COMMONWEALTH OF PUERTO RICO
Financial Information and Operating Data Report
October 30, 2014

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INTRODUCTION

The financial and operating information about the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico") included in this Report has been updated as of June 30, 2014, the end of the Commonwealth's 2014 fiscal year, except as otherwise provided herein. Certain information about the debt of the Commonwealth and its instrumentalities has been updated as of July 31, 2014.

Forward-Looking Statements

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

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

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

BASIC FACTS ABOUT THE COMMONWEALTH

Location and Population

Puerto Rico is an island located in the Caribbean approximately 1,600 miles southeast of New York City. It has an area of approximately 3,500 square miles and a population of approximately 3.6 million people.

Relationship with the United States

Puerto Rico came under United States sovereignty pursuant to the Treaty of Paris of 1898, which ended the Spanish-American War. Puerto Ricans have been citizens of the United States since 1917. In 1950, the United States Congress authorized Puerto Rico to draft and approve its own Constitution, guaranteeing a republican form of government. The Constitution was drafted by a popularly elected constitutional convention, approved in a special referendum by the people of Puerto Rico, amended and ratified by the United States Congress, and subsequently approved by the President of the United States in 1952.

The United States and the Commonwealth share a common defense, market and currency. The Commonwealth exercises virtually the same control over its internal affairs as do the 50 states. It differs from the states, however, in some aspects of its political relationship with the United States federal government with respect to the application of certain federal laws such as the Internal Revenue Code. The people of Puerto Rico are citizens of the United States but do not vote in Presidential elections. They are represented in Congress by a non-voting Resident Commissioner. Most federal taxes, except those such as Social Security and Medicare taxes, are not levied in Puerto Rico. Puerto Rico residents (other than certain federal employees) do not pay federal income tax on Puerto Rico-source income (but they do pay federal income tax on non-Puerto Rico-source income).

For many years, there have been two major views in Puerto Rico with respect to Puerto Rico's relationship with the United States: one favoring commonwealth status, represented by the Popular Democratic Party, which controls the Office of the Governor and the Legislative Assembly since the 2012 general elections, and the other favoring statehood, represented by the New Progressive Party. These two parties have obtained over 90% of the vote for Governor in all elections since 1972. (Or since 1960, if we include a previous pro-statehood party that existed before the New Progressive Party was established.)

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

Official Languages

The official languages of Puerto Rico are Spanish and English.

Government

The Constitution of Puerto Rico provides for the separation of powers of the executive, legislative, and judicial branches of government. The Governor is elected every four years. The Legislative Assembly consists of a Senate and a House of Representatives, the members of which are elected for four-year terms. The highest Puerto Rico court is the Supreme Court of Puerto Rico. Decisions of the Supreme Court of Puerto Rico may be appealed to the United States Supreme Court in the same manner as decisions from state courts. Puerto Rico constitutes a District in the federal judiciary and has its own United States District Court. Decisions of this court may be appealed to the United States Court of Appeals for the First Circuit and from there to the United States Supreme Court.

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

Fiscal Year

The Commonwealth's fiscal year runs from July 1 through June 30 of the following year. References in this Report to a fiscal year are to the period ending on June 30 of such year.

General Fund

The General Fund is the primary operating fund of the Commonwealth. References in this Commonwealth Report to General Fund revenues and expenditures (and to any resulting General Fund deficit), unless otherwise specified, are references to such revenues and expenditures as reflected in the Commonwealth General Fund budget, and are sometimes (but not always) referred to for clarity as General Fund budgetary revenues and budgetary expenditures. These budgetary revenues and expenditures do not include many sources of revenues and nonbudgetary funds and many classes of expenditures that are part of the General Fund for financial reporting purposes in accordance with United States generally accepted accounting principles.

Principal Officers Responsible for Fiscal Matters

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

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

Melba Acosta Febo was appointed President of GDB, effective October 27, 2014. Prior to this appointment, she was the Commonwealth's Secretary of Treasury. Since March 1, 2013, Ms. Acosta has also been the Chief Public Financial Officer of the Commonwealth of Puerto Rico. Before these appointments, Ms. Acosta was Director of OMB and Chief Information Officer from 2001 to 2004, and Chief of Staff of the Municipality of San Juan from 1997 to December 2000. In the private sector, Ms. Acosta worked as an attorney with McConnell Valdés from 1995 to 1997 and from 2010 to 2012. She served as Executive Vice President, Chief Operating Officer, and Chief Financial Officer of RG Financial Corporation and its bank subsidiary, RG Premier Bank, from 2004 to 2010. In addition, she served as Tax Consultant with Price Waterhouse from 1988 to 1990. Ms. Acosta is a certified public accountant and an attorney-at-law. She holds a bachelor's degree in Accounting from the School of Business Administration of the University of Puerto Rico, an MBA from the Harvard Graduate School of Business Administration and a Juris Doctor from the School of Law of the University of Puerto Rico. She is a member of the Boards of Directors of the Puerto Rico Art Museum, the Luis Muñoz Marín Foundation and GDB. Previously, she was a member of the Board of Directors of United Way of Puerto Rico.

Juan C. Zaragoza was designated Secretary of the Treasury Department of the Commonwealth of Puerto Rico on October 15, 2014, and is awaiting confirmation by the Puerto Rico Senate. He has over 30 years of experience providing tax consulting services, specializing in tax exemption, tax credits, restructuring, and sales and use taxes. Before this appointment, he co-founded in 2002 Zaragoza & Alvarado, a firm engaged in providing tax and business consulting services. Prior to establishing Zaragoza & Alvarado, he was the partner in charge of Arthur Andersen LLP's Tax and Business Advisory Services Practice in San Juan, Puerto Rico. He joined Arthur Andersen in 1993 and became a partner in 1995. From 1989 to 1992, he served as Assistant Secretary for Internal Revenue at the Treasury Department where he oversaw seven major bureaus and was responsible for implementing the Internal Revenue Division's policy-setting and related legislation. From 1983 to 1989, he worked at Price Waterhouse in Puerto Rico, in the Audit and Tax Divisions. Throughout his professional career, Zaragoza has always been very active in the development of tax legislation and the analysis of the tax system in Puerto Rico, both at state and municipal level. He is Past President of the Puerto Rico Certified Public Accountants Association (1997-1998). He holds an MBA in Management from Indiana University at Bloomington and a BBA in Accounting from the University of Puerto Rico.

Luis F. Cruz was appointed Director of OMB on October 22, 2014. Prior to this appointment, he served as Director of the Treasury and Budget Commission of the Puerto Rico

House of Representatives and as Advisor to the Speaker of the House on Tax, Finance and Budget issues from January 2013 to October 2014. Previously, he had a successful career in public accounting spanning more than 25 years. In 1994, he established his own firm, Luis F. Cruz & Co.—later incorporated as Cruz, Izaguirre & Co., CPA, PSC—to offer accounting, tax, audit, and financial consulting services. In 1999, he established Global Consulting Group, Inc., to offer consulting services in the fraud prevention and detection area, and the evaluation of internal controls. He has offered consulting services to a variety of clients in the private sector, such as Banco Popular de Puerto Rico, Banco Santander, and Ricoh Lanier Puerto Rico. In the public sector, he has provided services to the OMB, Treasury Department, Puerto Rico Office of Courts Administration, among others. Before founding his own firms, he worked with Caribe Detroit Diesel Allison (1990-1992), and with First Federal Savings Bank (now FirstBank) (1987-1990). Mr. Cruz was a member of the Puerto Rico State Board of Accounting (2002-2006) and a member of the Board of Directors and Treasurer of the Puerto Rico Chamber of Commerce, where he served in various committees (2007-2009). He is a member of the American Institute of Certified Public Accountants, of the Puerto Rico Society of Certified Public Accountants, and of the Association of Certified Fraud Examiners. He obtained an MBA in Finance from the InterAmerican University of Puerto Rico and a BBA in Accounting from the University of Puerto Rico. He is a Certified Public Accountant, a Certified Fraud Examiner, and a Chartered Global Management Accountant.

RECENT EVENTS

Issuance of Tax and Revenue Anticipation Notes

On October 10, 2014, GDB entered into a Note Purchase, Revolving Credit and Term Loan Agreement (the "GDB Notes Agreement") providing for the issuance of up to $900 million aggregate principal amount of 2015 Series B Senior Notes (the "GDB Notes") guaranteed by the Commonwealth. The GDB Notes Agreement provides for a $200 million revolving line of credit and a $700 million term loan with scheduled draws. In connection with the issuance of the GDB Notes, the Commonwealth entered into a Covenant Agreement with the initial holders thereof that requires compliance with certain financial covenants, among other matters, a violation of which could result in an increase in the interest rate on the GDB Notes. As of the date of this report, GDB had drawn $700 million and the remaining $200 million is scheduled to be drawn on November 13, 2014. The proceeds of the GDB Notes will be used to make a loan to the Commonwealth evidenced by $900 million aggregate principal amount of Tax and Revenue Anticipation Notes of the Commonwealth of Puerto Rico, Series B (2015) (the "Series B TRANs"). The GDB Notes mature on June 30, 2015 and are subject to amortization requirements which commence on April 16, 2015. The GDB also purchased $300 million aggregate principal amount of Tax and Revenue Anticipation Notes of the Commonwealth of Puerto Rico, Series C (2015), which are subordinated to the Series B TRANs. The TRANs interest cost payable by the Commonwealth exceeds by approximately $25 to $30 million the amount included in the fiscal year 2015 budget for such purpose.

Preliminary General Fund Budgetary Revenues for First Three Months of Fiscal Year 2015

Preliminary General Fund budgetary revenues for the first three months of fiscal year 2015 were $1.774 billion, an increase of $75 million over the same period of the prior fiscal year, but $36 million less than estimated revenues for the period. See "FISCAL CONDITION - Preliminary General Fund Budgetary Revenues for First Three Months of Fiscal Year 2015."

Approval of Fiscal Year 2015 Budget

The budget for fiscal year 2015 was approved on July 1, 2015. It provides for General Fund budgetary revenues and expenditures of $9.565 billion. This represents a revenue increase of $528 million over actual (unaudited) General Fund revenues for fiscal year 2014 ($9.037 billion) and of $40 million when compared with the fiscal year 2014 budget revenue projections ($9.525 billion). Budgeted expenditures of $9.565 billion are $320 million over the final amended budget for fiscal year 2014 ($9.245 billion), but $205 million less than the original approved budget for fiscal year 2014 ($9.770 billion). See "BUDGET OF THE COMMONWEALTH."

Enactment of Fiscal Sustainability Act

On June 17, 2014, the Commonwealth enacted the Fiscal Sustainability Act, which is a temporary fiscal emergency law designed to address the fiscal condition of the Commonwealth. Among other things, the Act freezes benefits under collective bargaining agreements and certain formula-based appropriations, and imposes substantial additional managerial and administrative controls on the operations of the Executive Branch. See "FISCAL CONDITION – Enactment of Fiscal Sustainability Act."

Enactment of Recovery Act

On June 28, 2014, the Commonwealth enacted the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the "Recovery Act"), which creates a legal framework that: (i) allows certain public corporations to adjust their debts in a manner that protects the interests of all affected creditors; (ii) 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 Constitution of each of the United States and Commonwealth; and (iii) maximizes the return to such public corporation's stakeholders. As of the date of this report, no public corporation has sought relief under the Recovery Act. The Commonwealth enacted the Recovery Act because public instrumentalities of the Commonwealth are not currently eligible to seek relief under Chapter 9 of the United States Bankruptcy Code, which is available to public instrumentalities of the 50 states of the United States. On July 31, 2014, Puerto Rico Resident Commissioner Pedro Pierluisi introduced a bill in the U.S. Congress that would empower the government of Puerto Rico to authorize Puerto Rico municipalities and public corporations to restructure their debt obligations under Chapter 9 of the United States Bankruptcy Code. See "FISCAL CONDITION – Enactment of Recovery Act."

Agreement Between PREPA and Certain Bondholders and Lenders

On August 14, 2014, the Puerto Rico Electric Power Authority, which has been experiencing significant financial difficulties, entered into forbearance agreements with certain bondholders, certain banks and GDB. Among other things, the banks agreed to extend the maturity of their loans until March 31, 2015, and all lenders party to the agreements agreed to forbear from exercising their rights against PREPA resulting from certain specified defaults until March 31, 2015. Pursuant to the forbearance agreements, PREPA appointed a restructuring officer, whose mandate is to work alongside PREPA's executive director to develop, organize and manage a financial and operational restructuring of PREPA. PREPA is also required to deliver a restructuring plan acceptable to the forbearing creditors by March 2, 2015. See "PUBLIC CORPORATIONS – Puerto Rico Electric Power Authority."

Proposed Legislation to Ensure that the Highways Authority Operates on Self-Sufficient Basis

On October 30, 2014, the Commonwealth introduced legislation in the Commonwealth House of Representatives that seeks to ensure that the Puerto Rico Highways and Transportation Authority ("PRHTA") can operate on a self-sufficient basis without support from the General Fund budget or from GDB to sustain its operations. The proposed legislation will also facilitates the refunding of loans made by GDB and other lenders to the PRHTA, as well as fund a portion of the operations of the newly created Integrated Transit Authority ("ATI"). The proposed legislation provides for a new petroleum products tax to be assigned to the Puerto Rico Infrastructure Financing Authority ("PRIFA") and a new petroleum products tax to be assigned to ATI. PRIFA expects to issue during the current or the next fiscal quarter bonds secured by collections of the petroleum products tax assigned to it and to use the proceeds of such bonds to repay loans made by GDB to the PRHTA and bond anticipation notes issued by the PRHTA. ATI will use the proceeds of the petroleum products tax assigned to it to fund the operations of Tren Urbano and other mass transit assets to be transferred to it by the PRHTA. The proposed legislation is expected to provide liquidity to GDB and to make the PRHTA self-sufficient by increasing its revenues and reducing its debt burden.

New Health Reform Contracts

On October 14, 2014, the Board of Directors of the PR Health Insurance Administration ("PRHIA") awarded the new contracts for the Government Public Health Insurance Plan (the "GHP"), which replaces the current "Mi Salud" plan, to five private insurance providers pursuant to a bidding process. The new contracts will be effective on April 1, 2015. On said date, the Commonwealth public health insurance model will change from a "third-party administrator" model, in which the Commonwealth is ultimately responsible for the cost of the health services provided, to a "managed care organization" model, in which PRHIA will pay the insurers a fixed premium for each insured beneficiary and the insurers will be responsible for the cost of such services. The premiums payable by the Commonwealth under the new contracts in fiscal year 2015 exceed by approximately $62 million the amounts included in the fiscal year 2015 budget for such purpose. See "FISCAL CONDITION – Health Insurance."

Status of Sales and Use Tax Collection at Ports

The Commonwealth recently began implementing its "Integrated Merchant Portal" (PICO) system for the collection of sales and use tax from importers of merchandise at their point of entry into Puerto Rico and the filing of electronic returns under the new system. Despite certain setbacks with the initial implementation of the system, the Treasury Department never stopped collecting the sales and use tax, as the Treasury Department implemented certain processes to allow merchants to temporarily file paper returns.

Downgrade of Bond Ratings

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, were lowered (more than once in most cases) to non-investment grade by Moody's, S&P, and Fitch. This has had an adverse effect on the Commonwealth's financing costs. See "RATINGS" and "RISK FACTORS - The downgrade of the Commonwealth's credit ratings to non-investment grade by the rating agencies has raised the Commonwealth's cost of borrowing and adversely affected the market price of outstanding bonds, and such downgrades may limit the ability of the Commonwealth to borrow and may have other adverse effects on the Commonwealth's financial condition."

Condition of Retirement Systems

On December 24, 2013, the Commonwealth enacted comprehensive reforms of the Judiciary Retirement System and the Teachers Retirement System. The constitutionality of these reforms were challenged in several lawsuits brought by participants in such retirement systems.

In two decisions rendered in February and April of 2014, the Puerto Rico Supreme Court struck down important parts of these reforms, holding that the reforms impermissibly impaired the Commonwealth's contractual obligations to current employees. The Court's decisions materially limit the expected savings of these two reforms, as the measures declared unconstitutional were those that modified the benefits of current employees, which impose the most significant burdens on plan assets. See "RETIREMENT SYSTEMS AND OTHER POST-EMPLOYMENT BENEFITS."

Issuance of $3.5 Billion in 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 issuance expenses and $245 million of original issue discount, were used to (i) repay and reprogram certain lines of credit extended by GDB to the Commonwealth and to the Puerto Rico Public Buildings Authority ("PBA"); (ii) repay certain bond anticipation notes issued by the Puerto Rico Sales Tax Financing Authority ("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; and (v) provide for a portion of the payment of interest on the Series 2014 Bonds through July 1, 2016.

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, this 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.

The downgrade of the Commonwealth's credit ratings to non-investment grade by the rating agencies has raised the Commonwealth's cost of borrowing and adversely affected the market price of outstanding bonds, and such downgrades may limit the ability of the Commonwealth to borrow and may have other adverse effects on the Commonwealth's financial condition.

Beginning in the first two weeks of February 2014, the credit ratings of the Commonwealth's general obligation bonds and Commonwealth guaranteed bonds were lowered (more than once) to non-investment grade by Moody's Investors Service ("Moody's"), Standard & Poor's Rating Services ("S&P"), and Fitch Ratings ("Fitch").

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 this Commonwealth Report or others not described herein.

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. 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, including credit rating downgrades to non-investment grade level. 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 "FISCAL CONDITION – GDB Funding and Liquidity."

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 threatened.

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 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 high level of debt may affect the performance of the economy and government revenues.

The Commonwealth's 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 July 31, 2014, the Commonwealth had outstanding a total of $23.005 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 for fiscal year 2015 on these bonds and notes ($1.365 billion, excluding $344 million in capitalized interest) represents approximately 14% of the General Fund budget for fiscal year 2015 ($9.565 billion). Maximum annual debt service on these bonds and notes ($2.332 billion in fiscal year 2028) would represent 24% of the General Fund budget for fiscal year 2015. The total outstanding public sector debt of the Commonwealth, its instrumentalities, and municipalities was $71.435 billion as of July 31, 2014, equivalent to approximately 101% 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. More recently, 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 financing.

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, such as those adopted to reduce appropriations at the end of fiscal year 2014, 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.

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.**

On July 31, 2014, Puerto Rico Resident Commissioner Pedro Pierluisi introduced a bill in the U.S. Congress that would empower the government of Puerto Rico to authorize Puerto Rico municipalities and public corporations to restructure their debt obligations under Chapter 9 of the United States Bankruptcy Code, which currently applies to municipalities and public corporations of the 50 states, but excludes those from Puerto Rico.

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 Public Finance Corporation, 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 to finance budget deficits, although it includes $344 million of capitalized interest that was borrowed in fiscal years 2012 and 2014 and reduces the additional uniform contribution for fiscal year 2015 to the Employees Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities (the "Employee Retirement System") 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 "FISCAL CONDITION – Enactment of Fiscal Sustainability Act." These measures faced significant opposition from organized labor and other constituencies, which have resulted in protests and work stoppages, 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 pressures on the General Fund budget. 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.

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 adversely 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. Revenues for the first quarter of fiscal year 2015 are $36 million below projected revenues for the period. Also, certain projected expenditures for the 2015 fiscal year (not all of which are direct General Fund expenses) have increased since the budget was adopted: Interest costs related to the TRANs will be higher than budgeted; the Department of Education has a projected overdraft of approximately $32 million plus certain additional non-recurring needs, which the Commonwealth expects to fund from possible General Fund surpluses in other areas; premiums for the new health insurance contracts scheduled to go into effect on April 1, 2015 (which are not direct General Fund obligations, but which the Commowealth may elect or need to support) are higher than anticipated; and there are non-budgeted transition costs for ATI's assumption of Tren Urbano operations (which are not direct General Fund obligations, but which the Commowealth may elect or need to support).

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. Although some of the revenue raising measures that are currently being contemplated focus on tax reforms that broaden the tax base and modify certain income and consumption tax rates, such legislation could still 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 Constitution of the Commonwealth provides that the Commonwealth may not issue general obligation debt if the principal and interest on all such debt payable in any fiscal year, together with any amount paid by the Commonwealth in the prior fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceed 15% of the average annual internal revenues of the Commonwealth in the two preceding fiscal years. The Commonwealth's maximum annual debt service of $1.149 billion represents approximately 13.7% of average revenues for fiscal years 2013 and 2014. Therefore, 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 this Constitutional limit (as well as the recent downgrade of its bond credit ratings and limited market access). As a result, the Commonwealth may be limited in its capacity 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. An 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 also provides that the Commonwealth shall not guarantee any obligation evidenced by bonds or notes if the principal and interest on all such debt payable in any fiscal year, together with any amount paid by the Commonwealth in the prior fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceed 15% of the average annual internal revenues of the Commonwealth in 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 actually paying 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 July 31, 2014, $5.536 billion of such guaranteed obligations were outstanding. In addition, on October 10, 2014, GDB entered into an agreement pursuant to which it issued $700 million (and could issue up to $900 million) of notes guaranteed by the Commonwealth and maturing on or prior to June 30, 2015, the proceeds of which were used to purchase Tax and Revenue Anticipation Notes of the Commonwealth.

The Commonwealth has statutory authority to provide additional guarantees until the 15% limitation is reached. As of July 31, 2014, the Commonwealth was authorized to guarantee approximately $4.6 billion of Puerto Rico Public Building Authority ("PBA") obligations, of which approximately $4.1 billion aggregate principal amount is currently outstanding, and $2.0 billion of obligations of GDB and certain instrumentalities, of which approximately $277 million (<u>excluding</u> the up to $900 million in notes mentioned above) is currently outstanding. The Commonwealth has also introduced legislation in the Legislative Assembly that would authorize the issuance of up to $2.9 billion of PRIFA bonds guaranteed by the Commonwealth, the proceeds of which would be used to refund certain debt of the PRHTA owed to GDB and other lenders.

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), and although <u>**there are no current plans to propose such an**</u>

amendment, 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. See table labeled "Debt Service Requirements of Bonds Issued or Guaranteed by the Commonwealth and Publicly-Issued Appropriation Bonds" under "DEBT."

The Commonwealth owes GDB a significant amount.

The Commonwealth owes GDB a significant amount of debt payable from budgetary appropriations, imposing a significant recurrent budgetary burden on the General Fund budget. In June 2014, in order to address unexpected General Fund revenue shortfalls, the Governor signed Executive Order 29-2014, which provided, among other things, for a reduction of $247 million in the appropriation for the payment of appropriation debt owed to GDB. The affected GDB appropriation debt was satisfied in part through a reallocation of approximately $200 million in proceeds from the Commonwealth's Series 2014 Bonds. The terms of the affected GDB appropriation debt not so reallocated were modified to provide for payment in future fiscal years.

Some of the corrective measures for the fiscal year 2015 General Fund budget also included a reduction of $79 million in the appropriations for payment of Commonwealth debt to GDB, adjusted by the Legislative Assembly as part of the budgetary approval process. There can be no assurance that a mutually agreeable debt reprogramming for the affected debt will be reached and formalized between the Commonwealth and GDB. Moreover, such arrangements may require that the Commonwealth fully or partially restore the adjusted appropriations, with the corresponding cost escalator effect on the fiscal year 2016 General Fund budget. See "DEBT – Public Sector Debt."

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

The economic recession that has affected the Commonwealth since fiscal year 2007 and the income tax reduction program adopted in fiscal year 2011 has negatively affected Commonwealth income tax revenues. 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 "COMMONWEATH TAXES, OTHER REVENUES AND EXPENDITURES – Special Excise Tax (Act 154)."

In addition, after December 31, 2017, absent action by the US Internal Revenue Service, 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 Treasury Department's projections for tax revenues involve many premises and assumptions, the effects of which are beyond its control, 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. (Revenues for the first quarter of fiscal year 2015 are $36 million below projected revenues for the period.) 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 "COMMONWEALTH TAXES, OTHER REVENUES, AND EXPENDITURES – Federal Grants."

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 adversely 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. The fiscal year 2015 General Fund budget contemplates a significant reduction in the Department of Education's expenditures. However, 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. Certain expenditures, such as those required to fund the Department's special education program, can increase unexpectedly as a result of court orders issued in pending lawsuits by special education students.

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 1.6 million qualifying (generally low-income) residents of Puerto Rico. The cost of this health insurance program is very significant. A substantial portion of this cost is currently paid by the federal government and funded principally by non-recurring funding provided pursuant to the federal Patient Protection and Affordable Care Act (the "Affordable Care Act" or "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 this non-recurring funding, the amount of federal funds available for this health insurance program 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 or both are 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.

If the availability of ACA funds is not renewed through Congressional action and if no changes to benefits, co-pays or eligibility are made, the annual deficit of the health insurance program (which the General Fund may be required to fund) could rise to as much as $2.0 billion by fiscal year 2019, from $59 million on fiscal year 2014.

The fiscal stability of the Commonwealth's health insurance program 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. 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 the health insurance program. If the Commonwealth is unable to reduce these 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. 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 Retirement Systems' cash flow needs in a manner that would permit them 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 for several decades.

As described under "RETIREMENT SYSTEMS AND OTHER POST-EMPLOYMENT BENEFITS," 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 will lead to the depletion of assets at these Retirement Systems. Furthermore, in the case of the Employee Retirement System, the Commonwealth has been unable to make all the additional employer contributions required by the reform legislation, which could also lead to the depletion of the assets of the Employee Retirement System. If this happens, 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).

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 legislated 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. It is currently 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. In the case of the Employees Retirement System, however, 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 additional annual contribution in full for fiscal year 2015.

Act 3-2013 provides that, from fiscal year 2015 and thereafter, the additional annual contribution shall be calculated such that the gross assets of the Employees Retirement System are never less than $1 billion. Given the extraordinary retirement pattern of central government employees during fiscal year 2014 resulting from the enactment of the pension reform, and the correspondingly lower payroll contribution base, it is likely that the required annual contribution will be in excess of $120 million. These funding requirements will place an additional demand on the Commonwealth's need to raise revenues, reduce expenditures, or both.

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, or that they will be able to make the additional annual contributions to the Retirement Systems in the future 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 financial condition of the Employees Retirement System will continue to deteriorate and its assets will be exhausted.

In the case of the Teachers Retirement System, the reforms enacted by Act 160-2013 were largely struck down by the Supreme Court. The reform measures that were upheld mostly affect benefits to participants that enter the System on or after August 1, 2014. Since most of the expected savings of the reform were based on the changes that affected current participants, primarily by freezing their defined benefit plan prospectively, unless an additional reform is enacted and upheld by the Supreme Court, the assets of the Teachers Retirement System will be exhausted in the near term. Similarly, in the case of the Judiciary Retirement System, the reforms enacted by Act 162-2013 were limited by the the Supreme Court. Unless alternate reforms are enacted or additional funding provided to that Retirement System, its assets will eventually be completely depleted.

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.

See "RETIREMENT SYSTEMS AND OTHER POST-EMPLOYMENT BENEFITS."

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%. However, the monthly economic indicators for fiscal year 2014 indicate that the final GNP figures for fiscal year 2014 may be lower than the last projection presented by the Puerto Rico Planning Board. This persistent contraction or minimal 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. See "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 tax revenues. According to the 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 on 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 increase 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 approximately $230 million.

The Commonwealth is currently a defendant in a lawsuit filed by Doral Financial Corporation and certain of its subsidiaries ("Doral") seeking the enforcement of a closing agreement that provides for a refund of approximately $230 million to Doral. On October 10, 2014, the trial court ruled in favor of Doral, holding that the closing agreement was valid. The Commonwealth has announced its intention to appeal this judgment, and to that effect recently filed a motion for reconsideration with the trial court. The closing agreement, if ultimately upheld in the appeals process, requires the Commonwealth to make payments to Doral of approximately $45 million annually during a five-year term. However, to the extent that the relevant provisions of the Fiscal Sustainability Act are applied, the Commonwealth may be able to extend the repayment period for the judgment over a substantially longer period. For more information regarding the status of this claim, see "LITIGATION."

FISCAL CONDITION

Fiscal Stabilization and Economic Growth Plan

When the current Commonwealth administration came into office in January of 2013, the Commonwealth faced a number of fiscal challenges. The projected General Fund budget deficit of the Commonwealth for fiscal year 2013 was approximately $2.213 billion; several of the Commonwealth's most important public corporations were under severe financial strain; and the assets of the Commonwealth's retirement systems were expected to be completely depleted in the near future. In response to this situation, the Commonwealth has been implementing a comprehensive fiscal stabilization and economic growth plan. This fiscal stabilization and economic growth plan has four primary objectives:

Enhance the Commonwealth's liquidity. Completed and planned capital market transactions are intended to improve the liquidity of the Commonwealth and GDB. In March of 2014 the Commonwealth issued $3.5 billion of general obligation bonds, which allowed the Commonwealth to repay a significant amount of loans to GDB. Then, on October 10, 2014, GDB issued short-term notes to fund the purchase of the Commonwealth's tax and revenue anticipation notes for fiscal year 2015. A planned PRIFA bond issuance will allow PRHTA to repay all or a substantial portion of PRHTA's loans with GDB. Partly as a result of these transactions, GDB has been reducing and expects to continue to reduce its portfolio of loans to the Commonwealth and its instrumentalities. The Commonwealth has also enacted or proposes to enact legislation designed to enhance its ability to access the capital markets through various financing vehicles. This includes (i) increasing the amount of sales and use taxes assigned to COFINA, which will allow it to issue additional bonds; (ii) creation of a new financing vehicle (the Municipal Finance Corporation), which will be able to issue bonds secured by the municipal sales and use tax; (iii) the proposed assignment of new petroleum products taxes to PRIFA, which will allow it to issue the bonds described above; and (iv) increasing the amount of GDB bonds that can be guaranteed by the Commonwealth.

Achieve a balanced budget without deficit financing or debt restructuring. Various expense reduction measures adopted by the Commonwealth and discussed below have reduced the General Fund budget deficit from an original projection of $2.213 billion to $1.310 billion in fiscal year 2013, and to $664 million in fiscal year 2014. In fiscal year 2015, the approved budget does not include any deficit financing or refinancing of maturing Commonwealth general obligation debt or PBA debt (it does include $344 of capitalized interest from prior bond issuances). These measures include:

> ***Enactment of Fiscal Sustainability Act***. This is discussed further below in this section.
>
> ***OMB controls***. To ensure compliance with austerity policy and appropriations limits, OMB has maintained significant institutional spending controls, including review of contracts for professional services, purchases, authorization of individual personnel transactions for budgetary impact, and approval of various agency transactions with budgetary impact, such as rent or lease agreements. The Commonwealth is committed to expense reduction through strategic initiatives directed at government efficiency. OMB

believes that there are three main opportunities. First, the creation of a centralized federal funds monitoring office with the objective of increasing the amount and effectiveness of federal funds utilization by agencies of the Commonwealth, through improved procurement, agency capability building and optimized loss mitigation. Second, the implementation of a robust and systemic upgrade of Commonwealth budget, accounting and payroll information systems, to integrate entities and concepts, such as the Department of Education and the Department of Health, to improve reporting and business intelligence. Third, a comprehensive re-engineering effort focused on government organization, human capital, and cost efficiency, covering the core administrative functions of the government such as real estate, transportation, purchasing, utilities, payroll and services.

Make the Commonwealth's public corporations self-sufficient. The Commonwealth has adopted various measures to turn the Commonwealth's public corporations into self-sufficient enterprises, and address structural problems that threaten the Commonwealth's long-term fiscal stability. These include:

PRASA water rate increase. The Puerto Rico Aqueduct and Sewer Authority ("PRASA") implemented in July of 2013 a 60% water rate increase (on average) that is expected to strenghthen the corporation's ability to cover its expenses and debt service. Further water rate increases are currently not expected be necessary at least until fiscal year 2017. As a result, the Commonwealth does not anticipate funding PRASA for its operational expenses.

Increase in PRHTA revenues. In June of 2013, the Commonwealth increased the petroleum products tax assigned to the PRHTA and assigned certain additional vehicle registration fees and cigarette taxes to PRHTA. The administration has also introduced legislation that will assign additional petroleum products taxes to PRIFA and ATI and that would allow PRIFA to repay a significant amount of PRHTA loans to GDB and other lenders and would facilitate the transfer of the Tren Urbano operation to ATI, which is intended to improve PRHTA's financial condition and allow it to operate without additional GDB or General Fund budget support.

Enactment of Recovery Act. The Commonwealth enacted the Recovery Act, which is intended to be used only in situations where it is necessary in order to implement required reforms at the public corporations.

Reform the Tax Code and grow the economy. The Treasury Department, together with OMB and GDB, is working with its consultants to design and enact a comprehensive tax reform that will increase revenues, equitably distribute the tax burden, promote economic growth, increase the competitiveness of the Commonwealth, minimize interference with private decision-making, and streamline tax compliance and administration. The tax reform is expected to result in a shift from taxing productivity to taxing consumption. It would incorporate relief for low-income individuals and small businesses, and protection for COFINA bondholders. Proposals under consideration include a reduction in individual income tax and corporate tax rates, the repeal of the gross profits tax (*patente nacional*), and a broadening of the tax base through the repeal of various tax expenditures. The Commonwealth expects to enact the tax reform during the third quarter of the 2015 fiscal year. In addition, the Commonwealth has pursued an aggressive economic development program that is discussed under "THE ECONOMY – Economic Growth."

Other Fiscal Measures

Extension of Special Excise Tax - Act 154. In February of 2013, the Commonwealth amended Act 154 to extend the duration of the special excise tax (which has become one of the major sources of government revenues) until December 31, 2017 and reset the excise tax rate at a fixed 4% commencing on July 1, 2013. See "COMMONWEALTH TAXES, OTHER REVENUES AND EXPENDITURES – Special Excise Tax (Act 154)."

Airport lease. In February of 2013, the Puerto Rico Ports Authority ("PRPA") executed a forty-year lease agreement with Aerostar Airport Holdings, LLC (Aerostar), pursuant to which Aerostar will finance, operate, maintain and improve PRPA's Luis Muñoz Marín International Airport. As a result of this transaction, PRPA received from Aerostar a lump-sum payment of $615 million, $491 million of which were used to retire 43% of the outstanding debt of the PRPA. The PRPA will also receive an estimated $552 million in revenue sharing over the life of the lease.

Reform of Employees Retirement System. The Commonwealth adopted, in April of 2013, a comprehensive reform of the Employees Retirement System which, among other changes, prospectively replaced the defined benefit system applicable to certain employees with a defined contribution system. See "RETIREMENT SYSTEMS AND OTHER POST-EMPLOYMENT BENEFITS."

Preliminary General Fund Budgetary Revenues for First Three Months of Fiscal Year 2015

Preliminary General Fund budgetary revenues for the first three months of fiscal year 2015 (July through September of 2014) were $1.774 billion, an increase of $75 million, or 4.4%, over the same period of the prior fiscal year, but $36 million less than estimated revenues for the period. Preliminary collections for the special temporary excise tax under Act 154 were $528 million, an increase of $93 million from the same period of the prior fiscal year, and $43 million more than the projected revenues for this period. Preliminary collections of individual income taxes were $444 million, an increase of $29 million over the same period of the prior fiscal year, but $26 million below projections. Preliminary collections of corporate income taxes were $358 million, $2 million more than the same period of the prior fiscal year, but $33 million below projections.

Preliminary General Fund Budgetary Revenues and Expenditures for Fiscal Year 2014

Revenues. Preliminary General Fund budgetary revenues for fiscal year 2014 (which are still subject to audit and other year-end adjustments) were $9.037 billion, and include: (i) total budgetary operating revenues of the General Fund of $8.803 billion, (ii) revenues from the electronic and traditional lotteries of $154 million that are available to the General Fund, and (iii)

$80 million in excess funds transferred from COFINA to the General Fund after payment of COFINA debt service. This represented an increase of $475 million over budgetary revenues for fiscal year 2013 ($8.562 billion), but is $488 million lower than the revised projected revenues for this period ($9.525 billion). The increase in budgetary revenues during this period when compared to fiscal year 2013 is primarily due to legislative measures adopted since January 2013.

