COMMONWEALTH OF PUERTO RICO
Financial Information and Operating Data Report
May 17, 2013

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INTRODUCTION

General

The financial and operating information about the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico") included in this Report has been updated as of March 31, 2013, except as otherwise provided herein. The Commonwealth's fiscal year runs from July 1 through June 30 of the following year. References in this Report to a particular fiscal year are to the year in which such fiscal year ends.

Forward-Looking Statements

The information included in this Report contains certain "forward-looking" statements. These forward-looking statements may relate to the Commonwealth's fiscal and economic condition, economic performance, plans, and objectives. All statements contained herein that are not clearly historical in nature are forward-looking, and the words "anticipates," "believes," "continues," "expects," "estimates," "intends," "aims," "projects," and similar expressions, and future or conditional verbs such as "will," "would," "should," "could," "might," "can," "may," or similar expressions, are generally intended to identify forward-looking statements.

These statements are not guarantees of future performance and involve certain risks, uncertainties, estimates, and assumptions by the Commonwealth that are difficult to predict. The economic and financial condition of the Commonwealth is affected by various financial, social, economic, environmental, and political factors. These factors can be very complex, may vary from one fiscal year to the next, and are frequently the result of actions taken or not taken, not only by the Commonwealth and its agencies and instrumentalities, but also by entities such as the government of the United States of America or other nations that are not under the control of the Commonwealth. Because of the uncertainty and unpredictability of these factors, their impact cannot, as a practical matter, be included in the assumptions underlying the Commonwealth's projections.

The projections set forth in this Report were not prepared with a view toward complying with the guidelines established by the American Institute of Certified Public Accountants with respect to prospective financial information, but, in the view of the Commonwealth's officers responsible for the preparation of such information, were prepared on a reasonable basis, reflect the best currently available estimates and judgments, and present, to the best of such officers' knowledge and belief, the expected course of action and the expected future financial performance of the Commonwealth. However, this information is not fact and should not be relied upon as being necessarily indicative of future results, and readers of this Report are cautioned not to place undue reliance on the prospective financial information. Neither the Commonwealth's independent auditors, nor any other independent auditors, have compiled, examined, or performed any procedures with respect to the prospective financial information contained herein, nor have they expressed any opinion or any other form of assurance on such information or its achievability and disclaim any association with the prospective financial information. Neither the Commonwealth's independent auditors, nor any other independent auditors, have been consulted in connection with the preparation of the prospective financial information set forth in this Report, which is solely the product of the Commonwealth, and the independent auditors assume no responsibility for its content.

Recent Developments; Overview of Economic and Fiscal Condition

2012 Elections

As a result of the November 2012 Puerto Rico elections, Alejandro J. García Padilla, a member of the Popular Democratic Party, was sworn in as Governor of the Commonwealth in January of 2013, succeeding Luis Fortuño of the New Progressive Party. The Popular Democratic Party also won a majority in the Senate and the House of Representatives.

Adoption of Comprehensive Reform of Employees Retirement System

On April 4, 2013, the Governor of Puerto Rico signed into law Act 3 of 2013 ("Act 3"), which adopted a comprehensive reform of the Employees Retirement System of the Commonwealth (the "Employees Retirement System"), the largest of the three Commonwealth retirement systems that are funded primarily with budget appropriations from the Commonwealth's General Fund. The other two systems are the Puerto Rico System of Annuities and Persons for Teachers (the "Teachers Retirement System") and the Commonwealth Judiciary Retirement System (the "Judiciary Retirement System"). See "RETIREMENT SYSTEMS" for a description of the three retirement systems.

Act 3, which is effective on July 1, 2013 ("Effective Date"), provides the following: (i) it freezes and grandfathers the benefits that have accrued through June 30, 2013 of those participants who are covered by the Employees Retirement System's defined benefit formula (those who joined the Employees Retirement System prior to January 1, 2000 whose retirement benefits accrued at a rate of 1.5% or 2% per year of creditable service) (the "Defined Benefit Employees"); (ii) it provides that, beginning on July 1, 2013, the retirement benefits accruing on and after the Effective Date for Defined Benefit Employees will be calculated based on a defined contribution formula, similar to the "System 2000" formula currently applicable to employees who joined the Employees Retirement System on or after January 1, 2000, with all such benefits being paid in the form of a lifetime annuity rather than a lump sum payment (upon retirement, the employee will receive the benefits accrued through June 30, 2013 based on the defined benefit formula plus the contributions made by the employee after June 30, 2013); (iii) it provides that defined contribution benefits accrued pursuant to System 200 will also be paid in the form of a lifetime annuity rather than a lump sum payment; (iv) it eliminates the so called "merit pension" that provided to participants who joined the Employees Retirement System prior to April 1, 1990, after attaining 30 years of service, a retirement benefit of 65% (if less than 55 years of age) or 75% (if age 55 or greater) of the average salary earned during the highest 36 months of employment; (v) it increases the retirement age for various groups of participants; (vi) it increases the employee contribution to the Employees Retirement System from 8.275% to 10%; (vii) it eliminates or reduces various retirement benefits previously granted by special laws; (viii) it increases the minimum pension from $400 to $500 per month for current retirees; and (ix) it eliminates or modifies other benefits, such as disability and survivor benefits.

For many years, the financial condition of the three Commonwealth retirement systems has been one of the principal fiscal challenges facing Puerto Rico. Although certain measures had been implemented in recent years, in an effort to address the recurring solvency issue, such as the enactment in 2011 of a gradual increase in the employer contributions to the Employees Retirement System and the Teachers Retirement System the funding ratios of the retirement systems were projected to continue to decline and the retirement systems were projected to run out of cash within the next ten years unless a more comprehensive reform was adopted. As of June 30, 2011, the date of the latest actuarial valuations of the three retirement systems, the unfunded actuarial accrued liability (including basic and system administered benefits) for the Employees Retirement System, the Teachers Retirement System and the Judiciary Retirement System was $23.7 billion, $9.1 billion and $319 million, respectively, and their funded ratios were 6.8%, 20.8% and 16.7%, respectively. The funding shortfall for fiscal year 2011 for each system was approximately $802 million, $314 million and $6.5 million, respectively. For fiscal year 2012, the preliminary funding shortfall was estimated at $839 million, $315 million and $8.5 million, respectively.

Absent the enactment of Act 3, it was anticipated that the assets of the Employees Retirement System would be depleted by fiscal year 2019 and that the cash funding shortfall during the period between fiscal year 2019 and fiscal year 2043 would be, on average, $905 million per year, which the Commonwealth and the other employers would have been required to contribute. With the enactment of Act 3, and taking into account an additional annual contribution of $140 million for the next 20 years, an appropriation which has been included in the proposed budget for fiscal year 2014, is projected that the cash funding shortfall of the Employees Retirement System will be eliminated.

The adoption of Act 3 is a critical step in addressing the financial condition of the Employees Retirement System. Based on current census data, expectation of market conditions and other actuarial assumptions, the Employees Retirement System’s actuaries expect that the changes to the System instituted by Act 3, when taken together with an additional annual contribution of $140 million for the next 20 years, will be sufficient to cover the System’s obligations now and in the long-term. Act 3 does not address the underfunding condition of the Teachers Retirement System or the Judiciary Retirement System, nor does it eliminate the need for the Commonwealth to make additional contributions to the Employees Retirement System, as discussed above. The Commonwealth is evaluating alternatives for addressing the funding shortfall of the Teachers Retirement System.

The constitutionality of Act 3 is currently being challenged in several lawsuits brought by participants of the Employees Retirement System. The Commonwealth of Puerto Rico believes that Act 3 is constitutional and intends to forcefully defend its constitutionality in all forums. For more information, see “LITIGATION”-Pension Reform”.

Since the Commonwealth and other participating employers are ultimately responsible for any funding deficiency in the three retirement systems, the depletion of the assets available to cover retirement benefits could require the Commonwealth and other participating employers to cover annual funding deficiencies. It is estimated that the Commonwealth would be responsible for approximately 74% of the combined annual funding deficiency of the three retirement systems, with the balance being the responsibility of the municipalities and participating public corporations.

The Commonwealth also provides non-pension post-employment benefits that include a medical insurance plan contribution. These benefits, which amounted to $114.2 million for fiscal year 2010 and $125.4 million for fiscal year 2011, are funded on a pay-as-you-go basis from the General Fund and are valued using actuarial principles similar to the way that pension benefits are calculated. Based on the latest actuarial valuations, as of June 30, 2011, the aggregate unfunded actuarial accrued liability of these benefits for the three retirement systems was $2.5 billion. Act 3 eliminated all the non-pension post employment system benefits to future retirees and reduced some of the benefits paid to current retirees. Act 3 did not change the medical insurance plan contribution for current retirees.

For more information regarding Act 3 and the situation of the Commonwealth retirement systems, see "RETIREMENT SYSTEMS."

Offset of Federal Funds

Since January 2013, certain federal funds due to the Commonwealth and/or its instrumentalities have been withheld by the United States Department of the Treasury (the "US Treasury") pursuant to the Treasury Offset Program ("TOP") to setoff payments due on a debt owed by the Commonwealth to the United States Army Corps of Engineers ("USACE") in connection with the completion of the Cerrillos Dam and Reservoir and the Portuguese-River and Bucana-River Projects (the "Reservoir Projects") during the 1980s. As of May 15, 2013, approximately $158 million in federal funds have been withheld by the US Treasury pursuant to the TOP.

In April 2011, the Commonwealth received a notification from USACE establishing an allocation of costs and repayment schedule for its allocated share of the construction costs of the Reservoir Projects amounting to $214 million. According to the USACE's notification, the allocated share of the construction costs plus accrued and projected interest calculated at a per annum rate of 6.063% through maturity (June 30, 2046) totaled approximately $598 million, as of April 2011. Due to non-payment by the Commonwealth of amounts deemed due by USACE, USACE notified the Commonwealth in late 2012 of its intention to refer the Commonwealth to the US Treasury for collection pursuant to the TOP of any amounts due. The Commonwealth expects that the approximately $158 million in federal funds withheld as of May 15, 2013 will be applied by the US Treasury against the principal and interest owed by the Commonwealth to USACE and therefore shall not be returned to the Commonwealth as part of any final debt agreement.

The USACE informed the Commonwealth on May 16, 2013 that it had decided to take the Commonwealth off the TOP pending the negotiation of the final debt agreement with the Commonwealth. The Secretary of the Treasury of the Commonwealth is in the process of negotiating a final debt agreement with the USACE and the United States Department of Justice to achieve more manageable repayment terms and to avoid further offsets of federal payments due to the Commonwealth and/or its instrumentalities. As part of such negotiations, the Commonwealth has requested that certain amounts constituting penalty interest be forgiven.

Proposed Budget for Fiscal Year 2014

The proposed budget for fiscal year 2014 provides for total resources of $16.050 billion, of which $9.835 billion are General Fund resources. Resources include $9.635 billion in projected General Fund revenues and $200 million in deficit financing. The principal changes in the fiscal year 2014 budgeted Central Government revenues compared to fiscal year 2013 are accounted mainly by the projected collections from sales and use taxes (up $1.05 billion), corporate income tax (down $139 million), withholding taxes on non-residents (down $140 million), alcoholic beverage (down $3 million), excise taxes on motor vehicles and accessories (up $16 million), projected increases in excise tax under Act 154 (up $317 million), and personal income taxes (up $54 million).

The proposed budget for fiscal year 2014 provides for total expenditures of $15.890 billion, consisting of $4.635 billion for education, $3.067 billion for welfare, $1.678 billion for public safety and protection, and $6.387 billion for other expenses, expecting a $159 million year-end balance. In comparison to fiscal year 2013, the fiscal year 2014 budget provides for an increase of $878 million in expenses.

For more information regarding the proposed budget for fiscal year 2014, see "Proposed Budget for Fiscal Year 2014" under BUDGET OF THE COMMONWEALTH OF PUERTO RICO.

Economic Condition

Gross National Product. Puerto Rico's economy is closely linked to the United States economy. In recent fiscal years, however, the performance of Puerto Rico's economy has not been consistent with the performance of the United States economy. Puerto Rico's economy entered a recession in the fourth quarter of fiscal year 2006. For fiscal years 2007, 2008, 2009, 2010 and 2011 Puerto Rico's real gross national product contracted by 1.2%, 2.9%, 3.8%, 3.6% and 1.6%, respectively, while the United States real gross national product grew at rates of 1.7% and 2.5% during fiscal years 2007 and 2008, respectively, contracted by 3.4% during fiscal year 2009, and grew by 0.5% and 2.5% during fiscal years 2010 and 2011. For fiscal year 2012 Puerto Rico's gross national product grew by 0.1%, while the United States' gross national product grew by 2.1%. According to the Puerto Rico Planning Board's latest projections made in April 2013, which took into account the preliminary results for fiscal year 2012, the estimated effects on the Puerto Rico economy of the United States' budget sequestration, the end of the ARRA funds, the impact of the initial phase of the tax reform, the recent initiatives to promote private employment creation, the end of the local stimulus plan, and other economic factors, it is projected that Puerto Rico's real gross national product for fiscal year 2013 will decrease by 0.4%. Puerto Rico's real gross national product for fiscal year 2014 is forecasted to grow by 0.2%.

Employment. According to the Household Survey, total employment fell by 1.1% in fiscal year 2012 and remained virtually stationary, with a negative 0.1% growth for the first nine months of fiscal year 2013. The unemployment rate for fiscal year 2012 and for the first nine months of fiscal year 2013 was 15.2% and 14.2%, respectively. According to the Establishment Survey, total payroll employment grew by 0.8% in fiscal year 2012 and increased by 0.1% during the first nine months of fiscal year 2013. March 2013 year-over-year total payroll employment decreased by 2.2%. The Household Survey figures were revised significantly to adjust them to the results of the population census of 2010.

Economic Activity Index. The Government Development Bank – Economic Activity Index (the "EAI") reflected an increment of 0.2% in fiscal year 2012, after a reduction of 2.9% for fiscal year 2011. For the first nine months of fiscal year 2013, the EAI showed a year-over-year increase of 0.2%, compared to a reduction of 2.9% for the same period of fiscal year 2012. The employment figures of the Establishment Survey were revised in March 2013 by the Bureau of Labor Statistics as part of the annual benchmark revision.

Fiscal Condition

Since 2000, the Commonwealth has faced a number of fiscal challenges, including an imbalance between its General Fund revenues and expenditures. This imbalance reached its highest historical level of $3.306 billion in fiscal year 2009, when revenues were $7.583 billion and expenditures were $10.890 billion. Through various measures designed to increase revenues and reduce expenses, the Commonwealth reduced the deficit during fiscal years 2010, 2011 and 2012. For fiscal year 2013, however, the deficit is projected to increase to $1.602 billion. The Governor's proposed budget for fiscal year 2014, which was submitted to the Legislative Assembly in April of 2013, contemplates a deficit of $775 million, consisting of $575 million of general obligations debt service payments to be restructured and $200 million of deficit financing. Although the Commonwealth continues to pursue deficit reduction policies, and recently enacted a comprehensive revision of its pension system, the Commonwealth's ability to continue to reduce its deficit will depend in part on its ability to continue increasing revenues and reducing expenditures, which in turn depends on a number of factors, including improvements in economic conditions.

The following table shows total revenues from taxes, licenses and other internal or external sources (which does not include financing proceeds), total expenditures (including debt service payments), the resulting deficit for the last four fiscal years. Total revenues and expenditures include certain non-recurring revenues and expenditures from temporary measures. Accordingly, the amount of the Commonwealth's "structural deficit," or the difference between recurring revenues and expenditures, is higher than the amount shown below. Depending on what revenues and expenditures are considered "recurring," such difference may be significant.

Revenues from the electronic and traditional lotteries (shown in footnote 1 to the table) are available to the General Fund, but for accounting purposes are included in a separate fund.

Deficit
Fiscal Years ended June 30,
(in millions)

Fiscal Year	Total Revenues[(1)]	Total Expenditures[(3)]	Deficit
2009	$7,583	$10,890	$(3,306)
2010	$7,593	$10,369	$(2,775)
2011	$8,096[(2)]	$ 9,897[(4)]	$(1,801)
2012*	$8,566	$10,094	$(1,528)

(1) Excludes General Fund revenues attributable to the electronic and traditional lotteries in the amount of $126.7 million, $122.8 million, $101.9 million, $94.0 million and for fiscal years 2009, 2010, 2011 and 2012, respectively.
(2) Includes approximately $103.1 million of moneys transferred to the General Fund during fiscal year 2011 from the Puerto Rico Sales Tax Financing Corporation consisting principally of sales and use tax collections remaining after providing for debt service on its bonds for that fiscal year.
(3) Includes debt service of $159.6 million, $517.8 million, $638.7 million and $839.4 million for fiscal years 2009, 2010, 2011 and 2012, respectively, on the Commonwealth's general obligation bonds and guaranteed bonds of Public Buildings Authority that was refinanced through the issuance of refunding bonds.
(4) Excludes approximately $123 million of non-recurring expenses that had been budgeted for fiscal year 2010 but were incurred in fiscal year 2011 principally related to the fiscal stabilization measures described below.

*Preliminary Unaudited Numbers.

Source: Commonwealth of Puerto Rico Comprehensive Annual Financial Report and Department of the Treasury.

The Commonwealth has undertaken various initiatives to reduce and eventually eliminate the deficit, restore sustainable economic growth and safeguard the investment-grade ratings of the Commonwealth bonds.

Since January 2013, the current administration has implemented the following measures to increase revenues and reduce the deficit: (i) an initiative that resulted in the collection of $280 million in advance payments of non-resident withholding tax related to manufacturing patents; and (ii) the transfer of $240 million in excess funds in the Redemption Fund to the General Fund. These and other measures have reduced the projected deficit for fiscal year 2013 from a January 2013 estimate of $2.213 billion to the current estimate of $1.602 billion as of March 31, 2013. In addition, the Government has implemented a tax amnesty program, designed to encourage taxpayers with older tax liabilities to pay them, and is considering additional measures such as the sale of tax accounts receivable to further reduce the deficit for the current fiscal year.

Prior administrations have also sought to address the budget deficit through expense reduction measures and various temporary and permanent revenue raising measures.

Among the initiatives previously adopted by the Government are those contained in Act No. 7 of March 9, 2009 ("Act 7"), which included (i) a reduction in payroll, which is the main component of government expenditures, and other expenses, and the reorganization of the Executive Branch; (ii) a combination of temporary and permanent revenue raising measures and additional tax enforcement measures; and (iii) certain financial measures.

In fiscal year 2009, the Commonwealth allocated a portion of its sales and use tax to the Puerto Rico Sales Tax Financing Corporation ("COFINA"), which was able to issue revenue bonds at favorable interest rates. The proceeds from these bonds were deposited in a "Stabilization Fund" managed by GDB and used to repay debt, finance operating expenses, including costs related to the implementation of a workforce reduction plan, and fund an economic stimulus plan. As of March 31, 2013, COFINA has $15.223 billion of revenue bonds outstanding.

The Government has also taken advantage of the low interest rate environment in recent years to restructure a significant amount of its debt and that of its public corporations and to finance its cash shortfalls. The Commonwealth refinanced $353.3 million of interest due on its general obligation bonds during fiscal year 2010, $490.9 million of interest and principal due in fiscal year 2011, and $686.0 million of interest and principal due in fiscal year 2012, and it refinanced $164.5 million of interest due on Public Building Authority ("PBA") bonds guaranteed by the Commonwealth during 2010, $147.8 million due in 2011, and $153.8 million due in 2012. On July 2012, the GDB granted a loan to the Secretary of the Treasury in the amount of $600.4 million for the purpose of providing funds to make monthly principal and interest deposits during FY2013 to pay for a portion of certain outstanding Public Improvement and Public Refunding Bonds. The transaction was done in order to complete the funding for the Commonwealth's operating budget for fiscal year 2013. The loan will be repaid from the issuance of GO refunding bonds, subject to market conditions, during fiscal year 2014. On the same date, a loan of $175 million was granted to PBA providing funds to make monthly interest deposits during FY2013 to pay interest on a portion of certain outstanding PBA Bonds. The loan will be repaid from the issuance of PBA refunding bonds, subject to market conditions, during fiscal year 2014.

Preliminary Results for First Nine Months of Fiscal Year 2013 and Projected Results for Fiscal Year 2013. The budget for fiscal year 2013 originally provided for General Fund total revenues of $8.750 billion and total expenditures of $9.083 billion, with the difference between revenues and expenditures to be covered with $333 million from COFINA bond proceeds. These expenditures excluded approximately $775 million of debt service payments on the Commonwealth's general obligation bonds and Commonwealth guaranteed PBA bonds which were expected to be refinanced (but which <u>are</u> included in the projected deficit of $1.602 billion). Projected revenues have been revised to take into consideration a $965 million reduction in base revenues (to $7,785 billion) as of January 31, 2013, which mainly resulted from the continuing contraction of the economy, and a $520 million increase in revenues from the special measures implemented by the current administration, described above, which result in revised projected revenues of $8,305 billion as of March 21, 2013. Preliminary General Fund revenues for the first nine months of fiscal year 2013 (from July 1, 2012 to March 30, 2013) were $5.811 billion, an increase of $172 million, or 3%, from the same period in the prior fiscal year. Expenditures for the fiscal year are expected to be approximately $9.907 billion (including the $775 million of debt service payments referred to above), resulting in a projected deficit of $1.602 billion for fiscal year 2013.

Preliminary Results for Fiscal Year 2012. General Fund preliminary total revenues (including lottery revenues) for fiscal year 2012 were $8.660 billion, representing an increase of $502 million, or 6.2%, from fiscal year 2011 revenues. The major changes from fiscal year 2011 were: (i) a decrease in income taxes from corporations of $236.7 million, or 14.1%, resulting from the implementation of the tax reform, (ii) a decrease of $109.7 million in taxes withheld from non-residents, (iii) a decrease of $202.6 million in the temporary special property tax adopted in 2009, and (iv) an additional $1.2 billion from the excise tax imposed on entities that purchase products manufactured in Puerto Rico by their affiliates under the provisions of Act 154, discussed below.

General Fund preliminary total expenses (on a cash basis) for fiscal year 2012 amounted to $10.094 billion, consisting of $9.148 billion of operational expenses, $694 million transferred to the Redemption Fund for the repayment of general obligation and Commonwealth guaranteed debt and $145.8 million used to pay certain expenses that had been budgeted for fiscal year 2013 and $106.2 million in other expenses. The difference between preliminary revenues and expenses for fiscal year 2012 of $1.434 billion was covered with proceeds from a COFINA bond issue of $610 million and $839.4 million of debt restructuring.

During fiscal year 2012, the Government originally expected to refinance approximately $537.7 million of debt service on the Commonwealth's general obligation bonds, consisting of approximately $449.9 million of interest to accrue during such fiscal year and approximately $87.8 million of principal due in such fiscal year. Given favorable market conditions, the Government refinanced an additional $148.3 million of principal due in such fiscal year to provide additional budgetary relief, allowing the Government to redirect the use of moneys that would have been used for such principal payments.

The Government also refinanced during fiscal year 2012 approximately $153.8 million of interest to be accrued for that fiscal year on Commonwealth guaranteed PBA bonds.

Results for Fiscal Year 2011. General Fund total revenues for fiscal year 2011 were $8.056 billion ($8.158 billion if you include approximately $101.9 million of revenues from the lotteries). General Fund total revenues for fiscal year 2011 include approximately $103.1 million of moneys transferred to the General Fund during fiscal year 2011 from COFINA, consisting principally of sales and use tax collections remaining after providing for debt service on the COFINA bonds for that fiscal year. General Fund total revenues (including revenues from the lotteries) for fiscal year 2011 increased by $442 million, or 5.7%, from fiscal year 2010.

General Fund total revenues of $8.056 billion ($8.158 billion including the lotteries) include certain post-audit adjustments made by the Department of the Treasury (the "Treasury Department") to the Commonwealth's audited financial statements for fiscal year 2011 included in the Comprehensive Annual Financial Report of the Commonwealth ("CAFR"). These adjustments, which are deemed not material, consist of a reduction in revenues of $40.4 million, or less than 1%, from those reported in the CAFR.

The increase in General Fund total revenues for fiscal year 2011, compared to fiscal year 2010, were mainly due to an increase of $170.1 million in tax withholdings from non-residents and the collection of $677.6 million as a result of the new temporary excise tax and the expansion of the taxation of certain foreign persons adopted as Act No. 154 of October 25, 2010, as amended ("Act 154") as part of the tax reform (discussed below under "Tax Reform"), which the Government began collecting in February 2011. This increase was partially offset by a decrease of $406.5 million in collections from income tax on individuals as a result of the tax relief provided to individual taxpayers as part of the tax reform and current economic conditions. These results are consistent with the Commonwealth's projection that the decrease in General Fund net revenues as a result of the tax relief provided to taxpayers as part of the tax reform would be offset by the temporary excise tax imposed on certain foreign persons by Act 154.

General Fund total expenses for fiscal year 2011 were $10.020 billion, consisting of $9.075 billion of total expenditures and $945 million of other financing uses (principally debt service payments). Total expenditures of $10.020 billion exceeded General Fund total revenues (including revenues from the lotteries and moneys transferred from COFINA) by $1.862 billion, or 22.8%. Total expenditures of $10.020 billion include (i) $638.7 million of debt service on the Commonwealth's general obligation bonds and guaranteed bonds of PBA that were refinanced through the issuance of refunding bonds and (ii) approximately $123 million of non-recurring expenses that had been budgeted for fiscal year 2010 but were incurred in fiscal year 2011 principally related to the fiscal stabilization measures. Excluding the debt service that was refinanced and such non-recurring expenses, General Fund total expenses for fiscal year 2011 were $9.258 billion and exceeded General Fund total revenues (including revenues from the lotteries and moneys transferred from COFINA, but excluding other financing sources) by $1.100 billion, or 13.5%. The difference between revenues and expenses for fiscal year 2011 was covered principally from proceeds of COFINA bonds.

Results for Fiscal Year 2010. General Fund total revenues for fiscal year 2010 were $7.593 billion ($7.716 billion if you include approximately $122.8 million of revenues from the lotteries). General Fund total revenues (including revenues from the lotteries) for fiscal year 2010 increased by $6.0 million, or 0.1%, from fiscal year 2009. The principal changes in sources of revenues from fiscal year 2009 included a decrease in the sales and use tax received by the General Fund of $256.8 million due to the assignment to COFINA of an additional 1.75% of the 5.5% Commonwealth sales and use tax. This decrease in the amount of sales and use taxes allocated to the General Fund was fully offset, however, by increases in property taxes and excise taxes on cigarettes and alcoholic beverages of approximately $227.8 million and $60.5 million, respectively, as a result of the temporary and permanent revenue raising measures implemented as part of the Commonwealth's fiscal stabilization measures. Revenues from income taxes for fiscal year 2010 were approximately the same as in fiscal year 2009, reflecting the continuing impact of the ongoing economic recession.

Total expenditures for fiscal year 2010 were $10.369 billion (which included $173 million of expenditures related to a local stimulus program, consisting of (i) $9.640 billion of total expenditures and (ii) $728 million of other financing uses (principally debt service payments). Total expenditures of $10.369 billion exceeded General Fund total revenues (including revenues from the lotteries, but excluding other financing sources) by $2.653 billion, or 34.4%. Excluding the debt service amounts that were refinanced, as discussed above, total expenditures for fiscal year 2010 were approximately $9.692 billion and exceeded General Fund total revenues (including revenues from the lotteries, but excluding other financing sources) by $1.976 billion, or 25.6%. The difference between revenues and expenses for fiscal year 2010 was covered principally by proceeds from a COFINA bond issue.

Results for Fiscal Year 2009. General Fund total revenues for fiscal year 2009 were $7.583 billion ($7.710 billion if you include approximately $126.7 million of revenues from the electronic and traditional lotteries that are available to the General Fund, but which for accounting purposes are included in the Commonwealth's audited financial statements as a separate fund from the General Fund). General Fund total revenues (including revenues from the lotteries) for fiscal year 2009 decreased by $648.8 million, or 7.8%, from fiscal year 2008. Total expenditures for fiscal year 2009 were $10.890 billion (consisting of $9.927 billion of total expenditures and $962 million of other financing uses, principally debt service payments) representing an increase of approximately $1.402 billion, or 14.8%, from original budgeted expenditures and exceeded General Fund total revenues (including revenues from the lotteries, but excluding other financing sources) by $3.180 billion, or 41.2%.

During fiscal year 2009, the Commonwealth faced an aggregate cash shortfall of $1.153 billion that, when added to the General Fund deficit, represented approximately $4.333 billion in excess expenditures and cash shortfall. The difference between General Fund revenues and total expenditures for fiscal year 2009 was principally paid from proceeds of COFINA bond issues and the restructuring of the corpus account of the Puerto Rico Infrastructure Financing Authority ("PRIFA") pursuant to the fiscal stabilization measures.

Ratings of Commonwealth General Obligation Bonds

On December 13, 2012, Moody's Investors Service lowered its rating on such bonds from "Baa1" to "Baa3" with a negative outlook. On March 13, 2013, Standard & Poor's Rating Services lowered its rating on such bonds from "BBB" to "BBB–" with a negative outlook. And on March 20, 2013, Fitch, Inc. lowered its rating on the Commonwealth's general obligation and appropriation debt from "BBB+" to "BBB-" with a negative outlook. The ratings reflect only the opinions of such rating agencies and an explanation of the significance of such ratings may be obtained only from the relevant rating agency.

Geographic Location and Demographic Trends

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

According to the United States Census Bureau, the population of Puerto Rico was 3,725,789 in 2010, compared to 3,808,610 in 2000. The population of San Juan, its capital and largest city, was 381,931 in 2010, compared to 434,374 in 2000.

Relationship with the United States

Puerto Rico came under United States sovereignty pursuant to the Treaty of Paris, signed on December 10, 1898, which ended the Spanish-American War. Puerto Ricans have been citizens of the United States since 1917. In 1950, after a long evolution toward greater self-government, 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.

The United States and the Commonwealth share a common defense, market and currency. The Commonwealth exercises virtually the same control over its internal affairs as do the 50 states. It differs from the states, however, in its relationship with the federal government. The people of Puerto Rico are citizens of the United States but do not vote in national elections. They are represented in Congress by a Resident Commissioner that has a voice in the House of Representatives but no vote (except in House committees and sub-committees to which he belongs). 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.

The official languages of Puerto Rico are Spanish and English.

Governmental Structure

The Constitution of 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 Legislative Assembly consists of a Senate and a House of Representatives, the members of which are elected for four-year terms. The highest court within the local jurisdiction is the Supreme Court of Puerto Rico. Decisions of the Supreme Court of Puerto Rico may be appealed to the Supreme Court of the United States under the same 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 the Commonwealth are similar in nature to those of the various state governments. In addition, the central government assumes responsibility for local police and fire protection, education, public health and welfare programs, and economic development.

Principal Officers Responsible for Fiscal Matters

Alejandro J. García Padilla was sworn in as Governor of Puerto Rico on January 2, 2013. From 2009 until becoming Governor, Mr. García Padilla served as an elected senator in the Senate of the Commonwealth of Puerto Rico. Prior to that, Mr. García Padilla was an attorney in the private sector. From 2005 to 2007, Mr. García Padilla was Secretary of the Commonwealth's Department of Consumer Affairs. Mr. García Padilla was a professor at the School of Law of the Inter American University of Puerto Rico from 2000 to 2002. Mr. García Padilla clerked for the Commonwealth's Court of Appeals from 1997 to 1999. He holds a bachelor's degree in Political Science and Economy from the University of Puerto Rico and a Juris Doctor from the Inter American University School of Law.

Melba Acosta was designated Secretary of the Treasury Department effective January 2, 2013 and confirmed by the Senate of the Commonwealth on February 25, 2013. Ms. Acosta was subsequently appointed on March 1, 2013 as Chief Public Financial Officer of the Commonwealth of Puerto Rico also. Before these appointments, Ms. Acosta was Director of OMB and Chief

Information Officer from 2001 to 2004, and Chief of Staff of the Municipality of San Juan from 1997 to December 2000. In the private sector, Ms. Acosta worked as an attorney with McConnell Valdés from 1995 to 1997 and from 2010 to 2012. She served as Executive Vice President, Chief Operating Officer, and Chief Financial Officer of RG Financial Corporation and its bank subsidiary, RG Premier Bank, from 2004 to 2010. In addition, she served as Tax Consultant with Price Waterhouse from 1988 to 1990. Ms. Acosta is a certified public accountant and an attorney-at-law. She holds a bachelor's degree in Accounting from the School of Business Administration of the University of Puerto Rico, an MBA from the Harvard Graduate School of Business Administration and a Juris Doctor from the School of Law of the University of Puerto Rico. She is a member of the Boards of Directors of the Puerto Rico Art Museum, the Luis Muñoz Marín Foundation and GDB. Previously, she was a member of the Board of Directors of United Funds.

Carlos D. Rivas Quiñones was appointed Director of OMB in January of 2013. Mr. Rivas returned to public service after having been General Manager of UPM Group and Principal with Advent Morro Equity Partners. Prior to his tenure with UPM Group, he was Executive Director of the Puerto Rico Housing Finance Authority from 2005 to 2008. Mr. Rivas' private sector experience includes serving as an associate with McKinsey & Company and with Davis Polk & Wardwell. Mr. Rivas' experience in public service includes serving as a Deputy Advisor on Economic Development and as Executive Aide to the Governor and the Chief of Staff, focusing on public finance, economic development and budget issues. Mr. Rivas holds a law degree from Stanford University and a bachelor's degree in Economics from Princeton University.

Javier D. Ferrer was appointed President of GDB effective January 2, 2013. Before entering public service, Mr. Ferrer was an attorney in the areas of securities and capital markets, public finance, banking and financial services, corporate and commercial law, insurance law, and investment companies. Prior to his appointment at GDB, Mr. Ferrer was cofounding partner in 1992 of the law firm of Pietrantoni Méndez & Álvarez, LLC. Over the years, his practice focused mainly on representing private and public companies in corporate, corporate governance and securities matters, including public and private offerings of equity and debt securities. Mr. Ferrer also garnered extensive experience in representing buyers and sellers in capital market transactions. Prior to his tenure with Pietrantoni Méndez & Álvarez, LLC, Mr. Ferrer had been with the law firms of McConnell Valdés from 1991 to 1992, Hernández Mayoral & Ferrer from 1989 to 1991, O'Neill & Borges from 1988 to 1989, and Kutak Rock & Campbell from 1986 to 1988. Mr. Ferrer holds a Juris Doctor from Boston College Law School and a B.A. from Harvard University. Mr. Ferrer is admitted to the Massachusetts and Puerto Rico bars and to the First Circuit Court of Appeals. He has been a member and secretary of the Board of the Santander Family of Funds and a member of the Advisory Board of Interlink Group, LLC.

Political Trends

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

	1996	**2000**	**2004**	**2008**	**2012**
Popular Democratic Party	44.5%	48.6%	48.4%	41.3%	47.7%
New Progressive Party	51.1%	45.7%	48.2%	52.8%	47.1%
Puerto Rico Independence Party	3.8%	5.2%	2.7%	2.0%	2.5%
Others, Blank or Void	-	0.5%	0.6%	3.9%	2.6%

With the results of the 2012 election, the Popular Democratic Party gained control of the Executive Branch and the Legislative Branch. The current membership of the Senate and House of Representatives by political party is as follows:

	Senate	**House**
Popular Democratic Party	18	28
New Progressive Party	8	23
Puerto Rico Independence Party	1	0
Total	27	51

The next general election (gubernatorial, municipal, and legislative) in Puerto Rico will be held in November 2016.

THE ECONOMY

General

Puerto Rico's economy experienced a considerable transformation during the second half of the twentieth century, from an agriculture-based economy to an industrial one. Factors contributing to this transformation included government-sponsored economic development programs, major tax incentives, increases in the level of federal transfer payments, and the relatively low cost of borrowing. In some years, these factors were aided by a significant rise in construction investment driven by infrastructure projects, private investment, primarily in housing, and relatively low oil prices.

In more recent years, significant oil price increases, the continuous contraction of the manufacturing sector, partially due to the long-term effects of the end of major federal tax incentives such as those under Section 936 of the Internal Revenue Code, and the budgetary pressures on government finances have triggered a general contraction in the economy.

Puerto Rico's economy entered a recession in the fourth quarter of fiscal year 2006. For fiscal years 2007, 2008, 2009, 2010 and 2011, the real gross national product contracted by 1.2%, 2.9%, 3.8%, 3.6% and 1.6%, respectively. For fiscal year 2012, preliminary reports indicate that the real gross national product grew by only 0.1%. The Puerto Rico Planning Board currently projects a decrease in real gross national product of 0.4% for fiscal year 2013 and an increase of 0.2% for fiscal year 2014.

In fiscal year 2012, aggregate personal income was $62.3 billion ($59.4 billion in 2005 prices) and personal income per capita was $16,934 ($15,995 in 2005 prices). Personal income includes transfer payments to individuals in Puerto Rico under various social programs. Total United States federal transfer payments to individuals amounted to $16.0 billion in fiscal year 2012 and $15.6 billion in fiscal year 2011. Entitlements for previously performed services or resulting from contributions to programs such as Social Security, Veterans' Benefits, Medicare, and United States Civil Service retirement pensions were $11.3 billion, or 70.4% of the transfer payments to individuals in fiscal year 2012 ($10.9 billion, or 70%, in fiscal year 2011). The remainder of the federal transfers to individuals is represented by grants, mostly concentrated in the Nutritional Assistance Program (Food Stamps) and Pell Grant scholarships (higher education).

Total average annual employment (as measured by the Puerto Rico Department of Labor and Human Resources Household Employment Survey, known as the "Household Survey") decreased during the last decade. From fiscal year 2000 to fiscal year 2012, total employment decreased at an average annual rate of 0.9%, from 1,150,291 to 1,035,465. A reduction in total employment began in the fourth quarter of fiscal year 2007 and has continued consistently through fiscal year 2012 due to the current recession and the contractionary fiscal adjustment measures. During the first nine months of fiscal year 2013, however, total employment has shown an average growth rate of 0.1% as compared to the same period for the prior fiscal year. The dominant sectors of the Puerto Rico economy in terms of production and income are manufacturing and services. The manufacturing sector has undergone fundamental changes over the years as a result of the phase out of Section 936 of the United States Internal Revenue Code and an increased emphasis on higher-wage, high-technology industries, such as pharmaceuticals, biotechnology, computers, microprocessors, professional and scientific instruments, and certain high technology machinery and equipment. At the present time, almost 90% of manufacturing is generated by chemical and electronic products. The service sector, which includes finance, insurance, real estate, wholesale and retail trade, transportation, communications and public utilities, and other services, plays a major role in the economy. It ranks second to manufacturing in contribution to gross domestic product and leads all sectors in providing employment.

The following table shows the Puerto Rico gross national product for fiscal years 2008 through 2012, compared to the annual percentage increase in real gross national product in the United States. Note that there are some differences between the previously reported figures of Puerto Rico's gross national product and the current ones below, due to the recent revision of several components of the gross national product, which included changes since fiscal year 2001.

Therefore, growth rates and shares before fiscal year 2001 are not wholly comparable with the amounts computed afterwards.

