COMMONWEALTH OF PUERTO RICO

QUARTERLY REPORT DATED JULY 17, 2014

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INTRODUCTION

This Quarterly Report of the Commonwealth of Puerto Rico (the "Commonwealth") is dated as of July 17, 2014, and is intended to update certain information included in the Commonwealth's Financial Information and Operating Data Report dated October 18, 2013 (the "Base Commonwealth Report"), which was supplemented by the Quarterly Report dated February 18, 2014 (the "February Quarterly Report"), and by the Official Statement dated March 11, 2014 (the "Official Statement"), relating to the issuance of the Commonwealth's General Obligation Bonds of 2014, Series A (the "Series 2014 Bonds"). The Base Commonwealth Report, as supplemented by the February Quarterly Report, the Official Statement and this Quarterly Report, is referred to as the "Commonwealth Report."

This Quarterly Report should be read in conjunction with the information contained in the Base Commonwealth Report, the February Quarterly Report and the Official Statement. Unless otherwise stated, the information included herein is current as of June 30, 2014, except for information relating to debt and certain litigation, which is current as of May 31, 2014. The Commonwealth is not updating the Commonwealth Report in its entirety. Therefore, there could be changes to the information set forth in the Commonwealth Report that are not reflected in this Quarterly Report. You should not assume that the information in this Quarterly Report and the other documents that form part of the Commonwealth Report is accurate as of any date other than the respective dates as of which such information is presented in such reports.

The Commonwealth's fiscal year begins on July 1 and ends on June 30 of the following year. References in this Quarterly Report to a particular fiscal year are to the fiscal year ending on June 30 of the same calendar year.

The Commonwealth Report provides an overview of the fiscal and economic condition of the Commonwealth, including historical revenues and expenditures of its General Fund (which is the primary operating fund of the Commonwealth). Although the Commonwealth Report discusses information about certain public instrumentalities, the Commonwealth Report does not, and is not intended to, provide detailed information as to the financial condition of each of the public corporations and instrumentalities.

Forward-Looking Statements

The information included in this Quarterly Report contains certain "forward-looking" statements. These forward-looking statements may relate to the fiscal and economic condition, economic performance, plans, or objectives of the Commonwealth and its instrumentalities. 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 forward-looking statements are not guarantees of future performance and involve certain risks, uncertainties, estimates, and assumptions by the Commonwealth and certain of its instrumentalities that are difficult to predict. The economic and financial condition of the Commonwealth and its instrumentalities 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. 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 or its instrumentalities' projections.

The projections set forth in this Quarterly 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 officers of the Commonwealth and its instrumentalities 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 and certain of its instrumentalities. However, this information is not fact and should not be relied upon as being necessarily indicative of future results, and readers of this Quarterly 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 Quarterly Report, which is solely the product of the Commonwealth and certain of its instrumentalities, and the independent auditors assume no responsibility for its content.

RISK FACTORS

The following discussion of risk factors does not necessarily reflect the relative importance of various factors and is not meant to be a complete list of risks that could materially adversely affect the Commonwealth's financial and economic condition, liquidity, and operations, and could cause the Commonwealth's actual results to differ materially from its historical results or the results contemplated by the forward-looking statements contained herein. Additional risks and uncertainties not currently known by the Commonwealth, or that the Commonwealth does not currently consider to be material, or that are generally applicable to all states and governmental instrumentalities, also may materially and adversely affect the financial condition of the Commonwealth and its ability to repay its bonds and honor its other obligations. Moreover, while some of the risks described below may also affect the Commonwealth's instrumentalities, the Commonwealth Report does not, and is not intended to, identify all the risks associated with each instrumentality. Any one or more of the factors discussed herein, and other factors not described herein, could lead to a decrease in the market value and the liquidity of the Commonwealth's bonds. There can be no assurance that other risk factors not discussed below will not become material in the future.

References to "bonds" in this section shall mean the Commonwealth's general obligation bonds and bonds guaranteed by the Commonwealth, and shall not include bonds issued by any of the Commonwealth's instrumentalities. Some of the risks discussed below, however, also affect Commonwealth appropriation bonds and bonds issued by Commonwealth instrumentalities.

Additional downgrades of the Commonwealth's non-investment grade credit ratings by the rating agencies could continue to raise the Commonwealth's cost of borrowing, which could further adversely affect the Commonwealth's ability to borrow in the future, could adversely affect the market price of outstanding bonds, and may have other adverse effects on the Commonwealth's financial condition.

During the first two weeks of February 2014, the credit ratings of the Commonwealth's general obligation bonds and Commonwealth guaranteed bonds were lowered to "Ba2" by Moody's Investors Service ("Moody's"), "BB+" by Standard & Poor's Rating Services ("S&P"), and "BB" by Fitch Ratings ("Fitch"), each of which is non-investment grade. S&P kept the Commonwealth's ratings on "CreditWatch" with negative implications, while each of Moody's and Fitch assigned a negative outlook on the Commonwealth's ratings.

During the first two weeks of July 2014, each of Moody's, Fitch and S&P lowered the credit rating of the Commonwealth's bonds to B2, BB- and BB, respectively, and all remain on negative outlook.

The market for non-investment grade securities is smaller and less liquid than the market for investment grade securities. As a result, it is possible that there may not be sufficient demand in the bond market, or with private commercial banks or other financial institutions, to enable the Commonwealth to issue any future bonds or notes or enter into borrowings in the amounts required by the Commonwealth or that the cost to the Commonwealth of any such borrowing could be substantially higher than if it were able to issue more highly-rated securities. In addition, changes in the Commonwealth's credit ratings are likely to affect its relationships with creditors and other business counterparties.

The Commonwealth faces a number of fiscal and economic challenges and its liquidity has been adversely affected by recent events. As a result, it may be unable to honor all of its obligations as they come due.

The Commonwealth faces a number of fiscal and economic challenges and its liquidity has been adversely affected by the ratings downgrades described above, by the significant increase in credit spreads for obligations of the Commonwealth and its instrumentalities, by the limited market access experienced by the Commonwealth and its instrumentalities, and by a significant reduction of liquidity in the local Puerto Rico capital markets. As a result, the Commonwealth has relied more heavily on short-term financings and interim loans from Government Development Bank for Puerto Rico ("GDB") and other private lenders, which reliance has constrained its liquidity and increased its near-term refinancing risk. These factors have also resulted in delays in the repayment by the Commonwealth and its instrumentalities of outstanding GDB lines of credit, which delays may limit GDB's ability to continue providing liquidity to the Commonwealth.

Under current market conditions, in part as a result of the Commonwealth's non-investment grade rating and the recent ratings downgrades discussed above, the Commonwealth may have limited market access. The Commonwealth may not be able to honor all of its obligations as they come due if it does not have sufficient access to the capital markets or alternative sources of financing to satisfy its liquidity needs, or as a result of the challenges and risk factors identified in the Commonwealth Report or others not described therein.

GDB, the principal source of short-term liquidity for the Commonwealth, has been adversely affected by recent events and it may be unable to provide necessary financing to the Commonwealth.

GDB serves as the principal source of short-term liquidity for the Commonwealth and its instrumentalities. Similar to the Commonwealth, GDB currently has a non-investment grade credit rating and its credit rating was recently further downgraded. On July 1, 2014, Moody's lowered its credit rating to "B3" and maintained its negative outlook.

GDB's liquidity has been adversely affected by, among other things, some of the same factors that have affected the Commonwealth's liquidity that are described above. Although GDB has previously assisted the Commonwealth in satisfying its obligations, GDB is not legally required to provide such assistance and there is no assurance that it will be able to continue to provide such assistance in the future. To the extent that GDB financing is unavailable, the Commonwealth may be required to find other sources of funding in order to meet its obligations. There is no assurance that the Commonwealth will be able to access other sources of financing or funding sufficient at any one time to meet its obligations as they come due. For a more detailed discussion of GDB's liquidity, see "Liquidity of Government Development Bank."

GDB's fiscal and financial condition depends to a large extent on the repayment of loans made to the Commonwealth and its instrumentalities. GDB may be adversely affected by the inability of the Commonwealth and certain of its instrumentalities that have loans from GDB to fully repay those loans when due. If certain of the Commonwealth's instrumentalities are unable to overcome the challenges described below under "*Significant financial and fiscal challenges facing the Commonwealth's instrumentalities may adversely affect the Commonwealth's* *financial and fiscal condition,*" GDB's financial and fiscal condition may be adversely affected, its balance sheet impaired and its solvency could be threatened.

GDB will make publicly available, substantially concurrently with this Quarterly Report, a revised projection of its liquidity. This projection is subject to the assumptions and disclaimers detailed and discussed therein. A copy of GDB's liquidity projection may be obtained through EMMA at http://emma.msrb.org as a voluntary filing related to debt securities issued by GDB or by visiting GDB's website at http://www.gdbpr.com. No information on GDB's website is deemed to be part of, or is incorporated by reference in, this report.

Significant financial and fiscal challenges facing the Commonwealth's instrumentalities may adversely affect the Commonwealth's financial and fiscal condition.

The Commonwealth's instrumentalities also face significant financial and fiscal challenges. The Commonwealth recently announced that its instrumentalities would be required to achieve self-sufficiency in the near future. The Commonwealth also recently enacted the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the "Recovery Act"), which provides a mechanism for certain Commonwealth public corporations, but not the Commonwealth itself, to restructure their obligations.

To the extent certain instrumentalities do not attain self-sufficiency, such instrumentalities may need to seek relief under the Recovery Act or under other laws which could be enacted in the future regarding insolvency, reorganization, moratorium and similar laws affecting creditors' rights. Moreover, certain of these instrumentalities offer basic and essential services to the population of Puerto Rico. To the extent that any of these instrumentalities is unable to continue to provide such essential services, the Commonwealth may be required to divert available Commonwealth resources to ensure that such services continue to be provided. To the extent Commonwealth resources are diverted to such essential services, the Commonwealth may not have sufficient revenues to honor its obligations as they come due.

The Commonwealth's very high level of debt may affect the performance of the economy and government revenues.

The Commonwealth's very high level of debt and the resulting required allocation of revenues to service this debt have contributed to significant budget deficits during the past several years, which deficits the Commonwealth has been required to finance, further increasing the amount of its debt. More recently, the Commonwealth's high level of debt, among other factors, has adversely affected its credit ratings and its ability to obtain financing at favorable interest rates. The Commonwealth expects that its ability to finance future budget deficits will be severely limited, and, therefore, that it will be required to reduce the amount of resources that fund other important governmental programs and services in order to balance its budget and continue honoring its obligations. While the Commonwealth may seek to reduce or entirely eliminate the practice of financing deficits or debt service, there is no assurance that budgetary balance will be achieved and, if achieved, that such budgetary balance will be based on recurring revenues or expense reductions or that the revenue or expense measures undertaken to balance the budget will be sustainable on an indefinite basis. Moreover, the effort to achieve budgetary balance may adversely affect the performance of the Commonwealth's economy which, in turn, may adversely affect governmental revenues.

As of May 31, 2014, the Commonwealth had outstanding a total of $23.364 billion aggregate principal amount of bonds and notes issued or guaranteed by the Commonwealth or payable from General Fund appropriations, equivalent to approximately 33% of the Commonwealth's gross national product for fiscal year 2013 ($70.740 billion). Debt service on these bonds and notes ($1.365 billion) represents approximately 14% of the General Fund budget for fiscal year 2015 ($9.565 billion). The total outstanding public sector debt of the Commonwealth, its instrumentalities, and municipalities was $72.602 billion as of May 31, 2014, equivalent to approximately 103% of the Commonwealth's gross national product for fiscal year 2013. See "DEBT – Public Sector Debt" below.

In addition to the above, from time to time public corporations and other Commonwealth instrumentalities have had to rely on the General Fund to make payments on debt incurred with GDB or third parties to finance their operating deficits. This practice also affects the liquidity and available resources of the General Fund.

If the Commonwealth's financial condition does not improve, it may need to implement emergency measures.

The Commonwealth has been facing a number of fiscal and economic challenges in recent years due, among other factors, to continued budget deficits, a prolonged economic recession, high unemployment, population decline and high levels of debt and pension obligations. In recent months, the widening of credit spreads for the Commonwealth's public sector debt and the downgrades of the Commonwealth's credit ratings and those of many of its instrumentalities to non-investment grade by Moody's, S&P and Fitch has put further strain on the Commonwealth's liquidity and may affect access to both the capital markets and private sources of financing, as well as the borrowing cost of any such funding.

As discussed in the Official Statement for the Series 2014 Bonds, if the Commonwealth's financial condition does not improve, it may lack sufficient resources to fund all necessary governmental programs and services as well as meet debt service obligations. In such event, it may be forced to take emergency measures. These could include administrative measures that give effect to the "priority norms" established by law for the disbursement of public funds when available Commonwealth resources are insufficient to cover all appropriations (see the information contained in the Base Commonwealth Report under the heading "Financial Control and Adjustment Procedures" under BUDGET OF THE COMMONWEALTH OF PUERTO RICO, which sets forth the constitutional and statutory order of disbursement of public funds in such a situation of insufficiency of resources).

The Commonwealth (like the states of the United States) is not currently eligible to seek relief under Chapter 9 of the United States Bankruptcy Code or under the Recovery Act. In the future, however, the United States Congress or the Legislative Assembly could enact legislation that entitles the Commonwealth, subject to any limitations imposed by the U.S. and Puerto Rico Constitutions, to seek a restructuring, moratorium or other remedy that affects the rights of its bondholders. **The Commonwealth is not currently contemplating any such action.**

The Commonwealth recently enacted the Recovery Act, which provides a mechanism for certain Commonwealth public corporations, but not the Commonwealth itself, to restructure their obligations.

The Commonwealth may be unable to achieve a General Fund budget without deficit financing for fiscal year 2015 and thereafter.

For more than a decade, the Commonwealth has experienced significant General Fund budget deficits. These deficits, including the payment of a portion of the Commonwealth's debt service obligations, have been covered primarily with the net proceeds of bonds issued by the Puerto Rico Sales Tax Financing Authority ("COFINA") and Commonwealth general obligation bonds, with interim financings provided by GDB and, in some cases, with extraordinary one-time revenue measures or expense adjustment measures. The Commonwealth expects that its ability to finance future budget deficits will be severely limited.

For fiscal year 2015, the Commonwealth adopted a budget that does not require additional borrowings, although it includes $344 million of capitalized interest that was borrowed in fiscal years 2012 and 2014 and reduces the additional contribution to the Employees Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities (the "Employee Retirement System" or "ERS") required to be made by the Commonwealth by the pension reform legislation. In order to implement this budget, the Commonwealth adopted a number of emergency measures, including the Fiscal Sustainability Act, discussed in greater detail under "RECENT DEVELOPMENTS – Enactment of Fiscal Sustainability Act." These measures have faced significant opposition from organized labor and other constituencies, which have resulted in protests and work stoppages that could become strikes or otherwise continue for extended periods, imposing significant costs on the Commonwealth's economy. In addition, these measures entail multiple risks, including (i) the estimates of fiscal impact may be incorrect due to forecasting errors or faulty or limited underlying data or calculations, especially since the accounting, fiscal management, and payroll systems of the Commonwealth suffer from substantial historical deficiencies; (ii) some of the assumptions used in the forecasting may turn out to be incorrect; (iii) many of the measures that imply cuts to benefits or activities have faced and will continue to face significant public and political opposition, which may put at risk their implementation; (iv) many of the measures involve substantial implementation challenges and execution risks, and may not be successfully implemented within the required period with the requisite fiscal impact; and (v) some of the public corporations that provide essential services may be unable to achieve economic self-sufficiency, and such failure may impose additional budgetary pressures on the General Fund. Overall, the emergency and corrective measures adopted constitute a comprehensive and aggressive cost cutting and appropriation program, and there can be no guarantee that the Commonwealth will have the operational, managerial or political capacity to carry the program through to successful implementation.

In addition, since the Fiscal Sustainability Act modifies contractual and other acquired rights, there is a possibility that it could be subject to legal challenge, and that such challenge could be successful, rendering ineffective some or all of the contemplated expense reduction measures. In the event of a successful legal challenge, there can be no assurance that the Commonwealth will be able to enact alternative measures to compensate the effect of any expense reduction measures that are invalidated. In addition, given the temporary nature of the Fiscal Sustainability Act, the Commonwealth will face again the same or larger cost escalators at the end of the effective period of the Act. There can be no assurance that the Commonwealth will be able extend the effective period of the Fiscal Sustainability Act.