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. Individual income tax collections for fiscal year 2014 were $1.979 billion, a decrease of $75 million, or 3.7%, from the same period of the prior fiscal year, and $24.6 million, or 1.22%, less than the revised projected revenues of this category for this period. 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 of this category for this period.

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.

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 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 which were carried over from previous fiscal years, (ii) purchase of tax credits above projections, (iii) postponed payments of corporate taxes due to corporations that filed tax return extensions, (iv) waivers granted on national "volume of business" tax on gross sales/revenues to businesses, (v) corporate reorganizations that reduced corporate tax liabilities, and (vi) corporate taxable income lower than expected.

Expenditures. The original fiscal year 2014 budgeted expenditures totaled $9.770 billion, 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 general obligation debt refunding, resulted in a total projected budget deficit of $820 million. The budget was subsequently amended to total $9.245 billion in expenditures (excluding the $575 million in general obligations debt service refunding) 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 appropriation for rent payments to the Public Buildings Authority of $24 million, a reduction in the appropriation to the Employees Retirement System required by the pension reform of $84 million, and a reduction in the appropriation for the payment of loans to the GDB of $247 million. (These reductions may adversely affect the liquidity of these entities.)

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, the Employees Retirement System 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 were lower than the amended amount of $9.245 billion by approximately $119 million, for an estimated expense of $9.126 billion. This includes a $38 million operating surplus at the agencies of the Commonwealth, and an $81 million operating surplus at the Department of Education. Due to legal and government accounting norms applicable to surplus balances of different sources 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 basis.

This estimate does not consider the estimated deficits of public corporations that receive material operating or program subsidies from the General Fund budget, such as the Maritime Transit Authority, PRHIA, the Public Buildings Authority, the Metropolitan Bus Authority, and the Medical Services Administration. PRHIA, the largest of these entities, had a $59 million deficit in fiscal year 2014.

This estimate 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 expenditures 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 expenditures 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 expenditures 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 $81 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 $81 million, combined with a $50 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 expenditures related to school repair and consolidations, among other purposes, means that the Department of Education has started fiscal year 2015 with a non-General Fund carry-forward reserve with a beginning balance of $162 million. This amount, by OMB regulation, will only be available to cover non-recurring expenditures; 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 budgetary revenues of $9.037 billion (which are still subject to audit and other year-end adjustments) and preliminary General Fund budgetary expenditures of $9.126 billion (which are still subject to audit and other year-end adjustments) (excluding the $575 million of general obligation debt service refunding) is equal to $89 million. This budget deficit was funded by a loan from GDB. If the $575 million general obligation debt service refunding is included, the total amount of the fiscal year 2014 budget deficit was $664 million. This number is subject to audit and other year-end adjustments, and the actual deficit may be materially different from this amount.

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 budget for fiscal year 2014 of $9.770 billion. The fiscal year 2015 budget includes incremental debt service on Commonwealth general obligations of $581 million, which when considered together with the $205 million reduction in total expenditures, 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 achieve a balanced General Fund budget in future years, 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 expenditures under existing collective bargaining agreements, incremental pension plan contributions, and formula-based budget allocations. At the time of budget approval, these escalators were estimated to 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 sources 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 Employees Retirement System and Teachers Retirement System.

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 expenditures 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 expenditures to non-General Fund sources; reduced appropriations due to lower expense basis (particularly headcount); and further actual cuts in existing appropriated expenditures. At the time of budget approval, these escalators were estimated to include:

$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 certain reductions related to the Employee Retirement System.
$147 million	From charging appropriations against non-General Fund sources, 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 expenditures 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 (Reform of the Employees Retirement System), 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 expenditures for purchases, 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 Corporation, the Automobile Accidents Compensation Administration, 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 expenditures (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 Branch 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 expenditures, 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.

These corrective measures reflect the estimated impact at the time of budget approval and are not updated to adjust for execution and actual effect.

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);
- the timing of the $400 bonus to senior citizens was delayed and 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 reprogramming of certain appropriation debt payments to further reduce the Commonwealth's fiscal year 2014 deficit (as discussed above in "Preliminary General Fund Revenues and Expenses for Fiscal Year 2014"). The downgrades in February 2014 of the credit ratings of the Commonwealth and most of its instrumentalities (including GDB) to non-investment grade 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 of approximately $1.9 billion of outstanding GDB lines of credit to the Commonwealth and PBA from the proceeds of the Series 2014 Bonds. 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'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 a s 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 2026 and (iii) repurchase agreements. The following table sets forth a breakdown of GDB's (excluding its subsidiaries') total funding by source as of

March 31, 2014, June 30, 2014 and September 30, 2014 (figures in thousands). These numbers are preliminary and unaudited.

Funding Sources	**3/31/2014**	**%**	**6/30/2014**	**%**	**9/30/2014**	**%**
Public Deposits	$5,157,368	50.1%	$5,521,952(1)	53.4%	$4,379,545	45.8%
Private Deposits	46,805	0.5%	46,738	0.5%	42,855	0.5%
Bonds and Notes	5,037,120	48.9%	4,713,181	45.6%	4,633,338	48.4%
Repurchase Agreements	50,000	0.5%	50,000	0.5%	512,353	5.4%
Total	$10,291,293	100%	$10,331,871	100%	$9,568,091	100%

As of September 30, 2014, GDB's average cost of funding was 2.74% and the average life of its liabilities was 2.3 years. Of the $4.6 billion of outstanding bonds and notes, approximately $397 million mature in fiscal year 2015 (staggered maturities in December 2014 and January and February 2015) and $876 million mature in fiscal year 2016 (staggered maturities in August and December 2015 and May 2016).

As of September 30, 2014, GDB's liquidity resources included (i) approximately $136 million of deposits made by PREPA for its Reserve Account, which are invested in GDB time deposits, (ii) $239.6 million of deposits made by PREPA for its Construction Fund, which are invested in GDB time deposits, and (iii) $71.3 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 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) amounts on deposit in the Commonwealth's 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 Account to pay debt service on PREPA's bonds. During fiscal year 2015, GDB also expects PREPA to use substantially all the funds on deposit in the Construction Fund and a portion of the funds on deposit in the Debt Service Reserve Fund currently held at GDB. As of July 1, 2014, GDB has been depositing the securities purchased with the monthly sinking fund payments for the Commonwealth General Obligation bonds with a third party financial institution and such securities are no longer held by GDB.

GDB is legally required to maintain reserves equal to 20% of its demand deposits. This requirement is met by investing in securities with maturities of up to 90 days.

Liquidity Resources. As of September 30, 2014, GDB's cash, bank deposits and investment portfolio at fair market value was $1.9 billion, or 16%, 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 Resources (in millions)	3/31/2014	6/30/2014	9/30/2014
Cash and Bank Deposits	$883	$719	$232
Federal Funds Sold and Money Market Instruments (excluding $39 million reverse repurchase agreement with GDB subsidiary)	1,253	1,052	340
Investment Securities			
U.S. Treasury and Agencies	1,092	1,191	1,356
Government-Sponsored MBS and CMOs	230	210	2
Other Securities	39	39	1
Sub-Total	1,361	1,440	1,359
Total	$3,497	$3,211	$1,931
Securities pledged	(50)	(72)	(533)
Net Liquidity	$3,447	$3,139 (1)	$1,398 (2)

(1) Includes approximately $700 million and $40 million in Commonwealth and PREPA deposits, respectively, which were in each case disbursed on July 1, 2014 to make all or a portion of such entity's respective debt service payments when due.

(2) Reflects the disbursement of $400 million in Commonwealth Tax and Revenues Anticipation Notes, Series A that were refinanced by the GDB Notes on October 10, 2014.

Net liquidity as of September 30, 2014 is net of disbursements amounting to $700 million relating to the Commonwealth's Tax and Revenue Anticipation Notes, Series A, $400 million of which were repaid on October 10, 2014.

GDB's investment portfolio consists mostly of investment securities classified among the three highest rating categories. As of September 30, 2014, the expected average life of the investment securities portfolio was 2.3 years and approximately $572 million, or 30%, matures in less than one year.

The decrease in cash and unencumbered investment securities held by GDB as of September 30, 2014 compared to June 30, 2014 was driven primarily by seasonal and cyclical factors affecting GDB's funding base. The primary factors driving such reduction were (i) the payment by the Commonwealth on July 1, 2014 of $700 million in Commonwealth general obligation bond debt service (the interest on which is due on January 1 and July 1 each year) from funds on deposit in the Commonwealth's Redemption Fund account at GDB, (ii) payment by PREPA on July 1, 2014 of $40 million PREPA debt service (the interest on which is due on January 1 and July 1 each year) from funds temporarily on deposit in PREPA's Debt Service Reserve Fund account at GDB, (iii) $700 million of Commonwealth tax and revenue anticipation notes financed by GDB during the quarter ended September 30, 2014, $400 million more than originally projected (such incremental amount was repaid by the Commonwealth on October 10, 2014) and (iv) ordinary course fluctuations in GDB's deposit base, including the Secretary of the Treasury's account at GDB.

As of September 30, 2014, of the approximately $1.4 billion investment securities portfolio, approximately $513 million was pledged to secure or repay borrowings of GDB, consisting of securities sold under agreements to repurchase and $20 million was pledged for other uses. Therefore, as of September 30, 2014, GDB liquidity resources, net of pledged securities, amounted to approximately $1.4 billion.

Possible PRHIA Line of Credit. GDB may be required to provide a majority share of an up to $200 million line of credit to PRHIA to fund monthly premium payments under the Commonwealth's health insurance program when PRHIA transitions from the third-party administrator model into a capitated "managed care organization" model on April 1, 2015. The Commonwealth's health insurance program is funded in part with federal funds, and such line of credit would be payable by PRHIA upon receipt of such federal funds. PRHIA is currently negotiating an extension or renewal of its existing line of credit with the lenders, the majority of which have expressed an interest in continuing to participate in such credit facility. GDB does not expect this possible financing to materially affect its liquidity.

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 expenditures; (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. The Recovery Act Judge oversees this process. 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. On July 22, 2014, an investment manager, on behalf of investment funds which purportedly hold bonds issued by PREPA, filed another lawsuit in the United States District Court for the District of Puerto Rico seeking a declaratory judgment that the Recovery Act violates the bankruptcy clause of the United States Constitution and other provisions of the United States and Commonwealth Constitutions, asserting similar arguments as the first complaint. On August 20, 2014, the District Court issued an order consolidating both actions.

On September 12, 2014, the Commonwealth, PREPA and GDB filed several Motions to Dismiss both lawsuits for failure to state a claim. The Motions to Dismiss asserted, among other things, that because the Recovery Act has never been invoked, the lawsuits are not ripe, and that there is no preemption by federal law, since there is no federal law applicable to the enforcement of the debts of Puerto Rico public corporations. The Commonwealth, PREPA and GDB will continue 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.

These challenges and any other that may be 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 these challenges will be consistent with the Commonwealth's position.

Health Insurance

The Commonwealth, through its Health Insurance Administration ("PRHIA"), provides health insurance coverage to approximately 1.6 million qualifying (generally low-income) residents of Puerto Rico. This insurance coverage was originally provided, commencing in 1993, under the Commonwealth's "Health Reform" program. On October 1, 2010, the Commonwealth implemented "Mi Salud," which replaced the "Health Reform" program. Effective on April 1, 2015 "Mi Salud" will be replaced by the "Government Public Health Insurance Plan" ("GHP"). Although there are some differences between the Health Reform program, Mi Salud and the GHP, they are all designed to provide comprehensive health insurance coverage to qualifying Puerto Rico residents.

From 1993 until July 1, 2013, insurance coverage under the Health Reform and Mi Salud was provided under a system in which the Commonwealth selected, through a bidding process, a private health insurance company for each designated region of the island and paid such insurance company the insurance premium for each eligible beneficiary within such region. This insurance company was ultimately responsible for the cost of the covered health services. On July 1, 2013, the Commonwealth changed its insurance program to a "third party administration" model in which the Commonwealth selected an insurance company to act as a third party administrator. The selected administrator is compensated with a "per member per month" administrative fee, and the Commonwealth bears the risk for the provision of health services to the insured beneficiaries. Effective on April 1, 2015, the Commonwealth will go back to an insurance model in which PRHIA will select an insurance provider for each region, and pay an insurance premium to such provider in exchange for the assumption by the insurer of the cost of providing the covered health services to the insured beneficiary.

On October 14, 2014, after cancelling an initial request for proposals for lack of satisfactory bids, and issuing a revised request for proposals, PRHIA awarded the contracts for the GHP to five private insurance providers. The new contracts are effective on April 1, 2015. On said date, as mentioned above, the Commonwealth's insurance model will change from a "third-party administrator" model to a "managed care organization" model in which the risk will be borne by the insurance companies. The per member per month (PMPM) premiums under the new contracts represent a 10% average increase with respect to the existing premiums. The increase is due primarily to expanded benefit coverage as required by the United States Patient Protection and Affordable Care Act (the "Affordable Care Act" or "ACA"), the change to the managed care orgaznization model, and increases in the cost of providing medical services. Although the premiums negotiated are in line with the forecasted PMPM for fiscal year 2016, they exceed the 5% increase considered in the PRHIA budget forecast for fiscal year 2015. As a result, the increase in premiums for fiscal year 2015 has an expected additional impact of $62 million in the last quarter of such fiscal year, and the forecasted deficit for fiscal year 2015 increased from $53 to $115 million. In addition, because the effect of the premium cost increase is partly absorbed by federal funding, primarily for the Medicaid program, the increase also accelerates the estimated depletion date of non-recurring funding under the ACA, discussed below.

The cost of the Commonwealth health insurance program 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 (the "Affordable Care Act" or "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).

Approximately 1.6 million persons were covered by the system during fiscal year 2014. Of these, approximately 1.4 million individuals are considered part of the "federal population" whose cost is subject to matching federal funding and approximately 200,000 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 Commonwealth budget for the health insurance program totals $2.647 billion for fiscal year 2015, an increase of $152 million over its cost for fiscal year 2014, which was $2.495 billion. The cost of the program for fiscal year 2014 represented an increase of $160 million compared to its cost for fiscal year 2013, which was $2.335 billion. The fiscal year 2015 budget for the health insurance program includes an appropriation of $885 million from the General Fund and approximately $1.5 billion in federal funds (which correspond to the federal fiscal year that commenced on October 1, 2014). The federal funds include $1.030 billion of non-recurring ACA federal funds, $305 million of recurring capped Medicaid funds, $140 million of funds from the Children's Health Insurance Program (CHIP), and $44 million from the prescription drug program. During fiscal year 2014, $885 million of the cost of Mi Salud was paid from the General Fund, $1.284 billion were paid from federal funds, and the remaining $292 million was paid from municipal, internal and other sources.

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 the health insurance program 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 the health insurance program (which the General Fund may be required to fund) could rise to as much as $2.0 billion by fiscal year 2019, from $59 million in fiscal year 2014.

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. Although the table incorporates the effect the new health insurance contracts in the calculation of the projected deficit for fiscal year 2015, no adjustment has been made for subsequent fiscal years, as PRHIA is still reviewing the projected costs for these years based on the new capitated managed care organization model. Therefore, the projected deficits could be materially higher than those presented herein.

	Fiscal Year				
	2015	2016	2017	2018	2019
PRHIA deficit	$115,000,000	$53,000,000	$165,000,000	$1,796,000,000	$2,020,000,000

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 GHP was potentially eligible for an enhanced share percentage in excess of the current Medicaid share. The Commonwealth decided, after due consideration, to request the enhanced federal share percentage proffered by the federal government. This acceptance materially improves the near term financial outlook of GHP but also accelerates the depletion date of ACA funds from January 2019, as of the previous estimate, to May of 2018.

The fiscal stability of the GHP is one of the most significant 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 the GHP. 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 the GHP.

Historical General Fund Budget Deficits

Since 2000, one of the most significant challenges that the Commonwealth has faced is an imbalance between its General Fund budgetary revenues and expenditures, which the Commonwealth has been required to finance with debt. This imbalance reached its highest historical level of $3.154 billion in fiscal year 2009, when revenues were $7.710 billion and expenditures were $10.864 billion. Since then, the Commonwealth has been able to reduce its budget deficit every year, except fiscal year 2012, through various measures designed to increase revenues and reduce expenditures. For fiscal year 2015, the Commonwealth approved a budget that does not require additional debt financing (although it includes $344 million of capitalized interest financed with prior bond offerings).

The table below shows total General Fund budgetary revenues from taxes, licenses and other internal or external sources, total General Fund expenditures (including debt service payments) and the resulting General Fund budget deficit for the last six fiscal years. Total revenues and expenditures include certain non-recurring items. Accordingly, the amount of the Commonwealth's General Fund budget "structural deficit," or the difference between recurring revenues and expenditures, is higher than the amount shown below. Depending on what revenues and expenditures are considered "recurring," such difference may be significant.

Revenues include General Fund revenues and revenues from the electronic and traditional lotteries that are available to fund General Fund budgetary expenditures. Other revenues may also be included as indicated in the footnotes to the table. Expenditures include General Fund budgetary expenditures, rental payments made by the Commonwealth to the Public Buildings Authority for properties leased by the Government and debt service payments for the Commonwealth's general obligation bonds.

Revenues and expenditures from the following sources or entities are not part of the General Fund budget, and consequently were excluded from the table below: federal grants and contracts, the portion of rum excise taxes assigned to certain component units and private institutions, motor vehicle licenses fees and fines, excise tax on gasoline, gas, oil, diesel oil, petroleum, a portion of cigarette taxes assigned to certain component units and private instutions, compulsory vehicle insurance premiums assigned to a private institution, a portion of the non-resident witholding income tax, a portion of the horse racing excise tax, a portion of sales and use tax allocated to COFINA, other charges for services which are assigned by law for specific purposes, other revenues assigned by law for specific purposes, and revenues and expenditures of agencies with independent treasuries. The table below was prepared in accordance with a statutory (budgetary) basis of accounting, which is not in accordance with US generally accepted accounting principles (US GAAP). The presentation of the General Fund revenues and expenditures in accordance with US GAAP would result in revenues, expenditures and a deficiency of revenues over expenditures significantly higher than the amounts presented in the table below.

The Department of Treasury and GDB are currently evaluating the methodology and presentation of the historical General Fund budget deficits of the Commonwealth. The table below may contain certain items that are not included in the statements or in the schedule of revenues and expenditures - budget and actual - budgetary basis - General Fund included in the Commonwealth's financial statements for the fiscal years 2009 to 2013, or otherwise in such financial statements. Some of these items are discussed in the footnotes to the table below.

General Fund Budget Deficit
Fiscal Years ended June 30,
(in millions)

Fiscal Year	Total Revenues[1] [2]	Total Expenditures[7][8][9]	Deficit
2009	$7,825	$10,689	$(2,864)
2010	$8,032[3]	$10,756	$(2,724)
2011	$8,343[4]	$10,144	$(1,801)
2012	$8,783	$11,158	$(2,375)
2013	$8,664[5]	$9,974	$(1,310)
2014 *	$9,141[6]	$9,805	$(664)

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*Preliminary and unaudited; subject to change.

[1] Includes General Fund revenues of $7.583 billion, $7.593 billion, $7.994 billion, $8.573 billion, $8.131 billion and $8.803 billion for fiscal years 2009 through 2014, respectively.

[2] Includes (i) revenues attributable to the electronic and traditional lotteries of $127 million, $123 million, $102 million, $94 million, $63 million and $154 million for fiscal years 2009 through 2014, respectively, and (ii) revenues from the 1.03% property tax of $115 million, 115 million, $122 million, $116 million, $102 million and $105 million, for fiscal years 2009 through 2014, respectively.

[3] Includes $201 million from the sale of securities in the Puerto Rico Infrastructure Authority corpus account.

[4] Includes approximately $125 million of moneys transferred to the General Fund during fiscal year 2011 from the Puerto Rico Sales Tax Financing Corporation, consisting principally of Sales and Use Tax Collections remaining after providing debt service on its bonds for that fiscal year.

[5] Includes (i) $242 million in excess funds transferred from the Redemption Fund to the General Fund and (ii) $126 million of excess funds transferred from the Puerto Rico Sales Tax Financing Corporation to the General Fund.

[6] Includes $80 million of excess funds transferred from the Puerto Rico Sales Tax Financing Corporation to the General Fund.

[7] Includes General Fund Budget total expenditures of $9.927 billion, $9.640 billion, $9.075 billion, $9.911 billion, $8.938 billion and $8.605 billion for fiscal years 2009 through 2014, respectively.

[8] Includes the transfer of rental payments made by the Commonwealth to the Public Buildings Authority for properties leased by the Government of $330 million, $251 million, $267 million, $331 million, $205 million and $358 million for fiscal years 2009 through 2014, respectively.

[9] Includes (i) debt service for general obligation bonds of $414 million, $865 million, $802 million, $849 million, $831 million and $842 million for fiscal years 2009 through 2014, respectively, and (ii) debt service for appropriations bonds of $18 million and $67 million for fiscal years 2009 and 2012, respectively.

Source: The "Statement of Revenues and Expenditures- Budget and Actual- Budget Basis- General Fund" as presented in the Commonwealth's financial statements for fiscal years 2009 to 2012; the "Required Supplementary Information-Unaudited- Schedule of Revenues and Expenditures- Budget and Actual- Budgetary Basis- General Fund" as presented in the Commonwealth's financial statements for fiscal year 2013; the Department of Treasury's financial records for fiscal year 2014; and Government Development Bank. Table presentation is different to the statements or schedule of revenues and expenditures- budget and actual –budgetary basis – General Fund included in Commonwealth's financial statements for the fiscal years 2009 to 2013.

THE ECONOMY

Overview

Puerto Rico's economy entered a recession in the fourth quarter of fiscal year 2006. The Commonwealth's gross national product (GNP) contracted (in real terms) every fiscal year between 2007 and 2011. GNP grew by 0.9% and 0.3% in fiscal years 2012 and 2013, respectively. According to the Puerto Rico Planning Board's latest projections, made in April of 2014, it is projected that Puerto Rico's real GNP for fiscal years 2014 and 2015 will increase by 0.1% and 0.2%, respectively. However, the monthly economic indicators for the whole fiscal year 2014 indicate that the final GNP figures for that fiscal year may end up lower than the last projection presented by the Puerto Rico Planning Board. The Planning Board's forecast for fiscal year 2014 took into account the estimated effect of the projected growth of the United States economy, tourism activity, personal consumption expenditures, federal transfers to individuals and an increase of investment in construction. The Planning Board is expected to publish a revision of this forecast during the second quarter of fiscal year 2015.

In fiscal year 2013, aggregate personal income was $63.4 billion ($60.4 billion in 2009 prices) and personal income per capita was $17,413 ($16,564 in 2009 prices). Personal income includes transfer payments to individuals in Puerto Rico under various social programs. Total United States federal transfer payments to individuals amounted to $15.6 billion in fiscal year 2013 and $15.7 billion in fiscal year 2012. Entitlements for previously performed services or resulting from contributions to programs such as Social Security, Veterans' Benefits, Medicare, and United States Civil Service retirement pensions were $11.8 billion, or 75.5% of the transfer payments to individuals in fiscal year 2013 ($11.4 billion, or 72.6%, in fiscal year 2012). The remainder of the federal transfers to individuals is represented by grants, mostly concentrated in the Nutritional Assistance Program (Food Stamps) and Pell Grant scholarships (higher education).

Total average annual employment (as measured by the Puerto Rico Department of Labor and Human Resources Household Employment Survey, known as the "Household Survey") decreased during the last decade. From fiscal year 2000 to fiscal year 2014, total employment decreased at an average annual rate of 0.9%, from 1,150,291 to 1,006,646. A reduction in total employment began in the fourth quarter of fiscal year 2007 and has continued consistently through fiscal year 2014 due to the current recession and contractionary fiscal adjustment measures. According to the Household Survey, during fiscal year 2014, total employment fell by 2.2% when compared to the prior fiscal year, and the unemployment rate averaged 14.3% compared to 14.0% for the prior fiscal year. Furthermore, for the first quarter of fiscal year 2015, total employment decreased by 3.3% with respect the first quarter of fiscal year 2014. The Household Survey numbers are the numbers used for the computation of the unemployment and participation rates. However, the Establishment Survey numbers are the numbers used to measure employment across the various sectors of the economy. According to the Establishment Survey, total payroll non-farm employment decreased by 1.3% during fiscal year 2014. However, a 0.4% increase was recorded in the total payroll non-farm employment during the first three months of fiscal year 2015. The relatively weak performance of total payroll employment during the past fiscal year could be 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 more than offset increases in private employment during this period.

The dominant sectors of the Puerto Rico economy in terms of production and income are manufacturing and services. The manufacturing sector has undergone fundamental changes over the years as a result of the phase out of Section 936 of the United States Internal Revenue Code and an increased emphasis on higher-wage, high-technology industries, such as pharmaceuticals, biotechnology, computers, microprocessors, professional and scientific instruments, and certain high technology machinery and equipment. At the present time, almost 90% of manufacturing is generated by chemical and electronic products. The service sector, which includes finance, insurance, real estate, wholesale and retail trade, transportation, communications and public utilities, and other services, plays a major role in the economy. It ranks second to manufacturing in contribution to gross domestic product and leads all sectors in providing employment.

The following table shows the Puerto Rico GNP for fiscal years 2009 through 2013, compared to the annual percentage increase in real GNP in the United States. There are some differences between the previously reported figures of Puerto Rico's GNP and the current figures set forth below due to the recent revision of several components of GNP, which included changes since fiscal year 2001. Therefore, growth rates and figures before fiscal year 2001 are not wholly comparable with the amounts reported afterwards.

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

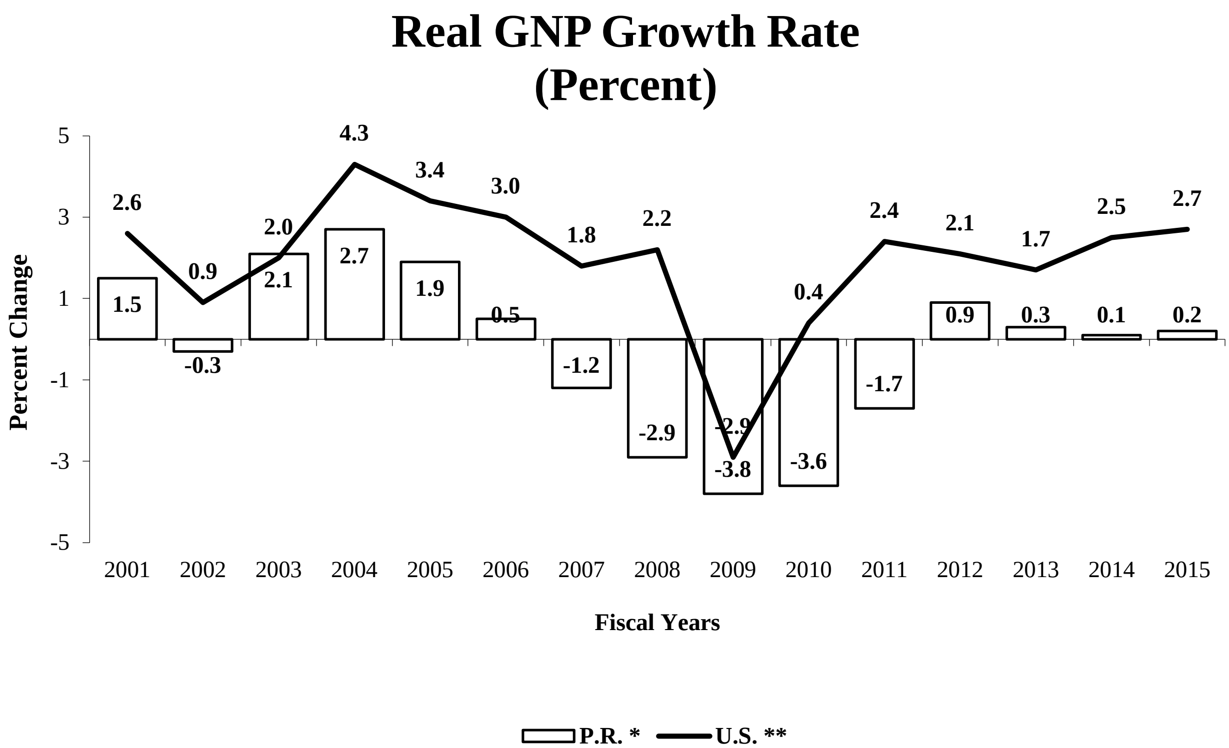
	2009	**2010**	**2011**	**2012**	**2013**[1]
GNP (PR) (current prices)	$63,618	$64,295	$65,721	$68,698	$70,740
Real GNP (PR) (2009 prices)	$63,618	$61,345	$60,312	$60,854	$61,061
Annual percentage increase (decrease) in real GNP (PR) (2009 prices)	(3.8)%	(3.6)%	(1.7)%	0.9%	0.3%
Annual percentage increase (decrease) in real GNP (United States) (2009 prices)	(2.9)%	0.4%	2.6%	2.5%	1.9%

(1) Preliminary.

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

The economy of Puerto Rico is closely linked to the United States economy, as most of the external factors that affect the Puerto Rico economy (other than oil prices) are determined by the policies and performance of the mainland economy. These external factors include exports, direct investment, the amount of federal transfer payments, the level of interest rates, the rate of inflation, and tourist expenditures. During fiscal year 2014, approximately 71.8% of Puerto Rico's exports went to the United States mainland, which was also the source of approximately 47.2% of Puerto Rico's imports. In fiscal year 2014, Puerto Rico experienced a positive merchandise trade balance of approximately $20 billion.

The following graph compares the growth rate of real GNP for the Puerto Rico and United States economies since fiscal year 2001, and the forecast of the growth rate for fiscal years 2014 and 2015.



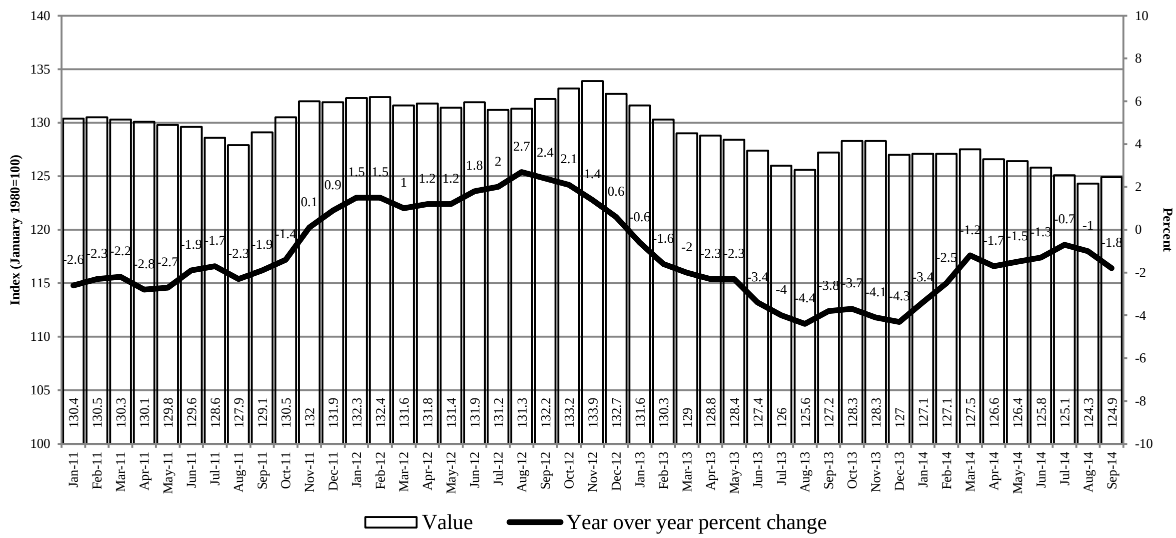
* Estimate for Puerto Rico from the Puerto Rico Planning Board (Apr 2014).
** Estimate for U.S. from IHS-Global Insight (Sep-2014).
Sources: Puerto Rico Planning Board & IHS-Global Insight.

Since the 1950s, the Planning Board has prepared a complete set of macroeconomic measures like those prepared for the United States by the Bureau of Economic Analysis ("BEA") of the Department of Commerce, as part of the National Income and Product Accounts ("NIPA"). In contrast with the BEA, which computes the economic accounts on a quarterly basis, the Planning Board computes Puerto Rico's NIPA on an annual basis. Like the BEA, the Planning Board revises its statistics on a regular basis. The Planning Board classifies its statistics as preliminary until they are revised and made final in conjunction with the release of new data each year. Thus, all macroeconomic accounts for fiscal year 2013 shown in this Report are preliminary until the revised figures for fiscal year 2013 and the preliminary figures for fiscal year 2014 are released, and the forecast for fiscal year 2015 is revised. The Planning Board could also revise back more than two years to the extent it obtains more complete information.

Certain information regarding current economic activity is available in the form of the EAI, a coincident indicator of ongoing economic activity. This index, shown in the following graph and published by GDB since October 2009, is composed of several variables (total payroll employment based on the Establishment Survey, total electric power generation, cement sales and consumption of gasoline) that highly correlate to Puerto Rico's real gross national product. However, the EAI does not measure the real GNP annual growth rates. Since the GDB-EAI is generated with only four variables, it is more volatile than the real GNP figures. This means that both increments and declines reflected in the GDB-EAI amplify the corresponding movements of the real GNP.

The EAI for September 2014 was 124.9, a 1.8% reduction compared to September 2013. The average cumulative value for the first three months of fiscal year 2015 showed a reduction of 1.2% compared to the same period of fiscal year 2014. For fiscal year 2014, the EAI showed a reduction of 3.0%, compared to the corresponding figure for fiscal year 2013. The average growth rate of the index for fiscal year 2013 was -0.1%, after an increase of 0.1% for fiscal year 2012. Notice that before the benchmark payroll employment revision of March 2014, published by the Bureau of Labor Statistics, the GDB-EAI was showing a reduction of 0.9% for fiscal year 2013. The latest revision implied a smaller rate of decrease of the Index for that fiscal year. (See "Employment and Unemployment" below.)

GDB Economic Activity Index



Economic Forecast for Fiscal Years 2014 and 2015

In April 2014, the Planning Board released its revised GNP forecast for fiscal year 2014 and its GNP forecast for fiscal year 2015. The GNP forecast for fiscal year 2014 was revised upward from a decrease of 0.1% to a projected growth of 0.1%, both in constant dollars. This revision took into account the effect on the Puerto Rico economy of general and global economic conditions, real growth in the United States gross domestic product, the volatility of oil prices, interest rates and the behavior of local exports, including expenditures by visitors. However, the monthly economic indicators for fiscal year 2014 indicate that the final GNP figures for that fiscal year may end up lower than the last projection presented by the Puerto Rico Planning Board. The Planning Board's forecast for fiscal year 2015 projects an increase in gross national product of 0.2% in constant dollars. The Planning Board's forecast for fiscal year 2015 took into account the estimated effect of the projected growth of the United States gross domestic product, tourism activity, personal consumption expenditures, and federal transfers to individuals. The Planning Board is expected to publish a revision of this forecast in October 2014.

According to the Household Survey, the number of persons employed in Puerto Rico during fiscal year 2014 averaged 1,006,646, a decrease of 2.2% compared to the previous fiscal year; and the unemployment rate averaged 14.3%.