Commonwealth of Puerto Rico
Gross National Product
Fiscal Years Ended June 30,
(dollar amounts in $ millions)

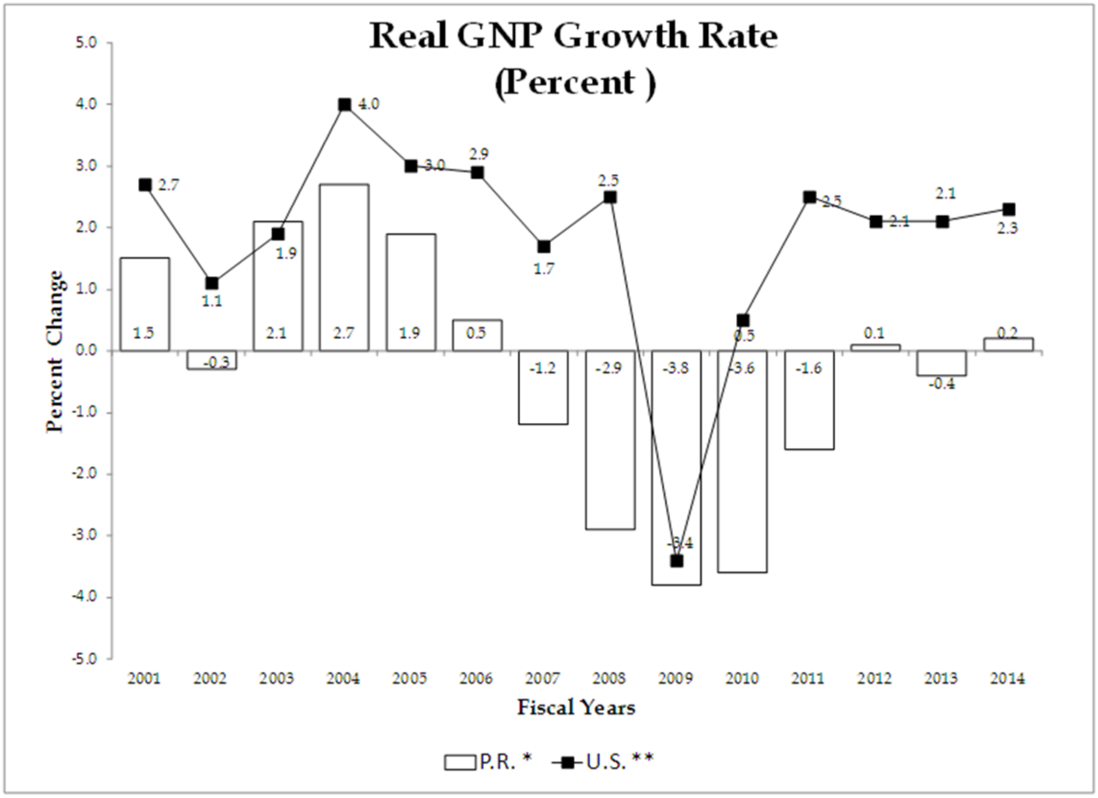
	2008	**2009**	**2010**	**2011**	**2012**[1]
Gross national product (PR) (current prices)[2]	$62,703	$63,618	$64,295	$65,567	$69,462
Real gross national product (PR) (2005 prices)	$52,908	$50,883	$49,065	$48,280	$48,317
Annual percentage increase (decrease) in real gross national product (PR) (2005 prices)	(2.9)%	(3.8)%	(3.6)%	(1.6)%	0.1%
Annual percentage increase (decrease) in real gross national product (United States) (2005 prices)	2.5%	(3.4)%	0.5%	2.5%	2.1%

(1) Preliminary.
(2) In current dollars. 2008-2011 revised figures.

Sources: Puerto Rico Planning Board and IHS-Global Insight.

The economy of Puerto Rico is closely linked to the United States economy, as most of the external factors that affect the Puerto Rico economy (other than oil prices) are determined by the policies and performance of the mainland economy. These external factors include exports, direct investment, the amount of federal transfer payments, the level of interest rates, the rate of inflation, and tourist expenditures. During fiscal year 2012, approximately 70.9% of Puerto Rico's exports went to the United States mainland, which was also the source of approximately 42.6% of Puerto Rico's imports. In fiscal year 2012, Puerto Rico experienced a positive merchandise trade balance of $12.3 billion.

The following graph compares the growth rate of real gross national product for the Puerto Rico and United States economies since fiscal year 2001, and the forecast of the growth rate for fiscal years 2013 and 2014.

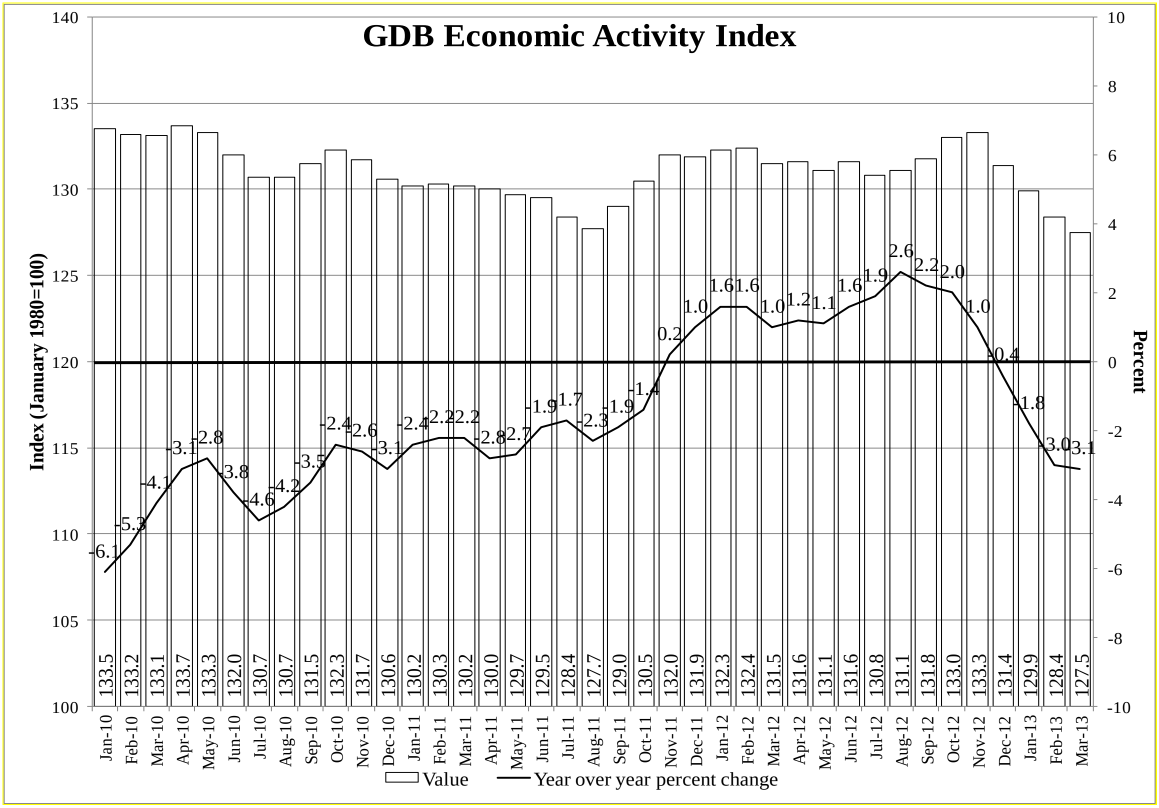


Estimate for Puerto Rico from the Puerto Rico Planning Board (Apr-2013).
** Estimate for U.S. from IHS-Global Insight (Apr-2013).
Sources: Puerto Rico Planning Board & IHS-Global Insight.

Since the 1950s, the Planning Board has prepared a complete set of macroeconomic measures like those prepared for the United States by the Bureau of Economic Analysis ("BEA") of the Department of Commerce, as part of the National Income and Product Accounts ("NIPA"). In contrast with the BEA, which computes the economic accounts on a quarterly basis, the Planning Board computes Puerto Rico's NIPA on an annual basis. Like the BEA, the Planning Board revises its statistics on a regular basis. The Planning Board classifies its statistics as preliminary until they are revised and made final in conjunction with the release of new data each year. Thus, all macroeconomic accounts for fiscal year 2012 shown in this Report are preliminary until the revised figures for fiscal year 2012 and the preliminary figures for fiscal year 2013 are released, and the forecast for fiscal year 2014 is revised.

Certain information regarding current economic activity, however, is available in the form of the EAI, a coincident indicator of ongoing economic activity. This index, shown in the following graph and published by GDB since October 2009, is composed of several variables (total payroll employment based on the Establishment Survey, total electric power generation, cement sales and consumption of gasoline) that highly correlate to Puerto Rico's real gross national product. The average growth rate of the index for fiscal year 2012 was 0.2%, after a reduction of 2.9% for fiscal year 2011. Although minimal (showing a situation of virtual stagnation, below the growth rate of fiscal year 2006 of 0.3%), this was the first average annual positive growth of the index since fiscal year 2006. For the first nine months of fiscal year 2013, the EAI increased by 0.2%, compared to a reduction of 2.9% for the same period of fiscal year

2012. Notice that the previously published figures of this index were reflecting a slight contraction (-0.2%) for fiscal year 2012, while the current index shows a slight increase (0.2%) for the same fiscal year. This is due to a major revision on the total non-farm employment numbers recently published by the Bureau of Labor Statistics (see the section *Employment and Unemployment* below).



Economic Forecast for Fiscal Years 2013 and 2014

In April 2013, the Planning Board released its revised gross national product forecast for fiscal year 2013 and its gross national product forecast for fiscal year 2014. The gross national product forecast for fiscal year 2013 was revised downward from a projected growth of 1.1% to a decline of -0.4%, both in constant dollars. This revision took into account the estimated effects on the Puerto Rico economy of the United States budget sequestration, the end of the federal ARRA funds, the impact of the initial phase of the tax reform, the recent initiatives to promote private employment creation, and the end of the local stimulus plan. The revised forecast also considered the effect on the Puerto Rico economy of general and global economic conditions, the United States economy, the volatility of oil prices, interest rates and the behavior of local exports, including expenditures by visitors. The Planning Board's forecast for fiscal year 2014 projects an increase in gross national product of 0.2% in constant dollars. The Planning Board's forecast for fiscal year 2014 took into account the estimated effect of the projected growth of the United States economy, tourism activity, personal consumption expenditures, federal transfers to individuals and an increase of investment in construction.

Fiscal Year 2012

The Planning Board's preliminary reports on the performance of the Puerto Rico economy for fiscal year 2012 indicate that real gross national product increased 0.1% (an increase of 5.9% in current dollars) over fiscal year 2011. Nominal gross national product was $69.5 billion in fiscal year 2012 ($48.3 billion in 2005 prices), compared to $65.6 billion in fiscal year 2011 ($48.3 billion in 2005 prices). Aggregate personal income increased from $61.6 billion in fiscal year 2011 ($50.0 billion in 2005 prices) to $62.3 billion in fiscal year 2012 ($49.7 billion in 2005 prices), and personal income per capita increased from $16,611 in fiscal year 2011 ($13,496 in 2005 prices) to $16,934 in fiscal year 2012 ($13,513 in 2005 prices).

According to the Household Survey, the number of persons employed in Puerto Rico during fiscal year 2012 averaged 1,035,465, a decrease of 1.1% compared to previous fiscal year; and the unemployment rate averaged 15.2%, one-percentage point below the reported number for fiscal year 2011.

Among the variables that contributed to the small growth in gross national product were the continuous contraction of the manufacturing sector and the increase in the average price of the West Texas Intermediate (WTI) oil barrel, which went up from $89.4 / bbl in fiscal year 2011 to $95.0 / bbl in fiscal year 2012, an increase of 6.3%. Historically low interest rates were not enough incentive to jumpstart private investment.

Fiscal Year 2011

The Planning Board's reports on the performance of the Puerto Rico economy for fiscal year 2011 indicate that real gross national product decreased 1.6% (an increase of 2.0% in current dollars) over fiscal year 2010. Nominal gross national product was $65.6 billion in fiscal year 2011 ($48.3 billion in 2005 prices), compared to $64.3 billion in fiscal year 2010 ($49.1 billion in 2005 prices). Aggregate personal income increased from $60.0 billion in fiscal year 2010 ($49.6 billion in 2005 prices) to $61.6 billion in fiscal year 2011 ($50.0 billion in 2005 prices), and personal income per capita increased from $16,078 in fiscal year 2010 ($13,287 in 2005 prices) to $16,611 in fiscal year 2011 ($13,496 in 2005 prices).

According to the Household Survey, total employment for fiscal year 2011 averaged 1,046,719, a decrease of 28,200, or 2.6%, from the previous fiscal year. The unemployment rate for fiscal year 2011 was 16.2%, a slight reduction from 16.3% for fiscal year 2010.

Among the variables contributing to the decrease in gross national product was the continuous contraction of the manufacturing and construction sectors and the increase in the average price of the West Texas Intermediate (WTI) oil barrel, which went up from $75.2/bbl in fiscal year 2010 to $89.4/bbl in fiscal year 2011, a rise of 18.9%. Although the continuation of the difficulties associated with the financial crisis kept short-term interest rates at historically low levels, such low interest rates did not translate into a significant improvement in the construction sector due in part to the high level of inventory of residential housing units.

Fiscal Stabilization and Economic Growth

Fiscal Stabilization

The current administration, which came into office in January of 2013, has sponsored various initiatives to seek fiscal balance, stimulate economic growth, and safeguard and strengthen the Commonwealth's investment grade credit rating. These include: (i) an initiative which resulted in $280 million in advance payments of non-resident withholding tax related to manufacturing patents; and (ii) the transfer of $240 million in excess funds in the Redemption Fund to the General Fund. These and other measures have reduced the projected deficit for fiscal year 2013 from a January 2013 estimate of $2.213 billion to the current estimate of $1.602 billion as of March 31, 2013. In addition, the Government implemented a tax amnesty program, designed to increase revenues by encouraging taxpayers with older tax liabilities to pay them and is considering additional measures such as the sale of tax accounts receivable to further reduce the deficit for the current fiscal year.

During the 2009-2012 period, under the prior administration, the Commonwealth sought to reduce the deficit primarily by reducing operating expenses, including payroll. Payroll expense is the most significant component of the government's recurring expenses. During this period, the Commonwealth reduced payroll expenses through incentivized voluntary resignations and workday reduction programs, an involuntary layoff plan, and the temporary suspension of certain provisions of laws, collective bargaining agreements, and other agreements. In addition, certain operational expenses, such as cellular phone use, credit cards, official vehicles, service contracts, and lease contracts, were subject to cost controls. Cost savings were also obtained through consolidating the operations of several agencies or public corporations.

Both the current and prior administrations have also sought to increase tax revenues by implementing various temporary and permanent tax measures, and by more rigorous and ongoing tax enforcement and compliance strategies, which have included: (i) enhancements to the administration of federal grants and fund receipts, (ii) stronger collections and auditing efforts on Puerto Rico's sales and use tax, and (iii) a voluntary tax compliance program.

The Commonwealth issued COFINA revenue bonds taking advantage of the low interest rate environment to finance its deficit and fund certain economic development initiatives, and to restructure a portion of the Commonwealth's debt service.

Until recently, the Commonwealth was able to counterbalance some of the adverse effects associated with its austerity measures with federal ARRA stimulus funds. Puerto Rico was awarded $7.1 billion in stimulus funds from ARRA. The funds were distributed in four main categories: relief to individuals, budgetary and fiscal relief, taxpayers' relief, and capital improvements. Funds were allocated to education, agriculture and food assistance, health, housing and urban development, labor, and transportation, among others. As of December 31, 2012, approximately $6.1 billion in ARRA funds had already been disbursed.

The Commonwealth also supplemented the ARRA funds with its own $500 million stimulus program designed to address specific local challenges associated with the local mortgage market, the availability of credit, and the infrastructure and construction sectors. Most municipalities received disbursements earmarked to pay outstanding debts and fund local projects. The Commonwealth also disbursed funds allocated towards job training programs, a strategic water distribution project in a southern municipality and the revamping of the Puerto Rico permits system.

Economic Growth

In recent years, the Commonwealth has emphasized the following initiatives to enhance Puerto Rico's competitive position: (i) a program designed to stimulate the creation of jobs, (ii) overhauling the permitting process, (iii) reducing energy costs, (iv) reforming the tax system, (v) promoting the development of various projects through public-private partnerships, (vi) implementing strategic initiatives targeted at specific economic sectors, and (vii) promoting the development of certain strategic/regional projects.

Jobs Act. The Jobs Now Act was signed into law on February 10, 2013. It purports to create jobs within 18 months by eliminating certain hurdles that delay and impede the process of establishing new businesses or expanding existing businesses in Puerto Rico, allow better access to capital, and provide incentives under agreements between certain eligible businesses and the Government of Puerto Rico through the Puerto Rico Commerce and Exports Company. The benefits provided under the law include, among others, partial reimbursement of salaries paid to certain persons previously unemployed, nominal rents on buildings owned by PRIDCO, two year property tax exemption for previously vacant buildings, preferential income tax rate for the first two years of operation, full municipal license tax and personal property tax exemption for first two years of operation and extended carryover period for net operating losses incurred during the first two years of operations and an energy credit per incremental job to be used against the electricity bill. The law also establishes an expedited permitting process for establishing eligible businesses. The Economic Development Bank is ordered to give priority to loan applications submitted by eligible businesses and to create programs to guarantee private financing to such eligible entities.

Permitting Process. In December of 2009, the permitting and licensing process in Puerto Rico was simplified in order to provide for a leaner and more efficient process that fosters economic development. The new permitting system seeks to reduce the number of inter-agency processes required by creating a centralized, client-focused system that simplifies and shortens the permitting process. The government body responsible for evaluating permit applications and issuing final determinations concerning construction and land use currently offers 80% of its services online, representing 90% of the total volume of transactions.

Energy Policy. In July of 2010, the Commonwealth enacted legislation focused on reducing Puerto Rico's dependence on fossil fuels, particularly oil, through the promotion of diverse renewable-energy technologies. This legislation seeks to lower energy costs, reduce energy-price volatility, and establish environmentally sustainable energy production through a reduction in ecologically harmful emissions. It creates a Renewable Portfolio Standard, recognizing many sources of renewable energy that utilize various technologies, and setting a hard target of 12% renewable energy production by 2015 and 15% by 2020, and a requirement for retail energy providers to establish a plan to reach 20% renewable energy production by 2035.

The legislation also provides incentives for the construction and use of renewable energy sources, and creates a Green Energy Fund through which the Commonwealth will co-invest $290 million in renewable energy projects over the next ten years. These initiatives are expected to address energy prices in Puerto Rico and provide a means for attracting investment in the energy sector.

Tax Reform. See "Major Sources of General Fund Revenues—Tax Reform" under PUERTO RICO TAXES, OTHER REVENUES AND EXPENDITURES for a summary of the principal provisions of the tax reform.

Public-Private Partnerships. The Government believes that public private partnerships (" PPPs") represent an important tool for economic development. PPPs are long-term contracts between government and non-governmental entities—such as private companies, credit unions, and municipal corporations to develop, operate, manage or maximize infrastructure projects and/or government services. PPP contracts are centered on the concept of risk transfer. The non-governmental partner takes on certain responsibilities and risks related to the development and/or operation of the project in exchange for certain benefits. PPPs can play an important role in restoring investment in infrastructure, improving the quality and the efficiency of important public services and bringing about economic growth. PPPs provide the opportunity for the government to lower project development costs, accelerate project development, reduce financial risk, create additional revenue sources, establish service quality metrics, re-direct government resources to focus on the implementation of public policy, improve the quality of infrastructure facilities and of services, create jobs and attract new investment. Puerto Rico has opportunities for the establishment of PPPs in the areas of toll roads, transit, airports and maritime ports, public schools, water provision, correctional facilities, and energy, among others.

On June 8, 2009, the Legislative Assembly approved Act No. 29 ("Act 29"), which established the legal framework for the establishment of PPPs in Puerto Rico to further the development and maintenance of infrastructure facilities improve the services rendered by the Government and foster the creation of jobs. Act 29 created the Public-Private Partnerships Authority (the "PPP Authority"), the entity tasked with implementing the Commonwealth's public policy regarding PPPs. On December 19, 2009, the PPP Authority approved regulations establishing the administrative framework for the procurement, evaluation, selection, negotiation and award process for PPPs in Puerto Rico.

As part of the Government's PPPs initiative, the PPP Authority and the Highways and Transportation Authority (collectively, the "Sponsors") completed in 2011 the procurement for a concession of toll roads PR-22 and PR-5 (the "Toll Roads"). The Sponsors selected Autopistas Metropolitanas de Puerto Rico, LLC ("Metropistas"), a consortium comprised of Goldman Sachs Infrastructure Partners and Abertis Infraestructuras, as the winning proponent based on a bid of $1.080 billion. On June 27, 2011, Metropistas and the Highways and Transportation Authority executed the concession agreement for the Toll Roads and, on September 22, 2011, the parties successfully completed the financial closing. As a result of this transaction, the Highways and Transportation Authority received a lump-sum payment of $1.136 billion and a commitment to invest $56 million in immediate improvements during the first three years of the concession, $300 million in capital improvements and construction during the term of the contract and comply with world-class operating standards.

To modernize public school facilities throughout the island and improve academic performance, the PPP Authority launched the “Schools for the 21st Century” program in order to modernize and build a selected number of public schools throughout Puerto Rico. At least one school in each municipality is benefiting from the “Schools for the 21st Century” program. The Government expects this project will impact nearly 50,000 students, 2,000 teachers and various communities and create 14,000 jobs throughout Puerto Rico’s 78 municipalities. The Government has funded this project with the proceeds of Qualified School Construction Bonds (QSCB) issued by PBA in the aggregate principal amount of $756 million. As of June 2011, the PPP Authority had awarded approximately $464 million in contracts and construction had begun in approximately 57 schools.

On August 8, 2011, the PPP Authority and the Puerto Rico Ports Authority (“Ports Authority”) received statements of qualifications from twelve (12) world-class consortia in response to the Request for Qualifications (RFQ) to acquire a concession to finance, operate, maintain and improve the Luis Muñoz Marín International Airport (“Airport”), the busiest airport in the Caribbean. The primary objectives of the PPP Authority and the Ports Authority were: (i) maximizing the upfront value for the Airport, (ii) improving the Airport’s safety standards, service levels and quality, (iii) maintaining and improving the quality of service to travelers as well as achieving a higher level of customer satisfaction, and (iv) creating a world-class gateway to Puerto Rico while increasing the Island’s profile as a destination in the Caribbean, in order to positively impact the development of the tourism industry and overall economic prospects in Puerto Rico. On July 17, 2012 the PPP Authority and the Ports Authority selected Aerostar Airport Holdings, LLC, a partnership formed by between Grupo Aeropuertuario de Sureste S.A.B. de C.V. (“ASUR”) and Highstar Capital IV, as the winning proponent based on an upfront payment of $615 million. On July 24, 2012, the parties executed the lease agreement for the Airport and, on February 27, 2013, the parties successfully completed the financial close. As a result of this transaction, on February 27, 2013, the Ports Authority received a lump-sum payment of $615 million and will receive an estimated $552 million in revenue sharing over the life of the lease. It is estimated that Aerostar will invest $1.4 billion in the Airport during the life of the lease, including a commitment to invest approximately $267 million in immediate improvements and comply with world-class operating standards.

The PPP Authority is currently evaluating projects for the development and construction of new infrastructure facilities. These projects include a rail transportation system from Caguas to San Juan, the extension of the PR-22 Highway from Hatillo to Aguadilla and a correctional facility, among others.

Sector Initiatives

The Commonwealth will complement the previously mentioned initiatives with specific strategic initiatives with the objective of creating jobs and increasing economic activity across various sectors of the Puerto Rico economy. The Commonwealth has natural or structural competitive advantages in several areas, such as pharmaceutical and biotechnology manufacturing. These advantages provide opportunities for the development of regional clusters in high-tech manufacturing, research and development, tourism, renewable energy, international trade and professional services. The specific initiatives will be designed to promote sustainable economic growth while accelerating to a knowledge-based and innovation driven economy, focused mainly in the development of human capital and intellectual property, thus diversifying Puerto Rico's economic base.

Strategic/Regional Projects

The Commonwealth has also targeted strategic/regional projects that will generate investments in various regions of Puerto Rico in order to foster a balanced economic development.

One of the strategic projects for the northern region of Puerto Rico is called the Bahia Urbana , an urban redevelopment project that incorporates the areas of Old San Juan, Puerta de Tierra, Isla Grande, including the Puerto Rico Convention Center District, and Condado, as well as other communities in the vicinity of historic San Juan Bay. The aim of the Bahia Urbana project is to develop San Juan Bay into a major tourism, recreation, commercial and residential sector which serves the local community and becomes a major attraction for leisure and business travelers, both local and external. Construction of the immediate improvements on the project footprint is currently underway.

Also in the northern region, Science City represents a critical effort to move Puerto Rico to the forefront of science, technology and research and development. It seeks to leverage Puerto Rico's competitive advantages in the knowledge-based sectors. Legislation enacted in 2011 expanded the benefits of investing in, and performing, science and technology research and development activities in the newly denominated "Science District", through the inclusion of such activities as eligible for tax exemption under the Economic Incentives Act (as defined below). See "Tax Incentives – Industrial Incentives Program" under THE ECONOMY.

In the eastern region of Puerto Rico, the Roosevelt Roads project entails the redevelopment of the old Roosevelt Roads navy facility in Ceiba and is a key element in the administration's strategy to create jobs and reignite the economy of Puerto Rico's eastern region, including Ceiba, Naguabo, Vieques, and Culebra. Negotiations with the Navy regarding the transfer of the property to the Local Redevelopment Authority were recently successfully concluded.

In the western region of Puerto Rico, the Commonwealth is focused on the redevelopment of the Aguadilla airport to serve as the second international airport of Puerto Rico and as a regional logistics hub. The Commonwealth is in the process of submitting a formal application to obtain a Foreign Trade Zone designation for the Aguadilla airport area.

Employment and Unemployment

According to the Household Survey, the number of persons employed in Puerto Rico during fiscal year 2012 averaged 1,035,465, a decrease of 1.1% compared to the previous fiscal year; and the unemployment rate averaged 15.2%. During the first nine months of fiscal year 2013, total employment averaged 1,033,300, a 0.1 % decrease with respect to the same period of the prior year, and the unemployment rate decreased to 14.2%.

The following table presents annual statistics of employment and unemployment for fiscal year 2008 through fiscal year 2012, and the average figures for the first nine months of fiscal year

2013. These employment figures are based on the Household Survey, which includes self-employed individuals and agriculture employment, instead of the non-farm, payroll employment survey (the "Payroll Survey"), which does not. The number of self-employed individuals represents around 16% of civilian employment in Puerto Rico, more than double the level in the United States. On the other hand, agriculture employment in Puerto Rico represented 1.6% of total employment in fiscal year 2012.

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

Fiscal Years Ended June 30,	Labor Force	Employed	Unemployed	Unemployment Rate[(2)]
		(Annual Average)		
2008	1,355	1,203	152	11.2%
2009	1,325	1,144	181	13.7%
2010	1,285	1,075	210	16.3%
2011	1,249	1,047	202	16.2%
2012	1,221	1,035	185	15.2%
2013[(3)]	1,204	1,033	171	14.2%

(1) Totals may not add due to rounding.
(2) Unemployed as percentage of labor force.
(3) Average figures for the first nine months of fiscal year 2013 (July 2012 through March 2013).
Source: Department of Labor and Human Resources – Household Survey

These Household Survey figures are different from the ones published previously, due to the fact that the Department of Labor finally published the revision of this survey which takes into account the new population numbers from the Census of 2010. Every decade, with every population census, employment and unemployment data are revised backwardly to consider population trends. Given that the Census of 2010 reported for the first time a population reduction in Puerto Rico, employment and unemployment data suffered a downward revision. As an example, for fiscal years 2011 and 2012 total employment figures were 30,300 and 49,700 employees below the previously published numbers. Similarly, for the same years, unemployed persons were below by 1,700 and by 5,400 from the numbers reported earlier. As a result, the unemployment rate did not change significantly, but the levels of total employment and unemployment varied downwardly.

Economic Performance by Sector

From fiscal year 2008 to fiscal year 2012, the manufacturing and service sectors generated the largest portion of gross domestic product. The manufacturing, service, and government sectors were the three sectors of the economy that provided the most employment in Puerto Rico.

The following table presents annual statistics of gross domestic product by sector and gross national product for fiscal years 2008 to 2012.

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

	Fiscal Years Ended June 30,				
	2008	2009	2010	2011	2012[1]
Manufacturing	$40,234	$43,872	$46,577	$46,832	$46,114
Service[2]	42,405	40,642	41,408	43,128	43,811
Government[3]	8,762	9,047	8,350	8,216	8,278
Agriculture	519	567	822	796	818
Construction[4]	2,031	1,777	1,580	1,462	1,471
Statistical discrepancy	(312)	480	(294)	(238)	(543)
Total gross domestic product[5]	$93,639	$96,386	$98,381	$100,196	$101,034
Less: net payment abroad	(30,936)	(32,768)	(34,087)	(34,629)	(31,573)
Total gross national product[5]	$62,703	$63,618	$64,295	$65,567	$69,462

(1) Preliminary.
(2) Includes wholesale and retail trade, utilities, transportation and warehousing, information, finance and insurance, real estate and rental, and certain services such as professional, scientific, technical, management, administrative, support, educational, health care, social, recreational, accommodation, food and other services.
(3) Includes the Commonwealth, its municipalities and certain public corporations, and the federal government. Excludes certain public corporations, such as the Electric Power Authority and the Aqueduct and Sewer Authority, whose activities are included under "Service" in the table.
(4) Includes mining.
(5) Totals may not add due to rounding.

Source: Planning Board

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

The following table presents annual statistics of average employment based on the North American Industry Classification System ("NAICS") for fiscal years 2008 to 2012.

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

	Fiscal Years Ended June 30,				
	2008	**2009**	**2010**	**2011**	**2012[(2)]**
Natural resources and construction	59,675	49,067	35,942	31,792	34,992
Manufacturing					
Durable goods	43,100	39,242	34,792	33,900	33,283
Non-durable goods	60,950	57,483	53,533	51,767	50,175
Sub-total	104,050	96,725	88,325	85,667	83,458
Trade, transportation, warehouse, and Utilities					
Wholesale trade	33,717	33,267	32,533	31,983	31,467
Retail trade	130,883	127,492	126,233	128,017	128,117
Transportation, warehouse, and utilities	16,742	15,692	14,550	14,333	14,567
Sub-total	181,342	176,450	173,317	174,333	174,150
Information	21,442	20,217	18,783	18,733	18,650
Finance	48,483	48,492	45,808	43,708	44,425
Professional and business	108,150	103,333	102,508	105,592	108,800
Educational and health	108,550	109,992	111,333	114,108	117,550
Leisure and hospitality	73,408	70,933	70,850	71,150	72,633
Other services	21,217	20,117	18,758	17,925	17,558
Government[(3)]	297,742	300,708	276,533	260,033	258,458
Total non-farm	1,024,058	996,033	942,158	923,042	930,675

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

(2) Preliminary.

(3) Includes state, local, and federal government employees.

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

Although the data from the Payroll Survey is revised annually, this year's revision presented major changes not observed during the past five years. For example, for calendar year 2010 the benchmark revision of the Payroll Survey implied an average reduction of 2,842 employees with respect to previously reported numbers for that year. Furthermore, for calendar year 2011 the annual benchmark revision implied an average increase of 4,067 employees with respect to earlier reports. From calendar years 2006 to 2011 the standard deviation of the revisions was around 4,400 employees, meaning that a revision could add or subtract 4,400 employees, on average. Nevertheless, the benchmark revision of calendar year 2012 implied an addition of 18,433 employees. This average increase affects previous interpretations of the behavior of the labor market, and had effects on other composed variables, like the GDB-EAI.

Manufacturing

Manufacturing is the largest sector of the Puerto Rico economy in terms of gross domestic product. The Planning Board figures show that in fiscal year 2012 manufacturing generated $46.1 billion, or 45.6%, of gross domestic product. During fiscal year 2012, payroll employment for the manufacturing sector was 83,458, a decrease of 2.6% compared with fiscal year 2011. For the first nine months of fiscal year 2013, manufacturing employment averaged 78,500, a reduction of 6.3% (or 5,300 employees) with respect to the same time period of the previous fiscal year. Most of Puerto Rico's manufacturing output is shipped to the United States mainland, which is also the principal source of semi-finished manufactured articles on which further manufacturing operations are performed in Puerto Rico. Federal minimum wage laws are applicable in Puerto Rico. For fiscal year 2012, however, the average hourly manufacturing wage rate in Puerto Rico was approximately 66.9% of the average mainland United States rate.

In the last three decades, industrial development in Puerto Rico has been relatively capital intensive and dependent on skilled labor. This gradual shift in emphasis from labor intensive to capital intensive industrial development is best exemplified by large investments over the last two decades in the pharmaceutical and medical-equipment industries in Puerto Rico. Historically, one of the factors that encouraged the development of the manufacturing sector was the tax incentives offered by the federal and Commonwealth governments. Federal legislation enacted in 1996, however, which amended Section 936 of the United States Internal Revenue Code of 1986, as amended (the "U.S. Code"), phased out these federal tax incentives during a ten-year period that ended in 2006. Moreover, Act 154 expanded the income tax rules as they relate to certain nonresident alien individuals, foreign corporations and foreign partnerships and imposed a new temporary excise tax on persons that purchase products manufactured in Puerto Rico by other persons that are members of the same controlled group. The elimination of the benefits provided by Section 936 of the U.S. Code has had, and Act 154 may have, a long-term impact on local manufacturing activity. See "Tax Incentives—Incentives under the U.S. Code" under THE ECONOMY and "Major Sources of General Fund Revenues—Tax Reform" and "Major Sources of General Fund Revenues—Income Taxes," respectively, under PUERTO RICO TAXES, OTHER REVENUES AND EXPENDITURES.

The following table sets forth gross domestic product by manufacturing sector for fiscal years 2008 to 2012.

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

	2008	2009	2010	2011	2012 [1]
Food	$ 822	$ 977	$ 868	$ 862	813
Beverage and Tobacco Products	1,243	1,209	1,358	1,092	1,116
Textile Mills & Product Mills	15	12	11	11	11
Apparel	252	270	283	276	264
Leather and Allied Products	20	18	22	25	26
Wood Products	22	20	19	17	18
Paper	66	63	45	56	57
Printing and Related Support Activities	119	100	115	121	118
Petroleum and Coal Products	95	347	353	367	348
Chemical	29,339	30,380	32,527	32,872	31,555
Plastics and Rubber Products	118	108	111	101	104
Nonmetallic Mineral Products	218	148	123	114	115
Primary Metals	151	145	200	174	173
Fabricated Metal Products	248	207	175	170	179
Machinery	234	174	233	228	246
Computer and Electronic Products	4,463	7,037	7,479	7,400	8,042
Electrical Equipment, Appliances and Components	657	654	677	724	750
Transportation Equipment	78	72	75	79	84
Furniture and Related Products	56	48	37	36	36
Miscellaneous	2,019	1,882	1,865	2,108	2,058
Total gross domestic product of manufacturing sector [2]	$ 40,234	$ 43,872	$ 46,577	$ 46,832	$ 46,114

(1) Preliminary.

(2) Totals may not add due to rounding.

Source: Planning Board

The following table presents annual statistics of average manufacturing employment by industry based on the NAICS for fiscal years 2008 to 2012.

Commonwealth of Puerto Rico
Non-Farm Payroll Manufacturing Employment by Industry Group*
(number of employees)

	Fiscal Years Ended June 30,				
Industry group	**2008**	**2009**	**2010**	**2011**	**2012[(1)]**
Durable goods					
Nonmetallic mineral products manufacturing	3,758	3,058	2,492	2,133	2,042
Fabricated metal products	5,375	4,908	4,042	3,625	3,600
Computer and electronic	8,600	7,042	5,733	5,967	5,200
Electrical equipment	6,658	5,867	5,058	5,042	5,100
Miscellaneous manufacturing	11,967	11,975	11,675	11,633	11,767
Other durable goods manufacturing	6,742	6,392	5,792	5,500	5,575
Total – durable goods	43,100	39,242	34,792	33,900	33,283
Non-durable goods					
Food manufacturing	11,725	11,383	11,592	11,908	11,467
Beverage and tobacco products manufacturing	3,267	3,133	3,275	3,000	2,508
Apparel manufacturing	9,633	9,825	8,808	8,775	9,692
Chemical manufacturing	27,900	25,042	22,392	21,033	19,975
Plastics and rubber products	1,983	1,967	1,908	1,750	1,608
Other non-durable goods manufacturing	6,442	6,133	5,558	5,300	4,925
Total – non-durable goods	60,950	57,483	53,533	51,767	50,175
Total manufacturing employment	104,050	96,725	88,325	85,667	83,458

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

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

Total employment in the manufacturing sector decreased by 33,800 from fiscal year 2005 to fiscal year 2012. For fiscal years 2007, 2008, 2009, 2010, 2011 and 2012, manufacturing employment decreased by 4.2%, 3.5%, 7.0%, 8.7%, 3.0% and 2.6%, respectively. For the first nine months of fiscal year 2013, average employment in the sector declined by 5,300 jobs, or 6.3%, compared to the same period of the previous year. Given that this sector pays, on average, the highest wages in Puerto Rico, its general downturn has represented a major difficulty for restoring growth for the whole economy. There are several reasons that explain this sector's job shrinkage: the end of the phase-out of the tax benefits afforded by Section 936 of the U.S. Code, the net loss of patents on certain pharmaceutical products, the escalation of manufacturing production costs (particularly electricity), the increased use of job outsourcing, and the increase of global competition. Puerto Rico's manufacturing sector continues to face increased international competition. As patents on pharmaceutical products manufactured in Puerto Rico expire and the production of such patented products is not replaced by new products, there may be additional job losses in this sector and a loss of tax revenues for the Commonwealth.

Service Sector

Puerto Rico has experienced mixed results in the service sector, which, for purposes of the data set forth below, includes wholesale and retail trade, utilities, transportation and warehousing, information, finance and insurance, real estate and rental, and certain services such as professional, scientific, technical, management, administrative, support, educational, health care, social, recreational, accommodation, food and other services. This sector has expanded in terms of income over the past decade, following the general trend of other industrialized economies, but with differences on the magnitudes of those changes. During the period between fiscal years 2007 and 2012, the gross domestic product in this sector, in nominal terms, increased at an average annual rate of 1.2%, while payroll employment in this sector decreased at an average annual rate of 0.4%. In the Puerto Rico labor market, self-employment, which is not accounted for in the Payroll Survey, represents approximately 15.5% of total employment according to the Household Survey. Most of the self-employment is concentrated in the service and construction sectors. The development of the service sector has been positively affected by demand generated by other sectors of the economy, such as manufacturing and construction.

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

The service sector ranks second to manufacturing in its contribution to gross domestic product. The service sector is also the sector with the greatest amount of employment. In fiscal year 2012, the service sector generated $43.8 billion, or 43.4%, of gross domestic product. Trade, professional and business support, and education and health, experienced growth at current prices in fiscal year 2012, as measured by gross domestic product, while transportation and warehousing, information, finance, and other services experienced reductions in fiscal year 2011, as measured by gross domestic product at current prices. Service-sector employment decreased from 565,242 in fiscal year 2007 to 553,767 in fiscal year 2012 (representing 59.5% of total, non-farm, payroll employment). The average service-sector employment for fiscal year 2012 represents an increase of 1.5% compared to the prior fiscal year. For the first nine months of fiscal year 2013, average service-sector employment was 559,267, an increase of 1.2% with respect to the same period for the prior fiscal year.