The Commonwealth's ability to operate within the fiscal year 2015 budget and to operate with a budget without deficit financing in future years also depends on a number of other factors, some of which are not wholly within its control, including the performance of the Commonwealth's economy, that actual collections of taxes meet the Treasury Department's projections, the adoption of additional legislation, the results of the Doral litigation discussed below, and the government's ability to reduce and control governmental expenditures, particularly in areas such as education and healthcare where expenses have in the past exceeded the budget.

The Commonwealth has frequently failed to meet its revenue and expense projections, and its accounting, payroll and fiscal oversight information systems and processes have deficiencies that significantly affect its ability to forecast expenditures. Thus, there can be no assurance that the Commonwealth will be able to collect the projected revenues or achieve the required spending cuts for fiscal year 2015 and achieve a balanced General Fund budget.

In order to operate with a balanced budget beyond fiscal year 2015, the Commonwealth may need to adopt additional legislation in order to raise revenues or implement significant expense cuts, and such legislation could also face significant opposition from the individuals, businesses, and other constituencies affected, as well as from elected officials. There is no assurance that these measures, if enacted, will be successfully implemented or succeed in eliminating the budget deficit.

The Commonwealth may not have sufficient capacity under constitutional debt limitations to continue financing its operations with general obligation debt.

The Commonwealth expects that its capacity to incur additional general obligation debt will be significantly limited for the next several years as a result of the limits imposed by the Constitution of Puerto Rico on the issuance of general obligation debt (as well as the recent downgrade of its bond credit ratings and limited market access). As a result, the Commonwealth may be unable to issue general obligation debt in the future to finance capital improvement projects, provide working capital, and meet short-term obligations. Although the Commonwealth could seek to issue debt for which the good faith, credit and taxing power of the Commonwealth is not pledged, there may not be sufficient demand for such debt. The inability to issue general obligation debt may affect the Commonwealth's ability to make required investment in infrastructure and, thus, adversely affect economic activity in the Commonwealth.

The Commonwealth may continue to pledge its good faith, credit and taxing power to guarantee bonds and notes issued by certain of its instrumentalities.

The Constitution of Puerto Rico provides that the Commonwealth shall not guarantee any obligation evidenced by bonds or notes if (a) the sum of (i) the total amount payable in any fiscal year on account of principal of and interest on all obligations issued by the Commonwealth and (ii) the amount paid by the Commonwealth in the next preceding fiscal year on account of obligations guaranteed by it exceeds (b) 15% of the average of the total annual internal resources of the Commonwealth for the two preceding fiscal years. Therefore, although bonds and notes guaranteed by the Commonwealth are considered public debt and enjoy the same priority of payment protection that is afforded by the Constitution of Puerto Rico to bonds and notes issued by the Commonwealth for which its good faith, credit and taxing power has been pledged, debt service payable on such guaranteed obligations is <u>not</u> taken into consideration for purposes of the Constitutional debt limit <u>unless</u> the Commonwealth is required to pay such debt service pursuant to its guarantee. Accordingly, the Commonwealth may continue to guarantee bonds and notes issued by its instrumentalities as long as the 15% limitation is not exceeded. As of May 31, 2014, there were outstanding $5.6 billion of such guaranteed obligations.

The Commonwealth has statutory authority to provide additional guarantees until the 15% limitation is reached. As of May 31, 2014, the Commonwealth was authorized to guarantee approximately $4.6 billion of Puerto Rico Public Building Authority ("PBA") obligations, of which approximately $4.2 billion aggregate principal amount is currently outstanding, and $2 billion of obligations of GDB and certain instrumentalities, of which approximately $377 million is currently outstanding.

The Constitution of Puerto Rico may be amended to increase the debt limit and allow the Commonwealth to incur additional general obligation debt.

Although the Constitution of Puerto Rico provides holders of general obligation debt certain protections, the Constitution of Puerto Rico may be amended to modify the provisions regarding public debt, such as raising the debt limit. Although amending the Constitution of Puerto Rico may be difficult (it requires the approval of at least two-thirds of the members of the House of Representatives and the Senate, and the approval of a majority of voters in a referendum of qualified voters), an amendment of this nature could be proposed and, if proposed, could be approved. As a result of an amendment of this nature, the Commonwealth could be authorized to incur general obligation debt, or guarantee bonds and notes of instrumentalities, in excess of the current debt limit. No assurance can be given, as a result, that the Constitutional debt limit will remain at its current level.

The Commonwealth's debt service will increase significantly in fiscal year 2016.

A portion of the proceeds from the issuance of the Series 2014 Bonds and from a 2012 bond issuance will be used to pay interest on such bonds. As a result, the Commonwealth General Fund budget will not include the total amount of interest on these bonds during fiscal years 2014 and 2015. Beginning in fiscal year 2016, the Commonwealth will be required to begin paying the total amount of interest on these bonds from its General Fund, which amount will be significant.

If the Commonwealth is unable to obtain financing through the issuance of tax and revenue anticipation notes, it may not have sufficient resources to maintain its operations.

The majority of the Commonwealth's General Fund revenues is received in the second half of the Commonwealth's fiscal year (January 1 through June 30). Expenditures from the General Fund occur more evenly throughout the fiscal year. The Commonwealth customarily addresses this timing difference by making use of internal revenues and by issuing short-term notes in the capital markets or to private financial institutions. Internal revenues consist principally of excise taxes and income taxes, a significant portion of which are received during the second half of the fiscal year, and sales and use taxes, which are received once the amounts due to COFINA have been transferred. External borrowing to cover this intra-year cash flow imbalance is typically done with tax and revenue anticipation notes that are payable later in the fiscal year in which they are issued. Due to the Commonwealth's financial challenges, it is uncertain whether private financial institutions will participate in the Commonwealth's tax and revenue anticipation note program for fiscal year 2015 or any subsequent fiscal year or whether the Commonwealth will be able to issue such notes in the capital markets. To the extent the

Commonwealth is unable to sell its tax and revenue anticipation notes to private financial institutions or access the capital markets therefor, GDB may be asked to finance a greater portion of the Commonwealth's cash flow needs. There is no assurance that GDB will be able to finance the Commonwealth's tax and revenue anticipation note program in the amounts required by the Commonwealth.

To the extent that GDB financing is not available, the Commonwealth may be unable to timely fund its operations during fiscal year 2015 or during any subsequent fiscal year. This may require the Commonwealth to adopt some of the emergency measures described above in "*If the Commonwealth's financial condition does not improve, it may need to implement emergency measures that may include a restructuring, moratorium or other actions affecting creditors' rights*" above.

The Commonwealth is dependent on a small number of corporate taxpayers to generate a significant amount of the Commonwealth's tax revenues.

As a result of the economic recession that has affected the Commonwealth since fiscal year 2007 and an income tax reduction program adopted in fiscal year 2011 to promote economic activity, the Commonwealth's revenues have decreased since fiscal year 2007. The special temporary excise tax imposed by Act 154-2010, as amended ("Act 154"), has become one of the Commonwealth's principal sources of tax revenues. For fiscal years 2012, 2013 and 2014, the revenues produced by Act 154 represented approximately 21.6%, 19.7%, and 20.3%, respectively, of the Commonwealth's General Fund revenues. During fiscal year 2013, the special temporary excise tax was paid by 27 groups of affiliated taxpayers, of which six groups accounted for approximately 75% of collections. To the extent that any of these groups of affiliated taxpayers reduces or moves its operations to a different jurisdiction, the Commonwealth's tax base would be reduced and its revenues would be adversely affected. Factors that can cause a reduction in the level of Act 154 revenues include a reduction in the level of local economic activity of the corporations that pay the Act 154 taxes, which might occur as a result of general economic conditions or factors affecting individual companies, any difficulties in the transition, after December 31, 2017, from the Act 154 temporary excise tax to the modified source of income rule under Act 154, and any action by the U.S. Treasury Department to reduce or eliminate the federal income tax credit available with respect to the Act 154 temporary excise tax. For a discussion of Act 154, see *Act 154* under **Major Sources of General Fund Revenues** in the Base Commonwealth Report.

In addition, after December 31, 2017, the special temporary excise tax will no longer apply and will be replaced by the "modified source of income rule" under Act 154. There is no assurance that the level of tax collection under the "modified source of income rule" will be sufficient to replace the tax revenues currently received by the Commonwealth pursuant to the special temporary excise tax under Act 154. To the extent the Commonwealth is unable to replace these tax revenues with revenues under the "modified source of income rule," it may not have sufficient revenues to fully fund its operations. This may require the Commonwealth to adopt some of the emergency measures described above in "*If the Commonwealth's financial condition does not improve, it may need to implement emergency measures that may include a restructuring, moratorium or other actions affecting creditors' rights.*"

The Commonwealth's projections for tax revenues involve many assumptions, the effects of which are beyond the control of the Commonwealth, such as the impact of external factors and events on the economy that may, in turn, affect tax revenues. The projections also require the forecasting of new revenue measures with no historical collections experience. In the past, the Commonwealth's projections of tax revenues have differed materially from what the Commonwealth has been able to achieve. As a result, there is no assurance that the Commonwealth will achieve its tax revenue projections and, to the extent the Commonwealth fails to achieve such projections, the Commonwealth may need to implement further expenditure reductions or revenue enhancing measures in order to meet its obligations as they come due.

A reduction of federal grants may significantly affect the Commonwealth's ability to provide many important services and may force the Commonwealth to allocate resources that would otherwise be used to pay debt service to the provision of such essential services.

Each fiscal year, the Commonwealth receives a significant amount of grant funding from the U.S. government. A significant portion of these funds is utilized to cover operating costs of those Commonwealth's educational, social services and healthcare programs that are subsidized by the U.S. government. If the aggregate amount of federal grant funds transferred to the Commonwealth were to be reduced, the Commonwealth would have to make reductions to these federally-supported programs or fund these programs from the General Fund. Reductions in federal funding would have an adverse impact on the Commonwealth's economy and on efforts to reduce its General Fund budget deficit. In addition, since the per capita income of the residents of Puerto Rico is substantially lower than those of the 50 states, a high percentage of the population of the Commonwealth benefits from these government programs. As a result, the impact on the Puerto Rico economy of any reduction in federal grant funds for such governmental programs would be greater than on the 50 states. Moreover, to the extent the Commonwealth is required to divert resources to continue providing essential services primarily funded through federal funds, the Commonwealth may be unable to honor its other obligations as they come due.

Another important factor is that certain federally funded programs are funded on a per-capita basis and a reduction in the number of beneficiaries due to demographic trends or changes in program parameters could result in a lower amount of federal funds. For instance, the Department of Education has experienced a substantial reduction in student enrollment in recent years which is expected to continue for the foreseeable future. Such reduction has been and will continue to be accompanied by a corresponding reduction in federal funding for some educational grants. To the extent that the cost saving opportunities presented by the reduction in the number of students are not fully realized, the net budgetary effect on the Department of Education of the reduction in student enrollment could be negative.

See the information contained in the Base Commonwealth Report under the heading "Components of General Fund Expenditures – Federal Grants" under PUERTO RICO TAXES, OTHER REVENUES, AND EXPENDITURES.

The Commonwealth's ability to achieve and maintain a budget without deficit financing depends in part on its ability to control its education costs, which represent a very high percentage of its budgetary expenditures, and the Commonwealth has had difficulty controlling such costs.

The budget appropriation for the Commonwealth's Department of Education has historically represented a significant portion of the total General Fund budget. Moreover, the

Commonwealth's accounting, payroll and fiscal oversight information systems have deficiencies that have significantly affected its ability to control Department of Education expenditures. As a result, the Department of Education has often produced annual operating expense overruns. Due to the considerable size of the Department of Education budget, the Commonwealth's ability to achieve and maintain a General Fund budget without deficit financing depends on its ability to monitor and control the Department of Education's expenditures.

There is no assurance that the Department of Education budget estimates for fiscal year 2015 will be achieved or that the Commonwealth will be able to continue to maintain sufficient cost and expenditure controls at the Department of Education in order to prevent future budget overruns.

The Commonwealth's healthcare costs represent a very high percentage of its budgetary expenditures, and the Commonwealth may be unable to continue to fund such healthcare costs.

The Commonwealth, through its Health Insurance Administration ("PRHIA"), provides health insurance coverage to approximately 1.63 million qualifying (generally low-income) residents of Puerto Rico through the "Mi Salud" government health plan. The cost of Mi Salud is very significant, and a substantial portion of this cost is paid by the federal government and funded principally by non-recurring funding provided pursuant to the federal Patient Protection and Affordable Care Act ("ACA"), as well as recurring Medicaid and Children's Health Insurance Program ("CHIP") funds, which in the case of the Commonwealth are capped at a level lower than that applicable to the states (which are not capped).

Upon exhaustion of the non-recurring ACA funds, currently estimated to occur in 2018, and absent Congressional action to renew the ACA funding, the amount of federal funds available for Mi Salud will revert to the recurring capped Commonwealth Medicaid and CHIP allocations, which would result in significantly higher requirements of Commonwealth funding, unless benefits or eligibility is reduced significantly. Although the Commonwealth can take various measures to address the imbalance, including reducing coverage and limiting eligible beneficiaries, federal regulations may prohibit or limit the application of these measures.

Assuming that the availability of ACA funds is not renewed through Congressional action and that no changes to benefits, co-pays and eligibility are made, the annual deficit of Mi Salud (which the General Fund may be required to fund) could rise to as much as $2.0 billion by fiscal year 2019. In addition, there is a possibility that the cost of providing services to beneficiaries upon expiration of the existing contracts with Mi Salud's insurance providers in May of 2015 will rise materially, including in excess of the levels considered in the PRHIA budget. See "RECENT DEVELOPMENTS – Health Care Update."

The fiscal stability of Mi Salud is one of the largest budgetary challenges facing the Commonwealth, especially if the availability of ACA funds is not renewed or Medicaid funds are not significantly increased. In light of the current disparity in the treatment that the Commonwealth receives compared with the states with respect to the cap imposed on Medicaid matching funds, the Commonwealth intends to intensify its efforts to have ACA funding renewed by Congress for Mi Salud. However, it is not possible to predict the likelihood that such efforts will succeed, and the Commonwealth will continue evaluating the fiscal structure of the program taking into consideration the current federal funding depletion estimates. To the extent these efforts are unsuccessful, it is unlikely that the Commonwealth would be able to assume a significantly higher portion of the cost of Mi Salud. If the Commonwealth is unable to reduce these healthcare costs, it may be required to adopt some of the emergency measures described above in "*If the Commonwealth's financial condition does not improve, it may need to implement emergency measures that may include a restructuring, moratorium or other actions affecting creditors' rights.*"

The Commonwealth's retirement systems have a significant unfunded actuarial accrued liability and a very low funding ratio, and recently enacted reforms do not address these problems. To the extent the retirement systems' assets are depleted, they may be unable to pay benefits in full.

A significant component of the Commonwealth's budget is the cost of its retirement systems (the "Retirement Systems"). The three principal pension systems of the Commonwealth (the Employees Retirement System, the Teachers Retirement System and the Judiciary Retirement System) have a significant unfunded actuarial accrued liability and a very low funding ratio. Although the Commonwealth enacted legislation in 2013 that attempts to reform the Retirement Systems by, among other measures, reducing benefits, increasing employer and employee contributions, and replacing most of the defined benefit elements of the system with a defined contribution system, these reforms were only designed to address the Commonwealth's cash flow needs and allow the Retirement Systems to make benefit payments when due. As a result, even after giving effect to these reforms, the Retirement Systems will continue to have a large unfunded actuarial accrued liability and a low funding ratio.

As described under "RECENT EVENTS – Status of the Reforms of the Teachers Retirement System and the Judiciary Retirement System" and "NEW ACTUARIAL VALUATIONS OF THE RETIREMENT SYSTEMS," the Puerto Rico Supreme Court declared invalid certain aspects of the legislation relating to the reform of the Teachers Retirement System and limited the effect of the reform of the Judiciary Retirement System. Failure to amend the legislation in order to compensate for the effect of the provisions declared invalid, or to be able to make employer contributions in excess of the additional contributions projected as part of the reforms, will lead to the depletion of assets at these Retirement Systems. If this occurs, the Retirement Systems would be operating solely on a "pay-as-you-go" basis, which means that they would be unable to pay benefits that exceed the actual employer and employee contributions received by the Retirement Systems (net of administrative and other expenses).