Fiscal Year 2013

The Planning Board's preliminary reports on the performance of the Puerto Rico economy for fiscal year 2013 indicate that real gross national product increased 0.3% (3.0% in current dollars) over fiscal year 2012. Nominal gross national product was $70.7 billion in fiscal year 2013 ($61.1 billion in 2009 prices), compared to $68.7 billion in fiscal year 2012 ($60.9 billion in 2009 prices). Aggregate personal income increased from $62.4 billion in fiscal year 2012 ($59.4 billion in 2009 prices) to $63.4 billion in fiscal year 2013 ($60.4 billion in 2009 prices), and personal income per capita increased from $16,956 in fiscal year 2012 ($16,152 in 2009 prices) to $17,413 in fiscal year 2013 ($16,564 in 2009 prices).

According to the Household Survey, the number of persons employed in Puerto Rico during fiscal year 2013 averaged 1,029,530, a decrease of 0.6% compared to the previous fiscal year; and the unemployment rate averaged 14.0%, a reduction from 15.2% for fiscal year 2012.

Among the variables that contributed to the small growth in gross national product were an increase in consumption expenditures and a slight increase in sales to the rest of the world. There was also a small reduction in the average price of West Texas Intermediate (WTI) oil, which went down from $95.0 per barrel in fiscal year 2012 to $92.1 per barrel in fiscal year 2013, a decrease of 3.1%. However, oil prices remained at a relatively high level, which constitutes a drag to the economy. After the financial crisis in the United States, which had significant direct consequences in the local economy, the historically low interest rates have not been enough incentive to jumpstart private investment or to counteract other external factors.

Fiscal Year 2012

The Planning Board's reports on the performance of the Puerto Rico economy for fiscal year 2012 indicate that real gross national product increased 0.9% (an increase of 4.5% in current dollars) over fiscal year 2011. Nominal gross national product was $68.7 billion in fiscal year 2012 ($60.9 billion in 2009 prices), compared to $65.7 billion in fiscal year 2011 ($60.3 billion in 2009 prices). Aggregate personal income increased from $61.2 billion in fiscal year 2011 ($59.7 billion in 2009 prices) to $62.4 billion in fiscal year 2012 ($59.4 billion in 2009 prices), and personal income per capita increased from $16,501 in fiscal year 2011 ($16,110 in 2009 prices) to $16,956 in fiscal year 2012 ($16,152 in 2009 prices).

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

Among the variables that contributed to the small growth in gross national product were an increase in consumption expenditures, government expenditures, and domestic fixed investment expenditures, and an increase in sales to the rest of the world. On the other hand, the increase of 6.3% in the average price of West Texas Intermediate (WTI) oil, which went up from $89.4 per barrel in fiscal year 2011 to $95.0 per barrel in fiscal year 2012, represented a drag in the performance of the local economy. After the financial crisis in the United States, which had significant direct consequences in the local economy, the historically low interest rates have not been enough incentive to jumpstart private investment or to counteract other external factors.

Economic Growth

Since January 2013, the Commonwealth 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 Government's goal is to protect Puerto Rico's manufacturing core while it transitions its economic ecosystem into a regional service and high technology industrial activities hub.

In terms of specific opportunities within the services sector, Puerto Rico offers a suite of tax incentives such as Laws 20, 22, 273, and 399. 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:

- **Law 20 to promote exportation of services.** Evaluation of over 270 tax grant applications within the following industries/sectors for the establishment of new export service operations on the island: (i) 17% related to Financial Services; (ii) 15% related to IT; (iii) 14% Headquarters and Centralized Management Services and Shared Services; (iv) 11% Advertising, Public Relations; (v) 9% Professional Services

- **Law 22 for individual investors.** There is a positive growth trend in new residents with over 300 tax grants since 2012 of which 90% have established service operations in the island under Law 20.

- **Law 273 International Financial Entities:** Strong growth since 2013 with 6 operating licenses approved in 2013 and 8 operating licenses approved YTD 2014. As of June 30, 2014, IFEs had total assets exceeding $250 million.

- **Law 399 International Insurance Center:** Promotional efforts and direct approaches with insurance carriers and underwriters, captive managers and related advisors have resulted in: (i) 12 authorized insurance companies; (ii) over 200 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.

Sector Initiatives

Manufacturing. Puerto Rico continues to be a strong global manufacturing center. The priorities of the administration for this sector have been to protect the existing industrial footprint, promote its expansion and attract new investment within emerging industrial segments such as Aerospace. Therefore, the administration has been focused on (i) retaining existing pharmaceutical operations and pursuing opportunities in the emerging generic pharmaceuticals and biologics markets, (ii) capturing new opportunities and moving up the value chain in medical devices manufacturing, and (iii) tapping growth opportunities in the emerging segments of bio-agriculture, aerospace and information technology.

- BioPharma Operations. BioPharma firms are continuing to grow in Puerto Rico. Progress in this field includes the arrival of Actavis to the local manufacturing footprint, demonstrating that Puerto Rico is a preferred destination for this type of investment because of its life-sciences experience, human capital and economic incentives. Actavis is investing approximately $48M to improve and expand the company's manufacturing operations in Puerto Rico. The new investment includes the development of a solid dosage manufacturing and packaging facility in Manati, and an expansion of Actavis' current hormone manufacturing and packaging center in Fajardo. The development and expansion of both the Manatí and Fajardo facilities are expected to create up to 300 new jobs over a 36-month period. Other important projects announced over that last year include a $200M investment of Lilly to expand production in Puerto Rico as part of a broader $715M investment to enhance its global insulin manufacturing capacity. Additionally, Neolpharma has made a $12M investment in a research and development lab, within one year of their acquisition of a Pfizer facility in 2013. Finally, although companies like Merck and Pfizer have announced the consolidation of certain global operations, including facilities in Puerto Rico, they will continue to maintain a significant presence in the island. For example, Merck has invested $100M in the last few years to transform its Las Piedras facility into a strategic high-technology location for the development and launch of new products. The Commonwealth remains confident that on-going negotiations with other companies will continue to result in additional opportunities within this segment.

- Medical Devices Manufacturing. Puerto Rico has a strong medical devices industry, and over the last months this segment has grown the most in terms of job commitments among the life sciences subsectors. Since January 2013, the medical devices subsector has accounted for over 1,300 new jobs committed to the Puerto Rico Industrial Development Company (PRIDCO). These include: (i) Coopervision investing $250M for the creation of 15 new production lines and 350 jobs; (ii) Medtronic bringing to Puerto Rico new manufacturing technologies with 150 new jobs, after an approximately $6M investment; and (iii) Aspen Surgical making a multimillion investment to improve and expand its medical device manufacturing operations committing to create new jobs while retaining another 200. Additional growth is expected in this subsector as the Commonwealth closes on expansion negotiations with various companies already manufacturing in Puerto Rico.

- Tapping opportunities in emerging sectors. During the current year 2014, the aerospace segment in Puerto Rico has been accelerating with major companies like Lufthansa, Infosys and Seaborne establishing operations, and others like Honeywell and UTC Aerospace Systems, expanding. This is the result of a concerted effort to diversify the industrial ecosystem developing the aerospace cluster in Puerto Rico. These business development initiatives have already resulted in the following additional achievements as of September 2014:

    - Over $625M in committed investment for manufacturing and knowledge services projects.
    - Over 15,400 jobs committed on manufacturing and knowledge services projects, out of which over 5,000 have been created already.

- Large MRO operation already in construction with an estimated investment of approximately $56M.
- High-tech laboratory in design process to serve the aerospace sector, with an estimated investment of approximately $35M.
- 200 new jobs in manufacturing of aerospace components, after an investment of $18M.
- Final headquarters and full operations relocation of a regional airline, with an investment of over $32 millions and the creation of 170 new jobs.

Knowledge Services. Puerto Rico has also engaged in business development opportunities to become a Knowledge Process Outsourcing ("KPO") hub, by providing knowledge services to clients worldwide. These efforts have resulted in several new and expansion projects that represent nearly $15M in committed investment and over 3,500 committed jobs. Successful initiatives in this sector as of September 2014 include:

- Infosys, a global consulting, technology and outsourcing company, making a $9 million investment to develop a business outsourcing operation with a 300 job potential.
- Rock Solid, a fast-growing technology company that develops and exports IT products and services to over 20 countries. As part of its local growth, the company has committed to the creation of 100 new jobs to serve new clients located in the Caribbean and other international destinations.
- Additional expansion of a growing contact center, with a commitment of 300 new jobs, additional to the 200 already committed by the same company early in 2013.

Tourism. The Tourism Company is focused on achieving the growth of the tourism sector's contribution to Puerto Rico's gross domestic product to an unprecedented 8% through 5 key strategies:

- Increasing air and maritime access.
- An innovative marketing campaign to strengthen Puerto Rico's position as the premier Caribbean destination.
- Expanding and diversifying hotel infrastructure.
- Identifying and supporting the development of key niche markets.
- Delivering all these under the highest Quality standards.

Fiscal year 2014 was a year of expansion for the Puerto Rico tourism industry. The Tourism Company made a strategic decision to expand its source of visitors beyond the United States and all its efforts, led by research, followed by a well-defined strategic plan and marketing campaign have been directed to that goal. Although, the US Northeast is and will continue to be the core market, representing 56 million potential travelers, the new expansion markets represent 500 million additional potential tourists for PR.

The expansion strategy has already provided positive results. The July 2013 launch of the new Avianca flight from Bogota resulted in over 70% load factor in year 1, with a 41% increase in hotel registrations from Colombia resulting in estimated revenue of $2.4 million for the Hotel Industry. In less than one year, the airline has added a 4th flight in July and a 5th one projected for December, 2014. Another great achievement was reconnecting Madrid with San Juan via Air Europa, the fastest growing airline in Europe and part of the Globalia conglomerate. Air Europa is also exploring expansion possibilities for Puerto Rico, using Puerto Rico's strength as a Caribbean hub to grow further.

The expansion to strategic cities in the Midwest also bore positive results. In November, JetBlue and United entered the Chicago-San Juan market. This resulted in over 75,000 additional passengers, a 12% increase in hotel registrations and $2.6 million dollars in revenue for the Hotel Industry. At the same time, Southwest airlines also expanded their routes from Houston.

Maritime traffic had a significant increase with over 1.2 million passengers, a significant 16.5% growth versus the previous fiscal year. Homeport cruise passengers increased by over 11% helping drive incremental hotel business and in-transit cruise passengers have grown an impressive 20%. This business is key for the rest of the tourism sector's distribution chain: restaurants, tour operations, taxis, and retail business. Puerto Rico expects to have a record year during Fiscal year 2014-15 as it projects to receive 1.5 million passengers this year, surpassing the all-time high of 2008. In late September Disney cruise lines will commence to use Puerto Rico as homeport. In early December, an expanded Pier 3 will be inaugurated to welcome Royal Caribbean's Quantum of the Seas to Puerto Rico. It is currently projected that in January 7th, there will be 7 ships and close to 20,000 passengers visiting San Juan. In summary, Puerto Rico's cruise business is expected to grow 53% in 2 years.

Puerto Rico has grown its hotel infrastructure. Since January 2013, Puerto Rico has added 451 endorsed hotel rooms, with an investment of $111.5 million dollars and resulting in the creation of 645 new jobs. Puerto Rico currently has 14,780 endorsed rooms and thee goal is to reach 15,300 rooms by the end of 2014. The upcoming inauguration of the Blok Hotel in Vieques, The Vanderbilt in Condado, Hyatt House at the Convention Center among others are expected to add nearly 500 new rooms. Occupancy remains a solid 72% even with a 2% increase in available rooms in the last semester as a result of the efforts to achieve 20,000 rooms by 2017. Preliminary results for July reflect an almost two percentage point increase in occupancy. The ADR increased by an impressive 15.7% through April 2014.

Commerce and Trade. One of the main sectors that will help the government of the Commonwealth of Puerto Rico reach economic and fiscal stability is the small and medium sized enterprises (SMEs) sector. SMEs were one of the sectors that outperformed the Commonwealth economy during FY 2013. The SME ecosystem has been strengthened by several incentives programs which target job creation. One of these initiatives was the Jobs Now Act which was implemented during the first 18 month of the current Commonwealth administration. The program resulted in the creation of 7,818 jobs out of the 823 certified businesses that participated.

Building upon the initial success of the Jobs Now Act, The Puerto Rico Commerce and Trade Company ("PR Trade") has implemented several initiatives to foster the growth of the SME sector such as:

- Community Economic Development
- Business Incubators
- EDCU – Salary Incentives for SMEs in Urban Centers
- Export Accelerators
- Export Franchises
- Incentives Act for the Generation and Retention of Jobs in the SMEs sector (successor of Jobs Now Act)
- Incentives and Financing Act for Young Entrepreneurs
- SME Sector Support Act
- Creative Industries Act

PR Trade has been awarded two important federal grants as of September 2014. One for $90,909 will help fund, in part, its new PRO-TECH program which is intended to promote the creation and commercialization of technology based start-ups. The other for $800,000 will help fund, in part, four main initiatives of PR Trade; (i) a federal and state procurement B2B event bringing buyers from the U.S. federal and state governments to meet with local suppliers of goods and services; (ii) the Lufthansa MRO supplier project, which will help identify potential suppliers for goods and services to build the business ecosystem to fulfill the expected needs of the Lufthansa Technik's MRO project in Aguadilla, Puerto Rico; (iii) the Expo Partner project, intended to increase the number of SMEs that export their services and products; and (iv) the Expo PR 2015, a multi-sector trade show where international buyers are brought to learn and buy Puerto Rico goods and services.

Energy Policy

The current administration is committed to providing reliable electric service and to diversify Puerto Rico's energy sources with the aim of lowering energy costs.

On May 27, 2014, the Governor signed into law Act No. 57 of 2014 ("Act 57-2014), known as "The Energy Transformation and Relief of Puerto Rico Act". Act 57-2014 provides that two entities will oversee the new law's implementation. The Puerto Rico State Office of Energy Policy ("SOEP") (formerly the Energy Affairs Administration), will be responsible for developing and promoting the Commonwealth's energy policy, and the Puerto Rico Energy Commission ("PREC"), will be responsible for overseeing and regulating the implementation of the Commonwealth's energy policy. Among its duties, PREC will be responsible for approving the electricity rates proposed by PREPA.

Act 57-2014 also amended PREPA's organic law in order to impose on PREPA a duty to provide reliable electric service, contributing to the general welfare and sustainable future of the Commonwealth, and while reducing the social, environmental and economic impacts of such efforts. Act 57-2014 establishes thresholds for energy consumption in the Commonwealth's public agencies and corporations and the legislative and judicial branches of the Government, as well as penalties for non-compliance with such requirements. The municipalities of the Commonwealth are now also subject to energy consumption limitations, as well as to a reduction in the Contribution in Lieu of Taxes (CILT) that they receive from PREPA.

The other principal component of the Commonwealth's fuel diversification strategy is the development of renewable energy generation. Act No. 82 of June 19, 2010 creates a Renewable Portfolio Standard, recognizing many sources of renewable energy that utilize various technologies, and setting a target of 12% renewable energy production by 2015 and 15% by 2020, and a requirement for retail energy providers to establish a plan to reach 20% renewable energy production by 2035. Act No. 83 of June 19, 2010 (Act 83-2010) provides incentives for energy diversification through the Green Energy Fund ("GEF") Program and provides different types of tax credits and subsidies for certain renewable energy technologies. Through the GEF, the Commonwealth will invest $185 million in renewable energy projects during the period between fiscal year 2012 and fiscal year 2020. The FEV provides reimbursements for the installation of renewable energy systems of 40% with a maximum capacity of 100 kilowatts (kW) (applies for residential and small business) and up to 50% for systems larger than 100 kW and up to 1 megawatt (MW) (applies for medium business and industries). Current GEF regulations allow for solar and wind renewable energy technology to be incentivized.

As of June 2014, 42.9 MW (from 890 GEF incentives applications) have been incentivized by the GEF, 10 MW of which are currently interconnected to the Puerto Rico electrical grid. From the beginning of the GEF in 2011 through June 2014, of a total of $61.5 million dollars assigned to the Program, SOEP has reserved a total of $59.4 million for renewable energy projects. Of those incentives that have been reserved, SOEP has disbursed $23.4 million (corresponding to almost 40% of the projects constructed). Currently, there are over 100 MW of large scale projects (over 1 MW) installed (almost all of which are wind technology systems) and approximately 50 MW of distributed generation installed in the Commonwealth (almost all of which is solar technology).

Public-Private Partnerships

The Government recognizes that public-private partnerships (“PPPs”) represent an important tool for economic development.

On June 8, 2009, the Legislative Assembly approved Act 29, which established the legal framework for the establishment of PPPs in Puerto Rico to further the development and maintenance of infrastructure facilities, improve the services rendered by the Government and foster the creation of jobs. Act 29 created the Public-Private Partnerships Authority (the “PPP Authority”), the entity tasked with implementing the Commonwealth’s public policy regarding PPPs.

As part of the Government’s PPPs initiative, the PPP Authority had completed three important projects: the concession of toll roads PR-22 and PR-5, the School Modernization Program and the concession of the Luis Muñoz Marín International Airport. As part of the toll roads and airport transactions the Government received a total of $1.751 billion in upfront payments and commitments from the concession holders to invest more than $1.756 billion in capital improvements during the term of the agreements. As for the School Modernization Program, the Government has funded this project with the proceeds of Qualified School Construction Bonds issued by the Public Buildings Authority in the aggregate principal amount of $756 million. As of June of 2014, the PPP Authority had awarded approximately $717 million in contracts for a total of 95 schools completed and currently seven schools are in progress. As a result, this project has impacted nearly 50,000 students, 2,000 teachers and various communities and has created more than 14,000 jobs throughout the Commonwealth.

The PPP Authority is committed to attracting long-term private investment in the infrastructure of the Commonwealth. Currently, the Authority is working three greenfield projects in the planning phase. These projects are: the Caguas-San Juan mass transit system, a woman's correctional facility and the infrastructure to receive, store and regasify natural gas for PREPA's San Juan and Palo Seco generating power plants.

The PPP Authority has agreed with the Autonomous Municipality of Caguas, the Department of Transportation and Public Works and the Puerto Rico Highways and Transportation Authority to develop a mass transit system that would connect the Central Eastern Region to the Metropolitan Area under the PPP model that will involve the design, construction, financing, the operation and maintenance of the facility once developed. The estimated total investment of the project is $600 million and the project is expected to generate more than 12,000 jobs during the construction phase. This project is currently in its planning phase.

The PPP Authority, in conjunction with the Department of Correction and Rehabilitation, is planning to develop a women's correctional facility. The project involves the design, construction, financing and maintenance of a new campus style facility with a capacity of 650 beds. It has an estimated total investment of $139 million and will generate approximately 2,780 jobs during the construction phase. The project is currently under technical evaluation. The PPP Authority, with the assistance of its consultants, is evaluating different design and construction options.

The PPP Authority and the PREPA are interested in establishing a PPP for the design, construction, operation, and maintenance of the necessary infrastructure for the receiving, storing and regasification of Liquid Natural Gas for the generating power plants of San Juan and Palo Seco in the northern part of Puerto Rico. PREPA estimates the development costs or investment will be approximately $180 million to $300 million and will generate from 3,600 to 6,000 jobs. PREPA submitted the project for the PPP Authority's evaluation in May of 2013. The PPP Authority is currently conducting a technical evaluation to determine the feasibility of the project as a PPP.

Strategic Projects

The Commonwealth is also targeting strategic/regional projects that are expected to generate investments in various regions of Puerto Rico in order to foster a balanced economic development.

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

The Science District will include the existing University of Puerto Rico (UPR) Medical Sciences Campus, the UPR Rio Piedras Campus, the new Biomedical Sciences Laboratory, and the soon-to-be-constructed Comprehensive Cancer Center. At the center of the Science District will be new laboratory and commercial space on the site of the former Rio Piedras State Penitentiary ("Oso Blanco").

Over the next several years, the Puerto Rico Science Trust will oversee two major initiatives to realize the full potential of the Science District. Specifically, the Trust will:

- complete preparation of the Oso Blanco site and secure a private "anchor tenant" to begin development of laboratory and commercial space.

- actively market and expand programs to fund Puerto Rican investors and entrepreneurs, such as funding for companies applying for Small Business Innovation Research (SBIR) awards, research grants and in-kind support for individual researchers and inventors, and tax exemptions for companies that pursue research at local universities.

In the eastern region of Puerto Rico, the Roosevelt Roads project entails the redevelopment of the old Roosevelt Roads navy base facilities in Ceiba and is a key element in the administration's strategy to create jobs and reignite the economy of Puerto Rico's eastern region, including Ceiba, Naguabo, Vieques, and Culebra. The site of the former Roosevelt Roads Naval Station represents an unparalleled opportunity for the development of a mixed-use development that incorporates tourist, residential, recreational, institutional, light industrial and commercial uses. With 3,400 acres of prime waterfront property available for redevelopment, close proximity to attractions such as Vieques, Culebra, El Yunque, and San Juan, and improvements including a major airfield and deep-water ports, Roosevelt Roads represents a unique large-scale development opportunity. Development on the site would also contribute greatly to the economic growth of eastern Puerto Rico by providing construction jobs and attracting more tourists to the wider area.

The Government, through the Roosevelt Roads Local Redevelopment Authority ("LRA"), intends to develop the site by searching for and entering into an agreement with a master developer and other private parties. The LRA launched an RFQ/RFP process to select a Master Developer on June 30, 2014, and currently has 4 development teams participating in the RFP process published on August 29, 2014. These 4 proponents must present proposals by November 21, 2014 and the LRA expects to select a top Master Developer by December 2014 and have a signed contract by the beginning of 2015. The Master Developer will be responsible for coordinating and implementing redevelopment efforts with other developers/investors in accordance with the approved Master Plan. The LRA already signed a short-term lease for operating the on-site marina, and is currently in the process of signing other 8 short-term leases with small businesses that are to provide eco-tourism and nature tourism related services. The LRA also signed an exclusive negotiating agreement with a shipyard company to establish a shipyard operation to fabricate, repair and maintain boats, and it is expected that we will sign a long term lease by end of March 2015.

The LRA anticipates that the redevelopment of Roosevelt Roads will create at least 1,500 to 2,000 jobs over the next five years, with the potential of up to 25,000 jobs over a longer-term horizon.

In the western region of Puerto Rico, the Commonwealth is focused on the redevelopment of the Aguadilla airport to serve as the second international airport of Puerto Rico and as a regional logistics hub. The PRPA is well on their way to finalize a redevelopment master plan in order to convert the international airport facilities into a regional maintenance, repair and overhaul ("MRO") and cargo hub. To this end, the PRPA completed the process and the Aguadilla airport has been designated as a Free Trade Zone providing huge competitive advantages for companies operating under this structure. The plan will include the creation of a comprehensive aeronautics/aerospace cluster leveraging the University of Puerto Rico's Mayagüez Campus and major aeronautics firms operating in the west/northwest corridor. This initiative is spearheaded by the agreement reached with Lufthansa Technik with the first phase of construction underway.

Employment and Unemployment

According to the Household Survey, the number of persons employed in Puerto Rico during fiscal year 2014 averaged 1,006,646, a decrease of 2.2% compared to the previous fiscal year; and the unemployment rate averaged 14.3%. During the first three months of fiscal year 2015, total employment averaged 974,800, a 3.3% reduction with respect to the same period of the prior year, and the unemployment rate averaged 14.7% compared to 14.9% for the same period of the prior year.

The following table presents annual statistics of employment and unemployment for fiscal year 2010 through fiscal year 2014. These employment figures are based on the Household Survey, which includes self-employed individuals and agricultural employment, instead of the non-farm, payroll employment survey (the "Payroll Survey"), which does not. The number of self-employed individuals represents around 15% of civilian employment in Puerto Rico, more than double the level in the United States. On the other hand, agricultural employment in Puerto Rico represented 1.7% of total employment in fiscal year 2014.

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

Fiscal Years Ended June 30,	Labor Force	Employed	Unemployed	Unemployment Rate(1)
		(Annual Average)		
2010	1,285	1,075	210	16.3%
2011	1,249	1,047	202	16.2%
2012	1,221	1,035	185	15.2%
2013	1,196	1,029	167	14.0%
2014	1,175	1,007	169	14.3%

Totals may not add due to rounding.
(1) Unemployed as percentage of labor force.

Source: Department of Labor and Human Resources – Household Survey

Every decade, with every population census, employment and unemployment data are revised retroactively to consider population trends. Given that the Census of 2010 reported for the first time a population reduction in Puerto Rico, employment and unemployment data suffered a downward revision. As an example, for fiscal years 2011 and 2012 total employment figures were 30,300 and 49,700 employees below the previously published numbers. Similarly, for the same years, the number of unemployed persons was lower by 1,700 and by 5,400 from the numbers reported earlier. As a result, the unemployment rate has been declining slowly, and simultaneously the levels of total employment and unemployment have decreased.

Another employment measurement comes from the Establishment Survey, which is used to gauge employment across different economic sectors. The Establishment Survey measures only non-farm payroll employment, i.e., does not include self-employed nor agricultural workers. Employment coming from this survey (henceforth, payroll employment) is corrected every year (specifically, every March) with a benchmark revision. From calendar year 2006 to calendar year 2011 the revisions implied additions or subtractions of around 4,400 jobs (the highest addition was in 2008 with 5,300 jobs, and the highest subtraction corresponded to 2009 with 6,500 less jobs). Nevertheless, the benchmark revision of 2013 added 18,433 jobs, which represented an increase of 2.0% from what had been previously reported for 2012 (from 2006 to 2012, each benchmark change did not reach the magnitude of 1%). Moreover, the revision of March 2014 (which affected mainly calendar year 2013) increased the number of jobs by 21,275.

On the other hand, the recent changes to the Employees Retirement System resulted in more retirements of state and local employees. Approximately 70% of the total payroll employment reductions experienced from April to December 2013 corresponded to decreases in state and local government employment. This recent behavior cannot be explained only by the usual attrition of public employment.

Finally, since total non-farm payroll employment is one of the components of the EAI, the latest benchmark revision implied a change on the behavior of the index, increasing the level of the index for calendar year 2013 by more than 1%, from 126.1 to 128.1. This change meant that instead a reduction of 4.3%, the GDB-EAI decreased by 3.0% in calendar year 2013.

Economic Performance by Sector

From fiscal year 2009 to fiscal year 2013, the manufacturing and service sectors generated the largest portion of gross domestic product. The manufacturing, service, and government sectors were the three sectors of the economy that provided the most employment in Puerto Rico.

The following table presents annual statistics of gross domestic product by sector and gross national product for fiscal years 2009 to 2013.

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

	Fiscal Years Ended June 30,				
	2009	**2010**	**2011**	**2012**	**2013(1)**
Manufacturing	$43,872	$46,577	$46,760	$45,915	$47,997
Service(2)	40,642	41,408	42,690	44,870	44,670
Government(3)	9,047	8,350	8,216	8,277	8,242
Agriculture	567	822	795	717	713
Construction(4)	1,777	1,518	1,332	1,423	1,413
Statistical discrepancy	480	(294)	559	(122)	100
Total gross domestic product(5)	$96,386	$98,381	$100,352	$101,081	$103,135
Less: net payment abroad	(32,768)	(34,087)	(34,631)	(32,383)	(32,394)
Total gross national product(5)	$63,618	$64,295	$65,721	$68,698	$70,740

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

Source: Planning Board

The data for employment by sector or industry presented here, as in the United States, are based on the Establishment Survey, which is designed to measure number of payrolls by sector. The Establishment Survey excludes agricultural employment and self-employed persons. During fiscal year 2014, total non-farm payroll employment averaged 924,917, a 1.3% reduction with respect to the prior fiscal year. Furthermore, for the first quarter of fiscal year 2015, total non-farm payroll employment increased slightly, by 0.4%, when compared to the same period of fiscal year 2014.

The following table presents annual statistics of average employment based on the North American Industry Classification System ("NAICS") for fiscal years 2010 to 2014.

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

	Fiscal Years Ended June 30,				
	2010	**2011**	**2012**	**2013**	**2014[2]**
Natural resources and construction	36,292	32,050	35,100	33,742	29,742
Manufacturing					
Durable goods	34,792	33,900	33,308	32,767	31,925
Non-durable goods	53,533	51,767	50,192	45,875	43,650
Sub-total	88,325	85,667	83,500	78,642	75,575
Trade, transportation, warehouse, and Utilities					
Wholesale trade	32,667	32,008	31,517	31,617	31,683
Retail trade	126,233	128,017	128,192	130,567	131,067
Transportation, warehouse, and utilities	14,592	14,392	14,625	14,642	14,717
Sub-total	173,492	174,417	174,333	176,825	177,467
Information	18,783	18,733	18,650	19,092	18,983
Finance	45,833	43,733	44,400	44,408	43,650
Professional and business	102,742	105,667	108,875	112,725	116,942
Educational and health	111,442	114,158	117,617	122,150	123,367
Leisure and hospitality	71,067	71,208	72,775	76,783	79,692
Other services	18,750	17,925	17,625	17,900	17,900
Government[3]	276,533	260,033	258,425	255,158	241,600
Total non-farm	943,258	923,592	931,300	937,425	924,917

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

(2) Preliminary.

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

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

Although the data from the Payroll Survey is revised annually, the calendar year 2012 revision presented major changes not observed during the previous five years. For example, for calendar year 2010 the benchmark revision of the Payroll Survey implied an average reduction of 2,842 employees with respect to previously reported numbers for that year. Furthermore, for calendar year 2011 the annual benchmark revision implied an average increase of 4,067 employees with respect to earlier reports. From calendar years 2006 to 2011 the standard deviation of the revisions was around 4,400 employees, meaning that a revision could add or subtract 4,400 employees, on average. Nevertheless, the benchmark revision of calendar year 2012 implied an addition of 18,433 employees. This revision affected previous interpretations of the behavior of the labor market, and had effects on other composed variables, like the GDB-EAI. Likewise, the benchmark revision of calendar year 2013 was also significant, which added an average of 21,275 jobs to what was previously reported for that year. This revision also had an effect on the measurement of the GDB-EAI.

Manufacturing

Manufacturing is the largest sector of the Puerto Rico economy in terms of gross domestic product. The Planning Board figures show that in fiscal year 2013 manufacturing generated $48.0 billion, or 45.6%, of gross domestic product. During fiscal year 2014, payroll employment for the manufacturing sector was 75,575, a decrease of 3.9% compared with fiscal year 2013. For the first three months of fiscal year 2015, manufacturing employment averaged 74,100, a reduction of 0.8% (or 600 employees) from the same time period of the previous fiscal year. Most of Puerto Rico's manufacturing output is exported to the United States mainland, which is also the principal source of semi-finished manufactured articles on which further manufacturing operations are performed in Puerto Rico. Federal minimum wage laws are applicable in Puerto Rico. For fiscal year 2014, however, the average hourly manufacturing wage rate in Puerto Rico was approximately 68.9% of the average mainland United States rate.

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

The following table sets forth gross domestic product by manufacturing sector for fiscal years 2009 to 2013.

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

	2009	2010	2011	2012	2013 (1)
Food	$ 977	$ 868	$ 834	$ 841	$ 859
Beverage and Tobacco Products	1,209	1,358	1,228	1,323	1,448
Textile Mills & Product Mills	12	12	10	10	10
Apparel	270	283	276	277	204
Leather and Allied Products	18	22	25	19	16
Wood Products	20	19	17	19	21
Paper	63	45	52	46	46
Printing and Related Support Activities	100	115	119	88	88
Petroleum and Coal Products	347	353	352	344	333
Chemical	30,380	32,527	32,039	30,072	31,102
Plastics and Rubber Products	108	111	97	101	110
Nonmetallic Mineral Products	148	123	96	128	125
Primary Metals	145	200	169	169	173
Fabricated Metal Products	207	175	155	159	164
Machinery	174	233	232	256	258
Computer and Electronic Products	7,037	7,479	8,123	8,985	9,891
Electrical Equipment, Appliances and Components	654	677	681	739	745
Transportation Equipment	72	75	79	86	91
Furniture and Related Products	48	37	35	35	36
Miscellaneous	1,882	1,865	2,140	2,217	2,277
Total gross domestic product of manufacturing sector (2)	$ 43,872	$ 46,577	$ 46,760	$ 45,915	$ 47,997

(1) Preliminary.

(2) Totals may not add due to rounding.

Source: Planning Board

The following table presents annual statistics of average manufacturing employment by industry based on the NAICS for fiscal years 2010 to 2014.

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

	Fiscal Years Ended June 30,				
Industry group	**2010**	**2011**	**2012**	**2013**	**2014[1]**
Durable goods					
Nonmetallic mineral products manufacturing	2,492	2,133	2,042	1,975	1,750
Fabricated metal products	4,042	3,625	3,608	3,583	3,358
Computer and electronic	5,733	5,967	5,175	4,658	4,400
Electrical equipment	5,058	5,042	5,117	5,225	5,183
Miscellaneous manufacturing	11,675	11,633	11,775	11,817	12,108
Other durable goods manufacturing	5,792	5,500	5,592	5,508	5,125
Total – durable goods	34,792	33,900	33,308	32,767	31,925
Non-durable goods					
Food manufacturing	11,592	11,908	11,467	11,183	11,167
Beverage and tobacco products manufacturing	3,283	3,150	2,792	2,633	2,417
Apparel manufacturing	8,808	8,775	9,692	6,558	4,425
Chemical manufacturing	22,392	21,033	19,967	19,083	18,625
Other non-durable goods manufacturing	7,458	6,900	6,275	6,417	7,017
Total – non-durable goods	53,533	51,767	50,192	45,875	43,650
Total manufacturing employment	88,325	85,667	83,500	78,642	75,575

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

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

Total employment in the manufacturing sector decreased by 41,742 from fiscal year 2005 to fiscal year 2014. During the period from 2010 through 2014, manufacturing employment decreased by a total of 14.4%. For the first three months of fiscal year 2015, average employment in the sector declined by 600 jobs, or 0.8%, compared to the same period of the previous year. Given that this sector pays, on average, the highest wages in Puerto Rico, its general downturn has represented a major difficulty for restoring growth for the whole economy. There are several reasons that could explain this sector's job shrinkage: the end of the phase-out of the tax benefits afforded by Section 936 of the U.S. Code, the net loss of patents on certain pharmaceutical products, the escalation of manufacturing production costs (particularly electricity), the increased use of job outsourcing, and the increase of global competition. Puerto Rico's manufacturing sector continues to face increased international competition. As patents on pharmaceutical products manufactured in Puerto Rico expire and the production of such patented products is not replaced by new products, there may be additional job losses in this sector and a loss of tax revenues for the Commonwealth.

Service Sector

Puerto Rico has experienced mixed results in the service sector, which, for purposes of the data set forth below, includes wholesale and retail trade, utilities, transportation and warehousing, information, finance and insurance, real estate and rental, and certain services such as professional, scientific, technical, management, administrative, support, educational, health care, social, recreational, accommodation, food and other services. This sector has expanded in terms of income over the past decade, following the general trend of other industrialized economies, but with differences on the magnitudes of those changes. During the period between fiscal years 2007 and 2013, the gross domestic product in this sector, in nominal terms, increased at an average annual rate of 1.6%, while payroll employment in this sector increased slightly at an average annual rate of 0.1%. In the Puerto Rico labor market, self-employment, which is not accounted for in the Payroll Survey, represents approximately 15.4% of total employment according to the Household Survey. Most of the self-employment is concentrated in the service and construction sectors. The development of the service sector has been positively affected by demand generated by other sectors of the economy, such as manufacturing and construction.