Puerto Rico has a developed banking and financial system. As of December 31, 2012, there were eleven commercial banks operating in Puerto Rico. Commercial banks in Puerto Rico are generally regulated by the Federal Deposit Insurance Corporation (the "FDIC") or the Board of Governors of the Federal Reserve System, and by the Office of the Commissioner of Financial Institutions of Puerto Rico (the "OCFI"). The OCFI reports that total assets of commercial banks (including assets of units operating as international banking entities) as of December 31, 2012 were $68.1 billion, as compared to $70.8 billion as of December 31, 2011. On April 30, 2010, the OCFI closed three commercial banks and the FDIC was named receiver. On the same date, the FDIC entered into loss share purchase and assumption agreements with three of the other commercial banks with operations in Puerto Rico, providing for the acquisition of most of the assets and liabilities of the closed banks, including the assumption of all of the deposits. Considering the magnitude of the consolidations, the amount of jobs lost to date as a result of these consolidations has not been significant. The Government expects that this consolidation will strengthen the Puerto Rico banking sector.

Broker-dealers in Puerto Rico are regulated by the Financial Industry Regulatory Authority ("FINRA"), the United States Securities and Exchange Commission and the OCFI, and are mainly dedicated to serve investors that are residents of Puerto Rico. According to the OCFI, assets under management by broker-dealers in Puerto Rico totaled $35.2 billion as of December 31, 2012, as compared to $33.9 billion on December 31, 2011. Another relevant component of the financial sector in Puerto Rico is the investment company industry. According to the OCFI, local investment companies had recorded assets under management of $17.3 billion as of December 30, 2012, as compared to $15.3 billion as of December 31, 2011.

Other components of the financial sector in Puerto Rico include international banking entities ("IBEs") and credit unions (locally known as "cooperativas"). IBEs are licensed financial businesses that conduct offshore banking transactions. As of December 31, 2012, there were 30 IBEs (including units of commercial banks) operating in Puerto Rico, with total assets of $36.5 billion, a decrease from $43.9 billion in total assets as of December 31, 2011. Meanwhile, credit unions, which tend to provide basic consumer financial services, reached $8.2 billion in assets as of December 31, 2012, an increase from $7.8 billion as of December 31, 2011.

In addition, there are specialized players in the local financial industry that include mortgage-origination companies and auto and personal finance companies.

The following table sets forth gross domestic product for the service sector for fiscal years 2008 to 2012.

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

	Fiscal Years Ended June 30,				
	2008	**2009**	**2010**	**2011**	**2012[1]**
Wholesale trade	$ 2,951	$ 2,846	$ 2,993	$ 2,975	$ 2,943
Retail trade	4,569	4,467	4,473	4,625	4,693
Transportation and warehousing	978	895	941	931	905
Utilities	2,118	1,967	1,982	2,010	1,854
Information	2,363	2,426	2,646	2,597	2,559
Finance and insurance	7,120	5,105	5,241	5,261	4,754
Real Estate and rental	13,098	13,660	13,785	14,868	16,011
Professional and business	3,184	3,009	3,083	3,313	3,415
Education and health	3,786	4,106	4,015	4,242	4,341
Leisure and hospitality	1,875	1,773	1,860	1,920	1,936
Other services	363	390	390	386	399
Total[2]	$42,405	$40,642	$41,408	$43,128	$43,811

(1) 2008-2011 revised figures and 2012 preliminary.
(2) Totals may not add due to rounding.
Source: Puerto Rico Planning Board

The following table sets forth employment for the service sector for fiscal years 2008 to 2012.

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

	Fiscal Years Ended June 30,				
	2008	**2009**	**2010**	**2011**	**2012(1)**
Wholesale trade	33,717	33,267	32,533	31,983	31,467
Retail trade	130,883	127,492	126,233	128,017	128,117
Transportation, warehouse and utilities	16,742	15,692	14,550	14,333	14,567
Information	21,442	20,217	18,783	18,733	18,650
Finance	48,483	48,492	45,808	43,708	44,425
Professional and business	108,150	103,333	102,508	105,592	108,800
Educational and health	108,550	109,992	111,333	114,108	117,550
Leisure and hospitality	73,408	70,933	70,850	71,150	72,633
Other services	21,217	20,117	18,758	17,925	17,558
Total(2)	562,592	549,533	541,358	545,550	553,767

(1) Preliminary.
(2) Totals may not add due to rounding.
Source: Department of Labor and Human Resources, Benchmark on Employment, Hours and Earnings

Hotels and Related Services—Tourism

For fiscal year 2012, the number of persons registered in tourist hotels, including residents of Puerto Rico and tourists, was 2,097,700, an increase of 9.4% over the number of persons registered during fiscal year 2011. The average occupancy rate in tourist hotels during fiscal year 2012 was 70.4%, an increase of 2.2% from the prior fiscal year. Also, during fiscal year 2012, the average number of rooms available in tourist hotels increased by 2.5% to 11,788 rooms compared to fiscal year 2011.

During the first five months of fiscal year 2013, the number of persons registered in tourist hotels, including residents of Puerto Rico and tourists, was 890,000, an increase of 10.0% over the number of persons registered during the same period of fiscal year 2012. The average occupancy rate in tourist hotels during the first five months of fiscal year 2013 was 69.5%, an increase of 4.4% from the prior fiscal year. Also, during the first five months of fiscal year 2013, the average number of rooms available in tourist hotels increased by 2.8% to 11,849 rooms compared to the same period of fiscal year 2012.

In terms of employment, this sector has shown a behavior that seems not totally consistent with the registration figures presented in the previous paragraphs. According to the Payroll Survey, employment in the leisure and hospitality sector was 72,600 for fiscal year 2012, an increase of 2.1% over employment for fiscal year 2011, a growth rate significantly smaller than the growth rates of tourist hotel registrations for the same time period (9.4%). Moreover, for the first nine months of fiscal year 2013, employment in this sector increased by 3.8% to 75,100 compared to the same period of the prior fiscal year, which is still a smaller rate than the average growth rate observed for the first five months on the tourist hotel registrations (10.0%). These figures could imply a significant improvement on the labor productivity of this sector during fiscal years 2012 and 2013.

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

Commonwealth of Puerto Rico
Tourism Data[1]
Number of Visitors

Fiscal Years Ended June 30,	Tourist Hotels[2]	Excursionists[3]	Other[4]	Total
2008	1,342,810	1,496,853	2,373,436	5,213,099
2009	1,277,749	1,232,010	1,905,503	4,415,262
2010	1,349,449	1,193,549	1,777,070	4,379,155
2011	1,408,536	1,165,758	1,539,931	4,213,673
2012[5].......................................	1,507,984	1,127,842	1,561,103	4,196,929

Total Visitors' Expenditures
(in millions)

Fiscal Years Ended June 30,	Tourist Hotels[2]	Excursionists[3]	Other[4]	Total
2008	$1,526.3	$194.3	$1,814.3	$3,535.0
2009	$1,464.4	$173.7	$1,537.7	$3,175.8
2010	$1,541.8	$171.4	$1,497.5	$3,210.7
2011[5].......................................	$1,618.9	$169.3	$1,354.6	$3,142.8
2012[5].......................................	$1,706.9	$167.7	$1,318.3	$3,192.9

(1) Only includes information about non-resident tourists registering in tourist hotels. They are counted once even if registered in more than one hotel.
(2) Includes visitors in guesthouses.
(3) Includes cruise ship visitors and transient military personnel.
(4) Includes visitors in homes of relatives, friends, and in hotel apartments.
(5) Preliminary.
Sources: Puerto Rico Tourism Company and the Planning Board

The Commonwealth, through the Puerto Rico Convention Center District Authority ("PRCDA"), has developed the largest convention center in the Caribbean, and the centerpiece of a 100-acre private development that includes hotels, restaurants, office space, and housing. The convention center district is being developed at a total cost of $1.3 billion in a public/private partnership effort to improve Puerto Rico's competitive position in the convention and group-travel segments. The convention center opened on November 17, 2005 and, since its inauguration, the facility has hosted more than 1,000 events accounting for more than 1 million attendees. A 500-room hotel located next to the convention center commenced operations in November of 2009.

The PRCDA also owns an 18,500-person capacity multipurpose arena, known as the José Miguel Agrelot Coliseum, located in San Juan, Puerto Rico. The coliseum was inaugurated in 2004 and has hosted more than 2.5 million people attending over 400 world-caliber events. The venue has received numerous awards including "Best International Large Venue of the Year" from Pollstar magazine in 2005.

Government

The government sector of Puerto Rico plays an important role in the economy. It promoted the transformation of Puerto Rico from an agricultural economy to an industrial one during the second half of the 20th century, providing the basic infrastructure and services necessary for the modernization of Puerto Rico.

In fiscal year 2012, the government (federal, state and local) accounted for $8.3 billion, or 8.2%, of Puerto Rico's gross domestic product. The government is also a significant employer, employing 258,500 workers (federal, state and local), or 27.8% of total, non-farm, payroll employment in fiscal year 2012. In fiscal year 2009, state and municipal government employment averaged 285,600. During fiscal year 2010, state and municipal government employment decreased by 25,700 jobs, or 9.0%. According to the Payroll Survey, the distribution of the job reductions during fiscal year 2010 was 20,700 jobs in the state government (including public corporations) and approximately 5,000 jobs in municipal government. During fiscal year 2011, state and municipal government employment decreased further by 14,900 jobs, or 5.7%, compared to fiscal year 2010. According to the Payroll Survey, the decrease was attributable to a reduction of 12,500 jobs in the state government and approximately 2,400 jobs in municipal government. Subsequently, during fiscal year 2012, state and municipal government employment also decreased, but considerably less; by 1,000 jobs, or 0.4%, when compared to fiscal year 2011. The drop was comprised of a reduction of close to 1,200 jobs in the state government, or a 0.7% decrease, and a concurrent 200 increase, or 0.4%, in municipal government employment. Nevertheless, during the first nine months of fiscal year 2013, total government employment (federal, state and local) remained virtually unchanged, with a "negative" growth rate of 0.017% from the previous fiscal year. This stagnation in government employment for the first nine months of fiscal year 2013 consists of an average decrease of 1,400 jobs, or 0.8%, in state government offset by an average increment of 1,600 jobs, or 2.7%, in municipal government employment and a small reduction of 300 jobs, or 1.8%, in federal government, respectively.

Transportation

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

Luis Muñoz Marín International Airport in the San Juan metropolitan area is currently served by 24 domestic and international airlines. The Airport receives over 8 million passengers per year, making it the busiest airport in the Caribbean. At present, there is daily direct service between San Juan and Atlanta, Baltimore, Boston, Chicago, Dallas, Miami, New York, Orlando, Philadelphia, and numerous other destinations within the United States mainland. San Juan has also become a hub for intra-Caribbean service. While the main hubs in the United States mainland serve as the gateway from San Juan to most international destinations, Latin American destinations are also served through Panama City, Panama, with connections to Central and South America. On February 27, 2013, the Puerto Rico Ports Authority closed a long term lease of the Luis Munoz Marin International Airport with Aerostar Holdings, LLC ("Aerostar") pursuant to a public-private partnership transaction. It is estimated that Aerostar will invest $1.4 billion in the Airport during the life of the lease, including a commitment to invest approximately $267 million in immediate improvements and comply with world-class operating standards.

Regarding other airports, Rafael Hernández Airport in Aguadilla is served by JetBlue and Spirit and has regularly scheduled service to and from Fort Lauderdale, New York, Newark and Orlando; and Ponce's Mercedita Airport is served by JetBlue and has regularly scheduled service to and from New York and Orlando. Both of these airports also have scheduled service to other Caribbean islands. Smaller regional airports serve intra-island traffic. Cargo operations are served by both Federal Express and United Parcel Service (UPS) at the airports in San Juan and Aguadilla.

Puerto Rico's major cities are connected by a modern highway system, which, as of December 31, 2011, totaled approximately 4,640 miles, and 12,045 miles of local streets and adjacent roads. The highway system comprises 389 miles of primary system highways, which are the most important interregional traffic routes and include PR-52, PR-22, PR-53, PR-66 and PR-20 toll highways, 232 miles of primary urban system highways, 959 miles of secondary system highways serving the needs of intra-regional traffic, and 3,061 miles of tertiary highways and roads serving local, intra-regional traffic. On September 22, 2011, the PPP Authority and the Highways and Transportation Authority completed the procurement for a concession of toll roads PR-22 and PR-5. See "Economic Development Program – Public-Private Partnerships" under Fiscal Stabilization and Economic Growth.

The Port of the Americas is a deep draft container terminal under development on the south coast of Puerto Rico in the City of Ponce, the Commonwealth's fourth largest municipality by population. Managed by the Authority of the Port of Ponce, the terminal can handle containerized import/export and transshipment cargo. The first phase of the port development was completed in 2004 while the second phase, which resulted in container yard with capacity of up to 250,000 Twenty-Foot Equivalent Units per year, was completed during the first quarter of calendar year 2009. A third development phase is still pending. The completion of phase three will result in an annual terminal processing capacity of up to 500,000 Twenty-Foot Equivalent Units as well as the installation of basic infrastructure required to develop an industrial value-added zone on land adjacent to the Port.

Construction

Although the construction industry represents a relatively small segment of the economy compared to other sectors, it has made significant contributions to the growth of economic activity due to its multiplier effect on the whole economy. From its peak in fiscal year 2000 to fiscal year 2012, real construction investment declined at an average annual rate of 5.9%. Construction investment started to decrease significantly in fiscal year 2005, as a consequence of the general economic conditions in Puerto Rico. During the last five fiscal years (from fiscal year 2007 to

2012) real construction investment decreased at an average annual rate of 7.3%. The Planning Board forecasts an increase in construction investment of 1.8% in real terms for fiscal year 2013, and of 4.9% for fiscal year 2014.

Public investment has been an important component of construction investment. During fiscal year 2012, approximately 59.0% of the total investment in construction was related to public projects, which represents an increase in its share of total construction investment compared to 37.9% in fiscal year 2000. Public investment in construction has been negatively affected by the Commonwealth's fiscal difficulties, while private investment in construction is still suffering from the credit conditions that prevailed during the last decade. Public investment was primarily in housing, schools, water projects, and other public infrastructure projects.

During fiscal year 2010, the number of construction permits decreased 15.2%, while the total value of construction permits dropped by 29.2% compared to fiscal year 2009. During the first ten months of fiscal year 2011 (the most recent data available), the total value of construction permits decreased further by 15.7%. The numbers and values of construction permits have become extremely outdated, and the Planning Board has stopped publishing them. Cement sales, on the other hand, declined by 26.3% in fiscal year 2010 and by 5.0% in 2011, reaching levels not seen in almost three decades. In fiscal year 2012 they increased by 7.3%, but during the first nine months of fiscal year 2013, however, cement sales decreased again by 9.1% from the same time period of the previous fiscal year.

Average payroll employment in the construction sector during fiscal year 2012 was 35,000, an increase of 10.1% from fiscal year 2011. Accordingly, during the first nine months of fiscal year 2013, payroll employment in the construction sector averaged 34,300 jobs, a slight decrease of 0.3% compared to the same period in fiscal year 2012.

On September 2, 2010, the Commonwealth enacted Act 132. Act 132 was designed primarily to stimulate the Puerto Rico real estate market, which in recent years has been suffering from lower sales, rising inventories, falling median prices and increased foreclosure rates. Pursuant to Act 132, the Commonwealth provided tax and transaction fee incentives to both purchasers and sellers of new and existing residential properties, as well as commercial properties with sale prices that do not exceed $3 million. The incentives provided by Act 132 (as subsequently amended) were effective from September 1, 2010 through October 31, 2011. Certain permanent incentives are also available for rental housing. On November 1, 2011, the Commonwealth approved Act 216, which provided incentives similar to the ones available under Act 132 but gradually reduced those incentives without disrupting the functioning of the housing market in Puerto Rico. The incentives provided by Act 216 (as subsequently amended) were effective from November 1, 2011 to June 30, 2013, with certain reductions after December 31, 2011 and June 30, 2012. New incentives were also available for property that constituted the seller's principal residence, as defined in Act 216.

Agriculture

The Department of Agriculture and related agencies have directed their efforts at increasing and improving local agricultural production, and stimulating the consumption of locally produced agricultural products. It should be noted, however, that agriculture production represents less than

1% of Puerto Rico's gross domestic product. During fiscal year 2012, gross income from agriculture was $784.5 million at current prices, which diminished slightly by 0.7% as compared with fiscal year 2011. In terms of gross domestic product, agriculture generated a level of production of $817.8 million at current prices in fiscal year 2012, an increase of 2.8% compared to fiscal year 2011. According to the Household Survey, the number of people employed in this sector has remained stable during the past three years, at 17,000 employees.

The Commonwealth government supports agricultural activities through incentives, subsidies, and technical and support services, in addition to income tax exemptions for qualified income derived by bona fide farmers. Act No. 225 of 1995 provides a 90% income tax exemption for income derived from agricultural operations, grants for investments in qualified agricultural projects, and a 100% exemption from excise taxes, real and personal property taxes, municipal license taxes and tariff payments. It also provides full income tax exemption for interest income from bonds, notes and other debt instruments issued by financial institutions to provide financing to agricultural businesses.

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

Higher Education

During the six decades from 1950 to 2010, Puerto Rico made significant advances in the field of education, particularly at the college and graduate-school level. The transformation of Puerto Rico during the 1950s and 1960s from an agricultural economy to an industrial economy brought about an increased demand for educational services at all levels. During the 1970s and 1980s, certain higher-wage, higher-technology industries became more prominent in Puerto Rico. More recently, employment in the service sector has increased significantly. This has resulted in an increased demand for workers having a higher level of education and greater expertise in various technical fields. During the same time period, enrollments in institutions of higher learning rose very rapidly due to growth in the college-age population, and the increasing percentage of college attendance by such population. During the 1990s and into the current decade, college attendance and college attendance as a percentage of the college-age population continued to increase, although the college-age population has declined since 2000.

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

Commonwealth of Puerto Rico
Trend in College Enrollment

	Commonwealth of Puerto Rico			United States Mainland		
Academic Year	**Population 18-24 Years of Age**	**Higher Education Enrollment**	**Percent[1]**	**Population 18-24 Years of Age**	**Higher Education Enrollment**	**Percent[1]**
1970	341,448[2]	57,340	16.8%	23,714,000[2]	8,580,887	36.2%
1980	397,839[2]	130,105	32.7%	30,022,000[2]	12,096,895	40.3%
1990	417,636[2]	156,147	37.4%	26,961,000[2]	13,818,637	51.3%
2000	428,894[2]	176,015	41.0%	27,141,150[2]	14,791,224	54.5%
2001	430,880[3]	184,126	42.7%	27,992,652[3]	15,312,289	54.7%
2002	428,065[3]	190,776	44.6%	28,480,708[3]	15,927,987	55.9%
2003	423,338[3]	199,842	47.2%	28,916,746[3]	16,611,711	57.4%
2004	417,141[3]	206,791	49.6%	29,302,179[3]	16,911,481	57.7%
2005	408,044[3]	208,032	51.0%	29,441,546[3]	17,272,044	58.7%
2006	398,586[3]	209,547	52.6%	29,602,839[3]	17,487,475	59.1%
2007	389,640[3]	225,402	57.8%	29,808,025[3]	17,758,870	59.6%
2008	384,751[3]	227,546	59.1%	30,194,274[3]	18,248,128	60.4%
2009	379,500[3]	235,618	62.1%	30,530,346[3]	19,102,814	62.6%
2010	375,145[2]	249,372	66.5%	30,672,088[2]	20,427,711	66.6%
2011	378,362[3]	250,192	66.1%	31,064,709[3]	21,016,126	67.7%

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

Sources: U.S. Census Bureau (U.S. Mainland Population), U.S. National Center for Education Statistics (NCES), Planning Board (Puerto Rico Population) and Council on Higher Education of Puerto Rico

The University of Puerto Rico, the only public university in Puerto Rico, has eleven campuses located throughout the island. The University's total enrollment for academic year 2010-2011 was approximately 61,722 students. The Commonwealth appropriates annually for the University of Puerto Rico an amount equal to 9.60% of the average annual revenue from internal sources (subject to certain exceptions) for each of the two fiscal years immediately preceding the current fiscal year.

In addition to the University of Puerto Rico, there are 40 public and private institutions of higher education located in Puerto Rico. Such institutions had an enrollment during academic year 2010-2011 of approximately 188,470 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.

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

Tax Incentives

One factor that has promoted and continues to promote the development of the manufacturing and service sector in Puerto Rico is the various local and federal tax incentives available, particularly those under Puerto Rico's Industrial Incentives Program and, until 2006, Sections 30A and 936 of the U.S. Code. Tax and other incentives have also been established to promote the development of the tourism industry. These incentives are summarized below.

Industrial Incentives Program

Since 1948, Puerto Rico has had various incentives laws designed to promote investment and job creation. 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 incentives laws is the Economic Incentives Act, enacted in May 2008 (the "Economic Incentives Act").

The benefits provided by the Economic Incentives Act are available to new companies as well as companies currently conducting tax-exempt operations in Puerto Rico that choose to renegotiate their existing tax exemption grants, expand current operations or commence operating a new eligible business. The activities eligible for tax exemption under the Economic Incentives Act include manufacturing, certain designated services performed for markets outside Puerto Rico (including the United States), the production of energy from local renewable sources for consumption in Puerto Rico and laboratories for research and development. The Economic Incentives Act expands the definition of eligible business from that included in Act No. 135 of December 2, 1997, as amended (the "1998 Tax Incentives Act"), to include clusters and supply chains.

Companies qualifying under the Economic Incentives Act can benefit from a simplified income tax system: in most cases, an income tax rate of 4% and a withholding tax rate of 12% on royalty payments. Alternatively, the income tax rate can be 8% and a withholding rate of 2% on royalty payments. Special rates apply to projects located in low and mid-development zones (an income tax reduction of 0.5%), certain local projects (an income tax rate as low as 3%), certain small- and medium-sized businesses (an income tax rate as low as 1%) and pioneering activities (an income tax rate of 1%, but for those using intangible property created or developed in Puerto Rico the income tax rate may be 0%). In addition, as with the 1998 Tax Incentives Act, the Economic Incentives Act grants 90% exemption from property taxes, 100% exemption from municipal license taxes during the first three semesters of operations and at least 60% thereafter, and 100% exemption from excise taxes, and sales and use taxes with respect to the acquisition of raw materials and certain machinery and equipment used in the exempt activities.

The Economic Incentives Act is designed to stimulate employment and productivity, research and development, capital investment, reduction in the cost of energy and increased purchase of local products.

Under the Economic Incentives Act, as with the 1998 Tax Incentives Act, companies can repatriate or distribute their profits free of Puerto Rico dividend taxes. In addition, passive income derived by exempted businesses from the investment of eligible funds in Puerto Rico financial institutions, obligations of the Commonwealth, and other designated investments is fully exempt from income and municipal license taxes. Gain from the sale or exchange of shares or substantially all the assets of an exempted business during the exemption period that is otherwise subject to Puerto Rico income tax would be subject to a special Puerto Rico income tax rate of 4%.

The Economic Incentives Act, like the 1998 Tax Incentives Act, also provides investors that acquire an exempted business that is in the process of closing its operations in Puerto Rico a 50% credit in connection with the cash purchase of such corporation's stocks or operational assets.

Individual Investors Act and Export Services Act

On January 17, 2012, the Legislative Assembly of Puerto Rico approved new legislation to promote the economic development of Puerto Rico: (i) Act No. 22, also known as the Act to Promote the Relocation of Individual Investors to Puerto Rico (the "Individual Investors Act), and (ii) Act No. 20, also known as the Act to Promote the Exportation of Services (the "Export Services Act"), which supersedes the provisions of the Economic Incentives Act that provide benefits to designated services performed for markets outside of Puerto Rico.

The Individual Investors Act seeks to attract new residents to Puerto Rico by providing total exemption from Puerto Rico income taxes on passive income realized or accrued after such individuals become bona fide residents of Puerto Rico. The Individual Investors Act applies to any individual investor that becomes a Puerto Rico resident on or before the taxable year ending on December 31, 2035, provided that such individual was not a resident of Puerto Rico at any time during the 15-year period preceding the effective date of the Individual Investors Act. This relocation should result in new local investments in real estate, services, and other consumption products, and in capital injections to the Puerto Rico banking sector, all of which will stimulate the economy of Puerto Rico.

The Export Services Act seeks to establish and develop in Puerto Rico an international export services center. This act seeks to encourage local service providers to expand their services to persons outside of Puerto Rico, promote the development of new businesses in Puerto Rico and stimulate the inbound transfer of foreign service providers to Puerto Rico. The Export Services Act also creates a special fund for the continuous development of new tax incentives that will promote export services and the establishment of new businesses in Puerto Rico. The Export Services Act applies with respect to any entity with a bona fide office or establishment located in Puerto Rico that is or may be engaged in an eligible service. Service providers operating under a tax exemption decree issued under the Export Services Act will enjoy various Puerto Rico tax incentives during the term of such decree, such as a 4% flat income tax rate on export services income and 100% tax-exempt dividend distributions.

Green Energy Incentives Program

On July 19, 2010 the Legislative Assembly enacted Act No. 83 of July 19, 2010 ("Act 83"), also known as the "Green Energy Incentives Act", to encourage the production of renewable energy on a commercial scale. The activities eligible for tax exemption under the Green Energy Incentives Act include businesses engaged in the production and sale of green energy on a commercial scale for consumption in Puerto Rico, a producer of green energy, the assembly and installation of machinery and equipment for the production of green energy, and the leasing of property used for the production of green energy (not including financing leases).

Companies qualifying under the Green Energy Incentives Act can avail themselves of the following tax benefits: a preferential income tax rate of 4% on income derived from eligible activities and a withholding tax rate of 12% on royalty payments, license fees and rental payments to non-Puerto Rico resident companies. In addition, the Green Energy Incentives Act grants a 90% exemption from property taxes, a 100% exemption from municipal license taxes during the first three semesters of operations and at least 60% thereafter, and a 100% exemption from excise taxes, and sale and use taxes with respect to the acquisition of raw materials and certain machinery and equipment used in the exempt activities.

Under the Green Energy Incentives Act, companies can repatriate or distribute their earnings and profits derived from the eligible activities free of Puerto Rico income taxes. Gain from the sale or exchange of shares or substantially all the assets of an exempted business during the exemption period that is otherwise subject to Puerto Rico income tax would be subject to a special Puerto Rico income tax rate of 4%.

In order to enjoy the tax benefits mentioned above, an eligible business must request and obtain a grant of tax exemption, which is a contract between the Commonwealth and the exempt business, and has a term of 25 years.

Moreover, the Green Energy Incentives Act creates a rebate program of a portion of the acquisition, installation, and related costs of the physical plant and the machinery and equipment of small and medium green energy projects located in Puerto Rico. In the case of large scale green energy projects (more than 1 MW) developed in Puerto Rico, the Green Energy Incentives Act creates a renewal green energy certificates program.

Tourism Incentives Program

For many years, Puerto Rico has enacted incentives laws designed to stimulate investment in hotel operations on the island. The Puerto Rico Tourism Development Act of 2010 (the "Tourism Development Act") provides partial exemptions from income, property, and municipal license taxes for a period of ten years. The Tourism Development Act also provides certain tax credits for qualifying investments in tourism activities, including hotel and condo-hotel development projects. The Tourism Development Act provides further tourism incentives by granting tax exemption on interest income, fees and other charges received with respect to bonds, notes, or other obligations issued by tourism businesses for the development, construction, rehabilitation, or improvements of tourism projects.

As part of the incentives to promote the tourism industry, in 1993 the Commonwealth established the Puerto Rico Tourism Development Fund ("TDF") as a subsidiary of GDB with the authority to (i) make investments in or provide financing to entities that contribute to the development of the tourism industry and (ii) provide financial guarantees and direct loans for financing tourism development projects. To date, TDF has provided direct loans and guaranteed loans and bonds in the aggregate amount of approximately $1.5 billion for 28 tourism projects representing 5,448 new hotel rooms and a total investment of approximately $2.5 billion.

Treatment of Puerto Rico Corporations under the U.S. Code - Controlled Foreign Corporations

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

CFCs operate under transfer pricing rules for intangible income that are different from those applicable to United States corporations operating under Section 936 of the U.S. Code ("Section 936 Corporations"). In many cases, they are allowed to attribute a larger share of this income to their Puerto Rico operation but must make a royalty payment "commensurate with income" to their United States affiliates. Section 936 Corporations were exempted from Puerto Rico withholding taxes on any cost-sharing payments they might have opted to make, but CFCs are subject to a 15% Puerto Rico withholding tax on royalty payments, unless they have a renegotiated Puerto Rico tax grant issued under the Economic Incentives Act, in which case this withholding tax could be lowered to 2% or 12%.

In May 2009, the United States Department of the Treasury announced proposed changes to the U.S. Code that include, among others, changes to remove incentives for shifting jobs overseas. Several of these initiatives could affect CFCs operating in Puerto Rico. As of this date, no legislation has been approved by either House of Congress of the United States. It is not possible at this time to determine the legislative changes that may be made to the U.S. Code, or their effect on the long-term outlook on the economy of Puerto Rico. The Commonwealth will develop policy responses to the United States government to seek to safeguard Puerto Rico's economic growth and development plans.

On September 22, 2011, HR No. 3020 was presented in the United States Congress House of Representatives, which allows corporations organized under the laws of Puerto Rico which derive fifty percent (50%) or more of their gross income from Puerto Rico sources to elect to be treated as domestic United States corporations for almost all provisions of the U.S. Code, including Section 243 of the U.S. Code pertaining to the dividends received deduction. By way of exception, the electing Puerto Rico corporations would not consider as part of their gross income for federal income tax purposes income derived from sources within Puerto Rico. If enacted, this legislation would constitute a significant incentive for CFCs owned by United States persons to establish or expand operations in Puerto Rico.

DEBT

Public Sector Debt

Public sector debt comprises bonds and notes of the Commonwealth, its municipalities, and public corporations ("notes" as used in this section refers to certain types of non-bonded debt regardless of maturity), subject to the exclusions described below.

Section 2 of Article VI of the Constitution of the Commonwealth provides that direct obligations of the Commonwealth evidenced by full faith and credit bonds or notes shall not be issued if the amount of the principal of, and interest on, such bonds and notes and on all such bonds and notes theretofore issued that is payable in any fiscal year, together with any amount paid by the Commonwealth in the fiscal year preceding the fiscal year of such proposed issuance on account of bonds or notes guaranteed by the Commonwealth, exceed 15% of the average annual revenues raised under the provisions of Commonwealth legislation and deposited into the treasury (hereinafter, "internal revenues") in the two fiscal years preceding the fiscal year of such proposed issuance. Section 2 of Article VI does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded through payments by the Commonwealth on such guaranteed debt. Internal revenues consist principally of income taxes, property taxes, sales taxes and excise taxes. Certain revenues, such as federal excise taxes on offshore shipments of alcoholic beverages and tobacco products and customs duties, which are collected by the United States Government and returned to the Treasury Department, and motor vehicle fuel taxes, crude oil and derivative products excise taxes and license fees, which are allocated to the Highway and Transportation Authority, are not included as internal revenues for the purpose of calculating the debt limit, although they may be available for the payment of debt service. In addition, the portion of the Sales Tax (as defined under "Major Sources of General Fund Revenues—Sales and Use Taxes" under "Puerto Rico Taxes, Other Revenues, and Expenditures" below) allocated to COFINA is not included as internal revenues since the legislation that created COFINA transferred ownership of such portion of the Sales Tax to COFINA and provided that such portion was not "available resources" under the Constitutional provisions relating to full faith and credit bonds.

As of March 31, 2013, future maximum annual debt service for the Commonwealth's outstanding general obligation debt is $989,231,968 in the fiscal year ending on June 30, 2016 (based on the assumption that the outstanding Public Improvement Refunding Bonds, Series 2003 C, Public Improvement Bonds of 2006, Series A, and Public Improvement Refunding Bonds, Series 2007A that are variable rate bonds, bear interest at the maximum rate of 12% per annum). This amount ($989,231,968) *plus* the amount paid by the Commonwealth in fiscal year 2012 on account of bonds or notes guaranteed by the Commonwealth ($17,315,000), for a total of $1,006,546,968, is equal to 12.44% of $8,089,241,500, which is the average of the adjusted internal revenues for the fiscal years ended June 30, 2011 and 2012. If the interest on the variable rate outstanding bonds described above was calculated using the effective fixed interest rate payable by the Commonwealth under the interest rate exchange agreements entered into in respect thereof, the future maximum annual debt service for the Commonwealth outstanding general obligations debt would be $948,635,824 in fiscal year 2020 and the percentage referred to in the preceding sentence would be 11.94%. The potential termination payment (which is a full faith and credit obligation of the Commonwealth) payable by the Commonwealth (based on the then applicable mark-to-market value) upon termination of the above mentioned swap agreements is not included in the calculation of the 15% constitutional debt limitation. For a discussion of the

Commonwealth's obligations under its interest rate exchange agreements, see "Interest Rate Exchange Agreements" under DEBT.

Except as set forth below, annual debt service payments on bonds guaranteed by the Commonwealth are not included in the calculation of the 15% debt limitation. In the event any of the public corporations issuers of guaranteed bonds are unable to make any portion of the future debt service payments on its guaranteed bonds, the Commonwealth would be required to make such payments under its guarantee from the General Fund, and such debt service would be included in the calculation of the 15% constitutional debt limitation.

As of March 31, 2013, Port of the Americas Authority ("PAA") had outstanding bonds guaranteed by the Commonwealth (the "PAA Guaranteed Bonds"), representing a $250 million GDB financing with an outstanding principal amount of $220.1 million. The Commonwealth has begun to make payments of debt service on the PAA Guaranteed Bonds and expects to make all payment on the PAA Guaranteed Bonds under the full faith and credit guarantee of the Commonwealth. During fiscal year 2013, the Commonwealth made payments under its guaranty of the PAA Guaranteed Bonds of $17.1 million. In addition, the Commonwealth had made special budgetary appropriations to PRASA to provide a subsidy for its operational expenses. See "Commonwealth Guaranteed Debt" below.

The Commonwealth's policy has been and continues to be to prudently manage such debt within the constitutional limitation. Debt of municipalities, other than bond anticipation notes, is supported by real and personal property taxes and municipal license taxes. Debt of public corporations, other than bond anticipation notes, is generally supported by the revenues of such corporations from rates charged for services or products. See "Public Corporations." However, certain debt of public corporations is supported, in whole or in part, directly or indirectly, by Commonwealth appropriations or taxes.

Direct debt of the Commonwealth (other than refunding bonds) is issued pursuant to specific legislation approved in each particular case. Debt of the municipalities is issued pursuant to ordinances adopted by the respective municipal legislatures. Debt of public corporations is issued in accordance with their enabling statutes. GDB, as fiscal agent of the Commonwealth and its municipalities and public corporations, must approve the specific terms of each issuance.

The following table presents a summary of public sector debt as of March 31, 2013. This table includes debt primarily payable from Commonwealth or municipal taxes, Commonwealth appropriations and rates charged by public corporations for services or products, as well as debt payable from other sources, some of which debt is set forth in footnote 6 below. Excluded from the table is debt the inclusion of which would reflect double counting including, but not limited to, $894.6 million of outstanding bonds (as of March 31, 2013) issued by Municipal Finance Agency to finance its purchase of bonds of Puerto Rico municipalities.

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

	March 31, 2013
GENERAL FUND RELATED DEBT	
Direct full faith and credit obligations	$ 10,599
Puerto Rico guaranteed debt(1)	5,617
Debt supported by Puerto Rico appropriations or taxes(2)	4,047
Tax and Revenue Anticipation Notes(3)	900
Pension Obligation Bonds(4)	2,948
TOTAL GENERAL FUND RELATED DEBT	$24,111
Sales Tax debt	$15,224
Public corporations and agencies(5)	25,142
Municipal debt	3,795
Limited obligations/non-recourse debt(6)	2,178
TOTAL PUBLIC SECTOR DEBT	$70,450

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* Totals may not add due to rounding.

(1) Consists of $651 million of bonds issued by Aqueduct and Sewer Authority, $452 million of State Revolving Fund Loans incurred under various federal water laws, $220.1 million of bonds issued by Port of the Americas Authority and $4.293 billion of PBA bonds. Excludes $267 million of GDB bonds payable from available moneys of GDB.

(2) Represents bonds and notes payable from the Commonwealth General Fund and Public Improvement Fund. Includes Public Finance Corporation bonds.

(3) Includes related short-term financings.

(4) Represents Senior Pension Funding Bonds, Series A, B, and C issued by the Employees Retirement System, which are payable solely from employer contributions made to the Employees Retirement System by the Commonwealth and its instrumentalities after the issuance of the bonds.

(5) Excludes $4.7 billion of notes issued by GDB, the proceeds of which have been principally used to fund loans to the Commonwealth, public corporations, agencies and municipalities. Loans made by GDB to the Commonwealth, public corporations, agencies and municipalities are included in the table.

(6) Includes the following: $1.3 billion of Children's Trust bonds, which are payable solely from the payments to be received pursuant to the tobacco litigation settlement; $161.2 million of Housing Finance Authority bonds, which are payable from Puerto Rico Housing Administration's annual allocation of Public Housing Capital Funds from the United States Department of Housing and Urban Development ("HUD"); $319.9 million of Capital Fund Modernization Program Subordinate Bonds, Series 2008 issued by the Housing Finance Authority and payable primarily from federal housing assistance payments made available by HUD; $145.9 million of Special Facilities Revenue Bonds issued by Highways and Transportation Authority, which are payable from net toll revenues collected from the Teodoro Moscoso Bridge; $155 million of Special Facilities Bonds issued by Ports Authority, which are solely payable from the pledge of certain payments made by a private corporation under a special facilities agreement; $72.7 million of Educational Facilities Revenue Bonds, 2000 Series A (University Plaza Project) issued by Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority ("AFICA"), which are payable from rent payments made by the University of Puerto Rico; and approximately $39.1 million of bonds issued by AFICA to finance the construction of various government infrastructure projects, which are payable from rent payments made by various government entities.

Source: Government Development Bank for Puerto Rico

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

Debt Service Requirements for Commonwealth General Obligation Bonds

The following table presents the debt service requirements for Commonwealth general obligation bonds outstanding on July 3, 2012. This table, however, does not include payments made by the Commonwealth on the PAA Guaranteed Bonds, which are paid from General Fund budgetary appropriations determined in consultation with GDB, as holder of the PAA Guaranteed Bonds. The amounts paid by the Commonwealth under the PAA Guaranteed Bonds for the prior fiscal year, however, are taken into account in the determination of the constitutional debt limit.

In addition, in respect of certain variable rate general obligation bonds, as to which the Commonwealth has entered into interest rate exchange agreements, the interest in the table is calculated by using the respective fixed rates of interest that the Commonwealth is paying under said agreements.

Debt service requirements for each fiscal year, as shown in the following table, include principal and interest due on July 1 immediately following the close of such fiscal year.