Moreover, it is anticipated that, as a result of the enacted reforms and other legislation enacted in 2011, the Commonwealth will have to provide significant additional annual funding to meet the Retirement Systems' annual pension obligations. In addition to the gradual increase in employer contribution rates that was enacted in 2011 and certain other supplemental contributions established by the reform laws, the reforms provide for the payment of an additional annual contribution from the employer at levels to be determined by the actuaries. At present, it is projected that the additional annual contribution required to be made by employers to the Employees Retirement System through fiscal year 2032 is approximately $120 million, of which approximately $78 million was allocable to the central government for fiscal year 2014 and the balance was allocable to the municipalities and participating public corporations. As discussed under "NEW ACTUARIAL VALUATIONS OF THE RETIREMENT SYSTEMS – *Employees Retirement System*," however, in the case of the Employees Retirement System, the

Commonwealth, municipalities and participating public corporations were not able to make the required additional annual contribution in full for fiscal year 2014 and will also be unable to make the required contribution in full for fiscal year 2015. In the case of the Teachers Retirement System, the required additional employer annual contribution would have been fully funded from the General Fund, and was initially estimated at $30 million for fiscal years 2017 and 2018 and $60 million thereafter until fiscal year 2042. These funding requirements place an additional demand on the Commonwealth's need to raise revenues, reduce expenditures, or both. In addition, to the extent the assumptions used to estimate the effect of these reforms on the General Fund are not realized, the Commonwealth may be adversely affected as it may have to use additional resources to meet these obligations.

There is no assurance that the Commonwealth, the municipalities and participating public corporations will be able to make-up for the shortfall in the additional annual contributions for fiscal years 2014 and 2015, as discussed under "NEW ACTUARIAL VALUATIONS OF THE RETIREMENT SYSTEMS – *Employees Retirement System*," and make any future additional annual contributions to the Retirement Systems in full and on a timely basis, including the increasing employer contributions required by these reforms. To the extent the Commonwealth, the municipalities and participating public corporations are unable to make such contributions, the Retirement Systems' financial condition may continue to deteriorate and their assets could be depleted.

See the information contained under RETIREMENT SYSTEMS in the Base Commonwealth Report and under NEW ACTUARIAL VALUATIONS OF THE RETIREMENT SYSTEMS in this Quarterly Report.

The Commonwealth's economy has been contracting and, absent future real growth, may be unable to sustain the Commonwealth's outstanding debt.

The Commonwealth's gross national product contracted in real terms in every year between fiscal year 2007 and fiscal year 2011 (inclusive), and grew by 0.9% (revised figures) and 0.3% (preliminary) in fiscal years 2012 and 2013. According to the Puerto Rico Planning Board, for fiscal years 2014 and 2015, gross national product is projected to increase by only 0.1% and 0.2%, and more recent data from the GDB suggest even slower growth or possibly a decline in real gross national product. This persistent contraction or very slow growth has had an adverse effect on employment and tax revenues, and has significantly contributed to General Fund budget deficits in those fiscal years. Factors that can adversely affect the Commonwealth's ability to increase the level of economic activity, some of which are not within the control of the Commonwealth, include the high cost of energy, the loss of patent protection of several products manufactured in Puerto Rico and global economic and trade conditions. There is no certainty that the measures being taken by the Commonwealth to grow its economy will produce the level of increase in economic activity required to generate sufficient tax revenues to resolve the structural budget deficits that have affected the Commonwealth and to enable the Commonwealth to continue to meet all of its debt service obligations when due. The failure by the Commonwealth to increase revenues, together with other factors discussed herein, may affect the Commonwealth's ability to continue to provide services at their current level while honoring all its obligations. This could force the Commonwealth to adopt some of the emergency measures described above in "*If the Commonwealth's financial condition does not improve, it* *may need to implement emergency measures that may include a restructuring, moratorium or other actions affecting creditors' rights.*"

See the information contained in the Commonwealth Report under THE ECONOMY.

If the population of the Commonwealth continues to decline, the Commonwealth's economy will be adversely affected and may not produce sufficient tax revenues to achieve and maintain a budget without deficit financing.

Changes in population have had, and may continue to have, an impact on economic growth and on the growth of tax revenues. According to United States Census Bureau, the population of Puerto Rico decreased by 2.2% from 2000 to 2010, and by an estimated 3.0% from 2010 to 2013, driven primarily by migration to the United States mainland. Reductions in population, particularly of working age individuals, are likely to have an adverse effect on tax and other government revenues that will not be entirely offset by reductions in government expenses in the short and medium term. In addition, the average age of the population of Puerto Rico is increasing, partly due to a reduction in birth rate, but primarily as a result of the migration of younger persons to the United States mainland. This phenomenon is likely to increase the demand for health and other services upon the Commonwealth, and the cost to the Commonwealth of providing such services, thus imposing limitations on the Commonwealth's ability to achieve a balanced budget and improve its financial condition.

The Commonwealth's macroeconomic data may not accurately reflect the performance of the economy of Puerto Rico.

The Puerto Rico Planning Board recently acknowledged the existence of certain significant deficiencies in the deflators of some of the gross national product components. As a result, the historical rate of change in gross national product at constant prices (real gross national product change) could have been either overstated or understated for several years. These deficiencies have also led to the delay in the publication of periodic economic data in order to provide the Planning Board with sufficient time to determine the particular deficiencies included in the calculation of the "deflators" and the procedures to fix such deficiencies. It is still too early to determine how these deficiencies have affected, or will affect, Puerto Rico's macroeconomic data. Until such time as these revisions are finalized and fully applied to Puerto Rico's macroeconomic data, there is no assurance that previously reported macroeconomic data accurately reflect the performance of the economy of Puerto Rico.

Commonwealth bondholders may face delays enforcing their remedies under the bonds, and the availability of some remedies is not certain.

The Constitution of Puerto Rico provides that public debt of the Commonwealth constitutes a first claim over available Commonwealth resources, and that the Secretary of the Treasury can be judicially required by bondholders to allocate funds to the payment of the public debt if available Commonwealth resources are insufficient to cover all budgeted appropriations. However, public policy considerations relating to the safety and well-being of the residents of the Commonwealth, as well as procedural matters, could result in delays in, or limitations on, the judicial enforcement of such remedies, and in limitations on the effectiveness of such remedies. The remedies available to bondholders are dependent on judicial actions, which are often subject to substantial discretion and delay.

The Constitution of Puerto Rico provides that the good faith, credit and taxing power of the Commonwealth are pledged to the payment of the Commonwealth's bonds. Since the Commonwealth has never failed to make a debt service payment on any of its bonds when due, the Puerto Rico Supreme Court has never had the opportunity to rule on whether bondholders have the right to compel the Legislative Assembly of the Commonwealth to increase taxes in the event that available Commonwealth resources are insufficient to pay the bonds, or to rule on how such right, if determined to exist, could be enforced.

Certain other statutory provisions affecting the rights of bondholders have never been tested. For example, although certain revenues assigned to Puerto Rico Highways and Transportation Authority, Puerto Rico Infrastructure Financing Authority and Puerto Rico Convention Center District Authority are stated by existing law to be available Commonwealth resources for purposes of the payment of public debt, their availability for such purpose is subject to there being no other available Commonwealth resources. It is not certain what steps a Commonwealth bondholder would be required to take or what proof such bondholder would be required to produce to compel the diversion of such funds from any such instrumentality to the payment of public debt, or how the necessary available Commonwealth resources would be thereafter allocated to each such instrumentality.

The liquidity of the Commonwealth's bonds is limited and Commonwealth bond prices may decline.

There is no assurance that the secondary market for the Commonwealth's bonds will provide holders thereof with sufficient liquidity for their investment or that such secondary market will continue. Moreover, debt obligations of the Commonwealth and its instrumentalities have experienced significant price declines. The market price of the bonds will be determined by factors such as relative supply of, and demand for, the bonds, general market and economic conditions in Puerto Rico, the United States and globally, and other factors beyond the Commonwealth's control. The risk of illiquidity may be exacerbated as a result of additional downgrades to the Commonwealth's credit ratings or as a result of market or other factors.

Holders of the Commonwealth's bonds may not attach the Commonwealth's property.

The Constitution of Puerto Rico provides that public property and funds of the Commonwealth shall only be disposed of for public purposes, for the support and operation of state institutions, and pursuant to law. Further, the Puerto Rico Supreme Court has determined that Commonwealth property cannot be attached or garnished in an attempt to enforce a judicial order, as it could undermine the Commonwealth's ability to operate and use its property for a public purpose.

The Commonwealth has not complied with its continuing disclosure obligations on a timely basis, and failure to comply may limit the Commonwealth's access to the capital markets.

On several occasions the Commonwealth has failed to comply with its continuing disclosure obligations on a timely basis. For example, the Commonwealth has failed to file the Commonwealth's Annual Financial Report before the 305-day deadline in nine of the past twelve years, including the two most recent fiscal years (2012 and 2013). Although the Commonwealth has implemented certain procedures to ensure timely compliance with its continuing disclosure obligations, there is no assurance that these procedures will be effective in ensuring timely compliance. Moreover, the Commonwealth's failure to comply with its continuing disclosure obligations on a timely basis could limit its access to the capital markets, because underwriters for Commonwealth bonds must be able to reasonably determine that the Commonwealth will comply with its continuing disclosure obligations before underwriting any future offerings of Commonwealth debt.

If Doral Financial Corporation prevails in its claim against the Commonwealth, the Commonwealth would be required to pay Doral $230 million over a five-year period.

The Commonwealth is currently a defendant in a lawsuit filed by Doral Financial Corporation and certain of its subsidiaries seeking the enforcement of a closing agreement that provides for a refund of approximately $230 million to Doral. If Doral prevails on its claim against the Commonwealth, the Commonwealth would be required to pay this amount over a five-year period. For more information regarding the status of this claim, see "LITIGATION" below.

RECENT DEVELOPMENTS

Sale of $3.5 billion aggregate principal amount of Commonwealth general obligation bonds

On March 17, 2014, the Commonwealth sold $3.5 billion aggregate principal amount of its Series 2014 Bonds. The proceeds of the Series 2014 Bonds, net of $245 million of original issue discount, were used to (i) repay certain lines of credit extended by GDB to the Commonwealth and to PBA; (ii) repay certain bond anticipation notes issued by COFINA; (iii) refinance certain of the Commonwealth's outstanding general obligation bonds; (iv) pay, either directly or through reimbursement to the Commonwealth, termination amounts under certain interest rate exchange agreements; (v) provide for a portion of the payment of interest on the Series 2014 Bonds through July 1, 2016; and (vi) pay expenses related to the issuance and sale of the Series 2014 Bonds. See USE OF PROCEEDS in the Official Statement.

Status of the reforms of the Teachers Retirement System and the Judiciary Retirement System

As discussed in the February Quarterly Report and the Official Statement, on December 24, 2013, the Governor signed into law Act 160-2013 ("Act 160") and Act 162-2013 ("Act 162"), which enacted comprehensive reforms of the Teachers Retirement System and the Judiciary Retirement System, respectively. The constitutionality of Act 160 and Act 162 were challenged in several lawsuits brought by participants in such retirement systems.

On February 21, 2014, the Puerto Rico Supreme Court upheld the constitutionality of Act 162, but only with respect to judges appointed on or after December 24, 2013, the date Act 162 was enacted. As a result, judges appointed before the approval of Act 162 will continue to enjoy their prior retirement benefits. For judges appointed on or after the approval of Act 162, the Puerto Rico Supreme Court interpreted Act 162 as creating two benefits regimes, one for judges appointed between December 24, 2013 and June 30, 2014, as to whom a modified benefits regime applies, and one for judges appointed on or after July 1, 2014, as to whom all provisions of Act 162 apply. The Commonwealth is currently studying the effects of the Court's decision on the financial condition of the Judiciary Retirement System in order to evaluate alternative courses of action. Failure to amend Act 162 or to provide additional employer contributions in order to compensate for the effect of the provisions declared unconstitutional will lead to the depletion of the Judiciary Retirement System's assets.

On April 11, 2014, the Puerto Rico Supreme Court struck down the sections of Act 160 that amended the pension benefits of active teachers who are participants in the Teachers Retirement System. Only new participants in the Teachers Retirement System will be subject to the amendments to the pension benefits enacted by Act 160. The Court upheld those sections of Act 160 that eliminated certain additional non-pension benefits of all participants. The Commonwealth is currently studying the effects of the Court's decision on the financial condition of the Teachers Retirement System in order to evaluate alternative courses of action. Failure to amend Act 160 in order to compensate for the effect of the provisions declared unconstitutional will lead to the depletion of the Judiciary Retirement System's assets.

For a discussion of the funding status of the Judiciary Retirement System and the Teachers Retirement System, see "NEW ACTUARIAL VALUATIONS OF THE RETIREMENT SYSTEMS" below.

Offset of Federal Funds

On May 5, 2014, the Commonwealth was formally notified that the United States Army Corps of Engineers ("USACE") had agreed to waive all cumulative penalty interest and fees and to reduce the interest rate applicable to the remaining principal amount owed by the Commonwealth to the USACE related to the construction of the Cerrillos Dam and Reservoir and the Portuguese-River and Bucana-River projects. The Commonwealth will make 33 annual payments commencing on June 7, 2014 consisting of a first payment of approximately $4.4 million and thirty-two additional payments of approximately $7.08 million.

For more information regarding this matter, see the information contained in the Base Commonwealth Report under the heading "*Offset of Federal Funds*" under "Recent Developments."

Enactment of Fiscal Sustainability Act

On June 17, 2014, the Legislature of the Commonwealth enacted Act No. 66-2014 (the "Fiscal Sustainability Act"). The Fiscal Sustainability Act is a fiscal emergency law enacted to address the fiscal pressures on the Commonwealth imposed by excessive leverage, persistent budgetary deficits, sluggish economic growth, and fiscally challenged public corporations, among others, as exacerbated by the credit rating downgrades that occurred in February of 2014. The Fiscal Sustainability Act will remain in effect for three fiscal years ending on June 30, 2017, or earlier if certain parameters are met, including (i) that the preceding fiscal year ends without a budget deficit; (ii) that the economic growth rate forecast for the following fiscal year be 1.5% or higher; and (iii) that a nationally recognized rating agency upgrade the credit rating of the Commonwealth's general obligations to investment grade level.

The principal corrective measures adopted by the Fiscal Sustainability Act include the following: (i) the freezing of benefits under collective bargaining agreements and the reduction of certain non-salary compensation; (ii) the contribution of the savings generated by certain public corporations to support certain General Fund expenses; (iii) the freezing of formula appropriation increases to the University of Puerto Rico and the municipalities; (iv) the freezing and reduction of formula appropriations to the Judicial Branch, the Legislative Assembly and certain other entities; (v) the reduction in school transportation costs; (vi) the reduction of rates for professional and purchased services; (vii) the freezing of water rates for governmental entities; and (viii) the implementation of a payment plan system for legal judgments, among others. In addition, the Fiscal Sustainability Act imposes substantial additional managerial and administrative controls on the operations of the Executive Branch, including hiring and contracting requirements and procedures, savings targets for rent and utilities, fines to public employees for unauthorized transactions, and overall strengthening of oversight by the Commonwealth's Office of Management and Budget ("OMB").

Since the Fiscal Sustainability Act modifies contractual and other acquired rights, there is a possibility that it could be subject to legal challenge, and that such challenge could be successful, rendering ineffective some or all of the contemplated expense reduction measures.

See "RISK FACTORS – The Commonwealth may be unable to balance its General Fund budget for fiscal year 2015 and thereafter." In the event of a successful legal challenge, there can be no guarantee that the Commonwealth management will be able to identify, or the Legislative Assembly will consent to enact, alternative measures to fully or partially compensate for the foregone fiscal impact. In addition, given the temporary nature of the Fiscal Sustainability Act, the Commonwealth will face again the same or larger cost escalators at the end of the effective period of the Act. There can be no guarantee that the Commonwealth management will seek, that the Legislative Assembly will enact, or that the Judicial Branch will uphold, an extension in the effective period of the Fiscal Sustainability Act.

Enactment of Puerto Rico Public Corporations Debt Enforcement and Recovery Act

On June 28, 2014, the Commonwealth enacted Act 71-2014, known as the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the "Recovery Act"). Prior to the enactment of the Recovery Act, there was no Commonwealth statute providing an orderly recovery regime for public corporations experiencing financial difficulties. At the same time, Chapters 9 and 11 of the United States Bankruptcy Code are generally inapplicable to public corporations that are governmental instrumentalities of the Commonwealth. Thus, the Recovery Act is intended to fill this statutory gap and provide for an orderly legal process governing the enforcement and restructuring of the debts and other obligations of certain public corporations of the Commonwealth.

The purpose of the Recovery Act is to create a legal framework that: (1) allows certain public corporations to adjust their debts in a manner that protects the interests of all affected creditors; (2) provides procedures for the orderly enforcement and restructuring of the debts and obligations of eligible public corporations in a manner that is consistent with the United States and Commonwealth Constitution; and (3) maximizes the return to such public corporation's stakeholders.

