820	254,345	29,984	284,329
2011 ...	149,822	104,030	253,852	29,928	283,781
2012 ...	158,195	88,610	246,805	30,127	276,932
2013 ...	148,740	80,397	229,137	30,128	259,264
2014 ...	117,068	91,405	208,472	30,125	238,597
2015 ...	121,955	86,701	208,656	30,126	238,782
2016 ...	126,335	82,252	208,587	30,121	238,707
2017 ...	132,512	76,249	208,760	30,122	238,882
2018 ...	137,870	70,794	208,664	30,126	238,790
2019 ...	148,200	39,538	187,738	30,125	217,863
2020 ...	156,825	32,049	188,874	0	188,874
2021 ...	121,760	23,862	145,622	0	145,622
2022 ...	105,820	17,759	123,579	0	123,579
2023 ...	87,845	12,452	100,297	0	100,297
2024 ...	68,950	7,846	76,796	0	76,796
2025 ...	49,485	4,053	53,538	0	53,538
2026 ...	27,760	1,388	29,148	0	29,148
Total	$4,180,681	$3,256,652	$7,437,333	$681,937	$8,119,270

* Totals may not add due to rounding.

Sources: GDB and Department of the Treasury.

Commonwealth Guaranteed Debt

As of December 31, 1997, $46,080,000 of Commonwealth guaranteed bonds of Housing Bank and Finance Agency were outstanding. These bonds were originally issued by Urban Renewal and Housing Corporation and refinanced in fiscal 1992 by Housing Bank and Finance Agency. Annual debt service on these bonds is $13,252,788 in fiscal 1999, which constitutes their maximum annual debt service. Their final maturity is October 1, 2001.

As of December 31, 1997, $1,814,511,000 of Commonwealth guaranteed bonds of Public Buildings Authority were outstanding. Annual debt service on these bonds is $150,008,064 in fiscal year ending June 30, 1998, with their final maturity being July 1, 2027.

No payments under the Commonwealth guaranty have been required to date for bonds of Housing Bank and Finance Agency or Public Buildings Authority.

As of December 31, 1997, $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, 1997, the Commonwealth had guaranteed certain outstanding revenue bonds of the Aqueduct and Sewer Authority in the aggregate principal amount of $400,340,000. On January 1, 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.

The Farm Credit Corporation ("Farm Credit"), created pursuant to Act No. 68, approved on June 8, 1960, as amended, assumed responsibility in 1971 for the administration of the Farm Credit Security Fund (the "Security Fund") from the Department of Agriculture. The Security Fund has guaranteed, under the good faith and credit of the Commonwealth, certain loans made by financial institutions and Farm Credit to farmers. The Security Fund is authorized to guarantee loans, of which approximately $11,393,053 has been committed as of December 31, 1997. As of December 31, 1997, $3,066,798 was available in the Security Fund to cover loan payment defaults by farmers.

The functions of Farm Credit and the administration of the Security Fund were transferred to Commercial and Agricultural Credit and Development Corporation, a new public corporation (which is an affiliate of Economic Development Bank) created to provide, among other things, loans to the commercial and agricultural sectors. Simultaneously with the creation of this new corporation, the amount of guarantees was limited to the outstanding loans which carry such guaranty. A joint resolution adopted by the Legislature on August 19, 1990, appropriated $8,000,000 per year beginning in fiscal 1993, to provide funds for the Security Fund. The proceeds of these appropriations were used to pay a $40,000,000 loan made by GDB to the Security Fund used to cover payment on loans guaranteed by the Security Fund. The GDB loan was fully repaid on November 4, 1996.

Trends of Public Sector Debt

Historically, Puerto Rico 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. The Government of Puerto Rico has also sought opportunities to realize debt service savings by refunding outstanding debt with obligations bearing lower interest rates.

During fiscal 1992 to 1996, public sector debt and gross product increased 27.5% and 27.7%, respectively. During fiscal 1993 to 1997, however, public sector debt increased 37.0% while gross product increased 27.7%. This higher level of growth of public sector debt over the growth of gross product is due to the increase during fiscal 1996 and 1997 in the amount of debt incurred to finance certain key infrastructure projects, which are important to the development of the economy and are expected to produce long term economic benefits. This trend of higher levels of public sector debt relative to the growth in gross product is expected to continue during the next few fiscal years as the level of public sector capital investment remains high.

As of December 31, 1997, outstanding short-term debt, relative to total debt, was 10.1%, including $600 million tax and revenue anticipation notes of the Commonwealth issued on December 3, 1997 and payable on July 30, 1998.

The following table shows the trends in gross product (in current dollars) and public sector debt for the five fiscal years ended June 30, 1997 and the first six months of fiscal 1998.

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
1993	$13,257	$ 985(3)	6.9%	$14,242	3.0%	$25,133	6.1%
1994	14,077	1,181(3)	7.7	15,258	7.1	26,641	6.0
1995	14,688	1,305	8.2	15,993	4.8	28,452	6.8
1996	16,316	1,310	7.4	17,626	10.2	30,331	6.6
1997	17,865	1,642(3)	8.4	19,507	10.7	32,102(p)	5.8
December 31, 1997	18,322(5)	2,059(4)	10.1	20,381	4.5	-	-

* Totals may not add due to rounding.
(p) Preliminary.
(1) In current dollars.
(2) Obligations issued with a 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 sufficient funds had been set aside for the payment of such notes in full prior to the end of said fiscal years.
(4) Includes $600,000,000 Tax and Revenue Anticipation Notes, Series 1998A, maturing July 30, 1998.
(5) As adjusted for the issuance on January 29, 1998 of the Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 1998, and the refunding of certain general obligation bonds of the Commonwealth.

Source: GDB.

The following table shows the trend of public sector debt by major category for the five fiscal years ended June 30, 1997 and the first six months of fiscal 1998.

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)	
1993	$3,483	$120(3)	$3,603	$497	$39	$536	$9,276	$ 825	$10,102	$13,257	$ 985(3)	$14,242
1994	3,713	120(3)	3,833	571	47	618	9,792	1,014	10,807	14,077	1,181(3)	15,257
1995	4,236	30	4,266(4)	679	53	732	9,773	1,222	10,995	14,688	1,305	15,993
1996	4,203	0	4,203(4)	706	58	765	11,405	1,251	12,657	16,316	1,310	17,625
1997	4,512	0(3)	4,512	843	51	894	12,509	1,590	14,000	17,865	1,642(3)	19,507
Dec.31, 1997	4,320(6)	600(5)	4,920	843	42	885	13,159	1,417	14,576	18,322	2,059	20,381

* Totals may not add due to rounding.
(1) Includes Commonwealth guaranteed debt.
(2) Obligations with a maturity of three years or less are considered short term debt.
(3) Does not include the tax and revenue anticipation notes which were outstanding at the close of the indicated fiscal years because prior to the end of said fiscal years sufficient funds had been set aside for the payment of such notes in full.
(4) Includes the GDB Tax Claims Loan and the Transferred CRUV Debt.
(5) Includes $600,000,000 Tax and Revenue Anticipation Notes, Series 1998A, maturing July 30, 1998.
(6) As adjusted for the issuance on January 29, 1998 of the Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 1998, and the refunding of certain general obligation bonds of the Commonwealth.

Source: GDB.

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, 1997 ("notes" as used in this section refers primarily to certain types of non-bonded debt regardless of maturity). Debt of certain other public corporations is excluded from this table because such debt is payable primarily from the Federal government or is payable from sources other than Commonwealth appropriations or taxes, or revenues of public corporations, or is payable from revenues derived from services or products, such as industrial development bonds. Also excluded from this table is debt of certain public corporations the inclusion of which would reflect double counting. No deductions have been made in the table for debt service funds and debt service reserve funds. More detailed information about the major public corporations is presented in the following sections.

Outstanding Debt
December 31, 1997
(in thousands)

	Bonds			Notes			Total Bonds and Notes		
	With Guaranty	Without Guaranty	Total	With Guaranty	Without Guaranty	Total	With Guaranty	Without Guaranty	Total
Agricultural Services Administration	$ 0	$ 0	$ 0	$ 0	$ 44,126	$ 44,126	$ 0	$ 44,126	$ 44,126
Aqueduct and Sewer Authority	400,340	67,216(1)	467,556	0	244,820	244,820	400,340	312,036	712,376
Agricultural and Commercial Credit and Development Corporation	0	0	0	0	21,176	21,176	0	21,176	21,176
Electric Power Authority(2)	0	3,516,040	3,516,040	0	160,000	160,000	0	3,676,040	3,676,040
Health Facilities and Services Administration	0	0	0	0	848,145(3)	848,145(3)	0	848,145	848,145
Highway and Transportation Authority	0	2,411,955	2,411,955	0	160,185	160,185	0	2,572,140	2,572,140
Housing Bank	46,080	783,495	829,575	0	245,554	245,554	46,080	1,029,049	1,075,129
Industrial Development Company(2)	0	202,488	202,488	0	25,104	25,104	0	227,592	227,592
Infrastructure Financing Authority	0	1,017,045	1,017,045	0	0	0	0	1,017,045	1,017,045
Public Finance Corporation	0	464,173(3)	464,173	0	0	0	0	464,173	464,173
Office for the Improvement of Public Schools	0	0	0	0	229,313	229,313	0	229,313	229,313
Ports Authority	0	122,455	122,455	0	142,613	142,613	0	265,068	265,068
Public Buildings Authority(2)	1,814,511	0	1,814,511	0	74,627	74,627	1,814,511	74,627	1,889,138
Sugar Corporation	0	0	0	0	27,419(3)	27,419(3)	0	27,419	27,419
Telephone Authority	0	894,365	894,365	0	0	0	0	894,365	894,365
University of Puerto Rico	0	330,330	330,330	0	185	185	0	330,515	330,515
Others	0	10,998	10,998	0	421,002	421,002	0	432,000	432,000
Total	$2,260,931(4)	$9,820,560	$12,081,491	$ 0	$2,644,269	$2,644,269	$2,260,931(4)	$12,464,829	$14,725,760

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

(2) Does not include accretion of interest from the respective issuance dates on capital appreciation bonds as follows: Electric Power Authority $107,265,418 as of December 31, 19 Industrial Development Company $7,875,256, as of December 31, 1997; and Public Buildings Authority $43,859,023, as of December 31, 1997.

(3) Payable primarily from Commonwealth appropriations.

(4) Authorization for Commonwealth guarantee of debt as of December 31, 1997, was $3,483,000,000. Excludes $11,393,053 of loans from lending institutions to farmers guarant by the Security Fund as of December 31, 1997.

Source: GDB.

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 November 30, 1997, $1,118,882,000 of bonds and notes of GDB were outstanding. GDB has $2,983,096,000 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, 1997.

GDB has the following principal subsidiaries:

Higher Education Assistance Corporation was established in May 1981 for the purpose of guaranteeing loans made to post-secondary school students under federal insurance programs. The operations of this Corporation were transferred to the Great Lakes Higher Education Corporation, a guarantee agency based in Wisconsin, and the Corporation is in the process of liquidation.

Housing Finance Corporation was created in November 1977 to provide needed rental housing units and stimulate the construction industry under federally subsidized programs. The Corporation has issued tax-exempt revenue bonds and notes to finance the construction of housing units approved for federal rental subsidies, which bonds and notes are limited obligations of the Corporation payable solely from revenues collected in respect of such housing units. The Federal Housing Administration has insured mortgages on certain of the housing units. As of December 31, 1997, $1,044,403,622 of bonds of Housing Finance Corporation were outstanding.

Tourism Development Fund was created in November 1993 to promote the hotel and tourism industry of Puerto Rico, primarily by making available guarantees to secure the payment of private financing used for new hotel development projects. The Tourism Development Fund is also authorized to make capital investments and provide direct financing to tourism related projects. As of December 31, 1997, the Tourism Development Fund had issued guarantees totaling $225,949,987.

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 established in December 1984 to provide agencies and instrumentalities of Puerto Rico with alternate means of meeting their financing requirements. On June 30, 1995, the Corporation issued $296,393,974 of bonds to purchase from GDB certain debt issued by Maritime Shipping Authority, a portion of which bonds was subsequently refunded. On April 23, 1996, the Corporation issued $192,108,735 of bonds to purchase from GDB a portion of a debt of the Secretary of the Treasury relating to advances made to the municipalities to settle certain property tax claims. As of December 31, 1997, the Corporation had $464,173,000 aggregate principal amount of bonds outstanding.

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

Other Public Corporations

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

Facilities and operations of the Authority's system are subject to regulation under numerous federal and Puerto Rico environmental laws, including the federal Clean Water Act administered by the United States Environmental Protection Agency ("EPA"). The Authority has embarked on an extensive capital improvement program for the five-year period ending June 30, 2002, that is estimated to cost approximately $1.7 billion. A portion of the capital improvement program is designed to enable the Authority to comply with federal and Commonwealth laws and regulations.

The Authority needs to make a substantial investment in infrastructure and a major overhaul of its operations to maintain the viability of the existing system and to finance its expansion for new users. Funds for this investment are expected to be provided through a combination of bond issues, legislative appropriations and federal grants. Due to the Authority's financial difficulties (discussed below) and its inability to access the bond market, Act No. 45 was enacted in July 1994 to provide a Commonwealth guaranty of the principal and interest payments to the bondholders of all outstanding debt previously issued by the Authority which, at that time, amounted to $388 million, and to also guarantee all future bonds or any other similar obligations incurred by the Authority to refinance such debt. In December 1995,, the Authority issued $400,340,000 of its Refunding Bonds, Series 1995 (the "Series 1995 Bonds") to refund all of the Authority's outstanding revenue and revenue refunding bonds. The Series 1995 Bonds are guaranteed by the Commonwealth pursuant to Act No. 45. On January 2, 1997, the Commonwealth began making all debt service payments under said guaranty in respect of the Series 1995 Bonds.

Legislation was approved in July 1994 providing for annual Commonwealth appropriations to the Authority to pay a portion of the principal of and interest on the Authority's indebtedness and/or to defray a portion of the Authority's operating and maintenance expenses, as follows: $20 million for fiscal 1995, $25 million for fiscal 1996, $30 million for fiscal 1997, and $35 million for fiscal 1998. Additional legislation was approved in August 1997 providing for annual Commonwealth appropriations of $35 million annually through fiscal 2008.

On May 26, 1995, the Authority and Professional Services Group, Inc. ("PSG") entered into a five-year agreement (the "Agreement") for the operation, management, repair and maintenance of the Authority's public water supply and sanitary sewer facilities (including its customer services systems) (the "Authority System"). PSG, which is headquartered in Houston, Texas, is a subsidiary of Compagnie Generale des Eaux, a French based international waste and wastewater utility and operations service company. The Agreement includes terms and conditions that are expected to result in improved efficiency of the Authority System. Fees and other amounts payable to PSG under the Agreement for fiscal years 1998 to 2001 will be approximately $360.1 million. The Agreement includes incentives to encourage PSG to improve collections from the Authority's customers, as well as penalties in the event PSG fails to operate the Authority System within specified employment parameters. The annual fees may be adjusted to provide for certain unforeseen events and circumstances, such as excessive overtime. The Agreement gives the Authority the right, without penalty, to terminate the contract at the end of the third year. PSG began its management and operations at the Authority on September 1, 1995.