Puerto Rico General Obligation Debt Service Requirements*
(In thousands)

Fiscal Year Ending June 30	Outstanding Bonds		
	Principal	Interest[3]	Total[3]
2013	384,235[1]	448,619	832,854
2014	376,453	452,614	829,067
2015	407,055	459,154	866,209
2016	425,640	514,381	940,021
2017	371,192	494,423	865,614
2018	327,015	476,400	803,415
2019	475,981	444,721	920,702
2020	534,935	413,701	948,636
2021	403,150	387,665	790,815
2022	350,690	369,002	719,692
2023	273,615	352,547	626,162
2024	272,545	339,291	611,836
2025	291,470	325,956	617,426
2026	366,935	310,442	677,377
2027	308,600	290,578	599,178
2028	329,780	274,016	603,796
2029	305,180	255,981	561,161
2030	316,925	239,508	556,433
2031	319,000	223,069	542,069
2032	231,220	206,538	437,758
2033	345,450	193,865	539,315
2034	293,885	175,463	469,348
2035	375,975	160,079	536,054
2036	318,145	139,505	457,650
2037	336,405	121,248	457,653
2038	398,575	102,245	500,820
2039	421,130	79,691	500,821
2040	505,180	55,640	560,820
2041	532,625	28,194	560,819
	$10,598,985	$8,334,534	$18,933,519

* Totals may not add due to rounding. Includes the effective fixed rate on certain variable rate general obligation bonds as to which the Commonwealth has entered into interest rate exchange agreements.

(1) Includes $75 million in Commonwealth bond anticipation notes issued in January 2012 and payable in fiscal year 2013.

(2) The figures for interest have been reduced by the interest that was capitalized through the issuance of Commonwealth general obligation bonds in the following amounts: $128.3 million in fiscal year 2013, $97.0 million in fiscal year 2014 and $73.9 million in fiscal year 2015.

Sources: Government Development Bank for Puerto Rico and Treasury Department

Interest Rate Exchange Agreements

General. The Commonwealth and various public corporations are party to various interest rate exchange agreements or swaps. Except for the basis swaps discussed below, the purpose of all of the interest rate exchange agreements currently in place is to hedge the Commonwealth's variable rate debt exposure and the interest rate risks associated therewith. When the Commonwealth or a public corporation has issued variable rate bonds, it has entered into an interest rate exchange agreement with a counterparty pursuant to which the Commonwealth or the public corporation agrees to pay the counterparty a fixed rate and the counterparty agrees to pay the Commonwealth or public corporation a variable rate intended to match the variable rate payable on the bonds (a "synthetic fixed rate swap"). In theory, the variable rate payments received by the Commonwealth under the swap off-set the variable rate payments on the bonds and, thus, the Commonwealth or the public corporation is left with a net fixed rate payment to counterparty. The intention of these swaps was to lower the all-in cost of borrowing below what could have been achieved by issuing fixed rate bonds.

Basis Swaps. The Commonwealth and PREPA are also party to agreements ("basis swaps"), entered into in June 2006 and March 2008, respectively, pursuant to which they are making payments on a specified notional amount based on a short-term interest rate index published by the Securities Industry and Financial Markets Association ("SIFMA") and are receiving from their counterparties payments on the same notional amount based on the published three-month London Interbank Offered Rate ("LIBOR") plus a specified fixed rate payment (the "basis annuity"). The basis swaps are the only interest rate exchange agreements that do not hedge specific variable rate debt. For fiscal year 2012 and the first nine months of fiscal year 2013, the Commonwealth received $9.8 million and $5.9 million, respectively, from its counterparties under the basis swap, net of the Commonwealth's payments to the counterparties, and PREPA received $11.1 million and $7.2 million, respectively, from its counterparty under the basis swap, net of PREPA's payments to the counterparty. In addition, (i) in January 2012, PREPA received approximately $265,000 in connection with the unwinding of $225 million of notional amount of the basis swap; (ii) in May 2012, PREPA assigned $600 million in notional amount of its basis swap to two highly rated counterparties in order to further diversify its counterparty exposure (PREPA sold to each dealer the right to convert the basis annuity to a straight percentage of three-month LIBOR); and (iii) in October 2012, the Commonwealth terminated, at no cost, $424.6 million of its basis swap.

Risks. By using derivative financial instruments, the Commonwealth exposes itself, among other risks, to credit risk (based on the counterparty's ability to perform under the terms of the agreement), market risk (based on the changes in the value of the instrument resulting from changes in interest rates and other market factors) and, in the case of basis swaps, basis risk (based on changes to the correlation between different indexes used in connection with a derivative and the variable rate debt they hedge). GDB, as fiscal agent, regularly monitors the exposure of the Commonwealth and the public corporations under the interest rate exchange agreements and attempts to minimize the risks. To minimize some of the credit risk, the Commonwealth and the public corporations enter into agreements with highly-rated counterparties. The outstanding interest rate exchange agreements are with ten different counterparties, all of which, except one, are rated in one of the three highest rating categories by either Moody's or S&P. In addition, most of the agreements contain requirements of posting collateral by the counterparties based on certain valuation thresholds and credit ratings.

During fiscal years 2009, 2010, 2011, 2012 and the first nine months of fiscal year 2013, in order to reduce the risks associated with the swap portfolio, the Commonwealth and the public corporations terminated approximately $4.8 billion of swaps. The aggregate notional amount of the swaps for the Commonwealth and the public corporations has decreased from $9.2 billion as of June 30, 2008, to $4.2 billion as of March 31, 2013, an aggregate decrease of 54%.

Notional Amounts. The table below shows the aggregate notional amount, as of March 31, 2013, of synthetic fixed rate swaps and basis swaps of the Commonwealth and the public corporations.

Swap Portfolio Breakdown
Notional Amount
(as of March 31, 2013)

	Synthetic Fixed	Basis Swaps	Total
Commonwealth (General Obligation)	$587,565,000	$1,273,777,500	$1,861,342,500
Electric Power Authority	411,825,000	1,150,000,000	1,561,825,000
Highways and Transportation Authority	647,025,000	—	647,025,000
Sales Tax Financing Corporation	136,000,000	—	136,000,000
Total	$1,782,415,000	$2,423,777,500	$4,206,192,500

Market Value. Generally, the interest rate exchange agreements may be terminated by the Commonwealth or the public corporations at any time at their then current market values. The agreements may also be terminated upon the occurrence of certain credit events. If a termination occurs due to a credit event, the Commonwealth or the public corporations may be obligated to pay to the applicable swap counterparty an amount based on the terminating swap's market value, which may be substantial, or vice versa, with other termination costs being paid by the defaulting party. The mark-to-market value of the swaps fluctuates with interest rates and other market conditions. The Commonwealth's obligations under the interest rate exchange agreements are secured by the full faith, credit and taxing power of the Commonwealth.

The following table shows, as of March 31, 2013, the net mark-to-market value of all outstanding interest rate exchange agreements. Except for two of the basis swaps of PREPA and two swaps of the Highways and Transportation Authority, the mark-to-market value of all swaps of the Commonwealth and the public corporations was negative as of March 31, 2013. Thus, the Commonwealth or the public corporations, as applicable, would owe money to the counterparties if any of the agreements with a negative mark-to-market had been terminated as of that date.

Swap Portfolio Mark-to-Market Valuation
(as of March 31, 2013)

	Synthetic Fixed	Basis Swaps	Total
Commonwealth (General Obligation)	$(104,674,974)	$(6,862,380)	$(111,537,354)
Electric Power Authority	(93,309,790)	7,112,039	(86,197,751)
Highways and Transportation Authority	(177,386,608)	—	(177,386,608)
Sales Tax Financing Corporation	(68,500,035)	—	(68,500,035)
Total	$(443,871,407)	$249,659	$(443,621,748)

Collateral Requirements. Under the majority of the interest rate exchange agreements, the Commonwealth and the public corporations are required to deliver collateral to the counterparties to guarantee their performance under the agreements based on the credit ratings of the Commonwealth and the public corporations and certain contractual mark-to-market value thresholds. In accordance with these requirements, the Highways and Transportation Authority had posted collateral of $70.7 million to its swap counterparties as of March 31, 2013, and PREPA was required to post collateral of $1.4 million as of the same date. If the mark-to-market value of the swap portfolio deteriorates or the credit ratings of the Commonwealth or the public corporations are lowered, the collateral posting obligations contained in the agreements may require further deliveries of collateral.

Variable Rate Bonds and Mandatory Tender Bonds

Variable Rate Bonds. The Commonwealth and various public corporations have outstanding variable rate bonds, consisting of (i) variable rate demand bonds which are subject to mandatory tender for purchase prior to their maturity on certain interest rate reset dates and upon expiration of an associated credit or liquidity facility ("VRDO Bonds"), (ii) variable rate bonds and notes that have been purchased directly from the Commonwealth by certain financial institutions which provide for periodic interest rate changes based on the LIBOR or SIFMA index and which are subject to mandatory tender on certain dates prior to their maturities ("Mandatory Tender FRNs"), and (iii) other bonds and notes which provide for periodic interest rate changes based on the LIBOR rate or a particular index, but which are not subject to tender prior to their maturity. The Commonwealth and the public corporations have hedged substantially all of their variable rate debt exposure by entering into interest rate exchange agreements with certain swap providers. Pursuant to these agreements, the Commonwealth and the public corporations receive a variable rate payment expected to approximate the interest cost of the variable rate bonds, and pay a fixed rate. See "Interest Rate Exchange Agreements."

The following table shows the breakdown of variable rate debt of the Commonwealth and the public corporations as of March 31, 2013.

Variable Rate Debt Breakdown
(as of March 31, 2013)

	VRDO Bonds	Mandatory Tender FRNs	Other Variable Rate Debt	Total
Commonwealth (General Obligation)	$203,625,000	$257,215,000	$ 126,725,000	$587,565,000
Electric Power Authority	—	—	411,825,000	411,825,000
Highways and Transportation Authority	200,000,000	—	447,025,000	647,025,000
Sales Tax Financing Corporation	—	—	136,000,000	136,000,000
Total	$403,625,000	$257,215,000	$1,121,575,000	$1,782,415,000

VRDO Bonds. The VRDO Bonds bear a floating interest rate adjusted at specified intervals, such as daily or weekly (each, a "remarketing date") and provide investors the option to tender or put the bonds at par on each remarketing date. The tendered bonds are then resold by a remarketing agent in the secondary market to other investors. The VRDO Bonds are secured by letters of credit or other liquidity or credit facilities ("credit/liquidity facilities") that provide for the payment of the purchase price payable upon the tender of the bonds. The credit/liquidity facilities expire prior to the final maturity of the bonds. If, upon the expiration or termination of any credit/liquidity facility with respect to a series of VRDO Bonds, the Commonwealth or the applicable public corporation is unable to renew or replace such facility with an alternate credit/liquidity facility, the VRDO Bonds of such series are subject to mandatory tender for purchase by the credit/liquidity facility provider and generally become subject to higher interest rates and accelerated amortization schedules pursuant to the terms of each expiring credit/liquidity facility.

The recent United States financial market crisis has resulted in a significant reduction in the availability of credit/liquidity facilities to support VRDO Bonds, and a related increase in the price of these facilities when they can be obtained. Thus, if the Commonwealth and the public corporations are not able to renew or rollover the expiring credit/liquidity facilities with respect to VRDO Bonds, or are not able to do so at an acceptable price, the Commonwealth and the public corporations would have to refinance the VRDO Bonds or otherwise obtain financing for such bonds in order to avoid the higher interest rates and accelerated amortization schedules set forth in the expiring credit/liquidity facility.

In addition, since there are interest rate exchange agreements with respect to all VRDO Bonds, if the Commonwealth or the applicable public corporation cannot renew or replace a credit/liquidity facility upon its expiration or remarket the related series of bonds successfully upon their mandatory tender as variable rate bonds, the Commonwealth or the applicable public corporation may have to terminate the interest rate exchange agreements associated with such series of VRDO Bonds. Termination of the applicable interest rate exchange agreement may result, depending on then current interest rate levels and market conditions, in the payment of a termination amount, which may be substantial, by the Commonwealth to compensate the counterparty for its economic losses. As of March 31, 2013, the mark-to-market value of all the interest rate exchange agreements with respect to VRDO Bonds was negative $40.8 million for the Commonwealth and negative $48.6 million for the public corporations. See "Interest Rate Exchange Agreements – Market Value."

The following table shows, by fiscal year, the amount of VRDO Bonds subject to mandatory tender upon expiration of the applicable credit/liquidity facilities.

VRDO Bonds Rollover
(by Fiscal Year)

	2013	**2014**	**Total**
Commonwealth (General Obligation)	—	$203,625,000	$203,625,000
Highways and Transportation Authority	$200,000,000	—	200,000,000
Total	$200,000,000	$203,625,000	$403,625,000

Mandatory Tender FRNs and Mandatory Tender Fixed Rate Bonds. As of March 31, 2013, the Commonwealth had outstanding $257.2 million of Mandatory Tender FRNs and PBA had $129.2 billion of fixed rate bonds guaranteed by the Commonwealth that were subject to mandatory tender for purchase prior to maturity (collectively, the "Mandatory Tender Bonds"). The Commonwealth and the public corporations have not provided any liquidity facility for the payment of the purchase price payable upon the mandatory tender, which purchase price is expected to be obtained from the remarketing of the bonds. If the Commonwealth or the applicable public corporation cannot remarket the Mandatory Tender Bonds, they would have to obtain other funds in order to provide for the purchase price of these bonds or, in some cases, the bonds would become subject to higher interest rates and an accelerated amortization schedule.

The following table shows, as of March 31, 2013, the breakdown of the Mandatory Tender Bonds of the Commonwealth and the public corporations and the respective dates when such bonds are subject to mandatory tender for purchase.

Mandatory Tender Bonds Breakdown
(as of March 31, 2013)

	Mandatory Tender Bonds	**Type**	**Mandatory Tender Date**
Commonwealth (General Obligation)			
	$ 44,905,000	Variable	May 1, 2013*
	14,925,000	Variable	June 1,2013
	197,385,000	Variable	June 1, 2014
Public Buildings Authority	129,225,000	Fixed	July 1, 2017
Total	$386,440,000		

* Rolled over until May 1, 2014.

As discussed previously, the Commonwealth has entered into interest rate exchange agreements with respect to all Mandatory Tender FRNs. In the event the Commonwealth cannot remarket these bonds on their mandatory tender dates as variable rate bonds, the Commonwealth may have to terminate the associated interest rate exchange agreements. As of March 31, 2013, the mark-to-market value of all interest rate exchange agreements with respect to the Mandatory Tender FRNs was negative $58.2 million.

Ratings of Commonwealth General Obligation Bonds

The Commonwealth's general obligation and appropriation debt is currently rated "Baa3" with a negative outlook by Moody's, "BBB-" with a negative outlook by Fitch, and "BBB-" with a negative outlook by S&P.

Commonwealth Guaranteed Debt

As of March 31, 2013, $4.293 billion of Commonwealth guaranteed bonds of PBA were outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds). Maximum annual debt service on these bonds is $961 million in fiscal year 2028, assuming the receipt of the issuer subsidy from the federal government on the $756,449,000 Government Facilities Revenue Bonds, Series R (Qualified School Construction Bonds – Issuer Subsidy) and the $121,528,000 Government Facilities Revenue Bonds, Series T (Qualified Zone Academy Bonds – Direct Payment), and $1.0 billion in fiscal year 2028 without taking into consideration said subsidy, with their final maturity being July 1, 2041. No payments under the Commonwealth guaranty have been required to date for these bonds.

As of March 31, 2013, $267 million of Commonwealth guaranteed bonds of GDB were outstanding. No payments under the Commonwealth guaranty have been required for these bonds.

As of March 31, 2013, GDB held approximately $220.1 million of the Port of the Americas Authority's outstanding bonds, which are guaranteed by the Commonwealth. The proceeds from these bonds have been used to continue the development of the Port of the Americas. Payments of $77.8 million under the Commonwealth guaranty have been required to pay interest and principal on these bonds. While the responsibility for the development and operation of the Port of the Americas was transferred from the Port of the Americas Authority to the Authority of the Port of Ponce in December 2011, the Port of the Americas Authority retained the liability for the outstanding bonds, which are expected to be paid by the Commonwealth under the guarantee. See "Other Public Corporations—Port of the Americas Authority" under "Public Corporations" below.

As of March 31, 2013, the aggregate outstanding principal amount of obligations of PRASA guaranteed by the Commonwealth was $1.103 billion. This amount consisted of $284.8 million in revenue bonds sold to the public, $365.8 million in bonds issued to the United States Department of Agriculture, Rural Development, and $452.3 million of loans by the State Revolving (Clean Water and Safe Drinking Water Act) Funds for the benefit of PRASA. From January 1997 through fiscal year 2005, the Commonwealth made debt service payments under its guaranty. Beginning with the debt service payment due January 1, 2006, the Commonwealth stopped making guarantee payments on these obligations and PRASA resumed making payment on this debt. In the event PRASA is unable to make any portion of the future debt service payments on its guaranteed obligations, the Commonwealth would be required once more to make such payments from the General Fund under its guarantee. See "Other Public Corporations—Puerto Rico Aqueduct and Sewer Authority" under "Public Corporations" below.

During fiscal years 2011 and 2012, the Commonwealth made subsidy payments to PRASA for its operational expenses in the amounts of $105 million and $70.2 million, respectively. After the 2012 Series Bonds issuance, which established a budgetary reserve fund of $180 million, the Commonwealth does not anticipate having to appropriate additional funds to PRASA for its operational expenses.

Trends of Public Sector Debt

The following table shows the growth rate of short-term and long-term public sector debt and the growth rate of gross national product (in current dollars) for the five fiscal years ended June 30, 2012 and the nine months ended March 31, 2013. As of March 31, 2013, outstanding short-term debt, relative to total debt, was 8.2%. Total public sector debt for fiscal year 2012 shown in the table below represented 93.2% of gross national product for fiscal year 2012.

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

	Public Sector					Gross National Product[1]	
June 30,	Long Term[2]	Short Term[3]	Total	Short Term as % of Total	Rate of Increase	Amount	Rate of Increase
2008	43,663	3,269[4]	46,932	7.0	10.0	62,703	3.4
2009	48,332	4,648[4]	52,980	8.8	13.0	63,618	1.5
2010	53,351	3,472	56,823	6.1	7.3	64,295	1.1
2011	54,804	4,380	59,184	7.4	4.2	65,567	2.0
2012	60,780	3981	64,760	6.2	9.5	69,462	5.9
March 31, 2013	60,006	5,318	65,324	8.2	1.0	-	-

* Totals may not add due to rounding.
(1) In current dollars.
(2) Does not include debt totaling $5.1 billion consisting of (i) Senior Pension Funding Bonds, Series A, B, and C issued by the Employees Retirement System, which are payable solely from employer contributions made to the Employees Retirement System by the Commonwealth, its municipalities and participating public corporations after the issuance of the bonds, identified in footnote 4, and (ii) bonds identified in footnote 6, of the table above entitled "Commonwealth of Puerto Rico—Public Sector Debt," which would have been issued and outstanding at the time, all of which would be considered long-term debt.
(3) Obligations (other than bonds) issued with an original maturity of three years or less and lines of credit with a remaining maturity of three years or less are considered short-term debt.
(4) Does not include the tax and revenue anticipation notes that were outstanding at the close of the indicated fiscal years because prior to the end of said fiscal years sufficient funds had been set aside for the payment of such notes in full.

Source: Government Development Bank

PUBLIC CORPORATIONS

In Puerto Rico, many governmental and quasi-governmental functions are performed by public corporations created by the Legislative Assembly with varying degrees of independence from the central government to perform generally a single function or a limited number of related functions. Most public corporations obtain revenues from rates charged for services or products, but many are subsidized to some extent by the central government. Most public corporations are governed by boards whose members are appointed by the Governor with the advice and consent of the Senate, but some public corporations are attached to departments of the central government. Capital improvements of most of the larger public corporations are financed by revenue bonds issued under trust agreements or bond resolutions, or by notes issued under loan agreements. The following table presents the outstanding bonds and notes of certain of the public corporations as of March 31, 2013 ("notes" as used in this section refers primarily to certain types of non-bonded debt regardless of maturity). Debt of certain other public corporations is excluded from this table because such debt is payable primarily from funds or grants provided by the federal government, is payable from sources other than Commonwealth appropriations or taxes or revenues of public corporations, or is payable from revenues derived from private sector services or products, such as industrial development bonds. Also excluded from this table is debt of certain public corporations the inclusion of which would reflect double counting. No deductions have been made in the table for debt service funds and debt service reserve funds. More detailed information about the major public corporations is presented in the following sections.

The following table shows the trend of public sector debt by major category for the five fiscal years ended June 30, 2012 and the nine months ended March 31, 2013.

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

	Commonwealth[1]			**Municipalities**			**Public Corporation[2]**			**Total**		
June 30,	**Long Term**	**Short Term[3]**	**Total**	**Long Term**	**Short Term[3]**	**Total**	**Long Term**	**Short Term[3]**	**Total**	**Long Term**	**Short Term[3]**	**Total**
2008.........................	9,273	519[4]	9,792	2,507	313	2,820	31,633	2,437	34,070	43,413	3,269	46,682
2009.........................	9,382	557[4]	9,939	2,691	306	2,997	36,259	3,785	40,044	48,332	4,648	52,980
2010.........................	10,033	270	10,303	2,905	326	3,231	40,413	2,876	43,289	53,351	3,472	56,823
2011.........................	10,199	164	10,363	3,204	333	3,537	41,401	3,883	45,284	54,804	4,380	59,184
2012.........................	11,578	266.2	11,844	3,515	357	3,872	45,687	3,358	49,045	60,780	3,981	64,760
March 31, 2013	11,696	1,278	12,974	3,421	374	3,795	44,889	3,666	48,555	60,006	5,318	65,324

* Totals may not add due to rounding.

(1) Does not include the Senior Pension Funding Bonds, Series A, B, and C issued by the Employees Retirement System, which are payable solely from employer contributions made to the Employees Retirement System by the Commonwealth, its municipalities and participating public corporations after the issuance of the bonds, identified in footnote 4 of the table above entitled "Commonwealth of Puerto Rico—Public Sector Debt."

(2) Includes Commonwealth guaranteed debt; does not include the bonds identified in footnote 6 of the table above entitled "Commonwealth of Puerto Rico—Public Sector Debt."

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

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

Source: Government Development Bank

In Puerto Rico, many governmental and quasi-governmental functions are performed by public corporations created by the Legislative Assembly with varying degrees of independence from the central government to perform generally a single function or a limited number of related functions. Most public corporations obtain revenues from rates charged for services or products, but many are subsidized to some extent by the central government. Most public corporations are governed by boards whose members are appointed by the Governor with the advice and consent of the Senate, but some public corporations are attached to departments of the central government. Capital improvements of most of the larger public corporations are financed by revenue bonds issued under trust agreements or bond resolutions, or by notes issued under loan agreements. The following table presents the outstanding bonds and notes of certain of the public corporations as of March 31, 2013 ("notes" as used in this section refers primarily to certain types of non-bonded debt regardless of maturity). Debt of certain other public corporations is excluded from this table because such debt is payable primarily from funds or grants provided by the federal government, is payable from sources other than Commonwealth appropriations or taxes or revenues of public corporations, or is payable from revenues derived from private sector services or products, such as industrial development bonds. Also excluded from this table is debt of certain public corporations the inclusion of which would reflect double counting. No deductions have been made in the table for debt service funds and debt service reserve funds. More detailed information about the major public corporations is presented in the following sections.

Commonwealth of Puerto Rico
Outstanding Debt of Public Corporations
March 31, 2013
(in thousands)

	Bonds			Notes			Total Bonds and Notes		
	With Guaranty	Without Guaranty	Total	With Guaranty	Without Guaranty	Total	With Guaranty	Without Guaranty	Total
Aqueduct and Sewer Authority	$ 650,592	$ 3,422,055	$ 4,072,647	$452,274	$124,154	$576,428	$ 1,102,866	$ 3,546,209	$ 4,649,075
Convention Center District Authority	-	428,650	428,650	-	147,933	147,933	-	576,583	576,583
Electric Power Authority	-	8,048,485	8,048,485	-	749,321	749,321	-	8,797,806	8,797,806
Highway and Transportation Authority	-	5,012,702[1]	5,012,702	-	2,047,404	2,047,404	-	7,060,106	7,060,106
Housing Finance Authority	-	112,545[2]	112,545	-	149,502	149,502	-	262,047	262,047
Industrial Development Company	-	188,065	188,065	-	87,842	87,842	-	275,907	275,907
Infrastructure Financing Authority[3]	-	2,263,188	2,263,188	-	42,260	42,260	-	2,305,448	2,305,448
Port of the Americas Authority	220,120	-	220,120	-	-	-	220,120	-	220,120
Ports Authority	-	-[4]	-	-	44,000	44,000	-	44,000	44,000
Public Buildings Authority	4,293,494	-	4,293,494	-	286,770	286,770	4,293,494	286,770	4,580,264
Public Finance Corporation	-	1,090,740[5]	1,090,740	-	-	-	-	1,090,740	1,090,740
P.R. Sales Taxes Financing Corp. (COFINA)	-	15,223,821	15,223,821	-	-	-	-	15,223,821	15,223,821
University of Puerto Rico	-	510,698[6]	510,698	-	86,999	86,999	-	597,697	597,697
Others[7]	-	-	-	-	2,871,791	2,871,791	-	2,871,791	2,871,791
Total[8]	$5,164,206	$36,300,949	$41,465,155	$452,274	$6,637,976	$7,090,250	$5,616,480	$42,938,925	$48,555,405

(1) Excludes $145.9 million of Special Facilities Revenue Bonds issued by the Highway and Transportation Authority, which are payable from net toll revenues collected from the Teodoro Moscoso Bridge.
(2) Excludes the $161.2 million of Housing Finance Authority bonds, which are payable solely from Puerto Rico Public Housing Administration's annual allocation of Public Housing Capital Funds from HUD; and $319.9 million of Housing Finance Authority Capital Fund Modernization Program Subordinate Bonds, Series 2008 issued by the Housing Finance Authority and payable primarily from federal housing assistance payments made available by HUD.
(3) Includes $37.8 million of Mental Health Infrastructure Revenue Bonds, 2007 Series A (MEPSI Campus Project), which bonds are limited obligations of the Infrastructure Financing Authority payable solely from the pledge of certain payments made by a governmental entity under a lease agreement. Also includes $492.5 million of Revenue Bonds (Ports Authority Project), Series 2011, which are limited obligations of the Infrastructure Financing Authority payable solely from loan payments made by the Ports Authority.
(4) Excludes $155.4 million of Special Facilities Revenues Bonds issued by the Ports Authority, which bonds are payable solely from the pledge of certain payments made by a private corporation under a special facilities agreement.
(5) Payable primarily from Commonwealth appropriations.
(6) Excludes $72.7 million of Educational Facilities Revenue Bonds, 2000 Series A (University Plaza Project) issued by AFICA, which bonds are payable from rent payments made by the University of Puerto Rico.
(7) Includes lines of credit with GDB.
(8) Excludes accretion of interest from the respective issuance dates on capital appreciation bonds. Also excludes $1.3 billion original principal amount of Children's Trust Tobacco Settlement Asset-Backed Bonds, Series 2002, 2005 and 2008 which bonds will be repaid from payments made by certain tobacco companies under a master settlement agreement. See "Children's Trust" under "Other Public Corporations" below.

Source: Government Development Bank

Government Development Bank for Puerto Rico

The principal functions of GDB are to act as financial advisor to, and fiscal agent for, the Commonwealth, its municipalities and public corporations in connection with the issuance of bonds and notes, to make loans and advances to public corporations and municipalities, and to promote the economic development of Puerto Rico. As part of its role as fiscal agent, during fiscal years 2009, 2010 and 2011, GDB entered into fiscal oversight agreements with PRASA, PREPA, the Highway and Transportation Authority, the Ports Authority, the Health Insurance

Administration and the Medical Services Administration. As part of these agreements, GDB imposed certain conditions on the extension of credit to these entities and continually monitors their finances, among other things.

As of June 30, 2012, GDB (including its blended component units) had total assets of $15.8 billion and total liabilities of $13.3 billion. As of December 31, 2012, GDB's total assets were $14.1 billion and its total liabilities were $11.5 billion (preliminary, unaudited).

On December 13, 2012, Moody's lowered GDB's rating to "Baa3" with a negative outlook. On March 14, 2013, S&P lowered GDB's rating to "BBB-" with a negative outlook.

As of March 31, 2013, $5.0 billion of bonds and notes of GDB (excluding its subsidiaries) were outstanding, consisting of $267 million in Commonwealth guaranteed bonds and $4.7 billion of medium term senior notes. Act No. 12 of May 9, 1975, as amended, provides that the payment of principal of, and interest on, specified notes and other obligations of GDB, not exceeding $550 million, may be guaranteed by the Commonwealth, of which $267 million were outstanding as of March 31, 2013.

Under Act No. 271 of November 21, 2002, GDB made a required special capital contribution to the Special Communities Perpetual Trust (the "Perpetual Trust") of $500 million and provided the Perpetual Trust with a $500 million, non-revolving line of credit. The amounts transferred to the Perpetual Trust were deposited in two investment accounts held by GDB for the benefit of the Perpetual Trust. As of December 31, 2012, the Perpetual Trust had repaid $136.4 million of its line of credit and had an outstanding balance of $363.6 million and an interest balance of $14.1million. The line of credit is payable from legislative appropriations.

As part of its role as lender and promoter of the economic development of Puerto Rico, GDB provides financing to the Commonwealth, its public corporations and municipalities. This financing includes interim loans to finance the capital expenditures of the Commonwealth in anticipation of the issuance of bonds and notes, and loans to cover operational deficits of those government entities. GDB generally does not provide financing to any governmental entity of the Commonwealth unless GDB reasonably believes that the borrower governmental entity will have sufficient resources, including the ability to issue bonds or notes or otherwise borrow funds, to repay such loan. GDB, however, has provided financing in the past and may continue to provide financing to governmental entities that do not have sufficient independent resources to cover operating expense, to the extent permitted by law. A material increase in the amount of loans to the public sector, coupled with continued deterioration of the public sector's fiscal situation and financial condition may have an adverse effect on GDB's financial condition and liquidity. As of March 31, 2013, GDB had outstanding loans to the Commonwealth in the aggregate principal amount of $2.4 billion, outstanding loans to, and bonds of, the public corporations in the aggregate principal amount of $4.2 billion (of which loans to PRHTA represented $2.2 billion), and outstanding loans to the municipalities in the aggregate principal amount of $2.2 billion.

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

Puerto Rico Housing Finance Authority. Puerto Rico Housing Finance Authority (formerly known as Housing Finance Corporation) provides financing for rental housing units, stimulates the construction industry under federally subsidized programs and provides interim financing for low-income housing projects and single-family homeownership programs. It is also engaged in insuring and servicing mortgages originated by the former Housing Bank and Finance Agency, which was dissolved in 2002 and its powers transferred to the Housing Finance Authority. As of March 31, 2013, the Housing Finance Authority's total outstanding principal balance of loans to the private sector for development of housing projects targeted to low and moderate income families was $181.4 million. The Housing Finance Authority's mortgage loans to low and moderate income homeowners represented an additional outstanding principal balance of $177.4 million as of the same date.

The Housing Finance Authority has outstanding tax-exempt revenue bonds the proceeds of which were loaned to the Puerto Rico Public Housing Administration to finance improvements to various housing projects in the Commonwealth. Such bonds are limited obligations of the Housing Finance Authority payable solely from revenues collected from such housing units, with certain exceptions. As of March 31, 2013, $481 million of these bonds were outstanding.

As of March 31, 2013, the Housing Finance Authority had total notes and bonds outstanding of $585.3 million (including $153.9 million of debt outstanding under GDB lines of credit and $431.4 million in bonds issued to fund certain payments under its mortgage subsidy programs for low and moderate income families). As of March 31, 2013, the Housing Finance Authority had total unrestricted net assets of $269.1 million.

As a subsequent event, the Housing Finance Authority entered into the following bond defeasance transaction as of April 2013: Homeownership Mortgage Revenue Bonds 1998 Series A, 2000 Series A, 2001 Series A, 2001 Series B, 2001 Series C and 2003 Series A for a total amount of $99.3 million, which includes an outstanding principal amount of $96.8 million and accumulated interests and other costs of $2.5 million.

Puerto Rico Tourism Development Fund. Puerto Rico Tourism Development Fund ("TDF") was created in September 1993 to facilitate the development of Puerto Rico's hotel industry by working with private-sector financial institutions in structuring financings for new hotel projects. TDF can provide guarantees to interim and permanent financings. In certain transactions, TDF can act as direct lender and provide preferred equity capital. As of March 31, 2013, TDF had $584.7 million in guarantees and $339.9 million in loans, net of loan loss reserves of $155 million. As of March 31, 2013, TDF's net assets were $30.0 million. In addition, TDF has a $50 million preferred equity investment in a tourism-related project.

Government Development Bank for Puerto Rico Capital Fund. Government Development Bank for Puerto Rico Capital Fund (the "Capital Fund") was created in November 1992 for the purpose of investing and trading in debt obligations and publicly traded shares of domestic and foreign corporations separate from GDB's general investment operations. On June 30, 2010, the Capital Fund transferred to TDF, on behalf of GDB, $72.1 million representing all the investments in the Capital Fund portfolio. As of March 31, 2013, the Capital Fund had assets of $194,000, consisting principally of money market investments.

Puerto Rico Development Fund. Puerto Rico Development Fund (the "Development Fund") was established in April 1977 to provide an alternate source of financing to private enterprises. The Development Fund is also authorized to guarantee obligations of those enterprises and invest in their equity securities. As of March 31, 2013, the Development Fund had assets of $20.7 million, including $6.7 million in loans to private entities, $10.4 million in interest bearing accounts, and $3.6 million in preferred shares of various private entities.

Puerto Rico Public Finance Corporation. Puerto Rico Public Finance Corporation ("PFC") was established in November 1984 to provide agencies and instrumentalities of the Commonwealth with alternate means of meeting their financing requirements. The trustees of certain limited obligation bonds issued by the PFC currently hold notes payable by the Commonwealth, the Maritime Shipping Authority, the Office for the Improvement of Public Schools, the Department of Health and PRASA, among others. All such PFC bonds are limited, non-recourse obligations of PFC payable solely from Commonwealth appropriations made to pay debt service on the notes held by the bond trustees. As of March 31, 2013, PFC had $1.1 billion aggregate principal amount of limited obligation bonds outstanding.

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

Other Public Corporations

Aqueduct and Sewer Authority. The Puerto Rico Aqueduct and Sewer Authority ("PRASA") owns and operates Puerto Rico's public water supply and wastewater systems. Such systems provide water and wastewater services to 97% and 58% of the Commonwealth's population, respectively.

PRASA reported an operating loss of $136.8 million for fiscal year 2012, compared to operating losses of $39.6 million and $58.3 million for fiscal years 2011 and 2010, respectively. In order to improve its financial condition, PRASA adopted a comprehensive plan to increase its revenues and reduce its expenses.

As of March 31, 2013, PRASA's total debt was $4.6 billion, including approximately $124.2 million of outstanding indebtedness with GDB. On December 13, 2012, Moody's lowered the rating on PRASA's senior debt to "Ba1". On March 26, 2013, S&P lowered its rating on PRASA's senior debt to "BB+." On April 18, 2013, Fitch lowered its rating on such debt to "BBB-."

The Commonwealth guarantees the principal and interest payments on the outstanding revenue refunding bonds, 2008 Series A and 2008 Series B, any bonds issued on or before June 30, 2015 to the Rural Utilities Service of the United States Department of Agriculture, and the loans granted on or before June 30, 2015 by the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Revolving Fund to PRASA. In the event that PRASA is unable to make all or any portion of the future debt service payments on these guaranteed debts, the Commonwealth will be responsible for covering such payments.

On April 28, 2006, PRASA entered into a consent decree with the United States Environmental Protection Agency ("EPA") that requires PRASA to implement system wide remedial measures at all of the wastewater treatment plants operated by PRASA. The EPA consent decree establishes deadlines for compliance with the conditions set forth therein and stipulates penalties for violation of any of those deadlines.

On December 15, 2006, a settlement agreement was signed between PRASA and the Department of Health of the Commonwealth ("DOH") relating to violations of the Safe Drinking Water Act. The settlement agreement was preliminarily approved by the supervising court on March 15, 2007, and was amended and finally approved by that court on June 20, 2008. PRASA agreed to implement a work plan to remediate the violations, establish preventive and mitigation measures, and execute a preventive maintenance program for the purpose of meeting the requirements of the Safe Drinking Water Act.

PRASA needs to make a substantial investment in infrastructure and a major overhaul of its operations to maintain the viability of the systems it owns and operates, to finance its expansion for new users and to implement remedial measures required by the consent decree between PRASA and the EPA and the settlement agreement with the DOH. Funds for this investment will be provided through a combination of revenues from PRASA, financing transactions, federal grants and other sources. PRASA has established a 15-year capital improvement program with a total investment of $2.2 billion in order to comply with the consent decree and the settlement agreement. PRASA has committed an investment of $1.2 billion to comply with the EPA consent decree and $1.0 billion to comply with the DOH settlement agreement.

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

As of March 31, 2013, the Children's Trust had outstanding senior and subordinate Tobacco Settlement Asset backed Bonds in the principal amount of $1.3 billion, which were issued in 2002, 2005 and 2008 to pay certain capital expenditures, to make grants to third parties, to pay certain expenses of the Commonwealth, to fund a Liquidity Reserve account and to pay costs of issuance. These bonds and any other additional senior bonds issued by the Children's Trust are payable solely from, and secured by a statutory pledge of, the payments made and to be made by the participating cigarette manufacturers under the Master Settlement Agreement. To date, all principal and interest payments required to be made by the Children's Trust on its outstanding bonds have been made on a timely basis from contribution payments made by the participating cigarette manufacturers under the Master Settlement Agreement.

Convention Center District Authority. The Convention Center District Authority was created to own, develop, finance, plan, design, build, operate, maintain, administrate and promote the Dr. Pedro Rosselló González Convention Center, a new convention center, and designated private parcels located within the Convention Center District in San Juan. The convention center opened in November 17, 2005. The Convention Center District Authority also owns a multipurpose coliseum in San Juan, known as the José Miguel Agrelot Coliseum. As of March 31, 2013, the Convention Center District Authority's debt was $428.6 million in outstanding bonds issued in March 2006 to finance the Convention Center and payable from a portion of a hotel room tax. As of March 31, 2013, the Convention Center District Authority also had outstanding indebtedness to GDB of approximately $148 million related to the financing of the Coliseum.

Electric Power Authority. The Puerto Rico Electric Power Authority ("PREPA") owns and operates Puerto Rico's electric power system.

PREPA reported a reduction in net assets of $281.3 million and $272.4 million during fiscal years 2012 and 2011, respectively, according to preliminary unaudited information. The total debt of PREPA was $8.8 billion as of March 31, 2013. This debt includes outstanding bonds of $8.0 billion and interim financing for operations of $749.3 million. PREPA's senior debt is rated Baa2, BBB+ and BBB+ by Moody's, S&P and Fitch, respectively. On March 14, 2013, Fitch placed PREPA's senior debt in negative rating watch.

On May 1, 2012, PREPA issued $630,110,000 Power Revenue Bonds, Series 2012A and $19,890,000 Power Revenue Refunding Bonds, Series 2012B, which proceeds were used to, among other things, refund approximately $21.3 million of outstanding bonds and repay approximately $161.9 million of GDB lines of credit.

As a means of reducing its dependency on oil, PREPA entered into long-term power purchase agreements with private operators of two co-generation plants that use fuels other than oil. Currently, these two co-generation plants provide approximately 31% of PREPA's energy needs. PREPA has also commenced developing plans for the conversion of its main oil-fired units into natural gas and clean-coal fired units, as well as other strategies to further reduce its dependency on oil.