The Recovery Act does not apply to the Commonwealth. It applies solely to public corporations, other than the following: the Children's Trust; the Employees Retirement System of the Government of the Commonwealth of Puerto Rico and its Instrumentalities; Government Development Bank for Puerto Rico and its subsidiaries, affiliates, and any entities ascribed to GDB; the Judiciary Retirement System; the Municipal Finance Agency; the Municipal Finance Corporation; the Puerto Rico Public Finance Corporation; the Puerto Rico Industrial Development Company, the Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority; the Puerto Rico Infrastructure Financing Authority; the Puerto Rico Sales Tax Financing Corporation (COFINA); the Puerto Rico System of Annuities and Pensions for Teachers; and the University of Puerto Rico.

The Recovery Act establishes two types of processes to adjust a public corporation's obligations. These two processes are designed to work together either concurrently or sequentially. The Recovery Act also provides for the creation of a specialized courtroom and for the designation of a judge (the "Recovery Act Judge") to handle all court proceedings involving the interpretation and application of the provisions of the Recovery Act. The specialized courtroom is part of the Court of First Instance, San Juan Part. The Chief Justice of the Puerto Rico Supreme Court has designated a judge from the Court of Appeals of the Commonwealth to preside over all proceedings filed in this specialized courtroom.

The first type of process established in the Recovery Act (Chapter 2 process) is a consensual debt modification process with limited judicial intervention that affects only financial debt and culminates in a recovery program whose objective is to enable the public corporation to become financially self-sufficient, allocate equitably among all stakeholders the burdens of the recovery program and provide the same treatment to all creditors within a class of debt. A Chapter 2 process can be initiated by the public corporation (or by GDB with the consent of the Governor) by posting a notice on its website. The debt relief available under this consensual process may include a combination of amendments (such as rate adjustments and maturity extensions), waivers, or exchanges affecting those debt instruments identified by the public corporation (the "affected debt instruments"). The debt enforcement remedies available to holders of affected debt instruments are suspended during the pendency of the process, up to 270 days (subject to 90 day extension with the approval of holders of 20% of the affected debt instruments in a particular class). Any amendments to a class of affected debt instruments must be approved by holders representing at least 75% of the amount of debt in such class that participate in the voting; provided, that holders of at least 50% of the amount of debt in such class participate in the voting. Once approved by such debt holders, the public corporation must obtain court approval in order for the amendments to be binding on all debt holders of the affected class. Compliance with the recovery program adopted by the public corporation (which need not be approved by the creditors) is monitored by an oversight commission appointed by the Governor of Puerto Rico, which provides periodic compliance reports.

The second type of process established in the Recovery Act (Chapter 3 process) is more akin to the type of procedures found in Chapters 9 and 11 of the United States Bankruptcy Code. This process is overseen by the Recovery Act Judge. The process begins with the filing of a petition for relief in the specialized courtroom described above. Upon the filing of the petition, any action for the enforcement of any claims against such petitioner is automatically stayed. A petitioner is eligible to file if it is: (1) currently unable or at serious risk of being unable to pay its valid debts as they mature, while continuing to provide public services, without additional legislative or financial assistance; (2) ineligible for relief under Chapter 11 of the United States Bankruptcy Code; and (3) authorized to file the petition by its governing body and GDB, or on its behalf by GDB at the request of the Governor of Puerto Rico. This process will allow a public corporation to defer its debt repayment and to decrease interest on and principal of its debt to the extent necessary to enable it to continue to fulfill its public functions. Collective bargaining agreements may be modified or rejected under certain circumstances. Other types of contracts can be rejected (giving rise to claims for breach of contract) and trade debt can be reduced when necessary.

The Chapter 3 process is designed to permit the eligible public corporations to satisfy their contractual obligations to the maximum extent possible, and to maximize distributions to creditors consistent with and subject to the execution of its vital public functions. Only the public corporation (or GDB in its stead) is authorized to file a petition for debt enforcement under this process — a creditor may not file a petition. The Chapter 3 process terminates when the debt enforcement plan presented by the public corporation, which must meet certain requirements specified in the Recovery Act (including approval by at least one affected class of claims, with the favorable vote of a majority of all votes cast in such class and of two thirds of the affected claims in such class), is approved by the Recovery Act Judge. The debt enforcement plan must provide creditors with (i) at least the value attainable had there been simultaneous enforcement of all creditor claims, plus (ii) a note entitling creditors to 50% of the public corporation's free cash flow for the next ten years. A Chapter 3 plan may involve the transfer of all or substantially all of a public corporation's assets, subject to certain limitations. Only the public corporation may propose a debt enforcement plan.

During the pendency of a Chapter 2 or Chapter 3 process, the public corporation remains in possession and control of its assets and operations. The Recovery Act, however, authorizes the Governor to appoint an emergency manager to carry out the functions of the public corporation's board of directors and of its executive director.

As of the date of this report, no public corporation has sought relief under the Recovery Act. In light of the Puerto Rico Electric Power Authority's ("PREPA") current liquidity constraints, however, PREPA may need to seek relief under the Recovery Act.

On June 28, 2014, certain holders of bonds issued by PREPA filed a lawsuit in the United States District Court for the District of Puerto Rico seeking a declaratory judgment that the Recovery Act violates multiple provisions of the United States Constitution. The complaint alleges that the Recovery Act is a law dealing with "bankruptcy matters" and that the Commonwealth is precluded by the United States Constitution from enacting this law since only the United States Congress can do so under the "bankruptcy clause" of the United States Constitution. The complaint further alleges that certain provisions of the Recovery Act, if enforced, would violate several provisions of the United States Constitution because they would constitute an unconstitutional impairment of the contract between PREPA and its bondholders or a "taking" of the bondholders' property without just compensation.

The Commonwealth, PREPA and GDB intend to defend vigorously the constitutionality of the Recovery Act. They believe that the provisions of the Recovery Act will be enforced in a manner that complies with the requirements of both the United States Constitution and the Commonwealth Constitution.

This and any other challenge that is filed in the future to the validity of the Recovery Act will take time to be ultimately resolved. There can be no assurance that the final resolution of this and any other challenge will be consistent with the Commonwealth's position.

Downgrades by credit rating agencies

Beginning in February of 2014, the credit ratings of the Commonwealth's general obligation bonds and Commonwealth guaranteed bonds, as well as the ratings of most of the Commonwealth's public corporations, have been lowered (more than once in most cases) to non-investment grade by Moody's, S&P, and Fitch. According to the ratings agencies, further downgrades are possible in some cases.

The following table sets forth the ratings of the Commonwealth and certain of its public corporations after giving effect to these downgrades:

	S&P	Moody's	Fitch
Commonwealth of Puerto Rico (General Obligations)	BB	B2	BB-
Government Development Bank	BB-	B3	
COFINA			
Senior Lien	BBB	Ba3	BB-
First Subordinate Lien	BBB-	B1	BB-
PR Electric Power Authority	B-	Caa2	CC
PR Highways and Transportation Authority			
Highway Revenue Bonds	B	Caa1	
Transportation Revenue Bonds	B	Caa1	
Subordinate Transportation Revenue Bonds	B	Caa2	
PR Aqueduct and Sewer Authority			
Revenue Bonds	BB-	Caa1	B+
Guaranteed Bonds	BB	B2	BB-
PR Public Buildings Authority	BB	B2	BB-
PR Employees Retirement System	BB-	B3	BB-
PR Public Finance Corporation (Commonwealth Appropriation Bonds)	BB-	B3	

Health Care Update

The Commonwealth, through its Health Insurance Administration ("PRHIA"), provides health insurance coverage to approximately 1.64 million qualifying (generally low-income) residents of Puerto Rico through the "Mi Salud" program. Of these, approximately 1.45 million individuals are considered part of the "federal population" whose cost is subject to matching federal funding and 185,000 individuals are considered part of the "Commonwealth population" whose cost is fully funded by the Commonwealth. (Enrollment figures assume implementation of the Universal Access Program.) The cost of "Mi Salud" is significant: for fiscal year 2015, the budget approved by the Board of Directors of PRHIA totaled $2.67 billion, of which $885 million is paid from the General Fund, representing approximately 9.2% of General Fund expenditures, approximately $1.44 billion is paid from federal funds, and the balance is being paid from municipal and other funding sources.

The federal funds currently used for "Mi Salud" include non-recurring funds provided pursuant to the Patient Protection and Affordable Care Act ("ACA"), as well as recurring Medicaid funds, which in the case of the Commonwealth are capped while the funds received by the 50 states are not capped. The non-recurring ACA federal funds drawn for "Mi Salud" during fiscal year 2015 are projected to be $1.030 billion, while the recurring capped Medicaid funds are projected to be approximately $293 million. Additional recurring federal funds for "Mi Salud" available from the federal Children's Health Insurance Program (CHIP) for fiscal year 2015 are projected to be $104 million and $14 million for the prescription drug program.

In January of 2014, the Commonwealth received a letter from the Centers for Medicare and Medicaid Services of the U.S. Department of Health and Human Services indicating that "Mi Salud" was potentially eligible for an enhanced matching percentage in excess of the current Medicaid match. The Commonwealth decided, after due consideration, to request the enhanced match percentage proffered by the federal government. This acceptance materially improves the near term financial outlook of "Mi Salud" but also advances the depletion date of ACA funds from January 2019, as of the previous estimate, to May of 2018, in each case assuming a 2% growth in beneficiaries and 5% growth in health premiums cost. However, the fiscal year 2015 estimated deficit declined from $140 million to $53 million.

The following table summarizes the revised five-year deficit forecast of the PRHIA, absent Congressional renewal of ACA funds or other waiver of the Commonwealth's Medicaid cap:

	Fiscal Year				
	2015	**2016**	**2017**	**2018**	**2019**
PRHIA deficit	$53,000,000	$53,000,000	$165,000,000	$1,796,000,000	$2,020,000,000

During the second semester of fiscal year 2014, the PRHIA conducted a Request for Proposals ("RFP") to select the health insurance provider for its eight regions starting on July 1, 2014. After review of the RFP responses, the price levels submitted by the participants, and the actuarial methodology underlying such levels, were unacceptable to PRHIA; moreover, in PRHIA's judgment there were not sufficient bidders at each individual region to allow for fair prices and adequate depth and quality of services. With acquiescence by the federal government, the contract for the current provider was extended until May of 2015. Based on the experience with the recently cancelled RFP process, there is a possibility that the cost of providing services during the final months of fiscal year 2015, upon conclusion of the upcoming RFP process, will rise materially, including in excess of the levels considered in the PRHIA budget. There can be no assurance that providers will be available and willing to continue to provide services under the current model at financially acceptable or viable levels.

COFINA Legislation

In anticipation of a bond issuance by COFINA in the second half of fiscal year 2014, legislation was adopted in October of 2013 to increase from 2.75% to 3.50% the portion of the Commonwealth sales and use tax transferred to COFINA. Since the COFINA bond issue was postponed, Act 72-2014, enacted in June of 2014, delays the transfer of these funds to COFINA until the fiscal year following the year in which the COFINA bond issue is consummated.

FISCAL CONDITION

General Fund Revenues and Expenses for Fiscal Year 2013

On June 30, 2014, the Commonwealth published its audited financial statements for fiscal year 2013.

Revenues. Total General Fund resources for fiscal year 2013 (on a budgetary accounting basis) were $8.814 billion, and include (i) total operating revenues of the General Fund of $8.131 billion, (ii) revenues from the electronic and traditional lotteries of $211 million that are available to the General Fund, (iii) $241 million in excess funds transferred from the Redemption Fund (which holds funds for the payment of debt service on general obligation debt of the Commonwealth) to the General Fund, (iv) $127 million in excess funds transferred from COFINA to the General Fund, and (v) $102 million in property taxes collected by the Municipal Revenue Collection Center (which are deposited in the Debt Service Fund because they must be used solely for payment of debt service on general obligations debt of the Commonwealth). Operating revenues of $8.131 billion were $442 million lower than operating revenues for fiscal year 2012 ($8.573 billion).

Expenses. Total General Fund expenditures for fiscal year 2013 (on a budgetary accounting basis) were $10.167 billion, consisting of (i) operating expenses of $8.938 billion, (ii) debt service on Commonwealth general obligation bonds of $865 million, (iii) rental payment to PBA of $205 million, and (iv) debt service on Commonwealth appropriation debt and GDB lines of credit of $158 million. Operating expenses decreased by $973 million when compared to fiscal year 2012 ($9.911 billion).

Fiscal Year 2013 Budget Deficit. The difference between General Fund operating revenues and operating expenses for fiscal year 2013 was $807 million. The difference between total General Fund resources and total expenditures was $1.353 billion. This amount was funded by (i) $775 million of general obligation and PBA debt service refunding, (ii) a $332 million debt issuance from COFINA, (iii) a short term line of credit with GDB of $98 million, and (iv) $148 million in cash management measures.

Preliminary General Fund Revenues and Expenses for Fiscal Year 2014

Revenues. Preliminary General Fund resources for fiscal year 2014 (which are still subject to audit and other year-end adjustments) were $9.037 billion, and include: (i) total operating revenues of the General Fund of $8.809 billion, (ii) revenues from the electronic and traditional lotteries of $154 million that are available to the General Fund, and (iii) $74 million in excess funds transferred from COFINA to the General Fund. This represents an increase over fiscal year 2013, but is $488 million lower than the revised projected revenues for this period. The increase in revenues during this period when compared to fiscal year 2013 is primarily due to legislative measures adopted since January 2013.

Preliminary corporate income tax collections for fiscal year 2014 were $1.914 billion, an increase of $628 million, or 48.8%, from the same period of the prior fiscal year. These revenues are $599 million, or 23.8%, less than the revised projected revenues for this period. Preliminary individual income tax collections for fiscal year 2014 were $1.979 billion, a decrease of $75 million, or 3.6%, from the same period of the prior fiscal year. Preliminary collections from withholdings from non-residents were $900 million, a decrease of $83 million, or 8.4%, from prior fiscal year, but $80 million, or 9.8%, more than the revised projected revenues for this period.

Preliminary sales and use tax collection received by the General Fund for fiscal year 2014 were $595 million, an increase of $55 million, or 10.2%, from the prior fiscal year, but $19 million, or 3.0%, less than the revised projected revenues for this period.

Preliminary collections for the special temporary excise tax under Act 154 for fiscal year 2014 were $1.902 billion, an increase of $270 million, or 16.5%, from the prior fiscal year, but $19 million, or 3.0%, less than the revised projected revenues for this period.

The primary reasons for the lower corporate income tax collections for fiscal year 2014 when compared to the budget include: (i) higher than estimated tax credits and other residual tax items carried over from previous fiscal years, which reduced projected tax payments, (ii) purchase of tax credits above projections, which affected corporate gross receipts tax revenues, (iii) timing differences in payments of corporate taxes due to corporations that filed tax return extensions, (iv) waivers granted which reduced the corporate gross receipts tax revenues, (v) corporate reorganizations that reduced corporate tax liabilities, and (vi) corporate taxable income lower than expected.

Expenses. The fiscal year 2014 approved budget totaled $9.770 billion in authorized appropriations, excluding $575 million in general obligation debt service to be refunded with the proceeds of the Series 2014 Bonds. The budget contemplated $245 million in new deficit financing from GDB which, when added to the $575 million debt refunding, resulted in a total projected budget deficit of $820 million. The budget was subsequently amended to total $9.245 billion (excluding the $575 million in refunded debt service) as follows:

(i) In February of 2014, the Puerto Rico Legislative Assembly approved a reduction of $170 million in various appropriations, including but not limited to the elimination of certain reserve and contingency accounts, a reduction in program appropriations that were not a priority, and a reduction in the operating budget of agencies chargeable to the General Fund.

(ii) In June of 2014, the Governor signed Executive Order 29-2014, which ordered cuts in appropriations totaling $355 million: a reduction in the appropriated rent expense payments to the Public Buildings Authority of $24 million, a reduction in the appropriation to the Employee Retirement System required by the pension reform of $84 million, and a reduction in the appropriation for the payment of appropriation debt to the GDB of $247 million.

The reductions made in June of 2014 were ordered pursuant to Article 4 of the Organic Law of the Office of Management and Budget (Act 147 of 1980), enacted pursuant to Article VI, Section 8 of the Constitution of the Commonwealth, which provides that whenever there are insufficient resources in a particular fiscal year to cover authorized appropriations for that year, the Governor may adjust disbursements and amend the underlying appropriations according to a schedule of priorities set forth in law.

These appropriations were selected for adjustment in conformity with the schedule of priorities set forth in Act 147, and in consideration of the fact that the magnitude and timing of the April revenue shortfall giving rise to the cash gap was such that countervailing cuts in operating expense appropriations were impractical without a drastic and sudden slowdown in government operations, particularly in light of the prior $170 million reduction in the budget.