The Authority has also entered into an agreement with Thames-Dick Superaqueduct Partners, Inc. for the planning, design, construction, operation and maintenance of the North Coast Superaqueduct Project (the "Project") to supply additional potable water to certain municipalities, mainly in the San Juan Metropolitan Area. The total estimated cost for the Project is approximately $345 million. GDB is providing interim financing for this Project, which is being paid over time from the proceeds of Commonwealth general obligation bonds or from Commonwealth General Fund appropriations. On May 20, 1997, in a suit brought by a local environmental group challenging the validity of the permits issued for the Project, the Puerto Rico Circuit Court of Appeals issued an order revoking the land use permit granted by the Planning Board and staying the construction of the Project. This decision was affirmed by the Puerto Rico Supreme Court. Construction of the Project resumed in June, 1997, however, after approval of legislation authorizing, among other things, a special permitting process for the Project. The Project is now approximately 50% complete and is expected to be completed by late 1998, as originally scheduled.

Included in the Authority's strategic projects is a major dredging program of the Carraízo Reservoir with an estimated cost of $60 million. The Carraízo Reservoir is the main water supply source for the San Juan Metropolitan

Area. This dredging project is directed at recovering reservoir storage capacity by removing approximately 6 million cubic meters of sediment. Under the agreement signed on October 7, 1996 with Weeks Marine Corporation, with headquarters in New Jersey, the Authority entered into a multi-year dredging program to remove sediment from the Carraízo Reservoir which includes the construction, operation, and maintenance of the areas that will be used to dispose of the dredged materials. GDB approved a $50 million line of credit to the Authority to provide partial interim financing to pay for the dredging and related costs. This financing will be paid from the proceeds of Commonwealth general obligation bonds or from Commonwealth General Fund appropriations. The dredging commenced on August, 1997.

Notwithstanding the issuance of the Series 1995 Bonds, the execution of the Agreement with PSG discussed above, and the legislative appropriations previously discussed, it is likely that additional substantial legislative appropriations to the Authority may be needed for several years in order to support the financial and operational viability of the Authority, and to allow the Authority to finance its capital improvement program. The Authority has reported net losses during the past three fiscal years ended June 30, 1997 of approximately $60.5 million, $91.0 million and $55 million, respectively. These losses reflect the continuing financial and operating difficulties that the Authority has experienced in recent years, and were further aggravated in fiscal 1996 by extraordinary items, including the required adoption of new government accounting requirements relating to required expense reserves, the posting of previous years' non-registered entries and adjustments, employees' salary increases and early retirement bonuses, and non-budgeted or underestimated expenses relating to the PSG Agreement.

Economic Development Bank was created in July 1985 to engage primarily in granting small direct loans, providing loan guarantees to private enterprises, and making equity investments in such enterprises. Its initial capital was provided by a transfer of loans in the principal amount of $15,000,000 previously administered by a now inactive subsidiary of GDB. As of June 30, 1997, the Economic Development Bank had outstanding $42,000,000 of collateralized Promissory Notes.

Electric Power Authority owns and operates the island's electric system. Capital improvements are 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, 1997, the Authority had $3,516,040,000 in bonds outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds). The Authority has entered into power purchase contracts relating to the construction of certain cogeneration plants that will use fuels other than oil. See "Economic Development Program—New Economic Model" under *The Economy* above.

Health Facilities and Services Administration ("AFASS") was created by Act No. 26 of November 13, 1975, as amended, for the purpose of carrying out the following functions: planning, evaluation and development of health services, alleviation of environmental contamination, operation of public hospitals and other health facilities, prevention and treatment of mental illness and administration of family planning programs and maternal and child care activities. The operations of AFASS are funded substantially by appropriations from the Commonwealth. AFASS' outstanding indebtedness to GDB as of December 31, 1997 was $848,145,000 payable primarily from Commonwealth appropriations. Such indebtedness is expected to be paid also from the proceeds of the sale of certain health facilities.

Highway and Transportation Authority is responsible for highway construction in Puerto Rico. Such construction is financed by debt (interim notes and revenue bonds), revenues of the Authority, and federal and Puerto Rico grants. Debt service on the Authority's revenue bonds constitutes a first lien on its gross revenues, which consist currently of all the proceeds of the gasoline tax, one-half of the proceeds of the tax on gas oil or diesel oil, all the proceeds of the excise taxes on crude oil, unfinished oil and derivative products, up to $120 million per fiscal year, highway toll revenues, and the gross receipts of $15.00 per vehicle per year from certain motor vehicle license fees. Such revenues (except for toll revenues) may be applied first to the payment of debt service on general obligation bonds and notes of the Commonwealth and payments required to be made by the Commonwealth under its guarantees of bonds and notes to the extent that no other revenues are available for such purpose. The Government of Puerto Rico has never applied such revenues for such payment. As of December 31, 1997, the Highway and Transportation Authority had $2,411,955,000 in bonds outstanding.

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.

The Authority has contracted with various qualified firms for the planning, design, construction, and operation of certain segments of a mass transit rail system to serve a portion of the San Juan metropolitan area.

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

As of December 31, 1997, the Agency had outstanding $829,575,000 of bonds (of which $46,080,000, originally issued by the Urban Renewal and Housing Corporation, are guaranteed by the Commonwealth) issued to pay obligations of the Commonwealth under law, otherwise payable from Commonwealth appropriations, to fund certain payments of the Commonwealth under its mortgage subsidy program for low and moderate income families, to guarantee certain insurance obligations of the Agency under certain programs, and to refund bonds originally issued by Urban Renewal and Housing Corporation to carry out activities related to the provision of low-cost housing for moderate income families, federally aided public housing for low income families, and urban renewal, housing and related activities. These bonds are payable principally from appropriations in substantially the amount that the Commonwealth would otherwise have been bound to appropriate for such purposes.

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 into the Economic Development Administration on 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, 1997, the Company had $202,488,000 in bonds outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds).

Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority was created in June 1977. The Authority has issued revenue bonds to finance industrial, tourist, pollution control, medical, and educational facilities in Puerto Rico for the use of private companies, non-profit entities, or government agencies. The bonds are payable solely from payments to be made to the Authority by such private companies, non-profit entities, or government agencies, and do not constitute a debt of the Commonwealth or any of its other public corporations or municipalities. As of December 31, 1997, $2,182,950,181 of the Authority's bonds were outstanding.

Infrastructure Financing Authority was created in June 1988 by virtue of Act No. 44 of June 21, 1988, as amended ("Act No. 44") to provide financial, administrative, consulting, technical, advisory, and other types of assistance to other public corporations and governmental instrumentalities of Puerto Rico authorized to develop infrastructure facilities and to establish alternate means for financing infrastructure facilities. Act No. 44 also established the Puerto Rico Infrastructure Fund, funded in the amount of $30 million during fiscal 1989 and $40 million for the following twenty-nine fiscal years with the first proceeds of federal excise taxes imposed on rum and other articles produced in Puerto Rico and sold in the United States which are transferred to Puerto Rico pursuant to the Internal Revenue Code of 1986, as amended. On July 7, 1997, Act No. 44 was amended to increase to $60 million for fiscal year 1998 and $70 million for each subsequent year until fiscal year 2028 the amount of federal excise taxes transferred to the Authority. The increased level of appropriations will be used by the Authority to provide additional financial support to Aqueduct and Sewer Authority.

In November 1988, the Authority issued $327,740,000 of Special Tax Revenue Bonds, Series 1988A to refund in advance certain outstanding revenue bonds and other debt of the Aqueduct and Sewer Authority. As of December 31, 1997, $209,285,000 of such bonds were outstanding. The Authority's Special Tax Revenue Bonds, Series 1988A are secured by a pledge of a portion of such federal excise taxes, subject to the prior application of such taxes to the payment of Puerto Rico's general obligation bonds and notes and certain other obligations guaranteed by Puerto Rico.

In December 1997, the Authority issued $801,760,000 Special Tax Revenue Bonds, Series 1997A and 1997B, to finance certain capital projects and working capital needs of Aqueduct and Sewer Authority. The Authority is expected to issue $134,660,000 Special Tax Revenue Refunding Bonds, Series 1998A, on or about April 2, 1998, to refund certain of its outstanding revenue bonds. The Authority had $1,011,045,000 in Bonds outstanding as of December 31, 1997.

Maritime Shipping Authority commenced operations in 1974 upon the acquisition of three shipping lines serving Puerto Rico and the United States mainland. The Authority acquired vessels and other equipment financed by the issuance of notes on a secured basis to the previous owners. As of the date of the sale of the Authority's assets referred to below, the Authority carried approximately 30% of the total cargo shipped between Puerto Rico and the United States mainland.

On March 3, 1995, the assets and operations of 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.

Act No. 112 of September 27, 1994, restructured the operations and administration of the Authority by creating the Maritime Shipping Authority as a public corporation affiliated with GDB, subject to the control of the President of GDB, but as a separate legal entity, apart from GDB and any of its other affiliates and subsidiaries. The remaining debt of the Authority was refinanced, as allowed under Act No. 113 of September 27, 1994, by the issuance of bonds by Public Finance Corporation, a subsidiary of GDB. The aggregate principal amount of such bonds as of December 31, 1997, was $374,135,000. The bonds are payable from funds to be appropriated annually by the Legislature of Puerto Rico. Public Finance Corporation purchased a note of the Authority from GDB with the proceeds of the bonds issued.

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 reserve, including investment income thereon. The Government of Puerto Rico has agreed to pay such amounts to the reserve as may be necessary to maintain it at its required level, subject to appropriation by the Legislature, which appropriation is not legally required to be made. To date no such payments have been required.

Ports Authority owns and operates the major airport and seaport facilities in Puerto Rico. The Authority derives revenues from a variety of sources, including charges on airplane fuel sales, air terminal space rentals, landing fees, wharfage, dockage and harbor fees, and rentals for the lease of seaport equipment and property. The Authority has a $126.3 million line of credit from GDB for capital improvements, of which approximately $99.3 million was outstanding as of December 31, 1997. This line of credit has been increased to $144.2 million to partially finance the dredging of San Juan Bay. In addition, GDB has approved a $32.9 million line of credit for the Authority to finance the construction of a new multi-level parking facility at the Luis Muñoz Marín International Airport. The Authority had total net losses of approximately $70 million during fiscal years 1993 and 1994, and, as a result, was not in compliance with its rate covenant with bondholders. After eliminating its operating losses through a comprehensive rate revision process including the implementation of annual (instead of triennial) rate revision analyses, the Authority is currently in compliance with its rate covenant. The Authority is implementing a plan to restructure its operations which, among other things, encompasses revisions to its capital improvement program, measures to increase collections from certain users of its facilities and proposals to improve the efficiency of its operations. As of December 31, 1997, the Authority had $122,455,000 in bonds outstanding.

Public Buildings Authority is authorized to construct, purchase or lease office, school, health, and social welfare facilities for lease to departments, public corporations, and instrumentalities of the Government of Puerto Rico. Bonds that have been issued by the Authority to finance such facilities (through retirement of interim notes or otherwise) are payable from lease payments, which are largely derived from legislative appropriations, and are further secured by the Commonwealth's guaranty. The Authority is authorized by Act No. 17 of 1968, as amended, to have outstanding at any one time up to $2,100,000,000 of bonds guaranteed by the Commonwealth. As of December 31, 1997, $1,814,511,000 of such bonds of the Authority were outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds). The Authority has four lines of credit for its capital improvement program totaling $694,457,805 of which $74,627,000 was outstanding as of December 31, 1997.

The Authority is undertaking a program to construct additional correctional facilities to be completed by the end of fiscal 2001 at an estimated cost of $187,000,000. The Authority has previously issued $126,972,552 in bonds to finance the construction of three correctional facilities, which will be operated by private companies.

At present, the Government of Puerto Rico is a defendant in a lawsuit filed in United States District Court in which it is charged with violating the constitutional rights of correctional system inmates as a result of severe overcrowding in the island's correctional system. Fines to assure compliance with minimum space standards have been assessed in the past against the Government of Puerto Rico. Most of these fines have been earmarked for improving the conditions of inmates but not for construction of additional correctional facilities to alleviate prison overcrowding. In April 1995, the District Court judge overseeing the above lawsuit imposed an additional series of fines against the Government of Puerto Rico for noncompliance with the minimum space standards, which fines may exceed $30 million. The Government of Puerto Rico can give no assurance that additional fines will not be levied in connection with the above mentioned lawsuit. The Authority is not responsible for the payments of these fines.

Sugar Corporation was created in 1973 to consolidate ownership and management of the Government of Puerto Rico's interests in Puerto Rico's sugar industry. Sugar Corporation owns or leases and operates virtually all the sugar production facilities on the island. Sugar Corporation buys all cane grown by private growers, processes the cane, and sells crude and refined sugar and molasses. For many years, its operations produced substantial operating deficits. For fiscal 1998 appropriations of approximately $8,543,086 were made to cover the operating deficit. As of December 31, 1997, the total debt of the Corporation was $27,419,000 payable primarily from Commonwealth appropriations.

At present, the Government of Puerto Rico is in the process of transferring the operations of the Corporation to certain entities to be formed by sugar cane growers. On September 5, 1996, the Governor of Puerto Rico signed into law Act No. 189, which authorizes the transfer, for a nominal sum, of certain assets and liabilities of the Corporation to entities to be created by the sugar cane growers. The Corporation will retain substantially all its liabilities. The transfer is subject to a definitive agreement to be negotiated between the sugar cane growers and the Corporation and is subject to the approval of the Legislature of Puerto Rico.

Telephone Authority was created in July 1974 when the Government of Puerto Rico purchased Puerto Rico Telephone Company ("PRTC") from International Telephone and Telegraph Corporation. Puerto Rico Telephone Company operates the principal telephone system in Puerto Rico. The Telephone Authority acquired the assets of the Puerto Rico Communications Authority on May 30, 1990. Capital improvements at present are financed by internally generated funds, although in the past they have also been financed with revenue bonds. The Authority's revenue bonds are payable from net revenues, which consist primarily of moneys received after payment of the Company's operating expenses. As of December 31, 1997, the Authority had $894,365,000 of bonds and other obligations outstanding, none of which was supported by the guaranty of the Commonwealth.

On April 7, 1997, Governor Rosselló announced the Government's intention to sell PRTC. The Government is currently conducting the sale process. The proceeds of the sale are expected to be used to create a trust fund for infrastructure to assist in the solution of the problems associated with the supply and distribution of water resources, to mitigate the unfunded pension benefit obligation of the Employees Retirement System of the Government of Puerto Rico and its Instrumentalities, and to pay certain benefits to PRTC employees.

University of Puerto Rico, with 68,020 students during academic year 1997-1998, 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 $330,330,000 were outstanding as of December 31, 1997.

Public corporations, in addition to those mentioned above, have outstanding debt in the aggregate amount of $684,615,000 as of December 31, 1997. Debt service on $255,424,000 of such outstanding debt is being paid from legislative appropriations. However, the Government of Puerto Rico 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, the Aqueduct and Sewer Authority, and the Telephone Authority, which are insured through arrangements and policies obtained by the respective Authorities. Personal injury awards against the Government of Puerto Rico are limited by law to $150,000 per occurrence.