The service sector ranks second to manufacturing in its contribution to gross domestic product. The service sector is also the sector with the greatest amount of employment. In fiscal year 2013, the service sector generated $44.7 billion, or 43.3%, of gross domestic product. Trade, transportation, finance, professional and business support, education and health and other services experienced growth, while information, and Real Estate & Rental experienced reductions in fiscal year 2013, as measured by gross domestic product at current prices. Service-sector employment increased from 565,450 in fiscal year 2007 to 578,000 in fiscal year 2014, an average annual rate increase of 0.3% (representing 62.5% of total, non-farm, payroll employment). The average service-sector employment for fiscal year 2014 represents an increase of 1.4% compared to the prior fiscal year.

Puerto Rico has a developed banking and financial system. According to the Office of the Commissioner of Financial Institutions of Puerto Rico (the "OCFI"), as of June 30, 2014, there were ten commercial banks operating in Puerto Rico. Commercial banks in Puerto Rico are generally regulated by the Federal Deposit Insurance Corporation (the "FDIC") or the Board of Governors of the Federal Reserve System, and by the OCFI. The OCFI reports that total assets of commercial banks (including assets of units operating as international banking entities) as of June 30, 2014 were $63.3 billion, as compared to $65.5 billion as of June 30, 2013. On April 30, 2010, the OCFI closed three commercial banks and the FDIC was named receiver. On the same date, the FDIC entered into loss share purchase and assumption agreements with three of the other commercial banks with operations in Puerto Rico, providing for the acquisition of most of the assets and liabilities of the closed banks, including the assumption of all of the deposits. Considering the magnitude of the consolidations, the amount of jobs lost to date as a result of these consolidations has not been significant. The Government expects that this consolidation will strengthen the Puerto Rico banking sector.

Broker-dealers in Puerto Rico are regulated by the Financial Industry Regulatory Authority ("FINRA"), the United States Securities and Exchange Commission and the OCFI, and are mainly dedicated to serve investors that are residents of Puerto Rico. According to the OCFI, assets under management by broker-dealers in Puerto Rico totaled $1.2 billion as of June 30, 2014, as compared to $1.6 billion on June 30, 2013. Another relevant component of the financial sector in Puerto Rico is the investment company industry. According to the OCFI, local investment companies had recorded assets under management of $9.4 billion as of June 30, 2014. Assets under management by local investment companies have decreased significantly as a result of the recent downgrades of bonds of the Commonwealth and its instrumentalities and the resulting reduction in the market prices of these bonds.

Other components of the financial sector in Puerto Rico include international banking entities ("IBEs") and credit unions (locally known as "cooperativas"). IBEs are licensed financial businesses that conduct offshore banking transactions. As of June 30, 2014, there were 32 IBEs (including units of commercial banks) operating in Puerto Rico, with total assets of $41.3 billion, an increase from $38.8 billion in total assets as of June 30, 2013. Meanwhile, credit unions, which tend to provide basic consumer financial services, reached $8.4 billion in assets as of June 30, 2014, an increase from $8.3 billion as of June 30, 2013.

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

The following table sets forth gross domestic product for the service sector for fiscal years 2009 to 2013.

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

	Fiscal Years Ended June 30,				
	2009	**2010**	**2011**	**2012**	**2013[(1)]**
Wholesale trade	$ 2,846	$ 2,993	$ 2,909	$ 2,928	$ 2,945
Retail trade	4,467	4,473	4,787	4,893	4,998
Transportation and warehousing	895	941	898	923	923
Utilities	1,967	1,982	1,868	2,081	1,752
Information	2,426	2,646	2,610	2,620	2,561
Finance and insurance	5,105	5,241	5,611	5,411	5,799
Real Estate and rental	13,660	13,785	14,369	15,922	15,230
Professional and business	3,009	3,083	3,311	3,489	3,643
Education and health	4,106	4,015	4,078	4,276	4,405
Leisure and hospitality	1,773	1,860	1,866	1,927	2,000
Other services	390	390	383	400	414
Total[(2)]	$40,642	$41,408	$42,690	$44,870	$44,670

(1) 2011-2012 revised figures and 2013 preliminary.
(2) Totals may not add due to rounding.
Source: Puerto Rico Planning Board

The following table sets forth employment for the service sector for fiscal years 2010 to 2014.

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

	Fiscal Years Ended June 30,				
	2010	**2011**	**2012**	**2013**	**2014[(1)]**
Wholesale trade	32,667	32,008	31,517	31,617	31,683
Retail trade	126,233	128,017	128,192	130,567	131,067
Transportation, warehouse and utilities	14,592	14,392	14,625	14,642	14,717
Information	18,783	18,733	18,650	19,092	18,983
Finance	45,833	43,733	44,400	44,408	43,650
Professional and business	102,742	105,667	108,875	112,725	116,942
Educational and health	111,442	114,158	117,617	122,150	123,367
Leisure and hospitality	71,067	71,208	72,775	76,783	79,692
Other services	18,750	17,925	17,625	17,900	17,900
Total[(2)]	542,108	545,842	554,275	569,883	578,000

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

Hotels and Related Services—Tourism

For fiscal year 2014, the number of persons registered in tourist hotels, including residents of Puerto Rico and tourists, was 2,238,000, an increase of 1.8% over the number of persons registered during fiscal year 2013. The average occupancy rate in tourist hotels during fiscal year 2014 was 72.3%, a slight decrease of 0.4% from the prior fiscal year. Also, during fiscal year 2014, the average number of rooms available in tourist hotels increased by 0.7% to 12,045 rooms compared to fiscal year 2013.

During the first month of fiscal year 2015, the number of persons registered in tourist hotels, including residents of Puerto Rico and tourists, was 263,200, an increase of 9.2% over the number of persons registered during the same period of fiscal year 2014. The average occupancy rate in tourist hotels during the first month of fiscal year 2015 was 82.1%, an increase of 0.4% from the prior fiscal year. Also, during the first month of fiscal year 2015, the average number of rooms available in tourist hotels increased by 4.1% to 12,518 rooms compared to the same period of fiscal year 2014.

In terms of employment, according to the Payroll Survey, employment in the leisure and hospitality sector was 76,783 for fiscal year 2013, an increase of 5.5% over employment for fiscal year 2012, which is a larger increment than the average growth rate observed for the tourist hotel registrations (4.8%) during that same year. For fiscal year 2014, employment in this sector increased by 3.8% to 79,692 compared to the prior fiscal year, a growth rate considerably higher than the increase observed in tourist hotel registrations during that same period. However, for the first three months of fiscal year 2015, the leisure and hospitality sector employment averaged 79,800 employees, an increase of 2.8% compared to the same period for the prior year, a growth rate considerably lower than the average increase of 9.2% observed during July 2014, the first month of registrations in tourist hotels for fiscal year 2015.

San Juan is the largest homeport for cruise ships in the Caribbean and one of the largest homeports for cruise ships in the world. During fiscal year 2014, the number of cruise passenger movement and trips increased by 16.5% and 10.6%, respectively. Also, during the first two months of fiscal year 2015, the number of cruise passenger movement and trips increased by 34.4% and 36.8%, respectively.

Commonwealth of Puerto Rico
Tourism Data[1]
Number of Visitors
(in thousands)

Fiscal Years Ended June 30,	Tourist Hotels[2]	Excursionists[3]	Other[4]	Total
2008	1,342.8	1,496.9	2,373.4	5,213.1
2009	1,277.7	1,232.0	1,905.5	4,415.3
2010	1,349.4	1,193.5	1,836.2	4,379.2
2011	1,408.5	1,165.8	1,639.4	4,213.7
2012	1,508.0	1,127.8	1,561.1	4,196.9
2013[5]......................................	1,586.1	1,038.0	1,613.6	4,237.7

Total Visitors' Expenditures
(in millions)

Fiscal Years Ended June 30,	Tourist Hotels[2]	Excursionists[3]	Other[4]	Total
2008	$1,526.3	$194.3	$1,814.3	$3,535.0
2009	$1,464.4	$173.7	$1,537.7	$3,175.8
2010	$1,541.8	$171.4	$1,497.5	$3,210.7
2011	$1,618.9	$169.3	$1,354.5	$3,142.8
2012	$1,706.9	$167.7	$1,318.3	$3,192.9
2013[5]......................................	$1,811.8	$156.0	$1,365.8	$3,333.5

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

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

The PRCDA also owns an 18,500-person capacity multipurpose arena, known as the José Miguel Agrelot Coliseum, located in San Juan, Puerto Rico. The coliseum was inaugurated in

2004 and has hosted more than 2.5 million people attending over 400 world-caliber events. The venue has received numerous awards including "Best International Large Venue of the Year" from Pollstar magazine in 2005.

Government

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

In fiscal year 2013 the government (federal, state and local) industrial sector accounted for $8.2 billion, or 8.0%, of Puerto Rico's gross domestic product. The government is also a significant employer, employing 241,600 workers (federal, state and local), or 26.1% of total, non-farm, payroll employment in fiscal year 2014. Government employment has decreased significantly, however, in recent years. In fiscal year 2009, federal, state and local government employment averaged 300,700. From fiscal year 2009 to fiscal year 2014, employment reductions have been of 1,300 jobs (-8.6%) in the federal government, 47,300 jobs (-21.7%) in the state government (including public corporations) and 10,400 jobs (-15.5%) in municipal government. During the first three months of fiscal year 2015, government employment has decreased further to a total amount of 237,700, or by 1.2% compared to the same period from the previous fiscal year. The reductions have occurred, for the most part, in the state and municipal government employment sectors and are related to the recent changes to the Employees Retirement System which prompted the voluntary departure of employees which qualified for retirement but were still employed.

Transportation

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

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

billion in the Airport during the life of the lease, including a commitment to invest approximately $267 million in immediate improvements and comply with world-class operating standards.

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

On April 10, 2014, the Ports Authority and PRIDCO signed a long-term lease agreement with Lufthansa Technik Puerto Rico, LLC ("LTPR") under which LTPR will lease from the Ports Authority certain areas of the Rafael Hernández Airport in Aguadilla, where LTPR will establish an aircraft maintenance, repair and overhaul operation. In addition to establishing Puerto Rico as a hub for this type of operations, the facility is expected to become a key driver of economic development and increased tax revenues for the Commonwealth.

Puerto Rico's major cities are connected by a modern highway system, which, as of December 31, 2013, totaled approximately 4,643 miles and 12,740 miles of local streets and adjacent roads. The highway system comprises 392 miles of primary system highways, which are the more important interregional traffic routes and include PR-52, PR-22, PR-53, PR-66 and PR-20 toll highways, 233 miles of primary urban system highways, 959 miles of secondary system highways serving the needs of intra-regional and inter-municipal traffic and 3,057 miles of tertiary highways and roads serving local, intra-municipal traffic. The PR-22 and PR-5 toll highways are currently operated by a private company pursuant to a Concession Agreement between the Puerto Rico Highways and Transportation Authority, the PPP Authority and Autopistas Metropolitanas de Puerto Rico, an affiliate of Abertis and Goldman Sachs.

The Port of the Americas is a deep draft container terminal under development on the south coast of Puerto Rico in the City of Ponce, the Commonwealth's fourth largest municipality by population. Managed by the Ponce Port Authority, the terminal can handle containerized import/export and transshipment cargo. The first phase of the port development was completed in 2004 while the second phase, which included the construction of a container yard with capacity for up to 250,000 Twenty-Foot Equivalent Units per year, was completed during the first quarter of calendar year 2009. A third development phase is still pending, which would result in an annual terminal processing capacity of up to 500,000 Twenty-Foot Equivalent Units and include the installation of the basic infrastructure required to develop an industrial value-added zone on land adjacent to the Port. In December of 2013, legislation was enacted to authorize the selection of an international level ports operator and an administrator for the adjacent value added zone. These measures are aimed at completing the remaining infrastructure required for the project to become operational in the near future.

Construction

Although the construction industry represents a relatively small segment of the economy compared to other sectors, it can make significant contributions to the growth of economic activity due to its multiplier effect on the whole economy. From its peak in fiscal year 2000 to fiscal year 2013, real construction investment declined at an average annual rate of 6.0%. Construction investment started to decrease significantly in fiscal year 2005, as a consequence of the recessionary economic conditions in Puerto Rico. During the last six fiscal years (from fiscal year 2007 to 2013) real construction investment decreased at an average annual rate of 7.3%. The Planning Board forecasts a decrease in construction investment of 12.4 and 14.6% in real terms for fiscal year 2014, and 2015.

Public investment has been an important component of construction investment. During fiscal year 2013, approximately 54.4% of the total investment in construction was related to public projects, which represents an increase in its share of total construction investment compared to 37.9% in fiscal year 2000. Public investment in construction has been negatively affected by the Commonwealth's fiscal difficulties, while private investment in construction is still suffering from the credit conditions that prevailed during the last decade. Public investment was primarily in housing, schools, water projects, and other public infrastructure projects. The end of federal ARRA funds also negatively affected public investment in construction during fiscal year 2014.

During fiscal year 2014, the number of construction permits decreased by 18.6%, while the total value of construction permits decreased by 13.8% when compared to fiscal year 2013. During the first two months of fiscal year 2015, the number of construction permits decreased by 9.6%, while the total value of construction permits increased by 10.1% compared to the same period of fiscal year 2014. Cement sales, on the other hand, have decreased every year since 2009, except 2012. In fiscal year 2014, cement sales decreased by 13.0% when compared to 2013. During the first three months of fiscal year 2015, cement sales have decreased by 13.2%, when compared to the same period in fiscal year 2014.

Average payroll employment in the construction sector during fiscal year 2014 was 29,742, a reduction of 11.9% from fiscal year 2013. During the first three months of fiscal year 2015, payroll employment in the construction sector averaged 31,000 jobs, a significant increase of 7.9% when compared to the same period in fiscal year 2014.

Agriculture

Agriculture production represents less than 1% of Puerto Rico's gross domestic product. During fiscal year 2012, gross income from agriculture was $784.5 million at current prices, which diminished slightly by 0.7% as compared with fiscal year 2011. In terms of gross domestic product, agriculture generated a level of production of $712.6 million at current prices in fiscal year 2013, a decrease of 0.7% compared to fiscal year 2012. According to the Household Survey, the number of people employed in this sector has remained stable during the past four years, at close to 17,000 employees.

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

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

Higher Education

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

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

Commonwealth of Puerto Rico
Trend in College Enrollment

	Commonwealth of Puerto Rico			United States Mainland		
Academic Year	**Population 18-24 Years of Age**	**Higher Education Enrollment**	**Percent[1]**	**Population 18-24 Years of Age**	**Higher Education Enrollment**	**Percent[1]**
1970	341,448[2]	57,340	16.8%	23,714,000[2]	8,580,887	36.2%
1980	397,839[2]	130,105	32.7%	30,022,000[2]	12,096,895	40.3%
1990	417,636[2]	156,147	37.4%	26,961,000[2]	13,818,637	51.3%
2000	428,894[2]	176,015	41.0%	27,141,150[2]	14,791,224	54.5%
2001	430,880[3]	184,126	42.7%	27,992,652[3]	15,312,289	54.7%
2002	428,065[3]	190,776	44.6%	28,480,708[3]	15,927,987	55.9%
2003	423,338[3]	199,842	47.2%	28,916,746[3]	16,611,711	57.4%
2004	417,141[3]	206,791	49.6%	29,302,179[3]	16,911,481	57.7%
2005	408,044[3]	208,032	51.0%	29,441,546[3]	17,272,044	58.7%
2006	398,586[3]	209,547	52.6%	29,602,839[3]	17,487,475	59.1%
2007	389,640[3]	225,402	57.8%	29,808,025[3]	17,758,870	59.6%
2008	384,751[3]	227,546	59.1%	30,194,274[3]	18,248,128	60.4%
2009	379,500[3]	235,618	62.1%	30,530,346[3]	19,102,814	62.6%
2010	375,145[2]	249,372	66.5%	30,672,088[2]	20,427,711	66.6%
2011	375,754[3]	250,192	66.6%	31,068,027[3]	21,016,126	67.6%
2012	374,592[3]	250,011	66.7%	31,353,406[3]	20,994,113	67.0%
2013	371,661[3]	245,495	66.1%	31,457,653[3]	20,642,819	65.6%

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

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

The University of Puerto Rico, the only public university in Puerto Rico, has eleven campuses located throughout the island. The University's total enrollment for academic year 2014-2015 was approximately 57,800 students. Commonwealth appropriations are the principal source of University revenues. The amount of the annual appropriation is based on a statutory formula, and equals 9.60% of the Commonwealth's average annual revenue from internal sources (subject to certain exceptions) for each of the two fiscal years immediately preceding the current fiscal year. Additional revenues are derived from tuition, student fees, auxiliary enterprises, interest income, federal grants, and other sources. The University's capital improvements have been financed mainly by revenue bonds.

In addition to the University of Puerto Rico, there are 40 public and private institutions of higher education located in Puerto Rico. Such institutions had an enrollment during academic year 2012-2013 of approximately 188,607 students and provide programs of study in liberal arts, education, business, natural sciences, technology, secretarial and computer sciences, nursing, medicine, and law. Degrees are offered by these institutions at the associate, bachelor, master, and doctoral levels.

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

Tax and Other Economic Development Initiatives

Since 2013, 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 and 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.

Summarized below are certain tax and other incentive programs designed to promote the development of the manufacturing, service and tourism sectors in Puerto Rico.

Industrial Incentives Program

Since 1948, Puerto Rico has had various incentives laws designed to promote investment and job creation. Under these laws, companies engaged in manufacturing and certain other designated activities were eligible to receive full or partial exemption from income, property, and other local taxes. The most recent of these incentives laws is the Economic Incentives Act, enacted in May 2008 (the "Economic Incentives Act").

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

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

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

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

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

Individual Investors Act

In January of 2012, the Legislative Assembly of Puerto Rico approved Act No. 2012-22, also known as the Act to Promote the Relocation of Individual Investors to Puerto Rico (the "Individual Investors Act). The Individual Investors Act seeks to attract new residents to Puerto Rico by providing total exemption from Puerto Rico income taxes on passive income realized or accrued after such individuals become bona fide residents of Puerto Rico. The Individual Investors Act applies to any individual investor that becomes a Puerto Rico resident on or before the taxable year ending on December 31, 2035, provided that such individual was not a resident of Puerto Rico at any time during the 15-year period preceding the effective date of the Individual Investors Act. This relocation is expected to result in new local investments in real estate, services, and other consumption products, and in capital injections to the Puerto Rico banking sector, all of which would stimulate the economy of Puerto Rico.

Over 260 Individual Investors Act tax grants have been granted since 2012, of which 90% have also established service operations in Puerto Rico under the Export Services Act, discussed below.

Export Services Act

In January of 2012 the Commonwealth enacted Act No. 2012-20, also known as the Act to Promote the Exportation of Services (the "Export Services Act"), which supersedes the provisions of the Economic Incentives Act that provide benefits to designated services performed for markets outside of Puerto Rico. The Export Services Act seeks to establish and develop in Puerto Rico an international export services center. This act seeks to encourage local service providers to expand their services to persons outside of Puerto Rico, promote the development of new businesses in Puerto Rico and stimulate the inbound transfer of foreign service providers to

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

Over 250 Export Services Act tax grant applications have been evaluated for the establishment of new export services operations in Puerto Rico within the following industries: centralized management services and shared services; information technology; financial services; advertising and public relations; and professional services. As of September 30, 2014, 170 cases had been approved under the Export Services Act.

Green Energy Incentives Program

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

Companies qualifying under the Green Energy Incentives Act can avail themselves of the following tax benefits: a preferential income tax rate of 4% on income derived from eligible activities and a withholding tax rate of 12% on royalty payments, license fees and rental payments to non-Puerto Rico resident companies. In addition, the Green Energy Incentives Act grants a 90% exemption from property taxes, a 100% exemption from municipal license taxes during the first three semesters of operations and at least 60% thereafter, and a 100% exemption from excise taxes, and sale and use taxes with respect to the acquisition of raw materials and certain machinery and equipment used in the exempt activities. In order to enjoy these tax benefits, an eligible business must request and obtain a grant of tax exemption, which is a contract between the Commonwealth and the exempt business, and has a term of 25 years.

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

The Green Energy legislation also provides incentives for the construction and use of renewable energy sources, and creates a Green Energy Fund through which the Commonwealth will co-invest $290 million in renewable energy projects over the next ten years. These initiatives are intended to address energy prices in Puerto Rico and provide a means for attracting investment in the energy sector. The fund will provide reimbursements for the installation of renewable energy generating equipment of up to 40% for residential and small businesses, and up to 50% for medium sized businesses and industries. This funding initiative will also provide access to Renewable Energy Certificates (“RECs”) to help finance renewable energy projects at a utility scale level. A REC is a personal asset that is marketable and negotiable. It can be bought, sold, assigned, and transferred between individuals for any lawful purpose, and as a whole, indivisible asset, it is equivalent to one Megawatt-hour of electricity generated by a source of sustainable or alternative renewable energy.

During fiscal years 2012 and 2013, 370 renewable energy projects were approved, of which 90 projects were completed. Between July and September of 2013, 62 projects were completed with Green Energy Fund incentives, representing an investment of more than $11 million and the creation of approximately 100 professional and technical jobs in the areas of design and construction.

Tourism Incentives Program

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

As part of the incentives to promote the tourism industry, in 1993 the Commonwealth established the Puerto Rico Tourism Development Fund (“TDF”) as a subsidiary of GDB with the authority to make investments in or provide financing (guarantees or loans) to corporate entities that develop hotel and related hospitality projects. As of July 31, 2014, TDF has provided direct loans and guaranteed loans and bonds in the aggregate amount of approximately $1.6 billion for 29 tourism projects representing 5,468 new hotel rooms, with a total investment of approximately $2.5 billion.

More recently, the Commonwealth has focused its 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 Hotels to Puerto Rico with two new "Hyatt Place" hotels that opened in December of 2013 and March of 2014, and a "Hyatt House" that opened in October of 2014 located within the Convention Center District.

- 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.

Manufacturing and Knowledge Services

The Commonwealth's recent outreach initiatives have resulted in the following 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.

International Finance Center

Act No. 273 of 2012 ("Act 273-2012"), also known as the "International Financial Center Regulatory Act", provides tax exemption to businesses engaged in eligible activities in Puerto Rico. To qualify for such benefits, a business needs to become an International Financial Entity ("IFE") by applying for a permit and licence and obtaining a tax exemption decree. The International Financial Center has experienced strong growth since 2013 with six operating licenses approved in 2013 and eight new operating licenses approved in 2014. As of June 30, 2014, International Financial Entities had $267,479,000 in Total Assets.

International Insurance Center

Act No. 399 of 2004 ("Act 399-2004"), provides Puerto Rico with a competitive environment, within which insurers and reinsurers can cover risks outside of Puerto Rico under a secure and flexible regulatory framework with attractive tax benefits. International insurance entities have various alternative ways to organize and operate within the Puerto Rico International Insurance Center. These options include operating as an international insurance holding company, an international insurer or a branch of an international insurer, as well as managing protected cell arrangements under a tax efficient framework. Most recently, Act 39-2014 was enacted to set the guidelines for the assumption of domestic risks, regulate third party risks assumptions by captives, and facilitates the organization of insurance linked securities programs (ILS/CAT Bonds).

Promotional efforts and direct approaches to insurance carriers and underwriters, captive managers and related advisors have resulted in: (i) 12 authorized insurance companies; (ii) over 180 approved protected cell arrangements and segregated asset plans; and (iii) total premium income of $149 million for 2013 (more than twice the $66 million in premium income for 2012).

Infrastructure investments

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.

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

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

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

In May 2009, the United States Treasury Department announced proposed changes to the U.S. Code that include, among others, changes to remove incentives for shifting jobs overseas. The Ways and Means Committee of the House of Representatives has also held recent hearings and released a tax policy white paper that puts forth certain proposed changes to the U.S. Code to combat base erosion and profit shifting by U.S. and foreign multinational corporations. While these initiatives are not directed at Puerto Rico, several of them could affect CFCs operating in Puerto Rico. As of this date, no legislation has been approved by either House of Congress of the United States. It is not possible at this time to determine the legislative changes that may be made to the U.S. Code, or their effect on the long-term outlook on the economy of Puerto Rico. The Commonwealth is developing policy responses to the United States government to seek to safeguard Puerto Rico's economic growth and development plans.

DEBT

Public Sector Debt

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

Section 8 of Article VI of the Commonwealth Constitution provides that public debt of the Commonwealth will constitute a first claim on available Commonwealth resources. For purposes of the Constitution, "public debt" includes only general obligation bonds and notes of the Commonwealth to which the full faith, credit and taxing power of the Commonwealth are pledged and, according to opinions rendered by the Attorney General of the Commonwealth, also any payments required to be made by the Commonwealth on account of bonds and notes issued by its public instrumentalities and guaranteed by the Commonwealth. Public debt does not include other obligations of the Commonwealth or obligations of public instrumentalities that are not guaranteed by the Commonwealth. As explained below, the portion of the Sales and Use Tax allocated to COFINA is not considered "available Commonwealth resources" under the Constitution.

Section 2 of Article VI of the Constitution of the Commonwealth provides that direct obligations of the Commonwealth evidenced by full faith and credit bonds or notes shall not be issued if the amount of the principal of, and interest on, such bonds and notes and on all such bonds and notes theretofore issued that is payable in any fiscal year, together with any amount paid by the Commonwealth in the fiscal year preceding the fiscal year of such proposed issuance on account of bonds or notes guaranteed by the Commonwealth, exceed 15% of the average annual revenues raised under the provisions of Commonwealth legislation and deposited into the treasury (hereinafter, "internal revenues") in the two fiscal years preceding the fiscal year of such proposed issuance. Internal revenues consist principally of income taxes, property taxes, sales and use taxes and excise taxes.

Section 2 of Article VI does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded through payments by the Commonwealth on such guaranteed debt. As stated above, annual debt service payments on bonds guaranteed by the Commonwealth are not included in the calculation of the 15% debt limitation unless the issuers of such guaranteed bonds are unable to make such payments and the Commonwealth is required to make such payments under its guarantee. During fiscal year 2014, the Commonwealth made debt service payments of $18.7 million on account of debt guaranteed by the Commonwealth (which were the bonds issued by the Port of the Americas Authority held by GDB).

Certain revenues, such as federal excise taxes on offshore shipments of alcoholic beverages and tobacco products and customs duties, which are collected by the United States Government and returned to the Treasury Department, and motor vehicle fuel taxes, crude oil and derivative products excise taxes and license fees, which are currently allocated to the Highway and Transportation Authority, are not included as internal revenues for the purpose of calculating the debt limit, although they may be available for the payment of debt service. In addition, the portion of the Sales and Use Tax allocated to COFINA is not included as internal revenues since the legislation that created COFINA transferred ownership of such portion of the Sales and Use Tax to COFINA and provided that such portion was not "available resources" under the Constitutional provisions relating to full faith and credit bonds.

As of July 31, 2014, future maximum annual debt service for the Commonwealth's outstanding general obligation debt is $1.162 billion in the fiscal year ending on June 30, 2016 (based on the assumption that $126.7 million principal amount of CPI-based variable rate bonds issued bear interest at the maximum rate of 12% per annum). This amount *plus* the amount paid by the Commonwealth in fiscal year 2014 on account of bonds or notes guaranteed by the Commonwealth ($18.7 million) totals $1.181 billion, which is equal to 13.8% of $8,552 billion, which is the average of the adjusted internal revenues for the fiscal years ended June 30, 2013 and 2014.

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

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

The table on the following page presents a summary of the debt of the Commonwealth and its instrumentalities outstanding as of July 31, 2014. 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 $4.9 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)

	July 31, 2014
Good faith and credit bonds and notes issued by the Commonwealth	$13,020[1]
Bonds and notes guaranteed by the Commonwealth's good faith and credit [2]	5,536
SUBTOTAL - GOOD FAITH AND CREDIT BONDS AND NOTES	18,556
Debt supported by Commonwealth appropriations or taxes	3,949[3]
Tax and Revenue Anticipation Notes [4]	500
SUBTOTAL - DEBT PAYABLE FROM GENERAL FUND	$23,005
Bonds and notes payable from sales and use tax revenues (COFINA)	$15,224
Debt issued by the Commonwealth and its instrumentalities	24,266[5]
Debt issued by municipalities	3,954
Pension Funding Bonds (payable from employer contributions to ERS) [6]	2,948
Other limited obligation debt and non-recourse debt [7]	2,038
SUBTOTAL - OTHER PUBLIC SECTOR DEBT	48,430
TOTAL PUBLIC SECTOR DEBT	**$71,435**

Totals may not add due to rounding.

(1) Includes approximately $113.5 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 $28.5 million debt from General Services Administration line of credit.

(2) Consists of $682 million of bonds issued by Puerto Rico Aqueduct and Sewer Authority ("PRASA"), $483 million of Puerto Rico State Revolving Fund loans made to PRASA under various federal water laws, $226.7 million of bonds issued by the POA (which are held by GDB), and $4.144 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, $2.102 billion of appropriation debt notes issued by the instrumentalities and agencies (including $64.7 million of notes issued by PBA), $719.8 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) Consists of $500 million in revolving notes purchased by GDB.

(5) Excludes (in order to avoid double counting) $4.9 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 $64.7 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) $136.1 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) $68.7 million of Educational Facilities Revenue Bonds, 2000 Series A (University Plaza Project) issued by Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority ("AFICA"), which are payable from rent payments made by the University of Puerto Rico; and (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
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	4,609	133,552	16,498	154,660	-	154,660
2043	1,882	-	15,608	17,490	-	17,490
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
	$24,818,909	$7,778,219	$2,682,727	$35,279,855	$1,795,223	$37,075,079

(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 $28.5 million General Services Administration line of credit. Amounts shown do not include capitalized interest of $344 million for fiscal year 2015 and $75 million for fiscal year 2016.

(2) Includes $682 million of bonds issued by PRASA, $483 million of Puerto Rico State Revolving Fund loans made to PRASA under various federal water laws, $226.7 million of POA Guaranteed Bonds, $267 million of GDB bonds payable from available moneys of GDB and $110 million of GDB senior guaranteed notes Series 2013B. Assumes that the POA Guaranteed Bonds, which are held by GDB and are due on January 1, 2015, are restructured as anticipated to provide for level debt service.

(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 September 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 September 30, 2014. This table does not include approximately $400 million in PRHTA Bond Anticipation Notes (of which approximately $292 million is currently outstanding) 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 September 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 September 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 September 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 September 30, 2014)

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

The following table shows, as of September 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 September 30, 2014)

	Synthetic Fixed
PREPA	($48,047,053)
COFINA	($60,406,860)
Total	($108,453,913)

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 September 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 or its swap counterparty may be required to post collateral during each fiscal year depending on the transaction's mark-to-market value. In accordance with these requirements, COFINA had posted collateral of $12 million to its counterparty as of September 30, 2014. The maximum amount COFINA is required to transfer in a given fiscal year is $15 million, with the total posting capped at $60 million. Each year, the Trustee will deposit $15 million from surplus revenues into an account which will be used to satisfy any collateral requirements for a given fiscal year.

Commonwealth Guaranteed Debt

As of July 31, 2014, $4.144 billion of Commonwealth guaranteed bonds of PBA were outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds). Maximum annual debt service on these bonds is $961 million in fiscal year 2028, assuming the receipt of the issuer subsidy from the federal government on the $756,449,000 Government Facilities Revenue Bonds, Series R (Qualified School Construction Bonds – Issuer Subsidy) and the $121,528,000 Government Facilities Revenue Bonds, Series T (Qualified Zone Academy Bonds – Direct Payment), and $1.0 billion in fiscal year 2028 without taking into consideration said subsidy, with their final maturity being July 1, 2042. No payments under the Commonwealth guaranty have been required to date for these bonds.

As of July 31, 2014, $26.7 million of Commonwealth guaranteed bonds of GDB were outstanding. No payments under the Commonwealth guaranty have been required for these bonds. On October 10, 2014, GDB issued or entered into agreements providing for the issuance of an aggregate of $900 million in notes guaranteed by the Commonwealth maturing on or prior to June 30, 2015, the proceeds of which were used to purchase Tax and Revenue Anticipation Notes issued by the Commonwealth.

As of July 31, 2014, GDB held approximately $226.7 million of the Port of the Americas Authority's outstanding bonds, which are guaranteed by the Commonwealth. The proceeds from these bonds have been used to continue the development of the Port of the Americas. The Commonwealth has been paying debt service on these bonds under its guaranty. While the responsibility for the development and operation of the Port of the Americas was transferred from the Port of the Americas Authority to the Ponce Ports Authority in December 2011, the Port of the Americas Authority retained the liability for the outstanding bonds, which are expected to be paid by the Commonwealth under the guarantee.

As of July 31, 2014, the aggregate outstanding principal amount of obligations of PRASA guaranteed by the Commonwealth was $1.166 billion. This amount includes revenue bonds sold to the public, bonds issued to the United States Department of Agriculture, Rural Development, and loans made by the State Revolving (Clean Water and Safe Drinking Water Act) Funds for the benefit of PRASA. From 1997 to 2005, debt service on these bonds was paid by the Commonwealth under its guaranty. Beginning in 2006, PRASA resumed making all debt service payments on this debt. See "PUBLIC CORPORATIONS - Puerto Rico Aqueduct and Sewer Authority."

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

Trends of Public Sector Debt

The following table shows the growth rate of short-term and long-term public sector debt and the growth rate of gross national product (in current dollars) for the five fiscal years ended June 30, 2014 and as of July 31, 2014. As of July 31, 2014, outstanding short-term debt, relative to total debt, was 7.6%. Total public sector debt for fiscal year 2014 shown in the table below represented 90.4% of nominal gross national product for fiscal year 2014.

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
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%	65,720	2.0%
2012	60,780	3,981	64,760	6.2%	9.5%	68,698	4.5%
2013	60,115	4,843	64,957	7.4%	0.3%	70,740	3.0%
2014	62,432	4,841	67,273	7.2%	3.6%	75,731	7.1%
7/31/2014	61,443	5,006	66,449	7.6%	1.2%	N/A	N/A

Totals may not add due to rounding.

(1) In current dollars.

(2) Does not include debt identified in footnotes 6 and 7 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 five fiscal years ended June 30, 2014, and as of July 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
2014	13,932	404	14,336	3,589	604	4,193	44,910	3,834	48,744	62,432	4,841	67,273
7/31/2014	13,551	704	14,255	3,400	554	3,954	44,492	3,748	48,240	61,443	5,006	66,449

Totals may not add due to rounding.

(1) Does not include the Senior Pension Funding Bonds identified in footnote 6 of the table above entitled "Commonwealth of Puerto Rico – Public Sector Debt." Includes certain lines of credit not evidenced by good faith and credit bonds and notes.

(2) Includes Commonwealth guaranteed debt; does not include the bonds identified in footnote 7 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 July 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, such as GDB, 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.

Commonwealth of Puerto Rico
Outstanding Debt of Public Corporations
July 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	$682,251	$3,364,564	$4,046,815	$483,377	$285,587	$768,964	$1,165,628	$3,650,151	$4,815,779
Convention Center District Authority	-	408,530	408,530	-	145,448	145,448	-	553,978	553,978
Electric Power Authority	-	8,322,405	8,322,405	-	731,838	731,838	-	9,054,243	9,054,243
Highway and Transportation Authority	-	4,717,127[1]	4,717,127	-	2,213,903	2,213,903	-	6,931,030	6,931,030
Housing Finance Authority	-	98,670[2]	98,670	-	159,944	159,944	-	258,614	258,614
Industrial Development Company	-	176,895	176,895	-	87,325	87,325	-	264,220	264,220
Infrastructure Financing Authority[3]	-	1,890,553	1,890,553	-	48,948	48,948	-	1,939,501	1,939,501
Port of the Americas Authority	226,677	-	226,677	-	1,700	1,700	226,677	1,700	228,377
Ports Authority[4]	-	-	-	-	256,578	256,578	-	256,578	256,578
Public Buildings Authority	4,144,139	-	4,144,139	-	175,417	175,417	4,144,139	175,417	4,319,556
Public Finance Corporation	-	1,090,740[5]	1,090,740	-	-	-	-	1,090,740	1,090,740
Sales Taxes Financing Corp. (COFINA)	-	15,223,821	15,223,821	-			-	15,223,821	15,223,821
University of Puerto Rico	-	470,775[6]	470,775	-	87,475	87,475	-	558,250	558,250
Others[7]	-	-	-	-	2,745,483	2,745,483	-	2,745,483	2,745,483
Total[8]	$5,053,067	$35,764,080	$40,817,147	$483,377	$6,939,646	$7,423,023	$5,536,444	$42,703,726	$48,240,170

(1) Excludes $136.1 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) $192.8 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 $68.7 million of Educational Facilities Revenue Bonds, 2000 Series A (University Plaza Project) issued by AFICA, which bonds are payable from rent payments made by the University of Puerto Rico.