Executive Order 29-2014 also orders the OMB to prepare a draft bill to recognize payables to the affected public entities (GDB, ERS and PBA), and to appropriate over a multi-year period sufficient payment to compensate for the adjustment in appropriations executed at the end of fiscal year 2014.

OMB estimates that actual expenditures for fiscal year 2014 will be lower than the amended amount of $9.245 billion by approximately $64 million, for a projected expense of $9.181 billion. This includes a $38 million operating surplus at the agencies of the Commonwealth, and a $26 million operating surplus at the Department of Education. Due to legal and government accounting norms applicable to surplus balances of different origins from the General Fund, including carryforward surpluses at the Department of Education, underspending may not result in a dollar-for-dollar improvement in the deficit or surplus balance on a budgetary accounting or GAAP basis.

This projection does not consider the forecasted deficits of public corporations that receive material operating or program subsidies from the General Fund, such as the Maritime Transit Authority, PRHIA, the Public Buildings Authority, the Metropolitan Bus Authority, and the Medical Services Administration. These entities are separate from a legal, governance, and financial reporting perspective. PRHIA, the largest of these entities, currently projects a $60 million deficit for fiscal year 2014. This figure may increase to $90 million if the eligibility level for certain federal programs, retroactive to January of 2014, is not increased by the federal government as expected and as requested by the Puerto Rico Department of Health.

This projection also considers special appropriations for fiscal year 2014, which have a three-year life per Puerto Rico government accounting statutes, as fully spent, even if they are projected to have unobligated balances at the end of the year. However, the projection does not consider expenses or obligations charged against special appropriations from prior fiscal years, especially fiscal years 2012 and 2013. Both the government agencies and OMB continue, in the ordinary course of business, to charge expenses from the current fiscal year against appropriations from prior fiscal years, until those are depleted. However, OMB has broad legislative authority to transfer unspent balances between special appropriations from prior years, essentially repurposing the original intended use of the funds. Sometimes, these transfers are executed to fund new programs, priorities, or contingencies arising in the course of the fiscal year, or to cover expenses that could otherwise be considered recurring in nature. During fiscal year 2014, OMB executed $33 million in fund transfers in appropriations from prior fiscal years that implied a change in the original intended use of the funds.

Department of Education Projections. The Department of Education, which constitutes 25% of the General Fund budget and which has typically accounted for the majority of expense volatility and variance from the approved budget, has presented a preliminary projected surplus of $26 million for fiscal year 2014. This projection considers the application of certain non-recurring expense adjustments or transfers including (i) use of an existing line of credit of $17 million to cover extraordinary levels of leave liquidation payments resulting from a 2011 law that provided certain early retirement incentives and from the reform of the Employees

Retirement System; (ii) transfer and use of $7 million in General Fund special appropriations from the OMB for fiscal year 2014, to cover certain payroll and other contingencies; and (iii) application of $11 million in non-General Fund carryover surplus balances from prior fiscal years. The fiscal year 2014 surplus of $26 million, combined with a $46 million unused non-General Fund carryover surplus balance from prior years, and $31 million from operating surpluses at other agencies (out of the $38 million mentioned above) that have been transferred by the OMB to cover expenses related to school repair and consolidations, among other purposes, means that the Department of Education will start fiscal year 2015 with a non-General Fund carry-forward reserve with a beginning balance of $103 million. This amount, by OMB regulation, will only be available to cover non-recurring expenses; however, this restriction is administrative (and thus subject to modification or waiver), and the characterization of an expense as recurring may be open to judgment and discretion.

Projected Budget Deficit for Fiscal Year 2014. The difference between preliminary General Fund revenues of $9.037 billion and preliminary General Fund expenses of $9.245 billion (excluding the $575 million of refunded debt service) is equal to $208 million. This budget deficit was covered by a $93 million loan from GDB, and $115 million in cash management measures. After considering the $575 million refunding, the total amount of the fiscal year 2014 budget deficit was $783 million.

Budget for Fiscal Year 2015

The budget for fiscal year 2015 was signed by the Governor on July 1, 2014. The budget provides for General Fund expenditures of $9.565 billion. This represents an increase of $320 million over the final budget for fiscal year 2014 ($9.245 billion), but a reduction of $205 million when compared with the original fiscal year 2014 budget of $9.770 billion. The fiscal year 2015 budget provides for incremental debt service on Commonwealth general obligations of $581 million, which when considered together with the $205 million reduction in total expenses, results in an aggregate decrease of $786 million in appropriations other than debt service. The fiscal year 2015 General Fund budget does not include any deficit financing as a source of funds, and does not include any refinancing of general obligation debt (although it includes $344 million of capitalized interest funded with a portion of the proceeds of previously issued general obligation bonds). No assurance can be given, however, that the Commonwealth will be able to continue to budget its General Fund expenses, in future years, without recourse to deficit financing or general obligation refinancing, particularly in light of higher debt service obligations starting in fiscal year 2016, higher pension contributions required to fund pensions benefits, and other cost escalators.

Cost Escalators. The approved budget addressed approximately $1.325 billion in "cost escalators" when compared with the initially approved budget for fiscal year 2014. These cost escalators include higher debt service costs, higher compensation expenses under existing collective bargaining agreements, incremental pension plan contributions, and formula-based budget allocations. These escalators include:

$620 million	For additional debt service to eliminate the practice of re-financing general obligation bonds and subsequent exclusion from the General Fund budget; provide for incremental principal and interest payments due on existing general obligation and GDB debt; and fund higher expected interest cost on the TRANs. The estimate for GDB incremental debt service already assumes the refinancing of three interest-only credit lines (ASES; ASEM; Judgments), which were otherwise due to begin paying principal on a five year amortization schedule starting in fiscal year 2015
$181 million	To fund the incremental effect on the General Fund of already-executed collective bargaining agreements and other pre-legislated payroll increases, including the full year effect of certain payroll benefits that came into effect in February of 2014 and the effect of benefits that would come into effect in July of 2014.
$172 million	For additional appropriations, including pre-legislated appropriations during fiscal year 2014; the full year effect of certain recruitments and academies (including Police and Corrections); and other program priorities added by the Legislature in the budget approval process. It should be noted that offsetting cuts for the most part are classified as corrective measures.
$132 million	To fund trailing revenue-based formula appropriations and other pre-existing legislation, to increase operating subsidies to the University of Puerto Rico, the Judicial Branch, and the Municipalities.
$119 million	To strengthen the operation of subsidized public corporations that provide social services and collective transport. It should be noted that the full amount was not appropriated and a majority of this need remained as necessary measures for management of each public corporation to identify and execute.
$73 million	To substitute non-recurring, non-General Fund origins that were funding program appropriations; in particular the Budgetary Support Fund drawn from contributions from Special State Funds and dividends from public corporations; and the Science and Technology Fund, capitalized from a tax on a one-time capital distribution by the highly-regulated Joint Underwriting Association (mandatory car insurance).
$29 million	To cover the incremental impact of the additional 1% payroll contribution rate increase for the Government Employee Retirement System (ERS) and Teachers Retirement System (TRS).

These cost escalators vary from those presented in the February Quarterly Report and at the time of submittal of the recommended budget, due to additions of new program priorities resulting from the legislative policymaking process; changes in policy assumptions; updates in estimates for year-end expense results of public instrumentalities; update in inputs for expense forecasting of public instrumentalities for the next fiscal year; fine-tuning of the forecasting methods; and other factors. In the case of the Department of Education, for example, year-end teacher attrition and the number of schools actually approved for consolidation was lower than expected at the time of budget configuration, but the current projected fiscal year 2014 results were better than then-forecasted and the legislative process resulted in a higher payroll appropriation to the Department of Education. The numbers set forth above reflect OMB estimates and are subject to forecasting or estimation error. There is also a substantial element of judgment as to which expenses are considered cost escalators, what actions are considered corrective measures, and how they relate. These numbers are provided as directional guides as to the magnitude of the challenges faced and the extent of the difficulty or risk that the Commonwealth faces in successfully addressing them.

Corrective Measures. The approved budget considers the implementation of approximately $1.530 billion in corrective measures. These include a combination of legislative neutralization of the cost escalators referred to above; shifting of expenses to non-General Fund origins; reduced appropriations due to lower expense basis (particularly headcount); and further actual cuts in existing appropriated expenses. These corrective measures are:

$165 million	From restructuring lines of credit and other financing facilities of the General Fund with the GDB, including $29 million in adjustments for revisions of projected disbursement schedules and $72 million in reduction to the repayment appropriations. The GDB and OMB expect, with respect to this $72 million reduction in the appropriation enacted by the Legislative Assembly, to develop a plan to address this cut. In addition, from reducing by the non-employer-contribution Uniform Additional Contribution to the Government Employee Retirement System established by the ERS.
$147 million	From charging appropriations against non-General Fund origins, particularly from unneeded capital improvements in the Municipal Improvements Funds and construction funds for the Cancer Center from the Science and Technology Fund. It should be noted that an attempt to match appropriations that are either non-recurring or are voluntary subsidies to Municipalities was made, but the match was not full and there is no assurance that in future years these expenses will not have to return to the General Fund. From redirecting excess available balances from Special State Funds to cover the cost of judgments, settlements and other contingencies, including the Police Reform stipulations with the U.S. Department of Justice.
$142 million	From significant net reduction in overall teacher staffing levels, without layoffs, through voluntary attrition, changes in staffing policies, school consolidation, and overall more effective and efficient use of human resources at the Department of Education. In the budget process, the Legislative Assembly approved a $108 million increase to an existing appropriation debt line of credit, previously used to cover extraordinary leave liquidations from retirements under Act 70-2011 (Early Retirement Incentives) and Act 3-2013 (ERS Reform), primarily in order to cover liquidations related to net reduction in the Department of Education headcount; the OMB currently estimates that approximately $60 million of that amount will be requested from the GDB. From further attrition in headcount outside the Department of Education and reduction in political appointee payroll.
$134 million	From reduction in special appropriations for operating or program purposes. Includes phased-out programs such as National Guard Coastal Shield or homeownership subsidy program; reduction in subsidy to Municipal payroll contributions; or other special appropriations that in OMB or Legislative judgment could be reduced. From a broader-based, less steep reduction of 10-20% over a wide range of special appropriations.
$133 million	From eliminating or deeply reducing special appropriations that were included in the fiscal year 2014 budget for contingencies and purposes that were estimated to be no longer relevant or needed in fiscal year 2015. Includes elimination of $51 million to cover liquidations from extraordinary retirements pursuant to Act 3-2014; elimination of $40 million for the assumption of Municipal debt in anticipation of a sales and use tax reduction did not go into effect; reduction in $22 million to cover annuity payments for Act 70-2011 retirees; $10 million to cover potential over-estimation in attrition from Act 70-2011; and $10 million for a Pilot Program for the Public Health Insurance Program.
$132 million	From freezing appropriations for revenue-based formulas and other pre-legislated increases in the operating subsidies to the University of Puerto Rico, the Judicial Branch and the Municipalities.
$120 million	From freezing payroll increases in collective bargaining agreements and other pre-legislated benefit increases to central government employees through the Fiscal Sustainability Act. It should be noted that the leadership of labor unions representing 99% of General Fund unionized employees executed, after extensive negotiations, voluntary modifications accepting these reductions subject to ratification, with certain periodic reviews, in recognition of the Commonwealth's fiscal situation.
$117 million	From the full year effect of lower starting base headcount in central government agencies, in particular maintaining overall headcount levels for fiscal year 2015 at the levels in place at the time of budget configuration.
$110 million	From reductions in operating expenses for purchased, facilities and professional services, including (i) regionalization and other cuts including provider rates in school transportation; (ii) savings on facilities expense and other relevant costs due to consolidation of approximately 70 schools in the Department of Education; and (iii) overall reduction in purchased and professional services due to austerity driven cuts in scope and rates of services and consolidation of certain smaller agencies.

$90 million	From contributions and dividends from public corporations with available balances or capacity, particularly the State Insurance Fund, the ACAA public car accident insurance corporation, and the corporations related to the promotion of economic development and growth. Includes (i) transfer of payroll savings arising from implementation of the Fiscal Sustainability Act to newly created Special State Funds; (ii) transfer of funds to newly created Special State Funds to associated related General Fund expenses (for example, therapies or job creation appropriations); and (iii) transfer of funds to the Legal Responsibility Fund to cover payment of legal judgments.
$86 million	Requirement of additional efficiency measures that must be identified by management at subsidized public corporations.
$51 million	From reducing non-salary benefits to government employees including setting a fixed uniform Christmas Bonus of $600 (the level of the private sector) and eliminating intra-year liquidation of excess sick leave.
$45 million	From additional reduction in the budgets of the Judicial Branch, the Legislative Assembly and other entities. Budgets were set by the Fiscal Sustainability Act to match the overall General Fund percentage reduction from fiscal year 2014 to fiscal year 2015, once the increase in general obligation debt service is deducted from the comparison.
$37 million	From net reduction from utilities expenses, including freezing of the scheduled water rate increase and application of existing credits in the Public Building Authority rent invoices.
$24 million	From eliminating operating or program subsidy appropriations to public corporations with the capacity, in OMB's judgment, to assume them, for example, elimination of the appropriation for cruise ship incentives to the Tourism Company, and reduction of the operating subsidy (apart from rent) to the PBA. Also considers adjustments to the appropriations of subsidized public corporations (such as collective transport and medical services) due to savings arising from the implementation of the Fiscal Sustainability Act.

New Revenue Raising Measures for Fiscal Year 2015

The fiscal year 2015 revenue estimate used in the preparation of the budget takes into consideration the lower revenues realized in fiscal year 2014 when compared to the original revenue projections and the absence of certain non-recurring revenues, and the expected impact of various revenue raising measures which are intended to increase the revenues of the General Fund. The following is a list of the most significant of these measures and their impact on estimated revenues:

- adjustment to individual alternative minimum tax brackets ($40 million);
- changes to taxation of passive income ($19 million);
- 10% deemed dividend tax to foreign owners of non-exempt corporations ($75 million);
- elimination of earned income tax credit ($124 million);
- $400 bonus to senior citizens made conditional to certain revenue targets ($100 million);
- changes to corporate gross receipts tax to exclude such tax from the alternative minimum tax computation and to ensure its application to conduit entities, exempting corporations with annual sales of $3 million or less, reducing tax rate for corporations with annual sales between $3 million and $100 million, providing for a special tax rate for corporations engaged in retail sale of foodstuffs and for an increase in the tax rate of corporations with sales in excess of $1.5 billion from 0.85% to 1.0% ($68 million);

- special tax rate for prepayment of IRAs, retirement plans and annuities ($80 million); and
- changes to the sales and use tax collection system at the point of entry ($170 million).

GDB Funding and Liquidity

During fiscal year 2014, GDB's liquidity position was adversely affected by, among other factors, a significant increase in credit spreads for obligations of the Commonwealth and its instrumentalities, the limited capital market access of the Commonwealth and its instrumentalities during such fiscal year, and a significant reduction of liquidity in the local Puerto Rico capital markets. These factors, in turn, resulted in delays in the repayment by the Commonwealth and its instrumentalities of their loans from GDB and, at the same time, caused the Commonwealth and its instrumentalities to rely more heavily on short-term financing from GDB. GDB's liquidity was also affected by the elimination of certain appropriation debt payments it was due in order to further reduce the Commonwealth's fiscal year 2014 deficit (previously discussed). The credit rating downgrades in February 2014 of the Commonwealth and most of its instrumentalities (including GDB) to non-investment grade categories and the further downgrades in July 2014 have affected and could further adversely affect GDB's liquidity position.

GDB's liquidity position, however, improved significantly in March 2014 as a result of the issuance of the Series 2014 Bonds and the repayment from a portion of the proceeds thereof of certain outstanding GDB lines of credit. Specifically, a portion of the bond proceeds were used to repay, in whole or in part, the following (a) Commonwealth lines of credit: (i) $547.5 million and $560 million used to pay interest and principal, respectively, on general obligation bonds, (ii) $94.1 million used for working capital and (iii) $234.9 million in anticipation of the issuance of bonds; and (b) PBA lines of credit: (i) $76.2 million and $111.1 million used to pay interest and principal, respectively, on outstanding bonds and (ii) $272.2 million used for working capital. The Commonwealth also used proceeds from the issuance of the Series 2014 Bonds to redeem or refund approximately $807 million in short-term obligations and cover approximately $47.7 million in interest rate swap termination payments that could have caused a further deterioration of GDB's liquidity position to the extent it may have been required to cover any payments due thereunder as a result of the Commonwealth's or a public corporation's inability to do so. GDB was also able to improve its liquidity position by increasing its public deposits by approximately $839.4 million from February 28 to June 30, 2014 (see *Liquidity Resources* below for a description of these public deposits) and implementing strict disbursement controls in connection with its loan portfolio in order to limit and prioritize disbursements under outstanding lines of credit.