RETIREMENT SYSTEMS

Public employees of the Government of Puerto Rico and its instrumentalities are covered by five retirement systems: the Employees Retirement System of the Government of Puerto Rico and its Instrumentalities (the "Employees Retirement System"), the Annuity and Pension System for the Teachers of Puerto Rico (the "Teachers Retirement System"), the Commonwealth of Puerto Rico 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 Government of Puerto Rico is not required to contribute directly to those two systems, although a large portion of University revenues are 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 Government of Puerto Rico, its municipalities and instrumentalities. As of June 30, 1997, the preliminary total number of active members of the three systems was as follows: Employees Retirement System, 159,680; Teachers Retirement System, 61,134 and Judiciary Retirement System, 346. The three systems are financed by contributions made by employers (the Government of Puerto Rico, public corporations, or municipalities), employees, and investment income. The government is responsible for approximately 66% of total employer contributions to the Employees Retirement System and 100% and 99% of total employer contributions to the Judiciary and Teachers Retirement Systems, respectively. Retirement and related benefits provided by the systems and required contributions to the systems by employees are determined by statute. Required contributions to the systems by employers are determined by statute with respect to the Teachers Retirement System and, with respect to the Employees and Judiciary Retirement Systems, by the Administrators of the Systems. In fiscal 1998, the Government of Puerto Rico has budgeted approximately $275,206,000 as its contribution to the Employees Retirement System, $4,323,000 as the contribution to the Judiciary Retirement System and $85,309,760 as its contribution to the Teachers Retirement System.

According to the most recent actuarial valuation of the Employees Retirement System and Judiciary Retirement System submitted by a firm of independent consulting actuaries, as of June 30, 1997, the total pension benefit obligation for the Employees Retirement System and Judiciary Retirement System was $6,913,900,000 and $76,500,000, respectively. The unfunded pension benefit obligation of the Employees Retirement System and Judiciary Retirement System for the same period was $5,469,429,000 and $19,245,000, respectively. The 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 for the Employees Retirement System of 3% every third year were assumed. This benefit increase was provided by the Legislature of Puerto Rico by Act No. 10 of May 10, 1992. The first 3% increase was granted to retirees who have been receiving their annuities for three or more years as of that date. The second 3% increase was granted to retirees who have 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. Subsequent increases will depend upon the explicit approval of the System's Board of Trustees and the Legislature, based on a favorable recommendation from the System's independent consulting actuary and given a minimum of 24 months of benefit payment reserves.

On February 1, 1990, the Legislature of Puerto Rico enacted Act No. 1 which is directed at ensuring the solvency of the Employees Retirement System for the next fifty years. Among other provisions, the legislation increases the level of contribution to the System and limits 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 reduces the level of occupational injury and death benefits received by new employees.

The most recent actuarial valuation of the Teachers Retirement System was submitted by a firm of independent consulting actuaries in December 1996. As of June 30, 1996, the actuarial accrued liability of the system was $2,615,833,862, the actuarial value of assets amounted to $1,652,819,537, and the resulting unfunded actuarial accrued liability was $963,014,325, a decrease of $163,357,932 from the valuation as of June 30, 1995. It is recognized that it will be necessary to further strengthen the finances of the Teachers Retirement System in order to assure that combined contributions and investment income continue to exceed benefit payments, avoiding the possible future drawdown of assets.

The following table presents in summary form, income and expenses of the retirement systems for the fiscal year ended June 30, 1996, preliminary numbers for the fiscal year ended June 30, 1997 and estimates for the fiscal year ending 1998.

Retirement Systems
Income and Expenses
(in thousands)

	Employees Retirement System	Judiciary Retirement System	Teachers Retirement System
Fiscal Year Ended June 30, 1996	Actual	Actual	Actual
Income:			
Employers contributions	$224,942	$ 3,890	$ 79,324
Employee contributions	177,250	1,618	62,991
Investment income	178,616	9,348	127,841
Total	580,808	14,856	270,156
Expenses:			
Benefit payments	399,665	5,846	153,493
Administrative and other expenses	26,907	1,072	14,369
Total	426,572	6,918	167,862
Net Income	$154,236	$ 7,938	$102,294
Fiscal Year Ended June 30, 1997	Actual	Actual	Actual
Income:			
Employers contributions	$248,523	$4,102	$ 82,431
Employee contributions	206,094	1,763	68,777
Investment income	230,412	9,290	268,167
Total	685,029	15,155	419,375
Expenses:			
Benefit payments	437,069	6,080	168,643
Administrative and other expenses	33,001	1,815	21,480
Total	470,070	7,895	190,123
Net Income	$214,959	$7,260	$229,252
Fiscal Year Ending June 30, 1998	Estimated	Estimated	Estimated
Income:			
Employers contributions	$270,000	$4,326	$ 87,250
Employee contributions	239,000	2,100	71,400
Investment income	250,000	9,000	294,984
Total	759,000	15,426	453,634
Expenses:			
Benefit payments	463,000	6,300	186,200
Administrative and other expenses	28,000	1,100	21,300
Total	491,000	7,400	207,500
Net Income	$268,000	$8,026	$246,134

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

SUMMARY OF COMMONWEALTH FINANCIAL STATEMENTS

Since fiscal 1990, the complete financial statements of the Commonwealth are audited. For fiscal 1997, such financial statements were audited by Deloitte & Touche LLP, whose report thereon is dated December 15, 1997. Preparation of the audited financial statements of the Commonwealth involves the collection and combination of audited financial statements from 48 separate reporting entities.

PUERTO RICO TAXES, OTHER REVENUES AND EXPENDITURES

The Secretary of the Treasury has custody of the funds of the central government and is responsible for the accounting, disbursement and investment of such funds. Central government funds are grouped into three major categories or "types" of funds, as follows: (i) Governmental Fund Types, which include the General, Special Revenue, Debt Service (also referred to herein as Redemption), and Capital Project Funds; (ii) Proprietary Fund Types, which include the Enterprise and Internal Service Funds; and (iii) Fiduciary Fund Types, which include the Trust and Agency Funds. These funds do not include funds of the municipalities, because the municipalities are governmental entities with independent treasuries. The Special Revenue Fund was incorporated into the General Fund commencing in fiscal 1993.

The General Fund is the primary operating fund of the Government of Puerto Rico. 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 Government of Puerto Rico. The primary expenditures of the Government of Puerto Rico through the General Fund are for grants and subsidies, and personal and other services.

Summary and Management Discussion of General Fund Results

The following table presents revenues and expenditures of the General Fund on a cash basis for fiscal 1994 through fiscal 1998. Insofar as the information relates to fiscal 1998, it is based on estimates provided by the Secretary of the Treasury as of October 30, 1997. The information for fiscal 1994 through fiscal 1997 is based on actual fiscal year end results. 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, as the latter statements reflect an expanded General Fund entity in accordance with generally accepted accounting principles.

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

	1994	1995	1996	1997	1998(1)
Beginning cash balance	$(116,501)	$ 309,055	$ 534,929	$ 147,066	$127,477
Revenues from internal sources:					
Income Taxes:					
Individuals	1,409,824	1,578,269	1,709,116	1,825,337	1,995,000
Corporations	1,107,265	1,304,612	1,348,160	1,440,691	1,402,000
Partnerships	1,802	3,391	3,323	2,120	3,000
Withheld from non-residents	73,626	79,072	78,235	88,603	90,000
Tollgate taxes	224,356	220,873	179,454	210,245	199,000
Interest	5,293	6,070	6,662	7,582	9,000
Dividends	33,968	28,650	43,225	35,438	33,000
Total income taxes	2,856,134	3,220,937	3,368,175	3,610,016	3,731,000
Commonwealth excise taxes					
Alcoholic beverages	220,882	222,187	237,915	229,043	238,000
Cigarettes	115,453	107,943	107,177	120,287	108,000
Motor vehicles	275,654	319,676	307,931	365,820	387,000
Other excise taxes	588,411	602,521	651,001	704,203	637,000
Total Commonwealth excise taxes	1,200,400	1,252,327	1,304,024	1,419,353	1,370,000
Property taxes	4,568	7,889	5,107	8,286	0
Inheritance and gift taxes	934	1,535	1,547	4,028	2,000
Licenses	49,084	49,100	50,467	53,535	113,000
Other:					
Lottery	62,348	63,317	60,856	52,829	58,000
Electronic Lottery	52,193	59,414	57,008	47,994	83,000
Miscellaneous non-tax revenues	131,909	125,973	127,734	139,838	138,000
Total other	246,450	248,704	245,598	240,661	279,000
Total revenues from internal sources	4,357,570	4,780,492	4,974,918	5,335,879	5,495,000
Revenues from non-Commonwealth sources:					
Federal excise taxes	185,285	187,494	194,917	203,755	210,000
Customs	122,477	112,153	77,781	61,114	50,000
Total revenues from non-Commonwealth sources	307,762	299,647	272,698	264,869	260,000
Sub-total revenues	4,665,332	5,080,139	5,247,616	5,600,748	5,755,000
Proceeds from special funds	55,564	14,155	20,716	23,217	37,000
Total Revenues	4,720,896	5,094,294	5,268,332	5,623,965	5,792,000
Other Income	558,069	307,931	113,515	80,388	384,627
Transfers to redemption fund (2)	(284,346)	(316,766)	(359,638)	(375,000)	(393,950)
Note proceeds (3)	700,963	0	0	551,186	601,892
Repayment of notes (4)	(717,850)	0	0	(563,628)	(617,775)
Adjusted revenues	4,977,732	5,085,459	5,022,209	5,316,911	5,766,794
Expenditures:					
Grants and subsidies	1,251,879	1,308,511	1,620,347	1,676,929	1,728,505
Personal services	1,559,152	1,805,996	1,993,176	2,164,007	2,690,821
Other services	492,653	579,568	602,460	666,004	664,028
Materials and supplies	64,945	82,701	86,370	84,789	103,223
Equipment purchases	41,885	54,288	54,685	37,507	64,702
Other debt service and capital outlays	128,396	0.00	116,863	47,269	217,588
Transfers to agencies	565,696	537,649	564,360	355,213	244,383
Other expenditures	447,570	436,181	371,811	304,782	157,000
Total expenditures	4,552,176	4,859,585	5,410,072	5,336,500	5,870,230
Adjusted revenues less expenditures	425,556	225,874	(387,863)	(34,667)	(103,436)
Ending cash balance	$ 309,055	$ 534,929	$ 147,066	$ 127,477	$ 24,041

) Budget, as adopted.

) 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.

) Consists of proceeds from Commonwealth tax and revenue anticipation notes issued in each such fiscal year.

) Consists of repayment of Commonwealth tax and revenue anticipation notes in each such fiscal year.

urce: Department of the Treasury

Estimated Fiscal 1998 Compared to Fiscal 1997

General Fund estimated total revenues for fiscal 1998 are forecast at $5,755 million, an increase of $154.3 million (2.75%) over fiscal 1997. Major projected changes are: an increase in income taxes of individuals of $121 million; an increase in license fees of $59.5 million and an increase in electronic lottery collection of $35 million.

Total projected expenditures for fiscal 1998 are estimated at $5,870 million, an increase of $533.7 million (10%) from fiscal 1997. The ending cash balance for the General Fund for fiscal 1998 is estimated to be $24 million, a decrease of $103.4 million from fiscal 1997.

Fiscal 1997 Compared to Fiscal 1996

General Fund total revenues for fiscal 1997 were $5,601 million, an increase of $353.1 million (6.73%) over fiscal 1996. Major changes were: an increase in income taxes of $241.8 million and an increase in excise taxes of $115.3 million.

Total expenditures for fiscal 1997 decreased by $73.6 million, when compared to fiscal 1996. The ending cash balance for the General Fund for fiscal 1997 was $127.5 million, a decrease of $19.6 million from fiscal 1996.

Fiscal 1996 Compared to Fiscal 1995

General Fund total revenues for fiscal 1996 were $5,247 million, an increase of $167.5 million (3.3%) over fiscal 1995. Major changes were: an increase in income taxes of $147.2 million; an increase in excise taxes of $51.7 million; and a decrease in customs of $34.4 million.

Total expenditures for fiscal 1996 increased by $550.5 million, when compared to fiscal 1995. The ending cash balance for the General Fund for fiscal 1996 decreased by $387.9 million.

Fiscal 1995 Compared to Fiscal 1994

General Fund total revenues for fiscal 1995 were $5,080 million, an increase of $414.8 million (8.9%) over fiscal 1994. Major changes were the following: total income taxes and excise taxes increased by $364.8 million and $51.9 million, respectively.

Total expenditures for fiscal 1995 increased by $307.4 million (6.8%), when compared to fiscal 1994. The ending cash balance for the General Fund for fiscal 1995 increased by $225.8 million.

Major Sources of General Fund Revenues

Income Taxes

Puerto Rico's Internal Revenue Code of 1994 (the "P.R. Code"), adopted on October 31, 1994, 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. The P.R. Code represented a major revision to the prior income tax structure. The purpose of the P.R. Code was to establish a more equitable tax structure that lowered tax rates and simplified and enhanced compliance.

Individuals. Resident individuals are subject to tax on their taxable income from all sources. The P.R. Code has five tax brackets with tax rates of 8%, 12%, 18%, 31% and 33%. Dividend income from Puerto Rico sources is taxed at a rate of 10%. Gains realized from the sale or exchange of a capital asset, if held for more than 6 months, are taxed at a rate of 20%.

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 is exempt from taxation.

Corporations and Partnerships. Puerto Rico corporations and partnerships are subject to tax on income from whatever source; 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 a 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*), it is subject to tax at graduated rates.

The P.R. Code provides six income tax brackets for corporations and partnerships, with the highest rate (39%) applicable to taxable income in excess of $275,000. Certain corporations and partnerships covered by the tax incentives act 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 Acts are subject to a maximum tax rate of 42% on their taxable income. The P.R. Code maintains the alternative minimum tax at 22%.

The P.R. Code imposes a branch profits tax on resident foreign corporations. The 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 recipients is no longer subject to withholding tax. Interest paid to certain related non-resident recipients is subject to a withholding tax of 29%. Dividends paid to non-resident corporate recipients is subject to a withholding tax of 10%. Gains realized from the sale or exchange of a capital asset, if held for more than six months, is taxed at a maximum rate of 25%. Payments in excess of $1,000 made by the Government of Puerto Rico and persons engaged in a trade or business in consideration of the receipt of services are now subject to a 7% withholding tax.

In July 1997 the P.R. Code was amended to include certain provisions designed to promote investments in local capital market instruments. The amendments include (i) reducing to 7% the long term capital gains rate applicable to gains from the conversion prior to the year 2001 of any privately owned Puerto Rico corporation or partnership to a publicly owned corporation or partnership; (ii) reducing to 17% the tax rate applicable to interest received by non-corporate taxpayers on certain debt instruments of Puerto Rico corporations or partnerships; and (iii) eliminating the special tax exemption for interest on GNMA Certificates issued after July 31, 1997 (other than those issued in connection with the initial conveyance of newly constructed low and moderate residential property in Puerto Rico).

Excise Taxes

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

Other Taxes and Revenues

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

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

Revenues from non-Puerto Rico sources include customs duties collected in Puerto Rico and excise taxes on shipments of alcoholic beverages from the island to the mainland United States. The customs duties and excise taxes on shipments are imposed and collected by the United States and returned to the Government of Puerto Rico.

Property Taxes

Personal property, which accounts for approximately 55% of total collections of taxable property, is self-assessed. Real property taxes are currently 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 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 Municipal Revenues Collection Center, 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.