(7) Includes lines of credit 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

RATINGS

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. These ratings and outlooks reflect only the opinions of such rating agencies and an explanation of the significance of such ratings may be obtained only from the relevant rating agency.

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	CCC	Caa3	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	
PR Municipal Finance Agency	B	B3	
PR Convention Center District Authority	BB	Caa1	
PR Industrial Development Company	BB-	Ba3	
PR Infrastructure Financing Authority			
Special Tax Revenue Bonds	BB	B3	
PR Ports Authority Project	BB	B3	
University of Puerto Rico			
Revenue Bonds	BB	Caa1	
AFICA – Plaza Universitaria Project	BB	Caa2	

COMMONWEALTH TAXES, OTHER REVENUES, AND EXPENDITURES

Overview

The Commonwealth reports its financial position and results of operations in funds, which are considered separate accounting entities, including those component units which are required to be blended. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions. The Secretary of the Treasury has custody of the funds of the central government and is responsible for the accounting, disbursement and investment of such funds. Central government funds are grouped into three major categories or "types" of funds, as follows: (i) Governmental Fund Types, which include the General, Special Revenue, Debt Service (also referred to herein as Redemption), and Capital Project Funds; (ii) Proprietary Fund Types, which include the Enterprise and Internal Service Funds; and (iii) Fiduciary Fund Types, which include the Trust and Agency Funds. These funds do not include funds of the municipalities, because the municipalities are governmental entities with independent treasuries.

The General Fund is the primary operating fund of the Commonwealth. References in this Commonwealth Report to General Fund revenues and expenditures (and to the resulting General Fund deficit), unless otherwise specified, are references to such revenues and expenditures as reflected in the Commonwealth General Fund budget, and are sometimes (but not always) referred to for clarity as General Fund budgetary revenues and budgetary expenditures. These budgetary revenues and expenditures do not include many sources of revenues and funds and many classes of expenditures that are part of the General Fund for financial reporting purposes in accordance with US GAAP. The Special Revenue Fund, for example, is incorporated into the General Fund for financial reporting purposes but not for budgetary purposes.

General Fund revenues are broadly based and include revenues raised internally as well as those from non-Puerto Rico sources. Internal revenues consist principally of income, excise and sales and use taxes. Revenues from non-Puerto Rico sources are derived from federal excise taxes and customs duties returned to the Commonwealth. In addition, for financial reporting purposes (but not for budgetary purposes), General Fund revenues include Federal grants and contracts under numerous Federal programs and charges for services. The principal sources of General Fund revenues are described in greater detail further below in this section.

General Fund budgetary revenues exclude the following revenues: federal grants and contracts, the portion of rum excise taxes assigned to certain component units and private institutions, motor vehicle licenses fees and fines, excise tax on gasoline, gas, oil, diesel oil, petroleum, a portion of cigarette taxes assigned to certain component units and private instutions, compulsory vehicle insurance premiums assigned to a private institution, a portion of the non-resident witholding income tax, a portion of the horse racing excise tax, a portion of sales and use tax allocated to COFINA, other charges for services which are assigned by law for specific purposes, other revenues assigned by law for specific purposes, and revenues and expenditures of agencies with independent treasuries.

The following table presents the General Fund budgetary revenues and expenditures, as well as other financing sources (uses) under a statutory (also referred to as budgetary) basis of accounting for fiscal years 2010 through 2014. Fiscal year 2014 results are preliminary and unaudited, and therefore subject to change.

The budgetary basis of accounting is not in accordance with US generally accepted accounting principles (US GAAP). Revenue is generally recognized when cash is received, net of tax refunds claimed by taxpayers as of year-end. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenue. Under the statutory basis of accounting, the Commonwealth uses "encumbrance accounting" to record the full amount of purchase orders, contracts, and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control. Expenditures are generally recorded when the related expenditure is incurred or encumbered. Encumbrances generally lapse the year following the end of the fiscal year when the encumbrance was established, as established by Act No. 123 of August 17, 2001. Unencumbered appropriations lapse at year-end. Amounts required for settling claims and judgments against the Commonwealth and certain other liabilities are not recognized until they are encumbered or otherwise processed for payment. If General Fund revenues and expenditures were presented in accordance with US GAAP, revenues, expenditures and the deficiency of revenues over expenditures would be significantly higher than the amounts presented in the table below.

The amounts shown in the following table as expenditures may be different than those reflected in the budget. As described above, the General Fund budgetary revenues and expenditures, and the transfers presented in the table, also differ from the General Fund revenues, expenditures and transfers presented in the financial statements of the Commonwealth, as the financial statements reflect an expanded General Fund entity in accordance with US GAAP.

Commonwealth of Puerto Rico
Schedule of General Fund Budget Revenues and Expenditures
(in thousands)

	2010	2011	2012	2013	2014[5]
Revenues:					
Income Taxes:					
Individuals	$2,589,981	$2,178,741	$2,099,564	$2,054,654	$1,979,448
Corporations	1,682,321	1,677,345	1,460,354	1,286,506	1,914,333
Partnerships	1,688	3,249	1,333	756	745
Withholdings from non-residents	830,352	1,000,428	890,761	982,896	899,865
Tollgate taxes	15,034	12,607	27,678	8,903	7,140
Interest	9,902	6,985	6,807	5,425	4,900
Dividends	29,774	26,756	35,087	34,064	39,713
Inheritance and gift taxes	3,617	3,101	5,465	1,833	1,395
Total income taxes	**5,162,669**	**4,909,212**	**4,527,049**	**4,375,037**	**4,847,539**
Sales and Use Tax	**540,348**	**553,020**	**540,026**	**539,929**	**595,256**
Excise Taxes:					
Alcoholic beverages	284,796	280,963	292,614	282,316	266,542
Foreign (Act 154)	-	677,565	1,875,823	1,632,549	1,902,193
Tobacco products	182,501	201,965	172,155	186,909	171,108
Motor vehicles	350,764	364,170	386,468	419,178	392,043
Revenues from component units- slot machines	23,273	23,738	19,957	24,594	21,910
Horses races	22,862	20,983	19,302	13,403	16,354
Insurance premiums	24,089	23,785	23,382	24,569	42,642
Other excise taxes	7,754	7,509	22,702	9,240	8,247
Total excise taxes	**896,039**	**1,600,678**	**2,812,403**	**2,592,758**	**2,821,039**
Property Taxes	**227,812**	**241,719**	**65,497**	**52,614**	**19,766**
Licenses and Other Taxes	**99,385**	**83,327**	**82,578**	**81,127**	**19,845**
Charges for Services	**213,165**	**228,003**	**179,962**	**105,644**	**108,428**
Miscellaneous Non-tax Revenues	**101,589**	**44,829**	**100,072**	**136,424**	**143,510**
Total revenues from internal sources	**7,241,007**	**7,660,788**	**8,307,587**	**7,883,533**	**8,555,383**
Revenues from Non-Commonwealth Sources:					
Federal excise taxes[1]	352,301	333,031	258,171	247,848	248,017
Customs	-	-	7,739	-	-
Total revenues from non-Commonwealth sources	**352,301**	**333,031**	**265,910**	**247,848**	**248,017**
Total Budgetary Revenues	**7,593,308**	**7,993,819**	**8,573,497**	**8,131,381**	**8,803,400**
Other Revenues:					
Cash distributions from Traditional Lottery [2]	**42,826**	**46,165**	**38,225**	**24,322**	**81,769**
Cash distributions from Electronic Lottery (Lotto) [2]	**80,006**	**55,690**	**56,163**	**38,876**	**72,287**
Excess of collateral received on derivative transactions	**-**	**-**	**-**	**241,777**	**-**
Receipts of COFINA bond proceeds from prior years issuances [3]	**-**	**62,642**	**-**	**125,848**	**79,485**
Total Revenues	**7,716,140**	**8,158,316**	**8,667,885**	**8,562,204**	**9,036,941**
Other Financing Sources (Uses):					
Transfers in from Debt Service Fund, Lotteries Fund and others	227,395	759,660	769,158	197,936	-
Receipts of COFINA bond proceeds from current year issuances [3]	2,688,173	1,489,323	952,615	333,300	-
Proceeds from notes payable issued for debt service payments [4]	147,869	559,626	877,034	600,433	575,000
Proceeds from notes payable issued to cover operating expenditures	-	-	-	-	89,059
Proceeds from issuance of tax revenue anticipation notes (TRANS)	2,275,000	1,850,000	1,100,000	900,000	1,200,000
Repayments of TRANS	(2,275,000)	(1,850,000)	(1,100,000)	(900,000)	(1,200,000)
Payments to refunded debts escrow agent and others	(30,340)	(558,003)	(978,403)	(12,478)	-
Total other financing sources, net	**3,033,097**	**2,250,606**	**1,620,404**	**1,119,191**	**664,059**
Total Resources	**10,749,237**	**10,408,922**	**10,288,289**	**9,681,395**	**9,701,000**
Expenditures:					
General government	1,367,333	1,410,070	1,957,580	1,382,066	1,220,953
Public safety	2,078,972	1,947,739	2,011,965	1,966,079	1,682,336
Health	1,636,814	1,654,661	1,686,402	1,378,397	1,387,641
Public housing and welfare	504,900	466,226	474,074	460,269	457,494
Education	3,092,788	2,800,677	2,926,638	2,916,347	2,994,997
Economic development	568,450	417,853	458,102	413,948	417,186
Intergovernmental	391,104	378,243	396,447	421,359	444,620
Total Budgetary Expenditures	**9,640,361**	**9,075,469**	**9,911,208**	**8,938,465**	**8,605,227**
Other Expenditures:					
Rent payments to Public Buildings Authority (PBA) [2]	**250,713**	**267,105**	**331,491**	**205,063**	**358,536**
Transfers out for debt service payments on general obligation bonds [2]	**447,312**	**722,456**	**745,201**	**728,869**	**737,237**
Total Expenditures	**10,338,386**	**10,065,030**	**10,987,900**	**9,872,397**	**9,701,000**
Excess (Deficiency) of Resources over (under) Expenditures	**$ 410,851**	**$ 343,892**	**$ (699,611)**	**$ (191,002)**	**$ -**

[1] Excludes transfers to the Conservation Trust Fund and amounts deposited into a separate account for the promotion of Puerto Rico rums in foreign markets.
[2] For purposes of the General Fund Budget, cash distributions received from lotteries are presented as transfers in and rental payments to PBA and debt service payments on general obligation bonds are presented as transfers out.
[3] Consists of amounts to pay principal of, and interest on, general obligation bonds and notes of the Commonwealth. Does not include amounts deposited directly into the Redemption Fund from non-General Fund revenues.
[4] Represents the COFINA bond proceeds deposited in the Stabilization Fund.
[5] Preliminary, unaudited and subject to change.

Sources: The "Statement of Revenues and Expenditures- Budget and Actual- Budget Basis- General Fund" as presented in the Commonwealth's financial statements for fiscal years 2010 to 2012; the "Required Supplementary Information- Unaudited- Schedule of Revenues and Expenditures- Budget and Actual- Budgetary Basis- General Fund" as presented in the Commonwealth's financial statements for fiscal year 2013; the Department of Treasury's financial records for fiscal year 2014; and Government Development Bank.

Preliminary General Fund Budgetary Revenues and Expenditures for Fiscal Year 2014 Compared to Fiscal Year 2013

Revenues. Preliminary General Fund budgetary revenues for fiscal year 2014 (which are still subject to audit and other year-end adjustments) were $9.037 billion, an increase of $475 million or 5.5% over fiscal year 2013. These revenues include: (i) General Fund budgetary operating revenues of $8.803 billion, (ii) revenues from the electronic and traditional lotteries of $154 million that are available to the General Fund, and (iii) $80 million in excess funds transferred from COFINA to the General Fund after payment of COFINA debt service. The increase in revenues during this period when compared to fiscal year 2013 is primarily due to legislative measures adopted since January 2013.

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. Individual income tax collections for fiscal year 2014 were $1.979 billion, a decrease of $75 million, or 3.7%, from the same period of the prior fiscal year. Collections from withholdings from non-residents were $900 million, a decrease of $83 million, or 8.4%, from prior fiscal year.

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.

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.

Expenditures. The fiscal year 2014 original 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:

(iii) 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.

(iv) 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 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 to GDB for the repayment of GDB loans to the Commonwealth 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 expenditure 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, the Employees Retirement System 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 budgetary expenditures for fiscal year 2014 were lower than the amended amount of $9.245 billion by approximately $119 million, for an estimated expenditure of $9.126 billion. This includes a $38 million operating surplus at the agencies of the Commonwealth, and a $81 million operating surplus at the Department of Education. Due to legal and government accounting norms applicable to surplus balances of different sources 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 US GAAP basis.

This estimate does not consider the estimated 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. PRHIA, the largest of these entities, had a $59 million deficit for fiscal year 2014.

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 expenditures 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 expenditure volatility and variance from the approved budget, has presented a preliminary estimated surplus of $81 million for fiscal year 2014. This estimate 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 approximately $11 million in non-General Fund carryover surplus balances from prior fiscal years. The fiscal year 2014 surplus of $81 million, combined with a $50 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 expenditures related to school repair and consolidations, among other purposes, means that the Department of Education started fiscal year 2015 with a non-General Fund carry-forward reserve with a beginning balance of $162 million. This amount, by OMB regulation, will only be available to cover non-recurring expenditures; however, this restriction is administrative (and thus subject to modification or waiver), and the characterization of an expenditure as recurring may be open to judgment and discretion.

General Fund Budgetary Revenues and Expenditures for Fiscal Year 2013 Compared to Fiscal Year 2012

General Fund budgetary revenues for fiscal year 2013 were $8.562 billion, a decrease of $106 million, or 1.2%, from fiscal year 2012. This total includes (i) $8.131 billion of budgetary operating revenues, (ii) $63 million of revenues from the electronic and traditional lotteries that are available to the General Fund, (iii) $242 million of excess collateral received on derivative transactions transferred from the Debt Service Fund and, (vi) $126 million of excess funds transferred from COFINA after payment of COFINA debt service.

The major changes from fiscal year 2012 were: (i) a decrease in income taxes from corporations of $174 million, or 12%, (ii) an increase of $92 million in taxes withheld from non-residents, and (iii) a decrease of $243 million from the excise tax imposed on entities that purchase products manufactured in Puerto Rico by their affiliates under the provisions of Act 154.

General Fund total expenditures for fiscal year 2013 amounted to $9.872 billion, consisting of $8.938 billion of operational expenditures, $205 million in rent payments to PBA and $729 million of transfers out for debt service payments on general obligation bonds. These expenditures were $1.115 billion or 10.1% lower than the total expenditures for fiscal year 2012.

General Fund Revenues and Expenditures for Fiscal Year 2012 Compared to Fiscal Year 2011

General Fund budgetary revenues for fiscal year 2012 were $8.668 billion, an increase of $510 million, or 6.2%, from fiscal year 2011. This total includes $8.573 billion of operating budgetary revenues and $94 million of revenues from the electronic and traditional lotteries that are available to the General Fund.

The major changes from fiscal year 2011 were: (i) a decrease in income taxes from corporations of $217 million, or 12.9%, (ii) a decrease of $110 million in taxes withheld from non-residents, (iii) a decrease of $176 million in the temporary special property tax, and (iv) an additional $1.198 billion from the excise tax imposed on entities that purchase products manufactured in Puerto Rico by their affiliates under the provisions of Act 154.

General Fund total budgetary expenditures for fiscal year 2012 were $10.988 billion, consisting of $9.911 billion of budgetary operating expenditures, $331 million in rent payments to the PBA, and $745 million of transfers out for debt service payments on general obligation bonds. These expenditures were $923 million or 9.2% higher than the total budgetary expenditures for fiscal year 2011.

General Fund Budgetary Revenues and Expenditures for Fiscal Year 2011 Compared to Fiscal Year 2010

General Fund budgetary revenues for fiscal year 2011 were $8.158 billion, an increase of $442 million, or 5.7%, from fiscal year 2010. This total includes (i) $7.994 billion of budgetary operating revenues, (ii) $102 million of revenues from the electronic and traditional lotteries that are available to the General Fund, and (iii) $63 million of excess funds transferred from COFINA after payment of COFINA debt service.

The major changes from fiscal year 2010 were: (i) decreases in income taxes from individuals of $411 million, or 15.9%, resulting from the implementation of the tax reform, (ii) an increase of $170.1 million in taxes withheld from non-residents, and (iii) an additional $678 million from the excise tax imposed on entities that purchase products manufactured in Puerto Rico by their affiliates under the provisions of Act 154.

General Fund budgetary expenditures for fiscal year 2011 were $10.065 billion, consisting of $9.075 billion of budgetary operating expenditures, $267 million in PBA rental payments and $722 million of transfers out for debt service payments on general obligation bonds. These expenditures were $273 million or 2.6% lower than the total expenditures for fiscal year 2010.

Income Taxes

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

Individuals. Resident individuals are subject to tax on their taxable income from all sources. The PR Code had four tax brackets for individuals, with tax rates of 7%, 14%, 25%, and 33%. The highest income tax bracket applicable to individuals under the PR Code was $50,000. Under the 2011 Code, the highest income tax bracket gradually increases every year from taxable year 2011 through taxable year 2015 from $60,000 to $67,250 and then increases to $121,500 for taxable years commencing with taxable year 2016. For taxable years starting before January 1, 2016, the income tax rates applicable to individuals remain unaltered under the 2011 Code. After January 1, 2016, the top individual rate is lowered to 30%. However, certain requirements must be satisfied in order for tax benefits under the 2011 Code to enter into effect for taxable years starting after December 31, 2013.

Dividend income from Puerto Rico corporations and certain qualifying foreign corporations is taxed at an income tax rate of 15%, in the case of distributions effected after June 30, 2014 (dividends prior to that date were taxed at 10%). Gains realized from the sale or exchange of a capital asset by resident individuals, if held for more than one year, is taxed at a rate of 15% in the case of sales or exchanges effected after June 30, 2014 (transactions prior to that date were taxed at 10% if held for more than six months).

Interest income in excess of $2,000 on deposit with Puerto Rico financial institutions is taxed at a rate of 10%; the first $2,000 of interest income from such institutions is exempt from taxation. Interest income on certain qualifying debt obligations issued by Puerto Rico corporations and certain qualifying foreign corporations and paid to resident individuals, trusts, estates, corporations and partnerships qualifies for a tax rate of 10%. If said income and other income subject to preferential tax rates exceed certain levels a higher alternate basic tax rate may apply.

With respect to income taxes for individuals, the following additional measures have been enacted since 2013 and are currently in effect:

(i) self-employed individuals with gross income in excess of $200,000 are subject to a 2% surtax on their gross income from self-employment.

(ii) individuals with income subject to alternate basic tax from $200,000 to $300,000 will have their alternate basic tax rate increased from 10% to 15%; individuals with income tax subject to alternate basic tax from $300,000 to $500,000 will have their alternate basic tax rate increased from 15% to 24%; individuals with income subject to alternate basic tax in excess of $500,000, will have their alternate basic tax rate increased from 20% to 24% ;

(iii) the total deduction for mortgage interest on residential property is now limited to the lower of the amount of interest paid, 30% of the individual's adjusted gross income, or $35,000;

(iv) the holding period for long term capital gains is increased from more than six months to more than one year effective for transactions taking place after June 30, 2014;

(v) capital losses may only be deducted up to the lower of 90% of capital gains or $1,000;

(vi) the alternate basic tax credit with respect to the alternate basic tax paid in prior years is limited to 25% of the current net regular tax over the alternate basic tax for such taxable year. The alternate basic tax credit is effectively eliminated for taxable years commenced on or after January 1, 2014;

(vii) the earned income credit was repealed for taxable years commencing after December 31, 2013;

(viii) the low income credit for the elderly was reduced from $400 to $200 for taxable years commenced after December 31, 2013. The credit may be increased back to $400 if certain budgetary projections of the General Fund are met.

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

In general, the 2011 Code originally provided that for taxable years commencing after December 31, 2010, the highest corporate income tax rate would be lowered to 30% for net taxable income in excess of $2,500,000 (which could be lowered to 25% for taxable years starting after December 31, 2013, subject to certain conditions) instead of the 39% top rate for net taxable income in excess of $300,000 provided under the PR Code. Pursuant to Act 40-2013, the maximum corporate income tax rate is reset at 39% for net taxable income in excess of $300,000. Pursuant also to recent legislation, the alternative minimum tax is set to the greater of (i) the amount produced by applying a minimum rate of 30% to the alternative minimum net income, or (ii) subject to certain exceptions, the amount produced by applying a 2% excise tax on the purchases from related parties of tangible personal property to be used in a Puerto Rico trade or business applicable to persons with gross sales of $10 million or more during any of three preceding taxable years, plus 20% of expenses paid to related parties that are not subject to Puerto Rico income tax.

Puerto Rico has also enacted a gross receipts tax that functions as an additional tax in the case of all types of taxpayers, effective for taxable years commenced after December 31, 2013. The applicable gross receipts tax rates range from .20% to 1% and are generally reduced for businesses with more than $3,000,000 but less than $100,000,000 in gross receipts from .5% applicable for taxable years commenced between January 1, 2011 and December 31, 2013 to .35%. Lower rates are provided for food retailers. Businesses with less than $3,000,000 of gross receipts are exempted from the additional gross receipts tax. The rate for businesses with over $1,500,000,000 gross receipts is increased from .85%, applicable to taxable years commenced between January 1, 2011 and December 31, 2013, to 1%. Corporation with grants under various tax exemption statutes, agricultural businesses and non-profit entities are exempt from this special tax with respect to their exempt income. The gross receipts tax may be deducted in determining net taxable income provided the taxpayer has paid the gross receipts tax on or before the due date for filing the income tax return for the year. Financial businesses are subject to 1% gross receipts tax of which .50% is creditable against income tax or alternative minimum tax payable by the financial business. Act 77 of 2014 provides that this gross receipts tax will be redesigned as part of the proposed tax reform expected to be applicable to taxable years commenced after December 31, 2014.

Gains realized from the sale or exchange of a capital asset, if held for more than six months, are taxed at a maximum regular income tax rate of 15% in the case of sales or exchanges effected before July 1, 2014. This rate is increased to 20% for transactions effecter after June 30, 2014 if capital asset held for more than one year. Dividends received by Puerto Rico corporations and partnerships from foreign corporations engaged in trade or business in Puerto Rico are subject to general income tax rates. A dividends received credit may be available when the corporation or partnership making the distribution is organized in Puerto Rico. Interest income on certain qualifying debt obligations issued by Puerto Rico corporations and certain qualifying foreign corporations, and paid to corporations and partnerships, qualifies for a special tax rate of 10%.

Resident foreign corporations whose gross income qualifies as income effectively connected with a Puerto Rico trade or business are generally subject to a branch profits tax. The branch profits tax is 10% of an annual dividend equivalent amount, and it applies without regard to the Puerto Rico source of income rules. Act 77-2014 amends the branch profits tax provision to exclude loans and credit transactions between affiliates, except when such transactions arise from the sale of property or in the case of banking entities, from Puerto Rico Assets and Puerto Rico Liabilities in determining the dividend equivalent amount.

In general, corporations, and the partners of partnerships operating under a new grant of tax exemption issued under the Economic Incentives Act, are subject to a maximum income tax rate of 4% during their basic exemption period. Corporations, and the partners of partnerships operating under a new grant of tax exemption issued under the Tourism Development Act of 2010, are subject to a maximum tax rate of 39% on their taxable income, after applying the 90% exemption granted under the Tourism Development Act of 2010, which results in a maximum effective tax rate of 3.9% on their net tourism development income.

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

Subject to certain exceptions, payments in excess of $1,500 during a calendar year, made by the Commonwealth and persons engaged in a trade or business in Puerto Rico in consideration of the receipt of services rendered in Puerto Rico are subject to a 7% income tax withholding. In addition, Act 48 of June 30, 2013 ("Act 48") provides for a special contribution of 1.5% on payments received from the Commonwealth, its municipalities, instrumentalities and agencies pursuant to contracts for professional services commencing on July 1, 2013.

With respect to income taxes for corporations, the following additional measures have been enacted since 2013 and are currently in effect:

(i) corporations will have their surtax exemption reduced from $750,000 to $25,000 and the surtax exemption must be allocated among members of a controlled group of corporations.

(ii) corporations will have their surtax rates reinstated to pre-2011 levels ranging from 5% to 19% for a maximum corporate income tax rate of 39% on net income in excess of $300,000.

(iii) the carryover for net operating losses is extended from 10 years to 12 years for losses incurred in taxable years commencing after December 31, 2004 and before January 1, 2013. The carryover for net operating losses incurred in taxable years commenced after December 31, 2012 will remain at 10 years but the deduction for such losses is limited to 90% of the net income of the year in which the deduction is claimed regardless of the year in which the loss is incurred.

(iv) 51% of the payments or transfers to related parties not engaged in trade or business in Puerto Rico or to the payor's home office that are not subject to tax in Puerto Rico, such as payments for services rendered outside of Puerto Rico, will be disallowed as deductions unless the payments are subject to tax in Puerto Rico. This disallowance does not apply to entities with tax exemption grants under the various Commonwealth tax incentives laws. The Secretary of Treasury has authority to waive this disallowance.

(v) capital losses may only offset 90% of capital gains;

(vi) carryover of capital losses is limited to 7 years;

(i) the alternative minimum tax credit with respect to AMT paid in prior years is limited to 25% of the current net regular tax over the AMT for such taxable year;

(ii) a new 10% tax on deemed dividends to a 50% or more foreign owner of certain corporations;

(iii) several prepayments of income tax at special rates including: appreciation of certain assets, individual retirement accounts, pension plans and variable annuity contracts;

(iv) removal of the special gross receipts tax from the AMT computation and its implementation as an additional tax as more fully discussed above, effective for taxable years commenced after December 31, 2013;

(v) for taxable years commenced after December 31, 2013 the AMT in the case of corporations is the highest of (i) 30% of the alternative minimum taxable income or (ii) the amount produced by multiplying 2% (or other applicable percentage) by the purchases from related parties as more fully described above, plus 20% of expenses paid to related parties that are not subject to Puerto Rico income tax;

(vi) the AMT book income adjustment is increased from 50% to 60%;

(vii) the net operating loss deduction for AMT purposes is decreased from 90% to 80% of the alternative minimum tax income;

(viii) payments to nonresident partners, shareholders or members owning 50% or more of interest in such pass-through entities will be disallowed as deductions if payments are not subject to tax in Puerto Rico. These disallowances will not apply to entities with tax exemption grants under the various Commonwealth tax incentives laws. Also, the Secretary of Treasury has the authority to waive the disallowances for other taxpayers;

(ix) pass-through entities will be required to pay the special additional tax on gross receipts at the entity level; and

(x) Act 77-2014 imposed a cap of $300 million to R&D credits the Government is authorized to grant per year.

Special Excise Tax (Act 154)

Act 154 was enacted, among other things, to balance the tax burden among the taxpayers and increase the tax revenues of the Commonwealth. Act 154 modified the income taxation of certain nonresident alien individuals, foreign corporations and foreign partnerships by expanding the circumstances in which such persons would be subject to Puerto Rico income taxation, and imposed an excise tax on the acquisition of certain personal property manufactured or produced in whole or in part in Puerto Rico and on the acquisition of certain manufacturing services carried out in Puerto Rico. Act 154 applies to income realized and acquisitions occurring after December 31, 2010. The Commonwealth estimates that this excise tax affects mostly foreign corporations or partnerships that are principally engaged in the manufacturing of pharmaceuticals and electronics.

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

On December 29, 2010, the Treasury Department adopted regulations that provide certain tax credits against the temporary excise tax that lessen its impact on affected taxpayers subject to the temporary excise tax. These regulations became effective on January 1, 2011. The regulations address implementation and interpretation issues and include provisions regarding certain applicable credits against the tax subject to maintaining a baseline employment and other conditions.

At the time of adoption of Act 154, the Commonwealth expected to raise approximately $1.4 billion from the excise tax during the first year of implementation and $5.6 billion for the six year period that the excise tax was originally intended to be in place. Although the amounts collected under Act 154 have met the initial projections, such revenue has not been sufficient to fully offset the reduction in tax revenues from other sources. As a result, on February 28, 2013 the Commonwealth amended Act 154 to extend the period of the excise tax until December 31, 2017 and reset the excise tax rate to a fixed 4% commencing on July 1, 2013

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

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

On March 30, 2011, the United States Internal Revenue Service ("IRS") issued Notice 2011-29 addressing the creditability of the excise tax imposed by Act 154. Notice 2011-29 provides that the provisions of the excise tax are novel and the determination of its creditability requires the resolution of a number of legal and factual issues. Pending the resolution of those issues, the IRS will not challenge a taxpayer's position that the excise tax is a tax in lieu of an income tax under Section 903 of the United States Internal Revenue Code of 1986, as amended.

The IRS also provided that any change in the foregoing tax credit treatment of the excise tax after resolution of the pending issues will be prospective and will apply to excise tax paid or accrued after the date that further guidance is issued.

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

Sales and Use Taxes

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

Act 117 also repealed the 5% (effective 6.6%) general excise tax imposed on imported goods and the 3.6% general excise tax imposed on goods manufactured in Puerto Rico. Other items, such as fuel, crude oil and petroleum products, and vehicles, however, remain subject to the excise tax previously applicable to such items, and are not subject to the Sales and Use Tax.

The Sales and Use Tax became effective on November 15, 2006 and the effective date of the repeal of the 5% general excise tax was October 16, 2006. Municipalities were authorized to implement the Municipal Sales and Use Tax starting on July 1, 2006. The revenues derived from the Sales and Use Tax was distributed as follows: 5.5% goes to the central government and 1.5% to Puerto Rico's municipalities. One half of the 5.5% Commonwealth Sales and Use Tax is transferred to the Dedicated Sales and Use Tax Fund, created by Act 91 of 2006, as amended, and the balance goes to the General Fund. The 1.5% Municipal Sales and Use Tax is divided as follows: (i) 1% goes to the municipalities, and (ii) 0.5% goes to the Municipal Improvements Fund. The increase in revenues generated by the Sales and Use Tax has been partly offset by the elimination of the 5% general excise tax and the effect of the income tax reduction measures included in Act 117.

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

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

The Sales and Use Tax generated revenues for the General Fund of approximately $543.2 million for fiscal year 2012 and generated approximately $552.8 million for fiscal year 2013 according to preliminary unaudited numbers for fiscal year 2013.

Act 40 of 2013 made the following changes to the Sales and Use Tax:

(i) the daily rental of motor vehicles is subject to the Sales and Use Tax unless it qualifies under the business to business services exemption.

(ii) the business to business services exemption to the Sales and Use Tax was amended to exclude various transactions such as bank service charges to commercial clients, collection services, security and armored services, cleaning services, laundry services, repair and maintenance of real and personal property (not capitalizable), telecommunication services, and waste disposal services. These services will qualify for the business to business services exemption if performed by related parties.

(iii) the resellers exemption certificate is limited for sales after July 31, 2013 to eligible resellers that mainly sell to businesses that purchase articles exempt from the Sales and Use Tax or for export. This date was administratively extended to August 15, 2013. Commencing August 16, 2013, sales to non-eligible resellers will be subject to the 6% of the Sales and Use Tax payable to the Treasury Department but a reseller credit mechanism will be available to such non-eligible resellers limited to 70% of the Commonwealth Sales and Use Tax paid by the reseller for each month. This credit may be increased to 100% once a demand deposit account is established by the taxpayer in Puerto Rico. Pursuant to administrative interpretation and a later amendment to the law, the sales to resellers will continue to be exempt from the 1% of the Sales and Use Tax payable to the municipalities. Also, pursuant to an administrative ruling, wholesalers that meet certain requirements will be entitled to a Sales and Use Tax collection waiver.

(iv) the exemption for purchases made by universities and higher education institution is repealed.

(v) the exemption for purchases made by cooperatives is repealed.

(vi) the exemption for purchases made by hospitals is limited.

(vii) the exemption for purchases during the back to school tax holiday period is limited. Textbooks and notebooks are will be exempt from the Sales and Use Tax all year round. Other school supplies such as uniforms will be subject to two tax holiday periods, one in July and another in January. Electronic items such as televisions and computers are no longer considered items covered by the back to school holiday.

(viii) the Municipal Sales and Use Tax is reduced from 1.5% to 1% effective December 1, 2013 for a total Sales and Use Tax of 6.5% instead of 7%. The decrease in the Sales and Use Tax may be postponed or reversed upon further study by the Government. Act 138-2013 extended the effective date of the reduction of the Municipal Sales and Use Tax to February 1, 2014. Act 18-2014 changed the Municipal and Commonwealth portions of the Sales and Use Tax. Effective February 1, 2014 the Municipal portion of the Sales and Use Tax is reduced from 1.5% to 1% and the Commonwealth portion was increased from 5.5% to 6%. Thus, the total Sales and Use Tax remains at 7%. Effective July 1, 2014 the municipalities must collect the 1% Municipal Sales and Use Tax directly. Treasury will no longer make the collection for any municipality.

The elimination or limitation of the various exemptions explained above, will broaden the tax base of the Sales and Use Tax.

In addition, (i) Act 40 also requires the establishment of a plan to control and monitor, the collection and deposit of the Sales and Use Tax to increase the Sales and Use Tax revenues of the Commonwealth; (ii) Act 42 of 2013 amended the 2011 Code to broaden the nexus rules used to determine when a merchant will be considered to be engaged in the sale of taxable items in Puerto Rico for purposes of the Sales and Use Tax; and (iii) Act 46 of 2013 requires the declaration and payment of the Sales and Use Tax on imported goods at the time of their entry into Puerto Rico. This requirement does not apply to goods imported for resale prior to August 1, 2014. Inventory imported on or after August 1, 2014 is subject to declaration and payment of Sales and Use Tax on at the time of entry into Puerto Rico.

Recently enacted Act 80 of July 1st, 2014 made substantial changes to the Sales and Use Tax provisions of the 2011 Code, including the following:

(i) property destined to a foreign trade zone is deemed to have been introduced into Puerto Rico upon arrival to the foreign trade zone.

(ii) inventory imported into Puerto Rico on or after August 1st, 2014 is subject to Sales and Use Tax upon importation.

(iii) manufacturer and eligible wholesaler waivers from collection of Sales and Use Tax are eliminated.

(iv) electronic filing of Declaration of Imports, Sales and Use Tax on Imports Return and Monthly Sales and Use Tax Return is required. Payment of Sales and Use Tax is generally due upon entry of goods unless the merchant is bonded

(v) credit for Sales and Use Tax paid by resellers is increased to 75% of the Sales and Use Tax liability.

(vi) establishes a Reseller Credit Control Account.

(vii) Act 80 created a new Monthly Sales and Use Tax on Imports Return due on the 10th of the month following importation.