GDB's funding and liquidity objectives are to maintain liquidity to fund its existing asset base and to maintain an appropriate amount of cash and high quality liquid assets to meet its obligations and fund new loans in accordance with its mission. GDB's cash and liquid assets are referred to herein as its "liquidity resources."

GDB's primary sources of funding consist of (i) public fund deposits, which are GDB's lowest cost source of funding, (ii) senior notes issued by GDB in the bond market with maturities ranging from calendar year 2014 through 2027, and (iii) repurchase agreements. The following table sets forth a breakdown of GDB's (excluding its subsidiaries) total funding by source as of June 30, 2014 (figures in thousands). These numbers are preliminary and unaudited.

Funding Source	01/31/2014	%	06/30/2014	%
Public Deposits	$4,541,675	42.7	$ 5,519,233	53.4
Private Deposits	42,105	0.4	49,479	0.5
Bonds and Notes	5,037,120	47.4	4,717,376	45.6
Repurchase Agreements	1,009,810	9.5	50,000	0.5
Total	$10,630,710		$10,336,088	

As of June 30, 2014, GDB's average cost of funding was 2.61% and the average life of its liabilities was 2.44 years. Of the $4.7 billion of outstanding bonds and notes, approximately $477 million mature in fiscal year 2015 (staggered maturities in August and December 2014 and January and February 2015) and $882 million mature in fiscal year 2016 (staggered maturities in August and December 2015 and May 2016).

GDB's Enabling Act requires it to maintain a reserve of 20% of its liabilities on account of demand deposits. This requirement is met by investing in securities with maturities of up to 90 days.

Liquidity Resources. As of June 30, 2014, GDB's cash, bank deposits and investment portfolio at fair market value was $3.2 billion, or 25%, of GDB's assets (excluding its subsidiaries). The following table shows GDB's liquidity resources by source, including the investment securities portfolio, which constitutes an important source of liquidity for GDB because it may be realized through either sales of securities or repurchase agreements:

Liquidity Resource	**01/31/2014**	**06/30/2014**
	(in millions)	
Cash and Bank Deposits	$ 261	$ 719
Federal Funds Sold and Money Market Instruments (excluding $39 million reverse repurchase agreement with GDB subsidiary)	339	1,052
Investment Securities		
U.S. Treasury and Agencies	1,215	1,191
Government-Sponsored MBS and CMOs	373	206
Other Securities	1	36
Sub-Total	1,589	1,432
Total	$2,189	$3,203

GDB's investment portfolio consists mostly of investment securities classified among the three highest rating categories. As of June 30, 2014, the expected average life of the investment securities portfolio was 0.8 years and approximately $2.5 billion, or 78%, matures in less than one year. Of the approximately $1.5 billion investment securities portfolio, approximately $50 million was pledged to secure or repay borrowings of GDB, consisting of securities sold under agreements to repurchase and $21.8 million was pledged for other uses.

As of June 30, 2014, GDB's liquidity resources included (i) $684 million of deposits made to a special fund with respect to the Commonwealth's general obligation bonds (the "Redemption Fund"), which funds are held by GDB in trust and invested in GDB time deposits pending their disbursement for the payment of debt service, (ii) approximately $205 million of deposits made by PREPA for its Reserve Fund, which are invested in GDB time deposits, (iii) $282 million of deposits made by PREPA for its Construction Fund, which are invested in GDB time deposits, and (iv) $71.6 million of funds classified as "restricted assets," mostly consisting of proceeds from the issuance of tax-exempt GDB notes that are required to be used for certain qualifying purposes and that GDB expects to use during fiscal year 2015 and the first quarter of fiscal year 2016 to fund qualified disbursements under lines of credit extended by GDB to the Commonwealth and certain public corporations. On July 1, 2014, GDB disbursed (i) the amounts on deposit in the Redemption Fund to pay debt service on the Commonwealth's general obligation bonds and (ii) approximately $42 million of the amount on deposit in the PREPA Reserve Fund to pay debt service on PREPA's bonds. During fiscal year 2015, GDB also expects PREPA to use for approved purposes substantially all the funds on deposit in the Construction Fund.

Cash, bank deposits and unencumbered investment securities held by GDB increased by approximately $1.7 billion as of June 30, 2014 compared to December 31, 2013. The increase was due primarily to (i) the repayment of various lines of credit extended to the Commonwealth and the PBA from the proceeds of the Series 2014 Bonds (approximately $1.9 billion) (discussed above), and (ii) an increase of $1.2 billion in public fund deposits received from various agencies and public corporations (including the Redemption Fund and PREPA Reserve Fund and Construction Fund discussed above). These increases were offset by the sale of investment securities, the proceeds of which were used principally to finance GDB's loan portfolio disbursements (including draws on letters of credit), to make scheduled payments of debt service on GDB bonds and notes, to make disbursements from the Redemption Fund for the Commonwealth's general obligation bonds (the interest on which is due each January 1 and July 1), to make disbursements of PREPA sinking fund deposits and to fund the repurchase of participation agreements with respect to GDB loans during this period.

Maturity of Certain Short-Term Debt Obligations of the Commonwealth Instrumentalities

After the repayment of certain Commonwealth, PBA and COFINA bonds and notes with the proceeds of the Series 2014 Bonds, the following short-term obligations of the Commonwealth instrumentalities that mature pursuant to their terms during the 2015 fiscal year remain outstanding. The list set forth below does not include scheduled debt service on medium and long-term obligations of the Commonwealth and its instrumentalities (including GDB). In addition, the list does not identify individual loans or lines of credit that are part of GDB's loan portfolio.

(i) Bond anticipation notes of Puerto Rico Highways and Transportation Authority ("PRHTA") in an original aggregate principal amount of $400 million, which were directly purchased by a financial institution, and which mature on September 1, 2015.

On February 12, 2014, the note documents were amended to limit the holder's right to accelerate the notes and waive covenant defaults due to the recent credit downgrades. On July 1, 2014, the note documents were further amended to allow the monthly principal set-asides to be used to optionally redeem the bond anticipation notes. On July 2, 2014, $50 million of such notes were optionally redeemed by PRHTA, reducing the outstanding balance to $350 million.

(ii) Two revolving lines of credit of Puerto Rico Electric Power Authority ("PREPA") in aggregate principal amounts of $150 million (after giving effect to $103 million payment in May of 2014) and $550 million, respectively (of which $146 million and $550 million were outstanding as of July 6, 2014) due to commercial banks, with a final maturity date of October 7, 2014, and August 15, 2014, respectively, but currently subject to acceleration. On July 7, 2014, PREPA announced that these lenders have agreed not to exercise remedies as a result of credit downgrades and other events in light of ongoing discussions. Under the agreements, PREPA may delay certain principal payments currently due until July 31, 2014. Over the next few weeks, PREPA expects to continue discussions with the lenders concerning its vision for the future as it evaluates various alternatives to improve its financial situation and operations.

(iii) Bond anticipation notes of Puerto Rico Aqueduct and Sewer Authority ("PRASA") in an aggregate principal amount of $200 million, which are due on March 31, 2015.

THE ECONOMY

Gross National Product

According to the Puerto Rico Planning Board's latest projections, made in April of 2014, it is projected that Puerto Rico's real gross national product for fiscal years 2014 and 2015 will increase by 0.1% and 0.2%, respectively. However, the monthly economic indicators for the first three quarters of fiscal year 2014 indicate that the final gross national product figures for fiscal year 2014 may end up lower than the last projection presented by the Puerto Rico Planning Board.

Employment

According to the Household Survey, during the first eleven months of fiscal year 2014, total employment fell by 2.2% as compared to the same period for the prior fiscal year, and the unemployment rate averaged 14.5% compared to 14.0% for the same period of the prior fiscal year. According to the Establishment Survey, total payroll non-farm employment decreased by 1.3% during the first eleven months of fiscal year 2014. This reduction is primarily attributable to attrition and to the changes to the Employees Retirement System made pursuant to the 2013 pension reform, which may have induced some government employees to accelerate their retirement. Employment reductions in state and local government employment more than offset increases in private employment during this period.

Economic Activity Index

GDB's Economic Activity Index (the "EAI") for May 2014 reflected a 1.1% reduction compared to May 2013. The average cumulative value for the first eleven months of fiscal year 2014 showed a reduction of 3.1% compared to the same period of fiscal year 2013. The EAI is a coincident indicator of ongoing economic activity but it does not measure the real GNP annual growth rates. Since the EAI is generated with only four variables (total payroll employment, cement sales, gasoline consumption, and electric power generation), it is more volatile than the real GNP figures. This means that both increments and declines reflected in the EAI amplify the corresponding movements of the real GNP.

Economic Development Initiatives

The Commonwealth's economic development team has embarked on a comprehensive outreach strategy in order to diversify Puerto Rico's economic base, pursue niche strategies such as Aerospace/Aeronautics, and leverage its human capital and fiscal autonomy to attract new investment opportunities. The Commonwealth's goal is to protect its manufacturing core while it transitions its economic ecosystem into a regional service and high tech industrial activities hub.

In terms of specific opportunities within the services sector, Puerto Rico offers a suite of tax incentives such as Act 20-2012 (Export Services), Act 22-2012 (Individual Investors), Act 273-2012 (International Finance Center) and Act 399-2004 (International Insurance Center). Each of these laws meets specific needs for organizations as well as for individual investors. Yet, the interconnectivity of these incentives provides an aggressive service platform which firms can leverage in order to enhance operational efficiencies and better serve their client base.

Promotional efforts in several fronts including participating in relevant industry conferences, direct approach and ongoing conversations with investors and service providers have resulted in the following:

Act 20-2012 to promote exportation of services. Evaluation of over 250 tax grant applications within the following industries/sectors for the establishment of new export services operations in Puerto Rico: (i) 16% Headquarters and Centralized Management Services and Shared Services; (ii) 13% related to IT; (iii) 12% related to Financial Services; (iv)11% Advertising, Public Relations; and (v) 10% Professional Services.

Act 22-2012 for individual investors. There is a positive growth trend in new residents with the approval of over 260 tax grants since 2012, of which 90% have also established service operations in the island under Act 20-2012.

Act 273-2012 International Finance Center: Strong growth since 2013 with 6 operating licenses approved in 2013 and 6 operating licenses approved thus far in 2014.

Act 399-2004 International Insurance Center: Promotional efforts and direct approach with insurance carriers and underwriters, captive managers and related advisors have resulted in: (i) 12 authorized insurance companies; (ii) over 150 approved segregated asset plans and protected cell arrangements; and (iii) total premium income of $149 million for 2013 (more than double the $66 million in premium income for 2012).

Manufacturing and Knowledge Services. The Commonwealth's recent outreach initiatives have resulted in the following positive developments:

- Lufthansa – Center for Aircraft Maintenance, Repairs and Overhaul (MRO) will soon commence construction with $56 million investment. This new project is expected to create 400 jobs and will drive additional growth to the aerospace cluster.

- Honeywell - New high-tech laboratory for aerospace activities is under construction with $35 million investment and 300 job potential.

- Actavis - Commitment of 300 new jobs from the expansion of a generic and specialty pharmaceutical manufacturer.

- Over 13,000 jobs committed since January 2013 in the aggregate, related to different manufacturing sectors, including biopharma, medical devices, knowledge services, aerospace electronics and information technology. Out of those jobs committed, more than 5,000 have been created already.

Tourism. The Commonwealth has focused its recent efforts on expanding Puerto Rico's air and maritime access given its importance for both tourism and trade growth and in the launching of its new destination advertising campaign. Recent developments include:

- Southwest Airlines entered the Puerto Rico market, substituting its subsidiary AirTran with routes to Baltimore, Atlanta, Fort Lauderdale, Tampa and Orlando. The entry of

Southwest resulted in an upgrade of aircraft, generating 33% more passengers during 2013-2014.

- Avianca Airlines, a Colombian flag-carrier began flying from Bogotá to San Juan three times a week and an economic impact of $150 million is expected during its first year of operation. Based on the success of this route and the recent opening of the Commonwealth's Office in Colombia, a fourth flight will be added by the end of this month, with a fifth one expected by December 2014.

- Air Europa, a Spanish flag-carrier with presence in many important cities in Europe, began flying from Madrid to San Juan two times a week in May 2014.

- JetBlue launched a direct nonstop service between Chicago O'Hare International Airport (ORD) to San Juan's Luis Muñoz Marín International Airport ("LMM"), which represents 150 available seats daily with an economic impact of over $40 million annually to the Puerto Rico economy.

- The move of Seabourne Airlines headquarters to Puerto Rico is expected to create 400 new jobs in addition to the relocation of its headquarters. Seaborne has started service from LMM to La Romana, Dominican Republic. Additional routes have started in 2014, including to St. Kitts and Nevis, Punta Cana (Dominican Republic) and St. Maarten.

- Cruise ship traffic was projected to increase 14% in fiscal year 2014 (1,181,594 passengers). For fiscal year 2015, an additional 20% is currently projected in cruise passengers (1,412,376). This increase is partly attributable to Royal Caribbean's Jewel of the Seas use of San Juan as its year-round homeport, and to increased transit calls from Carnival, Royal Caribbean and Celebrity Cruise Lines. Additionally, MSC Cruises has increased visits to the Island and Princess Cruise will restart visits to San Juan in early summer 2014, while Disney will homeport in San Juan during Sept-Oct 2014.

- $7 million in improvements at Pier 3 of the San Juan Harbor will soon be completed which will make it possible to accommodate the very large Quantum of the Seas and even larger Oasis-class vessels.

- Over 6,500 new rooms in financial, permits or construction phases. The construction of these new rooms is expected to create approximately 2,661 jobs.

- Five new hotels opened during fiscal year 2014, increasing the amount of available rooms to 14,700. The new hotels include the return of Hyatt to Puerto Rico with their new brand Hyatt Place.

- Establishment of the Bed & Breakfast Program in order to promote the creation of small businesses. The first official B&B, Casa Sol in Old San Juan, was inaugurated in 2013. Many more are being evaluated to be integrated in the program.

Jobs Now Act. Since the enactment of the Jobs Now Act in February of 2013, 819 businesses have been granted incentive decrees with an aggregate commitment to create 13,474 new jobs.

On February 5, 2014, the Governor announced that his administration will accelerate the infrastructure investment plan by pursuing $800 million in infrastructure investments, including public-private partnerships, that have been identified and by accelerating agency reviews of infrastructure investment plans. The Governor also stated that his Administration will continue to diversify and strengthen the economy by growing targeted sectors, such as the pharmaceutical, aerospace and tourism sectors, and attracting new investments.

DEBT

Public Sector Debt

The table on the following page presents a summary of the debt of the Commonwealth and its instrumentalities outstanding as of May 31, 2014. The table should be read in conjunction with the information set forth under DEBT in the Base Commonwealth Report. This table includes debt primarily payable from Commonwealth or municipal taxes, Commonwealth appropriations, and rates charged by Commonwealth public instrumentalities for services or products, as well as debt payable from other sources, some of which is set forth in footnote 6 below. Excluded from the table is debt that, if included, would result in double counting, including but not limited to $793 million of outstanding bonds issued by Puerto Rico Municipal Finance Agency to finance its purchase of bonds issued by Puerto Rico municipalities, as well as $4.8 billion of GDB notes that are outstanding not guaranteed by the Commonwealth.

No deductions have been made in the table on the following page for deposits on hand in debt service funds and debt service reserve funds. This table 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.

Commonwealth of Puerto Rico
Public Sector Debt
(in millions)

	May 31, 2014
Good faith and credit bonds issued by the Commonwealth	$13,398[1]
Bonds and notes guaranteed by the Commonwealth's good faith and credit [2]	5,620
SUBTOTAL - GOOD FAITH AND CREDIT BONDS AND NOTES	19,018
Debt supported by Commonwealth appropriations or taxes	3,846[3]
Tax and Revenue Anticipation Notes [4]	500
SUBTOTAL - DEBT PAYABLE FROM GENERAL FUND	$23,364
Bonds and notes payable from sales tax revenues (COFINA)	$15,224
Debt issued by the Commonwealth and its instrumentalities	24,838[5]
Debt issued by municipalities	4,155
Pension Funding Bonds (payable from employer contributions to ERS) [6]	2,948
Other limited obligation debt and non-recourse debt [7]	2,073
SUBTOTAL - OTHER PUBLIC SECTOR DEBT	49,238
TOTAL PUBLIC SECTOR DEBT	**$72,602**

Totals may not add due to rounding.