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
1993	$11,337,421	$378,750	$267,220	$21,579	$288,799
1994	11,735,626	443,448	329,058	32,654	361,712
1995	12,508,656	508,275	370,029	54,241	424,270
1996	17,499,974	533,362	400,207	70,571	470,778
1997(2)	19,272,428	619,344	471,445(p)	50,418(p)	521,863(p)

(p) Preliminary.
(1) Valuation set as of July 1 of fiscal year.
(2) Municipal Revenues Collection Center Distribution Report August 1997.

Source: Municipal Revenues Collection Center.

During 1997, legislation was enacted authorizing the Center to sell tax liens on residential and commercial properties to persons who, after payment of the purchase price to the Center, would then be responsible for collecting from the delinquent property tax payers.

Collections of Income and Excise Taxes

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

Transfers to General Obligation Redemption Fund

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

Components of General Fund Expenditures

Grants and Subsidies

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

Personal Services

This category includes compensation paid for personal services rendered to the Government of Puerto Rico 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 the payment of services other than the services referred to above, including advertising, printing, communication services, legal expenses, utility services, building and equipment rental and maintenance expenses, insurance premiums and miscellaneous services.

Materials and Supplies

This category includes all articles which ordinarily have 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

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

Other Debt Service and Capital Outlays

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

Transfers to Agencies

Includes repayment of loans and advances to other funds, certain refunds, advances from other funds and other receipts, repayment of advances from other funds, grants and contributions to other funds under the custody of the Secretary of the Treasury and other items. The major portion of grants and contributions in recent fiscal years consists of transfers to the Health Facilities and Services Administration and advances to the municipalities.

Other Expenditures

This category represents 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.

Federal Grants

Puerto Rico receives federal grants under numerous programs. The following table presents revenues from federal grants by broad program areas which are accounted in the central accounting system of the Department of the Treasury.

Puerto Rico

Federal Grants
(in thousands)

	Fiscal Year Ending June 30				
	1994	1995	1996	1997(p)	1998(e)
Education	$ 427,407	$ 472,409	$ 529,084	$ 518,254	$ 513,709
Social Services	1,329,671	1,440,351	1,463,802	1,508,969	1,524,318
Health	399,056	392,076	382,497	329,469	322,502
Labor and Human Resources (1)	196,736	150,857	136,508	107,800	116,286
Public Works and Transportation(2)	45	306	136	39	0
Crime	11,161	15,569	20,876	27,198	25,726
Housing(3)	201,695	222,312	239,586	224,965	224,787
Drug and Justice	6,417	5,148	5,613	9,209	9,714
Agriculture and Natural Resources	6,764	12,558	11,546	14,516	6,771
Contributions to Municipalities	61,801	65,993	66,389	64,911	64,911
Other	16,755	4,687	4,495	5,929	5,629
Total	$2,657,508	$2,782,266	$2,860,812	$2,811,259	$2,814,254

(p) Preliminary
(e) Estimated
(1) Amounts include grants to Right to Work Administration and the Occupational Development and Human Resources Council.
(2) Amounts of federal grants to the Highway and Transportation Authority are not included in the Public Works and Transportation area. For fiscal 1994, 1995, 1996 and 1997 the federal grants to this agency are $75.9 million, $90.8 million, $101.9 million and $128.2 million, respectively.
(3) Amounts include grants to the Public Housing Administration.

BUDGET OF THE GOVERNMENT OF PUERTO RICO

Office of Management and Budget

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

Budgetary Process

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

The annual budget, which is developed utilizing elements of program budgeting and zero-base budgeting, includes an estimate of revenues and other resources for the ensuing fiscal year under (i) laws existing at the time the budget is submitted, and (ii) legislative measures proposed by the Governor and submitted with the proposed budget, as well as the Governor's recommendations as to appropriations that in his 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 his 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 Government of Puerto Rico to continue to make payments of its operating and other expenses until a new budget is approved.

Financial Control and Adjustment Procedures

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

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

A Budgetary Fund was created by Act No. 147 of June 18, 1980, as amended (the "Budgetary Fund Act"), to cover the appropriations approved in any fiscal year in which the revenues available for such fiscal year are insufficient, honor the public debt, and provide for unforeseen circumstances in the provision of public services. The Budgetary Fund Act was amended in 1994 to require that an annual legislative appropriation equal to one third of one percent (.33%) of the total budgeted appropriations for each fiscal year be deposited in the Budgetary Fund. In 1997, the Budgetary Fund Act was further amended to increase the annual legislative appropriation required to be deposited in the Budgetary Fund to one percent (1%) of the net revenues of the preceding fiscal year, beginning in fiscal year 2000. In addition, other income (non-tax revenue) 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 six percent (6%) of the total appropriations included in the budget for the preceding fiscal year.

Appropriations

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

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

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

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

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

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

Approximately 24.9% of the General Fund is committed, including debt service on direct debt of the Commonwealth and on the debt of the Sugar Corporation, municipal subsidies, grants to the University of Puerto Rico, contributions to Aqueduct and Sewer Authority, and rental payments to Public Buildings Authority, among others.

Fiscal 1997 Budget

The following table presents a summary of the Commonwealth budget for the fiscal year ended June 30, 1997.

Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ended June 30, 1997
(in thousands)

	General Fund	Bond Fund	Special Funds	Total
Resources:				
Revenues from internal sources:				
Property taxes	$ 8,286	$ 0	$ 65,000	$ 73,286
Personal income taxes	1,825,337	0	0	1,825,337
Income tax withheld from non-residents	88,603	0	0	88,603
Corporation income taxes	1,440,691	0	0	1,440,691
Partnership income taxes	2,120	0	0	2,120
Tollgate taxes	210,245	0	0	210,245
17% withholding tax on interest	7,582	0	0	7,582
10% withholding tax on dividends	35,438	0	0	35,438
Inheritance and gift taxes	4,028	0	0	4,028
Excise taxes:				
Alcoholic beverages	229,043	0	0	229,043
Motor vehicles and accessories	365,820	0	200	366,020
Cigarettes	120,287	0	0	120,287
Special excise tax on certain petroleum products	158,739	0	0	158,739
General 5% excise tax	446,500	0	0	446,500
Other	98,964	0	67,310	166,274
Licenses	53,535	0	0	53,535
Miscellaneous non-tax revenues:				
Contributions from lottery fund	52,829	0	0	52,829
Electronic lottery	47,994	0	0	47,994
Registration and document certification fees	95,869	0	0	95,869
Other	43,969	0	151,208	195,177
Total revenues from internal sources	5,335,879	0	283,718	5,619,597
Revenues from non-Puerto Rico sources:				
Federal excise taxes on off-shore shipments	203,755	0	16,000	219,755
Federal grants [1]	0	0	2,811,259	2,811,259
Customs	61,114	0	0	61,114
Total revenues from non-Puerto Rico sources	264,869	0	2,827,259	3,092,128
Total revenues	5,600,748	0	3,110,977	8,711,725
Other:				
Miscellaneous income	51,175	0	0	51,175
Total other income	51,175	0	0	51,175
Payment in lieu of taxes PRTC	33,000	0	0	33,000
Balance from previous year	16,877	0	336,058	352,935
Bonds authorized	0	369,000	0	369,000
Total other sources	101,052	369,000	336,058	806,110
Total resources	$5,701,800	$369,000	$3,447,035	$9,517,835

	General Fund	Bond Fund	Special Funds	Total
Appropriations:				
Current expenses:				
General government	$ 534,527	$ 0	$ 26,740	$ 561,267
Education	1,804,283	0	591,360	2,395,643
Health	787,438	0	354,090	1,141,528
Welfare	319,599	0	1,734,248	2,053,847
Economic development	219,972	0	33,145	253,117
Public safety and protection	922,758	0	67,672	990,430
Transportation and communications	78,746	0	5,345	84,091
Housing	22,570	0	144,148	166,718
Contributions to municipalities	262,241	0	2,013	264,254
Special pension contributions	28,087	0	0	28,087
Debt service	375,000	0	65,000	440,000
Other debt service	300,824	0	0	300,824
Total appropriations-current expenses	5,656,045	0	3,023,761	8,679,806
Capital improvements	14,873	369,000	175,775	559,648
Total appropriations	5,670,918	369,000	3,199,536	9,239,454
Year end balance	30,882	0	247,499	278,381
Total appropriations and year-end balance	$5,701,800	$369,000	$3,447,035	$9,517,835

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

Sources: Department of the Treasury resources and Office of Management and Budget as reported on October 9, 1997.

In the fiscal 1997 budget proposal revenues and other resources of all budgetary funds total $8,795,900,000 excluding balances from the previous fiscal year and general obligation bonds authorized. The estimated net increase in General Fund revenues from fiscal 1996 are accounted for by increases in personal income taxes (up $116,221,000), corporation income taxes (up $92,531,000), motor vehicles and accessories (up $57,889,000), 5% excise taxes (up $49,811,000), tollgate taxes (up $30,791,000), excise taxes on cigarettes (up $13,110,000), withholding taxes (up $10,368,000), federal excise taxes on off-shore shipments (up $8,838,000), registration and document certification fees (up $6,864,000), property taxes (up $3,179,000), and decrease in alcoholic beverages (down $8,872,000), contributions from lottery fund (down $8,027,000), electronic lottery (down $9,014,000), 10% withholding tax on dividends (down $7,787,000), and customs (down $16,667,000).

Current expenses and capital improvements of all budgetary funds total $9,239,454,000, an increase of $63,797,000 from fiscal 1996. The major changes in General Fund expenditures by program in fiscal 1997 are: public safety and protection (up $91,767,000), education (up $98,572,000), general government (up $43,926,000), debt service (up $27,096,000), contributions to municipalities (up $20,973,000), other debts (up $14,493,000), special pension contributions (up $5,449,000), transportation and communications (up $2,146,000), housing (up $1,388,000), welfare (down $4,773,000), economic development (down $27,118,000), reserve to reimburse the General Fund (down $30,000,000), and health (down $82,931,000).

The general obligation bond authorization for the fiscal 1997 budget was $369,000,000.

Fiscal 1998 Budget

The following table presents a summary of the Commonwealth budget for the fiscal year ended June 30, 1998.

Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ending June 30, 1998
(in thousands)

	General Fund	Bond Fund	Special Funds	Total
Resources:				
Revenues from internal sources:				
Property taxes	$ 0	$ 0	$ 65,000	$ 65,000
Personal income taxes	1,995,000	0	0	1,995,000
Income tax withheld from non-residents	90,000	0	0	90,000
Corporation income taxes	1,402,000	0	0	1,402,000
Partnership income taxes	3,000	0	0	3,000
Tollgate taxes	199,000	0	0	199,000
17% withholding tax on interest	9,000	0	0	9,000
10% withholding tax on dividends	33,000	0	0	33,000
Inheritance and gift taxes	2,000	0	0	2,000
Excise taxes:				
Alcoholic beverages	238,000	0	0	238,000
Motor vehicles and accessories	387,000	0	200	387,200
Cigarettes	108,000	0	0	108,000
Special excise tax on certain petroleum products	48,000	0	0	48,000
General 5% excise tax	469,000	0	0	469,000
Slot machines and machines for entertainment	30,000	0	0	90,000
Other	90,000	0	69,040	159,040
Licenses	113,000	0	0	53,000
Miscellaneous non-tax revenues:				
Contributions from lottery fund	58,000	0	0	58,000
Electronic lottery	83,000	0	0	83,000
Registration and document certification fees	95,000	0	0	95,000
Other	43,000	0	142,978	185,978
Total revenues from internal sources	5,495,000	0	277,218	5,772,218
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	210,000	0	16,500	226,500
Federal grants (1)	0	0	2,814,353	2,814,353
Customs	50,000	0	0	50,000
Total revenues from non-Commonwealth sources	260,000	0	2,830,853	3,090,853
Total revenues	5,755,000	0	3,108,071	8,863,071
Other:				
Miscellaneous income	60,075	0	0	60,075
Total other income	60,075	0	0	60,075
Payment in lieu of taxes PRTC	58,550	0	0	58,550
Assets sales	65,000	0	0	65,000
Others income	140,000	0	0	140,000
Balance from previous year	30,882	0	247,499	278,381
Bonds authorized	0	500,000	0	500,000
Total other sources	354,507	500,000	247,499	1,102,006
Total resources	$6,109,507	$500,000	$3,355,570	$9,965,077

	General Fund	Bond Fund	Special Funds	Total
Appropriations:				
Current expenses:				
General government	$ 528,318	$ 0	$ 26,205	$ 554,523
Education	1,921,995	0	593,321	2,515,316
Health	928,491	0	337,493	1,265,984
Welfare	307,166	0	1,726,924	2,034,090
Economic development	224,061	0	29,083	253,144
Public safety and protection	1,017,718	0	62,249	1,079,967
Transportation and communications	62,150	0	5,283	67,433
Housing	18,851	0	145,629	164,480
Contributions to municipalities	264,518	0	2,209	266,727
Special pension contributions	29,595	0	0	29,595
Debt service	393,950	0	65,000	458,950
Other debt service	410,094	0	0	410,094
Total appropriations—current expenses	6,106,907	0	2,993,396	9,100,303
Capital improvements	230	500,000	167,251	667,481
Total appropriations	6,107,137	500,000	3,160,647	9,767,784
Year-end balance	2,370	0	194,923	197,293
Total appropriations and year-end balance	$6,109,507	$500,000	$3,355,570	$9,965,077

(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.

In the fiscal 1998 budget proposal revenues and other resources of all budgetary funds total $9,186,696,000 excluding balances from the previous fiscal year and general obligation bonds authorized. The estimated net increase in General Fund revenues from fiscal 1997 is accounted for by increases in personal income taxes (up $169,663,000), slot machines and machines for entertainment (up $90,000,000), electronic lottery (up $35,006,000), 5% excise taxes (up $22,500,000), motor vehicles and accessories (up $21,180,000), alcoholic beverages (up $8,957,000), and decrease in property taxes (down $8,286,000), customs (down $11,114,000), tollgate taxes (down $11,245,000), cigarettes (down $12,287,000), corporation income taxes (down $38,691,000), and special excise tax on certain petroleum products (down $110,739,000).

Current expenses and capital improvements of all budgetary funds total $9,767,784,000, an increase of $528,330,000 from fiscal 1997. The major changes in General Fund expenditures by program in fiscal 1998 are: health (up $141,053,000), education (up $117,712,000), public safety and protection (up $94,960,000), other debts (up $109,270,000), debt service (up $18,950,000), economic development (up $4,089,000), contributions to municipalities (up $2,277,000), special pension contributions (up $1,508,000), housing (down $3,719,000), general government (down $6,209,000), transportation and communications (down $16,596,000), and welfare (down $12,433,000).

The general obligation bond authorization for the fiscal 1998 budget is $500,000,000.