(viii) the due date for filing the Monthly Sales and Use Tax Return was changed from the 10th day to the 20th day of the month following the taxable event.

An integrated electronic system (PICO) was established by Treasury for all sales and use tax related filings. All merchants must register in PICO.

Excise Taxes

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

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

Act 41 of 2013 increased the excise tax applicable to cigarettes from $11.15 to $16.15 per hundred cigarettes effective July 1, 2013, and to $17.00 per hundred cigarettes effective July 1, 2015. Act 41-2013 also imposes a new tax on smokeless tobacco of $1.00 per pound for chewing tobacco and $3.02 per pound for powdered tobacco ("snuff") or other products derived from tobacco.

Act 40 of 2013 imposes a special 1% tax for taxable years commencing after December 31, 2012, on premiums earned after June 30, 2013 by insurance companies authorized to do business in Puerto Rico. Annuities and premiums for Medicare Advantage, Medicaid and Mi Salud programs are excluded.

Act 48 of 2013 imposed a special tax of 1.5% of the value of contracts for professional and consulting services, including advertising, legal, public relations, communications and lobbying services executed by the Government or any of its agencies, instrumentalities, public corporations and the legislative and judicial branches. This tax is not creditable or deductible for income tax purposes. Act 117-2013 amended Act 48 to clarify the special 1.5% is not creditable against the income tax but it is deductible as an ordinary and necessary business expense.

Act 31 of 2013 reduced the tax on gas oil or diesel oil from $.08 to $.04 per gallon and increased the tax on crude oil products and hydrocarbons from $3.00 per barrel dependent on the price of crude oil to a fixed $9.25 per barrel subject to adjustment for inflation every four years.

Licenses

Act 77 of 2014 increased the license fees for adult entertainment machines from $2,250 to $2,500.

Property Taxes

Personal property, which accounts for approximately 46% of total collections of taxable property, is self-assessed. Real property taxes are assessed based on 1958 property values. No real property reassessment has been made since 1958, and construction taking place after that year has been assessed on the basis of what the value of the property would have been in 1958. Accordingly, the overall assessed valuation of real property for taxation purposes is substantially lower than the actual market value. Also, an exemption on the first $15,000 of assessed valuation in owner-occupied residences is available.

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

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

Act 40 of 2013 provides that the Sales and Use Tax paid by a reseller is excluded from the valuation of inventory for personal property tax purposes.

The following table presents the assessed valuations and real and personal property taxes collected for fiscal years 2009 to 2013.

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

Fiscal Years Ended June 30,	Assessed Valuations(1)	Taxes Levied	Collections of Current Year	Collections of Previous Years	Total Collections
2009	$28,903,996	$1,032,570	$634,040	$244,411	$878,451
2010	175,025,782	1,093,769	666,429	269,857	936,286
2011	187,293,462	1,152,718	712,706	225,280	937,986
2012	197,624,523	1,164,156	677,709	288,484	966,193
2013*	191,139,478	1,141,443	677,988	277,855	955,844

(1) Valuation set as of July 1 of each fiscal year.
* Preliminary, unaudited numbers.

Source: Municipal Revenues Collection Center.

Recently enacted Act 136 of November 26, 2013 amended the Municipal Property Tax Act to require all taxpayers to make quarterly estimated tax payments of personal property tax on the 15th day of August, November, February and May.

Other Taxes and Revenues

Motor vehicle license plate and registration fees comprise the major portion of license tax receipts. Pursuant to Act 30 of 2013, which is effective for fiscal year 2014 and thereafter, a portion of such registration fees were assigned to PRHTA.

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

Revenues from Non-Commonwealth Sources

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

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

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

As permitted under Act 1 of 2011, the Commonwealth entered into a definitive agreement with three rum producers and is currently in negotiations with other producers to provide them a series of subsidies and incentives, by allowing such companies to benefit from the cover-over program rebate. These agreements are expected to promote and encourage the export of rum produced in Puerto Rico. As a result of these agreements, during fiscal year 2013 the Treasury Department allocated $75.4 million of total revenues from the federal excise tax on rum shipments for these incentives. The amount of the payments during fiscal year 2013 was affected by the federal offset of federal funds related to a debt with the USACE.

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

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

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

On September 28, 2010, the Treasury Department signed an agreement for the implementation of a new point of sale system that is intended to strengthen its Sales and Use Tax enforcement efforts. The system is designed to: (i) transmit daily to the Treasury Department information on all Sales and Use Tax transactions; (ii) reconcile transmitted transactional information with information reported by merchants; (iii) provide wireless transmission devices for use by street vendors; and (iv) capture a greater percentage of cash sales through the implementation of a special lottery using sales receipts as lottery tickets (the "IVU Loto").

The Treasury Department has developed various initiatives directed towards increasing collections of income taxes and the Sales and Use Tax through the implementation of various enforcement and compliance programs. Other programs are geared towards the use of technology to detect noncompliance. For example, the Treasury Department completed the integration of its general computer systems with the Sales and Use Tax database in order to better detect non-compliance. Such integration has allowed the Treasury Department to compare the electronic information provided by the transactional database and the data contained in the tax returns repository. Such comparison offers the Treasury Department with detailed information about which merchants reflect taxable transactions but are either (i) not duly submitting the corresponding sales and use tax return; (ii) submitting erroneously prepared tax returns – returns with less sales volume transactions than the information provided by the transactional database; (iii) merely submitting with no payment as the law requires; (iv) or merchants not reporting cash sales. In order to address these possible instances of non-compliance, the Treasury Department created a task force consisting of fiscal auditors and agents from the Consumer Tax Bureau and the Tax Evasion Bureau. The fiscal auditors are responsible for investigating inconsistencies reported by the point of sale system, determine tax deficiencies and issue preliminary deficiency notices. The agents of the Consumer Tax Bureau provide assistance to the fiscal auditors in connection with any additional information requirements and visit merchants and retailers to investigate the status of their permits and point of sale systems. Finally, the agents from the Tax Enforcement Bureau are responsible for investigating any tax crimes discovered by the fiscal auditors and/or agents from the Sales and Use Tax Bureau.

In addition to the above, the Treasury Department designed and developed a standardize selection process focused on merchants that have been affected by the enactment of Act 40-2013 to verify compliance with Sales and Use Tax, licenses, and IVU loto program. The design and development process was divided in two groups: (1) merchants that are affected by the business to business provisions and (2) any other merchants. On July 2, 2013, Treasury issued Circular Letter 13-04 to clarify application of the elimination of the business to business exemption for certain services. The Treasury Department implemented the initiative at the beginning of August 2013 by visiting the selected merchants to provide guidance on Circular Letter 13-04. By the end of fiscal year 2014, the Consumption Tax Bureau's Audit Division had completed 183 audits and collected an aggregate of $2.0 million from 94 such audits.

Treasury identified that taxpayers were incorrectly using the resellers exemption certificates negatively affecting the Sales and Use Tax collection. Act 40 eliminated the resellers exemption certificates, which have been cancelled as of August 16, 2013. As such, new processes are being implemented to issue new Reseller Certificates and to allow a credit for tax payment in resale businesses as provided on Act 40 on the Sales and Use Tax monthly tax return.

Effective August 16, 2013 the new Reseller Certificates only exempt the reseller from the 1% Municipal Sales and Use Tax. The Reseller Certificate is required to entitle the reseller to a credit for the Sales and Use Tax paid on its purchases of inventory items, subject to a limitation of 75% of the Sales and Use Tax liability.

On August 1, 2014, the Treasury Department implemented the Integrated Merchant Portal ("PICO") as a tool that would enable merchants and individuals to file Declarations of Imports, Tax on Imports Monthly Returns and Sales and Use Tax Monthly Returns and applicable payments electronically. Since the Sales and Use Tax is now collected at the point of entry revenues are received at the beginning of the chain of supply instead of the point of sale.

Act 163-2013 requires that for taxable years beginning after December 31, 2012, certain taxpayers are required to include audited financial statements and certain supplemental information. The supplemental information must be filed electronically.

Federal Grants

The Commonwealth receives grants under numerous federal programs. Federal grants to the agencies and instrumentalities of the Commonwealth are estimated to be $4.646 billion for fiscal year 2012, a decrease of $378 million, or 8%, from fiscal year 2011. Federal grants for fiscal year 2013 are projected at $4.499 billion, which is consistent with the level for fiscal year 2012. The following table presents revenues from federal grants by broad program areas, which are accounted in the central accounting system of the Treasury Department. The figures for fiscal years 2009 through 2012 are actual figures. The figures for fiscal year 2013 are the amounts included in the adopted budget.

Federal grants are not included in General Fund budgetary revenues.

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

	2009	2010	2011	2012	2013[1]
Education	$1,813,455	$1,270,589	$1,364,393	$1,080,342	$1,016,958
Social Services	2,453,605	2,481,447	2,431,381	2,400,747	2,416,049
Health	583,190	655,060	472,983	475,671	463,887
Labor and Human Resources	277,127	138,425	225,090	97,317	89,043
Crime	64,155	29,459	35,826	34,895	44,740
Housing	416,667	534,987	340,728	399,983	420,876
Drug and Justice	53,067	21,628	21,968	25,995	17,513
Agriculture and Natural Resources	114,920	25,501	14,960	16,206	11,814
Contributions to Municipalities	47,656	60,559	52,087	43,698	28,348
Other	67,017	73,813	64,219	70,499	70,822
TOTAL	$5,890,859	$5,291,468	$5,023,635	$4,645,503	$4,580,050

* Does not include grants received by agencies whose accounting systems are not centralized at the Treasury Department.
[1]Budget.
Source: Office of Management and Budget

BUDGET OF THE COMMONWEALTH OF PUERTO RICO

Office of Management and Budget

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

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

Budgetary Process

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

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

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

Financial Control and Adjustment Procedures

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

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

A Budgetary Fund was created by Act No. 147 of June 18, 1980, as amended (the "Budgetary Fund"), to cover the appropriations approved in any fiscal year in which the revenues available for such fiscal year are insufficient, to secure the payment of public debt, and to provide for unforeseen circumstances in the provision of public service. An amount equal to one percent of the General Fund net revenues of the preceding fiscal year is required to be deposited annually into the Fund. In addition, other income (not classified as revenues) that is not assigned by law to a specific purpose is also required to be deposited in the Budgetary Fund. The maximum balance of the Budgetary Fund may not exceed 6% of the total appropriations included in the budget for the preceding fiscal year. During the last fiscal years, the Legislative Assembly approved joint resolutions to halt temporarily the deposit of funds into the Budgetary Fund, and such funds were used instead to cover the budgetary deficit. As of September 30, 2014, the balance in the Budgetary Fund was $8.8 million.

An Emergency Fund was created by Act No. 91 of June 21, 1966 ("Act 91 of 1966"), as amended (the "Emergency Fund"), to cover unexpected public needs caused by calamities, such as wars, hurricanes, earthquakes, droughts, floods and plagues, and to protect people's lives and property and the public sector credit. The Emergency Fund is capitalized annually with an amount totaling no less than one percent of the General Fund net revenues of the preceding fiscal year. Act No. 91 was amended in 2003 to set an upper limit to the Emergency Fund of $150 million at the beginning of the fiscal year. Act No. 91 was further amended in 2005 to authorize the disbursement of funds from the Emergency Fund to cover certain General Fund expenditures and operational costs of the State Emergency Management Agency and authorized GDB to lend to the Commonwealth up to $150 million to replenish the Emergency Fund to provide funding for emergency and disaster needs. As of September 30, 2014, the Emergency Fund had $1.8 million available to be borrowed from GDB. Joint Resolution No. 60 of July 1, 2011 authorized the conversion of this loan into a revolving line of credit with the same authorized limit of $150 million.

Appropriations

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

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

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

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

(iv) *Bond Fund appropriations for capital expenditures financed by bonds*. Expenditures of these funds occur in one or more years.

(v) *Other Funds.* Appropriations may be made from time to time from non-recurring surplus funds extractions or dividends from control government agency special funds, public corporations or other sources.

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

The following table shows a breakdown between controllable and non-controllable General Fund expenditures for fiscal years 2014 and 2015. The following expenditures are categorized as controllable in the table: utility payments to public corporations and all contributions to the government retirement systems, including, among others, regular payroll contributions, Act 70 annuities, incremental Act 114 and Act 116 payroll contributions, voluntary additional appropriations and special laws.

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

	2014*	2015**
Non-Controllable Expenditures		
Mandated Expenditures (Formula)		
Contributions to Municipalities	$ 361	$ 361
University of Puerto Rico	834	834
Judicial Branch	349	323
Debt Payments to Public Buildings Authority	273	274
General Obligation Debt Service	162	743
Other Debt Service	441	395
Total of Non-Controllable Expenditures	$2,420	$2,929
Percent of Total General Fund Expenditures	25%	30%
Controllable Expenditures	$7,351	$6,636
Payroll and Related Costs(1) (2)	$3,636	$3,335
Payroll as a Percentage of Controllable Expenditures	50%	50%
Total General and Stabilization Funds Expenditures	$9,770	$9,565

* Preliminary
** Estimated based on FY15 Approved Budget
(1) Excludes University of Puerto Rico and the Judicial Branch.
(2) Includes the school wide Program teachers payroll appropriated in the Non-Distributed Allocations expenditure category.
Source: *Office of Management and Budget*

Budget for Fiscal Year 2015

The following table presents a summary of the adopted Commonwealth's central government budget for the fiscal year ending June 30, 2015.

Commonwealth of Puerto Rico
Summary of Central Government Approved Annual Budget
General Fund Budget and Reconstruction Fund
(in thousands)

	Fiscal Year 2014	Fiscal Year 2015
Revenues from internal sources:		
Personal income taxes	$2,088,000	$2,356,000
Retained non-resident income tax	820,000	807,000
Corporate income taxes	2,123,000	2,085,000
Partnership income taxes	1,000	2,000
Tollgate taxes	4,000	5,000
17% withholding tax on interest	6,000	7,000
10% withholding tax on dividends	37,000	116,000
Inheritance and gift taxes	3,000	3,000
Sales and use taxes	865,000	735,000
Excise taxes:		
Alcoholic beverages	284,000	281,000
Foreign (Act 154)	1,956,000	1,889,000
Motor vehicles and accessories	432,000	380,000
Cigarettes	186,000	170,000
Other (excise taxes)	140,000	121,000
Licenses	14,000	25,000
Miscellaneous non-tax revenues:		
Contributions from lottery fund	19,000	42,000
Electronic lottery	101,000	93,000
Registration and document certification fees	100,000	104,000
Other	124,000	118,000
Total revenues from internal sources	9,303,000	9,340,000
Revenues from non-Commonwealth sources:		
Federal excise taxes on off-shore shipments	222,000	225,000
Total revenues from non-Commonwealth sources	222,000	225,000
Total revenues	9,525,000	9,565,000
Other:		
Reconstruction Fund (Financing)	245,000	0
Bonds authorized	0	0
Total other sources	245,000	0
Total resources	9,770,000	9,565,000
Appropriations:		
Current expenses:		
General government	1,395,854	1,104,143
Education	3,375,079	3,087,149
Health	1,378,402	1,367,192
Welfare	437,464	413,605
Economic development	145,086	138,738
Public safety and protection	1,499,553	1,431,705
Transportation and communication	120,405	70,028
Housing	23,518	21,396
Contributions to municipalities	404,620	370,627
Special pension contributions	335,355	334,050
Debt service	162,237	742,718
Other debt service (appropriations)	492,427	483,649
Total appropriations – current expenses	9,770,000	9,565,000
Capital improvements	0	0
Total appropriations	9,770,000	9,565,000
Year-end balance	0	0
Total appropriations and year-end balance	$9,770,000	$9,565,000

Totals may not add due to rounding.
Sources: Treasury Department and Office of Management and Budget

The consolidated budget for fiscal year 2015 provides for total resources of $28.052 billion, of which $9.565 billion are General Fund resources.

The principal changes in the fiscal year 2015 budgeted General Fund revenues compared to preliminary fiscal year 2014 revenues are accounted mainly by new tax modifications, elimination of certain tax credits and the implementation of previously approved collection of sales and use tax at point of entry. The major changes from fiscal year 2014 are (i) an increase of $140 million in sales and use tax, (ii) an increase in corporate income tax of $171 million, (iii) a decrease in withholding taxes on non-residents of $93 million), (iv) an increase in alcoholic beverage taxes of $14 million, (v) a decrease in excise taxes on motor vehicles of $12 million, (vi) a decrease in excise tax under Act 154 of $12 million, and (vii) an increase in personal income taxes of $377 million.

The General Fund budget for fiscal year 2015 provides for total 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 obligation bonds and notes of $581 million, which when considered together with the $205 million reduction in total expenditures, results in an aggregate decrease of $786 million in appropriations other than debt service. The expense categories most significantly affected are (i) payroll accounts, which decreased by $301 million, including the Department of Education *Schoolwide Program* due to the full year effect of higher than expected fiscal year 2014 attrition and reduced benefits, (ii) other operating expenses accounts, which was reduced by $151 million as a result of reductions in purchases and professional service rate reductions and other initiatives, including school transportation reorganization and school consolidation, and (iii) agency and program special appropriations, which decreased by $121 million.

Differences between Budget and Basic Financial Statements

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

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

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

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

RETIREMENT SYSTEMS
AND OTHER POST-EMPLOYMENT BENEFITS

Overview

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

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

The Employees Retirement System is a statutory trust created by Act No. 447 of May 15, 1951, as amended ("Act 447"). Prior to the recent amendments made in 2013 by Act 3-2013 (discussed below), the Employees Retirement System was a hybrid defined benefit plan consisting of different benefit structures. Members who had entered the Employees Retirement System before January 1, 2000 participated in a defined benefit program. Members who began to participate prior to April 1, 1990 ("Act 447 Participants") were entitled to the highest benefits structure, while those who began to participate on or after April 1, 1990 ("Act 1 Participants") were subject to a longer vesting period and a reduced level of benefits, as provided by Act No. 1 of February 16, 1990 ("Act 1 of 1990").

In 1999, Act 447 was amended to close the defined benefit program for new participants and, prospectively, establish a new benefit structure similar to a cash balance plan (this new benefit structure is referred to as "System 2000"). Members who entered the Employees Retirement System on or after January 1, 2000 ("System 2000 Participants") participate solely in System 2000. Prior to the amendment made by Act 3-2013, under the System 2000 benefits structure, a participant was entitled to receive a lump-sum payment, which could be received in full or used to purchase an annuity from a third party, based solely on the amounts contributed in cash by such participant. Act 3-2013 amended the law to eliminate the lump sum distribution and substitute it for a life term annuity payable to the System 2000 Participant. This amendment was intended to alleviate the cash flow needs of the Employees Retirement System. System 2000 Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. System 2000 Participants do not benefit from any employer contributions. Instead, employer contributions made on account of System 2000 Participants are used to reduce the accumulated unfunded pension benefit obligation of the Employees Retirement System.

System 2000 is not a separate plan as there are no separate accounts for System 2000 Participants. Contributions received from System 2000 Participants are pooled and invested by the Employees Retirement System together with the assets corresponding to the defined benefit structure. Thus, future benefit payments under the defined benefit structure of Act 447 and Act 1 of 1990 and the defined contribution structure of System 2000, as amended by Act 3-2013, will be paid from the same pool of assets of the Employees Retirement System.

The Teachers Retirement System is a statutory trust created in 1951. It is a defined benefit pension plan for active participants hired on or before July 31, 2014 and a defined contribution pension plan for participants hired on or after August 1, 2014.

The Judiciary Retirement System is a statutory trust created in 1954. It is a defined benefit pension plan.

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

As previously mentioned, Act 3-2013, enacted in 2013, constitutes a comprehensive reform of the Employees Retirement System. This reform was necessary to address the growing funding shortfalls which threatened the long term solvency of the Employees Retirement System. See "Efforts to Address Cash Flow Shortfall and Improve Funding Ratio" below. The provisions of Act 3-2013 and its projected impact on the funding shortfalls are discussed below.

In addition, Act 160-2013 and Act 162-2013 were enacted in 2013 to carry out comprehensive reforms of the Teachers Retirement System and the Judiciary Retirement System, respectively. However, both laws were largely struck down by the Puerto Rico Supreme Court.

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

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

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

The Teachers Retirement System covers all active teachers of the Department of Education and the employees of the System who become plan members of the System at their date of employment. Licensed teachers working in private schools or other educational organizations have the option to become members of the System so long as the required employer and employee contributions are satisfied.

The following table shows the number of active members, retired members, disabled members and beneficiaries and terminated vested members for each of the Retirement Systems as of June 30, 2013.

Participant Data
(as of June 30, 2013)

	Active Members	Retired Members	Disabled Members	Beneficiaries	Terminated Vested Members(1)	Total
Employees Retirement System						
Act 447 Participants	19,281	89,925	14,933	13,362	7,219	144,720
Act 1 Participants	42,882	7,470	1,680		3,439	55,471
System 2000 Participants	63,508	-	36	-	-	63,544
Total	125,671	97,395	16,649	13,362	10,658	263,735
Teachers Retirement System	41,553	33,045	2,234	3,088	698	80,618
Judiciary Retirement System	364	372	0	58	59	853

(1) Represents generally members who ceased employment without the right to a retirement annuity and are due a refund of member contributions and, if applicable, employer contributions, plus interest thereon.

The assets contributed by the Commonwealth central government and all other participating employers are invested together and not segregated. As of June 30, 2013, the central government was responsible for making contributions with respect to approximately 73,523 active members of the Employees Retirement System, or 58.5% of total active members (consisting of approximately 12,217 Act 447 Participants, 27,747 Act 1 Participants and 33,559 System 2000 Participants). Municipalities were responsible for approximately 30,572, or 24.33%, active members (consisting of approximately 3,323 Act 447 Participants, 8,958 Act 1

Participants and 18,291 System 2000 Participants). Public corporations were responsible for approximately 21,576, or 17.17%, active members (consisting of approximately 3,741 Act 447 Participants, 6,177 Act 1 Participants and 11,658 System 2000 Participants).

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

As of July 1, 2011, after the adoption of Act 116 of July 6, 2011 ("Act 116"), the statutory employer contribution for the Employees Retirement System increased from a minimum of 9.275% to a minimum of 10.275% of covered payroll, and will continue to increase annually until fiscal year 2021. The employer contribution rate for fiscal year 2015 is 13.275%. See "Efforts to Address Cash Flow Shortfall and Improve Funding Ratio" below. Covered payroll is the compensation regularly paid to active employees on which contributions to the Retirement Systems are computed and is generally equivalent to their annual salary. Act 447 requires that employer contributions cover the difference between (i) the benefits provided by the Retirement System, plus administrative costs, and (ii) the contributions that employees are required to make to the Retirement System. This requirement, however, has not been adhered to and the level of employer contributions has been limited to the minimum statutory rate.

Required employee contributions for the Employees Retirement System vary according to how the individual employee's retirement benefits are coordinated with social security benefits. Act 3-2013 increased the employee contribution from 8.275% to 10% of covered payroll.

As a result of the adoption of Act 114 of July 5, 2011 ("Act 114"), the statutory employer contribution for the Teachers Retirement System is scheduled to increase annually from 8.5% of covered payroll in fiscal year 2011 to 19.75% in fiscal year 2021. Then, pursuant to Act 160-2013, the statutory employer contribution will increase to 20.525% of covered payroll commencing in fiscal year 2022. The employer contribution for fiscal year 2015 is 12.5% of covered payroll. The statutory employee contribution for the Teachers Retirement System is 9.0% of covered payroll for participants whose entry date is prior to August 1, 2014. Pursuant to Act 160-2013, in the case of new participants whose entry date is on or after August 1, 2014, the statutory employee contribution is (i) 10% from August 1, 2014 to June 30, 2017, (ii) 13.12% from July 1, 2017 to June 30, 2020, and (iii) 14.02% from July 1, 2020 thereafter. For the Judiciary Retirement System, the employer contribution is 30.34% of covered payroll and the employee contribution is 8% of covered payroll.

Pursuant to the Constitutional and statutory 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, employer contributions by the Commonwealth to the Retirement Systems fall within the third priority category, after payment of the public debt, the fulfillment of contractual obligations, eminent domain payments and certain commitments to protect the credit and good faith of the Commonwealth government. These priority norms do not apply to employer contributions made by public corporations and municipalities, because the funds of public corporations and municipalities are not available resources of the Commonwealth.

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

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

Composition and Market Value of Investment Portfolios. As of June 30, 2014, the market value of the Employees Retirement System's investment portfolio was $3.156 billion, compared to $3.790 billion as of June 30, 2013. As of June 30, 2014 the investment portfolio was comprised of approximately 22% of equity investments, 40% of fixed income securities, 20% of internally managed mortgage and personal loans portfolio, 12% of short-term cash equivalents (excluding receivables), and 6% of other investments. The decrease in value of the investment portfolio since June 30, 2013 principally reflects the continued use of investment portfolio assets and the sale of a portion of the personal loan portfolio to pay current benefits as discussed below. Total assets as of June 30, 2014 and June 30, 2013 were $3.554 billion and $3.996 billion, respectively, and the total net assets for such periods were $242 million and $731 million, respectively.

As of June 30, 2013 the market value of the Teachers Retirement System's investment portfolio was $1.877 billion, compared to $2.048 billion as of June 30, 2012. As of June 30, 2013, the investment portfolio was comprised of approximately 28% of equity investments, 49%

of fixed income securities, 22% of internally managed mortgage and personal loans portfolio, and 1% of other investments. The decrease in value of the investment portfolio principally reflects the continued use of investment portfolio assets to pay current benefits as discussed below. Total assets as of June 30, 2013 and June 30, 2012 were $1.980 billion and $2.297 billion, respectively, and total net assets for such periods were $1.907 billion and $2.099 billion, respectively.

As of June 30, 2014, the market value of the Judiciary Retirement System's investment portfolio was $66.1 million, compared to $63.4 million as of June 30, 2013. As of June 30, 2014, the investment portfolio was comprised of approximately 55% of equity investments, 34% of fixed income securities, 1% of internally managed mortgage and personal loans portfolio, and 10% of short-term cash equivalents (excluding receivables). The increase in value of the investment portfolio reflects the increased proportion invested in equity assets, which have had a superior performance in the stated period. Total assets as of June 30, 2014 and June 30, 2013 were $66.4 million and $63.5 million, respectively, and total net assets for such periods were $61.7 million and $59.0 million, respectively.

All the figures provided above for fiscal year 2014 are preliminary and unaudited.

Actuarial Valuations of the Retirement Systems

Historically, each of the Retirement Systems has conducted an actuarial valuation as of the end of every two fiscal years. However, due to the deterioration of the funding status of the Retirement Systems, as discussed below, each of the Retirement Systems began conducting annual actuarial valuations effective June 30, 2009. The latest actuarial valuations were conducted by Milliman Inc., a firm of independent consulting actuaries, as of June 30, 2013.

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

To calculate the actuarial accrued liability of each of the Retirement Systems, the actuarial valuations use several actuarial assumptions. Some examples of these assumptions include an expected rate of return of assets, age of retirement of active members, future pay increases for current employees, assumed rates of disability and post-employment life expectancies of retirees and beneficiaries. If the experience of the Retirement Systems is different from these assumptions, the UAAL of the Retirement Systems may increase or decrease to the extent of any variances. As discussed below, the actual return of assets of each of the Retirement Systems during fiscal years 2009 and 2012 was lower than the assumed investment return utilized to prepare the actuarial accrued liability. The actual return of assets of the Retirement Systems for fiscal years 2010 and 2011, however, was higher than the assumed investment return used to prepare the actuarial valuations.

The actual rate of return on assets of the Retirement Systems depends on the performance of their respective investment portfolios, which can vary materially from the expected rates of return assumed in the actuarial valuations. The investment portfolios of the respective Retirement Systems can be volatile. The value of the securities in the investment portfolios can dramatically change from one fiscal year to the next, which could, in turn, cause substantial increases or decreases in the net assets of the Retirement Systems, which directly impacts the UAAL. For fiscal year 2009, the annual rates of return of the assets of the Employees Retirement System, the Teachers Retirement System and the Judiciary Retirement System was negative 9.8%, negative 15.9% and negative 18.0%, respectively, contributing to the increase in the UAAL of the Retirement Systems between fiscal year 2007 and fiscal year 2009. For fiscal year 2010, the year-end return of the assets of the Employees Retirement System, the Teachers Retirement System and the Judiciary Retirement System was 8.7%, 12.5% and 12.7%, respectively. For fiscal year 2011, the year-end return of the assets of the Employees Retirement System, the Teachers Retirement System and the Judiciary Retirement System was 16.0%, 21.5% and 20.5%, respectively. For fiscal year 2012, the year-end return of the assets of the Employees Retirement System, the Teachers Retirement System and the Judiciary Retirement System was 5.1%, 2.0% and 2.5%, respectively. For fiscal year 2013, the year-end return of the assets of the Employees Retirement System, the Teachers Retirement System and the Judiciary Retirement System was 7.8%, 7.8% and 11.0%, respectively.

The June 30, 2013 actuarial valuations of the Employees Retirement System and Judiciary Retirement System were completed in accordance with the "projected unit credit" method, with an assumed investment return of 6.4% per year, in the case of the Employees Retirement System, and 6.3% per year, in the case of the Judiciary Retirement System, and yearly salary increases of 3% per year. The actuarial valuations of the Employees Retirement System and the Judiciary Retirement System as of June 30, 2012 had assumed investment returns per year of 6% and 6.1%, respectively. Under the "projected unit credit" method, a projected benefit is determined at each active participant's assumed retirement age assuming future compensation increases, and the projected benefit is attributed to each year of service using straight proration based on projected service to each assumed retirement age. The plan's normal cost is the sum of the present value of the portion of each active participant's projected benefit attributable to the current year of service.

The June 30, 2013 actuarial valuation of the Teachers Retirement System was completed in accordance with the "entry age normal" method and assumed an investment return of 6.25% per year and yearly salary increases of 3.5%. The actuarial valuation of the Teachers Retirement System as of June 30, 2012 had assumed investment returns of 5.95% per year. Under the "entry age normal" method, a projected benefit is determined at each active participant's assumed retirement age assuming future compensation increases. The plan's normal cost is the sum of each active participant's annual cost for the current year of service determined such that, if it were calculated as a level percentage of his compensation each year, it would accumulate (at the valuation interest rate over his total prior and future years of service to the participant's assumed retirement date) into an amount sufficient to fund the participant's projected benefits.

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

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

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

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 3-2013"), 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 3-2013. The most important aspects of the changes effected by Act 3-2013 are summarized below and in 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, 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 3-2013, 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 3-2013 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 3-2013, 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 (after deducting the $2.9 billion principal amount of outstanding pension obligations bonds) 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 3-2013 is not designed to improve the funding ratio in the near term, 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 3-2013, 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 3-2013, 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 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, or failure 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 3-2013 reform, will result in future asset depletion and the possible complete exhaustion of the assets of the Employees Retirement System.

Act 32 provides that, from fiscal year 2015 and thereafter, the additional annual contribution should be calculated such that the gross assets of the Employees Retirement System are never below $1 billion. Given the extraordinary retirement pattern of central government employees during fiscal year 2014 resulting from the enactment of the pension reform, and the correspondingly lower payroll contribution base, it is likely that the required contribution will be greater than $120 million, in order to ensure that the system does not run out of liquid assets to meet its obligations and to meet the threshold set forth in Act 3-2013.

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 resulted in a decrease of approximately $430 million in the actuarial accrued liability (AAL). This decrease was offset by other actuarial considerations, such as demographics, resulting in a reduction of $99 million in the AAL from $12,351 million in 2012 to $12,252 million in 2013.

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, and 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 due to the impairment of contractual rights. 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 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.

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

Fiscal Year Ending June 30,	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
Employees Retirement System						
2007	$2,892	$16,770	$13,878	17.2%	$4,246	326.8%
2009	1,851	18,944	17,092	9.8	4,293	398.2
2010	1,667	21,370	19,703	7.8	3,818	516.1
2011	1,724	25,457	23,734	6.8	3,666	647.3
2012	1,237	27,646	26,409	4.5	3,570	739.7
2013	731	23,712	22,981	3.1	3,489	658.6
Teachers Retirement System						
2007	$3,163	$7,756	$4,593	40.8%	$1,370	335.3%
2009	2,158	8,722	6,564	24.7	1,418	462.8
2010	2,222	9,280	7,058	23.9	1,370	515.0
2011	2,386	11,449	9,063	20.8	1,320	686.4
2012	2,099	12,351	10,252	17.0	1,293	792.8
2013	1,907	12,252	10,345	15.6	1,249	828.5
Judiciary Retirement System						
2007	$81	$259	$177	31.5%	$31	566.6%
2009	51	324	273	15.6	31	893.7
2010	55	338	283	16.4	32	882.0
2011	64	383	319	16.7	32	1002.2
2012	59	416	358	14.1	33	1081.9
2013	59	417	358	14.2	32	1113.1

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

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

Schedule of Employer Contributions to Retirement Systems (in millions)

Fiscal Year Ending June 30,	Actuarially Recommended Contributions[1]	Actual Employer Contributions[2]	Amount Unfunded[3]	Percent Contributed
Employees Retirement System				
2010	$1,460	$534	$926	36.6%
2011	1,735	702	1,033	40.5
2012	2,019	590	1,429	29.2
2013	2,193	641	1,552	29.2
2014	1,823	858	965	47.1
Teachers Retirement System				
2010	477	165	312	34.5
2011	528	160	368	30.3
2012	659	177	482	26.9
2013	737	187	550	25.5
2014	749	193	556	25.8
Judiciary Retirement System				
2010	28	11	17	39.1
2011	30	11	19	36.9
2012	34	11	23	34.1
2013	39	11	28	29.5
2014	41	11	30	27.2
Total				
2010	1,965	711	1,254	36.2
2011	2,293	874	1,419	38.1
2012	2,712	776	1,936	28.6
2013	2,969	838	2,131	28.2
2014	2,613	1,062	1,551	40.6

(1) The actuarially recommended contributions are based on the information contained in the actuarial valuations for the Retirement Systems as of June 30, 2013.
(2) The actual employer contributions for fiscal year 2014 are based on the statutory employer contribution plus the expected pay-as-you-go contributions for System Administered Pension Benefits, as set forth in the actuarial valuations as of June 30, 2013.
(3) Represents the difference between the actuarially recommended pension contribution and the actual contribution from the participating employers.

Source: Information regarding the actuarially recommended contributions was derived from the June 30, 2013 actuarial valuation reports for the Retirement Systems. Information regarding the actual contributions for the Retirement Systems was provided by the Retirement Systems.

The Commonwealth recognized that, based on the then current funding requirements of the Retirement Systems, the UAAL of the Retirement Systems was expected to continue to increase indefinitely into the future instead of being amortized, and that future scheduled contributions at the then current funding rates would not be sufficient to make future benefit payments when due. It recognized that additional funding from the Commonwealth would ultimately be necessary to cover such unfunded obligation. It was estimated that the Commonwealth would be responsible for approximately 62% of any such funding deficiency of the Employees Retirement System and approximately 74% of the combined funding deficiency of the three Retirement Systems, with the balance being the responsibility of the municipalities and participating public corporations.

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

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

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

During 2008, the Employees Retirement System issued approximately $2.9 billion of Senior Pension Funding Bonds (the "Pension Bonds"), with interest rates ranging from 5.85% to 6.55%, for which repayment the Employees Retirement System pledged all employer contributions made after the issuance of the bonds. The Pension Bonds are limited, non-recourse obligations of the Employees Retirement System payable solely from, and secured solely by, the employer contributions. The maturity of the Pension Bonds is not subject to acceleration for any reason including non-payment of debt service on the bonds. As of June 30, 2013, approximately $2.9 billion of the Pension Bonds remain outstanding. The purpose of this offering was to increase the assets of the System available to invest and pay benefits.