(1) Includes approximately $100 million of debt issued by the Treasury Department to GDB which is secured by a pledge of the Commonwealth's good faith and credit and is expected to be repaid with revenues of the Commonwealth or proceeds of a future bond issue. This debt had been previously included under "Debt issued by the Commonwealth and its instrumentalities." Includes also $33.2 million debt from General Services Administration line of credit.

(2) Consists of $686 million of bonds issued by Puerto Rico Aqueduct and Sewer Authority ("PRASA"), $488 million of Puerto Rico State Revolving Fund loans made to PRASA under various federal water laws, $224.8 million of bonds issued by the POA (which are held by GDB), and $4.221 billion of PBA bonds. Excludes (in order to avoid double counting) $267 million of GDB bonds payable from available moneys of GDB and $110 million of GDB senior guaranteed notes Series 2013B, the proceeds of which have been principally used to fund loans to the Commonwealth, instrumentalities, agencies and municipalities, which loans are included in the table in the corresponding line.

(3) Represents bonds and notes payable from the Commonwealth General Fund and Public Improvement Fund. Includes $1.090 billion of bonds issued by the Public Finance Corporation, $2.146 billion of appropriation debt notes issued by the instrumentalities and agencies (including $67.2 million of notes issued by PBA), $573.3 million of notes issued by the Treasury Department (such debt is excluded from the Public Corporations Debt Table) and $37.1 million of bonds issued by the Mental Health and Anti-Addiction Services Administration.

(4) Includes $200 million in revolving notes purchased by GDB and $300 million in notes purchased by private entities.

(5) Excludes (in order to avoid double counting) $4.8 billion of notes issued by GDB, the proceeds of which have been principally used to fund loans to the Commonwealth, instrumentalities, agencies and municipalities, which loans are included in the table in the corresponding line, and excludes a note for $67.2 million of PBA. Includes $110.6 million in notes issued by PBA.

(6) 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. The Commonwealth does not guarantee such bonds. Employer contributions made to the Employees Retirement System by the central government and its agencies and therefore payable from the General Fund currently represent approximately 59% of such total employer contributions. The balance of these contributions is made by the instrumentalities and the municipalities.

(7) Includes the following: (i) $1.2 billion of Children's Trust bonds, which are payable solely from the payments to be received pursuant to the tobacco litigation settlement; (ii) $151.1 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"); (iii) $307.8 million of Capital Fund Modernization Program Subordinate Bonds, Series 2008 issued by the Puerto Rico Housing Finance Authority and payable primarily from federal housing assistance payments made available by HUD; (iv) $141.3 million of Special Facilities Revenue Bonds issued by the Highways Authority, which are payable from net toll revenues collected from the Teodoro Moscoso Bridge; (v) $155 million of Special Facilities Bonds issued by the Puerto Rico Ports Authority, which are solely payable from the pledge of certain payments made by a private corporation under a special facilities agreement; (vi) $70.8 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 (vii) approximately $18 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

The following table sets forth (i) the current debt service requirements on the Commonwealth's general obligation bonds; (ii) the debt service requirements on all PBA bonds guaranteed by the Commonwealth; (iii) the debt service requirements on all other debt guaranteed by the Commonwealth; (iv) the total debt service requirements of debt described in items (i), (ii) and (iii); (v) the debt service requirement on all Commonwealth appropriation bonds, which are not guaranteed by the Commonwealth; and (vi) the total debt service requirements on all debt included in the table.

Debt Service Requirements for Bonds Issued or Guaranteed by the Commonwealth and Publicly-Issued Commonwealth Appropriation Bonds (in thousands)

Fiscal Year Ending June 30	General Obligation (G.O.) Bonds[1]	PBA Guaranteed Debt	Other Guaranteed Debt[2]	Total G.O. and Guaranteed Debt	Publicly Issued Appropriation Bonds[3]	Total G.O., Guaranteed and Publicly Issued Appropriation Debt
2014	$ 841,259	$ 312,131	$ 110,233	$ 1,263,622	$ 15,758	$ 1,279,380
2015	893,929	313,257	121,581	1,328,767	36,683	1,365,451
2016	1,161,778	313,004	381,558	1,856,340	93,656	1,949,996
2017	1,161,685	313,043	107,554	1,582,282	85,782	1,668,063
2018	1,098,799	281,101	144,702	1,524,602	85,665	1,610,268
2019	1,120,224	280,894	129,898	1,531,017	85,552	1,616,569
2020	1,144,648	281,564	135,031	1,561,243	85,462	1,646,705
2021	1,013,706	304,046	101,484	1,419,237	85,344	1,504,580
2022	1,013,144	303,075	100,880	1,417,100	85,220	1,502,320
2023	1,012,705	286,730	101,044	1,400,479	85,085	1,485,564
2024	1,012,268	288,448	103,990	1,404,706	84,884	1,489,590
2025	1,011,823	285,892	103,373	1,401,088	85,205	1,486,293
2026	1,011,257	272,673	103,094	1,387,025	85,101	1,472,125
2027	1,010,824	273,518	100,438	1,384,780	84,982	1,469,762
2028	1,010,299	1,000,141	97,837	2,108,277	223,979	2,332,256
2029	1,009,919	206,612	92,912	1,309,444	212,727	1,522,171
2030	1,009,425	362,782	86,317	1,458,523	103,243	1,561,766
2031	1,008,994	233,648	81,696	1,324,337	103,246	1,427,583
2032	1,008,474	215,143	79,549	1,303,166	83,409	1,386,575
2033	1,007,967	215,036	78,332	1,301,334	-	1,301,334
2034	1,007,427	214,925	72,647	1,294,999	-	1,294,999
2035	1,006,965	228,469	39,799	1,275,232	-	1,275,232
2036	465,093	214,808	39,076	718,977	-	718,977
2037	464,623	200,521	38,732	703,876	-	703,876
2038	507,318	186,389	38,551	732,258	-	732,258
2039	506,847	188,509	38,510	733,866	-	733,866
2040	566,374	190,220	37,001	793,595	-	793,595
2041	565,901	190,218	16,446	772,565	-	772,565
2042	-	133,552	16,498	150,050	-	150,050
2043	-	-	15,608	15,608	-	15,608
2044	-	-	14,316	14,316	-	14,316
2045	-	-	13,056	13,056	-	13,056
2046	-	-	12,038	12,038	-	12,038
2047	-	-	11,133	11,133	-	11,133
2048	-	-	8,422	8,422	-	8,422
2049	-	-	6,263	6,263	-	6,263
2050	-	-	5,671	5,671	-	5,671
2051	-	-	4,396	4,396	-	4,396
2052	-	-	2,191	2,191	-	2,191
2053	-	-	1,104	1,104	-	1,104
	$25,653,676	$8,090,350	$2,792,960	$36,536,986	$1,810,981	$38,347,967

(1) General Obligation Bonds debt service is calculated assuming any outstanding Variable Rate GOs (approximately $126.7 million aggregate principal amount outstanding) bear interest at the maximum allowable rate per annum under Puerto Rico law (12%) and includes a $31.7 million General Services Administration line of credit.

(2) Includes $690 million of bonds issued by PRASA, $479 million of Puerto Rico State Revolving Fund loans made to PRASA under various federal water laws, the POA Guaranteed Bonds, $267 million of GDB bonds payable from available moneys of GDB and $110 million of GDB senior guaranteed notes Series 2013B.

(3) Reflects debt issued by the Public Finance Corporation.

Variable Rate Bonds and Mandatory Tender Bonds

The Commonwealth and various public corporations have outstanding variable rate bonds consisting of bonds and notes which provide for periodic interest rate changes based on a LIBOR rate or a particular index, but which are not subject to tender prior to their maturity. Certain public corporations have hedged portions of their variable rate debt exposure by entering into interest rate exchange agreements with certain swap providers.

After the refunding of certain Commonwealth general obligation variable rate bonds and the termination of certain interest rate exchange agreements from the proceeds of the Series 2014 Bonds, the only outstanding variable rate debt issued by the Commonwealth is approximately $126.7 million principal amount of variable rate general obligation bonds (the interest rate on which is tied to the consumer price index). As of June 30, 2014, the Commonwealth has no outstanding interest rate exchange agreements.

The following table shows the breakdown of variable rate debt of the Commonwealth and the public corporations as of June 30, 2014. This table does not include approximately $400 million in PRHTA Bond Anticipation Notes sold directly to a private financial institution and $696 million in PREPA lines of credit with commercial banks, all of which bear interest at variable rates.

Variable Rate Debt Breakdown
(as of June 30, 2014)

Commonwealth (General Obligation)	$126,725,000
PREPA	411,825,000
PRHTA	447,025,000
COFINA	136,000,000
Total	$1,121,575,000

As of June 30, 2014, PBA had $129,225,000 of fixed rate bonds guaranteed by the Commonwealth that are subject to mandatory tender for purchase on July 1, 2017, prior to their maturity date (the "Mandatory Tender Bonds"). There is no liquidity facility in place 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 PBA cannot remarket the Mandatory Tender Bonds, it would have to obtain other funds in order to provide for the purchase price of these bonds or the bonds would become subject to higher interest rates and an accelerated amortization schedule.

Interest Rate Exchange Agreements

Certain public corporations are parties to various interest rate exchange agreements or swaps executed in order to hedge the issuer's variable rate debt exposure and the interest rate risks associated therewith.

Over the past several years, the Commonwealth has been reducing its exposure to variable rate debt and interest rate exchange agreements, due to the risks of expiring liquidity and credit facilities associated with the majority of this debt and the potential early acceleration or termination rights that could be exercised by lenders, credit facility providers or swap counterparties as a result of downgrades of the Commonwealth's credit rating with respect to its general obligation debt. The Commonwealth has been refunding this variable rate debt, and terminating the associated interest rate exchange agreements, with the proceeds of long-term fixed rate debt. The issuance of the Series 2014 Bonds enabled the Commonwealth to continue this strategy as described in greater detail in the Official Statement.

The aggregate notional amount of the swaps for the public corporations as of June 30, 2014 was $388.9 million. The table below shows the aggregate notional amount, as of that date, of synthetic fixed rate swaps of the public corporations.

Swap Portfolio Breakdown
Notional Amount
(as of June 30, 2014)

	Synthetic Fixed
PREPA	$252,875,000
COFINA	136,000,000
Total	$388,875,000

The following table shows, as of June 30, 2014, the net mark-to-market value of all outstanding interest rate exchange agreements. The mark-to-market value of all such agreements of the public corporations was negative as of such date. Thus, the public corporations 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 June 30, 2014)

	Synthetic Fixed
PREPA	($48,863,894)
COFINA	($59,072,363)
Total	($107,936,257)

Collateral Requirements and Additional Termination Events. Under its interest rate exchange agreements, PREPA may be required to deliver collateral to the counterparties to guarantee its performance under the agreements, depending on its credit ratings and the credit ratings of insurers, as well as the mark-to-market values. As of June 30, 2014, PREPA was not required to post any collateral. However, if the credit ratings of its swap insurers were to be lowered, PREPA could be required to post collateral on all swaps and certain trades may be subject to termination solely at the option of the applicable counterparty. If any such agreements were to be terminated, they would likely be terminated at their then current mark-to-market valuations, plus cost, which could differ substantially from the mark-to-market valuations set forth in the table above due to market conditions at the time of termination. Any collateral posted at the time of the terminations could be used to effectively offset a like-amount of liquidity needed to fund the termination payments. If any such agreements related to underlying variable rate debt were to be terminated, PREPA would then be subject to variable interest rate risk on the corresponding bonds.

Under its interest rate exchange agreement, COFINA and its swap counterparty have separate undeclared additional termination events against each other. The parties executed a standstill agreement that expires on July 18, 2014. If this agreement is terminated, COFINA would then be subject to variable interest rate risk on the corresponding bonds.

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 past five fiscal years ended June 30, 2013 and for the eleven months ended May 31, 2014 (except for the gross national product numbers for fiscal year 2013 that are not yet available). As of May 31, 2014, outstanding short-term debt, relative to total debt, was 7.6%. Total public sector debt for fiscal year 2012 shown in the table below represented 93.2% of nominal gross national product for fiscal year 2012.

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

	Public Sector Debt					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
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	3,981	64,760	6.2	9.5	69,462	5.9
2013	60,115	4,843	64,957	7.4	0.3	N/A	N/A
May 31, 2014	62,437	5,145	67,582	7.6	4.0	N/A	N/A

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 5, 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.

Source: Government Development Bank

The following table shows the trend of public sector debt by major category for the past five fiscal years ended June 30, 2013 and for the eleven months ended May 31, 2014.

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
2009	$9,382	$557	$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	11,844	3,515	357	3,872	45,687	3,358	49,045	60,780	3,981	64,760
2013	11,838	491	12,329	3,501	381	3,882	44,776	3,970	48,746	60,115	4,843	64,957
May 31, 2014	13,769	710	14,479	3,552	603	4,155	45,116	3,832	48.948	62,437	5,145	67,582

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.

Source: Government Development Bank

Debt of the Public Corporations

The following table presents the outstanding bonds and notes of certain of the public corporations as of May 31, 2014 ("notes" as used in this section refers primarily to certain types of non-bonded debt regardless of maturity). Bonds and notes listed under the columns labeled "With Guaranty" are guaranteed by the Commonwealth. 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, sources other than Commonwealth appropriations or taxes or revenues of public corporations, or 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 amounts on deposit in debt service funds and debt service reserve funds. More detailed information about the major public corporations is presented in the Commonwealth Report.

Commonwealth of Puerto Rico
Outstanding Debt of Public Corporations
May 31, 2014
(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	$686,339	$3,409,149	$4,095,488	$488,249	$264,329	$752,578	$1,174,588	$3,673,478	$4,848,066
Convention Center District Authority	-	418,805	418,805	-	151,369	151,369	-	570,174	570,174
Electric Power Authority	-	8,526,710	8,526,710	-	737,108	737,108	-	9,263,818	9,263,818
Highway and Transportation Authority	-	4,824,727[(1)]	4,824,727	-	2,213,903	2,213,903	-	7,038,630	7,038,630
Housing Finance Authority	-	100,826[(2)]	100,826	-	158,609	158,609	-	259,435	259,435
Industrial Development Company	-	178,215	178,215	-	87,325	87,325	-	265,540	265,540
Infrastructure Financing Authority[(3)]	-	2,063,993	2,063,993	-	48,671	48,671	-	2,112,664	2,112,664
Port of the Americas Authority	224,790	-	224,790	-	1,200	1,200	224,790	1,200	225,990
Ports Authority[(4)]	-	-	-	-	262,974	262,974	-	262,974	262,974
Public Buildings Authority	4,220,899	-	4,220,899	-	177,875	177,875	4,220,899	177,875	4,398,774
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	-	488,885[(6)]	488,885	-	88,740	88,740	-	577,625	577,625
General Services Administration Others[(7)]	-	-	-	-	2,809,622	2,809,622	-	2,809,622	2,809,622
Total[(8)]	$5,132,028	$36,325,871	$41,457,899	$488,249	$7,001,725	$7,489,974	$5,620,277	$43,327,596	$48,947,873

(1) Excludes $141.3 million of Special Facilities Revenue Bonds issued by PRHTA, which are payable by a private party from net toll revenues collected from the Teodoro Moscoso Bridge.

(2) Excludes the $151 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 $307.8 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 (i) $37.1 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 and (ii) $329.2 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 Puerto Rico Ports Authority.

(4) Excludes $155.4 million of Special Facilities Revenues Bonds issued by the Puerto Rico 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 $70.8 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 from GDB and private banks.

(8) Excludes accretion of interest from the respective issuance dates on capital appreciation bonds. Also excludes the debt listed in footnote 6 of the Public Sector Debt table above.

Source: Government Development Bank

NEW ACTUARIAL VALUATIONS FOR RETIREMENT SYSTEMS

Overview. The Employees Retirement System, the Teachers Retirement System and the Judiciary Retirement System (collectively, the "Retirement Systems") recently published their actuarial valuation reports as of June 30, 2013. The latest actuarial valuations were conducted by Milliman Inc., a firm of independent consulting actuaries.

The June 30, 2013 actuarial valuations of the Retirement Systems were performed using the same actuarial cost methods as the actuarial valuations as of June 30, 2012, except that the interest rate assumptions were revised, as described below, and, in the case of the Employees Retirement System, certain assumptions were revised due to Act 3-2013 ("Act 3"), which adopted a comprehensive reform of the Employees Retirement System.

The following table summarizes the results of the actuarial valuations, other than with respect to non-pension post-employment benefits (which are discussed below).