Differences between Budget and General Purpose Financial Statements

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

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

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

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

MRP137.IRN

[This page intentionally left blank]

APPENDIX II

Audited Financial Statements

Puerto Rico Highway and Transportation Authority

June 30, 1997

COMMONWEALTH OF PUERTO RICO

HIGHWAY AND TRANSPORTATION AUTHORITY

Puerto Rico Highway and Transportation Authority

Audited Financial Statements

June 30, 1997

Contents

ERNST & YOUNG LLP

1000 Scotiabank Plaza
273 Ponce de Leon Avenue
Hato Rey
Puerto Rico 00917-1989

Phone: 787 759 8212
Fax: 787 753 0808
Fax: 787 753 0813

Report of Independent Auditors

Hon. Carlos I. Pesquera, Secretary
Commonwealth of Puerto Rico
Department of Transportation and Public Works

We have audited the accompanying financial statements of the Puerto Rico Highway and Transportation Authority (the Authority) as of and for the year ended June 30, 1997 as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Puerto Rico Highway and Transportation Authority at June 30, 1997, and the results of its operations and the cash flows of its proprietary fund for the year then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 16, 1997 on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

September 16, 1997

Ernst + Young LLP

Stamp No. 1459745
affixed to
original of
this report.

Puerto Rico Highway and Transportation Authority

Combined Balance Sheet - All Fund Types and Account Groups

June 30, 1997
with comparative totals at June 30, 1996

	Governmental Fund Types		Proprietary Fund Type
	Debt Service	Capital Projects	Enterprise Fund
Assets			
Cash and investments	$ 24,640,542	$ 43,152,185	-
Cash and investments with trustee	327,954,352	14,613,381	-
Receivables (net of allowance for estimated uncollectible amounts of $33,718,112):			
Puerto Rico Treasury Department	2,755,259	-	-
Federal grants	-	33,369,445	-
Accrued interest and other	3,118,734	5,578,794	-
Advances to governmental entities for construction projects	-	16,409,965	-
Due from other funds	-	2,488,103	$ 2,572,844
Prepaid expenses	-	1,269,972	-
Property and equipment	-	-	11,142,296
Construction in progress	-	-	170,875,164
Amount available for retirement of general long-term debt	-	-	-
Amount to be provided for retirement of general long-term debt	-	-	-
Amount to be provided for payment of vacation and sick leave	-	-	-
Amount to be provided for payment of claims and judgements	-	-	-
Total assets	$358,468,887	$116,881,845	$184,590,304

Account Groups		Totals (Memorandum Only)	
General Fixed Assets	General Long-term debt	1997	1996
-	-	$ 67,792,727	$ 30,451,092
-	-	342,567,733	728,771,524
-	-	2,755,259	-
-	-	33,369,445	26,338,388
-	-	8,697,528	19,028,691
-	-	16,409,965	11,284,224
-	-	5,060,947	4,200,589
-	-	1,269,972	1,230,832
$47,612,436	-	58,754,732	48,370,513
	-	170,875,164	54,311,512
-	$ 237,743,016	237,743,016	227,550,979
-	2,174,211,984	2,174,211,984	2,235,914,021
-	7,056,994	7,056,994	11,600,000
-	6,795,000	6,795,000	6,795,000
$47,612,436	$2,425,806,994	$3,133,360,466	$3,405,847,365

Puerto Rico Highway and Transportation Authority

Combined Balance Sheet - All Fund Types and Account Groups

June 30, 1997
with comparative totals at June 30, 1996

	Governmental Fund Types		Proprietary Fund Type
	Debt Service	Capital Projects	Enterprise Fund
Liabilities and Fund Equity			
Liabilities:			
Matured interest payable	$ 68,404,924	-	-
Matured bonds	47,260,000	-	-
Puerto Rico Treasury Department			
Accounts payable	-	$ 68,660,881	-
Amounts retained from contractors	-	6,847,545	-
Due to other funds	5,060,947	-	-
Other liabilities	-	4,285,865	$ 9,459,768
Accrued legal claims	-	-	-
Accrued vacation and sick leave	-	10,307,457	-
Bonds payable:			
Term bonds	-	-	-
Serial bonds	-	-	-
Total liabilities	120,725,871	90,101,748	9,459,768
Fund Equity:			
Investment in general fixed assets	-	-	-
Contributed capital	-		175,130,536
Fund balances:			
Reserved for:			
Advances	-	16,409,965	-
Long-term accounts receivable	-	2,096,074	-
	-	18,506,039	-
Unreserved	237,743,016	8,274,058	
Total fund balance	237,743,016	26,780,097	-
Total fund equity	237,743,016	26,780,097	175,130,536
Total liabilities and fund equity	$358,468,887	$116,881,845	$184,590,304

See accompanying notes.

Account Groups		Totals (Memorandum Only)	
General Fixed Assets	General Long-term debt	1997	1996
-	-	$ 68,404,924	$ 58,780,447
-	-	47,260,000	39,655,000
			354,014
-	-	68,660,881	42,735,358
-	-	6,847,545	4,927,742
-	-	5,060,947	4,200,589
-	-	13,745,633	7,833,506
-	$ 6,795,000	6,795,000	6,795,000
-	7,056,994	17,364,451	18,121,518
-	1,493,785,000	1,493,785,000	1,498,035,000
-	918,170,000	918,170,000	965,430,000
-	2,425,806,994	2,646,094,381	2,646,868,174
$47,612,436	-	47,612,436	42,750,246
-	-	175,130,536	59,931,779
-	-	16,409,965	11,284,224
-	-	2,096,074	6,460,796
-	-	18,506,039	17,745,020
-	-	246,017,074	638,552,146
-	-	264,523,113	656,297,166
47,612,436	-	487,266,085	758,979,191
$47,612,436	$2,425,806,994	$3,133,360,466	$3,405,847,365

Puerto Rico Highway and Transportation Authority

Combined Statement of Revenues, Expenditures and Changes in Fund Balance - All Governmental Fund Types

Year ended June 30, 1997 with comparative totals for the year ended June 30, 1996

	Governmental Fund Types			Totals (Memorandum Only)	
	General	Debt Service	Capital Projects	1997	1996
Revenues:					
Excise taxes:					
Gasoline	-	$163,579,819	-	$163,579,819	$163,004,783
Diesel oil	-	16,552,138	-	16,552,138	14,083,134
Vehicle license fees	-	26,532,806	-	26,532,806	25,138,506
Toll fares	-	103,707,672		103,707,672	92,994,312
Grants:					
Federal government	-	-	$ 75,773,906	75,773,906	101,842,670
Commonwealth of Puerto Rico, municipalities and other	-	-	6,910,182	6,910,182	1,312,897
Interest income	-	16,126,859	16,224,874	32,351,733	19,805,016
Other	$ 815,488	-	-	815,488	677,571
Total revenues	815,488	326,499,294	98,908,962	426,223,744	418,858,889
Other financing sources/(uses)					
Net proceeds from bond issuance	-	-	-	-	1,023,006,443
Payment to refunded bond escrow agent	-	-	-	-	(194,476,570)
Proceeds from credit line advances	-	-	-	-	175,659,451
Payment of credit line advances		-	-	-	(250,000,000)
Transfers from/(to) other funds	31,836,270	(39,058,099)	(167,806)	(7,389,635)	(3,976,310)
Total revenues and other financing sources/(uses)	32,651,758	287,441,195	98,741,156	418,834,109	1,169,071,903
Expenditures:					
Toll highways administration and maintenance	26,936,677	-	-	26,936,677	23,021,009
Acquisition of operating property and equipment	5,715,081	-	-	5,715,081	4,329,558
Expenditures for traffic facilities	-	-	500,707,246	500,707,246	484,395,490
Other	-	334,160	-	334,160	265,415
Redemption of bonds:					
Serial bonds	-	47,260,000	-	47,260,000	39,655,000
Term bonds	-	4,250,000	-	4,250,000	4,100,000
Interest	-	136,619,373	-	136,619,373	109,694,717
Total expenditures	32,651,758	188,463,533	500,707,246	721,822,537	665,461,189
Excess (deficiency) of revenues and other financing sources/(uses) over/(under) expenditures	-	98,977,662	(401,966,090)	(302,988,428)	503,610,714
Fund balances at beginning of year	-	227,550,979	428,746,187	656,297,166	185,541,765
Residual equity transfer	-	(88,785,625)	-	(88,785,625)	(32,855,313)
Fund balances at end of year	$ -	$237,743,016	$26,780,097	$264,523,113	$656,297,166

See accompanying notes.

Puerto Rico Highway and Transportation Authority

Combined Statement of Revenues, Expenditures and Changes in Fund Balance
Budget and Actual - All Governmental Fund Types (Budgetary Basis)

Year ended June 30, 1997

	Budget (Cash Basis)	Actual (Cash Basis)	Variance Favorable (Unfavorable)
Revenues:			
Excise taxes and vehicle license fees	$201,300,000	$ 203,555,490	$ 2,255,490
Toll fares	100,900,000	103,707,672	2,807,672
Grants:			
Federal Government	128,200,000	68,742,849	(59,457,151)
Commonwealth of Puerto Rico, municipalities and other	7,600,000	6,910,182	(689,818)
Interest and other revenue	27,100,000	43,498,384	16,398,384
Total revenues	465,100,000	426,414,577	(38,685,423)
Other financing sources/(uses):			
Proceeds from credit line advances	73,000,000	-	(73,000,000)
Total revenues and other financing sources/(uses)	538,100,000	426,414,577	(111,685,423)
Expenditures:			
Construction, equipment, and administrative	658,200,000	467,753,136	190,446,864
Toll highways administration and maintenance	31,000,000	26,936,677	4,063,323
Redemption of bonds:			
Serial bonds	39,655,000	39,655,000	-
Term bonds	4,250,000	4,250,000	-
Interest	145,795,000	126,994,896	18,800,104
Advances to Department of Transportation and Public Works	5,000,000	12,471,568	(7,471,568)
Metrobus administrative and operating expenses	6,000,000	8,429,831	(2,429,831)
Transfers to propietary fund	85,300,000	88,785,625	(3,485,625)
Total expenditures	975,200,000	775,276,733	199,923,267
Excess (deficiency) of revenues and other financing sources/(uses) expenditures over/(under) expenditures	(437,100,000)	(348,862,156)	88,237,844
Funds carried forward from prior year	437,100,000	-	(437,100,000)
Fund balance at beginning of year	-	759,222,616	759,222,616
Fund balance at end of year	$ -	$ 410,360,460	$ 410,360,460

See accompanying notes.

Puerto Rico Highway and Transportation Authority

Combined Statement of Revenues, Expenses and Changes in Retained Earnings (Deficit) - Enterprise Fund

Year ended June 30, 1997

Operating revenues - user charges	$ 3,610,902
Operating expenses:	
General and administrative	11,000,537
Depreciation	676,326
Operating loss	(8,065,961)
Transfers from other funds	7,389,635
Net loss	(676,326)
Depreciation on fixed assets acquired by contributed capital	676,326
Retained earnings at end of year	$ -

See accompanying notes.

Puerto Rico Highway and Transportation Authority

Combined Statement of Cash Flows - Enterprise Fund

Year ended June 30, 1997

Operating activities	
Cash received from customers	$ 3,610,902
Cash paid for services	(11,000,537)
Net cash provided by operating activities	(7,389,635)
Investing activities	
Investment in Tren Urbano	(109,676,728)
Acquisition of operating equipment	(6,213,604)
Net cash used in investment activities	(115,890,332)
Financing activities	
Contributed capital	115,890,332
Transfers from other funds	7,389,635
Net cash provided by financing activities	123,279,967
Cash at end of year	$ -

See accompanying notes.

Puerto Rico Highway and Transportation Authority

Notes to Financial Statements

June 30, 1997

1. Organization and Significant Accounting Policies

The Puerto Rico Highway and Transportation Authority (the Authority) is a public corporation and instrumentality of the Commonwealth of Puerto Rico, created by Act No. 74 of June 23, 1965, as amended, to provide roads and other facilities for the movement of persons, vehicles, and vessels and for the planning, promotion and feasibility of mass transportation systems. The Authority is a component unit of the Commonwealth of Puerto Rico and accordingly is included in the general purpose financial statements of the Commonwealth. The powers normally exercised by a Board of Directors are vested with the Commonwealth Secretary of the Department of Transportation and Public Works (DTPW). The Authority is exempt from the payment of any taxes on its revenues and properties.

The accounting policies of the Authority conform to generally accepted accounting principles as applicable to governmental units. The following is a summary of the significant accounting policies:

Fund Accounting

The accounts of the Authority are organized on the basis of funds and account groups, each of which is considered to be a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balance, revenues, and expenditures. The various funds are summarized by type in the financial statements. The following fund types and account groups are used by the Authority:

Governmental Fund Types

Governmental funds are those through which most governmental functions of the Authority are financed. The acquisition, use, and balances of the Authority's expendable financial resources and the related liabilities are accounted for through governmental funds. The measurement focus is upon determination of changes in financial position, rather than upon net income determination. The following are the Authority's governmental fund types:

The General Fund is the general operating fund of the Authority. It is used to account for all financial resources except those required to be accounted for in another fund.

The Debt Service Fund is used to account for the accumulation of resources for, and the payment of, general long-term debt principal, interest and related costs, except those required to be accounted for in the General Fund. Long-term debt and interest due July 1 of the following fiscal year are accounted for as fund liabilities if there are available financial resources as of June 30.

1. Organization and Significant Accounting Policies (continued)

Governmental Fund Types (continued)

The Capital Projects Fund is used to account for financial resources to be used for the acquisition or construction of major capital facilities.

Proprietary Fund Type

Proprietary funds are used to account for activities that are similar to those often found in the private sector. The measurement focus is upon determination of net income and capital maintenance. The Authority has one proprietary fund, the Enterprise Fund, which is used to account for operations that are financed through user charges and management has decided that determination of net income is appropriate.

The Tren Urbano Fund is used to account for the costs incurred for the development of a mass rail transportation project (Tren Urbano). Tren Urbano is classified as an enterprise fund since, upon completion of construction and commencement of operations, the primary focus of the Tren Urbano will be on net income and capital maintenance.

Account Groups

Account groups are used to establish accounting control and accountability for the Authority's general fixed assets and general long-term debt. The following are the Authority's account groups:

The General Fixed Assets Account Group reflects the accumulation of expenditures for property and equipment used in the operations of the Authority. Since the General Fixed Assets Account Group is a memorandum account no depreciation is being provided.

The General Long-term Debt Account Group accounts for all long-term debt of the Authority.

Basis of Accounting

The modified accrual basis of accounting is followed by the governmental funds. Under the modified accrual basis of accounting, revenues are recorded when susceptible to accrual, i.e., both measurable and available. Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Expenditures and related liabilities are recorded in the accounting period in which the liability is incurred, except for interest on long-term obligations, which is recorded when due, except for interest due July 1 of the following year which is recorded when resources are available in the debt service fund, and litigation which is recorded in the long-term debt account group.

1. Organization and Significant Accounting Policies (continued)

Basis of Accounting (continued)

The accrual basis of accounting is used by proprietary funds. Under the accrual basis, revenues are recorded when earned, and expenses are recorded as liabilities when incurred, without regard to receipt or payment of cash.

In applying the susceptible to accrual concept to intergovernmental revenues, the legal and contractual requirements of the programs are used as guidance. There are, however, essentially two types of these revenues. In one, funds must be expended for the specific purpose or project before any amount will be paid to the Authority; therefore, revenues are recognized based upon the expenditures recorded. In the other, funds are virtually unrestricted as to purpose of expenditure and are usually revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenues at the time of receipt or earlier if the susceptible to accrual criteria is met.

The Authority adopted the provisions of Governmental Accounting Standards Board Statement No. 20 *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting* (GASB No. 20). In adopting GASB No. 20, the Authority elected not to apply all Statements and Interpretations of the Financial Accounting Standards Board, Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedure issued after November 30, 1989.