The table below shows the funding shortfalls for each of the last four fiscal years and the projected funding shortfall for the following five fiscal years for each of the Retirement Systems. The funding shortfalls for fiscal years 2010 through 2013 are based on the audited financial statements for the Retirement Systems for those years and the funding shortfalls for fiscal years 2014 through 2018 are based on the actuarial valuation report as of June 30, 2013. The projected funding shortfalls for the Employees Retirement System for fiscal year 2014 thru 2018 reflect the impact of the amendments made by Act 3-2013.

Funding Shortfalls
(in millions)

Fiscal Year Ending June 30,	Employer and Member Contributions[1]	Basic System Benefit Payments and Administrative Expenses[3]	Net Funding Shortfall[5]
Employees Retirement System			
2010	$727	$(1,102)	$(375)
2011	671[2]	(1,183)	(512)
2012	689	(1,528)	(839)
2013	747	(1,522)	(775)
2014	1,027[4]	(1,644)	(617)
2015	1,087[4]	(1,655)	(568)
2016	1,148[4]	(1,662)	(514)
2017	1,222[4]	(1,666)	(444)
2018	1,298[4]	(1,670)	(372)
Teachers Retirement System			
2010	248	(498)	(250)
2011	245	(593)	(348)
2012	247	(593)	(346)
2013	253	(603)	(350)
2014	256	(630)	(374)
2015	27	(645)	(367)
2016	301	(663)	(362)
2017	329	(684)	(355)
2018	359	(708)	(349)
Judiciary Retirement System			
2010	13	(19)	(6)
2011	13	(19)	(6)
2012	12	(21)	(9)
2013	13	(19)	(6)
2014	13	(24)	(12)
2015	13	(24)	(11)
2016	14	(25)	(12)
2017	14	(26)	(13)
2018	15	(27)	(13)

(1) Represents the statutory employer and member contributions and does not include amounts received from employers on account of System Administered Pension Benefits, except as described under footnote 4 below. For fiscal years 2014 through 2018, estimated payroll is assumed to grow 2.5% annually and employer contributions include the rate increases provided for by Act 114 and Act 116.

(2) Excludes $162.5 million contributed to the Employees Retirement System on June 23, 2011 and invested in COFINA bonds pursuant to Act 96.

(3) Includes, in the case of the Employees Retirement System, principal and interest paid on the Pension Bonds for fiscal years 2012 and 2013 in the amounts of $191 million and $192 million, respectively, and for fiscal years 2014 through 2018, debt service of $167 million per year.

(4) Includes $120 million additional annual contribution and savings generated by the System from the difference between receiving the $2,000 per retiree contribution as required under Act 3-2013 and paying $1,500 per retirees to cover certain System Administered Pension Benefits.

(5) Does not include interest income from asset investment. Totals may not add due to rounding.

Source: Information obtained from each of the Retirement Systems, Employees Retirement System projections made by Milliman, and the June 30, 2013 actuarial valuation reports.

The Employees Retirement System anticipates that its future cash flow needs for disbursement of benefits to participants, administrative expenses and debt service are likely to continue to exceed the sum of the employer and employee contributions received and its investment and other recurring income for a period of time, even after taking into account the increases in employer contributions provided for by Act 116, as described below and the amendments made by Act 3-2013. After the enactment of Act 3-2013, the Employees

Retirement System expects to have a decreasing annual funding shortfall (after payment of debt service on the Pension Bonds) and this positive trend is expected to continue, as shown in the table above. Based on the Employees Retirement System's funding and disbursement projections made prior to the enactment of Act 3-2013 (which reflected continued funding shortfalls) and other assumptions, the actuarial valuation as of June 30, 2012 stated that the Employees Retirement System was being rapidly defunded and projected that its net assets (total assets minus the Pension Bonds and other liabilities) would be depleted by fiscal year 2014 and its gross assets would be depleted by fiscal year 2019. This meant that during the period from fiscal year 2014 through fiscal year 2019, benefits were expected to be paid from the proceeds of the Pension Bonds, and that after depletion of the gross assets, there would be no funds remaining to pay pension benefits or debt service on the pension obligation bonds. With the enactment of Act 3-2013 and the incremental annual contributions from the General Fund required by Act 32 beginning in fiscal year 2014 and up to fiscal year 2033, it is projected that the gross assets will no longer be depleted. This incremental contribution will be determined on an annual basis based on actuarial studies to be performed by the System's actuaries.

The Teachers Retirement System has also covered funding shortfalls during the last decade through the sale of investment portfolio assets. For fiscal year 2015, the Teachers Retirement System expects to have a funding shortfall of approximately $367 million, even after taking into account the increases in employer contributions provided for by Act 114, as described below. Based on the Teachers Retirement System's current funding and disbursement projections (which reflect continued funding shortfalls) and other assumptions, the actuarial valuation as of June 30, 2013 states that the Teachers Retirement System is being gradually defunded and projects that its net and gross assets will be depleted by fiscal year 2020. The actuarial valuation as of June 30, 2014 will reflect those changes enacted by Act 160-2013 that were upheld by the Supreme Court.

The Judiciary Retirement System has also experienced funding shortfalls during the last five fiscal years and has used investment income to cover some of these shortfalls. For fiscal year 2013, the Judiciary Retirement System expects to have a funding shortfall of approximately $6 million, and this negative trend is expected to continue. Based on the Judiciary Retirement System's current funding and disbursement projections (which reflect continued funding shortfalls) and other assumptions, the actuarial valuation as of June 30, 2013 states that the Judiciary Retirement System is being defunded and projects that its net and gross assets will be depleted by fiscal year 2019. The actuarial valuation as of June 30, 2014 will reflect those changes enacted by Act 162-2013 that were upheld by the Supreme Court.

In the case of the Teachers Retirement Systems and the Judiciary Retirement Systems, if the level of contributions to those systems and the level of benefits were to remain unchanged, the funding deficiencies are expected to continue to be covered with the investment income from, and the sale of, assets of such systems, thus continuing to deplete such assets. Based on the actuarial valuation report as of June 30, 2013, for the period from fiscal year 2014 to fiscal year 2020, the average annual funding deficiency is projected to be approximately $356 million for the Teachers Retirement System and approximately $12 million for the Judiciary Retirement System. Once the assets of those systems are depleted, the funding deficiency would have to be covered by the employers. As indicated above, it is estimated that the Commonwealth would have to cover substantially all of the funding deficiency of the Teachers Retirement System and the Judiciary Retirement System.

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

The consulting actuaries have recommended that the funding requirements of the Retirement Systems be significantly increased in light of (i) the expected negative net cash flows and exhaustion of plan assets, (ii) the forecasted decrease in funded status, and (iii) the actuarially recommended contributions which significantly exceed actual employer contributions. Act 3-2013 was enacted in response to these recommendations with respect to the Employees Retirement System.

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

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

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

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

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

Another cause for the current situation of the Employees Retirement Systems is its personal loan program. The Employees Retirement System offers and manages a program that offers personal loans, mortgage loans and loans for cultural travels for retirement plan participants. Participants may obtain up to $5,000 in personal loans for any use. In 2007, the System increased this amount to $15,000, which reduced the cash in the System by approximately $600 million between 2007 and 2010. This deficit has been covered by funds from the System itself and has required the liquidation of assets that would have otherwise been available to make pension payments. Due to the amount of personal loans originated during recent years, the System's loan portfolio now has a significant amount of illiquid assets. In an effort to improve the situation, in 2011, the Board of Trustees of the Employees Retirement System lowered the maximum loan amount back to $5,000 and, in 2012, it approved the sale of approximately $315 million in loans. With a balance of $539 million as of June 30, 2013, personal loans are equivalent to approximately 76% of the Employees Retirement System's net assets.

Finally, in 2008, the Employees Retirement System issued $2.9 billion in pension obligation bonds ("POBs"). The purpose of this offering was to increase the assets of the System available to invest and pay benefits. Unlike some other U.S. jurisdictions that have used this strategy, POBs are obligations of the Employees Retirement System itself and government employer contributions constitute the repayment source for the bonds.

Impact of Funding Shortfall on the Commonwealth. The Commonwealth and other participating employers are ultimately responsible for any funding deficiency in the Retirement Systems. The depletion of the assets available to cover retirement benefits would require the Commonwealth and other participating employers to cover such funding deficiency. Due to its multi-year fiscal imbalances previously mentioned, however, the Commonwealth has been unable to make the actuarially recommended contributions to the Retirement Systems. If the measures taken or expected to be taken by the current Commonwealth administration fail to address the Retirement Systems' funding deficiency, the continued use of investment assets to pay benefits as a result of funding shortfalls and the resulting depletion of assets could adversely affect the ability of the Retirement Systems to meet the rates of return assumed in the actuarial valuations, which could in turn result in an earlier depletion of the Retirement Systems' assets and a significant increase in the unfunded actuarial accrued liability. Ultimately, since the Commonwealth's General Fund is required to cover a significant amount of the funding deficiency, the Commonwealth could have difficulty funding the annual required contributions if the measures taken or expected to be taken to reform the retirement systems do not have the expected effect. There may also be limitations on the Commonwealth's ability to change certain pension rights afforded to participants in the Retirement Systems.

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

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

The Commonwealth also enacted Act 114 and Act 116 of 2011. These Acts provide an increase in employer contributions to the Employees Retirement System and the Teachers Retirement System of 1% of covered payroll in each of the next five fiscal years and by 1.25% of covered payroll in each of the following five fiscal years. As a result of these increases, the Employees Retirement System and the Teachers Retirement System would receive approximately $110 million and $37 million, respectively, in additional employer contributions during fiscal year 2014, and per the Actuary's assumption, the additional employer contributions are projected to increase gradually each fiscal year (by an average aggregate increase of $76 million per fiscal year) to approximately $489 million and $192 million, respectively, by fiscal year 2021. The additional employer contributions for fiscal year 2014 were included in the approved budget for such fiscal year. With respect to the increases in the employer contributions corresponding to the municipalities, Act 116 provided that the increases for fiscal years 2012, 2013 and 2014 would be paid for by the Commonwealth from the General Fund budget, representing approximately $20.3 million, $45 million and $72.5 million in fiscal years 2012, 2013 and 2014, respectively.

The tables below show the projected additional contributions to the Employees Retirement System and the Teachers Retirement System as a result of Act 114 and Act 116, based on the expected payroll assumptions used in the actuarial reports as of June 30, 2013.

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

Fiscal Year	Original Employer Contribution Rate	Additional Employer Contribution Rate	Total Employer Contribution Rate	Expected Payroll	Original Employer Contribution	Additional Employer Contribution	Total Employer Contribution
2013	9.275%	2.000%	11.275%	$3,570	$331	$71	$403
2014	9.275%	3.000%	12.275%	3,489	324	105	429
2015	9.275%	4.000%	13.275%	3,576	332	143	475
2016	9.275%	5.000%	14.275%	3,665	340	183	523
2017	9.275%	6.250%	15.525%	3,757	348	234	582
2018	9.275%	7.500%	16.775%	3,851	357	289	646
2019	9.275%	8.750%	18.025%	3,947	366	345	711
2020	9.275%	10.000%	19.275%	4,046	375	405	780
2021	9.275%	11.250%	20.525%	4,147	385	467	852

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

Fiscal Year	Original Employer Contribution Rate	Additional Employer Contribution Rate	Total Employer Contribution Rate	Expected Payroll	Original Employer Contribution	Additional Employer Contribution	Total Employer Contribution
2014	8.50%	3.00%	11.50%	1,249	106	37	143
2015	8.50%	4.00%	12.50%	1,292	110	52	162
2016	8.50%	5.00%	13.50%	1,338	114	67	181
2017	8.50%	6.25%	14.75%	1,384	118	87	205
2018	8.50%	7.50%	16.00%	1,433	122	107	229
2019	8.50%	8.75%	17.25%	1,483	126	130	256
2020	8.50%	10.00%	18.50%	1,535	130	154	284
2021	8.50%	11.25%	19.75%	1,589	135	179	314

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

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

On July 2, 2010, the Commonwealth enacted Act 70 ("Act 70"), which is designed to reduce government expenditures by providing a voluntary early retirement window for central government employees. At the same time, Act 70 is expected to have a positive actuarial impact on the UAAL of the Employees Retirement System and the Teachers Retirement System. Under Act 70, central government employees meeting certain years of service criteria who opted for early retirement by December 31, 2012 receive a higher pension benefit rate than they would otherwise be entitled to receive based on their current years of service, but such pension rate is lower than what they would have been entitled to if they had waited to meet the full vesting requirements. Pursuant to Act 70, the Commonwealth, as employer, will continue making the applicable employer contributions to the Employees Retirement System and the Teachers Retirement System, as well as make payments to cover the annuity payments to the employees opting for the early retirement window, until both the years of service and age requirements for full vesting would have occurred, at which time the applicable Retirement System will continue making the annuity payments. As of June 30, 2014, approximately 8,300 employees participated of the benefits provided by these provisions of Act 70.

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

The most important aspects of the changes effected by Act 3-2013 are the following:

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

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

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

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

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

6. In the case of System 2000 Participants, the retirement benefits will no longer be paid as a lump sum payment and instead will be paid in the form of a lifetime annuity.

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

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

9. Survivor benefits will be modified.

Act 160. The most important aspects of the changes effected by Act 160-2013 are the following:

1. Active participants as of July 31, 2014 will continue to participate in the defined benefit plan.

2. Starting on August 1, 2014, new participants will contribute to a defined contribution plan, and will not participate in the defined benefit plan.

3. The retirement age for new employees is increased to age 62.

4. The employee contribution for new employees is increased to 10% from August 1, 2014 to June 30, 2017, 13.12% from July 1, 2017 to June 30, 2020, and 14.02% from July 1, 2020 and thereafter.

5. The statutory employer contribution is increased to 20.525% starting FY 2022.

6. With respect to post-employment benefits, the Christmas bonus payable to current retirees is reduced from $600 to $200 and the summer bonus is eliminated. Future retirees will not receive any post-employment benefits.

Act 162-2013. The most important aspects of the changes effected by Act 162-2013 are the following:

1. For all existing participants who joined the Judiciary Retirement System between December 24, 2013 and June 30, 2014, the defined benefit plan continued to exist, but with a maximum pension of 60% of salary. Their employee contribution was increased from 8% to 10%. All other existing benefits remained unchanged.

2. For all new participants who joined the Judiciary Retirement System after July 1, 2014, a new hybrid plan was enacted, which includes the following:

(i) No transfer of service from other branches of government will be credited for purposes of benefit accruals.

(ii) At least 12 years of service and attainment of age 65 will be required in order to accrue an annual pension equal to 1.5% of the employee's average salary for the last five years multiplied by years of service plus an annuity from the employee's contributions.

(iii) Disability benefits were reduced from 50% to 33% of salary. Participant must have at least five years of service to receive a pension that will not exceed the 33% of the average compensation for the last five years.

(iv) Death benefits payable for the surviving spouse were changed from 50% of salary to a reimbursement of the judge's pension contributions to the extent not already distributed.

(v) The employee contribution was increased from 8% to 12% of salary.

(vi) Christmas, summer and prescription bonuses were eliminated.

All other benefits remained unchanged.

Statements of Plan Net Assets and Changes in Plan Net Assets. The following tables present the Statement of Plan Net Assets and Statement of Changes in Plan Net Assets of each of the Retirement Systems for fiscal years 2010, 2011, 2012 and 2013.

The Commonwealth of Puerto Rico
Employees Retirement System
Statements of Plan Net Assets
As of June 30, 2011, 2012, 2013 and 2014
(in thousands)

	2014*	2013	2012	2011
ASSETS				
CASH AND SHORT TERM INVESTMENTS				
Cash and Cash Equivalents	$40,444	$80,683	$143,364	$220,852
Cash with Fiscal Agent	4,210	80,434	59,249	
Collateral for Security Lending	126,648	124,411	54,870	134,319
Deposits with GDB:				
Unrestricted	53,838	50,093	113,314	51,396
Restricted	25,093	30,836	233,931	411,946
Restricted Cash Bonds	143,830	173,020	166,436	170,653
Total Cash and Short Term Investment	394,063	539,477	771,164	989,166
SECURITIES LENDING, COLLATERAL INVESTED				
Marketable Securities:				
Notes and Bonds	1,268,216	1,314,404	1,370,694	814,408
Stocks	681,538	860,585	793,330	1,582,242
Private Equity Investments	55,777	55,067	57,371	65,457
COFINA investment	138,123	229,819	245,339	1,370,202
Total Investments	2,143,654	2,459,875	2,466,734	2,462,107
LOANS TO PLAN MEMBERS				
Mortgage	164,895	160,109	152,666	148,156
Personal	392,866	556,019	724,122	1,048,984
Cultural Trips	48,571	71,782	75,308	75,197
PEC	12,475	3,251	2,961	3,044
Total Loans to Plan Members	618,807	791,161	955,057	1,275,381
Investment in PRTA Holdings				
Total cash, investments and loans to plan members	3,851,844	3,790,513	4,192,955	4,726,654
RECEIVABLES:				
Employers	281,669	131,033	120,153	184,152
General Fund	25,752	2,940	4,518	6,147
Judiciary Retirement System	3,210	2,174	1,344.63	881.00
Investment Sales	10,976	729	87,261	9,546
Accrued Interest	9,500	11,494	13,044	7,594
Dividends Receivable				
Other	20,815	13,184	12,387	4,595
Total Receivables	351,922	161,554	238,708	212,915
CAPITAL ASSETS	11,009	8,072	11,195	8,951
OTHER ASSETS	5,595	5,261	5,375	6,375
Prepaid Bond Cost	28,886	29,981	31,077	32,172
Construction in Progress		522	472	
Total assets	3,554,036	3,995,903	4,479,782	4,987,067
LIABILITIES				
Book overdraft				62,843
Short Term Obligations				
Payables for securities lending	126,648	124,411	54,870	134,319
Funds of Mortgage Loans and Guarantee				
Insurance Reserve for Loans	7,236	7,482	8,351	9,596
Investment Purchases	19,009		82,384	1,854
Accounts Payable and Accrued Liabilities	12,154	13,905	26,972	12,923
Bonds Payable	3,091,243	3,065,065	3,026,593	3,003,482
Other Liabilities	41,015	37,542	28,457	24,363
Bonds Interest Payable				13,876
Accounts Payable Law 70	14,330	16,155	14,623	
Total Liabilities	3,311,635	3,264,561	3,242,250	3,263,256
Net Assets Held in Trust for Pension Benefits	$242,401	$731,342	$1,237,532	$1,723,811

Totals may not add due to rounding.

*Preliminary, unaudited numbers

The Commonwealth of Puerto Rico
Employees Retirement System
Statements of Changes in Plan Net Assets
As of June 30, 2011, 2012, 2013 and 2014
(in thousands)

ADDITIONS:	**2014***	**2013**	**2012**	**2011**
Contributions:				
Employer:	$ 564,538	$ 424,704	$388,102	$349,207
Participating employees	365,791	322,528	316,178	322,008
Other Special Laws	234,675	190,724	45,433	187,369
Early Retirement	40,300	2,201	812	305
COFINA Investment				162,500
Total Contributions	1,205,304	940,157	750,525	1,021,389
Investment (loss) Income:				
Realized Gain (or Loss)	126,074	54,311	263,992	472,076
Unrealized Gain (or Loss)	(1,655)	66,645	(153,171)	
Dividend Income	74	242	2,095	7,344
Interest Income	103,193	127,377	165,082	172,783
Total	227,686	248,575	277,998	652,203
Less Investment Expense:	3,128	3,553	684	6,483
Insurance Premium				
Other Income	27,197	22,035	24,728	49,257
Total Additions	1,457,059	1,207,214	1,052,567	1,716,366
DEDUCTIONS:				
Annuities	1,273,288	1,218,958	1,170,749	1,133,926
Benefits under Special Laws	234,675	190,724	45,433	170,369
Death Benefits	24,438	10,012	13,604	7,932
Refunds of Contributions:				
Employers	4,315	970	1,228	992
Participating Employees	161,588	51,336	51,000	90,203
Personal Loans Adjustment				
Law 70	17	3,773	14,623	
Other Expenses	24,969	16,096	16,475	13,199
Administrative Expenses	28,887	29,306	34,998	34,583
Interest on Bonds	193,822	192,230	190,736	189,342
Total Deductions	1,945,999	1,713,405	1,538,846	1,657,546
Net (decrease) Increase	(488,940)	(506,191)	(486,279)	58,820
Net Assets Held in Trust for Pension Benefits				
Beginning of the Year	731,341	1,237,532	1,723,811	1,664,991
End of Year	$242,401	$731,341	$1,237,532	$1,723,811

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

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

	2013	2012	2011	2010
ASSETS				
Cash:				
Cash and cash equivalents	$59,183	$321,635	$97,269	$24,019
Cash with fiscal agent	5,196	12,925	110	-
Collateral for Security Lending	48,420	20,528	70,938	48,673
Cash deposited with GDB	3,298	3,295	3,291	3,288
Total Cash	116,097	358,383	171,608	75,980
Investments at fair value:				
Bonds and notes	862,063	800,237	591,769	397,109
Stocks	524,157	612,458	1,211,084	1,295,232
Total investment at fair value	1,386,220	1,412,695	1,802,853	1,692,341
Other investments:				
Mortgage notes acquired from third parties				
Private equity investments	14,823	19,221	25,630	26,683
Total investments	1,401,043	1,431,916	1,828,483	1,719,024
Loans to plan members:				
Mortgage	146,917	135,698	128,312	119,937
Personal	262,238	266,303	276,692	288,463
Cultural trips	1,877	1,811	1,660	1,481
Total loans to plan members	411,032	403,812	406,664	409,881
Total investments and loans	1,812,075	1,835,728	2,235,147	2,128,905
Accounts receivable:				
Receivables for investments sold	57	38,743	2,320	332
Accrued interest and dividends receivable	7,847	7,603	3,982	4,584
Other	23,414	34,404	44,883	56,085
Total accounts receivable	31,318	80,750	51,185	61,001
Property and equipment, net	19,312	20,885	22,204	22,970
Other assets	781	832	472	832
Total Assets	1,979,583	2,296,578	2,480,616	2,289,688
LIABILITIES				
Investments purchased	65	153,714	1,701	2,722
Payable for securities lending	48,420	20,528	70,938	48,673
Cash overdraft in cash with fiscal agent	-	-	-	2,199
Accounts payable	1,906	2,150	1,530	1,476
Accrued expenses	14,954	14,087	13,321	6,184
Escrow fund of mortgage loans and guarantee insurance reserve for loans to plan members	6,308	5,773	6,322	5,763
Other liabilities	1,048	1,110	941	694
Total liabilities	72,701	197,362	94,753	67,711
Net Assets Held in Trust for Pension Benefits	$1,906,882	$2,099,216	$2,385,863	$2,221,977

Totals may not add due to rounding.

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

ADDITIONS:	**2013**	**2012**	**2011**	**2010**
Contributions:				
Participating Employees	$119,162	$121,773	$123,297	$129,888
Employer	133,369	123,614	112,071	118,127
Contributions transferred from other systems**	1,680	1,476	828	1,265
Special	54,075	53,405	47,753	46,572
Total contributions	308,286	300,268	283,949	295,852
Investment income:				
Interest income	71,457	56,306	57,008	61,303
Dividend income	2,693	4,342	6,915	10,111
Net appreciation (depreciation) in fair value of investments	86,573	(20,134)	421,923	203,265
Total investment income	160,723	40,514	485,846	274,679
Less investment expense	(3,229)	(3,361)	(4,682)	(4,735)
Net investment income	157,494	37,153	481,164	269,944
Other income	1,432	1,374	968	53,771
Total additions	$467,212	$338,795	$766,081	$619,567
DEDUCTIONS:				
Benefit paid to participants:				
Annuities and death benefits	579,144	547,955	513,874	470,683
Special benefits	49,130	48,492	48,286	47,870
Refunds of contributions	7,666	5,220	8,465	7,847
Administrative expenses	23,606	23,775	31,570	28,783
Total deductions	659,546	625,442	602,195	555,183
Net increase in net assets held in trust pension benefits	(192,334)	(286,647)	163,886	64,384
Net assets held in trust for pension benefits				
Beginning of year	2,099,216	2,385,863	2,221,977	2,157,593
End of year	$1,906,882	$2,099,216	$2,385,863	$2,221,977

Totals may not add due to rounding.

The Commonwealth of Puerto Rico
Judiciary Retirement System
Statements of Plan Net Assets
As of June 30, 2011, 2012, 2013 and 2014
(in thousands)

ASSETS	**2014***	**2013**	**2012**	**2011**
Cash and Investments:				
Cash and Cash Equivalents	$2,545	$1,663	$11,543	$6,409
Cash Deposited with GDB or Treasury Department:				
Unrestricted	3,142	916	745	1,010
Restricted				1
Collateral from Securities Lending	827	2,002	1,088	3,218
Total Cash	6,514	4,581	13,376	10,638
Receivables:				
Accrued Interest	175	191	255	263
Investment Sales				
Other	27	27	27	27
Total receivables	202	218	282	290
Marketable Securities:				
Notes and Bonds	22,729	22,016	30,524	39,954
Stocks	36,399	36,338	18,206	22,136
Total Investments	59,128	58,354	48,730	62,090
Loans and Interest Receivable from Members:				
Mortgage	100	0	4	17
Personal & PEG	381	378	386	750
Cultural Trips	62	58	81	78
Total Loans to Plan Members	543	436	471	845
Total cash, investments and loans to plan members	66,387	63,589	62,859	73,863
LIABILITIES				
Due to Treasury Department			1,603	5,560
Due to the Employees Retirement System	3,210	2,174	1,345	881
Collateral from Securities lending	826	2,002	1,088	3,218
Escrow Funds to plan Members and Guarantee Insurance	57	65	65	66
Investment Purchases	190			2
Other Liabilities	443	336	170	161
Total Liabilities	4,726	4,577	4,271	9,888
Net Assets Held in trust for Pension Benefits	**$61,661**	**$59,012**	**$58,588**	**$63,975**

Totals may not add due to rounding.

*Preliminary, unaudited numbers.

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

	2014*	2013	2012	2011
ADDITIONS:				
Contributions:				
Employer	$10,762	$10,034	$10,088	$9,966
Participating employees	3,803	2,825	2,942	2,789
Special Laws	2,066	1,944	537	629
Total Contributions	16,631	14,803	13,531	13,384
Investment Income:				
Realized Gain or Loss	3,153	1,926	7,354	9,726
Unrealized Gain	5,715	3,870	-6,837	3,201
Dividend Income			7	176
Interest Income	845	948	1,361	1,352
Total	9,713	6,744	1,885	14,455
Less Investment Expense	-58	-72	-166	-162
Other Income	183	27	18	10
Net Investment Income	9,828	6,699	1,737	14,303
Total Additions	26,459	21,502	15,304	27,687
DEDUCTIONS:				
Annuities	20,659	18,509	19,395	18,617
Benefits Under Special Laws	2,066	1,944	537	
Death Benefits			179	
Refunds to Participating Employees	77		64	5
Refunds to Employers	120			5
Administrative Expenses	650	625	516	495
Other Expenses	238			
Total Deductions	23,810	21,078	20,691	19,122
Net Increase	2,649	424	-5,387	8,565
Net Assets Held in Trust for Pension Benefits:				
Beginning of the Year	59,012	58,588	63,975	55,410
End of Year	**$61,661**	**$59,012**	**$58,588**	**$63,975**

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

Post-employment benefits other than pensions

The Commonwealth also provides other 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 3-2013 eliminated all other post-employment system benefits to future retirees of the Employees Retirement System. Act 3-2013 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 3-2013, 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, $35.9 million and $0.3 million, respectively, for fiscal year 2014.

In accordance with the provisions of GASB Statement No. 45, the Commonwealth is required to quantify and disclose its obligations to pay non-pension post-employment benefits to current and future retirees. The following table sets forth, according to the actuarial valuations, the actuarial accrued liability, UAAL, covered payroll and UAAL as a percentage of covered payroll for the non-pension post-employment benefits of the active and retired members of each of the Retirement Systems. Since these benefits are not pre-funded, as discussed above, the UAAL is equal to the actuarial accrued liability.

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

Fiscal Year Ending June 30,	Actuarial Value of Assets	Actuarial Accrued Liability[(1)]	Unfunded Actuarial Accrued Liability	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
Employees Retirement System						
2009	-	$1,633	$1,633	0%	$4,293	38.0%
2010	-	1,699	1,699	0	3,818	44.5
2011	-	1,758	1,758	0	3,666	48.0
2012	-	2,121	2,121	0	3,570	59.4
2013	-	1,482	1,482	0	3,489	42.5
Teachers Retirement System						
2009	-	750	750	0	1,418	52.9
2010	-	694	694	0	1,370	50.7
2011		706	706	0	1,320	53.5
2012	-	797	797	0	1,293	61.7
2013	-	793	793	0	1,249	63.5
Judiciary Retirement System						
2009	-	6	6	0	31	18.5
2010	-	6	6	0	32	18.1
2011	-	6	6	0	32	18.3
2012	-	7	7	0	33	19.9
2013	-	7	7	0	32	20.9

(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.

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

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

Fiscal Year Ending June 30,	Actuarially Recommended Contributions[1]	Actual Employer Contributions[2]	Amount Unfunded[3]	Percent Contributed
Employees Retirement System				
2009	$112	$87	$25	77.7%
2010	128	85	43	66.6
2011	129	94	35	72.3
2012	134	95	39	70.8
2013	155	113	42	72.9
2014	89	112	(23)	126.5
Teachers Retirement System				
2009	38	28	10	73.2
2010	42	28	14	66.9
2011	40	32	8	79.1
2012	41	37	4	90.0
2013	46	35	11	77.0
2014	46	36	10	78.0
Judiciary Retirement System				
2009	0.4	0.3	0.1	61.4
2010	0.5	0.3	0.2	60.4
2011	0.5	0.3	0.2	58.6
2012	0.6	0.3	0.3	56.3
2013	0.6	0.3	0.3	50.2
2014	0.7	0.3	0.4	50.7
Total				
2009	150.4	115.3	35.1	76.7
2010	170.5	113.3	57.2	66.5
2011	169.5	126.3	43.2	74.5
2012	175.6	132.3	43.3	75.3
2013	201.6	148.3	53.3	73.6
2014	135.7	148.3	(12.6)	109.3

(1) The actuarially recommended contributions are based on the information contained in the actuarial valuations for the Retirement Systems as of June 30, 2013.

(2) The actual employer contributions for fiscal year 2014 are based on the expected pay-as-you-go amounts for the post-employment benefits, other than pensions, as set forth in the actuarial valuations as of June 30, 2013.

(3) Represents the difference between the actuarially recommended pension contribution and the actual contribution from the participating employers.

PUBLIC CORPORATIONS

In Puerto Rico, many governmental and quasi-governmental functions are performed by public corporations created by the Legislative Assembly with varying degrees of independence from the central government to perform generally a single function or a limited number of related functions. Most public corporations obtain revenues from rates charged for services or products, but many are subsidized to some extent by the central government. Most public corporations are governed by boards whose members are appointed by the Governor with the advice and consent of the Senate, but some public corporations are attached to departments of the central government. Capital improvements of most of the larger public corporations are financed by revenue bonds issued under trust agreements or bond resolutions, or by notes issued under loan agreements.

On June 28, 2014, the Commonwealth enacted the Puerto Rico Public Corporation Debt Enforcement and Recovery Act, which creates a legal framework that allows certain public corporations to adjust their debts in a manner that protects the interests of all affected creditors. See "FISCAL CONDITION – Enactment of the Recovery Act."

Government Development Bank for Puerto Rico and its Affiliates

The principal functions of GDB are to act as financial advisor to, and fiscal agent for, the Commonwealth, its municipalities and public corporations in connection with the issuance of bonds and notes, to make loans and advances to public corporations and municipalities, and to promote the economic development of Puerto Rico. As part of its role as fiscal agent, during fiscal years 2009, 2010 and 2011, GDB entered into fiscal oversight agreements with PRASA, PREPA, PRHTA, PRPA, PRHIA, the Medical Services Administration, the Metropolitan Bus Authority and the Maritime Transportation Authority. As part of these agreements, GDB imposed certain conditions on the extension of credit to these entities and continually monitors their finances, among other things.

As of July 31, 2014, GDB (excluding its blended component units) had total assets of $11.9 billion and total liabilities of $9.5 billion**.**

As of July 31, 2014 $4.7 billion of bonds and notes of GDB (excluding its subsidiaries) were outstanding, consisting of $267 million in Commonwealth guaranteed bonds and $4.4 billion of medium term senior notes. In addition, on October 10, 2014, GDB issued $900 million of notes guaranteed by the Commonwealth and maturing on or prior to June 30, 2015, the proceeds of which were used to purchase Tax and Revenue Anticipation Notes of the Commonwealth.

Act No. 12 of May 9, 1975, as amended, provides that the payment of principal of, and interest on, specified notes and other obligations of GDB, not exceeding $550 million, may be guaranteed by the Commonwealth, of which $267 million were outstanding as of July 31, 2014.

Under Act No. 271 of November 21, 2002, GDB made a required special capital contribution to the Special Communities Perpetual Trust of $500 million and provided the Trust with a $500 million, non-revolving line of credit. The amounts transferred to the Special

Communities Perpetual Trust were deposited in two investment accounts held by GDB for the benefit of the Trust. As of July 31, 2014, the Special Communities Perpetual Trust had repaid $139.6 million of its line of credit and had an outstanding balance of $360.4 million. The line of credit is payable from legislative appropriations.

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

As of July 31, 2014, GDB had outstanding loans to the Commonwealth in the aggregate principal amount of $2.1 billion, outstanding loans to, and bonds of, the public corporations in the aggregate principal amount of $4.9 billion (of which loans to PRHTA represented $2.0 billion), and outstanding loans to the municipalities in the aggregate principal amount of $2.2 billion.

As of July 31, 2014, the approximate market value of GDB's investment portfolio was approximately $2.1 billion.

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

Puerto Rico Housing Finance Authority. Puerto Rico Housing Finance Authority (formerly known as Housing Finance Corporation) provides financing for rental housing units, stimulates the construction industry under federally subsidized programs and provides interim financing for low-income housing projects and single-family homeownership programs. It is also engaged in insuring and servicing mortgages originated by the former Housing Bank and Finance Agency, which was dissolved in 2002 and its powers transferred to the Housing Finance Authority. As of July 31, 2014, the Housing Finance Authority's total outstanding principal balance of loans to the private sector for development of housing projects targeted to low and moderate income families was $165.2 million. The Housing Finance Authority's mortgage loans to low and moderate income homeowners represented an additional outstanding principal balance of $179.0 million as of the same date.

The Housing Finance Authority has outstanding tax-exempt revenue bonds the proceeds of which were loaned to the Puerto Rico Public Housing Administration to finance improvements to various housing projects in the Commonwealth. Such bonds are limited obligations of the Housing Finance Authority payable solely from revenues collected from such housing units, with certain exceptions. As of July 31, 2014, $458.9 million of these bonds were outstanding. See "DEBT – Debt of Public Corporations" above for additional information on the outstanding debt of the Housing Finance Authority.

As of July 31, 2014, the Housing Finance Authority had total unrestricted net assets of $246.1 million.

Puerto Rico Tourism Development Fund. Puerto Rico Tourism Development Fund ("TDF") was created in September 1993 to facilitate the development of Puerto Rico's hotel industry by working with private-sector financial institutions in structuring financings for new hotel projects and hospitality related projects. TDF can provide guarantees to interim and permanent financings. In certain transactions, TDF can act as direct lender and also provide preferred equity capital. As of July 31, 2014, TDF had $557 million in guarantees and $119.6 million in loans, net of $247 million in allowances for losses on guarantees and letters of credit and $92.6 million of loan loss reserves. It also had $16.7 million in cash, $154.0 million in bank deposits, and $14.3 million in marketable securities. As of July 31, 2014, TDF had a net detriment balance of $230 million.