Funding Status
Actuarial Valuations as of June 30, 2013
($ 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	$ 731	$23,712	$22,981	3.1%	$3,489	658.6%
Teachers Retirement System	1,907	12,252	10,345	15.6	1,249	828.5
Judiciary Retirement System	59	417	358	14.2	32	1,113.1
Total	$2,697	$36,381	$33,684	7.4%	$4,770	706.2%

(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. Totals may not add due to rounding.

Source: Actuarial valuation reports as of June 30, 2013 for each of the Retirement Systems.

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. Investors are encouraged to review the actuarial valuations with the assistance of their own qualified professionals. No information contained on these websites is deemed incorporated herein by reference.

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 Retirement Systems provide basic benefits principally consisting of a retirement annuity and death and disability benefits (collectively referred to herein as "Basic System Pension Benefits"). The Retirement Systems also administer 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 and death benefits, ad-hoc cost-of-living adjustments, and summer and Christmas bonuses. 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 recovered by the Retirement Systems in full and on a timely basis from the Commonwealth and the participating public corporations and municipalities.

Employees Retirement System. The actuarial valuation of the Basic System Benefits and System Administered Benefits of the Employees Retirement System as of June 30, 2013 gives effect to the pension reform enacted in April 2013 through Act 3. The most important aspects of the changes effected by Act 3 are summarized in the Base Commonwealth Report and the actuarial valuation. As part of the pension reform, the Government also enacted Act 32-2013 ("Act 32"), which provides for an additional annual contribution from the participating employers (which includes the municipalities and certain public corporations) beginning in fiscal year 2014 and up to fiscal year 2033. This additional contribution, which is in addition to the increase in the statutory rates of employer contributions enacted in 2011 (described in the Base Commonwealth Report), will be determined on an annual basis by the System's actuaries as the amount necessary to avoid the projected gross assets of the System during any subsequent fiscal year to fall below $1 billion.

Act 3, together with Act 32, is a dynamic 50-year plan designed to provide enough cash to the Employees Retirement System to be able to make full payment of Basic System Benefits and System Administered Benefits as they come due, as well as to pay debt service on the Employees Retirement System's debt. Because of the long-term nature of the Act 3 reform, constant monitoring and future adjustments will be needed as a result of actual experience to make sure that the System remains solvent.

The actuarial valuation of the Basic System Benefits and System Administered Benefits as of June 30, 2013 reflects an actuarial accrued liability of $23.7 billion, compared to $27.6 billion as of June 30, 2012. The reduction in the actuarial accrued liability of $3.93 billion is mostly the result of Act 3, which decreased the actuarial accrued liability as of June 30, 2013 by $3.76 billion, or 13.7%. Despite the decrease in the actuarial accrued liability, the funded ratio as of June 30, 2013 decreased to 3.1%, from 4.5% as of June 30, 2012, as a result of a decrease in the actuarial value of assets from $1.2 billion to $731 million. The decrease in the actuarial value of assets reflects a system that is being defunded as a result of the continued net funding and cash flow shortfall that is exhausting plan assets. As mentioned above, Act 3 is not designed to improve the funding ratio, but rather to ensure that the System remains solvent.

For fiscal year 2013, the actuarially recommended contribution was $2.2 billion, while actual employer contributions to the Employees Retirement System were $637.6 million, or 29.1% of the actuarially recommended contribution. Act 3, however, reduced the actuarially recommended contribution for fiscal year 2014 by $0.46 billion, or 20.3%, to $1.8 billion.

The June 30, 2012 actuarial valuation projected that the gross assets of the Employees Retirement System would have been depleted by fiscal year 2019. Based on the actuarial assumptions used for the June 30, 2013 valuation report, the changes instituted by Act 3, the gradual increase in the statutory employer contribution rates enacted in 2011 and the additional annual contributions from the Commonwealth and other participating employers required by Act 32 to be made from fiscal year 2014 through fiscal year 2033 (assumed to remain constant at $120 million each fiscal year during the projection period), it is projected that the gross assets of the Employees Retirement System will be sufficient to cover the Employees Retirement System's current and future obligations and will no longer be depleted. An accelerated pace of retirements, however, may be one of the factors that could require an increase in the additional annual contributions from the base level of $120 million.

The latest actuarial valuation assumed that, for fiscal year 2014, the additional contribution under Act 32 of $120 million (of which approximately $78.9 million corresponded to the Commonwealth central government and $41.1 million corresponded to the public corporations and municipalities) was paid at the end of the fiscal year. The actual amount of the additional contribution received by the Employees Retirement System to date for fiscal year 2014, however, is $21.3 million, or $98.6 million less than the required amount. As discussed in this Quarterly Report under FISCAL CONDITION – *Preliminary General Fund Revenues and Expenses for Fiscal Year* 2014, as a result of the General Fund revenue shortfall, compared to budget, the Commonwealth made certain adjustments to the fiscal year 2014 budgetary appropriations following the "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. These adjustments included the reduction in full of the portion of the Act 32 additional contribution corresponding to the Commonwealth central government ($78.9 million), as well as the reduction of $5.4 million that had been included in the General Fund budget to assist public corporations and municipalities that did not have the financial capacity to make their corresponding portion of the additional contribution. For fiscal year 2015, the approved budget includes a reduced appropriation of $28.2 million for the Act 32 additional contribution, of which approximately $22.6 million corresponds to the Commonwealth central government (from an estimated contribution of $70.4 million) and $5.5 million is included to assist public corporations and municipalities. The Government intends to pay the portions of the Act 32 additional contribution that it has not been able to pay on a timely basis from future legislative appropriations. Failure by the Commonwealth and other participating employers to make up for the shortfall in the additional contribution for fiscal years 2014 and 2015, as well as to make future additional contributions at the level determined by the actuaries in accordance with Act 32 on a timely basis, will have a material adverse effect on the future solvency of the Employees Retirement System and, notwithstanding the Act 3 reform, will result in future asset depletion.

The actuarial valuation as of June 30, 2013 for Basic System Benefits and System Administered Benefits also reflects an interest rate assumption of 6.4% per year, compared to 6.0% per year for the June 30, 2012 actuarial valuation. The increase in the interest rate assumption decreased the actuarial accrued liability as of June 30, 2013, compared to June 30, 2012, by $1.29 billion, or 4.5%, and the actuarially recommended contribution by $54.9 million, or 2.4%.

Teachers Retirement System. The actuarial valuation of the Basic System Benefits and System Administered Benefits of the Teachers Retirement System as of June 30, 2013 reflects an actuarial accrued liability of $12.3 billion, compared to $12.4 billion as of June 30, 2012, and a funded ratio of 15.6%, compared to 17% as of June 30, 2012. The decrease in the funded ratio is the result of a decrease in the actuarial value of assets from $2.1 billion to $1.9 billion, due to the continued net funding and cash flow shortfall that is exhausting plan assets. 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, 2013 shows that the Teachers Retirement System is being gradually defunded and projects that its net and gross assets will be depleted by fiscal year 2020.

For fiscal year 2013, the actuarially recommended contribution was $736.6 million, while actual employer contributions to the Teachers Retirement System were $187.4 million, or 25.5% of the actuarially recommended contribution.

The actuarial valuation as of June 30, 2013 for Basic System Benefits and System Administered Benefits also reflects an interest rate assumption of 6.25% per year, compared to 5.95% per year for the June 30, 2012 actuarial valuation. The increase in the interest rate assumption decreased the actuarial accrued liability as of June 30, 2013, compared to June 30, 2012, by $0.43 billion, or 3.4%, and the actuarially recommended contribution by $25 million, or 3.2%.

The June 30, 2013 actuarial valuation does not take into consideration the effects of Act 160-2013 ("Act 160"), enacted in December 2013, which adopted a comprehensive reform of the Teachers Retirement System. The February Quarterly Report describes the principal changes that were included in Act 160, which also provided for additional annual contributions from the General Fund to the System of $30 million in fiscal years 2017 and 2018 and $60 million thereafter until fiscal year 2042. The reforms of the Teachers Retirement System, together with the gradual increase in the statutory employer contribution rates enacted in 2011 and the additional annual contributions described above, were projected, based on actuarial assumptions, to allow the System to make benefit payments when due. In April 2014, however, the Puerto Rico Supreme Court ruled that the amendments enacted by Act No. 160 to the pension benefits provided to active teachers who are participants in the Teachers Retirement System are unconstitutional. Only new participants in the Teachers Retirement System will be subject to the amendments to the pension benefits enacted by Act 160. The Commonwealth is currently studying the effects of the Court's decision on the financial condition of the System in order to evaluate alternative courses of action. Failure to amend Act 160 in order to compensate for the effect of the provisions declared unconstitutional will lead to the depletion of the System's assets, as projected by the June 30, 2013 actuarial report.

Judiciary Retirement System. The actuarial valuation of the Basic System Benefits and System Administered Benefits of the Judiciary Retirement System as of June 30, 2013 reflects an actuarial accrued liability of $416.7 million, compared to $416.3 million as of June 30, 2012, and a funded ratio of 14.2%, compared to 14.1% as of June 30, 2012. 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, 2013 shows that the Judiciary Retirement System is being gradually defunded and projects that its net and gross assets will be depleted by fiscal year 2019.

For fiscal year 2013, the actuarially recommended contribution was $38.5 million, while actual employer contributions to the Employees Retirement System were $11.4 million, or 29.6% of the actuarially recommended contribution.

The actuarial valuation as of June 30, 2013 for Basic System Benefits and System Administered Benefits also reflects an interest rate assumption of 6.3% per year, compared to 6.1% per year for the June 30, 2012 actuarial valuation. The increase in the interest rate assumption decreased the actuarial accrued liability as of June 30, 2013, compared to June 30, 2012, by $9 million, or 2.1%, and the actuarially recommended contribution by $0.8 million, or 2.0%.

The June 30, 2013 actuarial valuation does not take into consideration the effects of Act 162-2013 ("Act 162"), enacted in December 2013, which adopted a comprehensive reform of the Judiciary Retirement System. The February Quarterly Report describes the principal changes that were included in Act 162. The reforms of the Judiciary Retirement System were projected, based on actuarial assumptions, to allow the System to make benefit payments when due. In February 2014, however, the Puerto Rico Supreme Court upheld the constitutionality of Act 162, but only with respect to judges appointed on or after December 24, 2013, the date Act 162 was enacted. As a result, judges appointed before the approval of Act 162 will continue to enjoy their prior retirement benefits. For judges appointed on or after the approval of Act 162, the Puerto Rico Supreme Court interpreted Act 162 as creating two benefits regimes, one for judges appointed between December 24, 2013 and June 30, 2014, as to whom a modified benefits regime applies, and one for judges appointed on or after July 1, 2014, as to whom all provisions of Act 162 apply. The Commonwealth is currently studying the effects of the Court's decision on the financial condition of the System in order to evaluate alternative courses of action. Act 162 also provides that the System will request an actuarial report to determine the amount of the additional contribution the Commonwealth would have to make in order to avoid the projected gross assets of the System during any subsequent fiscal year from falling below $20 million. If the Commonwealth is not able to make such additional contributions or fails to take other corrective actions to compensate for the effect of the provisions declared unconstitutional, the System's assets will be depleted, as projected by the June 30, 2013 actuarial report.

Post-Employment Benefits Other Than Pensions. The Commonwealth also provides non-pension post-employment benefits consisting of a medical insurance plan contribution. These benefits are funded by each employer 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 these post-employment expenses.

Act 3 eliminated all non-pension post-employment system benefits to future retirees of the Employees Retirement System. Act 3 did not change the medical insurance plan contribution for current retirees, which amounts to up to $100 per month to the eligible medical insurance plan selected by the retiree or disabled member. As a result of the changes in Act 3, the actuarial accrued liability of the Employees Retirement System for these benefits, as of June 30, 2013, decreased by $0.66 billion, from $2.14 billion to $1.48 billion, or by 30.8%, compared to June 30, 2012.

Post-employment benefits other than pensions are valued using actuarial principles similar to the way that pension benefits are calculated. The following table summarizes the results of the actuarial valuations for these benefits. Since these benefits are not pre-funded, as discussed above, the unfunded actuarial accrued liability is equal to the actuarial accrued liability.

Post-Employment Benefits Other Than Pensions
Actuarial Valuations as of June 30, 2013
($ in millions)

	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	-	$1,483	$1,483	0%	$3,489	42.5%
Teachers Retirement System	-	793	793	0	1,249	63.5
Judiciary Retirement System	-	7	7	0	32	20.9
Total	-	$2,283	$2,283	0%	$4,770	47.9%

[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.

Source: Actuarial valuation reports as of June 30, 2013 for each of the Retirement Systems.

Post-employment benefits other than pensions paid by the Employees Retirement System, the Teachers Retirement System and the Judiciary Retirement System amounted to $91.5 million, $34.2 million and $0.3 million, respectively, for fiscal year 2013, and are estimated at $86.7 million, $36.2 million and $0.3 million, respectively, for fiscal year 2014.

LITIGATION

The following section provides an update to the information set forth under LITIGATION in the Base Commonwealth Report and the February Quarterly Report and under "RECENT DEVELOPMENTS- Litigation" in the Official Statement.

Reform of the Teachers Retirement System

On April 11, 2014, the Puerto Rico Supreme Court ruled that the amendments enacted by Act 160-2013 ("Act 160") to the pension benefits provided to active teachers who are participants in the Teachers Retirement System are unconstitutional. The Court stated that its conclusion was driven in part because the law created certain incentives for the early retirement of teachers and there was insufficient evidence of how the proposed reforms would safeguard or promote the solvency of the System if a significant number of teachers elected such early retirement. Only new participants in the Teachers Retirement System will be subject to the amendments to the pension benefits enacted by Act 160. The Court upheld those sections of Act 160 that eliminated certain additional non-pension benefits of all participants.

Act for the Redistribution and Adjustment of the Tax Burden

On May 12, 2014 the plaintiffs in the case challenging the constitutionality of the gross receipts tax or "*patente nacional*" filed a writ of Certiorari before the Supreme Court of Puerto Rico, which was opposed by the Commonwealth on May 21, 2014. The Court of First Instance had previously dismissed plaintiffs' suit and the Court of Appeals had affirmed the judgment. As of June 30, 2014, the Supreme Court has not issued the writ.

Police Institutional Reform

The Commonwealth was a defendant in a lawsuit filed 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. On July 17, 2013, the parties entered into a settlement agreement that requires certain institutional reforms of the Police Department, to be implemented during the next 10 years. Under the agreement, the court did formally dismiss the claim, but retained jurisdiction to assure compliance with the agreement through a Technical Compliance Advisor ("TCA") selected by the parties. Mr. Arnaldo Claudio was recently appointed and approved by the court as the TCA.

Doral Financial Corporation Litigation

On June 5, 2014, Doral Financial Corporation and certain of its subsidiaries filed a lawsuit against the Commonwealth of Puerto Rico and the Puerto Rico Department of the Treasury seeking a declaratory judgment regarding the validity of a closing agreement, which provided for a refund of approximately $230 million payable over a five-year period, executed on March 26, 2012, between Doral and the Commonwealth Treasury Department which had been declared null by the Treasury Department.

The Commonwealth Treasury Department filed a Motion to Dismiss for lack of jurisdiction to rule in the controversy. The Court of First Instance ruled that the Commonwealth Treasury Department had acted in accordance with the law when it had declared the Final

Agreement null. The Court also held that it lacked jurisdiction to determine whether Doral overpaid taxes during the period of 2000-2004 and therefore whether Doral was entitled to the refund.

On July 1, 2014, the Court of Appeals reversed the Court of First Instance, concluding that the Court has jurisdiction to determine the controversy. The Commonwealth Treasury Department has sixty days to file a petition for a writ of certiorari to the Puerto Rico Supreme Court.

Puerto Rico Debt Enforcement and Recovery Act

On June 28, 2014, certain holders of bonds issued by PREPA filed a lawsuit in the United States District Court for the District of Puerto Rico seeking a declaratory judgment that the Recovery Act violates certain provisions of the United States Constitution. The complaint alleges that the Recovery Act is a law dealing with "bankruptcy matters" and that the Commonwealth is precluded by the United States Constitution from enacting this law since only the United States Congress can do so under the "bankruptcy clause" of the United States Constitution. The complaint further alleges that certain provisions of the Recovery Act, if enforced, would violate several provisions of the United States Constitution because they would constitute an unconstitutional impairment of the contract between PREPA and its bondholders or a "taking" of the bondholders' property without just compensation.

The Commonwealth, PREPA and GDB intend to defend vigorously the constitutionality of the Recovery Act. They believe that the provisions of the Recovery Act will be enforced in a manner that complies with the requirements of both the United States Constitution and the Commonwealth Constitution.

The case is in its initial stages and motions to dismiss will be filed by the Commonwealth before the scheduled deadline.