Investments

Investments are stated at amortized cost, which approximates market value.

Advances to the Department of Transportation and Public Works

The Authority periodically advances funds to DTPW to carry out its participation in the construction program of the Authority. Also, the Authority makes contributions to DTPW for the maintenance program carried out by DTPW. A reservation of fund balance is provided for balances advanced to DTPW.

Property and Equipment

Property and equipment purchases are recorded as expenditures in the governmental funds and capitalized at cost in the general fixed assets account group.

Equipment acquired by the proprietary fund is stated at cost. Depreciation is provided using the straight-line method over an estimated useful life of 12 years. Depreciation on equipment acquired from contributed capital is reflected as a reduction of contributed capital.

1. Organization and Significant Accounting Policies (continued)

Property and Equipment (continued)

Expenditures incurred on the Tren Urbano project are recorded at cost in the proprietary fund. Funds provided by the Authority are recorded as residual equity transfers in the accompanying statement of Revenues, Expenditures and Changes in Fund Balance - All Governmental Fund Types. Funds provided by the Authority for the project, as well as grants provided by the Federal Government, are recorded as contributed capital in the proprietary fund.

Capital expenditures for infrastructure are not capitalized in the General Fixed Assets Account Group. Unaudited cumulative infrastructure expenditures through June 30, 1997 follow:

	Unaudited
Balance at June 30, 1996	$5,302,680,009
Plus: expenditures during the year ended June 30, 1997	500,707,246
Balance at June 30, 1997	$5,803,387,255

Vacation and Sick Leave

Employees earn annual vacation leave at the rate of 30 days per year up to a maximum permissible accumulation of 60 days for regular employees. Employees accumulate sick leave at the rate of 18 days per year. Sick leave is only payable if the regular employee resigns and has more than 10 years of employment, or retires and takes a pension. Maximum permissible accumulation is 90 days for all employees and the excess is paid within the next year.

The liability for the vested accumulated vacation and sick leave is recorded in the capital projects fund and the long-term debt account group.

Claims and Judgments

The estimated amount of the liability for claims and judgments which is due on demand, such as from adjudicated or settled claims, is recorded in the capital projects fund. The general long-term debt account group includes the amount estimated as a contingent liability and the liability with a fixed or expected due date which will require future available financial resources for its payment.

Totals Memorandum Only

Totals columns in the accompanying financial statements are captioned Memorandum Only to indicate that they are presented only to facilitate financial analysis. Data in these columns do not present financial position or results of operations in conformity with generally accepted accounting principles. Such data is not comparable to a consolidation since interfund eliminations have not been made.

1. Organization and Significant Accounting Policies (continued)

Budgetary Data

The Authority prepares its annual budget following the cash basis of accounting while the financial statements are presented under generally accepted accounting principles (GAAP). The actual results of operations presented in the Statement of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual - All Governmental Fund Types are in accordance with the budgetary basis of accounting to provide a meaningful comparison of actual with budget.

The Authority uses the following procedures in establishing the budgetary data reflected in the financial statements:

1. The Executive Director submits to the Commonwealth Secretary of Transportation and Public Works (the Secretary) a proposed operating budget for the fiscal year commencing the following July 1. The operating budget includes proposed expenditures and the means of financing them.

2. The budget is approved through a resolution by the Secretary.

3. After the approval of the operating budget, the Secretary is authorized to transfer budgeted amounts within any funds.

The major differences between the budgetary basis of accounting and GAAP are:

1. Revenues are recorded when payments are received (budgetary), as opposed to when susceptible to accrual (GAAP).

2. Expenditures are recorded when payments are made (budgetary) as opposed to when the liability is incurred (GAAP).

3. Advances to governmental entities for construction projects are recorded when paid (budgetary) as opposed to being recognized as expenditures for traffic facilities when the advances are used (GAAP).

1. Organization and Significant Accounting Policies (continued)

Budgetary Data (continued)

Adjustments necessary to convert the excess of revenues and other financing sources/(uses) over expenditures and fund balance at end-of-year from the GAAP basis to the budgetary basis are as follows (in thousands):

	Excess of Expenditures over Revenues	Fund Balance at End-of-Year
GAAP Basis	$(302,988)	$264,523
Adjustments:		
Accounts receivable, accrued interest and other	(5,975)	(63,718)
Accounts payable and accrued liabilities	31,697	95,161
Matured interest and bonds payable	17,229	115,665
Residual equity transfer from Debt Service Fund	(88,786)	-
Other	(39)	(1,270)
Per Statement of Revenues, Expenditures and Changes in Fund Balances - Budget and Actual - All Governmental Fund Types (Budgetary)	$(348,862)	$410,360

Amounts advanced to DTPW and transfers to the proprietary funds transferred in excess of the budgeted amounts do not require formal budget revisions.

2. Debt Service Fund

Debt service fund revenue is generated from gasoline and diesel oil excise taxes, certain motor vehicles license fees and toll charges which are deposited with a Fiscal Agent, as described in Note 5. The Fiscal Agent withholds the amounts necessary for the Authority's debt service requirements on the revenue bonds and transfers the excess to the General, Capital Projects and Enterprise Funds.

3. Cash and Investments

Cash and investments at June 30, 1997 consisted of the following:

Cash held by the Puerto Rico Department of the Treasury	$ 20,899,921
Interest-bearing deposits with commercial banks	52,027,803
Restricted cash held by escrow agent	2,977,911
Cash in banks	6,767,481
	82,673,116
Less checks issued in excess of bank balance	(14,880,389)
	$ 67,792,727

3. Cash and Investments (continued)

Cash with the Department of the Treasury is uninsured and uncollateralized. The interest-bearing deposits with commercial banks are covered by federal depository insurance or collateralized.

Restricted cash represents funds held in an escrow fund under an agreement with the U.S. Army Corps of Engineers (the Agreement). Under terms of the Agreement, the Authority is required to maintain escrow funds to secure performance in connection with a mitigation plan related to a construction project. The escrow funds will be released as performance is demonstrated. Final release of the escrow funds will occur upon compliance of the survival of mitigation (approximately May 2001).

The bank balance is covered by federal depository insurance or collateral. In this account checks are issued in excess of the bank balance, and subsequent deposits are made from cash transfers to cover such checks.

Cash and investments with trustee in the Debt Service Fund amounting to $327,954,353 at June 30, 1997 (market value of approximately $329,700,000) consist of Notes from the U.S. Government and Agencies, Corporate Notes and Repurchase Agreements, and include approximately $56,000,000 of collateralized time deposits maintained pursuant to an investment agreement with Bayerische Landesbank Girozentrale Bank of New York, expiring on December 1, 1997. These investments are held in the Authority's name.

The Authority is authorized to deposit funds only in institutions approved by the Department of the Treasury and such deposits should be maintained in separate accounts in the name of the Authority. Resolution 68-18 (Bond Resolution) requires that funds in the Debt Service Fund be held by the fiscal agent (The Chase Manhattan Bank, N.A.) in trust and applied as provided in the Bond Resolution. The law governing the Authority does not limit the type of securities in which the Authority may invest; however, funds in the Debt Service Fund must be invested only in direct obligations of the United States government, or obligations unconditionally guaranteed by the United States government, and/or interest bearing time deposits, or other similar arrangements, as provided by the Bond Resolution.

Investments in the Capital Projects Fund may be made in Investment Obligations, as defined in the Bond Resolution. Investment Obligations include time deposits of any bank, which are either issued by a bank with combined capital and surplus of at least $50 million, or collateralized by securities in direct obligations of the United States Government or guaranteed by the United States Government. Accordingly, as permitted by the bond resolution, investments in the Capital Projects Fund, amounting to $14,613,381, at June 30, 1997, consist of Notes from the U.S. Government and Agencies, and Corporate Bonds held by The Chase Manhattan Bank (the Trustee). The market value of these time deposits at June 30, 1997, approximates the carrying value. The investments are held by the trustee in the Authority's name.

4. General Fixed Assets

A summary of changes in property and equipment recorded in the General Fixed Assets Account Group for the year ended June 30, 1997 follows:

	Balance June 30, 1996	Additions	Retirements	Balances June 30, 1997
Property and equipment:				
Land	$ 290,000	-	-	$ 290,000
Machinery and equipment	30,358,580	$5,478,148	$850,920	34,985,808
Buildings	12,101,666	236,933	1,971	12,336,628
	$42,750,246	$5,715,081	$852,891	$47,612,436

5. Bonds Payable

Resolution No. 68-18 (Bond Resolution) of the Authority authorizes the issuance of revenue bonds to obtain funds to accelerate the construction of traffic facilities. Bonds outstanding at June 30, 1997 were as follows:

	Issue Date	Original Amount	Maturing July 1	Interest Rate	Outstanding Amount
Term bonds:					
A	Jan. 1, 1968	$ 20,000,000	1998	5.25%	$ 2,300,000
G	Jan. 1, 1973	45,000,000	2003	5.50	37,600,000
Q	Oct. 1, 1990	137,475,000	2010-2020	6.00-7.75	30,000,000
V	June 4, 1992	123,585,000	2007-2018	5.75-6.63	123,585,000
W	July 15, 1993	292,090,000	2013-2020	5.62-5.72	292,090,000
X	July 15, 1993	288,565,000	2013-2021	5.62-5.72	288,565,000
Y	April 9, 1996	677,045,000	2011-2036	5.00-6.25	677,045,000
Z	April 9, 1996	42,600,000	2018	5.63	42,600,000
		$1,626,360,000			1,493,785,000
Serial bonds:					
N	Sept. 14, 1988	98,295,000	1990-2001	6.40-7.65	15,655,000
O	Sept. 14, 1988	28,315,000	1990-2001	6.40-7.60	5,275,000
Q	Oct. 1, 1990	32,525,000	1992-2003	6.40-7.70	11,280,000
R	Nov. 1, 1990	19,115,000	1992-2002	6.20-7.25	7,580,000
U	June 4, 1992	53,225,000	1997-1999	3.5-5.88	28,175,000
V	June 4, 1992	9,960,000	2000-2005	3.50-5.88	7,600,000
W	July 15, 1993	24,700,000	2009	MCS	24,700,000
	July 15, 1993	46,750,000	2010	FLOATS	46,750,000
	July 15, 1993	46,750,000	2006-2010	RITES	46,750,000
X	July 15, 1993	228,695,000	1994-2022	2.85-5.10	274,760,000
	July 15, 1993	101,730,000	1995-1999	Variable	66,430,000
	July 15, 1993	66,150,000	2010	FLOATS	35,950,000
	July 15, 1993	66,150,000	2003-2010	RITES	35,950,000
Y	April 9, 1996	213,190,000	1997-2022	5.0-6.25	213,190,000
Z	April 9, 1996	142,440,000	1996-2016	4.0-6.25	141,700,000
FMHA-C	Jan. 27, 1981	4,510,000	1983-2020	5.00	3,685,000
Total serial bonds		$1,182,500,000			965,430,000
Less serial bonds payable on July 1, 1997					47,260,000
Serial bonds payable thereafter					918,170,000
Total bonds payable after July 1, 1997					$2,411,955,000

5. Bonds Payable (continued)

A summary of the Series Y and Series Z Bonds issued during fiscal year 1996 follows (in thousands):

	Series Y	Series Z	Total
Term Bonds:			
Fixed Rates	$609,745	$ 42,600	$ 652,345
Cap RITES	67,300		67,300
	677,045	42,600	719,645
Serial Bonds	213,190	142,440	355,630
	$890,235	$185,040	$1,075,275

The fixed rate term bonds bear interest rates of 5% to 6% and mature from 2011 to 2036. The Cap RITES Bonds will accrue interest from the date of the initial delivery through July 1, 1999 (the Scheduled Conversion Date) at a rate equal to 5.73% per annum (the Set Rate) plus the amount, if positive, obtained by subtracting 4.5% (the Level Rate) from the Variable Rate, subject to the application of the Maximum Cap RITES Rate of 11.48% per annum (the Maximum Cap Rites Rate) and thereafter at 6.25% per annum (the Constant Rate). Owners of the Cap RITES Bonds may elect on any business day prior to the applicable Scheduled Conversion Date to convert the interest to the Constant Rate. The fixed rate serial bonds bear interest rates of 4% to 6.25% and mature from 1997 to 2022.

The principal of and interest on the Series Y Bonds maturing between the years 2001 through 2009, 2011 and 2012 and the principal and interest of the Series Z Bonds maturing between 2001 and 2015 are insured by a municipal bond insurance policy issued by MBIA Insurance Corporation. The principal and interest on the Series Y Bonds maturing in the years 2015, 2016 and 2021 and the principal and interest on the Series Z Bonds maturing in 2016 and 2018 will be insured by a municipal bond insurance policy issued by Financial Security Assurance Inc.

The Series Y Bonds at the time outstanding maturing after July 1, 2014, other than the bonds maturing July 1, 2021 and 2036, may be redeemed on or after July 1, 2006 at the option of the Authority at the following prices (expressed as percentages of the principal amount):

Period during which redeemed	Redemption Price
July 1, 2006 through June 30, 2007	101 1/2 %
July 1, 2007 through June 30, 2008	100 3/4
July 1, 2008 and thereafter	100

5. Bonds Payable (continued)

The Series Y Bonds maturing July 1, 2036 may be redeemed on or after July 1, 2016 at the option of the Authority at a redemption price equal to the principal amount, plus accrued interest, without premium. The Series Z Bonds are not subject to optional redemption.

During fiscal year 1994, the Authority issued Series W and X and entered into an Interest Swap Agreement (the Swap Agreement). Under the terms of the Swap Agreement, which expires in 1999, the Authority will pay fixed interest rates on the $101,730,000 bonds at rates ranging from 2.8% to 3.769%.

A portion of the Series W Bonds were delivered as Multiple Component Securities (MCS) which allow the investors to receive the separate payments of all or a portion of the principal and interest on fixed coupon bonds. Potential MCS components include principal only, interest only, floating rate, inverse floating rate, and combinations thereof. Regardless of the combination on any MCS, the Authority will pay a Linked Fixed Rate of 9%.

A portion of the Series W and Series X were issued as Residual Interest Tax-Exempt (RITES) and as Floating Auction Tax-Exempt (FLOATs) Securities. FLOAT/RITES are variable securities consisting of a dutch-auction based floater (FLOATs) and a companion inverse floater (RITES) that together produce fixed-rate interest payments for the Authority ranging from 5.20% to 5.55%.

The 1993 Bonds, other than the MCS, the FLOAT/RITES, and the bonds maturing on July 1, 2013 and 2015, may be redeemed on or after July 1, 2003 at the option of the Authority at the following prices (expressed as percentages of the principal amount):

Period during which redeemed	Redemption Price
July 1, 2003 through June 30, 2004	101 1/2 %
July 1, 2004 through June 30, 2005	100 3/4
July 1, 2005 and thereafter	100

The FLOATS may be redeemed on or after July 1, 2003 at the option of the Authority at a redemption price equal to the principal amount, plus accrued interest, without premium.

The RITES may be redeemed on or after July 1, 2003 at the option of the Authority at the following prices (expressed as percentages of the principal amount):

Period during which redeemed	Redemption Price
July 1, 2003 through June 30, 2004	103 %
July 1, 2004 through June 30, 2005	101 1/2
July 1, 2005 and thereafter	100

5. Bonds Payable (continued)

The bonds issued prior to fiscal year 1994 do not contain early redemption provisions or variable interest rates.