Puerto Rico Development Fund. Puerto Rico Development Fund was established in April 1977 to provide an alternate source of financing to private enterprises. The Development Fund is also authorized to guarantee obligations of those enterprises and invest in their equity securities. As of July 31, 2014, the Development Fund had assets of $21.9 million, including $7.3 million in loans to private entities, net of allowances for loan losses of approximately $16.9 million, $11.0 million in cash and bank deposits, and $3.6 million in preferred shares of various private entities.

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

Electric Power Authority

The Puerto Rico Electric Power Authority ("PREPA") supplies substantially all of the electricity consumed in the Commonwealth. PREPA owns all transmission and distribution facilities and most of the generating facilities that constitute Puerto Rico's electric power system.

PREPA had preliminary net losses of $267 million during fiscal year 2014, compared with net losses of $283 million during fiscal year 2013 and net losses of $346 million during fiscal year 2012.

PREPA's operating results have been adversely affected in recent years by a decrease in electric energy demand caused in part by a declining population and a prolonged recession, high fuel costs which result from reliance on oil for energy generation, high capital expenditure requirements associated with ageing generating facilities, and a high level of debt. As of August 14, 2014, PREPA's debt included $8.322 billion of outstanding revenue bonds and $696 million under bank working capital lines of credit. PREPA also owed GDB approximately $35 million under a line of credit.

On August 14, 2014, PREPA entered into forbearance agreements with certain insurers of its bonds and beneficial owners of the bonds controlling, collectively, more than 60% of the principal amount of bonds outstanding under PREPA's Power Revenue Bonds Trust Agreement (the "Trust Agreement"), as well as with the banks that provide revolving lines of credit to PREPA, and with GDB. The forbearing creditors agreed to not exercise certain rights against PREPA resulting from certain specified defaults or potential defaults until March 31, 2015. The agreements are subject to termination prior to such date under certain circumstances. The agreements are available on GDB's website.

In accordance with the forbearance agreements, on September 4, 2014, PREPA appointed Lisa Donahue as Chief Restructuring Officer, whose mandate is to work alongside PREPA's executive director to develop, organize and manage a financial and operational restructuring of PREPA on terms to be approved by PREPA's board of directors.

The forbearance agreements require PREPA, among other things, to (i) retain FTI Consulting to evaluate and make recommendations to PREPA with respect to its billing practices, receivables, and contribution in lieu of taxes by November 15, 2014, (ii) deliver a business plan to the forbearing creditors or their advisors who have executed non-disclosure agreements by December 15, 2014, and (iii) deliver a restructuring plan acceptable to at least 66 2/3% of the forbearing bond creditors as well as the forbearing banks by March 2, 2015. Mrs. Donahue and a team comprised of eleven full time equivalents from both AlixPartners and FTI Consulting are working, alongside PREPA management, on completing these milestones. As part of this process, PREPA hired Leidos Engineering, LLC to conduct the first stage of an Integrated Resource Plan, which will mainly consist of a generation plan that will guide the development of the business and restructuring plans required by the forbearance agreements.

In addition, as required by the forbearance agreements, on August 27, 2014 PREPA and the trustee under the Trust Agreement executed an amendment to the Trust Agreement. The amendment allows PREPA to access its construction fund for the payment of current expenses (as defined in the Trust Agreement) subject to certain conditions. Furthermore, so long as the amendment remains in effect, it requires that the trustee transfer five installments of $34,112,097.79 on a monthly basis from a bond reserve account to a special defeasance account from which such moneys will be used to pay principal and interest under its bonds on or before

January 1, 2015. Meanwhile, the forbearance agreements require PREPA to continue to pay interest to the banks during the forbearance period.

On May 27, 2014, the Legislative Assembly enacted the Puerto Rico Energy Relief and Transformation Act. The law creates (i) the State Energy Public Policy Office, which is charged with developing the Commonwealth's energy policy; (ii) the Energy Commission, which is charged with, among other things, with implementing such public policy through regulations and approving PREPA's rate structure; (iii) the Independent Consumer's Protection Office, which will assist and represent PREPA's customers before PREPA and its regulator; and (iv) the Energy Administration, which will provide administrative services to these three other entities. Among other objectives, the legislation seeks to reduce PREPA's dependence on fossil fuels, promote the interconnection of renewable energy producers into PREPA's grid, increase its operating efficiency, and lower energy costs.

In order to reduce its dependency on fuel oil, reduce electricity costs, and comply with Mercury and Air Toxic Standards, PREPA has been pursuing a fuel diversification strategy. PREPA has entered into long-term power purchase agreements with private operators of two co-generation plants that use fuels other than oil. Approximately 32% of PREPA's current energy generation is purchased from these privately owned plants. As part of the efforts required under the forbearance agreements, PREPA is developing a business plan and ultimately a restructuring plan that will establish the most efficient way to implement a fuel diversification strategy. To date, the principal component of PREPA's fuel diversification strategy has been the conversion of specified oil-fired generating units to dual fuel units that can burn either fuel oil or natural gas and the development of the necessary natural gas transportation and delivery infrastructure. PREPA has already completed the conversion of the largest generating units of the Costa Sur power plant, representing approximately 14% of PREPA's total dependable generating capacity. PREPA receives natural gas at Costa Sur power plant through an existing pipeline from the EcoElectrica LNG terminal and pursuant to a Sale and Purchase Agreement with Gas Natural Electricidad SDG, S. A. PREPA has also executed certain agreements with affiliates of Excelerate Energy Limited Partnership for the development and operation of an offshore LNG receiving facility approximately three miles south of the Aguirre Power Complex (the "GasPort"), including an infrastructure agreement, a terminal operation and maintenance agreement, and a fifteen year charter agreement for a Floating Storage and Regasification Unit, which would receive and regasify LNG. Currently, Excelerate is pursuing the required permits for the construction of the GasPort.

PREPA has also signed a number of power purchase agreements for renewable energy projects. Four of the renewable energy projects are already in commercial operation, two of the renewable projects are in the initial stage of synchronization, and the rest of the projects are in various stages of development, most still being subject to obtaining financing and permitting.

On July 1, 2013, the Commonwealth enacted legislation that establishes a preferential "all in" rate for the sale of electricity to PRASA. The preferential rate, however, is capped at 750 million kilowatt hours per fiscal year. In addition, the legislation grants PREPA the power to revoke or modify the preferential rate if deemed necessary and prudent, following the processes provided in the applicable laws and the public policy established in Act 50, or when determined necessary to meet its obligations under the trust indenture for its bonds.

Aqueduct and Sewer Authority

The Puerto Rico Aqueduct and Sewer Authority ("PRASA") owns and operates Puerto Rico's public water supply and wastewater systems. Such systems provide water and wastewater services to 97% and 59% of the Commonwealth's population, respectively.

PRASA reported an operating loss of $291.9 million for fiscal year 2013, compared to operating losses of $136.8 million and $39.6 million for fiscal years 2012 and 2011, respectively. In order to improve its financial condition, PRASA adopted a comprehensive plan to increase its revenues and reduce its expenses. On July 3, 2013, PRASA's Board of Directors approved a rate adjustment, which became effective on July 15, 2013. PRASA management currently expects that the rate adjustment will be sufficient to allow PRASA to cover all expenses and debt service of the corporation with its own revenues until at least fiscal year 2017, although significant financing and refinancing risks remain.

See "DEBT – Debt of Public Corporations" above for information on PRASA's outstanding debt.

On July 1, 2003, PRASA entered into an agreement (Civil Action No. 01-1709) with Environmental Protection Agency "EPA") to attain compliance with the Clean Water Act in relation to PRASA's wastewater pump stations (WWPSs) in response to a significant number of sanitary sewer bypasses from these locations. The Clean Water Act prohibits discharges of sewage from any point in the collection and treatment system other than the authorized point at the treatment facility. PRASA completed all improvement projects required by EPA for these WWPSs on or before the established completion dates in the Agreement. On June 22, 2006, PRASA entered into a consent decree (Civil Action No. 06-1624) with EPA that requires PRASA to implement system-wide remedial measures at all of the wastewater treatment plants operated by the PRASA. The decree establishes deadlines for the compliance with the conditions set forth in the agreement and stipulates penalties for violation of any of those deadlines.

On December 15, 2006, an agreement (Civil Case No. KPE 2006-0858) was signed between PRASA and the Department of Health of the Commonwealth related to violations of the Safe Drinking Water Act (SDWA), as amended. The agreement was preliminarily approved by the supervising court on March 15, 2007 and it was amended and finally approved by that court on June 20, 2008. PRASA agreed to implement a work plan to remediate the violations, establish preventive and mitigation measures, and execute a preventive maintenance program for the purpose of meeting the requirements of the SDWA. This Act requires the compliance with parameters of water quality and treatment techniques

In November of 2007, PRASA entered into negotiation of a consent decree (Civil Action No. 10-1365) with EPA that requires PRASA to implement system wide remedial measures at all of the sludge treatment systems at the water treatment plants owned and operated by PRASA. The consent decree was lodged on May 3, 2010 and its entry date was August 24, 2010. This consent order supersedes previous Consent Orders known as PRASA II (Civil Action No. 92-

1511) and PRASA III (Civil Action No. 00-2554). This consent order establishes deadlines for the compliance with the conditions set forth in the proposed agreement and stipulates penalties for violation of any of those deadlines.

PRASA needs to make a substantial investment in infrastructure and a major overhaul of its operations to maintain the viability of the systems it owns and operates, to finance its expansion for new users and to implement remedial measures required by the consent decrees between PRASA and the EPA and the settlement agreement with the DOH. Funds for this investment are expected to be provided through a combination of revenues from PRASA, financing transactions, federal grants and other sources.

Highways and Transportation Authority

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

PRHTA reported a net operating loss of $567.7 million for fiscal year 2013, compared to a net operating loss of $511.8 million for fiscal year 2012 and $530.8 million for fiscal year 2010. As of June 30, 2013, PRHTA's total debt was $6.8 billion, consisting of $4.8 billion of bonds and $2.0 billion of GDB financings.

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

On June 25, 2013, the Commonwealth enacted Acts 30 and 31 to provide additional revenues to PRHTA. Pursuant to these laws, (i) PRHTA is receiving the motor vehicle license fee revenues previously received by the Commonwealth Treasury Department, which for fiscal year 2014 is expected to be approximately $59.4 million in additional annual revenues, (ii) the tax on petroleum products was increased from $3.00 per barrel to $9.25 per barrel, which for fiscal year 2014 is expected to be approximately $162.7 million in additional annual revenues, and (iii) PRHTA will receive the first $20 million in annual cigarette excise tax revenues collected by the Commonwealth Treasury Department.

PRHTA has a mass transit system, known as Tren Urbano, serving a portion of metropolitan San Juan. It was constructed under several design/build contracts and is being privately operated. The cost of the project was $2.4 billion, which cost was financed by federal Transit Administration grants, other federal funding sources and PRHTA's own resources, including revenue bonds. Tren Urbano commenced operations in June of 2005. The current annual operation and maintenance cost of the Tren Urbano is approximately $86 million. In August of 2014, legislation was adopted which creates the Puerto Rico Integrated Transit Authority. Under this legislation, the operations of the Tren Urbano, the Puerto Rico Maritime Authority and the Metropolitan Bus Authority will be consolidated under the newly created Authority.

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

On September 22, 2011, PRHTA and the PPP Authority awarded to Metropistas a concession for the operation of toll roads PR-22 and PR-5. In connection with the establishment of the concession, PRHTA defeased, redeemed or purchased approximately $873.1 million aggregate principal amount of its bonds.

Health Insurance Administration

The Puerto Rico Health Insurance Administration ("PRHIA") was created in 1993 to negotiate and contract for the provision of comprehensive health insurance coverage for qualifying (generally low income) Puerto Rico residents under the Commonwealth's "Health Reform" program. Under this system, the Commonwealth selected, through a bidding process, a private health insurance company for each designated region of the island and paid such insurance company the insurance premium for each eligible beneficiary within such region. The health insurance system covered the entire island. On October 1, 2010, the Commonwealth implemented "Mi Salud," which replaced the "Health Reform" program. Effective on April 1, 2015 "Mi Salud" will be replaced by the "Government Health Plan." Although there are some differences, Mi Salud and the Government Health Plan continue to provide comprehensive health insurance coverage to qualifying Puerto Rico residents.

See "FISCAL CONDITION – Health Insurance" for a description of Mi Salud and the Government Health Plan, and see "DEBT – Debt of Public Corporations" for information on the outstanding debt of PRHIA.

Children's Trust

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

As of July 31, 2014, the Children's Trust had outstanding senior and subordinate Tobacco Settlement Asset Backed Bonds in the principal amount of $1.2 billion, which were issued in 2002, 2005 and 2008 to pay certain capital expenditures, to make grants to third parties, and to pay certain expenses of the Commonwealth. These bonds and any other additional senior bonds issued by the Children's Trust are payable solely from, and secured by a statutory pledge of, the payments made and to be made by the participating cigarette manufacturers under the Master Settlement Agreement. To date, all principal and interest payments required to be made by the Children's Trust on its outstanding bonds have been made on a timely basis from such payments.

Convention Center District Authority

The Convention Center District Authority ("CCDA") was created to own, develop, finance, plan, design, build, operate, maintain, administrate and promote the Dr. Pedro Rosselló González Convention Center, and designated private parcels located within the Convention Center District in San Juan. The convention center opened on November 17, 2005. The CCDA also owns a multipurpose coliseum in San Juan, known as the José Miguel Agrelot Coliseum. Bonds issued by the CCDA in 2006 to finance the construction of the convention center are payable from a portion of a hotel room tax. See "DEBT – Debt of Public Corporations" above for additional information on the outstanding debt of the CCDA.

Industrial Development Company

The Puerto Rico Industrial Development Company ("PRIDCO") participates in the Commonwealth-sponsored economic development program by providing physical facilities, general assistance, and special incentive grants to manufacturers. PRIDCO reported consolidated change in net assets of negative $1.9 million (reduction in net assets) for fiscal year 2013, compared to consolidated change in net assets of $5.7 million (increase in net assets) for fiscal year 2012. Rentals derived from the leasing of specified facilities of PRIDCO are pledged to the payment of PRIDCO's revenue bonds. See "DEBT – Debt of Public Corporations" above for information on the outstanding debt of PRIDCO.

Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority

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

Infrastructure Financing Authority

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

As of July 31, 2014, PRIFA's total debt was approximately $2.0 billion. This debt includes bonds outstanding of $1.9 billion and interim financing for capital improvements of $52.6 million.

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

PRIFA also has custody and control of the Infrastructure Development Fund and its Corpus Account, a perpetual account established under Act No. 92 of June 24, 1998 that was funded with $1.2 billion of the proceeds of the sale of the Puerto Rico Telephone Company. In January of 2009, PRIFA sold the securities held in the Corpus Account and used the proceeds to (i) retire certain PRIFA bonds, (ii) make a deposit to the General Fund which was applied to cover a portion of the Commonwealth's budget deficit, (iii) make a transfer to GDB as a capital contribution, and (iv) make a deposit to the Corpus Account to be invested in a long-term investment agreement with GDB.

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

PRIFA is responsible for implementing in the Commonwealth the applicable provisions of ARRA. One of its main responsibilities regarding ARRA is to maximize the flow of funds from the Federal Government for the appropriate investment in qualified projects and activities. PRIFA also is responsible for the receipt, administration and disbursement of such funds and monitoring those governmental agencies and entities that receive ARRA funds.

Municipal Finance Agency

The Puerto Rico Municipal Finance Agency ("MFA") is authorized to issue bonds to purchase general obligation bonds and notes of Puerto Rico municipalities and to fund a debt service reserve. Debt service on MFA's bonds is payable from debt service payments on municipal bonds and notes held by MFA and from the debt service reserve, including investment income thereon. The Commonwealth has agreed to pay such amounts to the debt service reserve as may be necessary to maintain it at its required level, subject to appropriation by the Legislative Assembly, which appropriation is authorized but not legally required to be made. To date, no such payments have been required. See "DEBT – Debt of Public Corporations" above for information on the outstanding debt of MFA.

Port of the Americas Authority

The Port of the Americas Authority was originally responsible for the development and operation of the Port of the Americas, a deep draft port on the south coast of Puerto Rico. In 2011, the Ponce Ports Authority was created and given the exclusive jurisdiction of the Port of the Americas.

The Port of the Americas Authority had been authorized to issue bonds guaranteed by the Commonwealth in a maximum aggregate principal amount of $250 million for the development of the Port of the Americas. GDB was authorized by law to purchase said bonds, which had an outstanding principal amount of $226.7 million as of July 31, 20145. Although the responsibility for the development and operation of the Port of the Americas was transferred to the Ponce Ports Authority, the Port of the Americas Authority retained the liability for the outstanding bonds, which are expected to be paid by the Commonwealth under its guarantee.

Ponce Port Authority

The Port of the Americas is a deep draft container terminal under development on the south coast of Puerto Rico in the City of Ponce, the Commonwealth's fourth largest municipality by population. Managed by the Ponce Ports Authority since 2011, the terminal can handle containerized import/export and transshipment cargo. The first phase of the port development was completed in 2004 while the second phase, which included the construction of a container yard with capacity for up to 250,000 Twenty-Foot Equivalent Units per year, was completed during the first quarter of calendar year 2009. A third development phase is still pending, which would result in an annual terminal processing capacity of up to 500,000 Twenty-Foot Equivalent Units and include the installation of the basic infrastructure required to develop an industrial value-added zone on land adjacent to the Port. In December of 2013, legislation was enacted to authorize the selection of an international level ports operator and an administrator for the adjacent value added zone. These measures are aimed at completing the remaining infrastructure required for the project to become operational in the near future.

Puerto Rico Ports Authority

PRPA owns the major airport and seaport facilities in Puerto Rico. Until February 27, 2013, PRPA also operated all these facilities. On that date, PRPA transferred the operation of the Commonwealth's principal airport to a private consortium consisting of Grupo Aeroportuario del Sureste and Highstar Capital pursuant to a 40-year lease agreement. As a result of the transaction, PRPA received a $615 million upfront payment, of which it used $176.7 million to repay certain PRIFA limited obligation bonds. PRPA derives revenues from a variety of sources, including charges on airplane fuel sales, wharfage, dockage and harbor fees, and rentals for the lease of property and seaport equipment. PRPA had operating losses of $51.9 million and $13.9 million during fiscal years 2013 and 2012, respectively. See "DEBT – Debt of Public Corporations" above for additional information on the outstanding debt of PRPA.

Public Buildings Authority

PBA is authorized to construct, purchase or lease office, school, health, correctional and other facilities for lease to departments, public corporations, and instrumentalities of the Commonwealth. Bonds that have been issued by PBA to finance such facilities (through retirement of interim notes or otherwise) are payable from lease payments, which are largely derived from legislative appropriations and are secured by the Commonwealth's guaranty. PBA is authorized by law to have outstanding at any one time up to $4.7 billion of bonds guaranteed by the Commonwealth. See "DEBT – Debt of Public Corporations" above for additional information on the outstanding debt of PBA.

Sales Tax Financing Corporation

COFINA was originally created in 2006 for the purpose of financing the payment of certain appropriation-backed debt outstanding as of June 30, 2006, payable to GDB and PFC. In 2009, the Legislative Assembly of the Commonwealth expanded the purposes for which COFINA was created and increased from 1% to 2.75% (one-half of the sales and use tax rate of 5.5%) the portion of the Commonwealth sales and use tax that is transferred to COFINA. COFINA was then authorized to issue bonds for the following additional purposes: (i) to pay, in whole or in part, the debt of the Secretary of the Treasury with GDB in the amount of $1 billion, the proceeds of which were used to cover the budgetary deficit for fiscal year 2009, (ii) to pay, in whole or in part, certain financing granted to the Secretary of the Treasury by GDB payable from future Commonwealth general obligation bonds, and any debt of the Commonwealth outstanding as of December 31, 2008 that did not have a source of repayment or was payable from budgetary appropriations, (iii) to pay, in whole or in part, the accounts payable to suppliers of the Commonwealth, (iv) to pay or finance operational expenses of the Commonwealth for fiscal years 2009, 2010, and 2011, (v) to pay or finance operational expenses of the Commonwealth for fiscal year 2012, which would have to be included in the annual budget of the Commonwealth, (vi) to fund the Puerto Rico Economic Stimulus Fund, (vii) to fund the Commonwealth Emergency Fund in order to cover expenses resulting from catastrophic events such as hurricanes or floods, and (viii) to generate moneys to fund the Economic Cooperation and Public Employees Alternatives Fund.

On October 9, 2013, an amendment to the COFINA legislation was enacted which increases from 2.75% to 3.50% the portion of the Commonwealth sales and use tax transferred to COFINA and expands the permitted uses of COFINA bond proceeds to include, among others, the refinancing of bond anticipation notes and the financing of the Commonwealth's deficit for fiscal years 2013, 2014 and 2015. Since the planned 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.

See "DEBT – Debt of Public Corporations" above for additional information on the outstanding debt of COFINA.

Special Communities Perpetual Trust

The Perpetual Trust is a public corporation created by law to be an irrevocable and permanent trust. The Perpetual Trust's principal purpose is to fund development projects that address the infrastructure and housing needs of underprivileged communities. GDB made a special capital contribution to the Perpetual Trust of $500 million and provided the Perpetual Trust with a $500 million, non-revolving, line of credit. As of June 30, 2014, the Perpetual Trust had disbursed most of its funds and its line of credit with GDB had an outstanding balance of $360.4 million. The line of credit is payable from legislative appropriations.

University of Puerto Rico

The University of Puerto Rico, the only public university in Puerto Rico, has eleven campuses located throughout the island. The University's total enrollment for academic year 2014-2015 was approximately 57,800 students. Commonwealth appropriations are the principal source of University revenues. The amount of the annual appropriation is based on a statutory formula, and equals 9.60% of the Commonwealth's average annual revenue from internal sources (subject to certain exceptions) for each of the two fiscal years immediately preceding the current fiscal year. Additional revenues are derived from tuition, student fees, auxiliary enterprises, interest income, federal grants, and other sources. The University's capital improvements have been financed mainly by revenue bonds. See "DEBT – Debt of Public Corporations" above for information on the outstanding debt of the University.

The Fiscal Sustainability Act froze for the next three years the formula appropriations to the University at the same subsidized level granted in the fiscal year 2013 budget. The University has adjusted its operational budget making the necessary modifications to contain increases in costs.

LITIGATION

The Commonwealth is a defendant in numerous legal proceedings pertaining to matters incidental to the performance of its governmental operations. Under Act 104 of June 25, 1955, as amended, persons are authorized to sue the Commonwealth only for causes of actions specified in said Act. The Commonwealth may be liable under Act 104 for damages up to a maximum amount of $75,000, or $150,000 if the suit involves actions for damages to more than one person or where a single injured party is entitled to several causes of action.

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

With respect to pending and threatened litigation (5,832 cases), excluding the cases mentioned in the following paragraphs, as of June 30, 2014, the Commonwealth included in its financial statements reported liabilities of approximately $1.7 billion for awarded and anticipated unfavorable judgments. Such amount represents the amount estimated at the time as a probable liability or a liability with a fixed or expected due date, which would require future available financial resources for its payment. The amounts claimed as of such date exceed $7.9 billion; however, the ultimate specific liability cannot be presently determined, especially because of the nature of labor claims, where the awards for unpaid salaries are calculated by the agencies. The Commonwealth believes that most of the claims are excessive, frivolous, or both, and that its ultimate liability should not significantly exceed the amounts set forth in the Commonwealth's financial statements.

Act for the Redistribution and Adjustment of the Tax Burden

Act 40-2013, as amended, imposes a gross receipts tax or *"patente nacional"* on businesses with annual gross income of more than $1 million. MIDA, a commercial association whose members are in the food distribution and related businesses, brought an action challenging the constitutionality of this gross receipts tax. The trial court dismissed the action, and the dismissal was upheld by the appeals court. The Puerto Rico Supreme Court recently refused to hear the case, denying MIDA's petition for certiorari. MIDA currently has until October 30, 2014, to file a motion for reconsideration before the Puerto Rico Supreme Court.

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 2012 closing agreement between Doral and the Commonwealth Treasury, which provided for a refund of approximately $230 million payable over a five-year period, which closing agreement had been declared null by the Treasury Department. The Commonwealth initially argued that the court lacked jurisdiction to hear the case. Although the trial court agreed with the Commonwealth that it lacked jurisdiction, this decision was reversed by the trial court. A petition for review filed by the Commonwealth with the Puerto Rico Supreme Court is currently pending.

On October 10, 2014, the trial court ruled in favor of Doral, holding that the closing agreement was valid. The Commonwealth has announced its intention to appeal this judgment, and to that effect it recently filed a motion for reconsideration with the trial court. In the event the trial court confirms its previous judgment, the Commonwealth intends to appeal the judgment to the Puerto Rico Court of Appeals, and if necessary to the Puerto Rico Supreme Court.

The closing agreement, if ultimately upheld in the appeals process, requires the Commonwealth to make payments to Doral of approximately $45 million annually during a five-year term. However, the recently enacted Fiscal Sustainability Act provides that all adverse judgments, other than those resulting from eminent domain proceedings or court-approved payment plans, must be budgeted annually as part of the appropriations process, taking into consideration the financial condition of the Commonwealth and the date on which the adverse judgment became enforceable, and that in no event shall such appropriation exceed $3 million dollars for any fiscal year. The Commonwealth intends to apply the provisions of this Act in the event of a final adverse judgment.

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 (*Franklin California Tax Free Fund v. Commonwealth of Puerto Rico*) seeking a declaratory judgment that the Recovery Act violates several 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.

On July 22, 2014, an investment manager, on behalf of investment funds which purportedly hold bonds issued by PREPA, filed another lawsuit in the United States District Court for the District of Puerto Rico (*Bluemountain Capital Management, LLC v. Alejandro Garcia Padilla, et. al.*) seeking a declaratory judgment that the Recovery Act violates the bankruptcy clause of the United States Constitution and other provisions of the United States and Commonwealth Constitutions, asserting similar arguments as the *Franklin California Tax Free Fund* complaint. On August 20, 2014, the District Court issued an order consolidating both actions.

The Commonwealth, PREPA and GDB have filed motions to dismiss both lawsuits for failure to state a claim. The motions to dismiss assert, among other things, that since the Recovery Act has never been invoked, the lawsuits are not ripe, and that there is no preemption by federal law, because there is no federal law applicable to the enforcement of the debts of Puerto Rico public corporations. The Commonwealth, PREPA and GDB will continue to defend vigorously the constitutionality of the Recovery Act. They believe that the provisions of the Recovery Act can be enforced in a manner that complies with the requirements of both the United States Constitution and the Commonwealth Constitution.

Recovery of Medicaid Funds

The Commonwealth is a defendant in two lawsuits, one in Commonwealth court and one in the U.S. District Court for the District of Puerto Rico, filed by certain "Federally Qualified Health Centers" seeking to recover from the Commonwealth approximately $800 million in Medicaid "wraparound payments" which the Commonwealth Department of Health has failed to make since 1997, when the Commonwealth first became a participant in the Medicaid Program. The Commonwealth has admitted its noncompliance with the wraparound requirement and the only controversy is the total amount owed.

To date, five partial judgments have been entered in the Commonwealth court case. Four of the partial judgments are final. Under the four partial judgments that are final, the Commonwealth is required to pay approximately $28 million. In accordance with the court's order, the Commonwealth included $22.5 million of the total in its budget for fiscal year 2015. One of the partial judgments is pending appeal in the Commonwealth Court of Appeals. The approximate amounts owed under this partial judgment are $110.38 million owed by the Commonwealth to 17 centers and $1.33 million owed by one of the centers to the Commonwealth.

In the federal court case, the court has issued various orders requiring the Commonwealth to make the Medicaid "wraparound" payments to the health centers. The Commonwealth has already made approximately $40 million in uncontested payments pursuant to these orders, and has consigned an additional $29 million with the court pending certain appeals. The parties continue to litigate various issues relating to the calculation of the balance of the payments. The court has ordered the parties to discuss payment and settlement alternatives on or before December 1, 2014.

As of June 30, 2014, this legal contingency has an estimated exposure of $500 million.

Special Education Students

The Commonwealth is a defendant in a class action initiated in 1980 by parents of special-education students before Commonwealth courts alleging that the Puerto Rico Department of Education had failed to provide legally required special education and related services. In February of 2002, the court issued a judgment approving the stipulations reached by the parties regarding the manner special education services should be provided. Since December of 2002, the Department of Education has paid fines for not complying with the stipulations reached. The fines were originally set in the amount of $1,000 daily, and were raised to $2,000 daily in January of 2006. In February of 2010, the court issued a resolution advancing its intention to establish a new scheme of fines ranging from $0.25 to $0.75 daily per registered student. As of December 31, 2013, there were over 121,000 students registered in the Special

Education Program, but this number changes frequently since new claims are filed constantly. Said resolution also creates a new scheme of monitoring compliance with the stipulations, including the added participation of 12 experts (each party has the right to designate two experts) in six areas of expertise. Said monitoring scheme began on July 1, 2010.

The February 2002 judgment only disposed of the injunctive relief sought by plaintiffs. Still pending before the court are individual claims for damages regarding the failure to provide adequate services. In 2005, the Court denied class certification for the damages stage of the lawsuit, holding that every member of the class must prove their individual damages. In April of 2014, the court also denied plaintiffs' petition for consolidation of the damage claims, holding that each plaintiff must submit evidence of the causal link between the Department of Education's negligence and plaintiff's alleged damages. Plaintiffs are appealing this determination.

As of June 30, 2014, this legal contingency has an estimated exposure of $650 million.

Police Institutional Reform

The Commonwealth is 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 significant institutional reforms of the Police Department, to be implemented within the next 10 years. Although the Department of Justice's claim does not include damages, the Commonwealth estimates, based on recent expert opinion, that the institutional reform will require an investment of at least $200 million. The Commonwealth allocated $20 million for this purpose in its budget for fiscal year 2015. The Department of Justice also allocated $9 million for this purpose from the "Equitable Sharing Program" payments made to the Commonwealth of Puerto Rico for its assistance to the federal government in forfeiture cases. Under the settlement agreement, the court dismissed the claim, but retained jurisdiction to ensure compliance with the agreement.

Wage Claims

The Commonwealth is a defendant in two lawsuits instituted in 2007 and 2009 by a large group of employees from the Department of Family, the Administration of Vocational Rehabilitation and the Administration of Juvenile Institutions claiming that wages in an aggregate amount of $215 million are owed to them. The plaintiffs claim for loss of earnings due to the failure of compliance by the agency of the equal payment for equal work under different laws. The plaintiffs claim that they have been adversely affected by reason of the agencies failure to revise the scales of remuneration each time the federal minimum wage changed. All parties have filed petitions for summary judgment which are pending. As of June 30, 2014, this legal contingency has an estimated exposure of $215 million plus an undetermined amount for interest.

FINANCIAL STATEMENTS

For fiscal year 2013, the basic financial statements of the Commonwealth were audited by KPMG LLP. KPMG LLP did not audit the financial statements of certain activities, funds, and component units identified separately in its report dated June 30, 2014 (which report expresses an unqualified opinion and includes emphasis of matter paragraphs regarding liquidity risks and uncertainties relating to the Commonwealth, the Retirement Systems (as defined herein) and Government Development Bank, the Puerto Rico Public Corporation Debt Enforcement and Recovery Act, the Puerto Rico Electric Power Authority and the Commonwealth's adoption of new accounting pronouncement GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*). Those financial statements were audited by other independent auditors whose reports were furnished to KPMG LLP, and its opinion on the basic financial statements, insofar as it relates to the amounts included in the basic financial statements pertaining to such activities, funds and component units, is based solely on the reports of the other auditors.

The basic financial statements of the Commonwealth for fiscal year 2013 were filed by the Commonwealth with the Municipal Securities Rulemaking Board through its Electronic Municipal Markets Access System ("EMMA") on June 30, 2014.

CONTINUING DISCLOSURE

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

The Commonwealth's audited financial statements for the fiscal year ended June 30, 2012 were filed after the Commonwealth's filing deadline due to delays in the audit of such financial statements as a result of the government transition process, as a new administration entered office in January of 2013, and the failure of certain discretely presented component units to finalize their audited financial statements.

The basic financial statements of the Commonwealth for fiscal year 2013 were filed after the Commonwealth's filing deadline. Initially, the delay was primarily caused by (i) a delay in the commencement of the financial close and audit process for fiscal year 2013, which did not commence until the completion of the financial statement for fiscal year 2012 on September 16, 2013 (delays in the audit of the 2012 financial statements were principally caused by the government transition process after the November 2012 elections), (ii) delays related to the change of the Commonwealth's external auditors, and (iii) the implementation of GASB Statement No. 61, *The Financial Reporting Entity*, which changed the Commonwealth's financial reporting entity.

Although the Commonwealth addressed these issues by dedicating additional resources to the financial close and audit process for fiscal year 2013, the Commonwealth was unable to finalize the 2013 financial statements due to certain additional unanticipated delays attributable to (i) additional procedures required as part of the audit, (ii) delays in the issuance of the audited financial statements of the three Commonwealth retirement systems resulting from the pension reform legislation and the subsequent judicial modification of such reforms, and (iii) delays in the issuance of the audited financial statements of certain other blended and discretely presented component units. The financial reporting entity under government accounting standards for purposes of the Commonwealth's financial statements consists of the central government, seven blended component units, 45 discretely presented component units, and three fiduciary component units. Component units of the Commonwealth are generally separate legal entities that issue their own audited financial statements, but whose financial information is incorporated, after the issuance of such financial statements, into the Commonwealth's financial statements. Therefore, delays in financial reporting by any component unit can cause a delay in the finalization of the Commonwealth's financial statements.

The Commonwealth believes that the finalization of the 2013 financial statements prior to the end of the 2014 fiscal year will allow for a timely commencement of the financial close and audit process for fiscal year 2014, and a resulting timely finalization of the Commonwealth's financial statements prior to the Commonwealth's continuing disclosure deadline.

The Commonwealth's audited financial statements for the fiscal year ended June 30, 2008 (and certain prior years) were filed after the Commonwealth's filing deadline, because various governmental agencies did not submit their audited financial statements to the central government's external auditors on time, thereby delaying submission of the Commonwealth's audited financial statements.

The Commonwealth's audited financial statements for the fiscal year ended June 30, 2009 were also filed after the Commonwealth's filing deadline due to delays in the engagement and transition of new external auditors, the implementation of new government accounting pronouncements, and the restatement of the financial statements of certain discretely presented component units of the Commonwealth.

The Commonwealth Reports for the fiscal years ended June 30, 2008 and June 30, 2012, were filed after the Commonwealth's filing deadline.

The Commonwealth had recently established certain policies and procedures that it believed would ensure full and timely compliance with its continuing disclosure obligations. Such policies and procedures included the assignment of additional resources from local and international audit firms to those component units whose financial statements have not been timely provided to the Commonwealth; and the assignment of dedicated external and internal resources to assist the Central Accounting Division at the Treasury Department in the preparation of complex financial information that has historically delayed the audit and to provide periodic and consistent follow up on component unit financial statement deliverables and deadlines.

In light of the Commonwealth's continuing difficulties in the timely filing of its financial statements and the Commonwealth Report notwithstanding the establishment of the policies and procedures described above, the Commonwealth is reviewing how to improve such policies and procedures, and is considering additional measures, to ensure timely compliance in the future with its continuing disclosure obligations.

INSURANCE MATTERS

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