Health Insurance Administration. The Health Insurance Administration was created in 1993 to negotiate and contract for the provision of comprehensive health insurance coverage for qualifying (generally low income) Puerto Rico residents. Under this system, the The Commonwealth selected, through a bidding process, different private health insurance companies for the eight designated regions of the island and paid such insurance company the insurance premium for each eligible beneficiary within such region. The health insurance system covered the entire island. On October 1, 2010, the The Commonwealth implemented "Mi Salud," which is the health program that replaced the prior Health Reform program. The principal differences between "Mi Salud" and the Health Reform are the use of a preferred-provider network organization rather than independent practice associations, an increase of benefits and services and an expansion of eligible participants. Approximately 1.6 million persons were covered by the system during fiscal year 2012.

On July 7, 2011, the Secretary of Health of the Commonwealth announced the cancellation of the MCS contract effective on October 31, 2011. MCS HMO administered five regions, with approximately 850,000 insured, of the "Mi Salud" program. On October 17, 2011, the Health Insurance Administration and Triple-S Salud, Inc. ("Triple-S") entered into an agreement pursuant to which Triple-S will administer the provision of healthcare services to insured's in the five regions previously administered by MCS HMO. Pursuant to the agreement, Triple-S has acted as a third party administrator and has been compensated based on a per member per month administrative fee. In contrast to the agreement with MCS HMO, the The Commonwealth has been financially responsible and bears the risk for the provision of services to insured in the five regions administered by Triple-S.

The total cost of the health insurance program was $2.182 billion for fiscal year 2012, $2.017 billion for fiscal year 2011, $1.962 billion for fiscal year 2010, and $1.861 billion for fiscal year 2009. During fiscal year 2012, the General Fund covered $945 million of the total cost of the health insurance program. The remaining $1.360 billion were paid from federal, municipal, internal and other sources. As of March 31, 2013, the Health Insurance Administration had outstanding indebtedness to GDB and private financial institutions of $183.3 million, consisting of loans used to pay amounts owed to suppliers, including premiums owed to certain insurance companies for services rendered under the Health Reform program.

The Health Insurance Administration has estimated a total cost of $2.209 billion to administer "Mi Salud" for this current fiscal year 2013. The proposed budget includes an appropriation of $885 million from General Fund, an increase of $2.9 million over the prior year, while the remaining $1.324 billion will be paid from federal funds, municipal, and other sources. The expense projection assumes and requires the implementation of cost-saving measures including improved oversight of insurers; fraud prevention; changes to eligibility requirements; migration within sub-groups of beneficiaries (for example, from Medicaid to Medicare or from Commonwealth-funded to Medicaid-funded); and other expense control measures. The federal funds portion of the health insurance program is being partially covered by non-recurring American Affordable Carte Act (AACA) funds, as well as with the capped recurring Medicaid Commonwealth allocation. The federal funds contribution to the health insurance program for Fiscal Year 2014 is budgeted at $1.103B, while the Commonwealth cap for Medicaid is approximately $300 million. Upon exhaustion of AACA funds, currently estimated sometime in 2018 if the current utilization rate persists, federal contributions may revert to the recurring capped Medicaid Commonwealth allocation, resulting in higher requirements of Commonwealth funding, changes in the health program risk model, reductions in number of beneficiaries or scope services provided, or other revenue-enhancing or cost reduction measures.

Additionally, the Commonwealth has entered into contracts with seven Medicare Advantage organizations for the provision of health coverage to approximately 275,000 dual eligible beneficiaries. Pursuant to these agreements, the Commonwealth pays each Medicare Advantage organization a premium difference to cover services not included in their contracts with the Center for Medicaid and Medicare Services.

Highways and Transportation Authority. The Puerto Rico Highways and Transportation Authority ("PRHTA") is responsible for highway construction in Puerto Rico. Such construction is financed by debt (interim notes and revenue bonds), revenues of PRHTA, and federal and Commonwealth grants.

PRHTA reported a net operating loss of $517.2 million for fiscal year 2012, compared to a net operating loss of $530.8 million for fiscal year 2011 and $445.3 million for fiscal year 2010. As of March 31, 2013, PRHTA's total debt was $7.2 billion, consisting of $5 billion of bonds and $2.2 billion of GDB financings

Debt service on PRHTA's revenue bonds constitutes a first lien on its gross revenues, which consist currently of all the proceeds of the tax on gasoline, one-half of the proceeds of the tax on gas oil and diesel oil, all the proceeds of the excise taxes on crude oil, unfinished oil and derivative products, up to $120 million per fiscal year, highway toll revenues and the gross receipts of $15.00 per vehicle per year from certain motor vehicle license fees. Such revenues (except for toll revenues) may be applied first to the payment of debt service on general obligation bonds and notes of the Commonwealth and to payments required to be made by the Commonwealth under its guarantees of bonds and notes, to the extent that no other revenues are available for such purpose. The Commonwealth has never applied such revenues for such payment.

PRHTA's Highway Revenue Bonds are rated Baa2 and BBB+ by Moody's and S&P, respectively, and the Senior Transportation Revenues Bonds are rated Baa3 and BBB by Moody's and S&P, respectively. On December 28, 2012, S&P put the PRHTA's revenue and transportation bonds on credit watch for a possible downgrade.

PRHTA has a mass transit system, known as Tren Urbano, serving a portion of metropolitan San Juan. It was constructed under several design/build contracts and is being privately operated under a five-year contract with an additional five-year option at PRHTA's election. The cost of the project was $2.4 billion, which cost was financed by federal Transit Administration grants, other federal funding sources and PRHTA's own resources, including revenue bonds. Tren Urbano commenced operations in June 2005. The operation and maintenance cost of the Tren Urbano was $54.5 million, $54.4 million, $51.7 million, $64.5 million, and $62.5 million in fiscal years 2012, 2011, 2010, 2009 and 2008, respectively.

PRHTA 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 PRHTA, payable by the private operator of the bridge principally from toll revenues. The concession is for a term of 35 years, subject to earlier termination or extension. The bridge opened for traffic in February 1994. In certain circumstances described in the concession agreement, including where toll revenues are insufficient to generate certain rates of return to the private operator, the private operator may require PRHTA, among other things, to assume the operator's obligations with respect to the special facility revenue bonds. Some of those circumstances, including lower than projected toll revenues, exist at this time, but PRHTA does not currently anticipate that the operator will exercise its remedy against PRHTA.

On September 22, 2011, PRHTA and PPP Authority completed the procurement process whereby a concession agreement was awarded to Metropistas, for the operation of toll roads PR-22 and PR-5. In connection with the establishment of the concession, PRHTA defeased, redeemed and/or purchased approximately $873.1 million aggregate principal amount of its bonds. See "Public-Private Partnerships – Fiscal Stabilization and Economic Growth" under THE ECONOMY.

Industrial Development Company. The Puerto Rico Industrial Development Company ("PRIDCO") participates in the Commonwealth-sponsored economic development program by providing physical facilities, general assistance, and special incentive grants to manufacturers. PRIDCO reported consolidated change in net assets of $13.1 million for fiscal year 2012, compared to consolidated change in net assets of $7.0 million for fiscal year 2011. Rentals derived from the leasing of specified facilities of PRIDCO are pledged to the payment of PRIDCO's revenue bonds. As of March 31, 2013, PRIDCO's total debt was $364 million, including approximately $87.8 million from GDB financings and the outstanding debt of Puerto Rico Industrial Investment Corporation, a subsidiary of PRIDCO. PRIDCO's general purpose revenue bonds are rated Baal (stable) and BBB- by Moody's and S&P, respectively.

Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority. The Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority ("AFICA") was created to finance (through the issuance of its revenue bonds) industrial, tourist, educational, medical, and environmental control facilities in Puerto Rico for the use of private companies, non-profit entities, or government agencies. The bonds are payable solely from payments to be made to AFICA by such private companies, non-profit entities, or government agencies, and do not constitute a debt of the Commonwealth or any of its other public corporations or municipalities. As of March 31, 2013, approximately $1.2 billion of AFICA bonds were outstanding.

Infrastructure Financing Authority. The Puerto Rico Infrastructure Financing Authority ("PRIFA") was created to provide financial, administrative, consulting, technical, advisory, and other types of assistance to other public corporations, governmental instrumentalities, political subdivisions and municipalities (collectively, "Benefited Entities") authorized to develop infrastructure facilities and to establish alternate means for financing those facilities. PRIFA is authorized to issue bonds and provide loans, grants and other financial assistance for the construction, acquisition, repair, maintenance and reconstruction of infrastructure projects by Benefited Entities.

As of March 31, 2013, PRIFA's total debt was $2.3 billion. This debt includes bonds outstanding of $2.3 billion and interim financing for capital improvements of $42.3 million. PRIFA's outstanding bonds include $492.5 million of limited obligations bonds, the proceeds of which were loaned to the Ports Authority and are payable solely from loan payments to be made by the Ports Authority. PRIFA's Special Tax Revenue Bonds are rated Baa3 and BBB+ by Moody's and S&P, respectively.

PRIFA oversees the Puerto Rico Infrastructure Fund, which is being funded annually through fiscal year 2052 with the first $117 million of proceeds of federal excise taxes imposed on rum and other articles produced in Puerto Rico and sold in the United States that are transferred to Puerto Rico pursuant to the U.S. Code. See "Major Sources of General Fund Revenues – Revenues from Non-Commonwealth Sources" under PUERTO RICO TAXES, OTHER REVENUES AND EXPENDITURES. Rum is the only article currently produced in Puerto Rico subject to federal excise taxes, the proceeds of which are required to be returned to the Treasury Department. PRIFA is using these funds to pay debt service of bonds issued to finance various infrastructure projects.

PRIFA also has custody and control of the Infrastructure Development Fund and its Corpus Account, a perpetual account established under Act No. 92 of June 24, 1998 that was funded with

$1.2 billion of the proceeds of the sale of the Puerto Rico Telephone Company. The interest earned on the securities held in the Corpus Account was being used by PRIFA to pay debt service on its $1.1 billion Series 2000 A and B Bonds. Act No. 3, approved by the Legislative Assembly of the Commonwealth on January 14, 2009 ("Act 3"), authorized the sale of the securities held in the Corpus Account. PRIFA sold the securities in January 2009 and used the proceeds to: (i) make a deposit into an escrow account in an amount sufficient to retire the Series 2000 A and B Bonds on October 1, 2010, (ii) make a deposit to the General Fund which was applied to cover a portion of the Commonwealth's budget deficit, (iii) make a transfer to GDB as a capital contribution, and (iv) make a deposit to the Corpus Account to be invested in a long-term investment agreement with GDB.

As part of the Commonwealth's actions to address in part the financial condition of the Employees Retirement System, the Commonwealth enacted Act 96. On June 23, 2011, in accordance with Act 96, $162.5 million of funds on deposit in the Corpus Account were contributed to the Employees Retirement System and invested in capital appreciation bonds issued by COFINA maturing annually on August 1, 2043 through 2048 and accreting interest at a rate of 7%. PRIFA also invested $165.0 million of funds on deposit in the Corpus Account in capital appreciation bonds of COFINA maturing annually on August 1, 2045 through 2050 and accreting interest at 7%.

Pursuant to Act No. 8 of March 9, 2009, PRIFA is responsible for implementing in the Commonwealth the applicable provisions of ARRA. One of its main responsibilities regarding ARRA is to maximize the flow of funds from the Federal Government for the appropriate investment in qualified projects and activities. PRIFA also is responsible for the receipt, administration and disbursement of such funds and monitoring those governmental agencies and entities that receive ARRA funds.

Municipal Finance Agency. The Puerto Rico Municipal Finance Agency ("MFA") 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 MFA's bonds is payable from debt service payments on municipal bonds and notes held by MFA and from the debt service reserve, including investment income thereon. The Commonwealth has agreed to pay such amounts to the debt service reserve as may be necessary to maintain it at its required level, subject to appropriation by the Legislative Assembly, which appropriation is authorized but not legally required to be made. To date, no such payments have been required. As of March 31, 2013, MFA had $894.6 million of bonds outstanding.

Port of the Americas Authority. Up to the approval of Act 240 of December 12, 2011, PAA was responsible for the development and operation of the Port of the Americas, a deep draft port on the south coast of Puerto Rico. With the approval of said Act 240, the Authority of the Port of Ponce was created with the exclusive jurisdiction of the Port of the Americas.

PAA was authorized to issue bonds guaranteed by the Commonwealth, in a maximum aggregate principal amount of $250 million, for the development of the Port of the Americas. GDB was authorized by law to purchase said bonds of PAA. As of March 31, 2013, GDB held approximately $220.1 million of PAA's outstanding guaranteed bonds. While the responsibility for the development and operation of the Port of the Americas was transferred from PAA to the

Authority of the Port of Ponce, PAA retained the liability for the outstanding bonds, which are expected to be paid by the Commonwealth under the guarantee.

Ports Authority. The Ports Authority owns the major airport and seaport facilities in Puerto Rico. Until February 27, 2013, the Ports Authority also operated all these facilities. On that date, the Ports Authority transferred the operation of the Commonwealth's principal airport to a private consortium consisting of Grupo Aeroportuario del Sureste and Highstar Capital pursuant to a 40-year lease agreement. As a result of the transaction, the Ports Authority received a $615 million upfront payment, of which it used $176.7 million to repay the PRIFA limited obligation bonds described above under "Infrastructure Financing Authority." The Ports Authority derives revenues from a variety of sources, including charges on airplane fuel sales, air terminal space rentals, landing fees, wharfage, dockage and harbor fees, and rentals for the lease of property and seaport equipment. The Ports Authority had operating losses of $26.5 million and $18.4 million during fiscal years 2012 (preliminary results) and 2011, respectively. As of March 31, 2013, after giving effect to the redemption of the PRIFA bonds referred to above, the Ports Authority had outstanding indebtedness of $492.5 million.

Public Buildings Authority. PBA is authorized to construct, purchase or lease office, school, health, correctional and other facilities for lease to departments, public corporations, and instrumentalities of the Commonwealth. Bonds that have been issued by PBA to finance such facilities (through retirement of interim notes or otherwise) are payable from lease payments, which are largely derived from legislative appropriations and are secured by the Commonwealth's guaranty. PBA is authorized by law to have outstanding at any one time up to $4.7 billion of bonds guaranteed by the Commonwealth. On June 21, 2012, PBA issued $582,345,000 principal amount of its Government Facilities Revenue Bonds, Series U. The proceeds of such bonds were used to refund outstanding bonds and to repay advances made by GDB under a line of credit. As of March 31, 2013, PBA had $4.293 billion principal amount of bonds outstanding (not including accretion of interest on capital appreciation bonds) and $286.7 million outstanding under its line of credit with GDB. PBA debt is rated Baa3 by Moody's, BBB- by S&P, and BBB- by Fitch.

Sales Tax Financing Corporation. COFINA was originally created in 2006 for the purpose of financing the payment of certain appropriation-backed debt outstanding as of June 30, 2006, payable to GDB and PFC. In 2009, the Legislative Assembly of the Commonwealth expanded the purposes for which COFINA was created and increased from 1% to 2.75% (one-half of the tax rate of 5.5%) the portion of the Commonwealth sales and use tax that is transferred to COFINA. COFINA was then authorized to issue bonds for the following additional purposes: (i) to pay, in whole or in part, the debt of the Secretary of the Treasury with GDB in the amount of $1 billion, the proceeds of which were used to cover the budgetary deficit for fiscal year 2009, (ii) to pay, in whole or in part, certain financing granted to the Secretary of the Treasury by GDB payable from future Commonwealth general obligation bonds, and any debt of the Commonwealth outstanding as of December 31, 2008 that did not have a source of repayment or was payable from budgetary appropriations, (iii) to pay, in whole or in part, the accounts payable to suppliers of the Commonwealth, (iv) to pay or finance operational expenses of the Commonwealth for fiscal years 2009, 2010, and 2011, (v) to pay or finance operational expenses of the Commonwealth for fiscal year 2012, which would have to be included in the annual budget of the The Commonwealth, (vi) to fund the Puerto Rico Economic Stimulus Fund, (vii) to fund the Commonwealth Emergency Fund in order to cover expenses resulting from catastrophic events such as hurricanes or floods, and (viii) to generate moneys to fund the Economic Cooperation and Public Employees Alternatives Fund. As of March 31, 2013, COFINA had approximately $15.2 billion outstanding of its Sales Tax Revenue Bonds (excluding all accretion on capital appreciation bonds). COFINA's Sales Tax Revenue Bonds are rated Aa3, AA- and AA- by Moody's, S&P and Fitch, respectively, and its Sales Tax Revenue Bonds, First Subordinate Series, are rated A3, A+ and A+ by Moody's, S&P and Fitch, respectively.

On April 30, 2013, COFINA issued $333,300,000 in Bond Anticipation Notes ("BANs") in order to complete the funding for the Commonwealth's operating budget for fiscal year 2013. The BANs will be repaid from the issuance of COFINA bonds, when it has become more advantageous, during fiscal years 2013 or 2014.

Special Communities Perpetual Trust. The Perpetual Trust is a public corporation created by law to be an irrevocable and permanent trust. The Perpetual Trust's principal purpose is to fund development projects that address the infrastructure and housing needs of underprivileged communities. GDB made a special capital contribution to the Perpetual Trust of $500 million and provided the Perpetual Trust with a $500 million, non-revolving, line of credit. As of March 31, 2013, the Perpetual Trust had disbursed most of its funds and its line of credit with GDB had an outstanding balance of $363.6 million. The line of credit is payable from legislative appropriations.

University of Puerto Rico. The University of Puerto Rico (the "University"), with approximately 57,475 students at the beginning of academic year 2012-2013, is the largest institution of higher education in Puerto Rico. Government appropriations are the principal source of University revenues, but additional revenues are derived from tuition, student fees, auxiliary enterprises, interest income, federal grants, and other sources. University capital improvements have been financed mainly by revenue bonds. As of March 31, 2013, the University's total debt was $595.6 million (excluding $19.4 million owed by the University's Medical Services), consisting of $510.7 million of bonds and $84.9 million of loans. The University's debt is rated Ba1 and BBB- (negative outlook) by Moody's and S&P, respectively.

In 2000, AFICA issued its $86,735,000 Educational Facilities Revenue Bonds, 2000 Series A (University Plaza Project) for the purpose of financing the construction of additional student housing and parking and office space for the University. The project was built, is being operated by Desarrollos Universitarios, Inc., a Puerto Rico not-for-profit corporation, and is leased to the University for a term equal to the term of the bonds, with University lease payments being sufficient to pay debt service on said bonds as they become due. These bonds (of which $72.7 million were outstanding as of March 31, 2013) are not included in the University's total debt or outstanding revenue bonds set forth in the prior paragraph.

In June 2007, the Board of Trustees of the University established a new policy and methodology for tuition fees structure. This new structure covers the tuition fees to be charged to new students until academic year 2012-2013. This policy was adopted to pursue continued development and financial stability of the University.

In June 2010, the Board of Trustees of the University approved a $400 stabilization fee to be charged each semester to all students in addition to tuition charges and other fees already in place at the University. This stabilization fee was imposed to address the University's fiscal difficulties and was expected to increase annual revenues by approximately $40 million. The imposition of the stabilization fee resulted in student-led strikes that lasted approximately two months, which in turn caused the Middle States Commission on Higher Education (the "Commission"), the regional accreditation entity of the eleven units that comprise the University system, to place on probation ten of the University's units. The ten affected units remained fully accredited while on probation. After a Monitoring Report submitted by the ten affected units in September 2010 and subsequent evaluation visits, in June 2011 the Commission lifted probation and reaffirmed accreditation of seven of the ten affected units and in November 2011 lifted probation and reaffirmed accreditation of the three remaining units. In January 2013, the Board of Trustees of the University announced that if the exclusion pursuant to Act 7 of certain revenue sources from the basis upon which the UPR appropriation formula is calculated was eliminated, the stabilization fee would not be necessary. Due to the restoration of the original UPR formula basis, the Board of Trustees has approved elimination of the stabilization fee.

Other public corporations. Public corporations not described above have outstanding debt in the aggregate amount of $2.0 billion as of March 31, 2013. Debt service on $1.2 billion of such outstanding debt is being paid from legislative appropriations. The Commonwealth is not, however, obligated to make any such appropriations. Additional legislative appropriations are made to enable certain of such corporations to pay their operating expenses.

INSURANCE MATTERS

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

RETIREMENT SYSTEMS

General. Substantially all of the public employees of the Commonwealth and its instrumentalities are covered by five retirement systems: the Employees Retirement System, the Teachers 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 Employees Retirement System and the Teachers Retirement System are the largest plans, both in number of active members and retirees and in the amount of their actuarial accrued liabilities.

The University Retirement System and the Electric Power Authority Retirement System cover employees of the University and PREPA, respectively, and are funded by those public corporations from their revenues. Although the Commonwealth is not required to contribute directly to those two systems, a large portion of the University's revenues is derived from legally mandated legislative appropriations. The discussion that follows only covers the Employees Retirement System, the Teachers Retirement System and the Judiciary Retirement System (each a "Retirement System" and, collectively, the "Retirement Systems").

The Employees Retirement System is a trust created by Act No. 447 of May 15, 1951, as amended ("Act 447"). Prior to the recent amendments made by Act 3 (discussed below), the Employees Retirement System was a hybrid defined benefit plan consisting of different benefit structures. Members who had entered the Employees Retirement System on or before December 31, 1999 participated in a defined benefit program. Members who began to participate prior to April 1, 1990 ("Act 447 Participants") were entitled to the highest benefits structure, while those who began to participate on or after April 1, 1990 ("Act 1 Participants") were subject to a longer vesting period and a reduced level of benefits, as provided by Act No. 1 of February 16, 1990 ("Act 1 of 1990").

In 1999, Act 447 was amended to close the defined benefit program for new participants and, prospectively, establish a new benefit structure similar to a cash balance plan (this new benefit structure is referred to as "System 2000"). Members who entered the Employees Retirement System on or after January 1, 2000 ("System 2000 Participants") participate solely in System 2000. Prior to the amendment made by Act 3, under the System 2000 benefits structure, a participant was entitled to receive a lump-sum payment, which could be received in full or used to purchase an annuity from a third party, based solely on the amounts contributed by such participant. Act 3 amended the law to eliminate the lump sum distribution and substitute it for a life term annuity payable to the System 2000 Participant. This amendment was intended to alleviate the cash flow needs of the Employees Retirement System. System 2000 Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. System 2000 Participants do not benefit from any employer contributions. Instead, employer contributions for System 2000 Participants are used to reduce the accumulated unfunded pension benefit obligation of the Employees Retirement System.

System 2000 is not a separate plan as there are no separate accounts for System 2000 Participants. Contributions received from System 2000 Participants are pooled and invested by the Employees Retirement System together with the assets corresponding to the defined benefit structure. Thus, future benefit payments under the defined benefit structure of Act 447 and Act 1 of 1990 and the defined contribution structure of System 2000 will be paid from the same pool of assets of the Employees Retirement System. To the extent the assets of the Employees Retirement System are insufficient to cover all retirement benefits due to retired employees, the employees contributions made by the System 2000 Participants might not be available to be paid as retirement benefits to such participants.

The Teachers Retirement System is a trust created by Act No. 91 of March 29, 2004 ("Act 91 of 2004"), which superseded Act No. 218 of May 6, 1951, and is a defined benefit pension plan. The Judiciary Retirement System is a trust created by Act No. 12 of October 19, 1954 and is also a defined benefit pension plan.

The Retirement Systems are funded principally by contributions made by employers (the Commonwealth, public corporations and municipalities) and employees, as well as investment income.

As previously mentioned, Act 3 constitutes a comprehensive reform of the Employees Retirement System. This reform was necessary to address the growing funding shortfalls which threatened the long term viability of the Employees Retirement System. See "Efforts to Address

Cash Flow Shortfall and Improve Funding Ratio" below. The provisions of Act 3 and its projected impact on the funding shortfalls are discussed below.

Governance. Governance of the Employees Retirement System and the Judiciary Retirement System is vested in a Board of Trustees, which sets policy and oversees the operations consistent with applicable laws. There are nine members of the Board, as follows: the Puerto Rico Secretary of the Treasury (or his appointee), the President of GDB (or his appointee), the Commissioner of Municipal Affairs (or his appointee) and the Director of the Office of Human Resources of the Commonwealth (or his appointee), as *ex officio* members; three members appointed to three-year terms by the Governor of the Commonwealth, two of whom must be members of the Employees Retirement System or the Judiciary Retirement System, with at least ten years of credited service; and a member who is a pensioner of the Employees Retirement System or the Judiciary Retirement System. The Board is also responsible for appointing the Administrator of the Employees Retirement System and the Judiciary Retirement System.

Governance of the Teachers Retirement System is also vested in a Board of Trustees. There are nine members of the Board, as follows: the Puerto Rico Secretary of the Treasury (or his appointee), the President of GDB (or his appointee) and the Puerto Rico Secretary of Education (or his appointee), as *ex officio* members; one member who is the President of a teacher's organization, or his representative designated by the Governor of the Commonwealth, with the advice and consent of the Senate, for a term of four years; three teachers of the Teachers Retirement System, one of which shall represent active teachers and two of which shall represent retired teachers, each appointed by the Governor of the Commonwealth, with the advice and consent of the Senate, for a term of four years; one member who is the President of the collective bargaining unit for teachers pursuant to Puerto Rico law (or his appointee); and a member who represents the public interest, appointed by the Governor of the Commonwealth, with the advice and consent of the Senate, for a term of four years. The Board is also responsible for appointing an Executive Director of the Teachers Retirement System.

Covered Employees. The Employees Retirement System covers substantially all employees of the departments and agencies of the Commonwealth, all members and regular employees of the Legislative Branch, and all employees of the public corporations (other than the University or PREPA) and municipalities, except for those employees that are covered by the other two Retirement Systems. The Judiciary Retirement System only covers judges.

The Teachers Retirement System covers public school teachers and certain private school teachers, as well as teachers working in administrative positions. Act 91 of 2004 establishes that: (i) the Teachers Retirement System's active employees as of March 29, 2004 (not public school teachers or other Department of Education employees) have the option to participate in the Teachers Retirement System or in the Employees Retirement System; (ii) persons hired by the Teachers Retirement System after the approval of the new law may only become members of the Teachers Retirement System, (iii) active teacher employees of the Department of Education are members of the Teachers Retirement System, and (iv) licensed teachers working in private schools or other educational organizations may elect to become members of the Teachers Retirement System as long as the required employer and employee contributions are satisfied. Currently, there are no teachers from private schools or other educational institutions participating in the Teachers Retirement System.

The following table shows the number of active members, retired members, disabled members and beneficiaries and terminated vested members for each of the Retirement Systems as of June 30, 2012.

Participant Data
(as of June 30, 2012)

	Active Members	Retired Members	Disabled Members	Beneficiaries	Terminated Vested Members[1]	Total
Employees Retirement System						
Act 447 Participants	26,071	81,692	14,882	13,726	-	136,371
Act 1 Participants	46,452	5,773	1,668	99	-	53,992
System 2000 Participants	62,043	-	21	-	-	62,064
Total	134,566	87,465	16,571	13,825	-	252,427
Teachers Retirement System	42,707	31,370	2,171	2,964	738	79,950
Judiciary Retirement System	374	345	0	59	47	825

[1] Represents generally members who ceased employment without the right to a retirement annuity and are due a refund of member contributions and, if applicable, employer contributions, plus interest thereon. There are terminated vested members of the Employees Retirement System, but the Employees Retirement System does not possess reliable data on the amount of such members.

The Commonwealth central government (consisting of departments and agencies) is not the only employer participating in the Employees Retirement System. The municipalities and most public corporations participate as employers as well with respect to their employees. The assets contributed by the Commonwealth central government and all other employers, however, are invested together and not otherwise segregated. As of June 30, 2012, the central government was responsible for making contributions with respect to 81,266 active members of the Employees Retirement System, or 60.4% of total active members (consisting of 16,429 Act 447 Participants, 30,433 Act 1 Participants and 34,404 System 2000 Participants). Municipalities were responsible for 31,491, or 23.4%, active members (consisting of 4,783 Act 447 Participants, 9,630 Act 1 Participants and 17,078 System 2000 Participants). Public corporations were responsible for 21,809, or 16.2%, active members (consisting of 4,859 Act 447 Participants, 6,389 Act 1 Participants and 10,561 System 2000 Participants).

Funding Requirements. The Commonwealth central government is responsible for approximately 59% of total employer contributions to the Employees Retirement System, and the other 41% is the responsibility of public corporations and municipalities. The Commonwealth central government is also responsible for 100% and 99% of total employer contributions to the Judiciary and Teachers Retirement Systems, respectively. Retirement and related benefits provided by the Retirement Systems, and required contributions to the Retirement Systems by employers and employees, are determined by law rather than by actuarial requirements. The Commonwealth is ultimately responsible for any funding deficiency with respect to central government employees in the three Retirement Systems.

As of July 1, 2011, after the adoption of Act 116, the statutory employer contribution for the Employees Retirement System increased from a minimum of 9.275% to a minimum of 10.275% of covered payroll, and will continue to increase annually until fiscal year 2021. The employer contribution rate for fiscal year 2013 is 11.275% See "Efforts to Address Cash Flow

Shortfall and Improve Funding Ratio" below. Covered payroll is the compensation regularly paid to active employees on which contributions to the Retirement Systems are computed and is generally equivalent to their annual salary. The employer contribution rate of 9.275% had been in effect since February 1990. Act 447 requires that employer contributions cover the difference between (i) the benefits provided by the Retirement System, plus administrative costs, and (ii) the contributions that employees are required to make to the Retirement System. This requirement, however, has not been adhered to and the level of employer contributions has been limited to the minimum statutory rate.

Required employee contributions for the Employees Retirement System vary according to how the individual employee's retirement benefits are coordinated with social security benefits. Act 3 increased the employee contribution from 8.275% to 10% of covered payroll.

As of July 1, 2011, after the adoption of Act 114, the statutory employer contribution for the Teachers Retirement System increased from 8.5% to 9.5% of covered payroll, and will continue to increase annually until fiscal year 2021. See "Efforts to Address Cash Flow Shortfall and Improve Funding Ratio" below. The statutory employee contribution for the Teachers Retirement System is 9.0% of covered payroll. For the Judiciary Retirement System, the employer contribution is 30.34% of covered payroll and 8% for the employees. The employer contribution rate for the Judiciary Retirement System increased from 20.0% to 30.34% of payroll as of July 1, 2008.

The Constitution of the Commonwealth provides that, in the event the Commonwealth has insufficient funds to pay all approved appropriations, the available resources of the Commonwealth shall be used to pay public debt before being used for other purposes. Public debt of the Commonwealth includes general obligation bonds and notes of the Commonwealth to which the full faith, credit and taxing power of the Commonwealth are pledged and, according to opinions rendered by the Attorney General of the Commonwealth, also any payments required to be made by the Commonwealth under its guarantees of bonds and notes issued by its public instrumentalities. See DEBT. Furthermore, Puerto Rico law provides "priority norms" for the disbursement of public funds that apply during any fiscal year in which the resources available to the Commonwealth are insufficient to cover the appropriations approved for such year, as follows: first, the payment of the interest on, and amortization requirements for, public debt (Commonwealth general obligation and guaranteed debt); 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 government; third, current expenditures in the areas of health, protection of persons and property, education, welfare and retirement systems; and fourth, all other purposes. Thus, according to the priority norms, contributions by the Commonwealth to the Retirement Systems expressly fall within the third priority. These restrictions do not apply to employer contributions made by public corporations and municipalities, because the funds of public corporations and municipalities are not "available resources" of the Commonwealth.

Benefits and Special Benefits. Each Retirement System provides basic benefits principally consisting of a retirement annuity and death and disability benefits (collectively referred to herein as "Basic System Pension Benefits"). Each also administers benefits granted under various special laws that have provided additional benefits for the retirees and beneficiaries (collectively referred to herein as "System Administered Pension Benefits"). The System Administered Pension Benefits include, among others, additional minimum pension, death and disability benefits, ad-hoc cost-of-living adjustments and summer and Christmas bonuses. See Note 20 to the Commonwealth's audited financial statements for fiscal year 2011 included in the CAFR for a summary of the benefits provided by each of the Retirement Systems. Act 3 amended the various laws providing some of these System Administered Pension Benefits to reduce some of the amounts payable to existing retirees while eliminating the benefits for all future retirees (those retiring after June 30, 2013).

The System Administered Pension Benefits are funded on a pay-as-you-go basis by the Commonwealth from the General Fund or by the participating public corporation and municipalities. These benefits are not an obligation of the respective Retirement Systems. Except for the System Administered Pension Benefits corresponding to former employees of municipalities and public corporations, which are obligations of the municipalities and public corporations, most of the funds used to cover these benefits are required to be paid by the Commonwealth through annual appropriations from the General Fund. Historically, however, the Retirement Systems have made current payments of System Administered Pension Benefits to participants but the costs of these pension benefits have not been recuperated by the Retirement Systems in full and on a timely basis from the Commonwealth and the participating public corporations and municipalities.

Through June 30, 2004, the Teachers Retirement System had paid $119.6 million from its resources to cover System Administered Pension Benefits that should have been received from the Commonwealth through annual appropriations. On May 31, 2004, the Teachers Retirement System made a claim to OMB to collect this amount. OMB disputed the Teachers Retirement System's interpretation of certain System Administered Pension Benefit laws to the effect that the Commonwealth is required to reimburse the Teachers Retirement System for such benefits paid. During 2009, the Department of Education paid $12.2 million that was part of the amounts claimed to OMB. On April 23, 2010, OMB and the Teachers Retirement System settled the remaining claim for $53.8 million, to be paid in five equal installments of $10.8 million during the next five fiscal years, starting in fiscal year 2011. In July 2011, the Teachers Retirement System received the second installment and in July 2012, the Teachers Retirement System received the third installment.

The Employees Retirement System is also seeking reimbursement from the Commonwealth, the municipalities and public corporations in the amount of approximately $78 million, $24 million and $40 million, respectively, for cumulative System Administered Pension Benefits paid to its beneficiaries through June 30, 2011.

Composition and Market Value of Investment Portfolios. As of March 31, 2013, the market value of the Employees Retirement System's investment portfolio was $4.018 billion, compared to $4.192 billion as of June 30, 2012. As of March 31, 2013 the investment portfolio was comprised of approximately 24% of equity investments, 42% of fixed income securities, 18% of internally managed mortgage and personal loans portfolio, 15% of short-term cash equivalents (excluding receivables), and 2% of other investments. The decrease in value of the investment portfolio since June 30, 2012 principally reflects the continued use of investment portfolio assets and the sale of a portion of the personal loan portfolio to pay current benefits as discussed below.

Total assets for the above periods were $4.240 billion and $4.478 billion, respectively. See the Statements of Plan Net Assets and Changes in Plan Net Assets below.

As of March 31, 2013 the market value of the Teachers Retirement System's investment portfolio was $2.063 billion, compared to $2.194 billion as of June 30, 2012. As of March 31, 2013, the investment portfolio was comprised of approximately 47% of equity investments, 26% of fixed income securities, 20% of internally managed mortgage and personal loans portfolio, 6% of short-term cash equivalents (excluding receivables), and 1% of other investments. The decrease in value of the investment portfolio since June 30, 2012 principally reflects the continued use of investment portfolio assets to pay current benefits as discussed below. Total assets for the above periods were $2.121 billion and $2.358 billion, respectively. See Statements of Plan Net Assets and Changes in Plan Net Assets below.

As of March 31, 2013, the market value of the Judiciary Retirement System's investment portfolio was $68 million, compared to $63 million as of June 30, 2012. As of March 31, 2013, the investment portfolio was comprised of approximately 57% of equity investments, 31% of fixed income securities, 1% of internally managed mortgage and personal loans portfolio, and 11% of short-term cash equivalents (excluding receivables). The increase in value of the investment portfolio since June 30, 2012 reflects the increased proportion invested in equity assets, which have had a superior performance in the stated period. Total assets for the above periods were $68 million and $63 million, respectively. See Statements of Plan Net Assets and Changes in Plan Net Assets below.

Actuarial Valuations of the Retirement Systems. Historically, each of the Retirement Systems has conducted an actuarial valuation as of the end of every two fiscal years. However, due to the deterioration of the funding status of the Retirement Systems, as discussed below, each of the Retirement Systems began conducting annual actuarial valuations effective June 30, 2009. The latest actuarial valuations were conducted by Milliman Inc., a firm of independent consulting actuaries, as of June 30, 2011.

Informational copies of the actuarial valuation reports of the Employees Retirement System and the Judiciary Retirement System, as well as other financial information, are available on the website of the Administration of the Retirement Systems at www.retiro.pr.gov. Informational copies of the actuarial valuation report of the Teachers Retirement System, as well as other financial information, are available at the website of the Teachers Retirement System at www.srm.pr.gov. No information contained on these websites is deemed incorporated herein by reference.

The purpose of an actuarial valuation is to calculate the actuarial accrued liability of each of the Retirement Systems, which estimates on the basis of demographic and economic assumptions the present value of the benefits that each of the Retirement Systems will pay to its retired members and active members upon retirement. The actuarial valuations are performed in accordance with generally recognized and accepted actuarial principles and practices. The actuarial valuation compares the actuarial accrued liability with the actuarial value of assets and any excess of that liability over the assets represents an unfunded actuarial accrued liability ("UAAL") of the applicable Retirement System. In the case of the actuarial valuations of the Retirement Systems, the actuarial value of assets is equal to the market value of assets (net of liabilities). An actuarial valuation will also express the percentage that a Retirement System is funded through a "Funded Ratio" which represents the quotient obtained by dividing the actuarial value of assets of the Retirement System by the actuarial accrued liability of the Retirement System. An actuarial valuation will also state an actuarially recommended contribution rate, which is a recommended rate of covered payroll that consists of two components: (1) normal cost, which generally represents the portion of the present value of retirement benefits that are allocable to active members' current year service, and (2) an amortized portion of the UAAL. The amount that the Commonwealth and other participating entities actually contribute to the Retirement Systems is determined by statute and does not follow the recommendations of the actuaries, as discussed above. If additional employer contributions were to be made, they would have to be included in the Governor's budget request and approved by the Legislative Assembly.

To calculate the actuarial accrued liability of each of the Retirement Systems, the actuarial valuations use several actuarial assumptions. Some examples of these assumptions include an expected rate of return of assets, age of retirement of active members, future pay increases for current employees, assumed rates of disability and post-employment life expectancies of retirees and beneficiaries. If the experience of the Retirement Systems is different from these assumptions, the UAAL of the Retirement Systems may increase or decrease to the extent of any variances. As discussed below, the actual return of assets of each of the Retirement Systems during fiscal year 2009 was significantly lower than the assumed investment return utilized to prepare the actuarial accrued liability. The actual return of assets of each of the Retirement Systems for fiscal year 2010 and 2011, however, was higher than the assumed investment return used in the actuarial valuations as of June 30, 2011.