Changes in term and serial bonds during fiscal year 1997 were as follows:

	Outstanding Beginning-of-Year	Issued	Redeemed	Outstanding End-of-Year
Term	$1,498,035,000	-	$ 4,250,000	$1,493,785,000
Serial	965,430,000	-	47,260,000	918,170,000
	$2,463,465,000	-	$51,510,000	$2,411,955,000

The term and serial bonds require future payments of principal and interest as follows:

Year ending June 30	Principal	Interest	Total
1998	$ 54,115,000	$ 133,977,438	$ 188,092,438
1999	56,860,000	131,127,912	187,987,912
2000	60,820,000	128,370,850	189,190,850
2001	63,660,000	123,463,737	187,123,737
2002	66,595,000	120,172,872	186,767,872
Thereafter	2,109,905,000	1,817,288,248	3,927,193,248
	$2,411,955,000	$2,454,401,057	$4,866,356,057

The bonds are secured by a pledge of the gross receipts of the gasoline excise taxes and one half of the diesel oil excise taxes, $15 per vehicle per year from certain motor vehicle license fees, the proceeds of any other taxes, fees or charges which the Legislature of Puerto Rico may allocate to the Authority in the future and which the Authority may pledge, and proceeds of any tolls or other charges which the Authority may impose for the use of any of its traffic facilities. The proceeds of the gasoline tax, the gas oil tax, diesel oil tax, and the motor vehicle license fees allocated to the Authority are available taxes and revenues under the Constitution of the Commonwealth of Puerto Rico. Accordingly, if needed, they are subject to being applied first to the payment of debt service on the public debt of the Commonwealth but such taxes and fees are to be used for such payments only if and to the extent that all other available revenues of the Commonwealth under the Constitution are insufficient for such purpose. The Commonwealth has not applied these revenues for such payments. The Bond Resolution requires that proceeds from bonds issued be used to retire bond anticipation notes and for the construction of traffic facilities.

5. Bonds Payable (continued)

The Bond Resolution further provides that receipts of pledged revenues be deposited with the Fiscal Agent to the credit of the following accounts in the following order:

A. To the Bond Service Account in an amount equal to 1/6th of the amount of interest payable on all bonds of each series issued under the Bond Resolution on the next succeeding interest payment date and an amount equal to 1/12th of the next maturing installment of any serial bonds; provided, however, that the amount so deposited on account of the interest in each month after the delivery of the bonds of any series up to and including the month immediately preceding the first interest payment date thereafter of the bonds of such series, shall be that amount which when multiplied by the number of such deposits will be equal to the amount of interest payable on such bonds on such first interest payment date less the amount of any accrued interest paid on such bonds and deposited to the credit of the Bond Service Account. In the case of variable rate bonds, the actual interest on such bonds is deposited monthly with the Fiscal Agent.

B. To the Redemption Account, in an amount equal to 1/12th of the amortization requirement as defined in the Bond Resolution for such fiscal year for the term bonds of each series then outstanding plus an amount equal to 1/12th of the premium, if any, which would be payable on the first redemption date in the following fiscal year on a like principal amount of bonds if such principal amount of bonds should be redeemed prior to their maturity from moneys in the Sinking Fund.

C. To the Reserve Account, the amount required to make the amount deposited during the current fiscal year equal to the lesser of the maximum annual principal and interest requirements (as defined in the Bond Resolution) in any fiscal year on all outstanding bonds and 10% of the original amount of each Series of Bonds outstanding, permit any increase in the Reserve Requirement to be funded over five years and allow the Authority to use a letter of credit or insurance policy to fund the Reserve Requirement. Excess funds in the Reserve Account can be transferred to the Construction Fund, the Bond Service Account or the Redemption Account, as determined from time to time by the Authority.

   If funds in the Reserve Account are used to cover any deficiency in the Bond Service Account or the Redemption Account established under the Resolution, the Excise Act provides that the Reserve Account shall be reimbursed, subject to the provisions of the Constitution of the Commonwealth relating to payment of Commonwealth debt, from the first proceeds received by the Commonwealth in the next fiscal year or years derived from (i) any remaining portion of the tax on gasoline and gas oil and diesel oil then in effect and (ii) any other taxes which may then be in effect on any other fuels or propellants which are used, among other purposes, to propel highway vehicles.

D. Any revenues remaining after making the deposits referred to above are deposited in the Construction Fund for use by the Authority for any of its authorized purposes.

The requirements specified in paragraphs A., B. and C. above are cumulative.

5. Bonds Payable (continued)

The following analysis summarizes the cash transactions during the year ended June 30, 1997 in the Debt Service Accounts (in thousands).

	Bond Service Account	Redemption Account	Reserve Account	Total Debt Service fund
Balance at June 30,1996	$ 307	$ (4,098)	$300,800	$297,009
Increase:				
Revenues transferred	154,119	26,405	-	180,524
Investment income	3,559	1,917	15,845	21,321
	157,985	24,224	316,645	498,854
Decreases:				
Bond principal payments	21,600	22,305	-	43,905
Bond interest payments	126,995	-	-	126,995
	148,595	22,305	-	170,900
Balance at June 30, 1997	$ 9,390	$ 1,919	$316,645	$327,954

The Bond Resolution provides that additional bonds may be issued for the purpose of providing funds for completing payment of the cost of any traffic facilities or for paying all or any part of the cost of any additional traffic facilities, including the payment of any outstanding notes of the Authority which were issued to temporarily finance the costs of the traffic facilities for which such bonds are to be issued, and for refunding at or prior to their maturity or maturities all of the outstanding bonds of any series, or a portion thereof (as defined in the second Supplemental Resolution). However, the Authority must comply with certain requirements included in the Bond Resolution related to revenues and maximum amounts of principal and interest prior to any additional bond issuance.

Nothing in the Bond Resolution is to be construed as preventing the Authority from financing any facilities authorized by the Authority Act through the issuance of bonds or other obligations which are not secured under the provisions of the Bond Resolution.

6. Pension Plan

The Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is a cost-sharing multiple-employer defined benefit pension plan sponsored by, and reported as a component unit of, the Commonwealth of Puerto Rico. All regular employees of the Authority under age 55, at the date of employment, become members of the System as a condition of their employment.

The System provides retirement, death and disability benefits pursuant to Act 447, approved on May 15, 1951, as amended, which became effective on January 1, 1952. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

Members who have attained an age of at least fifty-five (55) years and have completed at least twenty-five (25) years of creditable service or members who have attained an age of at least fifty-eight (58) years and have completed at least ten (10) years of creditable service or at age 65 with 10 years of service if hired after April, 1990, are entitled to an annual benefit, payable monthly for life.

The amount of the annuity shall be one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case will the annuity be less than $200 per month.

Participants who have completed at least thirty years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five (55) years of age will receive 65% of the average compensation. Participants who have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service.

No benefit is payable if the participant receives a refund of his accumulated contributions.

Commonwealth legislation requires employees to contribute 5.775 percent for the first $550 of their monthly gross salary and 8.275 percent for the salary in excess of $550. The Authority's contributions are 9.275 percent of gross salary. The contribution requirement for the year ended June 30, 1997 was approximately $7,257,000, which consisted of approximately $3,943,000 from the Authority and $3,314,000 from employees. The payroll for employees covered by the System for the year ended June 30, 1997 was approximately $41,966,047 and the Authority's total payroll cost was approximately $66,500,488.

For the two preceding fiscal years the Authority contributed $3,457,000 and $3,600,000 which represented all required contributions.

6. Pension Plan (continued)

The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to-date. The measure, which is the actuarial present value of credited projected benefits, is intended to help users assess the System's funding status on a going concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons between public employee retirement systems and employers.

The actuarial present value of pension benefit obligation at June 30, 1996, the latest date available for the System as a whole, follows (amounts in millions):

Pension benefit obligation:	
Retirees, beneficiaries and terminated employees not yet receiving benefits	$ 3,021
Current employees:	
Vested	3,197
Nonvested	102
Total pension benefit obligation	6,320
Net assets available for benefits	1,230
Unfunded pension benefit obligation	$ 5,090

The following assumptions were used in the actuarial valuation:

Investment rate of return per year	8.5%
Salary increase	5%
Mortality rate table	GA'51

Trend information gives an indication of the progress made in accumulating sufficient assets to pay benefits when due. Trend information for the available years is as follows (amounts in millions):

Net assets available for benefits as a percentage of total pension benefit obligation:	
June 30, 1996	19%
June 30, 1995	18%
June 30, 1994	17%
Unfunded pension benefit obligation as a percentage of annual covered payroll:	
June 30, 1996	127%
June 30, 1995	134%
June 30, 1994	132%

6. Pension Plan (continued)

Showing unfunded pension benefit obligation as a percentage of annual covered payroll approximately adjusts for the effects of inflation for analysis purposes.

The Authority has a labor union contract that provides all union employees who work for the Authority upon retirement with the following lum-sum bonus payable at the retirement date computed as follows:

Years worked	Amount
10-15 years	$125 per year of service
16-20	$155 per year of service
21-25	$165 per year of service
26 and over	$175 per year of service

In addition, management employees have similar benefits under the same conditions granted to labor union personnel, as follows:

Years worked	Amount
10-15 years	$135 per year of service
16-20	$165 per year of service
21-25	$180 per year of service
26 and over	$200 per year of service

7. Enterprise Funds

The Authority maintains separate enterprise funds to account for the operations of the Metrobus system and the Tren Urbano project. The Metrobus consists of bus operations which are conducted by a private company. The Tren Urbano project will be a mass rail transportation project.

7. Enterprise Funds (continued)

The following summarizes the components of the enterprise funds included in the Combined Balance Sheet - All Fund Types and Account Groups:

	Metrobus	Tren Urbano	Total Metrobus
Due from other funds	$ 4,363	$ 2,568,481	$ 2,572,844
Property and equipment - net	10,325,406	816,890	11,142,296
Construction in progress	-	170,875,164	170,875,164
	$10,329,769	$174,260,535	$184,590,304
Other liabilities	$ 4,363	$ 9,455,405	$ 9,459,768
Contributed capital:			
Federal government	9,182,538	27,311,111	36,493,649
Authority's funds	1,142,868	137,494,019	138,636,887
	10,325,406	164,805,130	175,130,536
	$10,329,769	$174,260,535	$184,590,304

The capital expenditures related to Metrobus and Tren Urbano funds during the year ended June 30, 1997, amounted to $6,035,963 and $109,854,369, respectively.

All the revenues and expenses shown in the Combined Statement of Revenues, Expenses and Changes in Retained Earnings-Enterprise Fund are attributable to the Metrobus operations.

During 1997 the Authority transferred $1,223,952 and $87,561,673 to the Metrobus and Tren Urbano funds, respectively for a total residual equity transfer of $88,785,625.

8. Commitments and Contingent Liabilities

Construction

As of June 30, 1997, the Authority had commitments for approximately $352,000,000 related to construction contracts.

8. Commitments and Contingent Liabilities (continued)

Leases

The Authority has various noncancellable operating leases for office space with the Puerto Rico Public Buildings Authority and other lessors expiring from 2004 to 2090. The rental expenditure for the year ended June 30, 1997 was approximately $1,593,200. Future rental payments as of June 30, 1997 under these leases are as follows:

Year	Amount
1998	$ 1,309,900
1999	1,264,800
2000	1,240,100
2001	1,232,200
2002	1,232,200
Thereafter	6,763,900
Total minimum payments required	$13,043,100

Litigation

The Authority is defendant or co-defendant in various lawsuits for alleged damages. Substantially all of these cases are in connection with construction projects which are generally either fully or partially covered by insurance. The contractors are required, under the terms of the construction agreements, to carry adequate public liability insurance and to hold harmless the Authority from lawsuits brought on account of damages relating to the construction of the projects.

The Authority, based on legal advice, has recorded an adequate provision to cover probable losses on those claims not fully covered by insurance. In the opinion of legal counsel any liability, in excess of the insurance coverage and/or the recorded provision, that may arise from such claims would not be significant in relation to the Authority's financial position.

Special Revenue Facility Bonds

In March 1992, the Authority issued Special Facility Revenue Bonds amounting to approximately $117 million for the purpose of facilitating the construction of a toll bridge which traverses the San Jose Lagoon between the municipalities of San Juan and Carolina.

The proceeds from the sale of the bonds were transferred by the Authority to Autopistas de Puerto Rico y Compañía S.E. (the Borrower) pursuant to a loan agreement by and between the Borrower and the Authority.

8. Commitments and Contingent Liabilities (continued)

Special Facility Revenue Bonds (continued)

The Authority and the Borrower entered into a build/transfer/operate concession agreement for the design, construction, operation and maintenance of the Teodoro Moscoso Bridge (the Bridge). The initial term of this agreement is 35 years. Under certain circumstances, the Concession Agreement may be terminated and the Authority is then to assume all of the Borrower's obligations of the principal of and interest on the Bonds, which pursuant to the Loan Agreement will be paid from the proceeds of the use and operation of the Bridge. The outstanding debt (including accrued interest) and the sinking fund balances at June 30, 1997 amounted to approximately $126,012,900 and $1,400, respectively.

Metrobus

In connection with the responsibilities of the Authority for mass transportation systems, the Metrobus project was developed. The project consists of bus operations which are conducted by a private company under an agreement expiring in September 1, 1998.

The contract for the operation of the Metrobus Project provides for fixed payments to the operator. Operators' compensation is based on monthly payments amounting to one-twelfth of the total annual operating cost. Tollfares, which are retained by the operator, are reduced from such payments based on tollfare estimates. In addition, the Operator has various incentive fees for meeting or exceeding various performance standards.

9. Subsequent Events

On July 16, 1997 Law Number 34 was approved to assign additional recurring revenues to the Authority to a maximum of $10 million monthly derived from excise taxes over crude oil and its derivatives.

In addition, on July 18, 1997 the Authority requested a line of credit of $100,000,000 with the Government Development Bank for Puerto Rico expiring on July 1, 1999. This line of credit will be paid with the proceeds of future bond issuance.

[This page intentionally left blank]

JORGENSEN
Roy Jorgensen Associates, Inc.

APPENDIX III

Corporate Offices

3735 Buckeystown Pike
Post Office Box 70
Buckeystown, MD 21717-0070

Telephone: 1-301-831-1000
Facsimile: 1-301-874-2876

January 27, 1998

Dr. Sergio L. Gonzalez Quevedo, Executive Director
Puerto Rico Highway and Transportation Authority
P.O. Box 42007
San Juan, Puerto Rico 00940-2007

Dear Dr. Gonzalez:

This letter summarizes the results of our evaluation of the level of maintenance of the Puerto Rico Highway and Transportation Authority's Traffic Facilities and our review of the Construction Improvement Program for the period 1997-2001. Our study was conducted in accordance with Resolution No. 68-18, adopted June 13, 1968, as amended. Results of the study are documented in our Final Report, dated December 1997.

Based on our field inspections, we find that the overall level of maintenance has generally been adequate to preserve the investment and provide an acceptable level of service. Maintenance work methods and levels of service are in general conformance to widely accepted maintenance practices in transportation and public works departments in North America.

We have reviewed the 5-Year Construction Improvement Program. In our opinion, the program is a reasonable response to the immediate and short-term transportation needs of the Commonwealth and is generally consistent with the Authority's long-range transportation master plan. Revenue projections have been reasonably accurate in the past and provide a sound basis for determining the size of future programs.

Sincerely,

William C. Grenke

William C. Grenke
Senior Vice President

[This page intentionally left blank]

BROWN & WOOD LLP

ONE WORLD TRADE CENTER
NEW YORK, N.Y. 10048-0557

TELEPHONE: 212-839-5300
FACSIMILE: 212-839-5599

APPENDIX IV

March ___, 1998

Hon. Dr. Carlos I. Pesquera Morales
Secretary of Transportation and Public Works
San Juan, Puerto Rico

Dear Sir:

We have examined (a) Act No. 74 of the Legislature of Puerto Rico, approved June 23, 1965, as amended ("Act No. 74"), creating Puerto Rico Highways and Transportation Authority (hereinafter sometimes called the "Authority"), as a body corporate and politic constituting a public corporation and government instrumentality of the Commonwealth of Puerto Rico, (b) the Puerto Rico Internal Revenue Code of 1994 (Subtitle B of Act No. 120 of the Legislature of Puerto Rico, approved October 31, 1994, as amended in particular by Act No. 34 of the Legislature of Puerto Rico, approved July 16, 1997, as amended), which allocated (1) the proceeds of the sixteen cents per gallon tax imposed on gasoline and four cents of the eight cents per gallon tax on gas oil and diesel oil (the "Allocated Gasoline Tax Proceeds") and (2) the proceeds (up to $120 million per fiscal year) of the tax imposed on crude oil, unfinished oil and derivative products (the "Allocated Crude Oil Tax Proceeds") to the Authority for use for its corporate purposes, (c) the Vehicle and Traffic Law of Puerto Rico (Act No. 141 of the Legislature of Puerto Rico, approved July 20, 1960, as amended) which allocated the proceeds of the fifteen dollar increase in the motor vehicle license fees for public and private service automobiles imposed by Act No. 9 of the Legislature of Puerto Rico, approved August 12, 1982 (the "Allocated Additional License Fees"), to the Authority for use for its corporate purposes and (d) Reorganization Plan No. 6 of 1971 (Act No. 113 of the Legislature of Puerto Rico, approved June 21, 1968), which attached the Authority to the Department of Transportation and Public Works.

We have also examined certified copies of the proceedings of the Authority, including (I) Resolution No. 68-18, adopted on June 13, 1968, as amended by Resolution No. 72-08, adopted on February 17, 1972, Resolution No. 90-42, adopted on October 29, 1990, Resolution No. 92-42, adopted on June 23, 1992, Resolution No. 93-25, adopted on July 15, 1993 (effective September 8, 1993), and Resolution No. 93-30, adopted on August 10, 1993 (collectively, the "1968 Resolution"), with respect to the Highway Revenue Bonds (hereinafter mentioned), and (II) Resolution No. 98-06, adopted on February 26, 1998 (said Resolution No. 98-06, as the same may be amended as therein permitted, being herein called the "1998 Resolution"), together with a resolution adopted on February 26, 1998, with respect to the Series A Bonds described below and other proofs submitted relative to the authorization, sale and issuance of

LOS ANGELES • SAN FRANCISCO • WASHINGTON • BEIJING • TOKYO REPRESENTATIVE OFFICE
AFFILIATED WITH BROWN & WOOD, A MULTINATIONAL PARTNERSHIP WITH OFFICES IN LONDON AND HONG KONG

$1,129,643,740

**PUERTO RICO HIGHWAYS AND TRANSPORTATION AUTHORITY
TRANSPORTATION REVENUE BONDS
(SERIES A)**

Maturing in such principal amounts, subject to redemption, dated, and bearing interest at the rates, all as set forth in the 1998 Resolution and in said resolution adopted on February 26, 1998.

We have also examined one of said Series A Bonds as executed and authenticated.

From such examination we are of the opinion that:

1. Act No. 74, the Puerto Rico Internal Revenue Code of 1994, the Vehicle and Traffic Law of Puerto Rico and Reorganization Plan No. 6 of 1971 are valid.

2. Said proceedings have been validly and legally taken.

3. Said Series A Bonds have been duly authorized and issued to pay the cost of constructing highways, mass transit facilities and other transportation facilities, including the payment of notes heretofore issued by the Authority for such purposes, to refund certain Highway Revenue Bonds heretofore issued under the 1968 Resolution for certain of the foregoing purposes and to make a deposit to the credit of the Senior Bond Reserve Account in the Interest and Sinking Fund hereinafter mentioned.

4. The Authority has heretofore issued various series of Highway Revenue Bonds under and in compliance with the provisions of the 1968 Resolution. The 1968 Resolution provides for the issuance of additional Highway Revenue Bonds under the conditions and limitations therein set forth, and the Authority has covenanted in the 1998 Resolution to limit the issuance of such additional Highway Revenue Bonds.

5. The 1998 Resolution provides for the issuance of additional bonds on a parity with said Series A Bonds under the conditions, limitations and restrictions therein set forth (said Series A Bonds and such additional parity bonds being herein called the "Senior Transportation Revenue Bonds") for any lawful purpose of the Authority and for the purpose of refunding any bonds issued by the Authority under the 1998 Resolution and any other obligations of the Authority, including outstanding Highway Revenue Bonds. In addition, the 1998 Resolution provides for the issuance of bonds subordinate to the Senior Transportation Revenue Bonds as to their lien on the revenues and other moneys of the Authority, as described below, under the conditions, limitations and restrictions and for the purposes set forth therein (the Senior Transportation Revenue Bonds and such bonds subordinate thereto being herein collectively called the "Transportation Revenue Bonds").

6. The 1998 Resolution provides for the creation of a special fund designated "Puerto Rico Highways and Transportation Authority Transportation Revenue Fund" (the "Revenue Fund"), and, subject to the limitations of the next two paragraphs, for the deposit to the credit of said special fund of all moneys received by the Authority (a) from the Allocated Crude Oil Tax Proceeds, (b) from the Allocated Gasoline Tax Proceeds, (c) from the Allocated Additional License Fees, (d) from any tolls or other charges imposed by the Authority for the use of any Toll Facilities (other than

Existing Toll Facilities Revenues received by the Authority prior to the repeal and cancellation of the 1968 Resolution) (as such terms are defined in the 1998 Resolution) and (e) from the proceeds of any other taxes, fees or charges which the Legislature of Puerto Rico may allocate to the Authority and expressly authorizes the Authority to pledge to the payment of the principal of and interest on bonds or other obligations issued by the Authority and which are pledged by the Authority to the payment of the principal of and interest on Transportation Revenue Bonds issued under the provisions of the 1998 Resolution.

The Allocated Gasoline Tax Proceeds, the Allocated Crude Oil Tax Proceeds and the Allocated Additional License Fees, and any other taxes, fees or charges which the Legislature of Puerto Rico may allocate to the Authority, are subject to first being applied to the payment of interest and amortization of the public debt in accordance with the provisions of, and to the extent provided by, Section 8 of Article VI of the Constitution of Puerto Rico if needed for such purpose.

The 1968 Resolution provides for the prior deposit to the credit of a special fund designated "Puerto Rico Highways and Transportation Authority Construction Fund" (herein called the "1968 Construction Fund") of the Allocated Gasoline Tax Revenues, the Allocated Additional License Fees and all Existing Toll Facilities Revenues, after the required deposits of such moneys have been made to the credit of the Puerto Rico Highways and Transportation Authority Highway Revenue Bonds Interest and Sinking Fund. In the 1998 Resolution, the Authority has covenanted (i) monthly to withdraw from the 1968 Construction Fund and deposit to the credit of the Revenue Fund until the outstanding Highway Revenue Bonds have been paid or provision has been made for their payment and the repeal and cancellation of the 1968 Resolution, all unencumbered moneys held to the credit of the 1968 Construction Fund and (ii) except for the foregoing withdrawal and any encumbrances on the moneys in the 1968 Construction Fund existing on the date of adoption of and as provided in the 1998 Resolution, not further to encumber or otherwise withdraw or pledge any such available moneys in the 1968 Construction Fund.

7. Said Series A Bonds are valid and binding special obligations of the Authority payable solely from the special fund created by the 1998 Resolution and designated "Puerto Rico Highways and Transportation Authority Transportation Revenue Bonds Interest and Sinking Fund". The Authority has covenanted to deposit to the credit of said Interest and Sinking Fund a sufficient amount of the moneys held to the credit of the Revenue Fund, together with any other funds of the Commonwealth of Puerto Rico allocated to the Authority and available under the 1998 Resolution for the payment of principal of and interest on the Senior Transportation Revenue Bonds, to pay the principal of and interest on all Senior Transportation Revenue Bonds (including said Series A Bonds) issued under the provisions of the 1998 Resolution as the same may become due and payable and to create and maintain a reserve therefor. Said Interest and Sinking Fund is pledged to and charged with the payment of the principal of and the interest on all Senior Transportation Revenue Bonds (including said Series A Bonds) issued by the Authority under the provisions of the 1998 Resolution.

8. Said Series A Bonds do not constitute a debt of the Commonwealth of Puerto Rico or of any of its municipalities or other political subdivisions, and neither the Commonwealth of Puerto Rico nor any such municipality or other political subdivision is liable thereon, and said Series A Bonds are payable only out of the revenues and other moneys of or allocated to the Authority, to the extent provided in the 1998 Resolution.

9. Under the provisions of the Acts of Congress now in force and under existing regulations and judicial 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 1998 Resolution regarding the use, expenditure and investment of Series A Bond proceeds and the timely payment of certain investment earnings to the Treasury of the United States, if required, interest on said Series A Bonds is not includable in gross income for federal income tax purposes, and (ii) said Series A Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation.

Interest on said Series A Bonds is not an item of tax preference for the purpose of computing the alternative minimum tax on individuals and corporations imposed by the Code. Such interest will, however, be 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 said Series A Bonds or (b) the inclusion in certain computations (including, without limitation, those related to the corporate alternative minimum tax) of interest that is excluded from gross income.

The Authority 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 said Series A Bonds will remain exempt from federal income taxes to which it is not subject on the date of issuance of the said Series A Bonds. We are not aware of any provisions of the Constitution and laws of the Commonwealth of Puerto Rico which would prevent such compliance.

Respectfully submitted,

[To be signed by "Brown & Wood LLP"]

APPENDIX V

Ambac

Municipal Bond Insurance Policy

Ambac Assurance Corporation
c/o CT Corporation Systems
44 East Mifflin Street, Madison, Wisconsin 53703
Administrative Office:
One State Street Plaza, New York, New York 10004
Telephone: (212) 668-0340

Issuer:

Policy Number:

Bonds:

Premium:

Ambac Assurance Corporation (Ambac) A Wisconsin Stock Insurance Company

in consideration of the payment of the premium and subject to the terms of this Policy, hereby agrees to pay to United States Trust Company of New York, as trustee, or its successor (the "Insurance Trustee"), for the benefit of Bondholders, that portion of the principal of and interest on the above-described debt obligations (the "Bonds") which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

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

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

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

As used herein, the term "Bondholder" means any person other than the Issuer who, at the time of Nonpayment, is the owner of a Bond or of a coupon appertaining to a Bond. As used herein, "Due for Payment", when referring to the principal of bonds, is when the stated maturity date or a mandatory redemption date for the application of a required sinking fund installment has been reached and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by application of required sinking fund installments), acceleration or other advancement of maturity; and, when referring to interest on the Bonds, is when the stated date for payment of interest has been reached. As used herein, "Nonpayment" means the failure of the Issuer to have provided sufficient funds to the paying agent for payment in full of all principal of and interest on the Bonds which are Due for Payment.

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

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

President

AMBAC ASSURANCE CORPORATION CORPORATE SEAL WISCONSIN

Secretary

Effective Date:

Authorized Representative

UNITED STATES TRUST COMPANY OF NEW YORK acknowledges that it has agreed to perform the duties of Insurance Trustee under this Policy.

Authorized Officer

[This page intentionally left blank]

TABLE OF ACCRETED VALUES

Puerto Rico Highway and Transportation Authority
Transportation Revenue Bonds (Series A)

Date	Capital Appreciation Bonds Due July 1,			
	2015	2016	2017	2018
March 19, 1998	2,147.55	2,026.90	1,911.15	1,809.20
July 1, 1998	2,177.50	2,055.45	1,938.35	1,835.10
January 1, 1999	2,231.40	2,106.85	1,987.30	1,881.65
July 1, 1999	2,286.60	2,159.50	2,037.50	1,929.40
January 1, 2000	2,343.20	2,213.50	2,088.90	1,978.35
July 1, 2000	2,401.20	2,268.85	2,141.65	2,028.55
January 1, 2001	2,460.65	2,325.55	2,195.75	2,080.05
July 1, 2001	2,521.55	2,383.70	2,251.20	2,132.80
January 1, 2002	2,583.95	2,443.30	2,308.05	2,186.95
July 1, 2002	2,647.90	2,504.35	2,366.30	2,242.45
January 1, 2003	2,713.45	2,566.95	2,426.05	2,299.35
July 1, 2003	2,780.60	2,631.15	2,487.30	2,357.65
January 1, 2004	2,849.40	2,696.95	2,550.15	2,417.50
July 1, 2004	2,919.95	2,764.35	2,614.50	2,478.85
January 1, 2005	2,992.20	2,833.45	2,680.55	2,541.75
July 1, 2005	3,066.25	2,904.30	2,748.20	2,606.25
January 1, 2006	3,142.15	2,976.90	2,817.60	2,672.40
July 1, 2006	3,219.90	3,051.35	2,888.75	2,740.20
January 1, 2007	3,299.60	3,127.60	2,961.70	2,809.70
July 1, 2007	3,381.25	3,205.80	3,036.50	2,881.00
January 1, 2008	3,464.95	3,285.95	3,113.15	2,954.15
July 1, 2008	3,550.70	3,368.10	3,191.75	3,029.10
January 1, 2009	3,638.60	3,452.30	3,272.35	3,105.95
July 1, 2009	3,728.65	3,538.60	3,355.00	3,184.75
January 1, 2010	3,820.95	3,627.10	3,439.70	3,265.60
July 1, 2010	3,915.50	3,717.75	3,526.55	3,348.45
January 1, 2011	4,012.40	3,810.70	3,615.60	3,433.40
July 1, 2011	4,111.70	3,905.95	3,706.90	3,520.55
January 1, 2012	4,213.50	4,003.60	3,800.50	3,609.85
July 1, 2012	4,317.75	4,103.70	3,896.45	3,701.45
January 1, 2013	4,424.65	4,206.30	3,994.85	3,795.40
July 1, 2013	4,534.15	4,311.45	4,095.70	3,891.70
January 1, 2014	4,646.35	4,419.25	4,199.15	3,990.45
July 1, 2014	4,761.35	4,529.75	4,305.15	4,091.70
January 1, 2015	4,879.20	4,642.95	4,413.85	4,195.55
July 1, 2015	5,000.00	4,759.05	4,525.30	4,302.00
January 1, 2016		4,878.00	4,639.60	4,411.15
July 1, 2016		5,000.00	4,756.75	4,523.10
January 1, 2017			4,876.85	4,637.90
July 1, 2017			5,000.00	4,755.55
January 1, 2018				4,876.25
July 1, 2018				5,000.00