The actual rate of return on assets of the Retirement Systems depends on the performance of their respective investment portfolios, which can vary materially from the expected rates of return assumed in the actuarial valuations. The investment portfolios of the respective Retirement Systems can be volatile. The value of the securities in the investment portfolios can dramatically change from one fiscal year to the next, which could, in turn, cause substantial increases or decreases in the net assets of the Retirement Systems, which directly impacts the UAAL. For fiscal year 2009, the annual rates of return of the assets of the Employees Retirement System, the Teachers Retirement System and the Judiciary Retirement System was negative 9.8%, negative 16.0% and negative 18.0%, respectively, contributing to the increase in the UAAL of the Retirement Systems between fiscal year 2007 and fiscal year 2009. For fiscal year 2010, the year-end return of the assets of the Employees Retirement System, the Teachers Retirement System and the Judiciary Retirement System was 8.7%, 12.5% and 12.7%, respectively. For fiscal year 2011, the year-end return of the assets of the Employees Retirement System, the Teachers Retirement System and the Judiciary Retirement System was 16.0%, 22.5% and 20.5%, respectively.

The June 30, 2011 actuarial valuations of the Employees Retirement System and Judiciary Retirement System were completed in accordance with the "projected unit credit" method, with an assumed investment return of 6.4% per year, in the case of the Employees Retirement System, and 6.6% per year, in the case of the Judiciary Retirement System, and yearly salary increases of 3% per year. The actuarial valuations of the Employees Retirement System and the Judiciary Retirement System as of June 30, 2010 had assumed investment returns of 7.5% per year. Under the "projected unit credit" method, a projected benefit is determined at each active participant's assumed retirement age assuming future compensation increases, and the projected benefit is attributed to each year of service using straight proration based on projected service to each assumed retirement age. The plan's normal cost is the sum of the present value of the portion of each active participant's projected benefit attributable to the current year of service.

The June 30, 2011 actuarial valuation of the Teachers Retirement System was completed in accordance with the "entry age normal" method and assumed an investment return of 6.4% per year and yearly salary increases of 3.5%. The actuarial valuation of the Teachers Retirement System as of June 30, 2010 had assumed investment returns of 8% per year. Under the "entry age normal" method, a projected benefit is determined at each active participant's assumed retirement age assuming future compensation increases. The plan's normal cost is the sum of each active participant's annual cost for the current year of service determined such that, if it were calculated as a level percentage of his compensation each year, it would accumulate (at the valuation interest rate over his total prior and future years of service to the participant's assumed retirement date) into an amount sufficient to fund the participant's projected benefits.

Any amounts receivable from the Commonwealth with respect to benefits under System Administered Pension Benefits laws (discussed above) are considered in the actuarial valuation process to determine the unfunded pension benefit obligation of the Retirement Systems to the extent receivables are recognized as such by the Retirement Systems.

In performing the actuarial valuations, the actuaries rely on data provided by the Retirement Systems. Although the actuaries review the data for reasonableness and consistency, they do not audit or verify the data. If the data were inaccurate or incomplete, the results of the actuarial valuations may also be inaccurate or incomplete, and such defects may be material.

The following tables set forth, according to the actuarial valuations of the Retirement Systems, the actuarial value of assets, actuarial accrued liability, UAAL, funded ratio, covered payroll and UAAL as a percentage of covered payroll. The ratio of the UAAL to covered payroll is a measure of the significance of the UAAL relative to the capacity to pay it. The trend in the ratio provides information as to whether the financial strength of a pension plan is improving or deteriorating over time. As shown in the "Historical Funding Status" table, the steady increase in the UAAL to covered payroll for each of the Retirement Systems shows a significant deterioration in their financial strength.

Funding Status
Actuarial Valuations as of June 30, 2011
(in millions)

	Actuarial Value of Assets[1]	Actuarial Accrued Liability[2]	Unfunded Actuarial Accrued Liability[3]	Funded Ratio[4]	Covered Payroll[5]	UAAL as a Percentage of Covered Payroll[6]
Employees Retirement System	$1,724	$25,457	$23,734	6.8%	$3,666	647.3%
Teachers Retirement System	2,386	11,449	9,063	20.8	1,320	686.4
Judiciary Retirement System	64	383	319	16.7	32	1,002.2
Total	$4,174	$37,289	$33,116	11.2%	$5,018	659.9%

(1) The actuarial value of assets of each of the Retirement Systems is set forth in the actuarial valuation relating to each Retirement System and is equal to the full market value of the assets held by the Retirement Systems, including expected receivable contributions from the Commonwealth, municipalities and participating public corporations, less bonds payable and other liabilities.
(2) The actuarial accrued liability of each of the Retirement Systems is set forth in the actuarial valuation relating to each Retirement System and is an estimate based on demographic and economic assumptions of the present value of benefits that the Retirement System will pay during the assumed life expectancies of the applicable retired members and active members after they retire.
(3) The UAAL of each of the Retirement Systems is set forth in the actuarial valuation relating to each Retirement System and reflects the amount of the excess of the actuarial accrued liability of a Retirement System over its actuarial value of assets. The indicated amounts reflect the UAAL as calculated pursuant to the requirements of the Government Accounting Standards Board ("GASB") for purposes of presentation in the CAFR.
(4) The Funded Ratio of each of the Retirement Systems is presented in the actuarial valuation relating to each Retirement System and reflects the quotient obtained by dividing the actuarial value of assets of the Retirement System by the actuarial accrued liability of the Retirement System. The indicated percentages reflect the Funded Ratio as calculated pursuant to the requirements of GASB for purposes of presentation in the CAFR.
(5) The covered payroll of each of the Retirement Systems is presented in the actuarial valuation relating to each Retirement System and is equal to the annual salaries paid to active employees on which contributions to the Retirement System are made.
(6) The UAAL as a percentage of covered payroll is presented in the actuarial valuation relating to each Retirement System and reflects the quotient obtained by dividing the UAAL of the Retirement System by the covered payroll of the Retirement System.

Source: Actuarial valuation reports as of June 30, 2011 for each of the Retirement Systems.

Historical Funding Status[1]
Actuarial Valuations as of the Indicated Fiscal Years
(in millions)

Fiscal Year Ending June 30,	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
Employees Retirement System						
2005	$2,328	$13,969	$11,641	16.7%	$4,126	282.2%
2007	2,892	16,770	13,878	17.2	4,246	326.8
2009	1,851	18,944	17,092	9.8	4,293	398.2
2010	1,667	21,370	19,703	7.8	3,818	516.1
2011	$1,724	$25,457	$23,734	6.8	$3,666	647.3
Teachers Retirement System						
2004	$2,403	$ 4,702	$ 2,299	51.1%	$1,294	177.7%
2007	3,163	7,756	4,593	40.8	1,370	335.3
2009	2,158	8,722	6,564	24.7	1,418	462.8
2010	2,222	9,280	7,058	23.9	1,370	515.0
2011	2,386	11,449	9,063	20.8	1,320	686.4
Judiciary Retirement System						
2005	$70	$174	$105	40.0%	$29	356.8%
2007	81	259	177	31.5	31	566.6
2009	51	324	273	15.6	31	893.7
2010	55	338	283	16.4	32	882.0
2011	64	383	319	16.7	32	1002.2

[1] Please refer to the footnotes of the immediately preceding table for an explanation of the categories set forth in the columns of this table.
Source: Actuarial valuation reports as of June 30 of the fiscal years indicated above for each of the Retirement Systems.

The following table shows the actuarially recommended contributions, actual employer contributions and resulting amount unfunded and percent contributed for each of the Retirement Systems' last four fiscal years.

Schedule of Employer Contributions
to Retirement Systems
(in millions)

Fiscal Year Ending June 30,	Actuarially Recommended Contributions[(1)]	Actual Employer Contributions[(2)]	Amount Unfunded[(3)]	Percent Contributed
Employees Retirement System				
2008	$1,191	$663	$528	55.7%
2009	1,259	595	664	47.3
2010	1,460	534	926	36.6
2011	1,735	702	1,033	40.5
2012	2,019	597	1,422	29.6
Teachers Retirement System				
2008	$341	$159	$182	46.6%
2009	394	173	221	43.9
2010	477	166	311	34.8
2011	528	161	367	30.5
2012	659	175	484	26.6
Judiciary Retirement System				
2008	$20	$7	$13	35.0%
2009	22	11	11	50.0
2010	28	11	17	39.3
2011	30	11	19	36.7
2012	34	11	23	32.4
Total				
2008	$1,552	$829	$723	53.4%
2009	1,675	779	896	46.5
2010	1,965	711	1,254	36.2
2011	2,293	874	1,419	38.1
2012	2,712	783	1,929	28.9

(1) The actuarially recommended contributions are based on the information contained in the actuarial valuations for the Retirement Systems as of June 30, 2011.
(2) The actual employer contributions for fiscal year 2012 are based on the statutory employer contribution plus the expected pay-as-you-go contributions for System Administered Pension Benefits, as set forth in the actuarial valuations as of June 30, 2011.
(3) Represents the difference between the actuarially recommended pension contribution and the actual contribution from the participating employers.
Source: Information regarding the actuarially recommended contributions was derived from the June 30, 2011 actuarial valuation reports for the Retirement Systems. Information regarding the actual contributions for the Retirement Systems was provided by the Retirement Systems.

The Commonwealth recognized that, based on the then current funding requirements of the Retirement Systems, the UAAL of the Retirement Systems was expected to continue to increase indefinitely into the future instead of being amortized, and that future scheduled contributions at the then current funding rates would not be sufficient to make future benefit payments when due. It recognized that additional funding from the Commonwealth would ultimately be necessary to cover such unfunded obligation. It was estimated that the Commonwealth would be responsible for approximately 64% of any such funding deficiency of the Employees Retirement System and approximately 74% of the combined funding deficiency of the Retirement Systems, with the balance being the responsibility of the municipalities and participating public corporations.

Funding Shortfalls and Issuance of Pension Obligation Bonds. For several fiscal years, actual employer and employee contributions to each of the Retirement Systems have been lower than annual Basic System Pension Benefits payments and administrative expenses. These shortfalls in contributions over the amounts required to pay Basic System Pension Benefits and expenses are referred to herein as "funding shortfalls." The funding shortfalls, however, do not reflect the actual cash flow position of the Retirement Systems, which is affected, among other things, by their investment and financing activities. One type of investment that has particularly contributed to the deterioration of the Retirement Systems' actual cash position has been the increase in personal loans to their members, as discussed below under "*Factors That Have Contributed to Deterioration in Financial Solvency of the Employees Retirement System*."

The Retirement Systems have been forced to cover the funding shortfalls with investment income, loans from financial institutions and various non-recurring sources of funds. In some fiscal years, the funding shortfall has also exceeded the investment income of the Retirement Systems, causing the Systems' assets to decline and adversely affecting the funded status.

Besides using investment income to cover benefit payments, the Employees Retirement System has covered some of its historical funding shortfalls with the sale of investment portfolio assets and proceeds of loans from the Treasury Department or other financial institutions, some of which have been collateralized with the Retirement System's assets.

During 2008, the Employees Retirement System issued approximately $2.9 billion of Senior Pension Funding Bonds (the "Pension Bonds"), with interest rates ranging from 5.85% to 6.55%, for which repayment the Employees Retirement System pledged all employer contributions made after the issuance of the bonds. The Pension Bonds are limited, non-recourse obligations of the Employees Retirement System payable solely from, and secured solely by, the employer contributions. The maturity of the Pension Bonds is not subject to acceleration for any reason including non-payment of debt service on the bonds. As of June 30, 2012, approximately $2.9 billion of the Pension Bonds remain outstanding. The Pension Bonds increased the funds of the Employees Retirement System currently available to pay pension benefits. The original expectation was that the Employees Retirement System's investment earnings on the proceeds of the Pension Bonds would exceed the cost of the debt. The Employees Retirement System, however, has not obtained the expected arbitrage on invested proceeds and has also used some proceeds to pay current system benefits and operational expenses.

The table below shows the funding shortfalls for each of the last five fiscal years and the projected funding shortfall for the following five fiscal years for each of the Retirement Systems. The projected funding shortfalls for the Employees Retirement System for fiscal year 2014 thru 2018 reflect the impact of the amendments made by Act 3.

Funding Shortfalls
(in millions)

Fiscal Year Ending June 30,	Employer and Member Contributions[1]	Basic System Benefit Payments and Administrative Expenses[3]	Net Funding Shortfall[5]
Employees Retirement System			
2010	727	(1,102)	(375)
2011	671[2]	(1,183)	(512)
2012	689	(1,528)	(839)
2013	744	(1,550)	(806)
2014	1,043[4]	(1,567)	(524)
2015	1,101[4]	(1,589)	(488)
2016	1,160[4]	(1,607)	(447)
2017	1,234[4]	(1,622)	(388)
2018	1,307[4]	(1,632)	(325)
Teachers Retirement System			
2010	249	(503)	(254)
2011	236	(550)	(314)
2012	244	(559)	(315)
2013	267	(579)	(312)
2014	290	(600)	(310)
2015	315	(624)	(309)
2016	341	(650)	(309)
2017	373	(678)	(305)
2018	406	(708)	(302)
Judiciary Retirement System			
2010	13	(19)	(6)
2011	13	(19)	(6)
2012	12	(21)	(9)
2013	13	(22)	(9)
2014	13	(23)	(10)
2015	13	(24)	(11)
2016	14	(25)	(11)
2017	14	(26)	(12)
2018	15	(27)	(12)

(1) Represents the statutory employer and member contributions and does not include amounts received from employers on account of System Administered Pension Benefits, except as described under footnote 4 below. For fiscal years 2012 through 2016, estimated payroll is assumed to grow 3% annually and employer contributions include the rate increases provided for by Act 114 and Act 116.
(2) Excludes $162.5 million contributed to the Employees Retirement System on June 23, 2011 and invested in COFINA bonds pursuant to Act 96.
(3) Includes, in the case of the Employees Retirement System, principal and interest paid on the Pension Bonds for fiscal years 2010 and 2011 in the amounts of $188 million and $189 million, respectively, and for fiscal years 2012 through 2018, debt service of $167 million per year.
(4) Includes $140 additional annual contribution and savings generated by the System from the difference between receiving the $2,000 per retiree contribution as required under Act 3 and paying $1,500 per retirees to cover certain System Administered Pension Benefits.
(5) Does not include interest income from asset investment.

Source: Information obtained from each of the Retirement Systems, Employees Retirement System projections made by Milliman, and the June 30, 2011 actuarial valuation reports.

The Employees Retirement System anticipates that, based on the contributions and benefit structure established by Act 3, its future cash flow needs for disbursement of benefits to participants, administrative expenses and debt service are likely to continue to exceed the sum of the employer and employee contributions received and its investment and other recurring income, even after taking into account the increases in employer contributions provided for by Act 116, as described below and the amendments made by Act 3. After the enactment of Act 3, the Employees Retirement System expects to have a decreasing annual funding shortfall (after payment of debt service on the Pension Bonds) and this positive trend is expected to continue, as shown in the table above. Based on the Employees Retirement System's funding and disbursement projections made prior to the enactment of Act 3 (which reflected continued funding shortfalls) and other assumptions, the actuarial valuation as of June 30, 2011 stated that the Employees Retirement System was being rapidly defunded and projected that its net assets (total assets minus the Pension Bonds and other liabilities) would be depleted by fiscal year 2014 and its gross assets would be depleted by fiscal year 2020. This meant that during the period from fiscal year 2014 through fiscal year 2020, benefits were expected to be paid from the proceeds of the Pension Bonds, and that after depletion of the gross assets, there would be no funds remaining to pay pension benefits or debt service on the pension obligation bonds. With the enactment of Act 3 and the additional annual contribution of $140 million, it is projected that the gross assets will no longer be depleted. The Teachers Retirement System has also covered funding shortfalls during the prior five fiscal years through the sale of investment portfolio assets. For fiscal year 2013, the Teachers Retirement System expects to have a funding shortfall of approximately $312 million, even after taking into account the increases in employer contributions provided for by Act 114, as described below. Based on the Teachers Retirement System's current funding and disbursement projections (which reflect continued funding shortfalls) and other assumptions, the actuarial valuation as of June 30, 2011 states that the Teachers Retirement System is being gradually defunded and projects that its net and gross assets will be depleted by fiscal year 2022.

The Judiciary Retirement System has also experienced funding shortfalls during the last five fiscal years and has used investment income to cover some of these shortfalls. For fiscal year 2013, the Judiciary Retirement System expects to have a funding shortfall of approximately $9 million, and this negative trend is expected to continue. Based on the Judiciary Retirement System's current funding and disbursement projections (which reflect continued funding shortfalls) and other assumptions, the actuarial valuation as of June 30, 2011 states that the Judiciary Retirement System is being defunded and projects that its net and gross assets will be depleted by fiscal year 2019.

For fiscal year 2013, the combined unfunded amount of the Retirement Systems corresponding to the Commonwealth (assuming the Commonwealth is responsible for approximately 64% of the funding deficiency of the Employees Retirement System), is approximately $837 million, which represents approximately 10% of projected General Fund revenues for the fiscal year.

With the enactment of Act 3, which made significant changes designed to reduce the funding shortfalls for the next 25 years, the average annual funding deficiency for the Employees Retirement System for the period fiscal year 2014 and fiscal year 2038 is projected to be approximately $197 million, not taking into account investment income.

In the case of the Teachers Retirement Systems and the Judiciary Retirement Systems, if the level of contributions to the those systems and the level of benefits were to remain unchanged, the funding deficiencies are expected to continue to be covered with the investment income from, and the sale of, assets of the such system, thus continuing to deplete such assets. Based on the actuarial valuation reports, for the period from fiscal year 2014 to fiscal year 2022, the average annual funding deficiency is projected to be approximately $306 million for the Teachers Retirement System and approximately $12 million for the Judiciary Retirement System. Once the assets of those systems are depleted, the funding deficiency would have to be covered by the employers. As indicated above, it is estimated that the Commonwealth would have to cover substantially all of the funding deficiency of the Teachers Retirement System and the Judiciary Retirement System.

The estimated years for depletion of the assets stated above could vary depending on how actual results differ from the assumptions used in the actuarial valuations (including the assumed investment rate of return), as well as based on any future changes to the contribution and benefits structures of the Retirement Systems.

The consulting actuaries have recommended that the funding requirements of the Retirement Systems be significantly increased in light of (i) the expected negative net cash flows and exhaustion of plan assets, (ii) the forecasted decrease in funded status, and (iii) the actuarially recommended contributions which significantly exceed actual employer contributions. Act 3 was executed in response to these recommendations.

Factors That Contributed to Deterioration in Financial Solvency of the Employees Retirement System. Among the factors that have contributed most significantly to the deterioration of the Employees Retirement System are the following: (i) the inadequacy of the historical funding levels for the Retirement Systems, (ii) the enactment of special laws increasing pension benefits without providing the required funding source, (iii) the adoption of early retirement programs that were not adequately funded and that reduced the amount of contributions to the Retirement Systems, (iv) the increase in life expectancy in Puerto Rico; (v) the increase in the maximum amount of permitted personal loans to members, and (vi) the issuances of Pension Obligation Bonds by the Employee Retirement System.

Since their inception, the Retirement Systems have been inadequately funded by the government and the participating employees. On several occasions during the past decades, the Government has increased benefits without raising employer and employee contributions and failing to provide alternate methods to fund these increased benefits.

The Government has also approved several "Special Laws" granting additional benefits on top of those provided under Act 447 and Act 1. These benefits include: (i) a summer bonus; (ii) a medication bonus; (iii) a Christmas bonus; (iv) contributions to medical plans; (v) merit pensions; and (vi) cost of living adjustments (COLAs), among others. Although most of the benefits granted under the Special Laws are supposed to be funded by the General Fund or the other participating government employers, in fact these benefits are often not adequately funded.

The Government has also adopted various early retirement programs since 1994 to reduce the Government workforce. Although these measures reduced payroll expenses, which are a substantial portion of General Fund expenses, early retirement programs also reduced the Retirement Systems' revenues because they caused a decrease in employer contributions. These programs were generally not accompanied by up-front funding of the associated retirement costs and had a negative cash flow impact on the Employees Retirement System as the same funded early retirement benefits without timely reimbursement from the Commonwealth or sponsoring public corporation or municipality.

Another factor that contributed to the deterioration of the Retirement Systems was the increase in the average life expectancy in Puerto Rico and the United States from 59.5 years for men and 62.4 years for women in 1950 to 78 in 2008.[1] This has caused retired employees to receive benefits for more years than originally expected.

Another cause for the current situation of the Employees Retirement Systems is its personal loan program. The Employees Retirement System offers and manages a program that offers personal loans, mortgage loans and loans for cultural travels for retirement plan participants. Participants may obtain up to $5,000 in personal loans for any use. In 2007, the System increased this amount to $15,000, which reduced the cash in the System by approximately $600 million between 2007 and 2010.[2] This deficit has been covered by funds from the System itself and has required the liquidation of assets that would have otherwise been available to make pension payments. Due to the amount of personal loans originated during recent years, the System's loan portfolio now has a significant amount of illiquid assets. In an effort to improve the situation, in 2011, the Board of Trustees of the Employees Retirement System lowererd the maximum loan amount back to $5,000 and, in 2012, it approved the sale of approximately $315 million in loans. With a balance of $804 million as of December 2012, personal loans represent approximately half of the Employees Retirement System's net assets.

Finally, in 2008, the Employees Retirement System issued $2.9 billion in pension obligation bonds ("POBs"). The purpose of this offering was to increase the assets of the System available to invest and pay benefits. However, the Employees Retirement System has not obtained the expected arbitrage on invested proceeds and has also used some bond proceeds to pay current system benefits and operational expenses. Unlike other U.S. jurisdictions that have used this strategy, POBs are obligations of the Employees Retirement System itself and government employer contributions constitute the repayment source for the bonds.

Impact of Funding Shortfall on the Commonwealth. The Commonwealth and other participating employers are ultimately responsible for any funding deficiency in the Retirement Systems. The depletion of the assets available to cover retirement benefits will require the Commonwealth and other participating employers to cover such funding deficiency. Due to its multi-year fiscal imbalances previously mentioned, however, the Commonwealth is currently unable to make the actuarially recommended contributions to the Retirement Systems. If the Commonwealth fails to take action to address the Retirement Systems' funding deficiency, the continued use of investment assets to pay benefits as a result of funding shortfalls and the resulting depletion of assets could adversely affect the ability of the Retirement Systems to meet the rates of return assumed in the actuarial valuations, which could in turn result in an earlier depletion of the

[1] US National Center for Health Statistics, based on 2008 data.
[2] Source: Public Employees System.

Retirement Systems' assets and a significant increase in the unfunded actuarial accrued liability. Ultimately, since the Commonwealth's General Fund is required to cover a significant amount of the funding deficiency, the Commonwealth would have difficulty funding the annual required contributions unless it implements significant reforms to the retirement systems, obtains additional revenues, or takes other budgetary measures. There may be limitations on the the Commonwealth's ability to change certain pension rights afforded to participants in the Retirement Systems.

Efforts to Address Cash Flow Shortfall and Improve Funding Ratio. In recent years the Retirement Systems have been evaluating measures to improve their financial solvency. In order to maintain their long-term fiscal integrity and their ability to pay required benefits to their members, the Retirement Systems recognized that a combination of some or all of the following were necessary: (i) a substantial increase in contributions by the Commonwealth and the participating employers, and (ii) actions resulting in changes to liabilities of the Retirement Systems. Because of the multi-year fiscal imbalances mentioned above, the Commonwealth was unable to make the actuarially recommended contributions to the Retirement Systems.

As a result of the work of various commissions and task forces established by the Commonwealth, in recent years several bills were submitted to, and evaluated by, the Legislative Assembly to address in part the Retirement Systems' financial condition. One of such bills was enacted as Act 96. On June 23, 2011, in accordance with Act 96, $162.5 million of funds on deposit in the Corpus Account of the Puerto Rico Infrastructure Development Fund were contributed to the Employees Retirement System and invested in capital appreciation bonds issued by COFINA maturing annually on August 1, 2043 through 2048 and accreting interest at a rate of 7%. The principal amount of the COFINA bonds will grow to an aggregate amount of approximately $1.65 billion at their maturity dates.

The Commonwealth also enacted Act 114 and Act 116. These Acts provide an increase in employer contributions to the Employee Retirement System and the Teachers Retirement System of 1% of covered payroll in each of the next five fiscal years and by 1.25% of covered payroll in each of the following five fiscal years. As a result of these increases, the Employee Retirement System and the Teachers Retirement System would receive approximately $38 million and $14 million, respectively, in additional employer contributions during fiscal year 2013, and the additional employer contributions are projected to increase gradually each fiscal year (by an average aggregate increase of $71.8 million per fiscal year) to approximately $515 million and $203 million, respectively, by fiscal year 2021. The additional employer contributions for fiscal year 2013 were included in the approved budget for such fiscal year. With respect to the increases in the employer contributions corresponding to the municipalities, Act 116 provided that the increases for fiscal years 2012, 2013 and 2014 would be paid for by the Commonwealth from the General Fund budget, representing approximately $27.5 million, $30.2 million and $32.9 million in fiscal years 2012, 2013 and 2014, respectively.

The tables below show the projected additional contributions to the Employees Retirement System and the Teachers Retirement System as a result of Act 114 and Act 116, based on the expected payroll assumptions used in the actuarial reports as of June 30, 2011.

Projected Additional Employer Contributions
Employees Retirement System
($ in millions)

Fiscal Year	Original Employer Contribution Rate	Additional Employer Contribution Rate	Total Employer Contribution Rate	Expected Payroll	Original Employer Contribution	Additional Employer Contribution	Total Employer Contribution
2012	9.275%	1.000%	10.275%	$3,666	$340	$37	$377
2013	9.275%	2.000%	11.275%	3,758	349	75	424
2014	9.275%	3.000%	12.275%	3,852	357	116	473
2015	9.275%	4.000%	13.275%	3,948	366	158	524
2016	9.275%	5.000%	14.275%	4,047	375	202	578
2017	9.275%	6.250%	15.525%	4,148	385	259	644
2018	9.275%	7.500%	16.775%	4,252	394	319	713
2019	9.275%	8.750%	18.025%	4,358	404	381	786
2020	9.275%	10.000%	19.275%	4,467	414	447	861
2021	9.275%	11.250%	20.525%	4,579	425	515	940

Projected Additional Employer Contributions
Teachers Retirement System
($ in millions)

Fiscal Year	Original Employer Contribution Rate	Additional Employer Contribution Rate	Total Employer Contribution Rate	Expected Payroll	Original Employer Contribution	Additional Employer Contribution	Total Employer Contribution
2012	8.50%	1.00%	9.50%	$1,320	$112	$13	$125
2013	8.50%	2.00%	10.50%	1,367	116	27	144
2014	8.50%	3.00%	11.50%	1,414	120	42	163
2015	8.50%	4.00%	12.50%	1,464	124	59	183
2016	8.50%	5.00%	13.50%	1,515	129	76	205
2017	8.50%	6.25%	14.75%	1,568	133	98	231
2018	8.50%	7.50%	16.00%	1,623	138	122	260
2019	8.50%	8.75%	17.25%	1,680	143	147	290
2020	8.50%	10.00%	18.50%	1,739	148	174	322
2021	8.50%	11.25%	19.75%	1,800	153	203	356

Because of the Commonwealth's current budgetary constraints and the significant underfunding of the Retirement Systems discussed above, it is anticipated that improving the financial solvency of the Retirement Systems will require the adoption of additional measures beyond the enactment of Act 3 and that it will take several years before a significant improvement is achieved. The financial situation of the Retirement Systems presents a budgetary challenge to the Commonwealth. The required increase in employer contributions mandated by Act 114 and Act 116 may have an adverse impact on the Commonwealth's budgetary situation.

A fourth bill with respect to the Employees Retirement System was enacted as Act No. 196 of September 18, 2011, which authorized the Employees Retirement System to sell or pledge personal and mortgage loans in its portfolio. This bill also set up a loan program for members of the Employees Retirement System through certain financial institutions, while also limiting the amount of employee contributions that a member can pledge as collateral for a loan.

In addition to these measures, on August 8, 2011, the Board of Trustees of the Employees Retirement System adopted a new regulation regarding the rules relating to the concession of personal loans to its members, which, among other changes, lowered the maximum amount of those loans from $15,000 to $5,000. This change is expected to improve gradually the Employees Retirement System's liquidity.

On July 2, 2010, the Commonwealth enacted Act 70 ("Act 70"), which is designed to reduce government expenditures by providing a voluntary early retirement window for central government employees. At the same time, Act 70 is expected to have a positive actuarial impact on the UAAL of the Employees Retirement System and the Teachers Retirement System. Under Act 70, central government employees meeting certain years of service criteria who opted for early retirement by January 14, 2011 receive a higher pension benefit rate than they would otherwise be entitled to receive based on their current years of service, but such pension rate is lower than what they would have been entitled to if they had waited to meet the full vesting requirements. Pursuant to Act 70, the Commonwealth, as employer, will continue making the applicable employer contributions to the Employees Retirement System and the Teachers Retirement System, as well as make payments to cover the annuity payments to the employees opting for the early retirement window, until both the years of service and age requirements for full vesting would have occurred, at which time the applicable Retirement System will continue making the annuity payments. As of September 30, 2011, approximately 3,373 employees participated of the benefits provided by Act 70.

Act 3. Notwithstanding all of the above legislative and administrative measures directed at addressing the funding shortfall of the Retirement Systems, the funding situation of the Employees Retirement System presented a serious long term challenge that required more urgent and sweeping changes to improve the financial health and long term viability of the Employees Retirement System. With that objective in mind, on April 4, 2013, the new administration of Governor Alejandro Garcia Padilla succeeded in enacting Act 3.

The most important aspects of the changes effected by Act 3 are the following:

1. With respect to active employees who are Act 447 Participants and Act 1 Participants, all retirement benefits accrued through June 30, 2013 will be frozen, and thereafter all future benefits will accrue under a defined contribution formula which will be paid at retirement through a lifetime annuity.

2. The retirement age for Act 447 Participants will be gradually increased from age 58 to age 61.

3. The retirement age for current System 2000 Participants is increased gradually from age 60 to age 65.

4. The retirement age for new employees is increased to age 67, except for new state and municipal police officers, firefighters, and custody officers, which will be age 58.

5. The employee contribution will be increased from 8.275% to 10%.

6. For System 2000 Participants the retirement benefits will no longer be paid as a lump sum payment and instead will be paid in the form of a life time annuity.

7. In terms of post employment benefits, the Christmas bonus payable to current retirees is reduced from $600 to $200 (and is eliminated for future retirees) and the summer bonus is eliminated. Future retirees will not receive any post employment benefits.

8. Disability benefits will be eliminated and substituted for a mandatory disability insurance policy.

9. Survivor benefits will be modified.

Statements of Plan Net Assets and Changes in Plan Net Assets. The following tables present the Statement of Plan Net Assets and Statement of Changes in Plan Net Assets of each of the Retirement Systems for fiscal years 2010, 2011 and 2012.

The Commonwealth of Puerto Rico
Employees Retirement System
Statements of Plan Net Assets*
As of June 30, 2010, 2011, 2012 and March 31, 2013
(in thousands)

	March 31, 2013**	2012**	2011	2010
ASSETS				
CASH AND SHORT TERM INVESMENTS				
Cash and Cash Equivalents	$ 100,676	$ 143,364	$220,852	$ 54,175
Cash with Fiscal Agent	9,290	59,250		
Collateral for Security Lending	167,500	54,870	134,319	110,931
Deposits with GDB:				
Unrestricted	42,615	113,313	51,396	51,446
Restricted	116,232	233,931	411,946	741,082
Restricted Cash Bonds	159,624	166,436	170,653	172,226
Total Cash and Short Term Investment	595,938	771,164	989,166	1,29,860
SECURITIES LENDING, COLLATERAL INVESTED				
Marketable Securities:				
Notes and Bonds	1,456,383	1,370,694	814,408	563,454
Stocks	949,221	793,330	1,582,242	1,492,386
Private Equity Investments	62,351	57,371	65,457	55,307
COFINA investment	239,198	245,339		
Total Investments	2,707,153	2,466,733	2,462,107	2,111,147
LOANS TO PLAN MEMBERS				
Mortgage	148,900	152,666	148,156	141,588
Personal	497,885	724,122	1,048,984	1,018,498
Cultural Trips	66,031	75,308	75,197	63,729
PEC	2,918	2,961	3,044	2,340
Total Loans to Plan Members	715,734	955,057	1,275,381	1,226,155
Investment in PRTA Holdings				
Total cash, investments and loans to plan members	4,018,825	4,192,955	4,726,654	4,467,162
RECEIVABLES:				
Employers	137,225	111,975	184,152	273,139
General Fund	5,557	12,697	6,147	11,222
Judiciary Retirement System	1,685.53	1,344.63	881.00	19,138
Investment Sales	6,032	87,261	9,546	12,189
Accrued Interest	10,139	13,044	7,594	6,597
Dividends Receivable				
Other	13,166	12,387	4,595	3,893
Total Receivables	173,804	238,709	212,915	326,178
CAPITAL ASSETS	10,910	11,195	8,951	8,964
OTHER ASSETS	5,099	5,375	6,375	7,224
Prepaid Bond Cost	31,077	31,077	32,172	33,267
Construction in Progress	472	472		
Total assets	4,240,187	4,479,783	4,987,067	4,842,795
LIABILITIES				
Book overdraft			62,843	22,933
Short Term Obligations				
Payables for securities lending	167,500	54,870	134,319	110,931
Funds of Mortgage Loans and Guarantee				
Insurance Reserve for Loans	7,917	8,351	9,596	8,964
Investment Purchases	6,818	82,384	1,854	5,277
Accounts Payable and Accrued Liabilities	8,236	14,530	12,923	12,250
Line of Credit				
Bonds Payable	3,026,593	3,040,470	3,003,482	2,981,775
Other Liabilities	22,815	28,457	24,363	21,798
Bonds Interest Payable			13,876	13,876
Accounts Payable Law 70	12,407	13,848		
Total Liabilities	3,252,287	3,242,910	3,263,256	3,177,804
Net Assets Held in Trust for Pension Benefits	$ 987,900	$ 1,236,873	$ 1,723,811	$ 1,664,991

*Totals may not add due to rounding.

**Preliminary, unaudited numbers

The Commonwealth of Puerto Rico
Employees Retirement System
Statements of Changes in Plan Net Assets*
As of June 30, 2010, 2011, 2012 and March 31, 2013
(in thousands)

ADDITIONS:	**March 31, 2013 ****	**2012****	**2011**	**2010**
Contributions:				
Employer:	$ 297,749	$ 388,103	$ 349,207	$ 381,243
Participating employees	239,449	316,178	322,008	345,265
Other Special Laws	174,763	175,488	170,369	171,843
Early Retirement		812	305	3,399
Special Laws 127	16,291	16,291	17,000	17,000
COFINA Investment		11,810	162,500	
Total Contributions	728,253	908,682	1,021,389	918,750
Investment (loss) Income:				
Realized Gain or Loss	16,461	263,992	472,076	148,173
Unrealized Gain or Loss	146,959	(164,981)		67,838
Dividend Income	181	2,093	7,344	10,663
Interest Income	97,631	165,082	172,783	179,585
Total	261,231	266,186	652,203	406,259
Less Investment Expense:	1,263	5,618	6,483	(7,649)
Insurance Premium				
Other Income	13,631	24,727	49,257	31,783
Total Additions	1,001,852	1,193,977	1,716,366	1,349,143
DEDUCTIONS:				
Annuities	888,747	1,170,749	1,133,926	1,047,965
Special Laws 127	16	16,291	17,000	17,000
Benefits under Special Laws	191,038	175,488	170,369	171,843
Death Benefits	6,656	13,604	7,932	12,968
Refunds of Contributions:				
Employers	868	1,228	992	1,469
Participating Employees	25,008	51,000	90,203	43,677
Personal Loans Adjustment				
Law 70	35	14,526		
Other Expenses	8,683	18,785	13,199	10,255
Administrative Expenses	18,739	28,510	34,583	33,063
Interest on Bonds	111,033	190,736	189,342	188,055
Total Deductions	1,250,823	1,680,917	1,657,546	1,526,295
Net (decrease) Increase	(248,971)	(486,940)	56,453	(177,152)
Net Assets Held in Trust for Pension Benefits				
Beginning of the Year	1,236,871	1,723,811	1,664,991	1,842,143
End of Year	$ 987,900	$ 1,236,871	$ 1,723,811	$ 1,664,991

*Totals may not add due to rounding.
**Preliminary, unaudited numbers.

The Commonwealth of Puerto Rico
Teachers Retirement System
Statements of Plan Net Assets*
As of June 30, 2010, 2011, 2012 and March 31, 2013
(in thousands)

	March 31, 2013**	2012**	2011	2010
ASSETS				
Cash:				
Cash and cash equivalents	$ 74,137	$ 321,635	$ 97,269	$ 24,019
Cash with fiscal agent		12,925	110	-
Collateral for Security Lending	47,956	20,019	70,938	48,673
Cash deposited with GDB	3,297	3,295	3,291	3,288
Total Cash	125,390	357,874	171,608	75,980
Investments at fair value:				
Bonds and notes	544,171	682,728	591,769	397,109
Stocks	967,416	729,967	1,211,084	1,295,232
Total investment at fair value	1,511,587	1,412,695	1,802,853	1,692,341
Other investments:				
Mortgage notes acquired from third parties				
Private equity investments	19,102	19,221	25,630	26,683
Total investments	1,530,689	1,431,916	1,828,483	1,719,024
Loans to plan members:				
Mortgage	144,766	135,698	128,312	119,937
Personal	261,127	266,303	276,692	288,463
Cultural trips	1,659	1,811	1,660	1,481
Total loans to plan members	407,552	403,812	406,664	409,881
Total investments and loans	1,938,241	1,835,728	2,235,147	2,128,905
Accounts receivable:				
Receivables for investments sold	18	100,262	2,230	332
Accrued interest and dividends receivable	7,654	7,603	3,982	4,584
Other	29,803	34,404	44,883	56,085
Total accounts receivable	37,475	142,269	51,185	61,001
Property and equipment, net	19,713	20,885	22,204	22,970
Other assets	449	832	472	832
Total Assets	2,121,268	2,357,588	2,480,616	2,289,688
LIABILITIES				
Investments purchased	2,787	215,233	1,701	2,722
Payable for securities lending	47,956	20,019	70,938	48,673
Cash overdraft in cash with fiscal agent	32,214	-	-	2,199
Accounts payable	2,263	2,267	1,530	1,476
Accrued expenses	13,054	13,623	13,321	6,184
Escrow fund of mortgage loans and guarantee insurance reserve for loans to plan members	6,052	5,773	6,322	5,763
Other liabilities	254	1,110	941	694
Total liabilities	104,580	258,025	94,753	67,711
Net Assets Held in Trust for Pension Benefits	$ 2,016,688	$2,099,563	$2,385,863	$2,221,977

* Totals may not add due to rounding.
** Preliminary, unaudited numbers

The Commonwealth of Puerto Rico
Teachers Retirement System
Statements of Changes in Plan Net Assets*
As of June 30, 2010, 2011, 2012 and March 31, 2013
(in thousands)

ADDITIONS:	**March 31, 2013****	**2012****	**2011**	**2010**
Contributions:				
Participating Employees	$ 89,072	121,773	123,297	129,888
Employer	99,908	123,614	112,071	118,127
Contributions transferred from other systems**	1,196	1,476	828	1,265
Special	62,632	53,405	47,753	46,572
Total contributions	252,807	300,268	283,949	295,852
Investment income:				
Interest income	53,968	56,306	57,008	61,303
Dividend income	1,851	4,342	6,915	10,111
Net appreciation (depreciation) in fair value of investments	105,751	(20,134)	421,923	203,265
Total investment income	161,570	40,514	485,846	274,679
Less investment expense	(2,504)	(3,361)	(4,682)	(4,735)
Net investment income	159,066	37,153	481,164	269,944
Other income	1,206	1,257	968	53,771
Total additions	$413,079	$338,678	$766,081	$619,567
DEDUCTIONS:				
Benefit paid to participants:				
Annuities and death benefits	447,403	570,007	513,874	470,683
Special benefits	27,181	26,440	48,286	47,870
Refunds of contributions	4,879	5,220	8,465	7,847
Administrative expenses	16,492	23,311	31,570	28,783
Total deductions	495,955	624,978	602,195	555,183
Net increase in net assets held in trust pension benefits	(82,875)	(286,300)	163,886	64,384
Net assets held in trust for pension benefits				
Beginning of year	2,099,563	2,385,863	2,221,977	2,157,593
End of year	$2,016,688	$2,099,563	$2,385,863	$2,221,977

* Totals may not add due to rounding.
** Preliminary, unaudited numbers

The Commonwealth of Puerto Rico
Judiciary Retirement System
Statements of Plan Net Assets*
As of June 30, 2010, 2011, 2012 and March 31, 2013
(in thousands)

ASSETS	**March 31, 2013****	**2012****	**2011**	**2010**
Cash and Investments:				
Cash and Cash Equivalents	$ 4,714	$11,543	$ 6,409	$ 4,007
Cash Deposited with GDB or Treasury Department:		745	1,011	28
Unrestricted	741			
Collateral from Securities Lending	2,058	1,088	3,218	1
Total Cash	7,513	13,376	10,638	4,037
Receivables:				
Accrued Interest	176	255	263	271
Investment Sales			-	41
Other	27	27	27	27
Total receivables	203	282	290	339
Marketable Securities:				
Notes and Bonds	20,692	30,524	39,954	25,973
Stocks	38,861	18,730	22,136	50,275
Total Investments	59,553	48,730	62,090	76,248
Loans and Interest Receivable from Members:				
Mortgage	296	4	17	20
Personal	54	383	750	702
Cultural Trips	3	81	78	47
Total Loans to Plan Members	353	471	844	769
Total cash, investments and loans to plan members	67,622	62,859	73,863	81,393
LIABILITIES				
Due to Treasury Department	120	1,604	5,560	5,842
Due to the Employees Retirement System	1,686	1,345	881	isc19,138
Collateral from Securities lending	2,058	1,088	3,218	
Escrow Funds to plan Members and Guarantee Insurance	64	65	66	63
Investment Purchases	500		2	868
Other Liabilities		170	161	72
Total Liabilities	4,429	4,271	9,888	25,983
Net Assets Held in trust for Pension Benefits	**$ 63,193**	**$ 58,588**	**$ 63,975**	**$ 55,410**

* Totals may not add due to rounding.

**Preliminary, unaudited numbers.

The Commonwealth of Puerto Rico
Judiciary Retirement System
Statements of Changes in Plan Net Assets*
As of June 30, 2010, 2011, 2012 and March 31, 2013
(in thousands)

	March 31, 2013**	2012	2011	2010
ADDITIONS:				
Contributions:				
Employer	$ 7,505	$ 10,088	$9,966	$ 10,021
Participating employees	2,106	2,943	2,789	3,104
Special Laws	1,944	500	629	629
Total Contributions	11,555	13,531	13,384	13,754
Investment Income:				
Realized Gain or Loss	1,005	7,354	12,928	5,644
Unrealized Gain	5,288	(6,837)		1,741
Dividend Income		7	176	211
Interest Income	720	1,361	1,352	1,284
Total	7,013	1,885	14,456	8,880
Less Investment Expense	-	(166)	(162)	(164)
Other Income	5	18	10	804
Net Investment Income	7,018	1,736	14,628	9,520
Total Additions	18,573	15,266	27,688	23,274
DEDUCTIONS:				
Annuities	11,670	19,395	18,627	17,268
Benefits Under Special Laws	1,944	679		629
Refunds to Participating Employees		63		--
Administrative Expenses	354	516	496	533
Total Deductions	13,968	20,654	19,123	18,430
Net Increase	4,605	(5,387)	8,565	4,844
Net Assets Held in Trust for Pension Benefits:				
Beginning of the Year	58,588	63,975	55,410	50,566
End of Year	**$ 63,193**	**$ 58,588**	**$ 63,975**	**$ 55,410**

* Totals may not add due to rounding.
**Preliminary, unaudited numbers.

POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS

In addition to the pension benefits, the Commonwealth provides non-pension post-employment benefits that consist of a medical insurance plan contribution for retired employees meeting the service credit eligibility requirements. These benefits are administered by the Retirement Systems. The medical insurance plan contribution is a payment of up to $100 per month to the eligible medical insurance plan selected by the retiree or disabled member. Act 3 eliminated these benefits for employees who retire after June 30, 2013 but preserved them for current retirees and employees who retire prior to June 30, 2013.

The Commonwealth funds these post-employment benefits on a "pay-as-you-go" basis from the General Fund, which means that the Commonwealth does not pre-fund, or otherwise establish a reserve or other pool of assets against the medical insurance plan contribution expenses that the Commonwealth may incur in future years. For fiscal year 2011, the Commonwealth paid $125.4 million for these benefits for the eligible retirees of the Retirement Systems (including retirees of public corporations and municipalities, which are also paid for by the Commonwealth). For fiscal year 2012, these benefits are expected to amount to $142.7 million.

In accordance with the provisions of GASB Statement No. 45, the Commonwealth is required to quantify and disclose its obligations to pay non-pension post-employment benefits to current and future retirees. The most recent actuarial valuation reports of these benefits are dated as of June 30, 2011. Many of the actuarial assumptions used to project the actuarial accrued liability for these benefits are the same as those used to determine the accrued actuarial liabilities of the Retirement Systems. The following table sets forth, according to the actuarial valuations, the actuarial accrued liability, UAAL, covered payroll and UAAL as a percentage of covered payroll for the non-pension post-employment benefits of the active and retired members of each of the Retirement Systems. Since these benefits are not pre-funded, as discussed above, the UAAL is equal to the actuarial accrued liability.

Post-Employment Benefits Other Than Pensions
Actuarial Valuations as of the Indicated Fiscal Years
(in millions)

Fiscal Year Ending June 30,	Actuarial Value of Assets	Actuarial Accrued Liability[1]	Unfunded Actuarial Accrued Liability	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
Employees Retirement System						
2007	-	$1,557	$1,557	0%	$4,246	36.7%
2009	-	1,633	1,633	0	4,293	38.0
2010	-	1,699	1,699	0	3,818	44.5
2011		1,758	1,758	0	3,666	48.0
Teachers Retirement System						
2007	-	$652	$652	0%	$1,370	47.6%
2009	-	750	750	0	1,418	52.9
2010	-	694	694	0	1,370	50.7
2011		706	706	0	1,320	53.5
Judiciary Retirement System						
2007	-	$5	$5	0%	$31	15.0%
2009	-	6	6	0	31	18.5
2010	-	6	6	0	32	18.1
2011		6	6	0	32	18.3

(1) The actuarial accrued liability is the liability or obligation for benefits earned by active and retired employees through the valuation date based on certain actuarial methods and assumptions.

The following table shows the actuarially recommended contributions, actual employer contributions and resulting amount unfunded and percent contributed for the post-employment benefits, other than pensions administered by each of the Retirement Systems', for the last three fiscal years and the current fiscal year.

Schedule of Employer Contributions to Retirement Systems on Account of Post-Employment Benefits Other Than Pensions (in millions)

Fiscal Year Ending June 30,	Actuarially Recommended Contributions[1]	Actual Employer Contributions[2]	Amount Unfunded[3]	Percent Contributed
Employees Retirement System				
2008	$111	$80	$31	72.1%
2009	112	87	25	77.7
2010	128	85	43	66.6
2011	129	94	35	72.3
2012	134	109	25	81.3
Teachers Retirement System				
2008	$37	$26	$11	70.6%
2009	38	28	10	73.2
2010	42	28	14	66.9
2011	40	32	8	79.1
2012	41	34	7	82.5
Judiciary Retirement System				
2008	$0.4	$0.2	$0.2	55.4%
2009	0.4	0.3	0.1	62.0
2010	0.5	0.3	0.2	61.5
2011	0.5	0.3	0.2	60.4
2012	0.6	0.3	0.3	59.0
Total				
2008	$148.4	$106.2	$42.2	71.6%
2009	150.4	115.3	35.1	76.7
2010	170.5	113.3	57.2	66.5
2011	169.5	126.3	43.2	74.5
2012	175.6	143.3	32.3	81.6

(1) The actuarially recommended contributions are based on the information contained in the actuarial valuations for the Retirement Systems as of June 30, 2011.
(2) The actual employer contributions for fiscal year 2012 are based on the expected pay-as-you-go amounts for the post-employment benefits, other than pensions, as set forth in the actuarial valuations as of June 30, 2011.
(3) Represents the difference between the actuarially recommended pension contribution and the actual contribution from the participating employers.

COMMONWEALTH AUDITED FINANCIAL STATEMENTS

General

For fiscal year 2011, the basic financial statements of the Commonwealth were audited by Deloitte & Touche LLP. Deloitte & Touche LLP did not audit the financial statements of certain activities, funds, and component units identified separately in its report dated April 27, 2012 (which report expresses an unqualified opinion and includes emphasis of matter paragraphs regarding the Pension Trust Funds' unfunded actuarial accrued liability and funded ratio as of June 30, 2011). Those financial statements were audited by other independent auditors whose reports were furnished to Deloitte & Touche LLP, and its opinion on the basic financial statements, insofar as it relates to the amounts included in the basic financial statements pertaining to such activities, funds and component units, is based solely on the reports of the other auditors.

The CAFR for fiscal year 2011, which includes the basic financial statements of the Commonwealth for fiscal year 2011, was filed by the Commonwealth with the Municipal Securities Rulemaking Board ("MSRB") through its Electronic Municipal Markets Access System ("EMMA") on April 30, 2012, in compliance with its continuing disclosure undertakings pursuant to Rule 15c2-12 of the Securities and Exchange Commission promulgated under the Securities Exchange Act of 1934, as amended.

Prior Non-Compliance with Continuing Disclosure Obligations

The Commonwealth has made continuing disclosure undertakings in accordance with Rule 15c2-12 under the Securities Exchange Act of 1934, as amended, in connection with its bond issuances. Although the Commonwealth has filed all the reports and financial statements required to be filed, some of these filings have been made after the Commonwealth's filing deadline, which is normally May 1.

The Commonwealth's audited financial statements for the fiscal years ended June 30, 2006, 2007 and 2008 were filed after the filing deadlines, because various governmental agencies did not submit their audited financial statements to the central government's external auditors on time, thereby delaying submission of the Commonwealth's audited financial statements. The Commonwealth's audited financial statements for the fiscal year ended June 30, 2009 were also filed after the Commonwealth's filing deadline due to delays in the engagement and transition of new external auditors, the implementation of new government accounting pronouncements, and the restatement of the financial statements of certain discretely presented component units.

The Commonwealth Report for the fiscal year ended June 30, 2008 was filed after the Commonwealth's filing deadline. Except for that Commonwealth Report, the Commonwealth has timely filed the Commonwealth Report for all other fiscal years since 2006.

In 2011 and 2012, the Commonwealth complied with its continuing disclosure undertaking relating to fiscal years 2010 and 2011.

The Commonwealth has established new policies and procedures that it believes will ensure full and timely compliance with all continuing disclosure obligations in the future. Such new policies and procedures include: (i) the assignment of additional resources from local and international audit firms to those component units whose financial statements have not been timely provided to the Commonwealth; (ii) the assignment of dedicated external and internal resources to (a) assist the Central Accounting Division at the Treasury Department in the preparation of complex financial information that has historically delayed the audit and (b) provide periodic and consistent follow up on component unit financial statement deliverables and deadlines; (iii) the execution of a memorandum of understanding between the Treasury Department, OMB and GDB for the coordination of all financial statement related tasks and the designation of GDB, in its role as fiscal agent, to review and monitor the progress of certain component units; and (iv) the establishment of an Audit Oversight Committee comprised of the Treasury Department and GDB personnel in order to continuously monitor the status of the audit and the Commonwealth's financial statements.

Notwithstanding the above improvements in policies and procedures implemented by the Commonwealth, the Commonwealth was not be able to file its audited financial statements for fiscal year 2012 by the filing deadline of May 1, 2013. The Commonwealth anticipates that its audited financial statements for fiscal year 2012 will be filed no later than July 31, 2013. The Commonwealth has been unable to finalize its audited financial statements for fiscal year 2012 principally due to (i) delays in the audit of such financial statements as a result of the governmental transition process and (ii) the failure of certain discretely presented component units to finalize their corresponding audited financial statements. These discretely presented component units are generally separate legal entities that are part of the Commonwealth's financial reporting entity under governmental accounting standards. The Commonwealth is evaluating the implementation of measures to ensure future timely filings of its audited financial statements.

PUERTO RICO TAXES, OTHER REVENUES, AND EXPENDITURES

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

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

Summary and Management's Discussion of General Fund Results

The following table presents the actual revenues and expenditures of the General Fund on a cash basis for fiscal years 2008, 2009, 2010, 2011 and 2012.

The amounts shown in the following table as expenditures may be different than those reflected in the budget or in the Commonwealth's financial statements because the table shows only cash disbursements, while the budget includes all authorized expenditures, regardless of when the related cash is actually disbursed. In addition, transfers to the Redemption Fund (used to pay debt service on the Commonwealth's bonds), which are included in the budget under "debt service," are shown as a deduction from total revenues in calculating "adjusted revenues" in the table and are not included under "expenditures." Finally, certain expenditures incurred in excess of budgeted amounts may not be reflected in the table as expenditures to the extent they are paid from reserve funds, such as moneys in the Budgetary Fund. . A discussion of the budget for fiscal year 2013 and the proposed budget for fiscal year 2014 appears below under "Budget of the Commonwealth of Puerto Rico."

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

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

	2008	2009	2010	2011	2012
Revenues:					
Income Taxes:					
Individuals	$2,759,305	$2,648,261	$2,593,598	$2,187,080	$2,142,876
Corporations	1,565,534	1,375,596	1,682,321	1,677,345	1,440,664
Partnerships	1,942	1,839	1,688	3,249	1,1330
Withheld from non-residents	1,087,782	1,081,739	830,352	1,000,428	890,759
Tollgate taxes	21,610	19,372	15,034	12,607	27,673
Interest	13,657	11,738	9,902	6,985	6,807
Dividends	59,770	48,663	29,774	26,756	35,087
Total income taxes	5,509,600	5,187,208	5,162,669	4,914,450	4,545,196
Sales and use tax	911,000	797,194	540,348	531,837	543,241
Commonwealth excise taxes:					
Alcoholic beverages	268,094	277,401	284,796	280,963	286,131
Foreign (Act 154)	-	-	-	677,565	1,882,621
Cigarettes	119,124	129,429	182,501	201,965	172,192
Motor vehicles	366,341	310,920	350,764	364,170	386,815
Other excise taxes	110,014	86,874	77,978	77,649	75,912
Total Commonwealth excise taxes	863,573	804,624	896,039	1,602,312	2,803,671
Property taxes	219	1,011	227,812	246,619	43,978
Inheritance and gift taxes	6,600	5,064	3,617	3,101	4,729
Licenses	87,690	96,423	95,768	81,381	77,642
Other:					
Traditional lottery	46,636	51,480	42,826	46,165	38,225
Electronic lottery	105,298	75,213	80,006	55,690	55,746
Miscellaneous non-tax revenues	466,741	284,436	314,754	346,580	237,920
Total Other	618,675	411,129	770,843	448,435	331,891
Total revenues from internal sources	7,997,357	7,302,653	7,363,839	7,828,135	8,350.348
Revenues from non-Commonwealth sources:					
Federal excise taxes[(1)]	356,827	404,265	352,301	330,181	302,308
Customs	4,846	3,269	-	-	7,739
Total revenues from non-Commonwealth sources	361,673	407,534	352,301	330,181	310,047
Total revenues	8,359,030	7,710,187	7,716,140	8,158,316	8,660,395
Other Income (refunds)[(2)]	(10,797)	148,966	(57,241)[(8)]	(180,362)	91,583
(Transfer) Refunding to Redemption Fund[(3)]	(202,954)	(607,305)	(447,312) [(11)]	(86,834)[(12)]	(693,869)
Proceeds of notes and other borrowings[(4) (6) (13)]	2,710,000	3,982,893	2,375,000	1,850,000	1,321,951
Repayment of notes and other borrowings[(5) (7) (10)]	(2,580,764)	(3,858,393)	(2,698,818)	(1,850,000)	(1,527,320)
Receipt of COFINA Bond Proceeds [(9)]	-	3,051,008	2,501,053[(9)]	1,243,898	1,285,809
Total Resources	8,274,515	10,427,356	9,388,822	9,135,018	9,138,549
Expenditures:					
Grants and subsidies	3,471,922	3,117,817	3,581,751	3,996,469	4,010,353
Personal services	4,563,192	5,273,590	4,355,111	4,143,299	4,017,249
Other services	685,112	859,323	822,019	746,755	839,213.00
Materials and supplies	99,486	109,386	85,906	72,663	137,971.00
Equipment purchases	49,498	51,204	44,381	60,257	94,061
Capital outlays and other debt service	11,222	211,499	110,850	46,822	48,765
Prior year disbursements	-	-	-	-	-
Total expenditures	8,880,432	9,622,818	9,000,018	9,066,265	9,147,612
Total resources less expenditures	(605,917)	804,538	388,804	68,753	($9,063)
Ending cash balance	$(1,112,178)	$ (307,640)	$ 81,164	$ 149,917	$140,854

(1) Excludes transfers to the Conservation Trust Fund and amounts deposited into a separate account for the promotion of Puerto Rico rums in foreign markets.
(2) Consists of net revenues from the General Fund's non-budgetary funds plus a reserve for future tax refunds reduced by estimated tax refunds.
(3) Consists of amounts to pay principal of, and interest on, general obligation bonds and notes of the Commonwealth. Does not include amounts deposited directly into the Redemption Fund from non-General Fund revenues.
(4) Consists of proceeds of borrowings from GDB and a syndicate of commercial banks, and proceeds from Commonwealth's Tax and Revenue Anticipation Notes.
(5) Consists of repayments of borrowings from GDB and a syndicate of commercial banks, and repayments of Commonwealth's Tax and Revenue Anticipation Notes.
(6) Includes proceeds of $432.6 million generated by the issuance of the Commonwealth's Public Improvement Refunding Bonds, Series 2011 A, 2011 B and 2012 A, which were privately placed.
(7) Includes approximately $233 million for payment of Public Improvement Refunding Bonds Series 2011 C and 2011 D paid with transfers from COFINA.
(8) Includes $201 million transferred to the Commonwealth from the sale of securities in PRIFA's Corpus Account.
(9) Represents the COFINA bond proceeds deposited in the Stabilization Fund.
(10) Includes payment of refunded bonds of $394.5 million.
(11) Does not include amounts deposited directly into the Redemption Fund from non-General Fund revenues.
(12) Includes payment of $685,662,626 to Redemption Fund obtained from a line of credit to pay monthly interest deposits required with respect to certain refunded bonds.
(13) Includes proceeds of $685,662,626 from a line of credit to pay monthly interest deposits required with respect to certain refunded bonds.

Source: Treasury Department

General Fund Preliminary Revenues for Fiscal Year 2012 Compared to Fiscal Year 2011

General Fund preliminary total revenues (including lottery revenues) for fiscal year 2012 were $8.660 billion, representing an increase of $502 million, or 6.2%, from fiscal year 2011 revenues. The major changes from fiscal year 2011 were: (i) decreases in income taxes from corporations of $236.7 million, or 14.1%, (ii) a decrease of $109.7 million in taxes withheld from non-residents, (iii) a decrease of $202.6 million in the temporary special property tax and (iv) an additional $1.2 billion from the excise tax imposed on entities that purchase products manufactured in Puerto Rico by their affiliates under the provisions of Act 154, discussed below.

General Fund preliminary total expenses (on a cash basis) for fiscal year 2012 amounted to $10.094 billion, consisting of $9.148 billion of operational expenses, $694 million transferred to the Redemption Fund for the repayment of general obligation and Commonwealth guaranteed debt and $145.8 million used to pay certain expenses that had been budgeted for fiscal year 2013. The difference between preliminary revenues and expenses for fiscal year 2012 of $1.434 billion was covered with proceeds from a COFINA bond issue of $610 million and $839.4 million of debt restructuring.

General Fund Revenues for Fiscal Year 2011 Compared to Fiscal Year 2010

General Fund preliminary total revenues (including lottery revenues) for fiscal year 2011 were $8.158 billion, representing an increase of $442.2 million, or 5.7%, from fiscal year 2010 revenues. The major changes from fiscal year 2010 were: (i) decreases in income taxes from individuals of $406.5 million or 15.7%, resulting from the implementation of the tax reform, (ii) an increase of $170.1 million in taxes withheld from non-residents, and (iii) an additional $677.6 million from the excise tax imposed on entities that purchase products manufactured in Puerto Rico by their affiliates under the provisions of Act 154, discussed below.

General Fund preliminary total expenses (on a cash basis) for fiscal year 2011 amounted to $9.153 billion, which were composed of $9.1 billion of operational expenses and $86.8 million transferred to the redemption fund. The difference between preliminary revenues and expenses for fiscal year 2011 of $995 million was covered principally with proceeds from a COFINA bond issue.

General Fund Revenues for Fiscal Year 2010 Compared to Fiscal Year 2009

General Fund total revenues (including lottery revenues) for fiscal year 2010 were $7.716 billion, representing an increase of $6 million from fiscal year 2009 revenues and an increase of $46 million from budgeted revenues for fiscal year 2010. The principal changes in sources of revenues from fiscal year 2009 include a decrease in the sales and use tax received by the General Fund of $256.8 million due to the increased allocation of this tax to COFINA, as discussed in "Major Sources of General Fund Revenues – Sales and Use Taxes" below. This decrease in the amount of sales and use taxes allocated to the General Fund was fully offset, however, by increases in property taxes and excise taxes on cigarettes and alcoholic beverages of approximately $226.8 million and $60.5 million, respectively, as a result of the temporary and permanent revenue raising measures implemented as part of the Commonwealth's fiscal stabilization measures under Act 7. See "Major Sources of General Fund Revenues – Income Taxes" below. Revenues from income taxes for fiscal year 2010 were approximately the same as in fiscal year 2009, reflecting the continuing impact of the ongoing economic recession.

General Fund total expenses (on a cash basis) for fiscal year 2010 amounted to $9.447 billion, which were composed of $9.0 billion of operational expenses and $447.3 million transferred to the redemption fund. The difference between revenues and expenses for fiscal year 2010 of $1.7 billion was covered principally with proceeds from a COFINA bond issue.

General Fund Revenues for Fiscal Year 2009 Compared to Fiscal Year 2008

General Fund total revenues (including lottery revenues) for fiscal year 2009 were $7.710 billion, representing a decrease of $648.8 million, or 7.8%, from fiscal year 2008 revenues. The major changes from fiscal year 2008 were: (i) decreases in income taxes from individuals of $111 million and in corporate income taxes of $189.9 million, (ii) a decrease of $58.9 million in excise taxes, (iii) a decrease of $182.3 million in miscellaneous non-tax revenues, and (iv) a decrease of $113.8 million in the sales and use tax revenues due primarily to a one-time change in the manner sales and use tax collections are reported by the Treasury Department. Please refer to "Major Sources of General Fund Revenues – Sales and Use Taxes" below for further information regarding this reporting change. The decreases in revenues in these categories for fiscal year 2009, as compared to fiscal year 2008, reflect the acceleration of the economic recession during that fiscal year.

General Fund total expenses (on a cash basis) for fiscal year 2009 amounted to $10.230 billion, which were composed of $9.623 billion of operational expenses and $607 million transferred to the redemption fund. The difference between revenues and expenses for fiscal year 2009 of $2.5 billion was covered principally by proceeds from COFINA bond issues.

Major Sources of General Fund Revenues

Income Taxes

The historical revenue data presented in this Report is based on collections realized or accrued under the provisions of the Internal Revenue Code of 1994, as amended (the "PR Code"), which applied to taxable years beginning after June 30, 1995 and ending before January 1, 2011. The PR Code was replaced by the Internal Revenue Code for a New Puerto Rico, enacted as Act 1 of 2011, which will apply for taxable years commencing after December 31, 2010. See "Tax Reform" below. Many of the provisions of Act 1 of 2011 are identical to the equivalent provisions of the PR Code. Thus, unless otherwise noted, the discussion below refers to the provisions of both the PR Code and Act 1 of 2011.

The PR Code imposed a tax on the income of individual residents of Puerto Rico, trusts, estates, and domestic and foreign (if engaged in a trade or business in Puerto Rico) corporations and partnerships at graduated rates. A flat tax was imposed on certain payments made to non-residents of Puerto Rico, which was collected through an income tax withholding.

Individuals. Resident individuals are subject to tax on their taxable income from all sources. The PR Code had four tax brackets for individuals, with tax rates of 7%, 14%, 25%, and 33%. The highest income tax bracket applicable to individuals under the PR Code was $50,000. Under Act 1 of 2011, the highest income tax bracket gradually increases every year for the next six years from $60,000 to $121,500. For taxable years starting before January 1, 2016, the income tax rates applicable to individuals remain unaltered under Act 1 of 2011. After January 1, 2016, the top individual rate is lowered to 30%. See "Tax Reform" below for certain requirements that must be satisfied in order for tax benefits under Act 1 of 2011 to enter into effect for taxable years starting after December 31, 2013. Dividend income from Puerto Rico corporations and certain qualifying foreign corporations is taxed at an income tax rate of 10%.

Gains realized from the sale or exchange of a capital asset by resident individuals, if held for more than six months, is taxed at a rate of 10%.

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

Under a bill recently submitted by the Governor to the Legislative Assembly, two new measures relating to income taxes applicable to individuals are proposed to increase revenues. The first measure consists of imposing a surtax of 2% to self-employed individuals reporting gross income in excess of $200,000. The second proposed measure is to limit the annual maximum deduction an individual can claim for interest expense from a mortgage to the lesser of 30% of adjusted taxable income or $35,000. The proposed bill could be amended or rejected by the Legislative Assembly.

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

In general, the PR Code provided for six income tax brackets for corporations and partnerships, with the highest rate (39%) applicable to net taxable income in excess of $300,000. Gains realized from the sale or exchange of a capital asset, if held for more than six months, were taxed at a maximum regular income tax rate of 15%. Under Act 1 of 2011, for taxable years commencing after December 31, 2010, the highest corporate income tax rate is lowered to 30% for net taxable income in excess of $1,750,000 (it will be reduced to 25% for taxable years starting after December 31, 2013, subject to the satisfaction of certain conditions) and the alternative minimum tax is also reduced from a rate of 22% to the greater of (i) the amount produced by applying a minimum rate of 20% to the alternative minimum net income or, (ii) subject to certain exceptions, the amount produced by applying a 1% excise tax on the purchase from related parties of tangible personal property to be used in a Puerto Rico trade or business applicable to persons with gross sales of $50 million or more during any of three preceding taxable years. Dividends received by Puerto Rico corporations and partnerships from foreign corporations engaged in trade or business in Puerto Rico are subject to general income tax rates. A dividends received credit may be available when the corporation or partnership making the distribution is organized in Puerto Rico. Interest income on certain qualifying debt obligations issued by Puerto Rico corporations and certain qualifying foreign corporations, and paid to corporations and partnerships, qualifies for a special tax rate of 10%.

In general, corporations, and the partners of partnerships operating under a new grant of tax exemption issued under the Economic Incentives Act, are subject to a maximum income tax rate of 4% during their basic exemption period. Corporations, and the partners of partnerships covered by the Tourism Development Act, are subject to a maximum tax rate of 39% on their taxable income, after applying the 90% exemption granted under the Tourism Development Act, which results in a maximum effective tax rate of 3.9% on their net tourism development income. Under Act 1 of 2011, the net income of corporations and partnerships covered under the Tourism Development Act is subject generally to a maximum effective tax rate of 3%.

The PR Code and Act 1 of 2011 generally impose a branch profits tax on resident foreign corporations whose gross income qualifies as income effectively connected with a Puerto Rico trade or business. The branch profits tax is 10% of an annual dividend equivalent amount, and it applies without regard to the Puerto Rico source of income rules.

Interest from Puerto Rico sources paid by Puerto Rico resident borrowers to non-resident non-affiliated corporate recipients is not subject to any income or withholding tax. Interest paid by Puerto Rico resident borrowers to certain related non-resident recipients is subject to a withholding tax of 29%. Dividends paid to non-resident corporate recipients are subject to a withholding tax of 10%. Dividends distributed by corporations operating under new grants of tax exemption issued under the Economic Incentives Act and the Green Energy Incentives Act are not subject to Puerto Rico income tax. However, royalty payments made by corporations covered under the Economic Incentives Act to non-resident recipients are subject to an income tax withholding of 2% or 12%, depending on certain elections made by the grantee, and in the case of corporations covered by the Green Energy Incentives Act, royalty payments to non-residents are subject to an income tax withholding of 12%.

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

Under a bill recently submitted by the Governor to the Legislative Assembly, five new measures relating to income taxes applicable to corporations are proposed to increase revenues: (i) allowance of net operating losses for the determination of the AMT is reduced from 90% to 80%; (ii) allowance of net operating losses for purposes of calculating regular income taxes is reduced to 90%; (iii) intercompany charges when the entity making the charge is not engaged in a trade or business in Puerto Rico will be subject to a 20% tax; (iv) the deduction for the determination of the additional income tax is gradually reduced from $750,000 to $250,000; and

(v) adjustments to the AMT with respect to tangible property purchases made outside of Puerto Rico. The proposed bill could be amended or rejected by the Legislative Assembly.

Act No. 7 – Special Tax Measures Implemented for Fiscal Stabilization. Act 7 was enacted in 2009 as part of the prior administration's fiscal initiatives, and sought, among other things, to increase the tax revenues of the Commonwealth by imposing certain permanent and temporary tax increases. Most of the temporary tax increases were applicable for taxable years commenced after December 31, 2008 and before January 1, 2012 and have since expired.

Act 7 also provided as a permanent measure a change in the method of computing the net income subject to alternative minimum tax ("AMT") in the case of individuals by including in the computation various categories of exempt income and income subject to preferential tax rates under the PR Code, such as: (a) long-term capital gains, which enjoy a preferential tax rate of 10% under the PR Code; (b) dividends that are taxable at the rate of 10% under the PR Code; (c) interest on bank deposits and individual retirement accounts subject to the special 10% and 17% preferential income tax rates, respectively; and (d) interest from notes or bonds eligible for the special 10% tax rate provided by the PR Code.

Tax Reform

The 2011 tax reform focused on reducing taxes, to promote economic development and job creation, simplifying the tax system and reducing tax evasion. The tax reform was originally projected to provide taxpayers aggregate annual savings of $1.2 billion for each of the next six fiscal years, commencing on taxable year 2011.

The reduction in income tax revenues resulting from the implementation of the tax reform was expected to be offset by the additional revenues produced by (i) an expanded income tax source rule and a new excise tax imposed on entities that purchase products manufactured in Puerto Rico by their affiliates under the provisions of Act 154, discussed below, (ii) enhanced enforcement efforts, including the statutorily required reporting of certain client information by financial institutions to the Treasury Department, and (iii) increased economic activity produced by the tax relief measures. The combined effect of the tax reform measures and the revenue and enforcement measures was expected to be revenue positive but there was no assurance that sufficient revenues would be collected to partially offset the reduction in income tax revenues expected from the implementation of the tax reform. As a result, Act 1 of 2011 conditioned the implementation of the tax reductions applicable to individuals and corporations for taxable years commencing after December 31, 2013 on the Commonwealth's ability to continue its path towards fiscal stability. Specifically, the tax relief provisions for individuals and corporations for taxable years 2014 through 2016 will only be implemented if (i) OMB certifies that the expense control target has been met, (ii) the Treasury Department certifies that the General Fund revenue target has been met and (iii) the Planning Board certifies a year-over-year target increase in gross domestic product.

Act 154 – Expanded Income Taxation and New Excise Tax. Act 154, approved on October 25, 2010, as amended, seeks, among other things, to balance the tax burden among the taxpayers and increase the tax revenues of the Commonwealth. Act 154 modified the income taxation of certain nonresident alien individuals, foreign corporations and foreign partnerships (each a taxpayer) by expanding the circumstances in which such persons would be subject to Puerto Rico income taxation, and the act imposed an excise tax on the acquisition of certain personal property manufactured or produced in whole or in part in Puerto Rico and on the acquisition of certain manufacturing services carried out in Puerto Rico. Act 154 applies to income realized and acquisitions occurring after December 31, 2010.

The Act provides that, in certain circumstances, taxpayers will be deemed to be engaged in trade or business in Puerto Rico, and taxable in Puerto Rico with respect to a portion of the taxpayer's income, where the taxpayers engage in significant transactions with other persons that are members of the same controlled group. Where a person engages in significant transactions with a member of the same controlled group that has gross receipts of $75 million or more in any of the last three years, and that manufactures or produces goods in Puerto Rico, or provides services in connection with the manufacture or production of goods in Puerto Rico, the person will not be subject to income tax, and will instead be subject to the excise tax in lieu of any income tax. The excise tax is based on the value of the personal property or services acquired. The excise tax was originally scheduled to apply for a period of six years and was set at 4% for calendar year 2011, declining every year until reaching 1% in 2016. On February 28, 2013, however, the Commonwealth amended Act 154 to set the excise tax at a fixed 4% and extend the application of the excise tax until 2017. The amendment was part of a series of measures taken by the new administration to reduce the continuing fiscal imbalance of the Commonwealth.

On December 29, 2010, the Treasury Department adopted regulations that provide certain tax credits against the temporary excise tax that lessen its impact on affected taxpayers subject to the temporary excise tax. These regulations became effective on January 1, 2011. The regulations address implementation and interpretation issues and include provisions regarding certain applicable credits against the tax subject to maintaining a baseline employment and other conditions. The Commonwealth estimates that this excise tax will affect foreign corporations or partnerships that are principally engaged in the manufacturing of pharmaceuticals and electronics.

At the time of adoption of Act 154, the Commonwealth expected to raise approximately $1.4 billion from the excise tax during the first year of implementation and $5.6 billion for the six year period that the excise tax was originally intended to be in place. Although the amounts collected under Act 154 have met the initial projections, such revenue has not been sufficient to fully offset the reduction in tax revenues from other sources. As a result, in February the Government amended Act 154 to extend the period of the excise tax until 2017 and reset the excise tax rate to a fixed 4% commencing on July 1, 2013.

While the Commonwealth expects that certain taxpayers subject to the excise tax will be able to credit all or a portion of the excise tax paid against their United States federal income tax liabilities, it is uncertain how this tax will affect each individual taxpayer. The long-term effects of the excise tax on the manufacturing sector of the Puerto Rico economy are also uncertain.

In connection with the expansion of the taxation of foreign persons by Act 154, the Commonwealth obtained a legal opinion regarding the creditability of the excise tax for United States federal income tax purposes. The opinion concludes that this excise tax should be creditable against United States federal income tax. That conclusion was based in part upon a determination that the expansion of the taxation of foreign persons and the imposition of the excise tax will more likely than not satisfy the constitutional requirements of due process and the Commerce Clause of the United States Constitution, for reasons discussed therein.

On March 30, 2011, the IRS issued Notice 2011-29 addressing the creditability of the excise tax imposed by Act 154. Notice 2011-29 provides that the provisions of the excise tax are novel and the determination of its creditability requires the resolution of a number of legal and factual issues. Pending the resolution of those issues, the IRS will not challenge a taxpayer's position that the excise tax is a tax in lieu of an income tax under Section 903. The IRS also provided that any change in the foregoing tax credit treatment of the excise tax after resolution of the pending issues will be prospective and will apply to excise tax paid or accrued after the date that further guidance is issued.

Act 154 has not been challenged in court; consequently, no court has passed on the constitutionality of Act 154. There can be no assurance that its constitutionality will not be challenged and that, if challenged, the courts will uphold Act 154. To the extent a court determines that the imposition of the excise tax or the expansion of the income tax or both are unconstitutional, the Commonwealth's revenues may be materially adversely affected.

Sales and Use Taxes

Act No. 117 of July 4, 2006 ("Act 117") amended the PR Code to provide, among other things, for a general sales and use tax of 5.5% to be imposed by the central government (the "Commonwealth Sales Tax"). Act 117 also authorized each municipal government to impose a municipal sales and use tax of 1.5% (the "Municipal Sales Tax" and, together with the Commonwealth Sales Tax, the "Sales Tax"). In general, the Municipal Sales Tax has the same tax base, exemptions (except for unprocessed foods) and limitations as those provided for the Commonwealth Sales Tax. Act 117 also provides certain income tax reductions to address the regressive effect of the Sales Tax on taxpayers in lower income tax brackets. The Sales Tax is imposed on the sale, use, consumption and storage of taxable items, which include tangible personal property, taxable services, admission rights and certain other types of transactions covering separable and identifiable taxable items which are sold for a single price, subject to certain exceptions and limitations. The Sales Tax does not apply to, among other things: (i) motor vehicles, (ii) non-prepared food, (iii) healthcare services and prescription medicines, (iv) certain bakery goods, (v) crude oil and its derivatives, including gasoline, (vi) hotel room charges, (vii) financial services, (viii) services provided by the Commonwealth, including electricity and water, and (ix) local sales of goods to be used as content in a manufactured good, whether or not bound for export.

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

The Sales Tax became effective on November 15, 2006 and the effective date of the repeal of the 5% general excise tax was October 16, 2006. Municipalities were authorized to implement the Municipal Sales Tax starting on July 1, 2006. The revenues derived from the

Sales Tax are distributed as follows: 5.5% goes to the central government and 1.5% to Puerto Rico's municipalities. One half of the 5.5% Commonwealth Sales Tax is transferred to the Dedicated Sales Tax Fund, created by Act 91 of 2006, as amended, and the balance goes to the General Fund. The 1.5% Municipal Sales Tax is divided as follows: (i) 1% goes to the municipalities, and (ii) 0.5% goes to the Municipal Improvements Fund. The increase in revenues generated by the Sales Tax has been partly offset by the elimination of the 5% general excise tax and the effect of the income tax reduction measures included in Act 117.

The Treasury Department has reported and recorded Commonwealth Sales Tax revenues on a "modified cash basis." This means that the figures for each month represent the sales taxes corresponding to sales made by merchants and retailers and sales tax collected by such merchants and retailers during that month, but reported and remitted to the Treasury Department during the following month.

Effective fiscal year 2010, the Treasury Department began reporting Commonwealth Sales Tax revenues on a cash basis in order to report these revenues on the same basis and at the same time as it reports all other tax revenues. Accordingly, for fiscal year 2010, Commonwealth Sales Tax revenues were reported in the month in which such revenues were received by the Treasury Department. The new reporting method became effective as of July 1, 2009. Thus, the figures for sales tax collections previously reported in June 2009 were transferred to July 2009.

The Sales Tax generated revenues for the General Fund of approximately $543.2 million for fiscal year 2012 and are expected to generate approximately $552 million for fiscal year 2013 according to the most recent estimates.

Under a bill recently submitted by the Governor to the Legislative Assembly, the administration is proposing to broaden the tax base of the Sales tax by eliminating certain currently available exemptions such as business-to-business exemptions, exemptions related to services provided by professional businesses and exemptions applicable to the acquisition or purchase of goods and services by certain organizations and/or corporations. The proposed legislation also provides for enhanced administrative and operational means to both impose the tax and improve collections. Because of this broadening of the tax base, the administration is also proposing that the Sales Tax be reduced from a 7% to 6.5%. The proposed bill could be amended or rejected by the Legislative Assembly.

Excise Taxes

The PR Code imposes an excise tax on certain articles and commodities, such as cigarettes, alcohol, sugar, cement, motor vehicles, heavy equipment, boats and certain petroleum products, which are taxed at different rates.

Under Act 7, the excise tax was increased on certain articles (cigarettes and certain alcoholic beverages) and was expanded with respect to others (motor vehicles). With respect to cigarettes, the increase was approximately 81% per taxable unit. For certain alcoholic beverages, the increase ranged between $0.30 and $0.70 per standard gallon. Act 1 of 2011 incorporated most of the increases made by Act 7, but provided an increase in the tax applicable to concentrated wine must (from $4.48 to $7.00 per gallon), while reducing the tax payable with respect to champagne from concentrated wine must (from $4.48 to $2.25 per gallon). Motorcycles, all-terrain vehicles and "scooters," which used to be subject to the Sales Tax, are now subject to an excise tax of 10% under Act 1 of 2011.

A bill recently submitted by the Governor to the Legislative Assembly proposes an increase on the excise tax applicable to cigarettes from $11.15 to $16.73. It also proposes that a new excise tax of 1% be imposed on locally subscribed insurance premiums. The proposed bill could be amended or rejected by the Legislative Assembly.

Property Taxes

Personal property, which accounts for approximately 46% of total collections of taxable property, is self-assessed. Real property taxes are assessed based on 1958 property values. No real property reassessment has been made since 1958, and construction taking place after that year has been assessed on the basis of what the value of the property would have been in 1958. Accordingly, the overall assessed valuation of real property for taxation purposes is substantially lower than the actual market value. Also, an exemption on the first $150,000 of assessed valuation in owner-occupied residences is available.

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

One of the amendments incorporated in Act 7 was that, for fiscal years 2010 through 2012, the appraisal values of real property in Puerto Rico were increased tenfold and the real personal property tax rates applicable to such values were reduced tenfold so as to offset any increased tax that would have otherwise been applicable due to the increase in appraisal values. This temporary amendment, which is expected to be revenue neutral, was intended to increase the borrowing capacity of Puerto Rico's municipalities.

Act 7 did impose, however, an additional real property tax on residential and commercial real properties with appraised values in excess of approximately $210,000. This tax applied during fiscal years 2010, 2011 and 2012. The additional real property tax, which was collected by the Treasury Department, amounted to 0.591% of such properties' appraised value as determined by the CRIM. Act 1 of 2011 eliminated this additional real property tax for fiscal year 2012.

The following table presents the assessed valuations and real and personal property taxes collected for fiscal years 2008 to 2012.

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

Fiscal Years Ended June 30,	Assessed Valuations[(1)]	Taxes Levied	Collections of Current Year	Collections of Previous Years	Total Collections
2008	27,941,285	1,031,277	788,364	119,062	907,426
2009	28,903,996	1,032,570	634,040	244,411	878,451
2010	175,025,782	1,093,769	666,429	269,857	936,286
2011	187,293,462	1,152,718	712,706	225,280	937,986
2012	197,624,523	1,164,156	677,709	288,484	966,193

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

Source: Municipal Revenues Collection Center.

Other Taxes and Revenues

Motor vehicle license plate and registration fees comprise the major portion of license tax receipts. A bill recently submitted by the Governor to the Legislative Assembly proposes the transfer to the Highways and Transportation Authority of the portion of $25 currently allocated to the General Fund from the $40 charged as annual motor vehicle registration fees. The proposed bill could be amended or rejected by the Legislative Assembly.

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

Revenues from Non-Commonwealth Sources

Revenues from non-Commonwealth sources include customs duties collected in Puerto Rico and excise taxes on shipments of rum from Puerto Rico to the United States mainland. The customs duties and excise taxes on shipments are imposed and collected by the United States and returned to the Commonwealth. The excise tax on shipments of rum from Puerto Rico and other rum producing countries is currently $13.50 per gallon. Of this amount, the lesser of $10.50 per proof gallon and the actual excise tax imposed is currently returned ("covered over") to the Commonwealth. Since 1999, however, the United States Congress has enacted special supplementary legislation increasing the maximum amount covered over to the Commonwealth to $13.25 per proof gallon. For fiscal year 2012, the total excise taxes on rum shipments returned to the Commonwealth was $400.5 million, of which $302.3 million went to the General Fund.

In June 2008, the Government of the United States Virgin Islands (the "USVI") signed an agreement with Diageo USVI, Inc ("Diageo") for the construction and operation of a new rum distillery in St Croix, USVI, that will manufacture Captain Morgan branded products to be sold in the United States beginning in January 2012. Currently, all rum used in Captain Morgan products sold in the United States is procured through a supply contract with Serrallés Destillery ("Serrallés") in Puerto Rico which expired on December 31, 2011. The Commonwealth estimates that the exports of Captain Morgan rum produced in Puerto Rico by Serrallés during calendar year 2009 were 9,403,224 proof gallons. These rum exports of Captain Morgan resulted in an estimated $124.5 million in excise tax on rum shipments returned by the United States to Puerto Rico during fiscal year 2009. As a result of the termination of the contract between Serrallés and Diageo, it is expected that after 2011, the income received by the Commonwealth from the federal excise tax on rum shipments will decrease, unless Serrallés is able to find other clients in the United States for the volume of bulk rum previously purchased by Diageo for its Captain Morgan products.

In an effort to maintain the local rum industry, as a result of the threat posed by the USVI's agreement with Diageo, and to preserve or increase the amount of federal excise taxes on rum shipments returned to the Commonwealth under the cover-over program, Act No. 178 of December 1, 2010 ("Act 178") was enacted, which increases from 10% to 25% the portion of the monies from the federal excise tax that the Commonwealth may invest to provide incentives to, and promote, the Puerto Rican rum industry. The law also authorizes the Governor to increase this percentage up to 46% after December 31, 2011, through an Executive Order. In order to promote the Puerto Rican rum industry in general, the amount received from such refund will be transferred to a special account of the General Fund, which may be used for marketing, production and infrastructure investment incentives. Effective January 1, 2011, Act 1 of 2011 replaced Act 178 and contains identical provisions.

As permitted under Act 1 of 2011, the Commonwealth entered into a definitive agreement with two rum producers and is currently in negotiations with other producers to provide them a series of subsidies and incentives, by allowing such companies to benefit from the cover-over program rebate. These agreements are expected to promote and encourage the export of rum produced in Puerto Rico. As a result of these agreements, during fiscal year 2012 the Treasury Department disbursed $79.7 million of total revenues from the federal excise tax on rum shipments for these subsidies and incentives. This amount is expected to be partially offset by the economic activity generated by the increased investment in Puerto Rico by these rum producers.

Administrative Measures to Increase Collections of Income, Sales, and Excise Taxes and Property Taxes

The Treasury Department has elaborated a strategic plan designed to improve tax collections. The plan includes initiatives to foster tax compliance, implement effective enforcement measures, and attack tax evasion. To promote taxpayers' compliance, the Treasury Department has liberalized the procedures to enter into payment plans, offers-in-compromise agreements, and encouraged voluntary disclosure agreements.

In addition, the Treasury Department has developed initiatives focused on effective enforcement methods, such as improving the efficiency of its audit selection process, the creation of technological solutions to improve collections, and the establishment of cooperation agreements with federal and local governmental agencies. The Treasury Department has also integrated its databases and established a tax intelligence project to identify tax evasion and improve its audit selection process.

On September 28, 2010, the Treasury Department signed an agreement for the implementation of a new point of sale system that is intended to strengthen its sales tax enforcement efforts. The system is designed to: (i) transmit daily to the Treasury Department information on all sales tax transactions; (ii) reconcile transmitted transactional information with information reported by merchants; (iii) provide wireless transmission devices for use by street vendors; and (iv) capture a greater percentage of cash sales through the implementation of a special lottery using sales receipts as lottery tickets (the "IVU Loto"). The Treasury Department began a two phase implementation of this new point of sale system on December 1, 2010, through a pilot program in which 200 merchants in the Municipality of Ponce were selected to participate. The second phase, which includes the initial implementation of the point of sale system throughout the island, started in March 2011. Implementation of the new system was completed in late calendar 2012, although the Treasury Department continues deployment of the point of sale system. The Treasury Department adopted regulations on December 14, 2010 requiring that all qualifying merchants register for participation in the point of sale system program on or prior to April 30, 2011. As of November 7, 2011, the point of sale devices captured approximately 187.4 million transactions which resulted in sales of $4.4 billion and Commonwealth Sales Tax collections of $155.6 million. As of March 31, 2013 217,965 locations had registered in the program and 76,522 of such locations will be required to acquire and use the new point of sale system.

Specifically, the Treasury Department has developed various initiatives directed towards increasing collections of income taxes and the Commonwealth Sales Tax through the implementation of various enforcement and compliance programs. Other programs are geared towards the use of technology to detect noncompliance. For example, the Treasury Department completed the integration of its general computer systems with the Sales Tax database in order to better detect non-compliance. Such integration has allowed the Treasury Department to compare the electronic information provided by the transactional database (provided by the special lottery of sales receipts as explained below) and the data contained in the tax returns repository. Such comparison offers the Treasury Department with detailed information about which merchants reflect taxable transactions but are either (i) not duly submitting the corresponding sales and use tax return; (ii) submitting erroneously prepared tax returns – returns with less sales volume transactions than the information provided by the transactional database; (iii) merely submitting with no payment as the law requires; (iv) or merchants not reporting cash sales. In order to address these possible instances of non-compliance, the Treasury Department created a task force consisting of fiscal auditors and agents from the Sales and Use Tax Bureau and the Tax Evasion Bureau. The fiscal auditors are responsible for investigating inconsistencies reported by the point of sale system, determine tax deficiencies and issue preliminary deficiency notices. The agents of the Sales and Use Tax Bureau provide assistance to the fiscal auditors in connection with any additional information requirements and visit merchants and retailers to investigate the status of their permits and point of sale systems. Finally, the agents from the Tax Evasion Bureau are responsible for investigating any tax crimes discovered by the fiscal auditors and/or agents from the Sales and Use Tax Bureau. As a result of this initiative, as of March 31, 2013, the Treasury Department had identified approximately 205,912 unfiled monthly returns and sent notices to approximately 60,561 merchants and retailers. As of March 31, 2013, approximately 42,128 merchants and retailers had responded to the notices and approximately 65,578 unfiled monthly returns were filed, resulting in taxable sales reported of approximately $218 million and sales and use tax collections of $4.9 million. Merchants and retailers that filed monthly returns reporting no sales will receive a deficiency notice and all other merchants and retailers that have not responded will be referred to a fiscal auditor or the Tax Evasion Bureau.

In addition to the above, the new administration is pursuing the automatic collection of the sales and use tax directly at the point of sale. The Secretary of the Treasury has hired an expert consultant in the technology of point of sales systems and devices with the specific assignment of having this new collection methodology operational as soon as possible. Such initiative is already in the design and planning phase and is expected to be operational within the next 12 to 18 months. Other initiatives include the establishment of tax liens pursuant to the procedures of Act No. 12 of January 20, 2010, which enables the creation of tax liens through an expedited process. As of October 2011, the Treasury Department had established 16,000 liens in favor of the Commonwealth over approximately $742.5 million in assets. The Treasury Department is also enforcing a provision of Act 7 that allows the Treasury Department to revoke a certificate of exemption held by a merchant or retailer that fails to pay Sales Taxes collected in full by the 10th day of the month. Also, the Treasury Department will begin to seize the assets of businesses that are delinquent on their Sales Tax payments. In addition, the Treasury Department has entered into agreements with various municipalities to conduct simultaneous field visits and joint audits in order to increase the effectiveness of Sales Tax enforcement efforts as the ones described above.

The Treasury Department has also implemented a temporary measure to collect on payroll and employer withholding debts. This measure allows employers to enter into payment plans with the Treasury Department, subject to the employer making a down payment of 25%, in the case of payroll debts, and 40%, in the case of employer withholding debts, of the total outstanding debt. The payment plans do not provide for the abatement of interest, surcharges and penalties and the same must have been initiated on or before June 30, 2011. As of June 31, 2011, 216 employers entered into payment plan agreements in the amount of $5.5 million and made down payments in the amount of $1.7 million.

Transfers to General Obligation Redemption Fund

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

Components of General Fund Expenditures

Grants and Subsidies

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

Personal Services

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

Other Services

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

Materials and Supplies

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

Equipment Purchases

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

Capital Outlays and Other Debt Service

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

Transfers to Agencies

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

Other Expenditures

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

Federal Grants

The Commonwealth receives grants under numerous federal programs. Federal grants to the agencies and instrumentalities of the Commonwealth are estimated to be $4.619 billion for fiscal year 2012, a decrease of $405 million, or 8%, from fiscal year 2011. This decrease in federal grants is due to the termination of the ARRA program. Federal grants for fiscal year 2013 are projected at $4.606 billion, which is consistent with the level for fiscal year 2012. The following table presents revenues from federal grants by broad program areas, which are accounted in the central accounting system of the Treasury Department. The figures for fiscal years 2009 through 2011 are actual figures. The figures for fiscal year 2012 and 2013 are the amounts included in the respective adopted budgets.

The Commonwealth expects to receive a total of approximately $7.090 billion in stimulus funds from ARRA, of which $509 million, $2.68 billion and $2.18 billion were disbursed by the government during fiscal years 2009, 2010 and 2011, respectively. The amount of $916 million is expected to be disbursed by the government during fiscal year 2012 and $680 million is expected to be disbursed in fiscal year 2013. As of May 11, 2012, approximately $6.1 billion in ARRA funds, or 86% of awarded funds, had been disbursed. The table below only included the portion of these funds disbursed by agencies whose accounting systems are centralized in the Treasury Department.

The Commonwealth of Puerto Rico
Federal Grants*
(in thousands)

	2009	2010	2011	2012(1)	2013(2)
Education	$1,813,455	$1,270,589	$1,364,393	$1,028,471	$1,018,238
Social Services	2,453,605	2,481,447	2,431,381	2,413,800	2,409,232
Health	583,190	655,060	472,983	491,287	481,299
Labor and Human Resources(3)	277,127	138,425	225,090	101,063	94,046
Crime	64,155	29,459	35,826	42,590	31,695
Housing(4)	416,667	534,987	340,728	394,060	437,046
Drug and Justice	53,067	21,628	21,968	24,339	26,952
Agriculture and Natural Resources	114,920	25,501	14,960	14,576	14,713
Contributions to Municipalities	47,656	60,559	52,087	43,698	28,348
Other	67,017	73,813	64,219	64,687	64,539
TOTAL	$5,890,859	$5,291,468	$5,023,635	$4,618,571	$4,606,108

* Does not include grants received by agencies whose accounting systems are not centralized at the Treasury Department.
(1) Preliminary, unaudited.
(2) Budget.
(3) Amounts include grants to the Right to Work Administration and the Occupational Development and Human Resources Council.
(4) Amounts include grants to the Public Housing Administration.

Source: Office of Management and Budget

BUDGET OF THE COMMONWEALTH OF PUERTO RICO

Office of Management and Budget

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

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

Budgetary Process

The fiscal year of the Commonwealth begins each July 1. The Governor is constitutionally required to submit to the Legislative Assembly an annual balanced budget of total resources, capital improvements, and operating expenses of the central government for the ensuing fiscal year. The annual budget is prepared by OMB, in coordination with the Planning Board, the Treasury Department, 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 resources estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided by law."

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

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

Financial Control and Adjustment Procedures

Revenue estimates for budgetary purposes are prepared by the Treasury Department, except for estimates of federal grants, which are prepared by OMB based on information received from the various departments and other recipients of such grants. Revenue and federal grant estimates are under continuous review and, if necessary, are revised during the fiscal year.

Fiscal control over expenditures is exercised by the Governor, through the Director of OMB, and the Secretary of the Treasury.

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

A Budgetary Fund was created by Act No. 147 of June 18, 1980, as amended (the "Budgetary Fund"), to cover the appropriations approved in any fiscal year in which the revenues available for such fiscal year are insufficient, to secure the payment of public debt, and to provide for unforeseen circumstances in the provision of public service. An amount equal to one percent of the General Fund net revenues of the preceding fiscal year is required to be deposited annually into the Fund. In addition, other income (not classified as revenues) that is not assigned by law to a specific purpose is also required to be deposited in the Budgetary Fund. The maximum balance of the Budgetary Fund may not exceed 6% of the total appropriations included in the budget for the preceding fiscal year. During the last fiscal years, the Legislative Assembly approved joint resolutions to halt temporarily the deposit of funds into the Budgetary Fund, and such funds were used instead to cover the budgetary deficits. As of May 1, 2012, the balance in the Budgetary Fund was $3.1 million.

An Emergency Fund was created by Act No. 91 of June 21, 1966 ("Act 91 of 1966"), as amended (the "Emergency Fund"), to cover unexpected public needs caused by calamities, such as wars, hurricanes, earthquakes, droughts, floods and plagues, and to protect people's lives and property and the public sector credit. The Emergency Fund is capitalized annually with an amount totaling no less than one percent of the General Fund net revenues of the preceding fiscal year. Act No. 91 was amended in 2003 to set an upper limit to the Emergency Fund of $150 million at the beginning of the fiscal year. Act No. 91 was further amended in 2005 to authorize the disbursement of funds from the Emergency Fund to cover certain General Fund expenditures and operational costs of the State Emergency Management Agency and authorized GDB to lend to the Commonwealth up to $150 million to replenish the Emergency Fund to provide funding for emergency and disaster needs. As of March 31, 2013, the balance in the Emergency Fund was $0.7 million and $8.4 million was available to be borrowed from GDB. Joint Resolution No. 60 of July 1, 2011 authorized the conversion of this loan into a revolving line of credit with the same authorized limit of $150 million.

Appropriations

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

(i) *General Fund appropriations for recurring ordinary operating expenses of the central government and of the Legislative Assembly*. These are made by a single annual law known as the Joint Resolution of the General Budget.

(ii) *General Fund appropriations for special operating expenses, for contributions to municipalities, the University of Puerto Rico and the Judicial Branch, and for capital expenditures*. These are authorized by separate law.

(iii) *Disbursements of Special Funds for operating purposes and for capital improvements.* For the most part, these 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*. Expenditures of these funds occur in one or more years.

In Puerto Rico, the central government performs many functions, which in the fifty states are the responsibility of local governments, such as providing public education, police and fire protection. The central government also provides significant annual grants to the University of Puerto Rico and to the municipalities. In addition, the Commonwealth appropriates annually to the Judicial Branch an amount equal to 4% of the average annual revenue from internal sources for each of the two preceding fiscal years. This percentage may be increased upon review, with scheduled reviews every five years.

For fiscal year 2011, approximately 25% of the General Fund was committed to the payment of fixed charges such as municipal subsidies, grants to the University of Puerto Rico, mandated funding for the Judicial Branch, rent payments to PBA, and debt service on the direct debt of the Commonwealth (excluding debt service that was refinanced, as discussed below). This proportion is expected to remain stable in fiscal years 2012 and 2013.

For fiscal year 2009, over 64% of the controllable funds portion of the General Fund was committed for the payment of the central government payroll (not including the University of Puerto Rico and the Judicial Branch). This percentage has decreased gradually. In fiscal year 2014, it is expected that this percentage will average 54% due mainly to headcount reduction estimates resulting from Act 70 retirements during Fiscal Year 2013 and estimates of slightly abnormal attrition rates resulting from adoption of Act 3.

The following table shows a breakdown between controllable and non-controllable General Fund expenses for fiscal years 2012 through 2014. The following expenses are categorized as controllable in the table: utility payments to public corporations and all contributions to the government retirement systems, including, among others, regular payroll contributions, Act 70 annuities, incremental Act 114 and Act 116 payroll contributions, voluntary additional appropriations and special laws. The increase in rent payments shown in the table below corresponds to the planned payment in full by PBA of its debt service, and the corresponding effect on rent estimated to the General Fund. During prior fiscal years 2012 and 2013, PBA refinanced its debt service, leading to substantially lower rent payments. See "Recent Measures to Address Fiscal Condition and Promote Economic Growth" under "THE ECONOMY".

Expenses Breakdown for the General and Stabilization Funds
(in millions)

	2012	2013	2014*
Non-Controllable Expenses			
Mandated Expenses (Formula)			
Contributions to Municipalities	$ 353	$ 363	$ 363
University of Puerto Rico	772	757	834
Judicial Branch	343	343	343
Rent Payments to Public Buildings Authority	212	208	384
General Obligation Debt Service	179	148	162
Other Debt Service	597	417	496
Total of Non-Controllable Expenses	$2,456	$2,236	$2,582
Percent of Total General Fund Expenses	27%	25%	26%
Controllable Expenses	$6,801	$6,847	$7,253
Payroll and Related Costs(1) (2)	$3,973	$4,018	$3,948
Payroll as a Percentage of Controllable Expenses	58%	59%	54%
Total General & Stabilization Funds Expenses	$9,257	$9,083	$9,835

* Proposed 2014 Budget
(1) Excludes University of Puerto Rico and the Judicial Branch.
(2) Includes the Schoolwide Program teachers payroll appropriated in the Non-Distributed Allocations expense category
Source: *Office of Management and Budget*

Budget for Fiscal Year 2013

The following table presents a summary of the adopted Commonwealth's central government budget for the fiscal year ending June 30, 2013.

Commonwealth of Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ending June 30, 2013
(in thousands)*

	General and Stabilization Fund	Bond Fund	Special Funds	Total
Revenues from internal sources:				
Property taxes	$ 0	-	$ 116,843	$ 116,843
Personal income taxes	2,107,000	-	-	2,107,000
Retained non-resident income tax	942,000	-	-	942,000
Corporate income taxes	1,623,000	-	-	1,623,000
Partnership income taxes	2,000	-	-	2,000
Tollgate taxes	7,000	-	-	7,000
17% withholding tax on interest	7,000	-	-	7,000
10% withholding tax on dividends	27,000	-	-	27,000
Inheritance and gift taxes	5,000	-	-	5,000
Sales and use taxes	691,000	-	-	691,000
Excise taxes:		-	-	
Alcoholic beverages	290,000	-	-	290,000
Foreign (Act 154)	1,750,000	-	-	1,750,000
Motor vehicles and accessories	400,000	-	-	400,000
Cigarettes	173,000	-	-	173,000
Other (excise taxes)	78,000	-	740,426	818,426
Licenses	79,000	-	-	79,000
Miscellaneous non-tax revenues:		-	-	
Contributions from lottery fund	43,000	-	-	43,00
Electronic lottery	65,000	-	-	65,000
Registration and document certification fees	168,000	-	-	168,000
Other	70,000	-	335,788	405,788
Total revenues from internal sources	8,527,000	-	1,193,057	9,720,057
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	219,000	-	-	219,000
Federal grants(1)	0	-	4,606,108	4,606,108
Customs	4,000	-	-	4,000
Total revenues from non-Commonwealth sources	223,000	-	4,606,108	4,829,108
Total revenues	8,750,000	-	5,799,165	14,549,165
Other:				
Balance from previous year	0	-	735,006	735,006
COFINA Stabilization Fund	332,700	-	-	332,700
Bonds authorized	0	-	-	0
Total other sources	332,700	-	735,006	1,067,706
Total resources	9,082,700	-	6,534,171	15,616,871
Appropriations:				
Current expenses:				
General government	901,948	-	49,473	951,421
Education	3,076,357	-	1,356,121	4,432,478
Health	1,373,089	-	499,454	1,872,543
Welfare	437,747	-	2,623,224	3,060,971
Economic development	157,413	-	102,654	260,067
Public safety and protection	1,526,716	-	115,847	1,642,563
Transportation and communication	144,912	-	52,212	197,124
Housing	18,975	-	383,318	402,293
Contributions to municipalities	400,664	-	567	401,231
Special pension contributions	489,558	-	0	489,558
Debt service	148,437	-	116,843	265,280
Other debt service (appropriations)	406,884	-	745,595	1,152,479
Total appropriations – current expenses	9,082,700	-	6,045,308	15,128,008
Capital improvements	0	-	115,274	115,274
Total appropriations	9,082,700	-	6,160,582	15,243,282
Year-end balance	0	-	373,589	373,589
Total appropriations and year-end balance	$9,082,700	-	$6,534,171	$15,616,871

* Totals may not add due to rounding.

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

Sources: Treasury Department and Office of Management and Budget

For the fiscal year ending June 30, 2013, the Treasury Department mid-year revenue projections review estimates General Fund revenues amounting to $8.305 billion, which represents a shortfall of $445 million in relation to beginning revenue estimates of $8.750 billion. This shortfall is expected to continue to be reduced mostly in part due to a tax amnesty that has been signed into law and projects to generate revenues of up to $200 million, as well as additional administrative measures aimed at reducing tax evasion and maximizing collections. The numbers above do not include April collections. Revenue estimates are expected to be supplemented by spending side measures aimed at reducing the remaining gap.

Proposed Budget for Fiscal Year 2014

The following table presents a summary of the proposed Commonwealth's central government budget for the fiscal year ending June 30, 2014, as submitted by the Governor to the Legislative Assembly on April 25, 2013. As of this date of this Commonwealth Report, the Legislative Assembly was holding hearings on and evaluating the proposed budget. The Legislative Assembly could make substantial changes to the proposed budget.

Commonwealth of Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ending June 30, 2014
(in thousands)*

	General and Stabilization Fund	Bond Fund	Special Funds	Total
Revenues from internal sources:				
Property taxes	$ 0	-	$ 113,526	$ 113,526
Personal income taxes	2,071,000	-	-	2,071,000
Retained non-resident income tax	820,000	-	-	820,000
Corporate income taxes	1,439,000	-	-	1,439,000
Partnership income taxes	1,000	-	-	1,000
Tollgate taxes	4,000	-	-	4,000
17% withholding tax on interest	6,000	-	-	6,000
10% withholding tax on dividends	37,000	-	-	37,000
Inheritance and gift taxes	3,000	-	-	3,000
Sales and use taxes	1,607,000	-	-	1,607,000
Excise taxes:		-	-	
Alcoholic beverages	284,000	-	-	284,000
Foreign (Act 154)	1,956,000	-	-	1,956,000
Motor vehicles and accessories	432,000	-	-	432,000
Cigarettes	216,000	-	-	216,000
Other (excise taxes)	179,000	-	653,616	832,616
Licenses	14,000	-	-	14,000
Miscellaneous non-tax revenues:		-	-	
Contributions from lottery fund	19,000	-	-	19,00
Electronic lottery	101,000	-	-	101,000
Registration and document certification fees	100,000	-	-	100,000
Other	124,000	-	474,909	598,909
Total revenues from internal sources	9,413,000	-	1,242,051	10,655,051
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	222,000	-	-	222,000
Federal grants(1)	0	-	4,599,017	4,599,017
Customs	0	-	-	0
Total revenues from non-Commonwealth sources	222,000	-	4,599,017	4,821,017
Total revenues	9,635,000	-	5,841,068	15,476,068
Other:				
Balance from previous year	0	-	373,589	373,589
Reconstruction Fund (Financing)	200,000	-	-	200,000
Bonds authorized	0	-	-	0
Total other sources	200,000	-	373,589	573,589
Total resources	9,835,000	-	6,214,657	16,049,657
Appropriations:				
Current expenses:				
General government	940,732	-	69,908	1,010,640
Education	3,382,167	-	1,252,719	4,634,886
Health	1,390,241	-	492,499	1,882,640
Welfare	438,086	-	2,628,994	3,067,080
Economic development	162,302	-	113,759	276,061
Public safety and protection	1,566,293	-	111,368	1,677,661
Transportation and communication	141,339	-	59,642	200,981
Housing	19,359	-	408,991	428,350
Contributions to municipalities	402,095	-	567	402,662
Special pension contributions	734,222	-	0	734,222
Debt service	162,237	-	113,526	275,763
Other debt service (appropriations)	495,927	-	679,831	1,175,758
Total appropriations – current expenses	9,835,000	-	5,931,804	15,766,804
Capital improvements	0	-	123,720	123,720
Total appropriations	9,835,000	-	6,055,524	15,890,524
Year-end balance	0	-	159,133	159,133
Total appropriations and year-end balance	$9,835,000	-	$6,214,657	$16,049,657

* Totals may not add due to rounding.
(1) Does not include grants received by agencies whose accounting systems are not centralized in the Treasury Department.
Sources: Treasury Department and Office of Management and Budget

The proposed budget for fiscal year 2014 provides for total resources of $16.050 billion, of which $9.835 billion are General Fund resources. General Fund resources include $200 million in deficit financing to be provided by GDB or third party lenders.

The principal changes in the fiscal year 2014 budgeted General Fund revenues compared to fiscal year 2013 are accounted mainly by the projected collections from the Sales Tax (up $1.055 billion attributed mostly to the elimination of various exemptions to the application of the Sales Tax) , corporate income tax (down $139.0 million), withholding taxes on non-residents (down $140.0 million), alcoholic beverage (down $3.0 million), excise taxes on motor vehicles and accessories (up $16.0 million), projected increases in excise tax under Act 154 (up 317 million), and personal income taxes (up $54.0 million).

The proposed budget for fiscal year 2014 provides for total expenditures of $15.890 billion (of which $9.835 billion correspond to the General Fund), consisting of $4.635 billion for education, $3.067 billion for welfare, $1.678 billion for public safety and protection, and $6.387 billion for other expenses, expecting a $159 million year-end balance. The increase in proposed budget General Fund expenses for fiscal year 2014 totals $753 million. The main drivers of this increase are incremental debt service, additional contributions to government employee retirement systems, increases in funding pursuant to the University of Puerto Rico appropriation formula due to legislation approved which changes the basis for formula calculation; and an increase in the budget to the Department of Education which operated partially during Fiscal Year 2013 with a non-recurring, carry-forward surplus reserve from prior fiscal years.

Proposed incremental debt service from the General Fund of $297 million contemplates $205 million in additional general obligation and PBA debt service in order to reduce reliance on debt restructuring; proposed assumption of $50 million in certain municipal obligations previously payable from municipal share of the Sales Tax; and $47 million in other incremental debt service, including debt repayment from the General Fund to GDB.

Proposed incremental retirement system contributions from the General Fund of $245 million includes proposed additional appropriations of $140 million for increasing the liquidity and solvency of the Employees Retirement System, in excess of those appropriations provided for by Act 3; additional $30 million for increasing the liquidity and solvency of the Teachers Retirement System upon implementation of its structural reform; additional $46 million for 1% additional employer payroll contribution to the Employees Retirement System and the Teachers Retirement System pursuant to Act 114 and Act 116; additional $37 million to increase annuity payments for employees retired during Fiscal Year 2013 pursuant to Act 70; and net decrease of $8 million payable from the General Fund for special laws payable to the Employees Retirement System and the Teachers Retirement System, after implementation of Act 3.

Proposed incremental appropriation to the Department of Education from the General Fund of $120 million – net of higher rent payments to the PBA – substitutes funding of Fiscal Year 2013 expenses which were partially funded by a non-recurring, carry-forward reserve of prior year surpluses totaling $105 million; and which reinforces Commonwealth funding in light of declining levels of federal funding. Proposed appropriations to the University of Puerto Rico increased $77 million due to legislation which, among other changes, restored certain revenue sources which had been excluded by Act 7.

Differences between Budget and Basic Financial Statements

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

(i) The budgetary accounts are on a cash basis, while financial statements prepared by the Treasury Department 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 or amounts not budgeted for a particular fiscal year, but expended during that year, and, conversely, may exclude amounts appropriated for such fiscal year but not expended until later periods.

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

LITIGATION

General. The Commonwealth is a defendant in numerous legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Act No. 104 of June 25, 1955, as amended ("Act 104"), persons are authorized to sue the Commonwealth only for causes of actions specified in said Act. The Commonwealth may be liable under Act 104 for damages up to a maximum amount of $75,000, or $150,000 if the suit involves actions for damages to more than one person or where a single injured party is entitled to several causes of action.

Under certain circumstances, as provided in Act No. 9 of November 26, 1975, as amended, the Commonwealth may provide its officers and employees, including directors of public corporations and government instrumentalities and mayors of the municipalities of the Commonwealth, with legal representation, as well as assume the payment of any judgment that may be entered against them. There is no limitation on the amount of the judgment that may be paid under the Act in cases before federal court, but in all other cases the Puerto Rico Secretary of Justice may determine whether, and to what extent, the Commonwealth will assume payment of such judgment.

With respect to pending and threatened litigation (5,403 cases) excluding the litigation mentioned in the following paragraphs, as of December 31, 2012 the Commonwealth has included in its financial statements reported liabilities of approximately $500 million for awarded and anticipated unfavorable judgments. Such amount represents the amount estimated at the time as a probable liability or a liability with a fixed or expected due date, which would require future available financial resources for its payment. The amounts claimed exceed $12billion; however, the ultimate liability cannot be presently determined. The Commonwealth believes that the claims are excessive and that the ultimate liability in excess of amounts provided in the financial statements, if any, would not be significant.

Recovery of Medicaid Funds. The Commonwealth is a defendant in two lawsuits filed, one in Commonwealth court and one in the U.S. District Court for the District of Puerto Rico, by certain Federally Qualified Health Centers ("FQHC") seeking to recover from the Commonwealth approximately $800 million in Medicaid wraparound payments which the Department of Health failed to make since 1997. In June 2004, the Superior Court of the Commonwealth in San Juan determined that the Commonwealth must make Medicaid "wraparound" payments to the health centers to cover the difference between the reimbursement they are owed and what they are paid by managed care organizations. The Court of Appeals of Puerto Rico, however, upheld a partial ruling allowing the Commonwealth to deduct from the payments due to the FQHCs certain grants received by these centers from the federal government. Currently, attorneys in the case filed in Commonwealth court are trying to determine the amounts due to FQHCs thereunder.

With respect to the federal case, in February 2005, the U.S. Court of Appeals (First Circuit) upheld a preliminary injunction issued by the U.S. District Court for the District of Puerto Rico requiring the Commonwealth to make Medicaid "wraparound" payments to the health centers. In December 2008, the U.S. Court of Appeals determined that the U.S. District Court erred when it vacated the preliminary injunction entered against two of the FQHCs and determined that the Department of Health had met its obligations to establish and implement a payment system for FQHCs in compliance with the federal Medicaid statute. The U.S. Court of Appeals reversed the District Court's order vacating the preliminary injunction and remanded the case for further proceedings.

Recently, the Court entered a preliminary injunction as to the remaining 15 health centers, and granted a request by the Department of Health for Eleventh Amendment sovereign immunity. The plaintiff FQHCs immediately filed an appeal regarding the issue of Eleventh Amendment.

Meanwhile, the Department of Health filed a counter appeal regarding the Court's interpretation of certain components of the wraparound formula that must be used under the preliminary injunction to calculate wraparound payments owed to the plaintiffs. The Department has already made approximately $40 million in uncontested wraparound payments owed under the injunction. However, the Court granted the Department's request for a stay pending appeal regarding payment of an additional $29 million that are owed under the Court's wraparound formula. This sum has already been consigned with the Court pending appeal or otherwise deposited in specially earmarked accounts, but may have to continually be increased to reflect the difference between the amounts owed under the Court's formula and the Department's formula since the consignment.

As of December 31, 2012, the Commonwealth accrued $500 million in its financial statements for this legal contingency.

Special Education Students. The Commonwealth is also a defendant in a class action presented in 1980 by parents of special-education students before Commonwealth courts alleging that the Puerto Rico Department of Education had failed to provide legally required special education and related services. In February 2002, the court issued a judgment approving the stipulations reached by the parties regarding the manner special education services should be provided. Since December 2002, the Department of Education has paid fines for not complying with the stipulations reached. The fines were originally set in the amount of $1,000 daily, and were raised to $2,000 daily in January 2006. In February 8, 2010, the court issued a resolution advancing its intention to establish a new scheme of fines ranging from $0.25 to $0.75 daily per registered student. As of December 31, 2012, there were 121,339 students registered in the Special Education Program, but this number changes frequently since new claims are filed constantly. Said resolution also creates a new scheme of monitoring compliance with the stipulations, including the added participation of 12 experts (each party has the right to designate 2 experts) in 6 areas of expertise. Said monitoring scheme began on July 1, 2010.

The February 2002 judgment only disposed of the injunctive relief sought by plaintiffs. Still pending before the court are individual claims for damages regarding the failure to provide adequate services. Since, in 2005, the Court of First Instance denied damages for the class as a whole. The plaintiffs appealed the decision and, in October 2005, the Court of Appeals decided that there could be no general damages award, but that every member of the class must come forward and prove their individual damages within this case. Assuming the Court grants damages to the plaintiffs, the Commonwealth estimates that each plaintiff could receive at least $5,000. Based on the enrollment of approximately 120,000 students, the total award could amount to at least $600 million. The Commonwealth plans to defend vigorously each case.

The plaintiffs approached the Commonwealth to inquire about its disposition to reach a settlement agreement regarding the damages phase. At the Commonwealth's request, the plaintiffs submitted a settlement offer. Settlement conversations stopped after the parties reached an impasse during negotiations.

As December 31, 2012 the case was stayed until parties agree to a new monitor. Three candidates have being summited for each party and the procedures are expected to continue as of May 2013.

As of December 31, 2012, the Commonwealth had accrued $600 million in its financial statements for this legal contingency.

Police Institutional Reform. The Commonwealth is a defendant in a lawsuit presented by the United States Department of Justice alleging a pattern of civil rights violation and excessive use of force by the officers of the Police Department of Puerto Rico. Parties have reached a settlement agreement which include a deep institutional reform of the Police Department, to be implemented in the next 10 years.

Although the USDOJ's claim does not include damages, the institutional reform will require an investment of at least $600 million. The USDOJ is aware of the implementation costs, and it is willing to sign and submit a joint agreement providing that the Commonwealth allocate $20 million in the first year and the USDOJ $9 million, from the Asset Distribution. Under the agreement, the court will formally dismiss the claim, but retain jurisdiction to assure compliance through the Technical Compliance Advisor.

The Agreement is being reviewed by the parties and is scheduled to be jointly submitted to the court by May 30, 2013.

Pension Reform. As has been the case with each comprehensive pension reform measure enacted in the United States, certain public employees have brought suit challenging the constitutionality of pension reform in Puerto Rico.

As of May 14, 2013, the main case filed against Law 3 involves sixty-eight (68) employees of the Office of the Comptroller of the Commonwealth of Puerto Rico, who filed a Complaint on May 8, 2013, in the Commonwealth of Puerto Rico's Court of First Instance, San Juan Part, alleging that Law 3 is unconstitutional as applied to them. The Complaint alleges that plaintiffs have certain acquired rights under Act 447 and that Law 3 violates the Contract Clause because, although the solvency of the System is a compelling state interest, the State has not shown that the enactment of the law was necessary to promote that interest, nor that there were not less onerous means to advance or achieve that interest.

The Commonwealth of Puerto Rico believes that while claims challenging the constitutionality of Law 3 must run their natural course through the court system, the Commonwealth intends to forcefully defend the constitutionality of Law 3 in all forums.

Other. The Commonwealth and various component units are defendants in other lawsuits alleging violations of civil rights, breach of contract, and other damage claims. Preliminary hearings and discovery proceedings are in progress. No provision for any liability that may result upon adjudication of these lawsuits has been recognized by the Commonwealth. The Commonwealth believes that the ultimate liability, if any, would not be significant.